

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

No. 03-1206

**ARIZONA CORPORATION COMMISSION, 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

Whether the Commission appropriately determined that the public interest required conversion of FR contracts to CD contracts to assure the reliability of firm service on El Paso's transmission system.

STATUTES AND REGULATIONS

Pertinent sections of the Natural Gas Act ("NGA") and the Commission's implementing regulations are set out in the Addendum to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

Historically, El Paso provided two types of firm service,¹ contract demand (“CD”) and full requirements (“FR”). *El Paso Natural Gas Co.*, 104 FERC ¶61,045 (2003) (“July 2003 Order”) at ¶7, JA 1428. Both FR and CD service included system-wide receipt point rights, enabling customers to nominate transportation from any of the three El Paso receipt points. *El Paso Natural Gas Co.*, 99 FERC ¶61,244 (2002) (“May 2002 Order”) at 61,998, JA 820.

CD service, subscribed to mostly by California customers, provides transmission rights on El Paso’s system up to the maximum quantity designated in each customer’s service contract. July 2003 Order at ¶7, JA 1428. CD shippers’ reservation charges are based on their contract entitlements. May 2002 Order at 61,998, JA 820. FR service, by contrast, subscribed to mostly by East of California (“EOC”) customers, required customers to transport on El Paso, and for El Paso to transport, the customers’ full natural gas requirements each day, with no quantity limitations. July 2003 Order at ¶7, JA 1428. FR shippers’ reservation charges are based on their billing determinants set in a 1996 Settlement. May 2002 Order at 61,998, JA 820.

¹ Firm service is service that is not subject to a prior claim by another customer. May 2002 Order at 62,013 (citing 18 C.F.R. §284.7), JA 833, 853.

In July, 2001, complaints were filed against El Paso by both a group of its CD customers, R. 182, and a group of its FR customers (including a number of Petitioners here), R. 188, alleging that their firm contractual entitlements were not being met because El Paso was regularly prorating customer nominations. The Commission agreed with complainants that firm service on El Paso had deteriorated and was no longer reliable as “El Paso does not have sufficient firm capacity to meet growing demand for firm service on its system, and firm service has been curtailed through pro rata allocations of service nominations on a routine basis.” May 2002 Order at 62,001, 62,008, JA 823, 828.

Finding that the degradation in firm service was caused, in large part, by the significant and unrestricted growth in demand under the FR contracts and that FR contracts are a disincentive to pipeline-to-pipeline competition and offer no incentive for El Paso to build necessary expansion, the Commission determined that the public interest required, among other things, conversion of the FR contracts to CD contracts. *Id.* at 62,000-04, JA 822-25.

The conversion methodology ordered by the Commission was based on the FR shippers’ current needs and seasonal use of the system. *Id.* at 62,007, 62,009 and n.66, JA 827, 829-30, 852. All existing capacity, except that under contract to

CD customers and to small FR customers,² plus capacity El Paso was adding to its system, would be allocated to FR shippers at their current FR reservation charge rate. *Id.* at 62,009, JA 829. Thus, FR shippers would be converted to CD entitlements at levels that can reliably be met at no additional charge above the settlement rates. *Id.* at 62,010, JA 830. In addition, converting FR shippers would be able to augment their new capacity assignments by purchasing capacity CD shippers indicated they intended to turnback or release. *Id.* at 62,007, 62,010, 62,017, JA 827-28, 830, 836. This assured that all shippers' capacity needs were met. *Id.* at 62,010, JA 830.

II. STATEMENT OF FACTS

A. Events Leading to the Challenged Orders

El Paso's pipeline system transports gas from the San Juan, Permian, and Anadarko production basins to delivery points in California and east of California. July 2003 Order at ¶13, JA 1428. El Paso's rates and services were established in two settlements. The 1990 Settlement resolved issues related to the Commission's

² The Commission did not order conversion of small FR customers' contracts (those with peak loads less than 8,000 Mcf/day) because their minimal receipt rights did not have a significant impact on system use and continuation of their FR service for the remaining term of the Settlement would not negatively impact the adopted remedy as their service eligibility would be limited to 10,000 Dth/d. May 2002 Order at 62,017, JA 836.

contract unbundling mandate in Order No. 636³ by converting El Paso bundled sales service contracts into unbundled transportation service contracts. *El Paso Natural Gas Co.*, 54 FERC ¶61,316, *order on reh'g*, 56 FERC ¶62,290 at 62,148-49 (1991); May 2002 Order at 61,998, JA 820; July 2003 Order at ¶14, JA 1428-29. That Settlement allowed customers to convert their preexisting bundled sales entitlements into transportation service, *El Paso*, 56 FERC at 62,148, and provided for pro rata allocation of capacity among firm shippers if El Paso's capacity were insufficient to serve all transportation requests at a nominated receipt point, *El Paso*, 54 FERC at 61,923; May 2002 Order at 61,998, JA 820; July 2003 Order at ¶14, JA 1429.

In 1996, El Paso filed a proposed rate increase and, subsequently, a settlement resolving that proposal. *El Paso Natural Gas Co.*, 79 FERC ¶61,028 at 61,123, *order on reh'g*, 80 FERC ¶61,084 (1997). Because, at that time, substantial excess pipeline capacity existed in El Paso's market area and El Paso

³ Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol [Regs. Preambles Jan. 1991-June 1996] FERC Stats. & Regs. ¶ 30,939 (1992), *order on reh'g*, Order No. 636-A, [Regs. Preambles Jan. 1991-June 1996] FERC Stats. & Regs. ¶ 30,950 (1992), *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1993), *reh'g denied*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part*, *United Distrib. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *cert. denied*, 117 S.Ct. 1723 (1997) ("UDC"), *order on remand*, Order No. 636-C, 78 FERC ¶61,186 (1997), *order on reh'g*, Order No. 636-D, 83 FERC ¶61,210 (1998).

California customers were scheduled to turn-back firm capacity rights totaling 1,300 MMcf/d by January 1, 1998, it was likely no replacement shippers for the turned-back capacity would be found or that replacement shippers would contract only at discounted rates. July 2003 Order at ¶14, JA 1429; see *El Paso Natural Gas Co.*, 89 FERC ¶61,164 at 61,489 (1999). This threatened to almost double the firm transportation rates for El Paso's remaining customers. July 2003 Order at ¶14, JA 1429; *El Paso*, 89 FERC at 61,489.

The 1996 Settlement avoided this by sharing the risk of unsubscribed capacity, with El Paso responsible for 65 percent of the potential revenue loss during the first eight years of the settlement term and for 100 percent of the loss for the remaining two. July 2003 Order at ¶14; *El Paso*, 89 FERC at 61,489. To offset their share of the risk, El Paso's customers receive 35 percent of the revenues from future sales of unsubscribed capacity exceeding a specified threshold. May 2002 Order at 62,008 n. 63, JA 828, 852; *El Paso*, 89 FERC at 61,489. In approving the 1996 Settlement, the Commission noted that, even considering the unsubscribed capacity risk sharing amounts, the settlement rates were lower than preexisting rates. *El Paso*, 79 FERC at 61,126.

El Paso charges a two-part firm transportation rate comprised of a volumetric charge for transporting gas on El Paso's system and reservation charge to reserve capacity. May 2002 Order at 62,013, JA 833. Under the 1996

Settlement, CD shippers' reservation charges are based on the CD shippers' fixed contract entitlements and, thus, relate to the amount of capacity they can reserve. *Id.* at 61,998, JA 820. FR shippers' reservation charges, by contrast, are unrelated to the amount of capacity FR shippers reserve, but instead are based on the FR shippers' billing determinants established in the 1996 Settlement. *Id.* at 61,998, JA 820.

Since 1996, circumstances on El Paso's system have changed dramatically. *Id.* at 61,998, JA 820. First, FR shippers' total demand had grown significantly, by about 50 to 70 percent, and was expected to continue to grow exponentially, by at least 300 percent over the next few years.⁴ *Id.* at 61,998, 62,000-03, 62,008 and n.64, JA 821, 822-24, 828, 852. For example, Petitioners Arizona Public Service and Pinnacle West Energy Corporation's (APS/Pinnacle) proposed Redhawk generation facility, projected to be in service in Fall 2002, would increase their FR load by over 600% as compared to their 1996 Settlement billing determinant. *Id.* at 62,003, JA 824.

Additionally, the turned-back capacity at issue in the 1996 Settlement has been fully subscribed, and, because gas from the San Juan Basin became less expensive than gas from the other El Paso receipt points, demand for gas from that

⁴ Despite FR shippers' load growth, their reservation fees remained unchanged. May 2002 Order at 61,998, JA 820. As a result, FR shippers pay only a small usage charge for their ever increasing incremental takes above the levels used to set the settlement billing determinants. *Id.*

point increased. *Id.* at 61,997, 61,998, JA 820, 821; July 2003 Order at ¶15, JA 1429. As a result of these changed circumstances, El Paso no longer had sufficient capacity to meet the demands of all firm shippers, and, in accordance with El Paso's then-existing tariff provisions requiring pro rata curtailment when demands exceed capacity, all firm shippers experienced frequent pro-rata reductions in receipt nominations. May 2002 Order at 61,997, 61,998, JA 820, 821; July 2003 Order at ¶15, JA 1429.

