

104 FERC ¶ 61,045
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

El Paso Natural Gas Co. Docket No. RP00-336-006

Aera Energy, LLC, et al., Docket No. RP01-484-002
Complainants
v.
El Paso Natural Gas Co.,
Respondent

Texas, New Mexico and Arizona Shippers, Docket No. RP01-486-002
Complainants
v.
El Paso Natural Gas Co.,
Respondent

KN Marketing, L.P., Docket No. RP00-139-004
Complainant
v.
El Paso Natural Gas Co.,
Respondent

ORDER ON REHEARING

(Issued July 9, 2003)

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Executive Summary

1. This order on rehearing completes the assignment of Contract Demand (CD) rights to most firm shippers on El Paso Natural Gas Company's (El Paso) system. Upon full implementation of the Commission's required modifications to El Paso's prior rate settlements, its tariff and to the Full Requirements (FR) contracts, firm service will be restored on the El Paso system. The required modifications also bring balance to incentives and obligations for future service growth in the southwestern region of the United States.

2. The CD levels assigned to large customers in El Paso's Arizona, New Mexico and Texas markets will meet their current usage needs. (Small shippers may retain full requirements service.) All the converting FR shippers are being allocated capacity in amounts equal to or in excess of non-coincident peak (NCP) demands they experienced through 2001. In many cases, the converting FR shippers are receiving capacity allocations in excess of the amounts they would ideally like to have available to them through 2005, the end of the currently effective 1996 El Paso Rate Settlement. The FR shippers will receive these allocations at the current Settlement rates because the Commission has granted rehearing of its prior ruling regarding reallocation of FR costs. On rehearing, the Commission finds that reallocation of costs among the FR Shippers is not necessary to restore reliable firm service on El Paso. In addition, the former FR customers will no longer be bound to take all of their transportation service from El Paso. Instead, they may contract with any pipeline for additional service. Freeing the former FR shippers in this way will encourage the development of additional infrastructure, as needed.

3. A portion of the capacity allocated to the converting FR shippers will be constructed pursuant to the certificate issued by the Commission authorizing construction of El Paso's Power-Up Project.¹ The Commission believes that until the Power-Up Project is operational, it is necessary for El Paso to hold in reserve additional replacement capacity for the converting FR shippers as a safety net to ensure that El Paso can meet its service obligations. As the Power-Up Project capacity becomes available, El Paso will be permitted to resell this reserved capacity under its firm transportation rate schedules.

4. Specific receipt point rights are also assigned to all firm customers so as to end routine pro rata service allocations that have made firm service on El Paso Pipeline

¹El Paso Natural Gas Co., 100 FERC ¶ 61,280 (2003).

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unreliable. For California customers, this means that their contract rights will be honored.

5. El Paso Pipeline also is required to do more. The Commission is terminating settlement and tariff provisions that arguably condoned load growth without corresponding and necessary system expansions. As a result, El Paso will have no reason for any failure to deliver 100 percent of the volumes nominated by its CD customers. If El Paso does not fulfill that responsibility, it must pay demand charge credits, and it will have to pay partial demand charge credits if it is unable to deliver up to CD levels in force majeure events. It also will forego recovery of costs associated with the construction of the Power-Up project until its next general rate case. El Paso will similarly forgo, until its next general rate case, recovery of fixed costs associated with capacity that is allocated to serve the converting FR shippers' demand.

6. The Commission's actions here, in conjunction with the certification of the related Power-Up Project, will restore service reliability to the El Paso pipeline system, meet the needs of all customers, and encourage the development of additional infrastructure to the benefit of all users of gas in the Southwest.

Introduction

7. On May 31, 2002, the Commission issued an Order on Capacity Allocation and Complaints in this proceeding (May 31 order).² That order established a framework for a solution to the capacity allocation problems that have rendered firm service on El Paso Natural Gas Co. (El Paso) unreliable in recent years. El Paso has historically served its firm customers under two types of contracts, full requirements (FR) contracts and contract demand (CD) contracts. CD contracts provide specific delivery rights up to specified quantity limitations at delivery points designated in the contracts. FR contracts provide that El Paso must deliver and the customer must take from El Paso, the customer's full gas requirements each day; there is no limit on the amount of gas the FR shippers take, other than the capacity of their delivery points. The CD contracts on El Paso are held mainly by California customers, and the FR contracts are held mainly by east of California (EOC) customers.

8. Capacity on El Paso has become constrained in recent years, and El Paso has been unable to meet the demands of all of its firm customers. As a result, these customers have been subject to pro rata allocations of their nominations and have been unable to receive all of their nominated firm volumes. In order to eliminate these firm service interruptions, the May 31 order directed El Paso to modify its capacity allocation methodology to assure reliable firm service to its shippers. Specifically, the May 31 order directed that service under the FR contracts be converted to service under CD contracts. In addition, the May 31 order directed El Paso to assign primary receipt rights to its shippers, and make additional capacity available to its former FR shippers through the Line 2000 Power-Up Project, acceptance of turnback capacity, and use of California delivery points as receipt points.

9. The Commission clarified certain of the rulings in the May 31 order and adopted a capacity allocation methodology for El Paso in an order issued on September 20, 2002 (September 20 order).³ Timely requests for rehearing of those orders have been filed by the parties listed on Appendix A.

10. As discussed below, the requests for rehearing are generally denied. However, the Commission will grant rehearing of its prior ruling regarding the reallocation of costs among the FR shippers. As explained below, the Commission has determined that this

²99 FERC ¶ 61,244 (2002).

³100 FERC ¶ 61,285 (2002).

reallocation is not necessary to achieve the goal of restoring reliable firm service on El Paso. Further, the Commission will clarify its ruling regarding the inclusion of El Paso's Power-Up Project capacity in the initial allocation to the FR shippers in light of more recent information concerning the in-service date of that project. The Commission is also requiring El Paso to reserve additional capacity in a pool for FR shippers to ensure that all of their service needs will be met while the Power-Up Project is being constructed. In addition, the Commission will modify the September 20 order to require El Paso to pay demand charge credits during the interim period prior to the conversion of the FR contracts whenever it is unable to deliver 100 percent of the CD shippers' nominated volumes and further to pay partial demand charge credits when it is unable to schedule a shipper's firm nominations within its CD level for reasons of force majeure.

11. This order is in the public interest because it restores reliable firm service to the El Paso system and will provide proper market incentives for expansion of the infrastructure. By converting the FR contracts on El Paso to CD contracts, making all of El Paso's existing capacity plus new capacity from El Paso's Power-Up Project available to El Paso's firm shippers, and allocating specific receipt points to the firm customers, the remedy adopted by the Commission will eliminate the routine pro rata allocations that have rendered firm service unreliable on El Paso. In addition, by providing each firm shipper with a specific CD level, proper signals will be established for construction of additional capacity by El Paso and other pipelines.

12. The Commission will address in a separate order issued contemporaneously, El Paso's report detailing the results of the allocation process⁴ and El Paso's March 31, 2003 compliance filing to implement the conversion of the FR contracts to CD contracts and the conversion of system-wide receipt point rights to specific receipt points. The Commission will also address in a future order requests for rehearing of the Commission's December 26, 2002 order regarding the use of California delivery points as receipt points and the implementation of demand charge credits as well as El Paso's filing to comply with that order.

I. Background

13. El Paso operates a gas pipeline system that can deliver gas from three production basins, the San Juan, Permian, and Anadarko Basins, to delivery points on its system in California and east of California. In recent years, gas supplies from the San Juan Basin

⁴El Paso's report was filed on December 3, 2002, and modified on February 21, 2003, March 18, 2003, and April 8, 2003.

have been less expensive than gas from the Permian and Anadarko Basins, making the San Juan Basin the preferred gas supply area of El Paso's customers.

14. Rates and services on El Paso, and El Paso's service obligation to its customers, were established pursuant to two Settlements. In 1990, El Paso entered into a settlement⁵ to resolve issues related to the Commission's Order No. 636. The 1990 Settlement, among other things, provided for the conversion of El Paso's full requirements sales customers to full requirements transportation customers, thus continuing FR service on El Paso. The 1990 Settlement also provided for pro rata allocations of capacity among firm shippers. The state commissions and the CD shippers did not oppose these provisions. On March 15, 1996, El Paso filed another settlement (1996 Settlement) that set the current rates and terms and conditions of service for a ten-year period, i.e., until January 1, 2006. At the time the Commission approved the 1996 Settlement,⁶ there was substantial excess capacity on El Paso's system. California local distribution companies had turned back their rights to capacity on El Paso at the request of the CPUC.⁷ This excess capacity threatened to increase the rates of the remaining El Paso customers, and the 1990 Settlement resolved the issue through an agreed-upon sharing of the risk of unsubscribed capacity.

15. Since the 1996 Settlement, available capacity on El Paso has gone from an excess to a constrained condition. Firm service on El Paso has become unreliable because El Paso must routinely reduce nominations for firm service through pro rata allocations as

⁵54 FERC ¶ 61,316, reh'g, 56 FERC ¶ 61,290 (1991).

⁶79 FERC ¶ 61,028, reh'g denied, 80 FERC ¶ 61,084 (1997).

⁷The CPUC initiated the capacity turnback with orders in Re: Natural Gas Procurement and Reliability Issues; Re: Gas Utility Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities, 41 CPUC2d 668, 127 P.U.R. 4th 417 (1991); Order Instituting Rulemaking into Natural Gas Procurement and Reliability Issues, 47 CPUC2d 51, 138 P.U.R. 4th 569 (1992). See also CPUC's Section 5 Complaint in Docket No. RP00-241-000 (April 4, 2000).

set forth in its tariff.⁸ Both the FR and the CD shippers have filed complaints⁹ with the Commission arguing that capacity allocation procedures on El Paso are unjust and unreasonable and asking the Commission to provide a remedy for these problems.

16. In the May 31 order, the Commission agreed with the complainants that the quality of firm service on the El Paso system had deteriorated and would continue to deteriorate without Commission action. The Commission found that the current allocation methodology on El Paso, with pro rata allocations of firm service when El Paso has insufficient capacity to serve all of its firm customers, is not just and reasonable nor in the public interest.

17. Accordingly, the Commission established a framework for resolving the complicated capacity allocation problems that have disrupted and degraded firm service on El Paso. Specifically, the Commission required that the FR contracts on El Paso be converted to CD contracts, effective November 1, 2002, and gave the parties time to reach an agreement as to the FR customers' entitlements under their new CD contracts. The May 31 order stated that if the FR customers were unable to reach an agreement on their new entitlements by July 31, 2002, the Commission would determine the appropriate CD entitlements for the FR shippers. In addition, the order directed El Paso to accept turnbacks of existing CD entitlements for allocation to the converting FR shippers, and directed El Paso to pay demand charge credits to its firm shippers if it is unable to schedule firm service for reasons other than force majeure after the conversion of the FR contracts to CD contracts.

18. On August 1, 2002, El Paso notified the Commission that the FR customers were unable to agree to their CD entitlements. Therefore, on September 20, 2002, the Commission issued an order¹⁰ setting forth the method to be used by El Paso to convert the FR contracts to CD contracts and clarifying certain aspects of the process, as requested by some of the parties. Specifically, the Commission directed El Paso to use 5,400,000 Mcf/d as its system capacity for allocation purposes in this proceeding. The Commission directed El Paso to deduct from this total available capacity, capacity that is

⁸A detailed explanation of the capacity allocation problems on El Paso and the history of these problems is contained in the prior orders. See the May 31 order at 61,997-62,004.

⁹The CD Shippers filed a complaint against El Paso in Docket No. RP01-484-000 and the FR Shippers filed a complaint against El Paso in Docket No. RP01-486-000.

¹⁰100 FERC 61,285 (2002).

under contract to CD shippers and to reserve a reasonable amount of capacity for FT-2 FR shippers¹¹ and apportion the remaining available capacity among the FR shippers using each shipper's monthly demand over the 12 months ending August 31, 2002 to determine its pro rata share of the available capacity. Further, the Commission directed El Paso to reallocate the current FR revenue responsibility among the FR shippers pro rata based on the new CD levels. The Commission postponed the November 1, 2002 effective date established in the May 31 order to May 1, 2003, and imposed on El Paso the obligation to pay partial demand charge credits to CD shippers for any pro rata reductions in firm service during this interim period. The order also clarified that the Commission has not changed the 1996 Settlement provisions with regard to limitations on Block I and Block II capacity,¹² that El Paso should honor basin-specific contracts in the allocation process, and that the capacity turnback process should begin after the initial conversion of the FR contracts to CD contracts. The Commission also clarified that El Paso should immediately allow for receipts of gas at California delivery points on a secondary basis.

19. In accordance with the Commission's orders, El Paso provided an opportunity for CD shippers to turn back capacity and for FR shippers to offer to purchase that turned back capacity. The CD shippers offered to turn back 724,659 Mcf/d of firm capacity. Only one FR shipper bid on the capacity. MGI Supply, Ltd. (MGI) bid for and was awarded 14,663 Mcf/d. Additional bids were received from five California utilities, which were awarded aggregate capacity of 206,145 Mcf/d.

