ORAL ARGUMENT IS SCHEDULED FOR NOVEMBER 18, 2004

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

Nos. 03-1340 & 03-1341

**BURLINGTON RESOURCES OIL & GAS COMPANY L.P.,
PETITIONER,**

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

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COMMISSION
WASHINGTON, DC 20426**

**JUNE 25, 2004
FINAL BRIEF AUGUST 13, 2004**

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties:

The parties and amici are as stated in the brief of Burlington Resources Oil & Gas Company L.P.

B. Rulings Under Review:

The rulings for which review has been sought are as follows:

1. Burlington Resources Oil & Gas Company L.P., 102 FERC ¶ 61,003 (2003)
2. Burlington Resources Oil & Gas Company L.P., 103 FERC ¶ 61,005 (2003)
3. Burlington Resources Oil & Gas Company L.P., 104 FERC ¶ 61,317 (2003)
4. Panhandle Eastern Pipe Line Company, 103 FERC ¶ 61,002 (2003)
5. Panhandle Eastern Pipe Line Company, 103 FERC ¶ 61,007 (2003)
6. Panhandle Eastern Pipe Line Company, 105 FERC ¶ 61,141 (2003).

C. Related Cases:

The orders on review have never been before this Court or any other court. Counsel is aware of no other related cases pending in this or any other court.

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Judith A. Albert
Attorney

August 13, 2004

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GLOSSARY

Burlington	Burlington Resources Oil & Gas Company L.P.
FERC or Commission	Federal Energy Regulatory Commission
NGA	Natural Gas Act
NGPA	Natural Gas Policy Act of 1978
Pipelines	Northern Natural Gas Company and Panhandle Eastern Pipe Line Company
Southland	Burlington's predecessor-in-interest

IN THE UNITED STATES COURT OF APPEALS
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Nos. 03-1340 and 03-1432

BURLINGTON RESOURCES OIL & GAS COMPANY L.P.,
PETITIONER,

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 ISSUES

1. Whether the Commission properly determined that indemnity clauses in private take-or-pay settlements between pipelines and a natural gas producer could not relieve the producer of its statutory obligation to refund payments received for delivered natural gas in excess of the maximum price permitted by statute.

2. Whether the Commission's denial of a natural gas producer's request for equitable relief from statutory pricing limits was an appropriate exercise of the

Commission's discretion, when the request did not demonstrate any special hardship or inequity necessary to justify a waiver.

STATUTES AND REGULATIONS

The applicable statutes and regulations are contained in the addendum to this brief.

STATEMENT OF THE CASE

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

This case is the most recent of several pertaining to the proper rate treatment of the State of Kansas *ad valorem* tax on natural gas. Earlier litigation established that natural gas producers must refund *ad valorem* tax reimbursements paid by their customers to the extent that such reimbursements caused the prices received by the producers to exceed ceiling prices established by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3291, (*et seq.*). *See Public Service Company of Colorado v. FERC*, 91 F.3d 1478 (D.C. Cir. 1996) ("*Public Service of Colorado*"), *cert. denied*, 520 U.S. 1224 (1997). Petitioner Burlington Resources Oil & Gas Company, L.P. ("Burlington" or "Petitioner"), a natural gas producer, incurred such a refund liability.

This case also implicates take-or-pay contracts, another subject rich in litigation history. *See American Gas Assoc. v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990) ("*AGA*"). Take-or-pay costs "are incurred when a pipeline, in order to

maintain inventories for its sales customers, enters into a contract with the producer in which it promises either to take or to pay for the gas it has contracted to buy."[1] In the 1980's, as the demand for natural gas fell, pipelines reduced their takes from producers, thus incurring huge liabilities under the take-or-pay contracts. *See Associated Gas Distributors v. FERC*, 824 F.2d 981, 1021 (D.C. Cir. 1987) ("*AGD*"). After much litigation, the many pipelines and producers entered into settlements to resolve their take-or-pay problems. Burlington's predecessor, Southland Royalty Company ("Southland") entered into such settlements with Northern Natural Gas Company ("Northern") and Panhandle Eastern Pipe Line Company ("Pipeline") (collectively, "the Pipelines").

In the orders challenged here, the Commission rejected Burlington's argument that indemnity clauses in its take-or-pay settlements shifted the responsibility for paying Burlington's *ad valorem* refunds to the Pipelines, finding that if the settlements are interpreted as requiring the pipelines to make refunds, Burlington would unlawfully retain the monies it had collected in excess of the NGPA ceiling prices. This appeal followed.

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[1] *Baltimore Gas & Elec. Co. v. FERC*, 26 F.3d 1129, 1132 (D.C. Cir. 1994).

II. STATEMENT OF FACTS

A. Statutory and Regulatory Background

(1) The Kansas Ad Valorem Tax

Prior to 1978, the Federal Power Commission ("FPC") regulated producer sales of natural gas for resale in interstate commerce under the Natural Gas Act ("NGA"). In 1974, the FPC permitted producers to exceed the otherwise applicable NGA just and reasonable rates for wholesale sales of natural gas to allow recovery of "all State or Federal production, severance, or similar taxes."[2] The FPC found that the Kansas *ad valorem* tax constituted such a tax.[3]

In 1978, Congress enacted the NGPA, which established a "maximum lawful price" ("MLP" or "ceiling price") for a "first sale" of each of various categories of natural gas production.[4] An exception to the MLP was contained in NGPA § 110, 15 U.S.C. § 3320(a)(1) (1988), which permitted the first sale price to exceed the applicable ceiling price "to the extent necessary to recover . . . State severance taxes attributable to the production" of natural gas.

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[2] *See Just and Reasonable National Rates for Sales of Natural Gas*, Opinion No. 669, 51 FPC 2212, 2301, *clarified*, Opinion No. 699-D, 52 FPC 915, *reh'g denied in relevant part*, Opinion No. 699-H, 52 FPC 1604 (1974), *aff'd sub nom.*, *Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975).

[3] *See* Opinion No. 699-D, 52 FPC at 916.

[4] Congress repealed NGPA Title I pricing provisions effective January 1, 1993. *See* Natural Gas Wellhead Decontrol Act of 1989, Pub. L. 101-60, 103 Stat. 158 (1980).

In 1983, several parties requested FERC to overrule the FPC's allowance for separate recovery of the Kansas *ad valorem* tax, arguing that it was not a tax attributable to production within the meaning of NGPA § 110. FERC's denial of those challenges was remanded for further proceedings. *Colorado Interstate Gas Co. v. FERC*, 850 F.2d 769 (D.C. Cir. 1988) ("*Colorado Interstate*").