On November 10, 1999, the Commission directed El Paso to file a proposal to change its capacity allocation methodology. *Amoco Energy Trading Corp. v. El Paso Natural Gas Co.*, 89 FERC ¶61,165 (1999); *see* May 2002 Order at 61,999, JA 821. El Paso's March 28, 2001, filing proposed to allocate primary receipt rights to CD customers equal to their individual CD volumes and to FR customers equal to the billing determinants established in the 1996 Settlement. R. 150; *see* May 2002 Order at 61,999, 62,019-22, JA 821, 838-41. Alternative proposals were filed, *inter alia*, by Intervenor Southwest Gas Corp. ("Southwest Gas"), R. 314, and Petitioner Salt River Project Agricultural Improvement and Power District ("Salt River"), R. 335. *See* May 2002 Order at 61,999, 62,022, JA 821, 841-42.

In July, 2001, complaints were filed by a group of CD customers, R. 182, and a group of FR customers (including a number of Petitioners here), R. 188,

alleging that the El Paso's firm customers' contractual entitlements were not being met because El Paso was regularly prorating customer nominations.

B. The Challenged Orders

1. The May 2002 Order

After reviewing the voluminous record, the Commission agreed with complainants that firm service on El Paso had deteriorated and was no longer reliable, as "El Paso does not have sufficient firm capacity to meet growing demand for firm service on its system, and firm service has been curtailed through pro rata allocations of service nominations on a routine basis." *Id.* at 62,001, 62,008, JA 823, 828.

The Commission found the significant and unrestricted growth in demand under the FR contracts since the 1996 Settlement (50 to 70 percent) to be the most significant cause of the pro rata cuts to, and resultant degradation of, firm service on El Paso. *Id.* at 62,000, 62,002, 62,003, JA 822, 824-25. Moreover, the expected continued exponential growth of FR shippers' demand under the FR contracts (at least 300 percent over the next few years), would "further degrade the quality of CD service and cause corresponding, equivalent decreases in service to CD shippers," and would be unjust and unreasonable and contrary to the public interest. *Id.* at 62,000-03, 62,008 and n.64, JA 822-25, 828, 852.

In addition, because all FR customers' load growth must be served by El Paso under their existing FR contracts, other pipelines cannot compete to serve FR load growth, leaving no incentive for them to expand into El Paso's market. *Id.* at 62,004, JA 825. "And, because FR customers are not subject to increased reservation charges with increases in demand, there is no economic incentive for El Paso to add needed capacity at [FR contract] rates." *Id.* at 62,004, JA 825. The Commission found, therefore, that "FR contracts are a disincentive to pipeline-to-pipeline competition and provide no incentive for El Paso to provide for necessary expansion." *Id.* at 62,004, JA 825.

The Commission further determined that existing FR contract rates contravene 18 C.F.R. §284.10(b)(1) as they are not designed to achieve the objective of rationing capacity during peak periods. May 2002 Order at 62,003, JA 824, 850. Moreover, the Commission found, new power plants served under existing FR contracts have an unfair competitive advantage over other generators who would be subject to pass through of higher reservation charges related to the increased demand. May 2002 Order at 62,003, JA 824.

The Commission found it necessary in the public interest, therefore, "to convert the FR contracts to CD contracts to remedy the unjust and unreasonable impact unrestricted demand growth has on all firm shippers of El Paso. Continued unlimited growth of the FR contracts, without factoring [in] rate and service

consequences, is not in the public interest because it will continue to degrade firm service reliability.” May 2002 Order at 62,003, JA 824. “Once the FR contracts have been converted to CD contracts, FR customers will be able contractually to purchase transportation from pipelines other than El Paso. This will provide proper incentives and price signals for other pipelines to compete with El Paso and for El Paso to construct additional capacity to serve these needs.” *Id.* at 62,004, JA 825. Additionally, converting FR contracts to CD contracts will bring El Paso's operations more closely into compliance with the uniform business practices adopted by the North American Energy Standards Board and with Order Nos. 636 and 637,⁵ bringing additional benefits to all El Paso customers. *Id.* at 62,003, JA 824.

Having determined that the Mobile-Sierra doctrine⁶ applied to the FR contracts, the Commission, following the requirements of NGA § 5, found that El Paso's FR contracts contravene the public interest:

⁵ Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, FERC Stats. & Regs., Regulation Preambles, July 1996-December 2000 P31,091 (2000), order on reh'g, Order No. 637-A, FERC Stats. & Regs., Regulations Preambles, July 1996-December 2000 P31,099 (2000), aff'd in part and rev'd and remanded in part, *INGAA v. FERC*, 285 F.3d 18 (D.C. Cir. 2002).

⁶ See *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956); *United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

There are extraordinary circumstances on El Paso that require, in the public interest, modification of the FR contracts. The Commission's determination that the public interest requires modification of the FR contracts is not based merely on generalized statements of policy goals, but is based on a detailed analysis of how the FR contracts on El Paso harm the public interest and how the conversion of those contracts will further the public interest. The Commission has explained in detail how growth under the FR contracts has resulted in pro rata cuts that have eroded firm service on El Paso, and how this has resulted in firm shippers paying for service they do not receive. It is in the public interest to have reliable firm service on El Paso, and the Commission has explained how modification of the FR contracts on El Paso serves that goal. All customers will ultimately benefit from reliable firm service on El Paso and from the establishment of the proper market incentives for expansion of the infrastructure that will result from conversion of the FR contracts to CD contracts.

May 2002 Order at 62,005-06, JA 826; *see also id.* at 62,007, JA 827 (“conversion is necessary under section 5 of the NGA to protect all customers and the public interest and is consistent with the Mobile-Sierra doctrine.”). “While the Commission rarely alters an approved settlement,” it found “it has not only the authority, but also the responsibility under section 5 of the NGA to make an adjustment to a settlement if the terms of the settlement have become unjust and unreasonable and the settlement operates in a way that is contrary to the public interest.” *Id.* at 62,008 (citing, *e.g.*, *UDC v. FERC*, 88 F.3d 1105, 1131 (D.C. Cir. 1996)), JA 828, 852.

The Commission further determined that it would be contrary to the public interest to allow system-wide receipt point rights to remain in effect, as those rights also contributed to the frequent pro rata cuts in firm service. May 2002 Order at

61,998, 61,999-62,000, 62,014, 62,016, JA 820, 821-22, 833-34, 835-36. When gas from the San Juan Basin became less expensive than gas from the other El Paso receipt points, increased demand for gas from that point contributed to pro rata reductions of firm nominations. *Id.* at 61,997, 61,998, JA 820, 821. To remedy this, the Commission directed El Paso to assign specific primary receipt points rights on its system. *Id.* at 62,014, JA 834. “Conversion of FR contracts to CD contracts, coupled with the assignment of specific point rights, will restore certainty to firm service, assure that firm shippers receive the service they are paying for, and establish the proper price signals for expansion of capacity.” *Id.* at 62,000, JA 822.

The Commission also found it contrary to the public interest for El Paso to retain reservation charges for services not provided. May 2002 Order at 61,999-62,000, 62,001, JA 822, 823. “As a consequence of demand growth and pro rata allocations on El Paso, the firm CD shippers have been unable to use the full amounts of their firm contract entitlements.” *Id.* at 62,001, JA 823.

A shipper contracting for firm service, as compared to interruptible, pays the pipeline a charge to reserve capacity on the pipeline in addition to the volumetric charge for actually transporting the gas. If the reservation portion of the firm transportation rate does not in fact reserve capacity on the pipeline, that charge is unjust and unreasonable because the shipper is paying for a service that it does not receive. . . . It is not just and reasonable to charge a shipper the higher firm rate if the service the shipper receives is interruptible.

May 2002 Order at 62,001, 62,013, JA 823, 833. While “El Paso reasonably

applied the Settlement provisions concerning pro rata allocations where there was insufficient capacity to meet demand for firm service,” applying those Settlement provisions had led to the unreliability of firm service on El Paso. *Id.* at 62,013, JA 833. Therefore, the Commission directed that “El Paso amend its tariff, effective November 1, 2002, to provide for refunds of [reservation] charges to its customers on any day that El Paso is unable to deliver nominated CD volumes from a primary receipt point to a primary delivery point.” *Id.* at 62,018, JA 837.

The Commission further assured the reliability of firm service by prohibiting El Paso from entering into new firm service contracts unless it can demonstrate capacity is available to provide that service. May 2002 Order at 62,012, JA 832.

Several parties proposed FR contract conversion methodologies. May 2002 Order at 62,008-10, 62,019-24, JA 828-30, 838-44. The Commission rejected El Paso’s proposal to allocate capacity to the FR shippers at their 1996 Settlement billing determinant level because “[w]hile billing determinants determine the current cost allocation to the FR shippers pursuant to the 1996 Settlement, they do not reflect the current use of the system. Use of billing determinants would ignore all growth that has occurred since the 1996 Settlement, and would be unreasonable.” *Id.* at 62,008-09, JA 829. “A reasonable conversion methodology should reflect the current practices of these shippers.” *Id.* at 62,009, JA 829.

Also unreasonable was the EOC customers' proposal to convert FR shippers to annual CD levels based on historical non-coincident peaks. May 2002 Order at 62,009, JA 829.