20. On April 14, 2003, the Commission issued an order¹³ further postponing the effective date of the conversion of the FR contracts to CD contracts until September 1, 2003. The Commission explained that the complaint proceeding in Docket No. RP00-

¹¹The May 31 order provided that small shippers that are currently served under El Paso's Rate Schedule FT-2 will be permitted to retain full requirements service as long as their requirements remain less than 10,000 Dth/d. May 31 order at 62,017.

¹²The 1996 Settlement divided turned-back capacity into three blocks: Block I capacity has alternate receipt point rights unless the capacity is sold for maximum tariff rates and, in that event, it has primary receipt point rights only to the Permian and Anadarko Basins, but not to the San Juan Basin. Block II turned back capacity has primary access to all system receipt points including the San Juan Basin, but can be recalled by northern California shippers; it also has restricted delivery points. Block III capacity has primary access rights to all system receipt points.

¹³103 FERC ¶ 61,059 (2003).

241-000 is also pending before the Commission on exceptions to the initial decisions of the Chief Administrative Law Judge,¹⁴ and also involves capacity issues on El Paso. The Commission stated that on March 21, 2003, El Paso, its affiliates El Paso Merchant Energy Co. and El Paso Merchant Energy-Gas, L.P., together with the California Public Utilities Commission and other active California parties filed a Joint Motion to Defer Commission Action in Docket No. RP00-241-000. In their motion, the parties stated that they had reached an agreement in principle that would resolve all claims in Docket No. RP00-241-000, and that they would prepare a formal settlement agreement and submit it to the Commission for approval.

21. In the April 14, 2003 order, the Commission explained that it was not clear from the Joint Motion whether that settlement would affect the allocation issues in this case, but found that it was appropriate to grant a short postponement of the effective date of the conversion to enable the Commission to determine the impact of the settlement on the allocation issues in this case and consider the interrelated cases contemporaneously.

22. On June 4, 2003, El Paso and the other Settling Parties¹⁵ filed an Offer of Settlement and a Joint Settlement Agreement in the withholding case. The parties stated that they were in the process of finalizing a Master Settlement Agreement with other governmental and private parties, which they will file separately. That Master Agreement was filed on June 27, 2003.

23. Upon review of the initial documents filed in settlement of the Docket No. RP00-241-000 proceeding, the Commission has determined that no further postponement of the conversion date of the FR contracts is warranted. The conversion of FR contracts to CD contracts will become effective September 1, 2003, and service under those contracts will be provided by El Paso consistent with this decision and the decision on El Paso's compliance filing in Docket No. RP00-336-010 issued contemporaneously. The Commission will address the June 4 Settlement after reviewing the comments on that Settlement and the Master Agreement.

¹⁴Public Utilities Commission of the State of California v. El Paso Natural Gas Co., 97 FERC ¶ 63,004 (2001); Public Utilities Commission of the State of California v. El Paso Natural Gas Co., 100 FERC ¶ 63,041 (2002).

¹⁵El Paso Merchant Energy Company and El Paso Merchant Energy-Gas, L.P., the Public Utilities Commission of the State of California, Pacific Gas and Electric Company, Southern California Edison Company, and the City of Los Angeles.

II. Discussion

24. On rehearing, the parties have raised issues concerning the legal basis for the Commission's actions. Specifically, they have argued that the Commission's actions did not comply with Section 7 of the Natural Gas Act (NGA) and the Mobile-Sierra doctrine,¹⁶ the prohibition against undue discrimination, and the policy of comparability of service established by the Commission during the restructuring proceedings. In addition, the parties have sought rehearing of certain features of the Commission's reallocation methodology, including the amount of capacity to be allocated, the necessity for the Power-Up Project, the capacity turnback program, the prohibition against El Paso reselling contract capacity prior to the conversion date, the basis for establishing the new CDs of the former FR customers, the Block I and Block II capacity limitations, receipt point rights, basin-specific contracts, demand charge credits, and the ability of FR shippers to enter into contracts with other pipelines. Several parties also argue that they should be awarded damages for El Paso's failure to transport nominated volumes.

A. The Commission's May 31 Order is Consistent with Section 7 of the NGA

25. Section 7(b) of the NGA provides that prior to authorizing abandonment of service provided by a natural gas company, the Commission must find, after due hearing, that the present or future public convenience or necessity permit such abandonment.¹⁷ In the May 31 order, the Commission stated that conversion of FR contracts to CD contracts is fully consistent with the requirements of Section 7 of the NGA and with the Commission's duty to protect captive customers. On rehearing, the FR customers argue that the Commission erred in this ruling.

1. Relationship Between Abandonment Protection and Rates

26. In the May 31 order, the Commission stated that the abandonment provisions of the NGA are intended to protect captive customers from the monopoly power of the pipeline and to permit captive customers to receive the historic service upon which they have relied as long as they are willing to pay the maximum rate for that service. On rehearing, the FR Shippers argue that this statement incorrectly holds that the

¹⁶FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956); United Gas Pipeline Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956).

¹⁷15 U.S.C. § 717f(b).

abandonment protection applies only when the shipper is paying the maximum rate. They assert that the Commission's ruling would give a pipeline carte blanche to abandon service during the term of any contract that is not at the maximum rate.

27. The statement in the May 31 order cited by the FR Shippers merely quotes what the Commission has already held in Order No. 636¹⁸ and Order No. 637.¹⁹ There is nothing new or remarkable in this statement, and it is an accurate explanation of the Section 7 protections. Nothing in the Commission's order was intended or could be interpreted to authorize abandonment of service during a contract's term solely because the customer is paying less than the maximum rate. The Commission's decision here is 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,²⁰ and provide a mechanism for pro rata allocations of capacity to firm shippers²¹ 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.

28. As discussed below, the allocation methodology adopted by the Commission has resulted in capacity allocations to all of the converting FR shippers equal to or greater than their 2001 non-coincident peaks. In addition, the Commission is directing El Paso to establish a capacity pool for the FR customers to insure that they will receive their

¹⁸Order No. 636, aff'd. in pertinent part, UDC v. FERC, 88 F.3d 1105 (D.C. Cir. 1996), cert. denied, 520 U.S. 1224 (1997).

¹⁹Order No. 637 at pp. 31,335-40, aff'd. in pertinent part, INGAA v. FERC, 285 F.3d 18 (D.C.Cir. 2002).

²⁰See Section 3.6 of the 1990 Settlement provides that El Paso "shall not be required to construct any facilities that are not economically justifiable."

²¹See Section 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.

initial allocations until the Power-Up Project is operational. This will provide the FR shippers with sufficient capacity to meet their needs throughout the term of the 1996 Settlement. However, the conversion of the contracts ordered by the Commission may have a rate impact on the FR shippers to the extent they purchase additional capacity above their initial allocations. This result is not contrary to the policies of NGA Section 7. Section 7 of the NGA is intended to protect service, not rates. Any additional capacity that the FR shippers purchase will be at just and reasonable rates, consistent with the NGA.

2. Abandonment and Capacity

29. In addition, the FR Shippers argue that the Commission erred because abandonment protection is not dependent on the availability of capacity. They assert that the sole basis for the May 31 order is the Commission's belief that the sum of the usage entitlements under the FR contracts and the entitlements of the CD shippers is greater than the capacity of El Paso's system. They assert that the Commission's remedy will reduce the FR contracts by the full amount of the capacity shortfall, yet the Commission contends that this permanent reduction of FR rights does not constitute an abandonment.

30. Contrary to the FR Shippers' contention, the Commission has not stated that the conversion of FR contracts to CD contracts does not involve an abandonment of service. Instead, the Commission has held that in the particular circumstances on El Paso, abandonment of future unrestricted growth rights under the FR contracts is in the public convenience and necessity and required in the public interest. The FR Shippers are correct that this decision is based on our conclusion that the operation of the 1990 and 1996 Settlements have directly led to the situation where there is insufficient capacity on El Paso to meet the needs of its firm shippers. Further, the public convenience and necessity requires modification of the Settlements and conversion of the FR contracts to CD contracts to restore reliable firm service on El Paso.

31. The former FR shippers' new CD contracts will help establish the appropriate price signals and economic incentives on El Paso and other pipelines²² in the service area to expand the infrastructure to meet growing demand. When CD shippers need additional capacity to serve increased demand, they contract for the additional amount at just and reasonable rates, including demand charges. This requirement to separately

²²As discussed below, Kinder Morgan Interstate Gas Transmission LLC asked the Commission to clarify that it can enter into contracts with the FR customers for service to commence after the conversion date. The Commission has granted that clarification.

contract for additional service provides an incentive for the pipeline to incur the costs necessary to expand its system to meet future growth needs. Therefore, the conversion of the FR contracts to CD contracts will provide the proper incentives to expand.

32. Moreover, the Commission finds that because the El Paso system has become capacity-constrained, 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 and do not serve the public convenience and necessity.²³ The continuation of these 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. The Commission finds that in this context continued growth in FR service is contrary to the public interest and the public convenience and necessity. Prior 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. The FR contracts provided the customers with a guaranteed gas supply to satisfy seasonal swings in demand, and because their volumes were small, the pipeline could provide the FR service, even for the peak demands, without degrading service to other firm customers. In those circumstances, the FR contracts provided benefits to both the pipeline and the shippers that used such contracts, and did not harm the other firm shippers on the 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. Further, when coupled with the capacity allocation provisions and the economic qualification in the provision concerning capacity expansion incorporated in the 1990 and 1996 Settlements, firm services on El Paso have been rendered unreliable.

33. Abandonment of unrestricted future growth rights under the FR contracts with conversion to CD service does not preclude shippers from contracting for additional capacity with El Paso or other pipelines to meet load growth requirements. Further, such contracts will be at Commission-approved just and reasonable rates.

²³As discussed below, at the time these FR contracts were approved by the Commission, El Paso was not capacity constrained, and at the time the Commission approved the 1996 Settlement, excess capacity was a problem on the system. See 89 FERC ¶ 61,164 at 61,489 (1999).

34. The Commission concludes that in these circumstances, the conversion of FR contracts to CD contracts is in the public convenience and necessity and is fully supported by the facts in this case and is consistent with the legal requirements of the NGA.

3. Historic Levels of Service

35. The FR Shippers argue that the abandonment protection is not limited to historic levels of service and that the Commission erred in making a distinction between the FR customers' historic use of the system and the growth rights under their contracts. They state that the Commission has recognized that El Paso's obligation to serve its full requirements customers is not capped by the historic levels of service,²⁴ and that Section 7(b) of the NGA protects service rights, including anticipated levels of usage that are part of a customer's certificated service rights. They allege that if the Commission can limit Section 7(b) protection to their current needs, as measured by recent actual usage, then abandonment protection could be removed merely by a pipeline's failure to deliver or by a temporary drop in demand in a firm contract.

36. The Commission has not limited the abandonment protection to current service, but instead has held that in the circumstances of this case, abandonment of the right to unlimited future growth under the FR contracts is in the public convenience and necessity because the 1990 and 1996 Settlements have led to unjust and unreasonable results with respect to El Paso's firm service. The Commission and the courts have recognized that the abandonment provisions of the NGA are intended to protect the historic service of captive customers.²⁵ The Commission has also recognized that the abandonment protection is a limited protection intended to be a means of defense against pipeline monopoly power, not a mechanism to give certain customers an advantage over other shippers.²⁶ Distinguishing in this case between the current service needs of the FR customers, which reflect significant growth since 1996, and unlimited future growth

²⁴The FR Shippers cite El Paso Natural Gas Co., 54 FERC 61,318 at 61,982 (1991).

²⁵See Order No. 637, FERC Stats & Regs ¶ 31,091 at 31,336, 31,339, and 31,340 aff'd, in pertinent part, INGAA v. FERC, 285 F.3d 18 (D.C.Cir. 2002).

²⁶Order No. 637 at 31,339. This view is also consistent with the decision in Municipal Defense Group v. FERC, 170 F.3d 197 (D.C. Cir. 1999), that small customers that are given preferential treatment for their existing service must compete on an equal basis for additional capacity.

under their contracts appropriately balances the interests of all of the parties and the public interest in restoring reliable firm service on El Paso for all current contract demand shippers. The Commission's decision is limited to the circumstances on El Paso, where the operation of the 1990 and 1996 Settlements have led to unjust and unreasonable results. The Commission's action in these circumstances does not support a conclusion that abandonment protection could be removed by a pipeline's failure to deliver service or by a temporary drop in usage in a firm contract.