On remand, the Commission found that the Kansas *ad valorem* tax was not eligible for NGPA § 110 reimbursement, and required producers (first sellers) to refund *ad valorem* payments received from pipelines with respect to tax bills rendered after June 28, 1988, the date *Colorado Interstate* issued. *Colorado Interstate Gas Co*., 65 FERC ¶ 61,292 (1993), *order on reh'g*, 67 FERC ¶ 61,209 (1994) ("*Colorado Interstate Order*"). On appeal, this Court affirmed FERC's finding that the Kansas tax was not a severance tax, but concluded that producers must refund *ad valorem* taxes collected "with respect to production since October 1983," the date of the Federal Register notice that the recoverability of the tax was at issue. *Public Service of Colorado*, 91 F.3d at 1492.[5]

On September 10, 1997, the Commission ordered any first seller that had collected revenues in excess of the MLP due to Kansas *ad valorem* tax

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[5] Further litigation ensued as to the meaning of "with respect to production." *See Public Service Co. of Colo*., 80 FERC ¶ 61,264 (1997), *reh'g denied*, 82 FERC ¶ 61,058 (1998), *aff'd in relevant part*, *Anadarko Petroleum Corp. v. FERC*, 196 F.3d 1264, *reh'g granted*, 200 F.3d 867 (D.C. Cir. 2000), *cert. denied*, 530 U.S. 1213 (2000).

reimbursement to refund the excess to the purchasers with interest. *Public Service Co. of Colo.*, 80 FERC ¶ 61,264 at 61,955 (1997)("*Public Service Order*"). Pipelines were required to serve on first sellers a statement of refunds due for the period October 4, 1983 through June 28, 1988, and, within 30 days of receipt of refunds from the producers, to flow through the refunds in lump-sum cash payments to those customers who had actually been overcharged. *Id.* The Commission assigned separate dockets to each pipeline owed refunds.[6] Aided by FERC's Office of Alternative Dispute Resolution, the parties engaged in extensive discussions, resulting in settlement of most claims. On January 2, 2003, the Commission set the remaining disputes for hearing.

(2) Take-Or-Pay

The regulatory and economic conditions that necessitated reform of take-or-pay contracts are recounted in *AGD*, 824 F.2d at 995, 1021 and in FERC's Order No. 500-H at 31,509 *et seq*.[7] In brief, the artificially low natural gas prices of the 1960's and 1970's increased demand for natural gas. With demand increasing, pipelines typically entered into long-term (10 years or more) contracts which

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[6] The two dockets relevant here are No. RP98-39 (Northern), and No. RP98-40, (Panhandle).

[7] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 500-H, FERC Stats. & Regs. 1986-1990, Regs. Preambles ¶ 30,867 (1989), 54 Fed. Reg. 52344, *order on reh'g*, Order No. 500-I, FERC Stats. & Regs. 1986-1990, Regs. Preambles ¶ 30,880 (1990).

incorporated high prices and take-or-pay provisions requiring the pipeline to pay for some specified percentage, say 75 percent, of the deliverable gas regardless of the amount actually taken. *AGD*, 824 F.2d at 995-96.

The low prices also discouraged producers from drilling for new supplies, resulting in severe gas shortages, which led to enactment of the NGPA. The NGPA provided needed incentives for new gas production, but had the consequence of artificially raising prices for new gas supplies. Order No. 500-H at 31,509. By 1982, the higher natural gas prices, combined with decreasing oil prices, resulted in reduced demand for gas as consumers switched from gas to oil. *Id*. at 31,510; *AGD* at 1021. This, in turn, led pipelines to reduce their takes of gas, which triggered take-or-pay liabilities. By year-end 1985, pipeline take-or-pay liabilities amounted to $9.34 billion, Order No. 500-H at 31,510, and by 1987 over $24 billion, *id*. at 31,513; *see also AGD*, 824 F.2d at 1021.

In 1985, the Commission's Take-or-Pay Policy Statement[8] sought to resolve issues impeding producer/pipeline negotiations on the take-or-pay problem by promulgating a regulation, 18 C.F.R. § 2.76, that found that pipeline payments to producers as consideration for amending or waiving take-or-pay provisions are payments for breaches of contract, not part of the price for an NGPA § 504(a)

[8] Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations, FERC Stats. & Regs., Regs. Preambles 1982-1985 ¶ 30,637 (April 10, 1985), 50 Fed. Reg. 16,076 (April 24, 1985) ("Take-or-Pay Policy Statement").

"first sale" of "natural gas" "delivered" during a particular month. *See* Take-or-Pay Policy Statement at 31,302-03. Consequently, such payments would not result in violations of NGPA MLPs for first sales. *See Associated Gas Distributors v. FERC*, 893 F.2d 349 (D.C. Cir. 1989) (affirming that take-or-pay buyouts are not part of a pipeline's payment for gas). The regulation also provided that pipelines could recover such payments through a rate filing other than a filing to recover purchased gas costs.

Subsequently, FERC Order No. 436[9] addressed the natural gas supply and pricing problems by restructuring the natural gas industry to provide for "open access" to interstate gas pipeline transportation.[10] Although Order No. 436 also considered various actions to address the take-or-pay liabilities problem, the Commission ultimately concluded that no further regulatory action (beyond retaining the policy described above) was necessary. *AGD*, 824 F.2d at 1023.

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[9] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, 50 Fed. Reg. 42,408 (Oct. 18, 1985, FERC Stats. & Regs., Regs. Preambles 1982-1985 ¶ 30,665 (Oct. 9, 1985), *modified*, Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 23, 1985), FERC Stats. & Regs., Regs. Preambles 1982-1985 ¶ 30,675 (Dec. 12, 1985), modified further, Order No. 436-B, 51 Fed. Reg. 6,398 (Feb. 14, 1986), *reh'g denied*, Order No. 436-C, 34 FERC ¶ 61,404 (Mar. 28, 1986), *reh'g denied*, Order No. 436-D, 34 FERC ¶ 61,405 (Mar. 28, 1986), *reconsideration denied*, Order No. 436-E, 34 FERC ¶ 61,403 (Mar. 28, 1986), *aff'd in part and remanded in part*, *AGD*, 824 F.2d at 994.

[10] This was done by unbundling the pipelines' transportation and merchant functions. See *AGD*, 824 F.2d at 994.

On appeal, this Court vacated and remanded so that the Commission, among other things, could "more convincingly address" the Order No. 436 effects on pipeline take-or-pay problems. *AGD*, 824 F.2d at 1044. The Court found that FERC had not rebutted the thesis that Order No. 436 open access denied pipelines much of their leverage in the take-or-pay negotiations, *i.e.*, "the threat to refuse a producer transportation of new gas when the producer refuses to compromise liabilities under old contracts." *Id*. at 1023-24.

FERC Order No. 500,[11] issued in response to the concern about the pipelines' loss of bargaining power vis-à-vis producers, established a crediting mechanism under which a pipeline could deny a producer the benefits of open access unless the producer allowed the crediting of transported gas against the transporting pipeline's take-or-pay obligation.[12] This Court affirmed the crediting rule, observing, *inter alia*, that, "[t]he producers concede that the crediting mechanism (or the threat of its use) helped pressure them into settling much of their take-or-pay rights against the pipelines." *AGA*, 912 F.2d at 1510.

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[11] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 500, FERC Stats. & Regs. 1986-1990, Regs. Preambles ¶ 30,761 (1987), 52 Fed. Reg. 30,334 (Aug. 14, 1987).

[12] Order No. 500 stated that the Commission would issue a final rule after collection and analysis of additional data. This Court held that the ensuing delay in issuing a final rule did not comply with the *AGD* mandate and ordered the Commission to issue a final rule within 60 days. *American Gas Assoc. v. FERC*, 888 F.2d 136, 142 (D.C. Cir. 1989). Order No. 500-H followed and was affirmed in *AGA*.

B. The Northern Natural Proceeding.

(1) Northern's Take-or-Pay Settlement

On February 28, 1989, Northern and Southland (predecessor to Burlington) entered into a Take-or-Pay Settlement Agreement. Burlington First Reh'g Req. at 1. NR 365, JA 125. Northern agreed to make a one-time payment to Southland for all take-or-pay claims through January 31, 1989 and to make additional payments each month from February 1, 1989 through April 30, 1992.[13] *See* ¶ 1 of Settlement (attached as Exhibit A to Burlington's rehearing request). JA 147. Northern's take obligation was reduced to Southland's "ratable share of Northern's market demand." *See* Settlement at ¶ 2 (JA 148) and Exhibit B to Settlement at ¶¶ 1-2 (JA 155). As further consideration, Northern and Southland contemporaneously executed a transportation agreement covering certain gas in New Mexico. Settlement at ¶ 1. JA 148. Paragraph 5 stated that the agreement "resolves all disputes between the parties under any and all of [the contracts listed in the settlement exhibit A], and that Northern and Southland:

> "each hereby fully, completely, and finally releases and discharges the other . . . from any and all liabilities, claims, and causes of action . . . arising out of, or in conjunction with, or relating to said contracts . . ."