Non-coincident peaks represent . . . the one day when a shipper experiences its highest demand for the year. Shippers are likely to experience non-coincident peaks on different days and sometimes different seasons of the year. It is for that reason that pipelines do not design their systems based on non-coincident peaks. . . . In addition, because there is insufficient capacity to serve both the CD contracts and FR non-coincident peak demands, use of non-coincident peak would result in a reduction of the CD shippers' allocation below the current CD level. The Commission finds that it is not just and reasonable to allocate less capacity to these firm CD shippers than the capacity for which they have contracted and paid.

Id. at 62,009, JA 829.

To "assure that all FR shippers [would] receive a fair allocation of available capacity needed to meet their new CD entitlements," the Commission required that the initial step of the FR contract conversion methodology take into account the FR shippers' current needs and seasonal use of the system. May 2002 Order at 62,007, 62,009 and n.66, JA 827, 829, 852. All existing capacity, except that under contract to CD customers and to small FR customers,⁷ plus the 230,000 Mcf/d of capacity El Paso was adding to its system with its Line 2000 project, would be allocated to FR shippers at the reservation charges they paid under the 1996

⁷ See n.2, *supra* (explaining why conversion of small FR customers was not required by the public interest).

Settlement. *Id.* at 62,009, JA 829. “In that way, the FR shippers are converted to CD entitlements at levels that can reliably be met at no additional charge above the Settlement rates.” *Id.* at 62,010, JA 830.

The Commission provided the parties the opportunity to agree on individual CD entitlements for converting FR shippers. May 2002 Order at 62,010, JA 830. If the parties could not agree, the Commission would issue an order to specify those entitlements. *Id.* at 62,017, JA 836.

To enable FR shippers to augment their CD capacity assignments, the Commission ordered a capacity rationalization process during which converting shippers would be able to purchase capacity turned-back or released by current shippers. The purchasing shipper would assume reservation charge responsibility for any new capacity. May 2002 Order at 62,007, 62,010, 62,017, JA 827-28, 830, 836. The capacity CD shippers stated they intended to turnback would mean sufficient capacity would be available to meet all shippers' current needs. *Id.* at 62,010, JA 830. As an additional measure, the Commission required El Paso, throughout the 1996 Settlement period, to solicit and accept turnback capacity, and to give existing shippers priority access to any available capacity. *Id.* at 62,012, 62,018, JA 832, 837.

2. The September 2002 Order

On August 1, 2002, El Paso notified the Commission that the parties could not agree on FR customers' CD entitlements. *El Paso Natural Gas Co.*, 100 FERC ¶61,285 (2002) ("September 2002 Order") at ¶2, JA 1144. The Commission directed, therefore, that the available capacity be allocated based on the higher of each FR shipper's individual monthly demand over the most recent twelve month period (September 1, 2001-August 31, 2002) or its 1996 Settlement billing determinant. *Id.* at ¶33, JA 1149. "Allocating capacity to the FR shippers based upon each shipper's latest monthly demands will reflect the current use of the system by these customers and accommodate each shipper's seasonal needs" *Id.* at ¶34, JA 1149. From that starting point, El Paso would conduct the capacity rationalization and receipt point allocation processes. *Id.* at ¶34, JA 1149.

The Commission postponed the date by which conversion must be completed, from November 1, 2002, to May 1, 2003, to "give all the parties sufficient time to implement the changes set forth in the May [2002] order and [to] afford the FR shippers additional time to prepare for the shift to contract demand service. Deferring the conversion date will provide time to complete the capacity allocation process, including the ordered turnback and recontracting procedures." September 2002 Order at ¶12, JA 1146. Additionally, "deferring the date will simplify the conversion and allocation process because the conversion date will

occur close to the time when El Paso's Power Up Project capacity [adding 320,000 Mcf/d of capacity to El Paso's system] is expected to be available. . . . [T]his will enable El Paso to allocate the full 5,400,000 Mcf/d of capacity in the initial conversion." *Id.* at ¶¶12, 23, JA 1146, 1148.

The Commission "recogniz[ed] that, even with the additional capacity that will be provided by Line 2000 in November 2002, the postponement of the conversion date of the FR contracts could result in some pro rata reductions in firm service to CD shippers [during the postponement period]." *Id.* at ¶13, JA 1146. "[T]o alleviate some of the hardship this may cause to the CD shippers," the Commission required El Paso to provide partial reservation charge credits to the CD customers during this interim period. *Id.* at ¶13, JA 1146. As the Commission explained:

The pro rata reductions in service necessitated by the current allocation methodology on El Paso are not caused either by El Paso or the CD shippers. Instead, . . . these allocations stem from the terms and conditions of the 1996 Settlement which the Commission has determined are no longer just and reasonable under the current circumstances on the system. At the present time, the CD shippers bear all of the risk of these pro rata allocations because they are paying [reservation] charges for service they do not receive. Because these allocation reductions are no-fault occurrences, it is not just and reasonable to require one party to bear all the adverse consequences associated with them.

September 2002 Order at ¶14, JA 1146.

Thus, during the interim period, the Commission directed El Paso to give a partial reservation charge credit to a CD shipper:

whenever El Paso is unable to deliver . . . the CD shipper's nominated quantity out of any basin for reasons other than force majeure. For example, if a CD shipper makes its nomination out of the San Juan Basin and there is insufficient capacity in the San Juan Basin to schedule the amount nominated, but the nominated quantity could be scheduled out of the Permian or Anadarko Basins, El Paso would not be obligated to pay a [reservation] charge credit. Therefore, if the CD customer chooses for economic reasons not to take delivery from the Permian or Anadarko Basins, El Paso will have no [reservation] charge credit obligation.

Id. at ¶15, JA 1146.

After a tentative agreement was reached in a related case involving El Paso capacity issues (Docket No. RP00-241-000), the FR Shippers sought a further postponement of the conversion date. The Commission granted postponement to September 1, 2003 to consider the impact of the RP00-241 proceeding on this case. *El Paso Natural Gas Co*, 103 FERC ¶ 61,059 (2003); *see* July 2003 Order at ¶21, JA 1430.

3. The July 2003 Order

On rehearing, the Commission explained that its determinations were:

based on the finding that the provisions of the 1990 and 1996 Settlements that place no limit on growth under the FR contracts, place a limited obligation on the part of El Paso to expand its system at its own expense to meet growing needs, [⁸] and provide a

⁸ Citing § 3.6 of the 1990 Settlement, which provides that El Paso "shall not

mechanism for pro rata allocations of capacity to firm shippers, [⁹] have rendered firm service on El Paso unreliable. Termination of the Settlement and tariff provisions that allow pro rata allocations of capacity in situations other than force majeure, coupled with the conversion of the FR service to CD service at levels consistent with (and in most cases higher than) the FR shippers' current use of the system will restore service reliability, consistent with the public convenience and necessity. Further, conversion of the FR contracts to CD contracts will provide an incentive for El Paso and other pipelines to build expansions to meet increasing FR demands.

July 2003 Order at ¶27, JA 1431.

The Commission further explained that, when it approved the FR contracts, “[p]rior to open-access transportation in the gas industry, FR contracts were held primarily by small municipalities with minimal demands for capacity, and service under these FR contracts was not provided to the detriment of other firm customers.” *Id.* at ¶32 and n.23, JA 1432. No capacity constraints existed on El Paso’s system. *Id.* at n.23, JA 1432. Moreover, “when the Commission approved the 1996 Settlement, excess capacity was a problem on the system.” *Id.* Now, however, “because the El Paso system has become capacity-constrained, open-ended FR contracts with large shippers that contain no limitation on the amount of

be required to construct any facilities that are not economically justifiable.”

⁹ Citing § 4.2 of the General Terms and Conditions of El Paso's tariff, which provides that if the capacity of El Paso's system, or any portion of its system, is insufficient to serve all requests for transportation made on a scheduling day, El Paso will allocate its capacity pro rata among its firm shippers with primary point capacity.

capacity that can be demanded, and the related provisions of the 1990 and 1996 Settlements are not in the public interest” *Id.* at ¶32, JA 1432; *see also id.* at ¶61, JA 1437 (“circumstances on El Paso that led to the approval of the 1990 and 1996 Settlements changed, *i.e.*, a situation of excess capacity became constrained, and this resulted in unreliable firm service on El Paso's system.”).

The Commission found that the “FR contracts were never intended to be a vehicle to allow large shippers to increase their demands by more than 600 percent on a system that has no unsubscribed capacity to accommodate these increased demands,” and “continuation of [certain] Settlement provisions and of FR service and the unlimited growth it permits, would further erode the quantity and quality of contract demand service even with El Paso's current expansion projects.” July 2003 Order at ¶32, JA 1432. The Commission reaffirmed, therefore, that, “in this context[,] continued growth in FR service is contrary to the public interest,” because “when coupled with the capacity allocation provisions [in Tariff §4.2] and the economic qualification in the provision concerning capacity expansion [1990 Settlement § 3.6] incorporated in the 1990 and 1996 Settlements, firm services on El Paso have been rendered unreliable.” *Id.* at ¶32, JA 1432.