37. The FR Shippers also argue that the Commission's statement that only future growth is at risk is incorrect because use of a methodology that uses actual deliveries as a measure of current needs would make permanent the curtailments that have already been imposed. They argue that the Commission failed to show how the permanent reduction of entitlements of captive wholesale customers serving human needs customers can meet the public convenience and necessity standard. They argue that this standard requires that the Commission show that the public interest "will in no way be disserved" by the abandonment.²⁷

38. As explained more fully below, the Commission has allocated all of the available and newly provided capacity on El Paso, after reserving capacity necessary to meet the needs of the CD and FT-2 shippers,²⁸ to the FR shippers using each shipper's monthly demand over the last twelve months. This initial allocation includes new capacity currently available from El Paso's Line 2000 (230 MMcf/d) and capacity that will soon be available through the Power-Up Project (320 MMcf/d) with no added reservation charges. Further, the Commission is establishing a capacity pool to guarantee that the converting FR shippers will receive their allocated CDs pending the in-service dates of the Power-Up Project. In addition, the Commission has 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. 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.

²⁷The FR Shippers cite *Michigan Consolidated Gas Co. v. FPC*, 283 F.2d 204, 214 (D.C.Cir. 1960); *Transcontinental Gas Pipeline Co. v. FPC*, 488 F.2d 1325 (D.C.Cir. 1973).

²⁸FT-2 shippers are shippers with requirements less than 10,000 Dth/d. May 31 order at 62,017.

39. This is all of the capacity that will be available on El Paso and includes additional expansion capacity, turnback capacity, and backhaul capacity that has not been available to the FR shippers in the past. El Paso's capacity allocation plan filed on December 3, 2002 confirms that the FR customers have been allocated sufficient capacity to meet their current usage patterns.²⁹ Therefore, the Commission has acted consistently with the policies that underlie the abandonment protections of the NGA and the Commission's duty to protect the historic service of captive customers against the monopoly power of the pipeline.³⁰

4. Requirement for a Hearing

40. Finally, the FR Shippers argue that the abandonment issues should have been set for hearing, and that the Commission violated Section 7(b) of the NGA when it issued the May 31 order without providing the parties an opportunity for hearing. The FR Shippers argue that there are material issues of fact in dispute regarding the amount of capacity on El Paso, the extent of constraints on the system, and the locations and causes of the constraints. The FR Shippers argue that by adopting one party's view of the material disputed issues of fact, the Commission has violated the NGA and its own precedents.

41. While Section 7(b) of the NGA provides that the Commission may grant an abandonment "after due hearing," the Commission has substantial discretion to determine what type of hearing is due and whether a trial-type hearing should be convened or

²⁹Arizona Electric argues that the rejection of non-coincident peak (NCP) as a measure of current usage and a requirement that Arizona Electric accept a CD below its NCP is not merely a limitation on future growth, but is forced abandonment of certificated service that Arizona Electric has under contract and has been using for at least 10 years. El Paso's December 3, 2002 filing indicates that the FR customers have been allocated capacity based upon recent demand. Finally, the compliance filing in Docket No. RP00-336-010 indicates that all converting FR shippers are allocated capacity equal to or in excess of their 2001 NCP demands. See contemporaneous Order Accepting Allocation Report in Docket No. RP00-336-010.

³⁰E.g., Order No 637 at 216, aff'd in pertinent part, *INGAA v. FERC*, 285 F.3d 18 (D.C.Cir. 2002).

whether this requirement may be satisfied through a written record.³¹ A trial-type evidentiary hearing is not required prior to granting an abandonment.³² In this proceeding the Commission has held two technical conferences and a public conference and has analyzed numerous submissions from the parties regarding the available capacity on El Paso's system.³³ In addition, the parties have had an opportunity to address these issues as part of the reallocation process on El Paso. This record is sufficient to enable the Commission to determine that FR contracts must be converted to CD contracts to restore reliable firm service on El Paso.

B. The May 31 Order is Consistent with the Mobile-Sierra Doctrine

42. In the May 31 order, the Commission found that the Mobile-Sierra doctrine applies to the Commission's decision to modify the provisions of the 1990 and 1996 Settlements and the contracts executed under those Settlements.³⁴ The Mobile-Sierra doctrine grew out of two Supreme Court cases³⁵ that engaged in a balancing of private contract rights, on the one hand, with the regulatory power to modify contracts when necessary in the public interest. In the first of these cases, United Gas Pipeline Co. v.

³¹See, e.g., Iroquois Gas Transmission Corp., 101 FERC ¶ 61,131 at P. 9 (2002); CNG Transmission Corp. v. FERC, 40 F.3d 1289, 1293 (D.C. Cir. 1994).

³²See Kansas Power and Light Co. v. FERC, 851 F.2d 1479 (D.C.Cir. 1988) (trial-type hearing not required to address allegations of possible future harm). See also Arkla Gathering Services, Inc., 70 FERC ¶ 61,079 at 61,221 (1995); Mississippi River Transmission Corp., 57 FERC ¶ 61,028 at 61,108 (1991).

³³For example, the June 26, 2002 Motion of Full Requirements Shippers Requesting Expeditious Clarification of El Paso's Available Capacity and Response to EOC Shippers' Letter to Chairman Wood and responsive filings.

³⁴May 31 order at 62,005. The 1996 Settlement provides that El Paso may not change its rates or its tariff, with certain limited exceptions, until the Settlement term expires on December 31, 2005, and that the parties waive their Section 5 rights to challenge the provisions of the Settlement. See Sections 12.1 and 16.6 of the 1996 Settlement.

³⁵FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956); United Gas Pipeline Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956).

Mobile Gas Service Corp.,³⁶ the Court held that the NGA did not give natural gas companies the right to change their rate contracts unilaterally, and stated that the NGA “evinces no purpose to abrogate private contracts as such.” The Court further stated that “denying to natural gas companies the power unilaterally to change their contracts in no way impairs the regulatory powers of the Commission, for the contracts remain fully subject to the paramount power of the Commission to modify when necessary in the public interest. The Act thus affords a reasonable accommodation between the conflicting interest of contract stability on the one hand and public regulation on the other.”³⁷ In FPC v. Sierra Pacific Power Co.,³⁸ the Court explained that purpose of the power given to the Commission to modify private contracts is the protection of the public interest, as distinguished from the private interests of the utilities.

43. The courts have since held that the public interest that permits contract modification by the Commission is different from and more exacting than the public interest that the Commission seeks to serve when it promulgates rules.³⁹ Further, the public interest is not the same as the interests of the parties to the contracts, and the Commission does not protect the parties from the consequences of their bargains.⁴⁰ It is not enough to justify contract modification that a contract has become uneconomic for one of the parties,⁴¹ and “the parties may be required to live with their bargains as time passes and various projections about the future are proved correct or incorrect.”⁴² The Commission has recognized that the public interest standard applies to decisions concerning contract reformation.⁴³

³⁶350 U.S. 332 (1956).

³⁷350 U.S. at 344.

³⁸350 U.S. 348 (1956)

³⁹Texaco, Inc. v. FERC, 148 F.3d 1091 (D.C. Cir. 1998).

⁴⁰See FPC v. Sierra Pacific Power Co., 350 U.S. at 350.

⁴¹Id.

⁴²Town of Norwood v. FERC, 587 F.2d 1306, 1312 (D.C.Cir. 1978).

⁴³E.g., Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc., 103 FERC ¶ 61,353 (2003); Public Utilities Commission of California v. Sellers of Long-Term Contracts, 103 FERC ¶ 61,354 (2003); PacifiCorp v. Reliant

44. In the May 31 order, the Commission 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. The Commission recognized that in these circumstances, the public interest standard applies,⁴⁴ and concluded that there are extraordinary circumstances on El Paso that require 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.

45. The FR Shippers, the ACC, APS/Pinnacle, and SoCalEdison seek rehearing of the Commission's rulings on the Mobile-Sierra issues.

1. The Commission's Decision to Convert the FR Contracts to CD Contracts is Consistent with the Mobile Sierra Doctrine

46. On rehearing, the FR Shippers, the ACC, and APS/Pinnacle argue that the Commission has not satisfied the requirements of Mobile-Sierra because the Commission's public interest finding is based on unsupported findings of fact. They do not argue that the degradation of firm service on El Paso is not a sufficient public interest to require contract reformation, but instead argue that the Commission has not provided a sufficient factual basis to link the degradation of firm service on El Paso to growth in the FR contracts.

47. Specifically, these parties argue that there is no evidence to support the Commission's conclusion that there is currently a capacity allocation problem on El Paso, that the Commission did not accurately analyze the causes of capacity shortages on the system or the harm that resulted from the shortages, and that the Commission made errors of fact regarding the consequences of the capacity rationalization. They further argue that the remedy adopted by the May 31 order is deficient because the Commission has not accurately defined the amount of capacity on El Paso that is available for allocation among the FR shippers. They assert that because of these unresolved material issues of

⁴³(...continued)
Energy Services, Inc., 103 FERC ¶ 61,355 (2003).

⁴⁴See May 31 order at 62,005, citing *Texaco, Inc. v. FERC*, 148 F.3d 1091 (D.C.Cir. 1998).

fact underlying the Commission's finding that FR contracts are contrary to the public interest, a full evidentiary hearing on these issues is required. For the reasons discussed below, the requests for rehearing are denied.

48. The restoration of reliable firm service on El Paso is in the public interest and will benefit all users of the national pipeline grid. As the Commission explained in the May 31 order, under the Commission's regulations, firm service is defined as service that is not subject to a prior claim by another customer.⁴⁵ The Commission stated that it is inconsistent with this regulation for firm shippers to be charged for firm service, but have their service reduced by pro rata allocations on a non-emergency basis so that the pipeline can provide service to another shipper. Firm service is guaranteed, reliable service and shippers must be able to depend on a definition of firm service that is consistent on every pipeline.

49. In its decisions in Orders Nos. 636 and 637, the Commission acted to promote open access and to improve competition and efficiency across the national pipeline grid. In Order No. 636, the Commission stated that all shippers must have meaningful access to the pipeline transportation grid so that buyers and sellers can meet in a competitive national market.⁴⁶ For these goals to be realized, all parts of the national pipeline grid must provide reliable firm service. El Paso's pipeline system is a significant part of the national pipeline infrastructure in the West and into California, and by restoring service reliability to this portion of the infrastructure, the Commission's action here will promote the goals of Order No. 636 and 637 and benefit all natural gas users and customers in the national market. Moreover, to foster the competitive market envisioned in Order No. 636 and 637, there must be the proper economic incentives in place for pipelines to expand. The conversion of FR contracts to CD contracts will provide those incentives for expansion.

a. The Current Capacity Allocation Problem on El Paso

50. The FR Shippers, the ACC and APS/Pinnacle argue that there is no factual basis for the Commission's conclusion that there currently is a capacity allocation problem on El Paso. Each of these parties refers to what it characterizes as conflicting statements made at the April 16, 2002 public conference by El Paso's representative, on the one

⁴⁵May 31 order at 62,013, citing 18 C.F.R. § 284.7.

⁴⁶Order No. 636 at 30,393.

hand, that El Paso was not curtailing nominations at that time,⁴⁷ and the statement of Indicated Shippers' representative, on the other, that its members had been curtailed continuously for several years and were being curtailed at that time.⁴⁸ Further, the FR customers, APS/Pinnacle, and the ACC argue that the capacity allocation problems on El Paso were caused by transient events including the pipeline rupture at Carlsbad, New Mexico, an exceptionally dry hydro-electric year, a Topock delivery point problem, the controversial El Paso Merchant contracts, and the price differential between the California border and the production basins. They assert that these conditions no longer exist on the system, and, as a result, schedule cuts have abated and producers want to turn back their contracts for capacity. Therefore, they argue, the Commission's conclusion that El Paso is or continues to be in "full crisis" is disputed. APS/Pinnacle asserts that the CD shippers would not be able to prove in an evidentiary hearing that curtailments are a current problem.

51. The statements made at the public conference do not contradict the underlying facts 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 (NCP) exceed its peak day capacity (CP). Concerns over the unreliability of firm service have been brought to the Commission by all of El Paso's customers, both FR and CD.⁴⁹ Southwest Gas states that it has been complaining about firm service degradation on El Paso for 10 years.⁵⁰ 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.⁵¹

⁴⁷April 16, 2002 Tr. at 33, 38.

⁴⁸April 16, 2002 Tr. at 145.

⁴⁹See Amoco Energy Trading Corp., Amoco Production Co., and Burlington Resources Oil & Gas Co. v. El Paso Natural Gas Co., 93 FERC ¶ 61,060 (2000). See also complaints filed in Docket Nos. RP01-484-000 and RP01-486-000.

⁵⁰Renewed Emergency Request of Southwest Gas Corporation For Extension of Full Requirements Customers Conversion Date and Answer of Southwest Gas Corporation to El Paso Natural Gas Co. at p. 16 (August 13, 2002).

⁵¹See, e.g., September 3 Report of El Paso Natural Gas Company in compliance with May 31, 2002 Order at p. 6.