J.A. 149.

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[13] The payment amounts are redacted in the copy of the settlement provided to FERC.

(2) The January 2 Northern Order

When, on September 10, 1997, the Commission ordered first sellers to refund Kansas *ad valorem* taxes collected in excess of the NGPA ceiling price between October 3, 1983 and June 28, 1988, the docket assigned to refunds involving Northern was Docket No. RP38-39. Extensive settlement discussions ultimately led to a Commission-approved settlement resolving *ad valorem* issues between Northern and all producers except Burlington and Continental Energy. *Northern Natural Gas Co*., 93 FERC ¶ 61,311 (Dec. 27, 2000). NR 320, JA 1-7. Subsequently, an order set a hearing to address the issues related to Burlington and other non-settling first sellers. *Burlington Resources Oil and Gas Co*., 102 FERC ¶ 61,003 (Jan. 2, 2003) ("January 2 Northern Order"). NR 354, JA 8-9.

(3) The April 1 Northern Order

Burlington requested rehearing, stating that its refund obligation involved only the legal issue as to whether the Northern Take-or-Pay Settlement had released and indemnified Burlington for any claims for refund of Kansas *ad valorem* taxes. The Commission agreed that no hearing was necessary and removed Burlington as a party in the hearing. In the same order, after reviewing Burlington's and Northern's arguments on the issue, the Commission found that Burlington is obligated to make the refund. *Burlington Resources Oil and Gas*

Co., 103 FERC ¶ 61,005 (April 1, 2003) ("April 1 Northern Order"). NR 413, JA 10-14.

FERC questioned whether the indemnity clause (paragraph 5, quoted *supra* at 10) Burlington relied upon actually addressed *ad valorem* tax refund liability, but held that even if the clause could be read as having that meaning, it would not relieve Burlington of its refund liability. *Id*. at ¶ 25, JA 13. FERC precedent interpreted the NGPA as precluding a buyer in a first sale from paying "more than the MLP," and thus any agreement to do so "is unenforceable." *Id*. at ¶ 26, *citing Anadarko Petroleum Corp. v. Pan Energy Pipe Line Co.*, 86 FERC ¶ 61,040 at 61,158 (1999) ("*Anadarko II*"). JA 13.

Similarly, *Williams Natural Gas Co*., 67 FERC ¶ 61,153 at 61,450 (1994) ("*Williams*") had expressly addressed "whether a pipeline's settlement with producers resolving take-or-pay liabilities and reforming gas sales contracts, could relieve those producers of the liability for *ad valorem* tax refunds relating to those contracts." April 1 Northern Order at ¶ 27. JA 13. FERC found that:

> "[t]o the extent producers are required to make refunds in [the *ad valorem* tax refund] . . . case of amounts charged in excess of ceiling prices, they must make such refunds regardless of any agreement by their customers to pay amounts in excess of the ceiling price. Thus, take-or-pay . . . settlements between pipelines and their producer/suppliers cannot interfere with refunds required by the Commission to remedy violations of NGPA ceiling prices, or with the flowthrough of such refunds by the pipelines to their customers."

Id. quoting Williams, 67 FERC at 61,450.

Accordingly, the Northern Take-or-Pay Settlement could not relieve Burlington of its obligation to make *ad valorem* tax refunds. *Id*. Moreover, Burlington's argument that the indemnity clause did not require Northern to pay more than the MLP was unavailing, because "giving the clause the effect that Burlington seeks, results in that very outcome because the producer will be permitted to retain the excess over the MLP." April 1 Northern Order at ¶ 28. JA 14.

The Commission also rejected Burlington's contention that its proposal here was no different from settlements under which pipelines were allowed to retain the *ad valorem* tax refunds rather than flowing them through to their customers. *Id*. at ¶ 29-30. JA 14. The settlements in those cases were between the pipeline and its customers and are governed by the NGA, which does not provide any Congressionally-mandated MLPs. A settlement between a first-seller (producer) and a pipeline, in contrast, regarding payment for first sales are governed by the NGPA, which makes it "unlawful for any person (1) to sell natural gas at a first sale price in excess of any applicable [MLP] . . . .". *Id*. at ¶ 30, *citin*g NGPA § 504(a), 15 U.S.C. § 3414(a). JA 14. Thus, the parties are barred from agreeing to a higher price than the MLP. *Id*.

The Commission also denied Burlington's alternative request that it be relieved of any obligation to pay interest, finding that the request constituted a

collateral attack on the *Public Service Order*, 80 FERC at 61,955. *Id*. at ¶ 31. JA 14. Finally, after concluding that Burlington had not shown that payment of the refund would result in hardship or inequity, FERC denied Burlington's request for waiver under NGPA § 502(c), 15 U.S.C. § 3412(c). *Id*. at ¶ 32. JA 14.

(4) The Northern Rehearing Order

Burlington requested rehearing, which was denied in *Burlington Resources Oil & Gas Co., et al.*, 104 FERC ¶ 61,317 (Sept. 23, 2003) ("Northern Rehearing Order"). NR 453, JA 15-20. *Williams* and *Anadarko II* had made clear that the producer and its pipeline-buyer, by agreement between themselves alone, could not make the pipeline responsible for any *ad valorem* tax refund. Northern Rehearing Order at ¶ 25. JA 19.

The Commission rejected Burlington's argument that not giving effect to the indemnification clause in its take-or-pay settlement is inconsistent with approval of Northern's overall *ad valorem* settlement where refunds claimed from settling producers were eliminated or reduced. *Id*. at ¶ 26. JA 19. While the take-or-pay settlement between Northern and Southland was not filed with the Commission, Northern's customers and affected state commissions were parties supporting (or not opposing) Northern's *ad valorem* settlement when it was filed with FERC. *Id*. While the NGPA MLPs were Congressionally-mandated, the Commission has discretion in determining how to expend its resources in the enforcement of these

prices, and agreed with the parties to the *ad valorem* settlements that waiver or reduction of a portion of the refunds to collect the larger amount without delay or additional litigation expense was appropriate. Northern Rehearing Order at ¶ 26. JA 19.

The Commission again distinguished the statutory basis (NGA) for settlements between the pipelines and their customers, which permitted the pipelines to retain the *ad valorem* tax refunds they received from producers without flowing them through to their customers, from the take-or-pay settlements at issue here. *Id*. at ¶ 29. JA 19. Burlington had argued that NGPA § 601(b), 15 U.S.C. § 3431(b), which deems the amounts paid up to the ceiling price to be just and reasonable, makes the NGA relevant also to any agreement between the producer and the pipeline to waive the producer's payment of refunds to the pipeline. However, the primary purpose of NGPA § 601 was to remove the first sales prices from NGA jurisdiction, thus precluding the Commission from acting under the NGA to alter MLP prices. *Id*. at ¶ 30. JA 19. NGA § 601(c), 15 U.S.C. § 3431(c), prevents the Commission from denying the pipeline's right to pass through the MLP gas price to its customers, but does not affect the Commission's NGA discretion to permit customers to waive receipt of NGPA refunds as part of an overall settlement concerning a pipeline's NGA jurisdictional rates. Northern Rehearing Order at ¶ 30. JA 19.