The public interest further required conversion because while,

[u]nder normal market conditions, El Paso and other pipelines would have an incentive to expand their capacity to meet increased demand for service, . . . under the terms of the 1996 Settlement, the FR shippers would receive any expanded capacity at no additional

[reservation] charge. This would not provide El Paso with an opportunity to recover the costs of the expansion plus a reasonable return on its investment. In addition, because the FR contracts provide that the FR shippers must purchase all of their capacity from El Paso, no other pipeline has any incentive to construct capacity to meet the increased demand.

Id. at ¶61 (footnote omitted), JA 1437. For the open access goals of Order Nos. 636 and 637 to be realized, moreover, there must be reliable firm service and proper economic incentives for pipelines to expand on all parts of the national pipeline grid, of which El Paso's system is a large part. *Id.* at ¶49, JA 1435. Conversion of the FR contracts will provide those incentives for expansion and will restore reliable firm service. *Id.* at ¶49, JA 1435.

The record supported the Commission's determinations "that there have been *pro rata* reductions in firm service over a long period of time on El Paso and that El Paso's firm service obligations ([non-coincident peak]) exceed its peak day capacity ([coincident peak])." July 2003 Order at ¶51, JA 1435. "Concerns over the unreliability of firm service have been brought to the Commission by all of El Paso's customers, both FR and CD[,] . . . and El Paso has stated that it does not have capacity to serve the aggregate needs of the FR and CD customers without the turnback capacity that will be made available through the capacity rationalization process and has further stated that it lacks the capacity to serve continued FR growth." *Id.* at ¶51 (footnotes omitted), JA 1435. El Paso's statements were supported by other record evidence as well. *See e.g., id.* at ¶¶64

(citing R. 538 at Attachment A), 133, JA 1438, 1452. Moreover, the Commission found:

[t]he allegations of the FR Shippers that there is no current capacity allocation problem on El Paso are undercut by their contemporaneous arguments that they will not receive sufficient capacity in the reallocation process adopted by the Commission. . . . If, as the FR shippers argue, all of the current available capacity on El Paso, together with the additional capacity to be provided by the Power-Up Project, is not sufficient to meet the FR shippers' current and future needs, then the logical conclusion is that a capacity problem exists on the El Paso system. Continued operation of the 1990 and 1996 Settlements, including the FR contracts, will continue to exacerbate these problems. Accordingly, the public interest requires that the Commission act to rationalize capacity on El Paso.

July 2003 Order at ¶52, JA 1435-36.

Thus, the Commission:

[a]ct[ed] in the public interest to restore reliable firm service on the El Paso system. Modification of the Settlements to convert FR contracts, the allocation of specific receipt points, and the elimination of the pro rata allocation of capacity except in force majeure situations will not only serve the public interest, but will remedy the harm to all of El Paso's shippers, including the FR shippers, who allege that they also have been harmed by the pro rata allocations on El Paso.

Id. at ¶82, JA 1443. This “followed the *Mobile-Sierra* imperative to both respect private contractual arrangements and carry out the statutory mandate to guarantee that pipeline services are consistent with the public interest.” July 2003 Order at ¶44, JA 1434.

[E]xtraordinary circumstances on El Paso . . . require[d] modification of the 1990 and 1996 Settlements and conversion of the FR contracts to CD contracts, consistent with this public interest standard.

Specifically, the Commission found that it must act to protect natural gas customers and remedy a discrimination by restoring reliable firm service on the El Paso system and providing the proper economic incentives for expansion of capacity either by El Paso or by new entrants into the market.

Id. at ¶ 44 (footnote omitted), JA 1434; *see also id.* at ¶¶42-52, 82-90, 173, JA 1434-36, 1443-45, 1458-59.

The Commission also assured that its capacity allocation procedures provided converting FR customers with sufficient capacity to meet their needs. July 2003 Order at ¶¶2, 39, 82, 84, 88, 116, 119, App. B, JA 1427, 1433, 1443-44, 1449-50, 1465. In the initial allocation process, “all the FR shippers were allocated capacity amounts that are equal to or in excess of their 2001 non-coincident peak demands.^[10] In many cases, the FR shippers received allocations in excess of the amounts they stated they would ideally like to have available to them through the term of the Settlement.” July 2003 Order at ¶82, JA 1443; *see also id.* at ¶¶ 2, 39, 84, 88, App. B, JA 1427, 1433, 1443-44. These amounts were allocated to the FR shippers without change in their 1996 Settlement rates. *Id.* at ¶¶2, 83, JA 1427, 1443.

¹⁰ Citing July 2003 Order at App. B, JA 1465. The Commission found that the one exception, Navajo Tribal Utility Authority, had, in any event, “been allocated sufficient capacity because it has elected its east end allocations and has received west flow allocations in excess of its west-flow billing determinant.” July 2003 Order at n.84, JA 1443.

On top of that initial allocation, the Commission provided for:

additional capacity for the FR shippers through the use of California delivery points as receipt points (which promotes shippers' ability to exchange gas with other supply sources not attached to El Paso), and has provided opportunities for the converting FR shippers to purchase turnback capacity from current CD customers who are willing to give up their firm service contracts.^[11] The Commission has also required that El Paso offer any additional turnback capacity that becomes available during the term of the Settlement to the existing shippers before offering it to other shippers.

July 2003 Order at ¶38, JA 1433. Converting FR shippers desiring additional capacity were, therefore, provided with “a variety of options to supplement their capacity, such as turn back capacity, capacity release, and service from competing pipelines, as those projects develop.” *Id.* at n. 133, JA 1453.

Thus, the Commission concluded, “after contract conversion, the FR customers will receive service that is comparable to the service they have been receiving under the FR contracts in terms of the quantity of service they receive.”

July 2003 Order at ¶119, JA 1450. “Their new CD service,” however, “will be superior to the quality of service they have been receiving under the FR contracts because their firm service will no longer be subject to pro rata receipt point allocations due to insufficient receipt point capacity on the El Paso system. *Id.* at ¶119, JA 1450.

¹¹ Although shippers offered to turn back 724,659 Mcf/d of firm capacity, only one FR shipper [not a party here] bid for capacity (14,663 Mcf/d). July 2003 Order at ¶¶19, 88, JA 1430, 1444.

The petitions for review followed.

SUMMARY OF ARGUMENT

The Commission appropriately determined, consistent with Mobile-Sierra, that the public interest required conversion of FR contracts. FERC was not concerned about protecting the parties from an improvident bargain. Nor did the Commission rely on only broad generalizations about public policy. Rather, the Commission found it necessary, in the specific and extraordinary changed circumstances on El Paso, to modify the Settlements and to convert the FR contracts to the extent necessary to remedy unduly discriminatory conditions, restore reliable firm service, and provide proper economic incentives for expansion of capacity in the market.

The Commission agreed with complainants' (including Petitioners) allegations, and El Paso's concession, that El Paso had insufficient mainline capacity to satisfy all firm service demands on its system. Not only did the record establish, and the Orders find, that mainline curtailments were a regular occurrence on El Paso, but the Commission also found that, because FR demand was expected to continue to grow exponentially, regular curtailments were expected to increase.

An on-the-record trial type hearing was not necessary to resolve the issues raised in this case. Many of the issues alleged to require an evidentiary hearing were resolved as a matter of law or policy, and the factual issues raised by the

parties either were not in dispute or were not material to the Commission's ruling. Furthermore, the Commission held two technical conferences and a public conference, and received over seven rounds of written submissions from the parties in this proceeding. Petitioners had a full opportunity, therefore, to present their views.

Finally, FERC appropriately exercised its remedial discretion in this case. FERC's remedy was not unduly discriminatory, as FR and CD shippers are not similarly situated. Moreover, the Commission's chosen remedy was targeted to fix the identified problem, protected the parties' benefits of their bargain to the extent possible, and provided converting FR shippers access to sufficient capacity to meet their needs. As the Commission's discretion is at its zenith in fashioning remedies, its remedial determination should be upheld.

ARGUMENT

THE COMMISSION APPROPRIATELY DETERMINED THE PUBLIC INTEREST REQUIRED CONVERSION OF FR CONTRACTS TO ASSURE THE RELIABILITY OF FIRM SERVICE ON EL PASO

I. Standard of Review

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *E.g., Florida Municipal Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003). Under that standard, the Commission's decision must be reasoned and based upon substantial evidence in the record. For

this purpose, the Commission's factual findings are conclusive if supported by substantial evidence. NGA §19(b). The substantial evidence standard “requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.” *Florida Municipal*, 315 F.3d at 365 (quoting *FPL Energy Me. Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002)).

Moreover, the Court defers to the Commission's interpretation of a Commission approved settlement. *Northern Municipal Distributors Group v. FERC*, 165 F.3d 935, 943 (D.C. Cir. 1999); *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1576-77 (D.C. Cir. 1993); *National Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563, 1568-72 (D.C. Cir. 1987). In addition, "the breadth of agency discretion is, if anything, at [its] zenith when the action assailed relates primarily not to the issue of ascertaining whether conduct violates the statute, or regulations, but rather to the fashioning of policies, remedies and sanctions." *Connecticut Valley Electric Co. v. FERC*, 208 F.3d 1037, 1044 (D.C. Cir 2000) (quoting *Niagara Mohawk Serv. Corp. v. FERC*, 379 F.2d 153, 159 (D.C. Cir 1967)).