52. The 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. The Commission has allocated all the current available capacity on El Paso pro rata to the FR customers, after reserving capacity to serve the CD and FT-2 shippers. In addition, the Commission directed El Paso to allocate to the FR customers all of the new 320 MMcf/d that will be made available by El Paso's Power-Up Project. In this order, the Commission is also establishing an additional capacity pool discussed below that will be available to FR shippers until the Power-Up Project is in operation. As discussed below, the FR customers argue that this amount of capacity, i.e., all the current available capacity plus the additional capacity to be provided by the Power-Up Project, is insufficient to meet their current peak needs and the anticipated growth under their contracts. The ACC refers to the rapid growth in the state of Arizona and is concerned that if service to FR shippers is limited to the 2001 FR service levels, it will be inadequate to meet the 2002 FR needs.⁵² 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.

b. Causes of the Allocation Problems

53. The FR Shippers, the ACC, and APS/Pinnacle argue that the May 31 order does not accurately analyze the causes of the shortages that have resulted in pro rata reductions in nominated firm service. These parties acknowledge that takes under the FR contracts have grown during recent years, but argue that this was not the only change that affected usage of the system. They assert that other changes affecting system usage include demand under new CD contracts, material changes in use of contract entitlements by existing CD shippers, changes in the utilization of capacity on the SoCalGas intrastate system, the economic decisions of the CD shippers not to take gas from basins other than San Juan, and general changes in usage patterns by FR shippers. Thus, they argue, the Commission's conclusion that growth in demand under the FR contracts is the most significant cause of the mainline capacity shortage on El Paso is not based on substantial evidence.

⁵²See ACC's Request for Rehearing of the May 31, 2002 order at p.10.

54. The Commission recognizes that growth under the FR contracts is but one cause of firm service unreliability that stems from the 1990 and 1996 El Paso Settlements.⁵³ However, the factors cited by the FR Shippers do not account for all of the problems and do not recognize the need to reform the Settlements, El Paso's tariff, and the FR contracts to restore quality to firm services and provide incentives for expansion of capacity. In this regard, CD contract shippers are entitled to nominate and receive full contract service levels on each and every day. Any change in usage patterns under the CD contracts should not cause capacity shortages because El Paso is obligated to reserve capacity to serve the nominations of these shippers up to their full contract demands. Further, capacity resold from expiring contracts pursuant to the terms of the 1996 Settlement did not result in El Paso entering into new CD obligations.⁵⁴ Thus, the total CD demand has not grown.

55. On October 4, 2002, APS/Pinnacle filed a renewed motion for hearing arguing that the initial decision in Docket No. RP00-241-006 supports its allegation 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. APS/Pinnacle states that the Chief ALJ found that nominations from the Permian Basin to PG&E's delivery point in California at Topock dropped by 58 percent during a 15-day period in January 2001 because the price of gas in the Permian Basin was not competitive after adding the cost of transportation to the California border.⁵⁵ APS/Pinnacle states that while this relates only to a 15-day period, it does confirm that California shippers do not use available capacity from the Permian Basin during periods when the price of gas makes such use uneconomic in California. They argue that this finding confirms the need to have hearings in this proceeding to determine the extent to which pro rata curtailments on El Paso are due to the CD shippers' failure to renominate to the Permian Basin after being cut back in the San Juan Basin.

56. Indicated Shippers responded to APS/Pinnacle's motion stating that APS/Pinnacle has taken the Chief ALJ's words out of context. Indicated Shippers argue that the Chief ALJ used this 15-day period as an example to show that El Paso Merchant did not

⁵³May 31 order at 62,002-3.

⁵⁴Under the terms of the 1996 Settlement, El Paso was authorized to remarket this capacity and share the revenues with its customers. See Section 3.4 of the 1996 Settlement.

⁵⁵APS/Pinnacle cites the Initial Decision in Docket No. RP00-241-000 at 8.

exercise market power, and provides no basis to conclude that the CD shippers did not experience cuts from supply basins other than the San Juan Basin. Indicated Shippers state that their sworn affidavits attest to the fact that their scheduled capacity was cut on El Paso's mainline and not just out of one of the supply basins.

57. The Commission also 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. After implementation of contract-specific primary receipt point rights on September 1, 2003, nominations will no longer exceed the capacity of the receipt points, thus eliminating pro rata allocations caused by point constraints such as those in the San Juan Basin.

58. The FR Shippers argue that they are only a small part of the customer base on El Paso and that growth in FR demand was not the primary cause of mainline capacity shortfalls. They assert that from 1997 to the beginning of 2001, the average day westward throughput on the system increased from 1,865 MMcf/d to 3,704 MMcf/d. They further state that the Commission found that the FR demands increased during this same period from 1,135 MMcf/d to 1,500 MMcf/d.⁵⁶ The FR Shippers argue that it was not reasoned decisionmaking for the Commission to conclude that this 365 MMcf/d increase in FR demand was the principal cause of the 1,839 MMcf/d increase in total average demand on El Paso.

59. While the CD contracts in past years were underutilized, that capacity was reserved and paid for by the CD shippers. It is not available for sale or commitment to other firm shippers, although it may be used when available to serve interruptible transportation. The increase in westward demand that the FR Shippers cite points out a flaw in the 1990 and 1996 Settlements themselves. By not limiting growth but calling for pro rata allocations where there was a capacity shortfall, the Settlements do not guarantee that firm service will be available to all firm shippers.⁵⁷

⁵⁶The FR Shippers cite the May 31 order at 62,002.

⁵⁷El Paso Pipeline FERC Gas Tariff, Second Revised Volume No. 1A, GT&C, Section 4.2.

60. APS/Pinnacle argues that the Commission failed to recognize that increased FR demand was contemplated by the 1996 Settlement and was accommodated in the parties' bargain. Similarly, the FR Shippers also argue that any order premised on a conclusion that past growth was unreasonable or that future growth will be unreasonable must focus on the circumstances of each shipper. They argue that any determination that the FR contracts do not cover future growth must be based on the mutual intent of the parties. They state that the conclusion that future growth is permitted by the contracts is consistent with the words of the contracts, prior Commission decisions approving full requirements service, and the actions of the parties. They state that El Paso and the FR shippers, by their actions, have recognized that all growth that has occurred to date was covered by the FR contracts.

61. The Commission's decision to convert the FR contracts to CD contracts is not premised on a conclusion that growth under those contracts was unreasonable.⁵⁸ The Commission approved the Settlements that provided for FR service without a cap on growth under those contracts which was coupled with provisions that placed a limited obligation on the part of El Paso to expand its system at its own expense to meet growing needs, and provided for capacity allocations when capacity was constrained. However, 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. Under normal market conditions, El Paso and other pipelines would have an incentive to expand their capacity to meet increased demand for service. However, under the terms of the 1996 Settlement, the FR shippers would receive any expanded capacity at no additional demand 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,⁵⁹ no other pipeline has any incentive to construct capacity to meet the increased demand. In these circumstances, capacity rationalization is necessary and in the public interest.

c. Available System Capacity

⁵⁸May 31 order at 62,004.

⁵⁹The FR shippers assert that some of the FR contracts permit the shippers to convert to CD service, so there is no need for the Commission to direct the conversion to provide an incentive to expand. But, this argument misses the point. The conversion to CD contracts is necessary to provide proper economic incentives for expansion. It is not sufficient that it may be an option for some shippers.

62. The FR Shippers and the ACC argue that the Commission erred by failing to establish a hearing to determine the amount of capacity that is available on El Paso for allocation to the FR shippers. They assert that the May 31 order is deficient because it does not define the amount of pipeline capacity that will be available to allocate among the FR shippers during the capacity rationalization process, but instead merely accepts El Paso's untested assertion that it has an operating capacity of 5,400,000 Mcf/d. The FR Shippers state that neither El Paso nor the Commission has explained whether this amount represents summer capacity, winter capacity, design capacity, westflow capacity, or any of the other variants by which capacity can be defined. The ACC states that the order's failure to define available capacity provides El Paso an incentive to low-ball the figure.

63. 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,⁶⁰ a hearing is not necessary on a purely technical issue especially where there have been multiple opportunities to analyze the evidence and file comments. The Commission has held two technical conferences and a public conference to receive information on capacity issues, in addition to the numerous written submissions of the parties.⁶¹ The issue of the amount of available capacity on El Paso can be resolved based on the written record in this proceeding.

64. In addition to the information in the pleadings and obtained at the technical and public conferences, the parties had an opportunity to address the capacity issues as part of the reallocation process. Specifically, during the period when El Paso and its FR Shippers attempted to agree to new CD levels for the FR shippers, El Paso indicated that the existing westflow capacity is approximately 4,300,000 Mcf/d with net west-flow capacity available for FT-1 FR CDs equal to about 930,000 Mcf/d during the winter.⁶²

⁶⁰958 F.2d 1101, 1113-14 (D.C. Cir. 1992)(a trial-type hearing is not necessary on a purely technical issue, such as pipeline capacity where there has been an opportunity to analyze the evidence and file comments).

⁶¹Over seven rounds of comments were filed.

⁶²July 3, 2002 Answer of El Paso Natural Gas Company to Motion of Full Requirements Shippers Requesting Expedient Clarification of El Paso's Available

(continued...)

El Paso provided support to demonstrate that its sustainable capacity is 5,400,000 Mcf/d.⁶³ The Commission has reviewed this evidence and has found it persuasive. Additionally, El Paso provided a reconciliation to show how the 4,300,000 Mcf/d of sustainable west-flow capacity is consistent with the 5,400,000 Mcf/d capacity, including the Power-Up.⁶⁴

65. In the September 20 order, the Commission again analyzed the data on El Paso's available capacity and concluded that the 5,400,000 Mcf/d that El Paso asserts will be available with the Power-Up is consistent with the information El Paso has provided throughout this proceeding.⁶⁵ The Commission again explained that the 5,400,000 Mcf/d is consistent with a westflow capacity of 4,300,000 Mcf/d.⁶⁶ In these circumstances the Commission's assessment of the amount of available capacity on El Paso is fully supported, and further proceedings on this issue are not necessary or appropriate.

66. In the requests for rehearing of the September 20 order, parties now argue that these capacity figures should be increased to reflect the findings of the Chief ALJ in Docket No. RP00-241-006 that El Paso withheld capacity, including 210 MMcf/d to manage transients, *i.e.*, intraday system flow and pressure requirements. They argue that

⁶²(...continued)

Capacity and Response to EOC Shippers' Letter to Chairman Wood, Attachment A. With the addition of the Line 2000 capacity (230 MMcf/d) and the Power-Up Project capacity (320 MMcf/d), total capacity available for allocation to FR shippers will be 1,480 MMcf/d (930 plus 550) which approximates the 1,500 MMcf/d of FR shipper demand identified previously.

⁶³July 3, 2002 Answer of El Paso Natural Gas Company to Motion of Full Requirements Shippers Requesting Expedious Clarification of El Paso's Available Capacity and Response to EOC Shippers' Letter to Chairman Wood at 4-8. See also April 16, 2002 Public Conference Tr. at 17.

⁶⁴July 3, 2002 Answer of El Paso Natural Gas Company to Motion of Full Requirements Shippers Requesting Expedious Clarification of El Paso's Available Capacity and Response to EOC Shippers' Letter to Chairman Wood at 4-6.

⁶⁵September 20 order at P 23.

⁶⁶September 20 order at P 23 & n.13.

in accordance with the Chief ALJ's decision, El Paso capacity must reflect operation at Maximum Allowable Operating Pressure (MAOP) conditions.⁶⁷

67. Exceptions to the initial decision of the Chief ALJ in Docket No. RP00-241-000 have been filed by the parties to that proceeding. Further, as stated above, on June 4, 2003, an offer of settlement and a joint settlement agreement were filed in that proceeding and the settling parties have stated that they are in the process of finalizing a Master Settlement Agreement with other governmental and private parties, which they will file separately. The Commission has deferred action on the Initial Decisions in that proceeding pending review of the settlement. Action to implement the decision of the Chief ALJ is therefore not appropriate.

68. Moreover, the arguments that MAOP data should be used for the purpose of identifying sustainable and allocable firm capacity reflect fundamental misunderstandings of the role of MAOP in meeting a pipeline's certificate obligations under NGA Section 7. The misunderstandings are compounded by the misapplication of steady-state pipeline flow data and analysis to a dynamic pipeline system operation. The Commission's review of pipeline facility design proposals in certificate applications

seeks to ensure that the pipeline will satisfy its service obligations, but the Commission does not establish operating conditions. In order to clarify the misunderstanding, the Commission will explain the relationship between its Section 7 certificate authority and the pipeline's MAOP.