Thus, whether or not the pipeline can keep the *ad valorem* refunds pursuant to agreements with its customers does not invoke NGPA § 504(a) which bars the producer from collecting charges in excess of the MLP. *Id.* Accordingly, "the fact that [the] customer and the pipeline can agree how the NGPA refund should be treated does not mean that the pipeline and producer can agree that the producer can receive more than the MLP." *Id.* Here, where Burlington admits it received more than the MLP, Commission precedent requires that it refund the amounts; further, Northern customers and affected state commissions have not agreed to waiver of Burlington's refund obligation. *Id.* at ¶ 31. JA 20.

The Commission then reaffirmed its denial of Burlington's request for waiver, finding, *inter alia*, that no hardship had been shown.

C. The Panhandle Proceeding

(1) Panhandle's Take-Or-Pay Settlement

On November 24, 1992, Panhandle and Southland entered into a Letter Agreement regarding three separate gas purchase and sales agreements, one of which pertained to gas produced in Kansas. Burlington Reh'g Req. at 10. PR 169, JA 303. The Letter Agreement amended the contracts effective July 1, 1992, required Panhandle to pay stated amounts or at stated rates for gas taken during certain periods in 1992, and terminated and canceled the purchase and sale agreements, thereby relieving Panhandle from any obligation to take additional gas

under the agreements. *Id.*; *see* Letter Agreement, attached as Exhibit A to Burlington's rehearing request. JA 316. Paragraph 7 states that:

> Except for the obligation and rights specifically provided in this Letter Agreement, [Panhandle] and [Southland] hereby forever release, discharge, waive and indemnify each other from and against all claims, demands, causes of action, damages, liabilities, expenses or payments, known or unknown, present or future, that each party has or may have had against the other party relating to all the above referenced contracts.

Letter Agreement, JA 317.

(2) The January 2 Panhandle Order

After extensive settlement discussions following FERC's September 10, 1997 order requiring sellers to refund excess Kansas *ad valorem* taxes, a settlement was reached and approved in Docket No. RP98-40 resolving *ad valorem* issues between Panhandle and most producers. *Panhandle Eastern Pipe Line Company*, 96 FERC ¶ 61,274 (Sept. 13, 2001). Subsequently, an order issued establishing a hearing to address the remaining issues, including those raised by Burlington. *Panhandle Eastern Pipe Line Co.*, 102 FERC ¶ 61,002 (Jan. 2, 2003) ("January 2 Panhandle Order"). PR 158, JA 203-04.

(3) The April 1 Panhandle Order

Burlington requested rehearing, stating that its refund obligation involved only the legal issue as to whether the Panhandle Letter Agreement had released and indemnified Burlington for any claims for the Kansas tax refunds. The

Commission agreed that no hearing was necessary, removed Burlington as a party in the hearing, and after reviewing arguments presented by Burlington and Panhandle, found that Burlington is obligated to make the refund. *Panhandle Eastern Pipe Line Co*., 103 FERC ¶ 61,007 (April 1, 2003) ("April 1 Panhandle Order"). PR 186, JA 205-10.

FERC questioned whether the release clause (paragraph 7 quoted above) Burlington relied upon actually indemnified Burlington for *ad valorem* tax refund liabilities, but held that even if the clause could be read as having that meaning, Burlington could not be relieved of the refund liability, *id*. at ¶ 25 (JA 208), and rejected Burlington's other arguments for essentially the same reasons it had rejected these same claims in the Northern orders. *Id*. at ¶¶ 26-31. JA 208-09. FERC also rejected Burlington's arguments similar to those it made in the Northern case that it should be relieved of any obligation to pay interest or should be granted relief under NGPA ¶ 502(c). *Id*. at ¶¶ 32-33. JA 209.

(4) The Panhandle Rehearing Order

Burlington requested rehearing, which was denied in *Panhandle Eastern Pipe Line Co.*, 105 FERC ¶ 61,141 (Oct. 28, 2003) ("Panhandle Rehearing Order"). PR 108, JA 210. As Burlington had raised again the same general issues as presented in the Northern proceeding, the Commission adopted its reasoning from the Northern Rehearing Order in denying rehearing here. *Id*. at ¶ 7. JA 211.

Burlington also raised several new arguments that warranted fuller discussion, including that the orders were inconsistent with the Commission's general policy of favoring settlements and its encouragement of settlements of the take-or-pay disputes. Panhandle Rehearing Order at ¶ 8. JA 211. FERC found that regardless of its pro-settlement policies, it did not intend for take-or-pay settlements to allow the NGPA ceiling prices to be exceeded. *Id*. at ¶ 9. JA 211.

Finally, the Commission rejected Burlington's construction of the indemnity clause as applying to the *ad valorem* tax refund. *Id*. at ¶ 10. JA 212. FERC found that the Panhandle indemnity clause, which releases claims "each party has or may have had against the other party . . . ", does not apply to the *ad valorem* tax refund as the refund arises not from a contract, or a claim by Panhandle against Burlington (Southland), but "from a Commission order requiring all parties to comply with the NGPA . . .". *Id*.

SUMMARY OF ARGUMENT

The take-or-pay settlements do not relieve Burlington of its obligation to make refunds for *ad valorem* taxes. If the settlements are interpreted as requiring the pipelines to make these refunds, Burlington would unlawfully retain the monies it collected in excess of the NGPA MLPs. In the instant case, the Northern and Panhandle take-or-pay settlements do not apply to gas that was actually delivered as part of the particular sales transactions in which Burlington received payment in excess of the MLP. Rather, the take-or-pay settlements involve gas that was not taken. Consequently, the settlements cannot relieve Burlington of its NGPA refund obligations.

Burlington's argument, that under the indemnity clause the customers will still receive refunds but from the pipelines, not it, misses the point. Burlington would retain the excess, even though NGPA § 504(a) prohibits the *seller* from retaining payments in excess of the MLPs. Thus, pipeline payments to their customers will not remedy Burlington's violation of the statute.

Burlington's contention that the Commission erred by failing to consider the valuable consideration received by the Pipelines also misses the point. Since the indemnification clauses are unenforceable as to Burlington's NGPA refund obligations, consideration is not relevant. Moreover, the take-or-pay settlements were not about Burlington's obtaining indemnification for its *ad valorem* refund

obligations, but were about producers gaining access to transportation. Order No. 500 motivated producers to settle take-or-pay issues so that they could obtain open access transportation of their gas without the substantial disadvantages that could accompany the credits they would otherwise have to offer to the pipelines. Southland settled its Northern and Panhandle take-or-pay problems after Order No. 500 issued and Southland received the same benefits as other producers upon settlement, *i.e.*, open access to gas transportation without the crediting rules and, *inter alia*, buyout payments from the pipelines.

Holding these indemnity clauses to be unenforceable is not inconsistent with the Commission's approval of the Pipelines' overall *ad valorem* settlements with their customers, state commissions, and producers even though the latter resulted in reduction or waiver of some refunds. An agency's authority to approve settlements has long been recognized as an essential regulatory tool. Here the customers, who might or might not have been due additional refunds after litigation, chose to accept immediate payment of a substantial part of the refunds in dispute rather than incur delay and higher costs attendant to litigation. The Commission properly exercised its discretion in approving the settlements despite the fact that the entire refund was waived for small producers.