As explained below, the Commission's determinations were well-reasoned, supported by substantial evidence, and consistent with applicable law. Accordingly, the challenged orders must be upheld.

II. FERC's Findings Complied With Mobile-Sierra

In compliance with Mobile-Sierra, the Commission ordered limited modification of specific components of the 1990 and 1996 Settlements that: placed no limit on FR demand growth (the FR contracts); placed only a limited obligation on El Paso to expand its system at its own expense (§ 3.6 of the 1990 Settlement); and required pro rata allocation of capacity to firm shippers (Section 4.2 of El Paso's Tariff), only after it found their modification required by the public interest. *E.g.* July 2003 Order at ¶27 and nn 20 and 21, ¶32, JA 1431, 1432. As the Commission explained, “[w]hile [it] rarely alters an approved settlement, it has not only the authority, but also the responsibility under section 5 of the NGA to make an adjustment to a settlement if the terms of the settlement have become unjust and unreasonable and the settlement operates in a way that is contrary to the public interest.” May 2002 Order at 62,008 (citing, *e.g.*, *UDC*, 88 F.3d at 1131), JA 828, 852.

Notwithstanding the Commission's repeated explanations for why the modifications were required by the public interest, Petitioners erroneously claim that FERC acted “simply to protect the parties from what turned out to be an ‘improvident bargain.’” Br. at 23. To the contrary, the Commission required FR contract modification because those contracts, along with certain other Settlement

components, “rendered firm service on El Paso unreliable.” July 2003 Order at ¶27, JA 1431.

Specifically, FERC determined that the public interest required FR contract conversion because:

The routine pro rata capacity reductions and resultant degradation of firm service on El Paso were caused primarily by the significant and unrestricted growth in demand under the FR contracts since 1996, *e.g.*, May 2002 Order at 62,003, JA 824;

FR demand was expected to continue to grow exponentially, causing greater degradation to firm service, *e.g.*, May 2002 Order at 62,000-01, 62,003, 62,008 and n.64, JA 822-23, 824, 828, 852;

FR contracts were never intended to allow for the level of demand growth experienced on El Paso where capacity could not economically be built to meet that growth, July 2003 Order at ¶32, JA 1432;

As a result of what had become routine pro rata allocations, CD customers were paying reservation charges for firm service they were not receiving, *e.g.*, May 2002 Order at 62,001, JA 823;

The FR contracts are a disincentive to pipeline-to-pipeline competition as FR customers must take from El Paso all capacity needed to serve their load, *e.g.*, May 2002 Order at 62,003-04, JA 824-25, July 2003 Order at ¶61, JA 1437;

The FR contracts provide no economic incentive for El Paso to expand its system to serve growing FR demand as FR contract reservation charges do not grow with FR load growth, *e.g.*, May 2002 Order at 62,003-04, JA 824-25; July 2003 Order at ¶61, JA 1437;

The FR contracts’ detrimental effects on firm service thwart the open access goals of Order Nos. 636 and 637, July 2003 Order at ¶49, JA 1435;

FR contract rates contravene 18 C.F.R. §284.10(b)(1) as they are not designed to achieve the objective of rationing capacity during peak periods, May 2002 Order at 62,003 and n.33, JA 824, 850; and

New power plants served under existing FR contracts have an unfair competitive advantage over others, May 2002 Order at 62,003, JA 824.

As this synopsis shows, the Commission was not concerned about protecting the parties from an improvident bargain. Nor did the Commission rely on only “broad generalizations about public policy . . . to support contract modification” as Petitioners’ claim (Br. at 35). Rather, the Commission found it necessary, in these specific and extraordinary circumstances, to modify the Settlements and to convert the FR contracts in order to remedy unduly discriminatory conditions, restore reliable firm service, and provide proper economic incentives for expansion of capacity in the market. May 2002 Order at 62,005-08, JA 826-28; July 2003 Order at ¶¶27, 30-32, 44, 48-49, 82-83, JA 1431-32, 1434, 1435, 1443.

Also consistent with Mobile-Sierra, FERC modified the Settlements and FR contracts only to the extent necessary to restore firm service reliability on El Paso, thereby retaining, to the extent possible, converting FR customers’ benefits of their settlement bargain. July 2003 Order at ¶¶ 91-93, 173, JA 1445, 1458-59. Rather than abrogating the FR contracts as Petitioners claim (*e.g.*, Br. at 22-23, 38), the challenged orders simply modified them as necessary. For example, the Commission retained FR shippers’ 1996 Settlement reservation rates even though

their converted capacity allocations were, for the most part, greater than their 1996 Settlement billing determinants on which their reservation rates were based.¹² September 2002 Order at ¶¶33-34, JA 1149; July 2003 Order at ¶¶2, 10, 39, 82, 84, 88, App. B, JA 1427, 1428, 1433, 1443-44, 1465.

Further, “[i]n recognition of the Settlement provision that commits El Paso to provide the full requirements of the FR shippers through the term of the Settlement,” the Commission “require[d] El Paso to give existing shippers priority for any new capacity that El Paso might propose to construct through the term of the Settlement.” May 2002 Order at 62,018, JA 837. Additionally, “through the term of the Settlement,” the Commission “require[d] El Paso to accept turnback to meet growth in the needs of its existing shippers. At least once a year, El Paso must determine whether any existing shippers require additional CD allocations and to solicit turnback of capacity to meet those additional requests.” May 2002 Order at 62,018, JA 837. The Commission also retained the provisions requiring customers to be credited a percentage of the revenues from capacity resales, which FR shippers indicated had reached \$50 million per year. July 2003 Order at n.90, JA 1445. This nonexhaustive list of retained FR benefits after conversion obviates Petitioners’ claim (Br. at 22) that FERC inappropriately denied them the benefit of

¹² Converting FR shippers whose current use was lower than their 1996 billing determinants were given capacity allocations at their billing determinant level, preserving the benefit of their bargain as well.

their bargain when it made the limited modifications to the Settlements and FR contracts as required by the public interest.

Contrary to Petitioners' assertions (Br. at 24), the changed circumstances on El Paso were relevant to and helped to justify the Commission's Mobile-Sierra determinations. While El Paso had excess capacity at the time of the 1990 and 1996 Settlements, "El Paso system has become capacity-constrained," and therefore, "open-ended FR contracts with large shippers that contain no limitation on the amount of capacity that can be demanded, and the related provisions of the 1990 and 1996 Settlements are not in the public interest" because they adversely affect reliability for all firm customers. July 2003 Order at ¶32, JA 1432; *see also id.* at ¶61, JA 1437 ("circumstances on El Paso that led to the approval of the 1990 and 1996 Settlements changed, *i.e.*, a situation of excess capacity became constrained, and this resulted in unreliable firm service on El Paso's system."). The "FR contracts were never intended to be a vehicle to allow large shippers to increase their demands by more than 600 percent on a system that has no unsubscribed capacity to accommodate these increased demands." *Id.* at ¶32, JA 1432.

Nor did FERC base its public interest determination on a concern that "the agreement ha[d] become undesirable or uneconomic" as Petitioners posit (Br. at 24-25). FERC's findings were based on firm service reliability concerns.

In this regard, FERC did not, as Petitioners argue (Br. at 24-25), fail to adhere to *Metropolitan Edison Co. v. FERC*, 595 F.2d 851 (D.C. Cir 1979), when it stated (July 2003 Order at ¶61, JA 1437) that El Paso would not have “an opportunity to recover the costs of the expansion plus a reasonable return on its investment.” While Petitioners’ argument makes it appear that FERC made that statement in support of a finding that the FR contracts had become undesirable or uneconomic to El Paso, the true context of that statement was a discussion of how the FR contracts created a disincentive for infrastructure expansion:

Under normal market conditions, El Paso **and other pipelines** would have an incentive to expand their capacity to meet increased demand for service, . . . under the terms of the 1996 Settlement, the FR shippers would receive any expanded capacity at no additional [reservation] charge. This would not provide El Paso with **an opportunity to recover the costs of the expansion plus a reasonable return on its investment**. In addition, because the FR contracts provide that the FR shippers must purchase all of their capacity from El Paso, no other pipeline has any incentive to construct capacity to meet the increased demand.

July 2003 Order at ¶61 (emphases added), JA 1437.

Petitioners concede that FR contracts discourage pipeline-to-pipeline competition and do not support a national pipeline grid, and that their fixed billing determinants discourage the building of new capacity. Br. at 35. They argue however, that “[n]either concern is new nor extraordinary; neither justifies contract modification” because “[b]oth in 1990 and 1996, FERC found FR service to be in the public interest in the context of the overall settlement.” In Petitioners’ view,

“[h]aving previously approved these provisions FERC cannot now be allowed to conclude that the existence of these provisions in the contracts is an ‘extraordinary circumstance’ under *Mobile-Sierra* justifying abrogation.” Br. at 35-36.