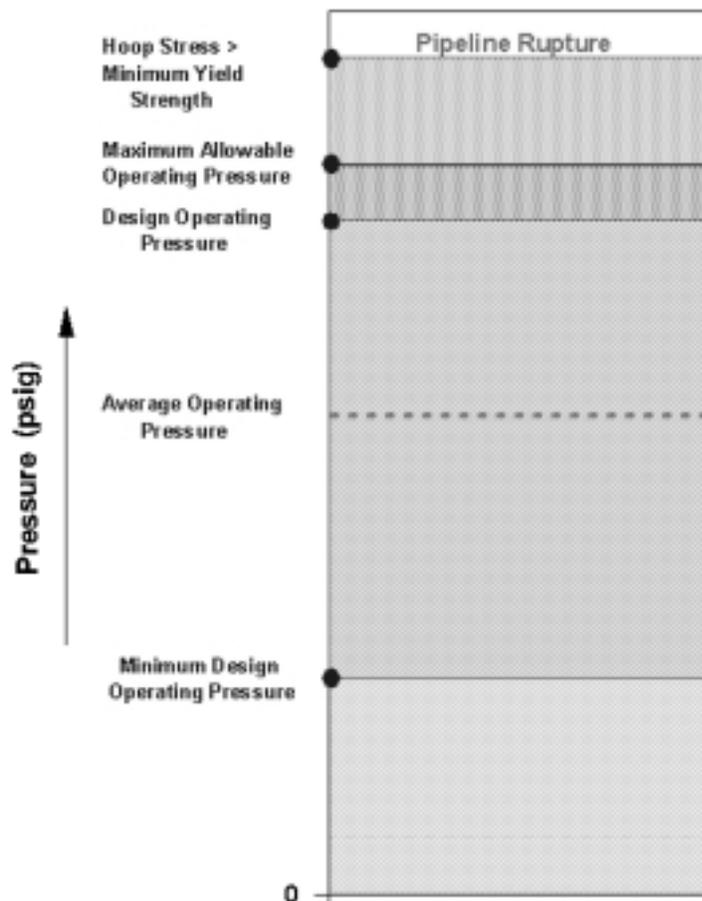


Figure 1 Relationship of various pipeline pressures

69. Figure 1 shows several pipeline pressures, starting at the bottom with zero and increasing the pressure to the point where the pressure will rupture the pipeline.

70. A pipeline facility will rupture when the "hoop stress," or the pressure of the fluid (natural gas) inside the pipe, exceeds the stress (or pipeline pressure) necessary to deform or damage the integrity of the pipe. This is known as the minimum yield strength. The

⁶⁷See, e.g., requests for rehearing of the FR Shippers and SoCalEd.

Commission has no role in determining any pipeline facility's yield strength. The pipe strength must conform to specifications established in 49 C.F.R. Part 192 and ANSI B31.8.⁶⁸

71. While the Commission does not establish or regulate MAOPs for pipeline facilities, the Commission does require all pipeline certificate holders to operate their facilities consistent with the Department of Transportation's (DOT) calculation of MAOP,⁶⁹ which establishes the maximum pressure at which a pipeline or pipeline segment may operate.⁷⁰ Further, pipelines are required to install pressure-relieving or pressure-limiting devices to protect against over-pressuring the pipeline segment during limited periods when the operating pressure may exceed the MAOP, such as during the startup or shutdown of a pipeline.⁷¹ The DOT also has the authority to change a pipeline facility's MAOP from time-to-time, which it did in El Paso's case following the Carlsbad Rupture.⁷²

⁶⁸American National Standards Institute (ANSI) B31.8-99 Gas Transmission and Distribution Piping Systems Code covers the design, fabrication, installation, inspection, and testing of pipeline facilities used for the transportation of gas. This Code also covers safety aspects of the operation and maintenance of those facilities.

⁶⁹18 C.F.R. § 157.14(a)(9) (2003).

⁷⁰49 C.F.R. § 192.3 (2003). Part 192 of 49 C.F.R. establishes the standards for numerous aspects of gas pipeline safety, including the design of pipeline components and pipeline operations. DOT regulations establish an operational or safety-based MAOP constraint to "prevent pipeline failure that could result from excess operating pressure." Comments of the Office of Pipeline Safety, Research and Special Programs Administration, Department of Transportation, filed with the Commission on November 11, 2002, in Docket No. PL02-9-000.

⁷¹49 C.F.R. § 192.605(b)(5) (2003).

⁷²On August 19, 2000, El Paso's Line 1103 ruptured and ignited approximately 300 feet upstream of the Pecos River, near Carlsbad, New Mexico. On August 23, 2000, following the rupture, DOT's Office of Pipeline Safety issued a Corrective Action Order to El Paso that imposed a variety of conditions on El Paso's Southern Mainline System.

72. Pipeline certificate applicants are required to provide the Commission with pipeline facility pressure data to support daily design capacity.⁷³ In Figure 1, this is reflected in the pressure range between "Design Operating Pressure" and "Minimum

Design Operation Pressure." The Design Operating Pressure cannot exceed the MAOP, but it can be at or below MAOP. The proposed daily design capacity for a facility is based on customer service profiles, and pipelines must support their proposed design day figures consistent with the expected profiles.⁷⁴ In contrast, Minimum Design Operating pressure reflects various physical constraints. For example, compressors require certain amounts of throughput to operate safely. Additionally, some types of meter facilities require minimum pressures to operate or to achieve design levels of accuracy.

73. The Commission requires certificate applicants to provide MAOP data in their applications. If a facility's design capacity is not based on MAOP, the Commission requires the applicant to provide flow diagrams showing the facility's existing and proposed maximum capabilities "under most favorable operating conditions...".⁷⁵ However, the Commission does not expect "most favorable operating conditions" to exist continuously. In fact, pipeline facilities are not certificated to perform continuously at their most favorable operating levels.⁷⁶

74. Pipelines are certificated to perform at expected service levels. As Figure 2 shows, whether customer load profiles are non-coincidental or coincidental has considerable effect on design capacity. Figure 2 also shows that, if a pipeline facility is designed to serve a non-coincidental peak set of customers at a level of 160 MMcf/d, but

⁷³18 C.F.R. § 157.14(a)(7) (2003).

⁷⁴18 C.F.R. §§ 157.14(a)(9)(v), 157.14(a)(11)(iv) (2003). Customers typically have load profiles that vary depending on the season, condition of the economy, production process requirements, time of day, and many other factors.

⁷⁵18 C.F.R. § 157.14(a)(8) (2003).

⁷⁶The Commission also requires MAOP information for supply and delivery lateral facilities constructed under the blanket certificate program. The blanket certificate program is defined in the Commission's regulations at 18 C.F.R. Part 157, Subpart F (2002). The reporting requirement is stated in 18 C.F.R. § 157.208(f)(2) (2003). As with mainline certificate authorizations, the MAOP is not established by the Commission.

if the customer load profile shifts to the coincidental peak example, the coincidental service obligation would require 185 MMcf/d of capacity, although the pipeline design facilities would remain at the original design level of 160 MMcf/d.

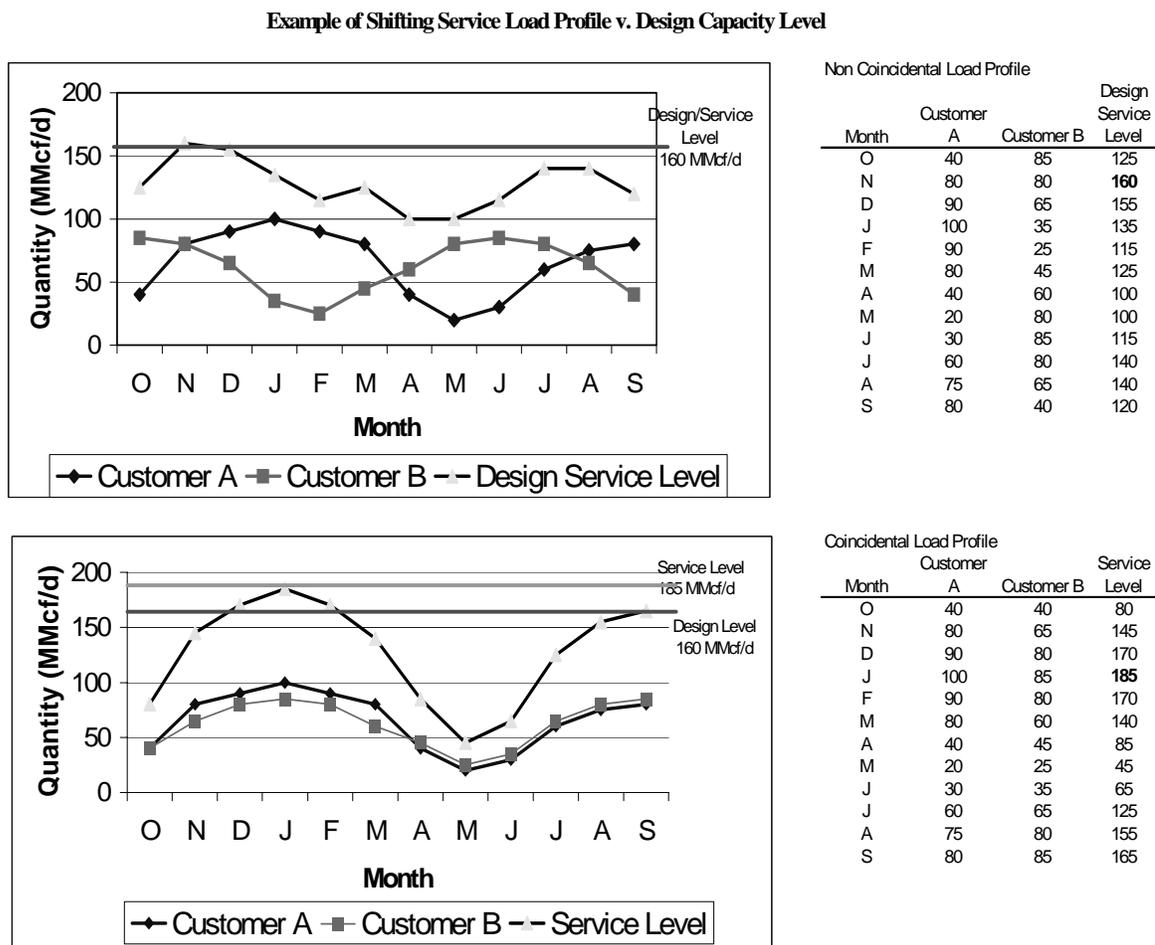


Figure 2 Examples of Shifting Service Load Profiles v. Design Capacity

75. El Paso experienced a significant change in its EOC Customer load profile after its facilities were certificated. However, its tariff accommodates these changes through pro rata allocation⁷⁷ or through capacity expansions if, in El Paso's judgment, such expansions are economically feasible.⁷⁸

⁷⁷El Paso's FERC Gas Tariff, Second Revised Volume No. 1A, GT&C, Section 4.2.

⁷⁸El Paso Natural Gas Co., 54 FERC ¶ 61,316, at 61,923-24 (1991).

76. Service levels also are defined by pipeline tariffs. For example, tariffs can define minimum and maximum receipt and delivery pressures.

Reproduced here is Exhibit A from the pro forma transportation service agreement found in El Paso's tariff. It shows that the receipt pressure is established in the contract between the shipper and El Paso. Delivery pressures are established in Exhibit B of the same pro forma agreement.⁷⁹ These contract levels cannot exceed MAOP, but they can be established at any level between MAOP and the Minimum Design Operating Pressure. The Commission certifies the service levels that are reflected in the executed service agreements. Thus, El Paso fulfills its obligations when it delivers to its shippers within the pressure levels established by its contract.

El Paso Natural Gas Company: Second Revised Volume No. 1A
Second Revised Sheet No. 423

FORM OF TRANSPORTATION SERVICE AGREEMENT
APPLICABLE TO FIRM TRANSPORTATION SERVICE UNDER
RATE SCHEDULE FT-1
(Continued)

EXHIBIT A

To The
Transportation Service Agreement
Dated _____
Between El Paso Natural Gas Company
and _____

Receipt Point(s)	Delivery Pressure(s) (psig)*	Maximum Daily Quantity ()

* Necessary pressure to enter the El Paso System and, except as otherwise noted, not in excess of.

A. Effective Date of this Exhibit A: _____

B. Supersedes Exhibit A Effective:

EL PASO NATURAL GAS

COMPANY

By _____ By _____

Example El Paso Pipeline Tariff Sheet Establishing Receipt Pressure Obligation

77. Most of the data discussed above with respect to MAOP and the Commission's certification requirements use "steady-state" numbers. Steady-state figures take a snap-

⁷⁹El Paso Pipeline FERC Gas Tariff, Second Revised Volume No. 1-A, Original Sheet No. 424, which contains Exhibit B to Rate Schedule FT-1's pro forma agreement, provides as follows:

Unless otherwise specified on this exhibit, the Delivery Pressure(s) for the point(s) listed above shall be the pressure existing from time to time at the metering facility; however, El Paso reserves the right to deliver quantities at pressures up to the MAOP of that facility.

shot in time for a defined set of conditions. However, pipeline operating conditions are dynamic and can change year-by-year, season-by-season, day-by-day, hour-by-hour, or even minute-by-minute. Mathematical models used to create steady-state data often are not adequate to model a dynamic system. Further, pipelines cannot react instantaneously to changing conditions. Gas must flow from point to point on the system, and gas flows take time. Mathematical models that take into account variables that change over time are referred to as "transient flow" models. Thus, throughput capacities based on steady state assumptions will not match either real-world or transient flow model outcomes.