The challenged orders are also not inconsistent with the Commission's approval of settlements between pipelines and their customers under which the

pipelines retained the refunds instead of flowing them through. The NGA, not the NGPA, applies to a pipeline's settlement with its customers, and the Commission may exercise its discretion under the NGA to permit customers to waive receipt of NGPA refunds as part of an overall settlement of the pipeline's jurisdictional rates. In contrast, *ad valorem* refunds are governed by the NGPA, which prohibits producer retention of payments in excess of the MLPs.

The challenged orders are not inconsistent with the Commission's policy of encouraging settlements, as that policy obviously does not give parties *carte blanche* to include a provision that conflicts with statutory requirements. The Commission properly found Burlington's reading of the indemnity provisions unenforceable.

The Commission was not required to interpret the Northern take-or-pay settlement because Burlington could not be relieved of its NGPA § 504(a) obligations in any case. Nevertheless, FERC correctly determined that the Panhandle take-or-pay settlement does not indemnify Burlington for *ad valorem* refunds because the indemnity clause releases claims "each party has against the other" and the *ad valorem* tax refund arises from a Commission order requiring all parties to comply with the NGPA.

The Commission's refusal to grant Burlington's request for waiver of its refund liability was a proper exercise of its discretion. Waiver requires a showing

of hardship, inequity, or undue burden under NGPA § 502(c). Burlington did not make the requisite showing, but repackaged its substantive arguments contending that the take-or-pay settlements relieved it of its refund obligations. More specifically, Burlington claimed no hardship from the payment of the refunds.

ARGUMENT

I. BURLINGTON MAY NOT TRANSFER ITS NGPA OBLIGATIONS TO THE PIPELINES THROUGH PRIVATE CONTRACTS.

A. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See*, *e.g*., *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). For this purpose, the Commission's factual findings are conclusive if supported by substantial evidence. NGPA § 506(a)(4), 15 U.S.C. § 3416(a)(4). A court must satisfy itself that the agency "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). A court need only find that the agency "has met the minimum standards set forth in the statute;" it cannot "substitute its own judgment for that of the [agency]." *United States Postal Service v. Gregory*, 534 U.S. 1, 11 (2001). Deference to FERC's decisions regarding rate issues is broad, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968).

Where the issue is the Commission's interpretation of its governing statute, the Court applies the methodology set forth in *Chevron, Inc. v. Natural Resources*

Defense Counsel, Inc., 467 U.S. 837 (1984). The Court must first determine whether "Congress has directly spoken to the precise question at issue," and if it has, the Court "must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-43. If the Court determines that "the statute is silent or ambiguous with respect to the specific issue," the court should defer to an agency's interpretation if its construction of the statute is reasonable. *Id.* at 843.

This Court also follows the *Chevron* analysis to review FERC's interpretation of settlements. *See National Fuel Gas Supply Corp. v. FERC*, 811 F.2d 1563, 1569 (D.C. Cir. 1987). Accordingly, if a settlement does not speak to the precise question at issue, the Court will defer to a reasonable interpretation by the Commission. *Id.* Deference is appropriate "because 'Congress explicitly delegated to FERC broad powers over ratemaking, including the power to analyze relevant contracts,' and because the Commission has greater technical expertise in this field than does the Court." *Lomak Petroleum, Inc. v. FERC*, 206 F.3d 1193, 1198 (D.C. Cir. 2000) (citations omitted).

B. The Commission Explained Why Burlington Is Responsible For Refunding The Excess Ad Valorem Tax Reimbursements.

Burlington complains (Br. at 20) that the Commission provided no explanation for concluding that Burlington remains responsible for refunding *ad valorem* amounts received in excess of NGPA MLPs. To the contrary, however,

FERC made findings that are well-grounded in the NGPA and Commission precedent.

The Commission's findings rest on NGPA § 504(a)(1), which makes it "unlawful for any person to sell natural gas at a first sale price in excess of any applicable maximum lawful price under this Act." *See* April 1 Northern Order at ¶ 30 (JA 14); April 1 Panhandle Order at ¶ 30 (JA 208). In 1993 and again in 1997, the Commission ordered producers to comply with this statutory provision by refunding tax reimbursements that caused the MLP to be exceeded. *Colorado Interstate Order*, 65 FERC at 62,374;[14] *Public Service Order*, 80 FERC at 61,955.[15] The Commission issued its 1997 order pursuant to a remand by this Court which held, *inter alia*, "Producers are liable to refund all Kansas ad valorem taxes collected with respect to production since October 1983." *Public Service of Colorado*, 91 F.3d at 1492. Burlington does not dispute that it received the MLP for its first sales of Kansas gas to the pipelines. It necessarily follows that reimbursement of its *ad valorem* taxes by the Pipelines meant Burlington received

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[14] "Any first seller that collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales on or after June 28, 1988, shall refund any such excess revenues to the purchaser . . .".

[15] "Any First Seller that collected revenues in excess of the applicable maximum lawful price established by the NGPA as a result of the reimbursement of the Kansas *ad valorem* taxes for sales based upon a tax bill rendered on or after October 4, 1983, shall refund in full any such excess revenues to the purchaser . . .".

more than the MLP for the first sales of the gas at issue, contrary to NGPA § 504(a)(1), and thus was liable for refunds.

Burlington contends (Br. at 20-21) that the Commission did not explain why the take-or-pay settlement indemnity clauses, which it claims require the Pipelines to pay the refunds instead of it, were unenforceable when it gave valuable consideration to the Pipelines in exchange. As FERC explained, however, unenforceability does not turn on whether the Pipelines received consideration. NGPA § 504(a)(1) bars Burlington from making any first sale of gas at a price exceeding the MLP, and, as the Commission explained, "giving the clause the effect that Burlington seeks, namely that Burlington does not have to pay the refund, results in that very outcome because the producer will be permitted to retain the excess over the MLP." April 1 Panhandle Order at ¶ 27-28 (JA 208); Northern Rehearing Order at ¶ 11 (JA 17). In other words, the provision, even if read as Burlington desires, would be unenforceable as violating the NGPA, whether or not consideration was given.

Burlington's argument fails to acknowledge the distinction between NGPA first sales and take-or-pay liability. Take-or-pay liability results from a pipeline's failure to have accepted (taken) sufficient quantities of gas to meet the minimum take requirement in the take-or-pay contracts. An NGPA first sale occurs when the producer actually delivers gas to the purchaser. *ANR Pipeline Co. v. Wagner*, 44

FERC ¶ 61,057 at 61,157 (1988), *reh'g denied*, 49 FERC ¶ 61,101 (1989).[16] Thus, a take-or-pay payment is made in lieu of taking delivery, and so no sale is transacted. The take-or-pay payments are not included in determining the amount received from the sale of other gas that was actually delivered to the pipeline and is not payment for a "first sale." *Id*. at 61,158.

The Northern and Panhandle take-or-pay settlements resolved obligations arising from the pipelines' past and future failures to take gas.[17] Consistent with Commission precedent, the take-or-pay settlements did not implicate the NGPA pricing scheme, and the settlements do not address whether Burlington received payments in excess of the MLPs in violation of the NGPA.

Burlington contends (Br. at 23, 26) that there is no NGPA violation in giving effect to its proposed reading of the indemnity clauses. Although that reading will allow Burlington to retain the excess over the MLP, Burlington claims to have

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[16] *See supra* at 2*; see also*, *Diamond Shamrock Exploration Corp. v. Hodel*, 853 F.2d 1159, 1167 (5th Cir. 1988) ("Far from being payments for the purchase of gas, take-or-pay payments are payment for the pipeline-purchaser's failure to purchase (take) gas.")(emphasis in original); *Kaiser-Francis Oil Co. v. Producer's Gas Co*., 870 F.2d 563, 570 (10th Cir. 1989).