Petitioners’ argument ignores the Commission’s finding that, since 1996, the bases upon which the Commission had approved FR contracts on El Paso no longer existed. May 2002 Order at 61,998, JA 820-21; *see also* July 2003 Order at ¶33, JA 1432. FR shippers’ demand under the FR contracts had grown significantly and was expected to continue to grow exponentially. May 2002 Order at 61,998, 62,000-03, 62,008 and n.64, JA 821, 822-25, 828, 852. Additionally, the turned-back capacity at issue in the 1996 Settlement was resubscribed. May 2002 Order at 61,997, 61,998, JA 820, 821; July 2003 Order at ¶15, JA 1429. As a result of these changed circumstances, El Paso no longer had sufficient capacity to meet the demands of all firm shippers, and conversion of the FR contracts was required by the public interest to restore firm service reliability. May 2002 Order at 61,997, 61,998, JA 820, 821; July 2003 Order at ¶15, JA 1429.

Petitioners contend for the first time on appeal that FERC was required to make individual findings that each FR contract harmed the public interest rather than the generic finding made here. Br. at 25-26. This Court lacks jurisdiction to consider that contention because Petitioners did not raise it on rehearing, giving

FERC no opportunity to address it as required under NGA §19(b).¹³ In any event, while “[i]n most cases, intervening circumstances are unique to the relationship between contracting parties[,] . . . where intervening circumstances . . . affect an entire class of contracts in an identical manner, [there is] nothing in the *Mobile-Sierra* doctrine to prohibit FERC from responding with a public interest finding applicable to all contracts of that class.” *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 710 (D.C. Cir 2000) (“*TAPS*”), *aff’d New York v. FERC*, 535 U.S. 1 (2002).

The intervening circumstances here -- dramatic growth in large FR customer demand on El Paso’s system with no concomitant increase in reservation charges that caused, in conjunction with certain provisions of the 1990 and 1996 Settlements, firm service on El Paso to become unreliable in contravention of the public interest – did not differ from one large FR customer to another, but were the same for all large customer FR contracts. In this situation, nothing in the *Mobile-Sierra* doctrine prohibited FERC from responding with a public interest finding applicable to all FR contracts of that class. As in *TAPS*, “to deny FERC authority to make generic findings in such a case would simply impose on it and the parties

¹³ For the same reason, the Court lacks jurisdiction to address Petitioners’ argument (Br. at 49-50) that the Commission erred when it directed El Paso to accept firm offers for turnback capacity for only 110 MMcf/d to establish a reserve pool of capacity until Power-Up Project completion to assure converting FR shippers’ needs are met. July 2003 Order at ¶¶10, 150-54, JA 1428, 1455.

the repetitive burden of proving the public interest in each and every case.” 225 F.3d at 710.

Atlantic City Electric Co. v. FERC, 295 F.3d 1 (D.C. Cir 2002), does not, contrary to Petitioners’ assertion (Br. at 26), change this. In that case, the Court held a generic finding by FERC that existing contracts had to be modified to reflect Order No. 888 transmission pricing inappropriate because:

In Order No. 888 and its progeny, FERC indicated that the new transmission pricing rules were to apply prospectively only. Pre-existing contracts would be left unchanged unless the parties voluntarily agreed to an amendment or the customer proved, on a case-by-case basis, that the facts presented by an individual contract justified a change. *See* Order No. 888, 61 Fed. Reg. at 21,557-58. Yet, in the [Orders at issue] the Commission ordered that all pre-existing contracts be modified without making any of the required findings under the *Mobile-Sierra* doctrine.

Atlantic City, 295 F.3d at 14. In the instant case, by contrast, FERC never found that individual, rather than generic, *Mobile-Sierra* findings would be required as to each FR contract before the FR contracts could be modified in the public interest.

Moreover, while FERC’s generic finding in *Atlantic City* broadly applied to all preexisting contracts, the finding here did not. FERC’s *Mobile-Sierra* finding here applied only to those preexisting contracts that the record showed were causing firm service on El Paso to be unreliable and must, therefore, be modified in the public interest. Thus, the Commission did not order modification of small

FR contracts (those with peak loads limited to 10,000 Dth/d) or CD contracts. May 2002 Order at 62,017, JA ____.

In addition, the Commission's finding that continuation of large customer FR contracts would harm other firm shippers by making service unreliable, *e.g.*, May 2002 Order at 62,000, 62,001, JA 822, 823, is a finding specifically sanctioned under Mobile-Sierra as justifying contract modification. *See Sierra*, 350 U.S. at 355 (contract modification allowed where continuation places excessive burden on other customers).

III. El Paso Had Insufficient Mainline Capacity To Satisfy All Firm Demand

Petitioners' myriad claims under the heading "FERC Failed To Recognize That Production Area Curtailments Are Not New Or Extraordinary And Do Not Signify That Firm Service Is Unreliable" (Br. at 27-35), are based on the mistaken premise that FERC held that, in order for firm service to be reliable, El Paso's firm customers (all of whom had system-wide receipt point rights) must be able to receive all of their gas from a particular basin. FERC explicitly held, however, that "Shippers with system-wide receipt rights do not have rights in any specific basin and are not entitled under their contracts to gas from a particular basin; they are not entitled to gas from the least expensive basin." July 2003 Order at ¶205, JA 1463.

Complainants (including Petitioners) alleged, the record established, and FERC found, that El Paso had insufficient mainline capacity to satisfy all firm

service demands.¹⁴ “While *pro rata* allocations did result at times from the economic decisions of El Paso's customers, *pro rata* allocations also occurred when the mainline was full and shippers could not have received gas from alternate receipt points.” July 2003 Order at ¶57, JA 1436; Cf. May 2002 Order at 62,001 and n. 23 and 62,015 (citing R. 272 at Response No. 4, JA 254), JA 823, 850, 835. El Paso’s “firm service contractual obligations exceed[ed] its westflow capacity by about 220 MMcf/d.” July 2003 Order at ¶111 and n.109, JA 1448.¹⁵

The record established “that there have been *pro rata* reductions in firm service over a long period of time on El Paso . . . and that “[c]oncerns over the unreliability of firm service have been brought to the Commission by all of El Paso's customers, both FR and CD.[¹⁶] [FR shipper] Southwest Gas states that it

¹⁴ E.g., May 2002 Order at 61,999, 62,000 and n. 15, 62,001, 62,008, App. C, JA 821-23, 828, 846-49, 849-50; July 2003 Order at ¶¶51-53, 56-58, 111 and n.109, 113, 133, JA 1435-37, 1448, 1449, 1452; R. 188 at 2, 5, 19, Lander testimony at 18-19, JA 136, 139, 153, 173-74; R. 234 at 9-10, JA 217-18; R. 421 at 13, 18, 82, 118; JA 488, 493, 557, 593; R. 276 at 1, 7, 10, 24, 27, JA 270, 276, 279, 293, 296; R. 302 at 2, 3, JA 398, 399; R. 315 at 2, JA 307; R. 422 at Ex. A, JA 749-55; R. 182, JA 41-131; R. 421 at 145, JA 620; R. 441 at 7, JA 772; R. 532 at 5, 6, 10, 17, JA 939, 940, 944, 951.

¹⁵ Thus Petitioners err in claiming (Br. at 49) that FERC “failed to quantify the alleged capacity shortfall.”

¹⁶ Citing *Amoco Energy Trading Corp. v. El Paso Natural Gas Co.*, 93 FERC ¶61,060 (2000), and the complaints by FR (R. 188) and CD customers (R. 182) in the instant proceeding.

has been complaining about firm service degradation on El Paso for 10 years.”^[17] Petitioners’ own assertions corroborated that El Paso’s mainline capacity was insufficient. For example, in their complaint Petitioners stated that “customers for at least the past year have begun to experience cutbacks in scheduled quantities due to capacity constraints, regardless of the supply basin accessed,” and that “El Paso’s overtaxed mainline system is reaching the breaking point,” R. 188 at 5, JA 139. And, as the Commission found, “[i]f, as the FR shippers argue[d], all of the current available capacity on El Paso, together with the additional capacity to be provided by the Power-Up Project, is not sufficient to meet the FR shippers’ current and future needs, then the logical conclusion is that a capacity problem exists on the El Paso system.” July 2003 Order at ¶52, JA 1435-36.

El Paso corroborated this as well, admitting that “it does not have capacity to serve the aggregate needs of the FR and CD customers without the turnback capacity that will be made available through the capacity rationalization process and . . . that it lacks the capacity to serve continued FR growth.” July 2003 Order at ¶51 and n.51 (citing R. 592 at 6, JA 1052), JA 1435. Thus, Petitioners’ claims that it was “uncontested” that “capacity routinely had been available to CD Shippers,” Br. at 32, mainline curtailments of firm service “may only have existed briefly after the Carlsbad rupture during the California energy crisis,” Br. at 28, 32,

¹⁷ Citing R. 581 at 16, JA 1025.

39, and “the record does not support a finding that there were non-*force majeure* mainline curtailments,” Br. at 31-32, are refuted by substantial record evidence and the Commission’s findings.

Petitioners contend (Br. 31) that FERC’s citation to an El Paso filing indicating that there were more than 10,000 pro rata allocations of service nominations on El Paso between August 2000 and July 2001 is irrelevant because that filing also indicated that “a substantial majority of the incidents of capacity allocation . . . were the result of shippers using systemwide receipt point flexibility currently available to them to nominate gas from preferred receipt points.” R. 272 at Response No. 4, JA 254. Petitioner is wrong. Even if a “substantial majority” of the more than 10,000 pro rata capacity allocations were due to economic reasons, that still means thousands were due to mainline capacity constraints.