78. In any event, the issue in this proceeding is not whether El Paso did or should have operated at MAOP, but whether it is reasonable for El Paso to reserve capacity for managing transients, and not post that capacity as available firm capacity. El Paso, like all pipelines, must reserve capacity to manage transients, such as daily and hourly load swings, to provide reliable firm service to its firm shippers. On El Paso, the gas supplies for both the EOC Markets and the California markets are located several hundred miles from these markets, but must move through the same pipeline.

79. El Paso has only one storage field, which is located on the Southern Mainline, far upstream of the major El Paso markets, and therefore El Paso must rely on line pack to manage swings. Because of the large swings in daily requirements, El Paso must reserve mainline capacity to support the hourly service demand variations of its EOC Customers. Without this additional flexibility, the hourly and daily variations in demand by the EOC Customers would deplete the line pack on El Paso Pipeline's system.

80. The Commission concludes that there is no basis for a finding that would increase beyond 5,400,000 Mcf/d the amount of capacity available on El Paso for allocation purposes. The issue here is whether it is reasonable for El Paso to reserve capacity for purposes of system management, not whether El Paso is required to operate at MAOP. The capacity reserved for managing transients is necessary to render firm services. We reiterate that under the Commission's regulations,⁸⁰ El Paso may not sell or contract for firm service capacity that is subject to a prior claim. Capacity that is needed to manage transients is subject to such prior claim. Therefore, it is not appropriate to make an adjustment to available system capacity to include capacity used to manage transients because that capacity is not available for firm sales.

⁸⁰18 C.F.R. § 284.7(a)(3) (2003).

d. Balancing the Public Interests

81. The FR Shippers, the ACC, and APS/Pinnacle argue that the record does not contain a factual analysis of the consequences of the conversion of the FR contracts. The FR Shippers argue that the record does not contain analysis of the relative needs of FR and CD shippers, the availability of alternatives for these shippers, and the kinds of customers they serve. They argue that the Commission has provided no analysis of the impact of its order on consumers in the areas served by the FR shippers, and ignored warnings that its action will result in blackouts and curtailments to human needs customers. Similarly, the ACC further states that there are public benefits of the FR contracts for captive shippers and that conversion of these contracts would harm the public interest in Arizona, and the Commission erred in failing to take these interests into account.

82. The Commission has appropriately balanced the interests of all the parties, including the FR customers, in determining an appropriate remedy for the capacity allocation problems on El Paso. Contrary to the assertions of these parties, the Commission has considered the needs of the FR shippers. As discussed below, all the FR shippers were allocated capacity amounts that are equal to or in excess of their 2001 non-coincident peak demands.⁸¹ 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. The Commission is acting 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. The Commission's decision in the May 31 order is consistent with its decision in Amoco Energy Trading Co. v. El Paso Natural Gas Co. (Topock)⁸² where the Commission found that El Paso's pro rata allocation of capacity at Topock and other delivery points was unjust and unreasonable because firm shippers were not receiving firm service.

⁸¹See Appendix B.

⁸²93 FERC 61,060 (2000), order on clarification, 93 FERC 61,222 (2000), order on reh'g, 94 FERC 61,225 (2001), aff'd, Southern California Gas Co. v. FERC, 2002 U.S. App. LEXIS 15040 (9th Cir. 2002).

83. The Commission has considered the consequences of its actions on all shippers and has explained in the May 31 order⁸³ and its discussion above, that its action in converting the FR contracts is consistent with its duty to protect captive customers. The Commission has provided the converting FR customers with all of El Paso's available capacity, including the capacity that will be supplied in the future by the Power-Up Project, at the same aggregate revenue responsibility as was provided for in the 1996 Settlement. In addition, the Commission is establishing a pool of additional capacity that must be held in reserve to serve converting FR shippers so as to assure that their current needs will be met pending completion of the Power-Up Project. The Commission has also made additional capacity available to the FR shippers through capacity turnback and use of California delivery points as receipt points.

84. The Commission is satisfied that the allocation process will provide FR shippers with sufficient capacity to meet all of their current needs. Indeed, as discussed below, all of the converting FR shippers have received capacity in the initial allocation equal to or greater than their 2001 non-coincident peaks.⁸⁴ Further, in many cases, the converting FR shippers received allocations in excess of the amounts that they stated they would ideally like to have available to them.⁸⁵

85. APS/Pinnacle argues that the Commission failed to give adequate weight to the public interest implications of APS/Pinnacle's justified reliance on the 1996 Settlement

⁸³May 31 order at 62,007.

⁸⁴Appendix B shows a comparison of the converting FR shippers' 2001 peak demand and the allocations they would receive on their peak month, as contained in El Paso's December 3 report. The table shows that each shipper's peak month allocation is equal to or greater than their 2001 NCP. The one anomaly is Navajo Tribal Utility Authority which has a 2001 NCP of 24,860 Mcf/d and a peak month allocation of 19,462 Mcf/d. The backup data in the December 3 report shows that Navajo's peak month west flow allocation of 9,661 Mcf/d exceeds its west flow billing determinant of 2,339 Mcf/d. Further, El Paso states that the allocations of east end capacity to Navajo and others are based on shipper elections rather than on throughput during the September 2001 through August 2002 period. The Commission concludes that Navajo has 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.

⁸⁵The FR customers' projected demands were submitted in an August 16, 2001 data response issued in connection with the July 2001 technical conferences wherein El Paso agreed to perform capacity studies under various scenarios.

and the irreparable harm that will be sustained by undermining APS/Pinnacle's reasonable expectations.⁸⁶ APS/Pinnacle states that it is physically captive to El Paso and a change in the allocation methodology could interfere with its ability to maintain a secure gas supply in peak generation months, and undermine its ability to serve its Phoenix and Yuma load pockets. APS/Pinnacle asserts that abrogating FR service would leave idle essential gas generation capacity located within the load pockets and force APS/Pinnacle to rely on oil-fired generation, which is less desirable. Further, APS/Pinnacle states that lack of adequate transportation capacity could cause APS/Pinnacle's systemwide generation capacity to remain idle during periods of peak demand. APS/Pinnacle states that the Commission failed to balance or discuss the potential harm to APS/Pinnacle if it does not obtain firm transportation capacity to supply its new generation plant or to all FR shippers who will have their allocations reduced.

86. The Commission has been informed and did appropriately consider the consequences of conversion of the FR contracts. The Commission has taken action to make all the capacity on El Paso, after reserving capacity for the CD and FT-2 shippers, available to the FR customers, including APS/Pinnacle. APS/Pinnacle received in the initial allocation filed by El Paso on December 3, 2002, 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.

⁸⁶APS/Pinnacle states that its General Manager established that it expended in excess of \$10,000,000 on start-up costs, certification and consulting fees, and upgrades on pipelines and other infrastructure, and \$500,000,000 on new power plants to serve increases in electric demand in Arizona. APS/Pinnacle cites Joint Initial Comments of the Arizona Public Service Company and Pinnacle West Energy Corporation at App.B (October 15, 2001). Further, APS/Pinnacle states that at the April 16 conference, its representative clarified that the total financial investment committed to new gas-fired generation was over \$1 billion. APS/Pinnacle states that these persons testified that in planning these projects, APS/Pinnacle relied on the availability of natural gas in sufficient quantities and at rates contained in the 1996 Settlement agreement.

87. The parties also argue that the Commission made errors of fact regarding the consequences of the conversion. These arguments were made after issuance of the May 31 order and alleged that the converting FR customers would receive inadequate capacity in the allocation process. For example, the ACC argued that there is no factual basis for the Commission's statement that the capacity rationalization process will enable converting FR shippers to receive service at the levels they used the system in 2001, and argues that the converting FR customers will not be able to receive capacity equal to their billing determinants in the conversion process.

88. As the reallocation process has proceeded, it has become clear that there is available capacity to provide the converting FR customers an initial allocation sufficient to meet their monthly demands over the 12-month period ending August 31, 2002.⁸⁷ As discussed below, El Paso's December 3 report shows that El Paso's currently available capacity, combined with the proposed Power-Up Project capacity, exceeds the monthly average usage of the converting FR shippers during the year ending August 2002. There has been additional turnback capacity available to supplement the initial allocation, although only one FR customer chose to purchase such capacity.

89. Further, the ACC stated that it was error for the Commission to state that once the FR contracts are converted to CD contracts, the shippers will be able to purchase capacity from other pipelines. The ACC asserts that the converting FR shippers are captive shippers and there are no other pipelines from which they can purchase transportation. Further they assert that the Commission failed to clarify whether provisions of the FR contracts that bind the shippers contractually to El Paso would be removed.

90. When 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

⁸⁷As noted above, current FR shipper demands approximate 1,500 MMcf/d. To meet this demand, El Paso will allocate 930 MMcf/d of capacity available in 2001. Since that time the Line 2000 capacity of 230 MMcf/d has come on line and will be allocated to FR shippers. Additionally, 320 MMcf/d associated with the Power-Up Project will also be allocated to FR shippers. In aggregate, the existing and expansion capacity approximates current demand levels. Because the capacity associated with the Power-Up Project is not yet available, the Commission is requiring El Paso to establish a pool of additional capacity to be held in reserve to serve converting FR shippers' demands until the new capacity is available.

pipelines to offer service to these shippers.⁸⁸ The Commission clarifies that provisions of the FR contracts that bind the shippers contractually to El Paso will be abrogated as part of the conversion process, and the FR shippers are free to contract with other pipelines for capacity.⁸⁹

2. Partial Versus Complete Abrogation of the 1996 Settlement

91. As discussed above, the FR Shippers argue that the Commission erred in modifying the 1996 Settlement by converting the FR contracts to CD contracts. However, they further argue that once the Commission decided to modify the Settlement in part, it erred by failing to terminate the Settlement in its entirety because the Commission's action has eliminated the benefits of the Settlement for the FR shippers while maintaining it for the CD shippers.⁹⁰ The FR Shippers assert that a new rate case with an open season would be a fairer procedure.

92. Similarly, SoCalEdison asserts that the Commission has adopted a partial solution that will not result in just and reasonable rates, services, and practices on El Paso. It argues that the Commission's action will result in unduly preferential rates for the converting FR customers. SoCalEdison argues that circumstances have changed drastically on El Paso since the 1996 Settlement was executed and the circumstances on El Paso that made the 1996 Settlement reasonable at the time do not exist today. Further, SoCalEdison states, both the costs and cost allocation methodology underlying the 1996

⁸⁸For example, Kern River has indicated an interest in serving this area. See Motion to Intervene and Protest of Kern River Gas Transmission Co. in Docket No. CP03-1-000 (filed October 31, 2002) at pp. 3, 13-14.

⁸⁹As discussed below in response to a request for clarification filed by Kinder Morgan, once the FR contracts are converted to CD contracts, the converted FR shippers may purchase transportation service from other pipelines and may negotiate, prior to the conversion date, for service to commence after the date of conversion.

⁹⁰The FR shippers also argue that the Commission has provided a windfall to El Paso inherent in the Settlement's termination of the revenue crediting provision after eight years, which the FR Shippers believe is worth \$50 million a year now that the pipeline is subscribed at maximum rates. But, the Commission has not changed the revenue crediting provisions of the Settlement. The FR Shippers also state that El Paso will receive a windfall in the reduction of fuel discounts required under its tariff for gas delivered from San Juan to certain EOC delivery points. The FR shippers are in error. The Commission's order does not reduce fuel discounts.

Settlement failed to reflect El Paso's operations. Therefore, SoCalEdison asserts that there is no reason to continue to defer to that Settlement. SoCalEdison argues that the measures adopted in the May 31 order can be justified only as an interim solution, and that going forward, the Commission must establish just and reasonable rates under Section 5 of the NGA. At a minimum, SoCalEdison argues, the Commission should eliminate the prohibition in the 1996 Settlement that bars consenting parties from initiating a Section 5 challenge to El Paso's rates.

93. The Commission concludes that the facts and applicable law in this case do not support either of the extremes advocated by these parties. The Commission has already explained why the FR contracts must be converted to CD contracts to restore reliable firm service on El Paso. However, it does not necessarily follow that once the Commission modified the Settlement in this manner, the other elements of the Settlement should have been abrogated. There is no evidence in this proceeding that provisions of the Settlement unrelated to the provision of firm service have contributed to the service disruptions on El Paso, and therefore there is no factual or legal basis for abrogating the entire Settlement. El Paso is required by the terms of the 1996 Settlement to file a new rate case effective January 1, 2006. That rate filing will provide the opportunity to review the justness and reasonableness of the rates and practices on El Paso's system.

C. Reallocation of Costs Among the FR Customers

94. In the September 20 order, the Commission directed El Paso, after the allocation of capacity to the FR shippers is made, to reallocate the current aggregate FR revenue responsibility among the FR shippers pro rata based on the new CD levels. On rehearing, APS/Pinnacle argues that there is no factual or legal basis for redistributing the revenue responsibility that was expressly negotiated, agreed to and approved as an integral part of the 1996 Settlement.