[17] *See* the 1985 Take-or-Pay Policy Statement, finding payment for amending or waiving take-or-pay provisions does not violate NGPA § 504(a) because the payment is for contract breaches and is not an NGPA "sale" of natural gas. Regs. Preambles (1982-1985) at 31,302-03. An NGPA sale includes any "sale, exchange, or other transfer for value," and a "first sale" encompasses the sales of "any volume of natural gas" to or by specified entities. NGPA § 2(20) and NGPA § 2(21). As payments by buyers to natural gas sellers to resolve past or future liability for breaches of contracts are outside of these definitions, payments for reduction or waiver of take-or-pay obligations are not payments for sales of gas.

given consideration for such retention in the form of take-or-pay relief to the pipelines. Further, Burlington sees no harm to the pipelines' customers as the pipelines will refund the excess payments to their customers. NGPA § 504(a)(1), however, is directed at the amount received by the first seller, not whether the excess is paid by the pipelines or their customers. That section prohibits the first seller from receiving amounts in excess of the MLP, and Burlington, as the first seller, cannot avoid the specific NGPA prohibition by its reading of the indemnification provisions in wholly separate take-or-pay settlements.

C. *Williams* and *Anadarko* Support The Findings At Issue Here.

The challenged orders are consistent with FERC precedent holding that a private agreement between a producer and a pipeline cannot override the statutory and regulatory requirements for producers to refund amounts charged in excess of NGPA MLPs. Northern Rehearing Order at ¶ 22-25, *citing Williams* and *Anadarko II*. JA 18-19. Burlington contends (Br. at 20) that reliance on the *Williams* and *Anadarko* precedents improperly was taken "in lieu of an explanation" and that these decisions also fail to provide an explanation.[18] As

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[18] Burlington's contention (Br. at 20-21), that the relevant statements in *Williams* and *Anadarko* are *dicta*, is incorrect. In *Williams*, the Commission's rejection of any interference by private take-or-pay settlements with refunds required to remedy NGPA violations was central to its denial of Missouri's motion for stay. *Williams*, 67 FERC at 61,450. Rejection of interference by a spin-off agreement was similarly central to FERC's conclusion that Anadarko, not the pipeline, was responsible for refunds during the period it was a first seller. *Anadarko II*, 86 FERC at 61,158.

demonstrated above, FERC did provide an explanation in the challenged orders, and the explanation is consistent with the explanation in *Williams* on the same point. In *Williams*, a state commission had requested a stay until the effect of Williams' take-or-pay settlements on whether producers were required to pay *ad valorem* refunds could be determined. *Williams*, 67 FERC at 61,449-50. Williams responded that nothing in the *Colorado Interstate Order* suggested that FERC intended take-or-pay settlements to defeat the refunds that the producers had been ordered to pay pursuant to the NGPA. *Williams*, 67 FERC at 61,450. The Commission agreed, finding as here (*see*, *e.g*., April 1 Northern Order at ¶ 27-28, JA 13-14), that producers must make required refunds of amounts received in excess of the MLP regardless of agreements by customers to pay more than the MLPs. *Id.* *Anadarko*, which, as Burlington states (Br. at 21-22), involved a spin-off possibly not at arm's length, nevertheless still stands for the general principle that a private settlement between a first seller and a gas purchaser cannot relieve the first seller of the obligation to refund an NGPA overcharge. *Anadarko II*, 86 FERC at 61,158.

D. Burlington's Contention Concerning Consideration Misses The Point And Ignores The Valuable Consideration Burlington Received.

Burlington's contention (Br. at 22) that the Commission erred by failing to recognize that the consideration given by Burlington in the take-or-pay settlements

exceeds its *ad valorem* refund liability misses the point. Burlington could not bargain away that liability, as it was required by the statute and Commission orders to refund amounts exceeding the MLP. Even if, in fact, the take-or-pay settlements intended the Pipelines to indemnify Burlington for the *ad valorem* refunds (which the Commission found doubtful), such provisions would be unenforceable because private settlements cannot trump statutory mandates that prohibited Burlington from retaining the excess payments above the MLP. An unenforceable settlement provision cannot be transformed into an enforceable provision simply because a party claims to have given consideration for the switch.

More to the point, the consideration in the take-or-pay settlements was not Burlington's surrender of its take-or-pay contract rights in exchange for *ad valorem* indemnification, as Burlington seems to imply (Br. at 22-24). Nowhere in the history, discussed *supra* at 6-9, did the Commission, the Court, or the industry suggest such a *quid pro quo*; rather, considerable effort was expended to achieve the right set of incentives to encourage settlements of the take-or-pay problem that would be equitable to all players in the industry.[19] Pipeline payments to buy out take-or-pay contracts were determined to be for actual or potential breaches of

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[19] *See*, *e.g*., Order No. 500 at 30,778-79: "In brief, no one segment of the natural gas industry . . . appears wholly responsible for the pipelines' excess inventories of gas. As a result, all segments should shoulder some of the burden of resolving the problem."

contract, not for "first sales" of gas, thus freeing producers to accept buyouts without violating NGPA § 504(a). *Take-or-Pay Policy Statement* at 31,302-03. At the same time, the pipelines were assured that they could recover buyout costs from their customers. *Id.*

To the extent Order No. 436 reduced the pipelines' bargaining power in the take-or-pay negotiations by requiring open access, *AGD*, 824 F.2d at 1044, Order No. 500 responded by adopting a crediting requirement, "as a condition on open access transportation, designed to . . . assist the pipelines in the negotiation of take-or-pay obligations." Order No. 500-H at 31,516. In essence, the mechanism mandated that a pipeline would not be obligated to transport a producer's gas unless the producer offered to credit the volumes transported against the pipeline's outstanding take-or-pay obligation with the producer.

The crediting mechanism had various sticks and carrots to prompt take-or-pay settlements. Order No. 500-H at 31,526. For example, the crediting mechanism authorized pipelines to apply the credits against a producer's highest priced contracts, and did not require pipelines to notify producers which contracts would be off-set until the end of the year, which made the producers' revenues subject to uncertainty in the interim. *Id*. at 31,527. Moreover, crediting raised

difficulties with royalty owners,[20] made property transfers much more difficult,[21] and, where multiple working interest owners had to consent to credits, made settlement of the take-or-pay liabilities the only practical way to obtain transportation.[22] On review, this Court observed that, "[t]he producers concede that the crediting mechanism (or the threat of its use) helped pressure them into settling much of their take-or-pay rights against the pipelines." *AGA*, 912 F.2d at 1510.

Under these circumstances, Burlington's implication that the pipelines' assumption of the *ad valorem* tax refunds was the *quid pro quo* for its take-or-pay

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[20] The producers were "concerned that, since the pipelines could apply the credits against a contract covering leases other than those from which the gas to be transported was produced, the pipelines' use of credits subjected the producers to suits by royalty owners whose royalty payments were reduced but who received no benefit from the sale of the gas transported." Order No. 500-H at 31,527.