Nor is there merit to Petitioners’ claim, Br. at 28, that “FERC never even attempted to quantify the extent to which it believed that mainline curtailments occurred.” Not only did the record establish, and the Orders find, that mainline curtailments were a regular occurrence on El Paso, but the Commission also found that, because FR demand was expected to continue to grow exponentially, regular curtailments were expected to increase. May 2002 Order at 62,000-03, 62,008 and n.64, JA 822-25, 828, 852; July 2003 Order at ¶32, JA 1432.

While Petitioners argue that FERC did not recognize until the final challenged order “that a preference for nominating San Juan basin gas has contributed to the *pro rata* allocations on [El Paso]’s system,” Br. at 29-30 (quoting July 2003 Order at ¶57, JA 1436), the orders establish otherwise. The Commission found in the May 2002 Order that “[t]he preference for the San Juan Basin gas, together with the growth in demand from the FR shippers and the lack of incentives to expand the infrastructure have caused all firm shippers to experience frequent pro-rata nomination reductions.” May 2002 Order at 61,998, JA 821; *see also* May 2002 Order at 61,997, 61,999-62,000, 62,014, 62,016, JA 820, 821-22, 833-34, 835. To remedy the impact receipt point preferences had on nomination reductions, the Commission directed El Paso to assign specific primary receipt points rights on its system. May 2002 Order at 62,014, JA 833-34; *see also* July 2003 Order at ¶57, JA 1436.

There also is no merit to Petitioners’ follow-on argument that FERC’s determination that system-wide receipt point rights were contributing to capacity allocation problems on El Paso shows that FERC found firm service on El Paso unreliable solely because “requests for service from San Juan exceeded its capacity to deliver.” Br. at 30 (citing July 2003 Order at ¶57, JA 1436). In response to FR shipper claims “that CD curtailments on El Paso are due in large part to the CD customers’ failure after *pro rata* cuts in initial nominations to the San Juan Basin,

to take advantage of their rights to renominate to other supply basins” (July 2003 Order at ¶55, JA 1436), and CD statements that “their scheduled capacity was cut on El Paso’s mainline and not just out of one supply basin” (July 2003 Order at ¶56, JA 1436), the Commission stated that it:

recognizes that a preference for nominating San Juan Basin gas has contributed to the *pro rata* allocations on El Paso's system. The Commission's decision in the May 31 order to modify the Settlements and El Paso's tariff so as to replace system-wide primary receipt point rights with contract-specific receipt point rights is designed to address this problem. While *pro rata* allocations did result at times from the economic decisions of El Paso's customers, *pro rata* allocations also occurred when the mainline was full and shippers could not have received gas from alternate receipt points.

July 2003 Order at ¶57, JA 1436. In addition, the Commission made modifications to reduce curtailment based on economic decisions by requiring specific receipt point designations and allowing reservation charge credits only where no capacity available at any receipt point.

There is no inconsistency, therefore, with FERC precedent, as Petitioners allege. Br. at 31, 34 (citing *Arizona Corporation Commission v. El Paso Natural Gas Co.*, 59 FERC ¶61,183 at 61,636 (1992)). Consistent with *Arizona*, FERC held here that “[s]hippers with system-wide receipt rights do not have rights in any specific basin and are not entitled under their contracts to gas from a particular basin.” July 2003 Order at ¶205, JA 1463.

Petitioners' complaint that FERC inappropriately took official notice of data provided by El Paso in the related complaint proceeding in Docket No. RP00-241 (Br. at 33) fares no better. It was appropriate for the Commission to take official notice of evidence from the complaint proceeding as that evidence was publicly available and referenced in the challenged orders, allowing for rebuttal and judicial review.¹⁸ *Wisconsin Power & Light v. FERC*, 363 F.3d 453, 463 (D.C. Cir 2004); *Union Electric Co. v. FERC*, 890 F.2d 1193, 1202-03 (D.C. Cir 1989).

East Texas Electric Coop., Inc. v. FERC, 331 F.3d 131 (D.C. Cir 2003) does not, as Petitioners assert (Br. at 33 and n.43), hold otherwise. In that case, the rehearing order "did not make any findings, but instead referred to 'earlier findings' in its Initial Order," which did not exist. *Id.* at 138. The Court found that "[g]iven the lack of both factual findings by FERC and any statement in the Orders concerning the ground to support a finding regarding [the matter at issue], a remand [was] required." *Id.*

¹⁸ The Commission also appropriately determined not to consider findings made by the Administrative Law Judge in his initial decision in RP00-241, contrary to Petitioners' arguments (Br. at 14, n.17, 40, 52-53). The Commission found that "[a]ction to implement the decision of the Chief ALJ is . . . not appropriate" because a settlement was pending in that proceeding. The Commission later vacated the initial decision in that case.

IV. FERC Appropriately Exercised Its Discretion In Determining An Oral Evidentiary Hearing Was Unnecessary

Despite Petitioners' claims to the contrary, Br. at 39-41, the Commission appropriately exercised its discretion in determining "that an on-the-record trial-type hearing is not necessary to resolve the issues raised in these proceedings." May 2002 Order at 62,018, JA 837-38. *Entergy Services, Inc. v. FERC*, 319 F.3d 536, 545 (D.C. Cir 2003); *Arkansas Elec. Energy Consumers v. FERC*, 290 F.3d 362, 369-70 (D.C. Cir 2002). The Commission found that "[m]any of the issues that the parties allege require an evidentiary hearing have been resolved by the Commission as a matter of law or policy. . . . In addition, the factual issues raised by the parties are either not in dispute or are not material to the Commission's ruling." May 2002 Order at 62,018-19, JA 838. For example,

[a] determination of the amount of capacity available on the El Paso system is not the type of issue that requires resolution in an evidentiary hearing. It is a technical issue that can be resolved by the Commission based on the pleadings and information obtained from the conferences in this proceeding and related proceedings before the Commission. As the court explained in *Louisiana Ass'n of Independent Producers and Royalty Owners v. FERC*, [958 F.2d 1101, 1113-14 (D.C. Cir. 1992),] a hearing is not necessary on a purely technical issue especially where there have been multiple opportunities to analyze the evidence and file comments.

July 2003 Order at ¶63, JA 1437.¹⁹

¹⁹ The Commission also rejected Petitioners' contention (Br. at 54) that FERC might have interpreted §16.3 of the 1996 Settlement differently if it "had taken evidence on the reasons for" it:

Here, the Commission held two technical conferences and a public conference,²⁰ and received over seven rounds of written submissions from the parties. July 2003 Order at ¶¶41, 63 and n.61, JA 1433, 1437-38. The parties also had another chance to raise any concerns during the reallocation process. *Id.* at ¶64, JA 1438. Petitioners had a full opportunity, therefore, to present their views.

V. FERC Appropriately Exercised Its Remedial Discretion

Petitioners complain that FERC's remedy was unduly discriminatory because it modified FR contracts, but not CD contracts. Br. at 37-38, 49-51. FERC's remedy was not unduly discriminatory: "FR and CD shippers are not similarly situated" because "the rates paid and the services received by these shippers under the Settlements and under their contracts are different." July 2003 Order at ¶115; *see Washington Water Power Co. v. FERC*, 201 F.3d 497, 504

[Petitioners] had not shown the need for a hearing. The Commission has relied on its knowledge of the industry and the regulatory context in which the Settlement was executed and approved to determine the most reasonable interpretation. To the extent that the FR shippers claim a more reasonable interpretation exists, they have failed to demonstrate that a full evidentiary hearing is necessary to support their claim.

July 2003 Order at ¶107, JA 1448.

²⁰ While Petitioners complain that "the Commission relied upon oral declarations made at a public conference in which shippers had 5 minutes to make remarks but could not challenge assertions made by other participants" (Br. at 40 n.53, citing R. 421), they were permitted to, and did, make multiple filings thereafter. *See Certified Index To The Record.*

(D.C. Cir 2000) (holding that to prevail on an undue discrimination claim, petitioner must demonstrate not only different treatment between two customer classes, but that it is similarly situated to the other class).

As a result of their differences, the impact of the reduced service from pro rata curtailment on FR and CD customers was different. While the routine pro rata allocations cut service to both CD and FR customers, “[i]n the case of the CD customers, [reservation] charges have already been paid for this capacity, and the customers therefore do not receive the service they are paying for.” May 2002 Order at 62,000 n.15, 62,009, JA 849, 829; September 2002 Order at ¶14, JA 1146.

Further, because FR demand growth was directly linked to the firm service degradation, while CD contract amounts were not, it was necessary to modify FR contracts, but not CD contracts, to remedy the degradation. May 2002 Order at 62,002-03, JA 824. As the Commission explained:

the two services have a different impact on capacity allocation on the El Paso system, and the Commission's remedy reasonably takes those different impacts into account. As explained above, the operation of the 1990 and 1996 Settlements and related growth in FR demands have been factors in leading to the *pro rata* allocations on the El Paso system. Further, El Paso has stated that the uncertainty regarding the amount of capacity that will be used under the FR contracts has made it difficult for it to establish pathing on its system. In addition, the FR contracts do not provide the proper incentives for any pipelines to expand capacity to meet growth in demand under the FR contracts.