95. Upon further consideration, the Commission has concluded that it is not necessary to reallocate costs among the FR shippers in order to resolve the capacity allocation problems on the El Paso system. The Commission's Section 5 action in this proceeding is narrow, and is intended only to remedy the firm service interruptions on El Paso that have rendered firm service unjust and unreasonable. Reallocation of costs among the FR shippers goes beyond this narrow purpose and would unnecessarily disturb the parties' settlement bargain. Therefore, rehearing on this issue is granted.

D. El Paso's Service Obligation

96. In the May 31 order, the Commission stated that El Paso has an obligation to reasonably ensure the quality of firm service and that its actions not degrade the quality of that service.⁹¹ Therefore, the Commission held that El Paso may not enter into new contracts for firm service unless it can demonstrate that it has available capacity to provide that service. Further, the Commission stated, during the pendency of the 1996 Settlement, El Paso must first offer firm capacity that becomes available to its existing shippers. The Commission also stated that El Paso does not have an unqualified obligation to expand its system at its own expense.⁹²

97. In ruling on El Paso's service obligations to its customers, the Commission considered Section 3.6 of the 1990 Settlement and Article 16.3 of the 1996 Settlement. Section 3.6 of the 1990 Settlement provides in part:

It is stipulated and agreed that El Paso's obligation to provide firm transportation to converting sales customers is subject to the capacity limitations of El Paso's pipeline system as that system may exist from time to time and to the operating terms and conditions applicable to firm transportation set forth in El Paso's FERC Gas Tariff as it may be modified from time to time.....

.....

If at any time, the capacity of the El Paso system is not sufficient to satisfy the demands of a converting full requirements transportation customer, El Paso shall construct such non-jurisdictional facilities and/or apply to the FERC for authorization to construct such jurisdictional facilities as may be required to satisfy those demands; *provided however, that El Paso shall not be required to construct any facilities that are not economically justifiable.* The provisions of this Section 3.6 shall survive the term of this Stipulation and Agreement. (Emphasis added.)

Article 16.3 of the 1996 Settlement provides:

Service Obligations. El Paso agrees and confirms that, during the effectiveness of this Stipulation and Agreement, it will maintain and operate facilities sufficient to satisfy and perform the service obligations with respect to both quality and quantity of service imposed upon it by, and subject to the conditions applicable to, the provisions of this Stipulation and Agreement and its firm TSAs in effect on December 31, 1995.

⁹¹May 31 order at 62,012.

⁹²May 31 order at 62,003 n.36.

98. On rehearing, ACC, APS/Pinnacle, the FR Shippers, PG&E, and SoCalEdison argue that the capacity allocation problems on El Paso have been caused largely by the actions of El Paso itself and that the Commission overlooks El Paso's contribution to these problems. These parties assert that El Paso wrongfully failed to construct additional capacity to meet the needs of its customers, oversold its system, remarketed capacity from expiring contracts when that capacity was needed by current customers, sold capacity to its affiliate when the capacity on its system was constrained, and breached its service obligation all in violation of the Commission's regulations and the terms of the Settlements, its tariffs, and its contracts with its shippers. These parties argue that the Commission erred because it has adopted a remedy that does not hold El Paso accountable for its wrongdoing, but instead modifies the contracts of innocent parties. As discussed below, the Commission recognizes that El Paso's firm commitments exceed its available capacity, but has concluded that it is appropriate to provide a remedy going forward, rather than penalize El Paso for following its tariff and Settlements.

1. El Paso's Obligation to Construct Additional Capacity

99. In the May 31 order, the Commission recognized that under the 1990 and 1996 Settlements, El Paso's obligation to expand its system is limited if it would require El Paso to expand at its own expense to meet the growing needs of the FR shippers. This limited obligation to expand mainline capacity is conditioned on the construction being economically justifiable. The Commission also noted that there appears to be no economic incentive for El Paso to construct facilities to serve customers that will pay only a commodity charge for use of the new facilities. In any event, the Commission stated, El Paso had agreed to increase its capacity through the Power-Up Project.

100. On rehearing, APS/Pinnacle and the FR Shippers argue that the Commission erred in finding that El Paso does not have an obligation under the Settlements to expand its system to meet increased demand of the FR shippers. APS/Pinnacle argues that to the extent that the Commission found that El Paso lacks sufficient capacity to serve the requirements of the FR shippers, the appropriate remedy is to order El Paso to expand its system pursuant to Section 3.6 of the 1990 Settlement, not to abrogate the FR contracts. APS/Pinnacle argues that the 1990 Settlement places an obligation on El Paso to construct additional capacity to meet increased demands of the FR shippers. They assert that the "economically justified" clause was intended to place a reasonableness limitation on El Paso's obligation to construct capacity so as to avoid requiring the pipeline to build capacity that could never be cost justified by increased demand. APS/Pinnacle argues that this provision was not intended to be a shield to be used by the pipeline to skirt its obligation under the Settlement to serve growing FR demands for the 10-year Settlement

period. They argue that the Commission's statement that construction would not be economically justifiable if the shipper did not pay an increased reservation charge for the service would essentially read the construction obligation out of the Settlement because the Settlement holds the FR demand charge steady for the 10-year Settlement period.

101. In determining the meaning of a settlement, the Commission applies the traditional rules of contract construction.⁹³ Pursuant to these rules, the Commission must ascertain the intent of the parties by considering the language of the document itself, its purpose, and the circumstances of its execution and performance.⁹⁴ Thus, the Commission looks to the language of the Settlement and its regulatory context.⁹⁵ In the absence of an ambiguity, the Commission determines the meaning of the agreement from the language of that agreement without resort to extrinsic or parole evidence.⁹⁶ If extrinsic evidence is appropriate to show intent, that evidence must show the mutual intent of the parties at the time of the negotiations.⁹⁷

102. In accordance with these principles, the Commission must determine the meaning of the "economically justified" qualification on El Paso's obligation to construct capacity in light of the regulatory context in which the 1990 Settlement was approved. In the order approving the 1990 Settlement,⁹⁸ the Commission stated that the decision whether to build additional facilities is a business decision that is left to the pipeline in the first

⁹³E.g., *Mid Louisiana Gas Co. v. FERC*, 780 F.2d 1238 at 1243 (5th Cir. 1986).

⁹⁴*Pennzoil Co. v. FERC*, 645 F.2d 360, 388 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1981).

⁹⁵*Amerada Hess Pipeline Corp.*, 74 FERC 61,318 (1996), aff'd, *Amerada Hess Pipeline Corp. v. FERC*, 117 F.3d 596 (D.C.Cir. 1997); *Columbia Gas Transmission Corp.*, 64 FERC 61,365 at 63,582 (1993) (citing *Pennzoil Co. v. FERC*, 645 F.2d 360, 368 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1981)).

⁹⁶*Seattle v. FERC*, 923 F.2d 713, 716 (9th Cir. 1991); *Alabama Power Co. v. FERC*, 993 F.2d 1557, 1565 (D.C.Cir. 1993).

⁹⁷E.g., *Farmland Industries v. Grain Board of Iraq*, 904 F.2d 732, 738 (D.C. Cir. 1990). See *Amerada Hess Pipeline Corp.*, 74 FERC ¶ 61,318 at 62,007 n.18 (1996).

⁹⁸*El Paso Natural Gas Co.*, 54 FERC ¶ 61,316 (1991), reh'g, 56 FERC ¶ 61,290 (1991).

instance under the NGA.⁹⁹ The Commission also addressed concerns that the "economically justifiable" qualification on El Paso's obligation to construct additional capacity to serve the FR customers' needs was too vague. The Commission rejected these arguments stating that El Paso had an obligation under the Commission's regulations to build capacity for its customers in a not unduly discriminatory manner.¹⁰⁰ Further, in accepting the qualification, the Commission stated "[g]reater specificity as to who pays for the new capacity can be made when a pipeline expansion proposal is filed."¹⁰¹ In addition, the Commission stated that it assumed that El Paso would seek to expand its system to eliminate constraints when economically feasible with or without the settlement, since to do otherwise would be to forego additional revenues and encourage competitors to vie for its market share.¹⁰²

103. The Commission's order therefore makes clear that the Commission did not at the time the Settlement was approved interpret Section 3.6 of the Settlement to place an unqualified obligation on El Paso to build capacity at its own expense to serve the growing needs of the FR shippers. The Commission held that "economically justified" meant either that the new capacity would bring increased revenues to El Paso or that the FR shippers would share the expense of the expansion with El Paso. The Commission's statement that the parties to the Settlement could specify who would pay for expansion capacity at the time a specific proposal is filed shows that the Commission reasonably interpreted the qualification as contemplating that shippers would contribute to the costs of an expansion to serve their needs in order to make that expansion economically justifiable to El Paso.¹⁰³

104. APS/Pinnacle's assertion that the appropriate solution to the capacity allocation problems on El Paso is for the Commission to order El Paso to build additional capacity

⁹⁹54 FERC at 61,924.

¹⁰⁰54 FERC at 61,923.

¹⁰¹54 FERC at 61,923-24.

¹⁰²Id.

¹⁰³The FR Shippers have declined to contribute to expansions to serve their needs. El Paso held an open season solicitation for new capacity into California for its Line 2000 Project, (See El Paso Natural Gas Co., 95 FERC ¶ 61,176 (2001)), and neither the FR nor the CD shippers responded to the solicitation.

at its own expense to serve the needs of APS/Pinnacle is not consistent with the meaning of the Settlement or the terms of the NGA.¹⁰⁴

105. The FR Shippers argue that the 1996 Settlement included a new commitment by El Paso to operate and maintain its system in the same manner as it had in 1995 when there were few service interruptions. They argue that to the extent that this new commitment is inconsistent with the 1990 Settlement or the settlement and tariff provisions concerning pro rata allocations, it overrides those provisions. They state that the Commission's justification for modifying the FR contracts, *i.e.*, the need to give El Paso an incentive to construct capacity to meet service needs, would be unnecessary if the Commission determined that the 1996 Settlement already requires it to do so.

106. The Commission does not interpret Section 16.3 of the 1996 Settlement to override Section 3.6 of the 1990 Settlement, as well as the pro rata allocation provisions of El Paso's tariff¹⁰⁵ to place an unqualified obligation on El Paso to build capacity at its own expense to meet their needs. Section 16.3 of the 1996 Settlement refers to an obligation to "maintain" and "operate" pipeline facilities. It does not mention construction of facilities, and does not place an obligation on El Paso to construct facilities at its own expense to meet increased FR shipper needs. Moreover, there is nothing in the plain language of this provision that would repeal either Section 3.6 of the 1990 Settlement, which specifically provides that it shall remain in effect beyond the term of the 1990 Settlement, or Section 4.2 of the GT&C of El Paso's tariff that provides for pro rata allocation of capacity when El Paso has insufficient capacity to meet the needs of its firm shippers. The language of Section 16.3 is general in nature and does not supercede the specific 1990 Settlement and tariff language concerning construction of capacity and pro rata allocations.

107. The FR Shippers assert that if the Commission had held a hearing on this issue, it would have found that the 1996 service obligation was intentionally written as a service

¹⁰⁴The Commission does not have the authority under the NGA to order a pipeline to construct additional capacity. *E.g.*, *Panhandle Eastern Pipeline Co. v. FPC*, 204 F.2d 675, 680 (3rd 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.")

¹⁰⁵Section 4.2 of the General Terms and Conditions of El Paso's tariff 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.

guarantee to protect the shippers from El Paso overselling its capacity, and that the service obligation in Section 16.3 places the risk on El Paso to have the necessary facilities to meet this firm service guarantee. However, the FR shippers have 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.

108. The Commission affirms its conclusion that the 1990 and the 1996 Settlements do not place upon El Paso an unqualified obligation to construct capacity at its own expense. The operation of these elements of the Settlements, coupled with El Paso's daily allocation procedures, are the primary reasons for unreliable firm service on El Paso, and are in need of modification to restore firm service reliability on the system.

109. In any event, El Paso has recently added an additional 230 MMcf/d of capacity on its Line 2000 for its existing customers, and the Commission has issued a certificate authorizing an additional expansion of 320 MMcf/d on Line 2000 through the Power-Up Project.¹⁰⁶ El Paso will forgo additional revenues from these projects until its next rate case.

2. Whether El Paso Oversold its System

110. The FR Shippers argue that the Commission erred by acknowledging that El Paso has continued to re-market firm service capacity as contracts expired irrespective of current capacity availability on its system,¹⁰⁷ but concluding that it is not necessary or material to the adoption of an allocation methodology to determine whether El Paso has oversold its system.¹⁰⁸ They argue that El Paso was aware of increased utilization of its system by its existing customers when it sold its unsubscribed capacity to its affiliates, El Paso Merchant Energy-Gas, L.P., and El Paso Merchant Energy Company, and that these sales rendered El Paso unable to maintain its service reliability as required by the 1996 Settlement. Further, they argue that El Paso's right to remarket unsubscribed capacity was subject to its obligations under Section 16.3 of the 1996 Settlement to maintain its pipeline so that service to its preexisting firm shippers was maintained as it was in 1995,

¹⁰⁶El Paso Natural Gas Co., 100 FERC ¶ 61,280 (2003).