[21] ". . . pipelines' rights to credits are based on producer ownership of leases as of June, 1987, regardless of [their] subsequent assignments or other property transfers. The assignee is unlikely to take the assignment unless it can obtain transportation of any gas it produces. But, under the crediting rules, the assignee can only obtain transportation if the assignor offers the pipeline credits against its take-or-pay obligations to the assignor. This the assignor may be reluctant to do since it receives no benefit from the sale of gas produced by the assignee. However, the ability to freely purchase and sell leases is an important part of a producer's business." *Id.*

[22] The crediting rule required 85 percent of the transported gas "to be covered by offers of credits from the actual working interest owners of the leases in question or the pipeline could refuse to transport the gas. Since many leases had multiple working interest owners, and gas from a number of leases could be transported in a single package," having to provide credits would also increase the administrative burden of obtaining signed offers of credits from all the interest owners. Consequently, settling the take-or-pay liabilities, may have been "the only way to obtain transportation of the gas when the owners of more than 15 percent of the gas [were] unwilling to provide offers of credit." Order No. 500-H at 31,527.

settlements lacks merit. Order No. 500 issued in 1987, the Northern take-or-pay settlement occurred in 1989, and the Panhandle settlement in 1992. This meant Southland (Burlington's predecessor) was subject to the same Order No. 500 incentives to settle as were other producers, and settled its take-or-pay contracts for the same consideration as did other producers, *i.e.*, for open access to gas transportation free from the crediting rules and for payments from the pipelines that avoided protracted litigation.

E. The Challenged Orders Are Not Inconsistent With The Commission's Approval of The *Ad Valorem* Settlements.

Burlington contends (Br. at 24-25) that the Commission's approvals of Northern and Panhandle *ad valorem* settlements, which eliminated refund payments for small producers and reduced it for others, contradict FERC's conclusion that the indemnification provisions in the Northern and Panhandle take-or-pay settlements (assuming they covered *ad valorem* refunds) are unenforceable. The *ad valorem* settlements, as the challenged orders explain, resolved various disputes over the refund claims, including the amounts of the refunds due.[23] April 1 Northern Order at ¶ 30 (JA 14); Northern Rehearing Order at ¶ 26 (JA 19). The customers, who might or might not have been due additional refunds if they had

[23] *See also Northern Natural Gas Co*., 93 FERC at 62,073, stating, ". . . many working interest owners challenged, among other things: (1) Northern's liability amounts in formal proceedings filed with the Commission; (2) Northern's allocation of refund claims among working interest owners; and (3) the uncollectability of royalty related refunds."

not settled, chose to accept immediate payment of a substantial part of the refunds in dispute rather than incur further litigation costs, and all other interested parties accepted the settlement as well. *Id*. That the refund amounts were determined by settlement rather than litigation is immaterial; it has long been recognized that an agency's authority to approve settlements is an essential regulatory tool. *Pennsylvania Gas & Water Co. v. FERC*, 463 F.2d 1242, 1246 (D.C. Cir. 1972). The Commission approved the *ad valorem* settlements as being in the public interest and the producers satisfied their NGPA § 504(a) obligations by paying the refund amounts determined by the settlements. *See* Northern Rehearing Order at ¶ 26 (JA 19) ("the Commission approved the settlement as a means for obtaining for those customers the maximum amount of refunds practical.").

The fact that the *ad valorem* settlements eliminated the full refund obligations of some producers (but only the "smaller claims," *id*.) is also immaterial. The Commission has a degree of prosecutorial discretion to resolve disputes regarding refund amounts related to the NGPA ceiling price requirement. Northern Rehearing Order at ¶ 26. JA 19. Resolving those disputes through litigation would likely have involved considerable expenditures of time and resources because the *ad valorem* cases were very complex. In *Panhandle* for example, Panhandle, 34 producer parties, and 14 non-producer parties were

involved. *Panhandle Eastern Pipe Line Co.*, 96 FERC at 62,038. JA 194. Determining the amounts of refunds due would have required, *inter alia*, determining the amount of "headroom" (if any) between the MLP and the amount charged for first sales over a long-past five-year period (1983-88) under various contracts for various producers. Under these circumstances, the Commission properly exercised its prosecutorial discretion in accepting the settlement "to resolve a controversy without the undue expenditure of resources," Northern Rehearing Order ¶ 26 (JA 19), even though it meant foregoing possible refunds related to smaller producer claims. *Id.*

F. The Challenged Orders Are Not Inconsistent With The Commission's Approval of Settlements Between The Pipelines And Their Customers.

The challenged orders distinguished on statutory grounds pipeline/producer take-or-pay settlements from pipeline/customer settlements under which pipelines can retain some portion of the *ad valorem* refunds instead of flowing them through to their customers.[24] April 1 Northern Order at ¶ 30. JA 14. Flowthrough of refunds to customers is governed by the NGA and does not contain any Congressionally-mandated MLPs. *Id.* Consequently, the Commission may exercise its discretion under the NGA to approve a settlement under which customers agree to waive receipt of NGPA refunds as part of an overall resolution

[24] *El Paso Natural Gas Co.*, 85 FERC ¶ 61,003 (1998) and *ANR Pipeline Co.*, 85 FERC ¶ 61,005 (1998).

of the pipeline's NGA jurisdictional rates, without the NGPA § 504(a) prohibition being invoked. Northern Rehearing Order at ¶ 30. JA 19. Burlington argues against this result (Br. at 27-28) by claiming NGPA § 601, which deems the NGPA MLPs to be just and reasonable, does not authorize pipelines to pass through more than the MLPs by, for example, retaining a portion of *ad valorem* tax refunds.

The challenged orders properly disposed of this contention. Northern Rehearing Order at ¶¶ 29-30 (JA 19-20); April 1 Panhandle Order at ¶¶29-30 (JA 208). NGPA § 601(b)(1)(A) is designed to foreclose an NGA just and reasonable determination as to first sale prices:

> (A) First sales . . . for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable . . .

This is reinforced by NGPA § 601(c)(2), which precludes the Commission generally from denying pipeline recovery of costs incurred for first sale purchases of gas:[25]

> (2) Recovery of just and reasonable prices paid. For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if, under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act . . .

[25] An exception is made if the payment is excessive due to fraud, abuse, or similar grounds.

As the challenged orders state, this language "only prevents the Commission from denying the pipeline's right to pass through the cost of any MLP gas to their customers; it does not affect the Commission's discretion under the NGA to permit customers to waive receipt of NGPA refunds as part of an overall settlement with the pipeline concerning its NGA jurisdictional rates." Northern Rehearing Order at ¶ 30. JA 19. Thus, Burlington's argument that the challenged orders are inconsistent with the pipeline/customer settlement approvals is unavailing.

G. The Challenged Orders Are Not Inconsistent With the Commission's Policy Of Encouraging Settlements.

It is, of course, true, as Burlington states (Br. at 29-31), that Commission policy is to encourage settlements in general and in take-or-pay cases in particular. *See Panhandle Eastern Pipeline Co.*, 96 FERC at 62,042-43 (JA 198-99), and discussion *supra* at 31-33 (concerning the efforts of the Court, the industry, and the Commission to arrive at the proper balance of incentives to encourage settlement of the take-or-pay problem). Nevertheless, the general policy does not give parties *carte blanche* to include any provision in their settlements. The Commission's consistent ruling, notwithstanding the general policy, has been that take-or-pay settlements cannot allow prices in excess of the NGPA MLPs, and it followed that ruling here. *See* Panhandle Rehearing Order at ¶ 9. JA 211-12.

Nothing in Burlington's argument (Br. at 29-31) contradicts this basic principle that a general policy of encouraging settlements does not bar prohibition

of certain settlement provisions. Burlington repeats its claim (Br. at 30) that it will be foreclosed "from receipt of the full measure of the consideration to which it is entitled" for its take-or-pay concessions unless it can avoid its *ad valorem* obligations. But, as demonstrated earlier, that claim overlooks the valuable consideration Burlington received in the form of unhampered open access transportation. In any case, Burlington is barred by NGPA § 504(a) from retaining payments that exceed the MLPs.