July 2003 Order at ¶116, JA 1449. Since the Commission's chosen remedy was targeted to fix the identified problem, and the Commission's discretion is at its

zenith in fashioning remedies, *Connecticut Valley*, 208 F.3d at 1044; *Niagara Mohawk*, 379 F.2d at 159, its remedial determination should be upheld.

Petitioners contend that El Paso's "capacity problems were caused, first and foremost, by [El Paso] selling more capacity than it had," but FERC "assiduously avoided blaming [El Paso]." Br. at 52. This contention misstates the matter. The Commission found that the most significant cause of El Paso's capacity shortage was growth in FR demand. May 2002 Order at 62,002-03, JA 824. Moreover, the Commission reviewed the 1990 and 1996 Settlements and their resultant Tariff and contract provisions, and discerned that the "the terms of El Paso's tariffs, contracts, and Settlements operate[d] to create conflicting requirements."²¹ July 2003 Order at ¶112, JA 1449; May 2002 Order at 62,013, JA 833. Thus, while "El Paso's firm commitments exceed[ed] its available capacity," the Commission exercised its remedial discretion and "concluded that it is appropriate to provide a remedy going forward [including termination of provisions that conflicted with El Paso's

²¹ While Article 16.3 of the 1996 Settlement required El Paso to "maintain and operate facilities sufficient to satisfy and perform [its] service obligations," that requirement was conditioned by §3.6 of the 1990 Settlement, which required El Paso to construct additional facilities only if they were "economically justifiable." July 2003 Order at ¶97, JA 1446; *see also* July 2003 Order at ¶¶99-108, JA 1446-48. As the Commission approved both settlements, its reasonable interpretation of them merits deference. *E.g.*, *Northern Municipal*, 165 F.3d at 943.

obligations under Article 16.3], rather than penalize El Paso for following its tariff and Settlements.” July 2003 Order at ¶98, JA 1446.

The Commission’s interpretation of §3.6 -- that it required El Paso to construct additional facilities only if they were “economically justifiable” -- does not, as Petitioners assert (Br. at 56), read that provision out of the settlements. Under the settlements, El Paso would be able to recover additional reservation charges related to any expansion to serve load growth other than FR, and thus such expansion would be “economically feasible.” See May 2002 Order at 62,004, JA 825.

There also is no merit to Petitioners’ claim that the Commission erred in not ordering El Paso to expand its system. Br. at 38. “The Commission does not have authority under the NGA to order a pipeline to construct additional capacity.” July 2003 Order at n.104, JA 1447 (citing *Panhandle Eastern Pipeline Co. v. FPC*, 204 F.2d 675, 680 (3d Cir. 1953) (“Congress intended to leave the question whether to employ additional capital in the enlargement of its pipeline facilities to the unfettered judgment of the stockholders and directors of each natural gas company involved.”)).²²

²² Petitioners’ assertions that *Panhandle* does not bar FERC from ordering El Paso to expand its facilities (Br. at 58-59) and that FERC had authority under NGA §16 to require expansion (Br. at 58) are not properly before the Court as those assertions were not raised on rehearing. NGA §19(b). In any event, NGA §16 does not grant FERC authority to expand its jurisdictional reach beyond the limits

That did not leave FERC “powerless to remedy the problem” as Petitioners claim (Br. at 59). FERC remedied the problem by: converting FR contracts; prohibiting El Paso from entering into new firm service contracts unless it can demonstrate that it has available capacity to provide that service (May 2002 Order at 62,012, JA 832); removing from El Paso’s Tariff provisions conflicting with its obligation to administer its pipeline system in a manner that provides reliable firm service to its customers as set forth in Section 16.3 and the Commission’s regulations (May 2002 Order at 62,013, JA 833; July 2003 Order at ¶112, JA 1449); adding to El Paso’s Tariff the requirement that El Paso provide reservation charge credits to its firm customers when it is unable to transport nominated volumes for reasons other than force majeure or a customer’s economic choice (May 2002 Order at 62,013, JA 833); and, directing El Paso, throughout the Settlement period, to give existing shippers priority for any new capacity and to solicit and accept turnback capacity to meet existing shippers’ load growth (May 2002 Order at 62,018, JA 837). Contrary to Petitioners’ contention (Br. at 38 and n.51), therefore, the Commission’s remedy appropriately “took . . . action against” El Paso. In doing so, the Commission increased capacity available to existing shippers and increased incentives to build new capacity.

Petitioners' complaint that "FERC's passing reference to FR Shippers' ability to contract with others, [July 2003 Order at ¶¶ 2, 33[; JA 1427, 1432], is purely hypothetical" (Br. at 36) misconstrues FERC's statement. The Commission did not indicate that FR shippers currently had the ability to contract with other pipelines for capacity. Rather, the Commission explained that its remedy provided the incentive for new capacity options to come into the area: "[w]hen the FR contracts are converted to CD contracts, the converted FR shippers will no longer be required to take their full requirements from El Paso. These new CD shippers will be able to explore other service options, which will encourage competing pipelines to offer service to these shippers.^[23]" July 2003 Order at ¶90, JA 1444-45; *see id.* at ¶89, JA 1444. "Freeing the former FR shippers in this way will encourage the development of additional infrastructure, as needed." July 2003 Order at 2, JA 1427.

APS/Pinnacle argue that FERC did not consider that their financial investments in the new Redhawk gas-fired electric generation facility were made in expectation that they would receive service under their FR contracts for that facility. Br. at 41-45. The Orders establish otherwise. The Commission found that APS/Pinnacle "had no reasonable basis on which to assume a prior Commission commitment for service to the Redhawk plant." July 2003 Order at

²³ "For example, Kern River has indicated an interest in serving this area." July 2003 Order at n. 88, JA 1445.

¶166, JA 1457. The proposed Redhawk plant would increase APS/Pinnacle's FR load by over 600% from its 1996 Settlement billing determinant, and the Commission found the "FR contracts were never intended to be a vehicle to allow large shippers to increase their demands by more than 600 percent on a system that has no unsubscribed capacity to accommodate these increased demands." May 2002 Order at 62,003, JA 824; July 2003 Order at ¶32, JA 1432.

Moreover, the Commission had not issued a certificate to El Paso regarding service to the Redhawk facility. Rather, the only orders regarding potential El Paso service for the Redhawk facility specifically declined to address whether it could be served under the FR contract. July 2003 Order at ¶166, JA 1457 (citing *El Paso Natural Gas Co.*, 95 FERC ¶61,461, *reh'g denied*, 96 FERC ¶61,343 (2001)). Nor did the orders address whether El Paso had a service obligation or sufficient capacity to serve the Redhawk facility, or indicate from where gas would be obtained to serve that facility. *Id.*

Next, despite acknowledging that the Redhawk plant was not yet fully constructed or in operation during the 12-month period used to determine the initial capacity allocation, APS/Pinnacle claims the Commission erred by "fail[ing] to adopt a remedy that provided [it] with firm capacity needed to serve the natural gas requirements of the Redhawk plant." Br. at 45-48. The Commission explained why allocations were based on actual, not projected needs, however:

Data regarding each shipper's use of the system during the most recent 12-month period is a just and reasonable basis for allocating capacity based on current needs, and is consistent with the Commission's use of representative periods in rate proceedings. All converting FR shippers will be allocated as their new CDs, capacity equal to the greater of their billing determinants under the 1996 Settlement or their use of the system over the last 12 months. The same method of establishing new CD levels will apply to all converting FR customers and therefore does not discriminate unduly among the FR customers.

July 2003 Order at ¶165, JA 1457. Additionally, APS/Pinnacle's initial capacity allocation was more than 20 percent above its peak usage during the most recent 12-month period:

APS/Pinnacle received in the initial allocation . . . a peak month allocation of 366,434 Mcf/d, as compared to its 2001 non-coincident peak of 294,097 Mcf/d. This allocation is as much as El Paso and the Commission can provide. While not all of APS/Pinnacle's future demands have been met from this allocation, this order attempts to create the proper economic incentives for service of its electric generation requirements. Despite its stated concerns over insufficient capacity, APS/Pinnacle chose not to contract for additional capacity when it was offered through the turnback procedures. This additional capacity is also available for APS/Pinnacle to contract at just and reasonable rates if it needs additional capacity to supply its new generation facilities.

July 2003 Order at ¶186, JA 1444. Thus, APS/Pinnacle had the opportunity to obtain the capacity needed for the Redhawk Plant.

Finally, Petitioners contend (Br. at 51) the Commission ignored allegations that the allocation process would not meet the historical usage levels of FR shippers whose copper mining and smelting operations had been suspended during the 12-month period upon which the initial allocation was based. In fact, however,

the Commission did consider this claim, and found that these shippers' historical needs will be met as they, like all FR shippers, will receive in the initial allocation capacity at least equal to their 1996 billing determinants which they can supplement in the capacity rationalization process.²⁴ July 2003 Order at ¶165, JA 1457.

CONCLUSION

For the foregoing reasons, the petitions for review should be denied.

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²⁴ The Commission also noted that, while BHP Copper characterized the suspension of its copper mining and smelting operations as temporary, it had been suspended for the past three years. July 2003 Order at n.153, JA 1457.