H. Interpretation Of The Indemnity Clauses Is Unnecessary For Resolution Of This Proceeding.

Burlington complains (Br. at 31) that the Northern Rehearing Order did not interpret the Northern settlement's indemnity provision while the Panhandle Rehearing Order did so with respect to the settlement at issue there. FERC, however, found that Burlington could not be relieved of its NGPA § 504(a) refund obligations regardless of how the clauses were construed, which makes any interpretation of the clauses is irrelevant to their validity. *See* April 1 Northern Order at ¶ 27 (JA 13); April 1 Panhandle Order at ¶ 27 (JA 208).

Burlington also complains (Br. at 32) that FERC's statement (Northern Rehearing Order at ¶ 31 (JA 20)) that Burlington was free to bring its claim in court is inconsistent with FERC's findings that the indemnity clauses are unenforceable. The Commission concedes that the cited statement is incorrect, but harmless as FERC's position that the clauses are unenforceable is clear.

As *Anadarko* explains, the correct statement is that producers are free to bring claims about the allocation of the refund obligation among producers to court. The Commission found that Anadarko, a producer and first seller, must pay *ad valorem* refunds to Panhandle, but that as between Anadarko and Production, another first seller, claims about how reimbursement was to be allocated between two first sellers could be litigated in court:

> Anadarko must pay the refund for sales it made to Panhandle as a first seller. This covers all sales after Anadarko was created in 1985.
>
> [The other first seller] must make the refund for sales it made as the first seller, before Anadarko was created in 1985. Any claims for reimbursement by either party can be established in an action in court.

Anadarko Petroleum Corp. v. PanEnergy Pipe Line Co., 85 FERC ¶ 61,090 at 61,333 (1998), *reh'g denied*, *Anadarko II*, 86 FERC at 61,158 (holding that it would not violate the NGPA for the parties involved in a transfer of a production interest to agree among themselves as to the extent to which each would be responsible for any refunds).

Except for the single misstatement in the Northern Rehearing Order, the Commission has consistently found that indemnity clauses between first sellers and pipelines are unenforceable with regard to shifting the *ad valorem* tax refund obligation. *See Anadarko II*, 86 FERC at 61,158; *Williams*, 67 FERC at 61,450; April 1 Northern Order at ¶ 27 (JA 13); and April 1 Panhandle Order at ¶¶ 26-27 (JA 208). Indeed, the Northern Rehearing Order itself explicitly finds at other

places the indemnity clauses to be unenforceable. Northern Rehearing Order at ¶¶ 22-25. As FERC's position is clear, the misstatement is harmless. *Cf.*, *Florida Mun. Power Agency v. FERC*, 315 F.3d 362, 367 (D.C. Cir. 2003) (court upholds agency decisions if supported by substantial evidence, "notwithstanding their expository shortcomings") (citations omitted).

Burlington's contention (Br. at 33) that the Commission erred by failing to interpret the Northern take-or-pay settlement is without merit because, as explained above, the indemnity clauses if interpreted as Burlington would like, would still be unenforceable. Nevertheless, Burlington's argument (Br. at 35) that FERC failed "to provide a reasoned basis" for its conclusion that the Panhandle take-or-pay settlement does not indemnify Burlington for *ad valorem* refunds is incorrect. *See* Panhandle Rehearing Order at ¶ 10. JA 212. The mutual release clause Burlington relied upon, by its own terms, releases claims "each party has or may have had against the other party . . .". In contrast, "[t]he *ad valorem* tax refund is a refund that arises not from the contract, or a claim by one party to the contract against another party to the contract, but from a Commission order requiring all parties to comply with the NGPA, regardless of the terms of any contract the parties may have entered into. The mutual release of claims each party may have against the other in a settlement to which the Commission was not a party, and which was not

filed with the Commission for its approval, does not release any claims that arise from Commission orders." *Id*.

This reasoning follows, moreover, from the Commission's 1993 *Colorado Interstate Order*, which directed producers to refund the excess revenues to the purchaser and required the pipelines to flow through the refunds to their customers, and the 1997 *Public Service Order* directing the pipelines to notify producers of the refund obligations. The Commission found that the fact "that the pipeline is the entity requesting payment of the *ad valorem* refund from the producer does not make the *ad valorem* tax refund liability the type of claim that comes within the 'indemnity' clause. The *ad valorem* tax liability is not a claim by a party to the settlement. Rather, the pipeline is merely the vehicle for enforcing the Commission's order, and the NGPA ceiling price." Panhandle Rehearing Order at ¶ 11. JA 212. In short, the Commission did not find Burlington's reading credible.

II. THE COMMISSION'S REFUSAL TO WAIVE BURLINGTON'S REFUND LIABILITY WAS A PROPER EXERCISE OF ITS DISCRETION UNDER NGPA § 502(c).

A. Standard of Review

As the NGPA § 502(c) adjustment is discretionary, "appellate review ... is necessarily limited in scope … [and] the abuse of discretion standard for reviewing the FERC's denial of such special relief" applies. *Perlman v. FERC*, 845 F.2d 529, 532 (5th Cir. 1988). In reviewing denials of adjustments, the scope of review is

limited to ascertaining whether there is a rational basis for and substantial evidence supporting the agency's determination. *Id.* "[W]hile equities of a certain case may appear to support a deviation from the strict application of the NGPA, the FERC is guided at all times by the principle that … FERC's duty [is to] balance congressional policy with the equities of each situation," and absent an abuse of discretion, the FERC decision will not be overturned. *Perlman*, 845 F.2d at 532 [citations omitted].

B. Burlington Did Not Demonstrate That Waiver Pursuant to NGPA § 502(c) Was Warranted Here.

Under NGPA § 502(c), the Commission may make such adjustments, "consistent with the other purposes of [the NGPA]," as may be necessary "to prevent special hardship, inequity, or an unfair distribution of burdens." 15 U.S.C. § 3412(c). Burlington contends that such relief should be granted to it "in order to avoid inequity" on the premise that the Pipelines received the full benefits of the take-or-pay settlements while Burlington did not obtain relief from its *ad valorem* refund liability. Br. at 39-41. Burlington's arguments for adjustment merely restate its arguments advanced for not being obligated to pay the refunds. As the Commission had already reviewed, analyzed and denied these arguments, April 1 Panhandle Order at ¶ 33 (JA 209), it was well within the Commission's discretion to deny Burlington's request for an equitable adjustment based on the same arguments. The requested adjustment was inconsistent with the purposes of the

NGPA, in that it would permit Burlington to retain payments it admittedly had received in excess of the MLP, and with other take-or-pay settlements with indemnity clauses, (*e.g.*, *Williams*), where the producers were required to pay *ad valorem* refunds in spite of the clauses. Moreover, Burlington claimed neither hardship in paying these amounts nor any reliance on possible recoupment of its *ad valorem* payments when it agreed to the take-or-pay settlements.

Burlington argues (Br. at 39) that it would be inequitable to relieve the Pipelines of their indemnity clause obligations when the Pipelines have already received the benefits of the settlements. However, as demonstrated *supra*, Burlington has received considerable benefit under the settlements as well. In light of this, and, *inter alia*, NGPA § 502(c)'s admonition to consider the purposes of the NGPA, the Commission's denial of Burlington's request for waiver was well within its discretion to make.

CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

Respectfully submitted,

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