¹⁰⁷The FR Shippers cite the May 31 order at 62,002-03.

¹⁰⁸The FR Shippers cite the May 31 order at 62,019.

with very limited service interruptions. The parties argue that the Commission erred in failing to make a definitive finding that El Paso breached its service obligations. El Paso, on the other hand, argues that the Commission erred in stating that firm shippers are not receiving the service they are paying for, because the Settlements and the contracts provide for pro rata allocations.

111. The data presented by El Paso itself in the complaint proceeding in Docket No. RP00-241-000 shows that its total firm service contractual obligations exceed its westflow capacity by about 220 MMcf/d.¹⁰⁹ The FR Shippers argue that the authority to remarket capacity, and to impose pro rata allocations, are subject to the service commitment in Section 16.3 of the 1996 Settlement. The Commission recognizes that the 1996 Settlement authorized El Paso to remarket expired capacity contracts and share the revenues from those sales with its firm customers.¹¹⁰ The Commission approved some of these remarketed contracts as consistent with the Settlement.¹¹¹ However, when it became apparent that circumstances had changed¹¹² and further remarketing of expired capacity contracts threatened El Paso's ability to meet the needs of its current shippers, the Commission denied further sales of the expired capacity contracts, as evidenced by our May 31 order, and the May 1, 2002 order in El Paso's negotiated rate filing in Docket No. RP97-287-057.¹¹³

¹⁰⁹El Paso testified that total firm demand that utilizes west-flow capacity includes 3,290 MMcf/d of CD service and 1,133 MMcf/d of FR demand (plus fuel for FR service of 95 MMcf/d) for a total of 4,518 MMcf/d. El Paso's available capacity is 4,300 MMcf/d, which reflects 210 MMcf/d reserved for management of system transients. See Oral Argument Transcript at 153 and 154, and El Paso Brief on Exceptions to Phase II Initial Decision at 15 and 16 in Docket No. RP00-241-000.

¹¹⁰See Section 25.3 of El Paso's GT&C; Article 3.4 of the 1996 Settlement.

¹¹¹The Commission accepted a negotiated rate tariff filing between El Paso and Dynegy Marketing and Trade. 88 FERC ¶ 61,139 at 61,405 (1999), and stated that the transaction was consistent with the 1996 Settlement. See also El Paso Natural Gas Co., 90 FERC ¶ 61,050 (2000).

¹¹²As discussed above, at the time of the 1996 Settlement, there was a problem related to excess capacity, while more recently capacity has been constrained.

¹¹³El Paso Natural Gas Co., 99 FERC ¶ 61,140 (2002)(expressing concern that El Paso had not demonstrated that it has the capacity to serve the shipper on a firm basis and suspending the effectiveness of the contract).

112. The Commission concludes that El Paso has an 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 El Paso remarketed expired capacity when it could not meet all of its firm service obligations. But, because the terms of El Paso's tariffs, contracts, and Settlements operate to create conflicting requirements, including pro rata allocations, the Commission concludes that the net result of the 1990 and 1996 Settlements, the tariffs, and the contracts is unjust and unreasonable and not in the public interest. The Commission will adopt a remedy going forward from September 1, 2003 to modify the Settlements in a manner that will end the pro rata allocations that occur on El Paso's system.

E. The Remedy Adopted by the Commission is Not Unduly Discriminatory

113. Both the FR Shippers (and the ACC) and the California customers argue that the Commission's remedy to the capacity allocation problem is unduly discriminatory to them and unduly preferential to the other class of shippers. The FR Shippers and APS/Pinnacle argue that by limiting future growth under their contracts, the Commission has placed upon them the entire burden of the capacity shortage on the El Paso system. They argue that both CD and FR shippers on El Paso are firm shippers, and that El Paso's contractual obligation to them is identical.¹¹⁴ These parties argue that by leaving current CD contracts intact while reducing contract entitlements of FR customers, the Commission has unduly discriminated among sub-groups of firm customers. They state that the Commission correctly concluded that it should not allow service to one group of firm customers to cause financial harm to another group of firm customers,¹¹⁵ yet approved procedures that will cause permanent harm to FR customers in order to provide better service to other, and in many cases, newer, firm customers. Further, they argue, it was not reasoned decisionmaking for the Commission to conclude that CD shippers have sustained financial harm without recognizing that FR Shippers also sustained the same

¹¹⁴The FR shippers cited the portion of the firm FR and CD service agreements that provide that El Paso is obligated to "receive on each day at each Receipt Point, such quantity of natural gas, if any, up to the Maximum Daily Quantity specified for each Receipt Point on Exhibit A, not to exceed the physical capacity of such point, as may be tendered to El Paso by Shipper (or for Shipper's account) and to transport such quantity on a firm basis for shipper." The FR Shippers stated that this provision is identical in the CD and FR contracts. While some of the phrases in the FR and CD contracts may contain similar language, the contracts themselves are not identical.

¹¹⁵The FR shippers cite the May 31 order at 62,001.

pro rata harm, and that it was not a rational response to concerns of financial harm to CD shippers to require the entire mainline capacity shortfall to be borne by the FR Shippers. The FR Shippers assert that the procedure will require some, if not all, FR shippers to convert to CD contracts with maximum entitlements that are less than the quantities they historically received without any corresponding requirement of CD shippers to contribute to resolving the problem by reducing their entitlements.

114. On the other hand, SoCalEdison argues that the remedy adopted by the Commission provides for unduly preferential rates for the FR customers. SoCalEdison states that the Commission expressly recognizes that the rates paid by the FR customers do not ration capacity and provide unfair advantages for new power plants that are served under existing FR contracts, but, nonetheless, did not change the rates paid by the FR customers. As a result, SoCalEdison argues, gas-fired power generators located East of California will continue to enjoy a competitive advantage over generators in California.

115. Discrimination is undue when there is a difference in rates or services among similarly situated customers that is not justified by some legitimate factor.¹¹⁶ Both FR and CD services are firm services, as the parties assert, but they have very different characteristics. CD customers can nominate volumes on El Paso up to the fixed amount of their contract demand. FR customers, on the other hand, nominate their daily requirements with no limit on the amount of mainline capacity they can nominate other than the physical capacity of the delivery point. The CD shippers pay demand charges for their contract demand amounts, while the FR shippers pay monthly charges according to the 1996 Settlement billing determinants regardless of the amount nominated. Thus the rates paid and the services received by these shippers under the Settlements and under their contracts are different, and we conclude that FR and CD shippers are not similarly situated.

116. Moreover, 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. Therefore, the Commission has adopted an allocation methodology that requires separate

¹¹⁶E.g., Order No. 436, FERC Stats. & Regs (Regulations Preambles 1982-1985) ¶ 30,655 at 31,541 (1985).

or amended contract entitlements for future growth by these shippers while providing them with service to meet their existing needs at their current rates. As we have explained, the FR Shippers' assertion that the procedure adopted by the Commission will require FR shippers to convert to CD contracts with maximum entitlements that are less than the quantities they historically received is not accurate. The Commission's methodology provides each FR customer with capacity to satisfy its historic and current needs.

117. The capacity reallocation process does not alter the separate rate treatments that FR and CD shippers have received. The reallocation merely continues the current CD and FR rates agreed to by the parties through the term of the 1996 Settlement. The CD customers agreed as part of their economic bargain in the 1996 Settlement that they would pay a different rate for service for their CD volumes than the FR Shippers would pay for their service. The Commission has placed an upper limit on the quantities that can be nominated by the FR shippers at the Settlement rates to solve the capacity allocation problems on the system. The Commission concludes that it is not unduly discriminatory against the CD shippers or the converting FR shippers to continue receiving the separate rate treatment to which they agreed through the term of the 1996 Settlement.

F. Elimination of FR Service and the Policy of Service Comparability

118. The FR Shippers argue that the Commission erred by failing to address in the May 31 order its arguments that FR service cannot be eliminated on El Paso without undermining the guarantee of comparability of service established by the Commission during restructuring, *i.e.*, the guarantee that unbundled transportation service would be comparable to previously bundled sales service. The FR customers argue that the Commission found unbundled transportation service comparable to previously bundled service on El Paso based on the existence of El Paso's construction obligation and the preservation of FR service and pro-rata capacity allocation with system-wide receipt point rights. They argue that because El Paso did not offer storage or no notice service, FR service was essential to provide customers service comparable to the service they had as sales customers, similar to captive customers on other pipeline systems. They argue that terminating the FR service now without creating a no-notice service or storage service is not in the public convenience and necessity. They argue that the Commission must assess the real life service impact of any new allocation methodology to ensure service comparability, including the reliability of transportation service to meet the demands of weather-sensitive captive customers.

119. As explained above, 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. Their new CD service 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. However, if any of the FT-1 FR customers would prefer to receive all or a portion of their new CD service as no-notice service, the Commission directs El Paso to discuss with those customers the terms and conditions and rates for such no-notice service. The rates for any no-notice service would not necessarily be the 1996 Settlement rates because, as the Commission has explained, no-notice service is a superior service and it is appropriate to design a rate for this service that reflects its quality and costs.¹¹⁷

G. Refunds and Reparations

120. In the May 31, 2002 order, the Commission denied the requests of the CD shippers that El Paso be directed to refund all demand charges paid with respect to capacity that was not scheduled. The Commission explained that it was acting under Section 5 of the NGA to establish just and reasonable allocation procedures on El Paso, and that refunds are not available under Section 5. The Commission stated that while refunds are not available, El Paso will be required to pay demand charge credits prospectively to its firm shippers whenever it fails to deliver nominated quantities within the shipper's contract demand.

121. On rehearing, Indicated Shippers and ONEOK argue that the Commission erred in failing to order refunds. Both parties argue that monetary awards are appropriate here because El Paso engaged in wrongdoing. These parties assert that the Commission found that El Paso violated Section 284.7 of the Commission's regulations by assessing demand charge credits for a firm service that it does not provide. In addition, Indicated Shippers argue that El Paso acted illegally by continuing to sell firm service when it knew it could not meet its existing firm demand¹¹⁸ and violated Section 7 of the NGA by illegally abandoning its service.

122. Both parties state that they are not seeking refunds under Section 5. Instead, ONEOK states that it is seeking the return of improperly charged rates for service that was never rendered. Indicated Shippers assert that refunds should be ordered here

¹¹⁷See, e.g., Williams Natural Gas Co., 62 FERC 61,261 at 62,744 (1993).

¹¹⁸Indicated Shippers cite the May 31 order at 62,003 & n.30.

pursuant to Section 7 of the NGA, not Section 5, because El Paso violated Section 7 by illegally abandoning its service, by failing to provide firm service as required by Section 284.7 of the Commission's regulations, and by continuing to sell firm service when it knew it could not meet its existing firm demand.¹¹⁹

123. Indicated Shippers and ONEOK argue that a monetary award in these circumstances is supported by the case law. Indicated Shippers cite Mustang Fuel Corp.¹²⁰ where the Commission rejected a minimum bill and ordered refunds of amounts paid based on its finding that it was unjust and unreasonable for shippers to pay for service they did not receive. Further, Indicated Shippers cite Atlantic Refining Co. v. Public Service Commission of New York¹²¹ as holding that the NGA is intended to provide shippers with "a complete, permanent, and effective bond of protection from excessive rates and charges." They assert that unless refunds are ordered in this case, there will not be a complete bond of protection for shippers, and El Paso will have received a "windfall." Indicated Shippers also assert that retroactive relief has been afforded to correct legal errors where the Commission returns the parties to the position they would have occupied had the legal error not been made¹²² and that when a party has notice that a rate will be challenged, this changes what would be purely retroactive ratemaking into a functionally prospective process by placing the relevant audience on notice at the outset that the rates being promulgated are provisional only and subject to later revision.¹²³ Thus, they assert there is regulatory and statutory authority for refunds

¹¹⁹Indicated Shippers cite the May 31 order at 62,003& n.30.

¹²⁰31 FERC ¶ 61,256 (1985).

¹²¹360 U.S. 378 (1959).

¹²²Indicated Shippers cite, inter alia, Panhandle Eastern Pipeline Co. v. FERC, 907 F.2d 185, 189 (D.C. Cir. 1990); Office of Consumers' Counsel, State of Ohio v. FERC, 826 F.2d 1136, 1139 (D.C. Cir. 1987). They also cite CPUC v. FERC, 143 F.3d 610 (D.C. Cir. 1998) as holding that refunds were proper where an LDC collected illegal access charges from interstate shippers.

¹²³Indicated Shippers cite Natural Gas Clearinghouse v. FERC, 965 F.2d 1066, 1075, citing Columbia Gas Transmission Corp. v. FERC, 895 F.2d 791, 797 (D.C. Cir. 1990), cert. denied, 498 U.S. 907 (1990); Exxon USA Inc. v. FERC, 182 F.3d 30, 54 (D.C.Cir. 1999).

of demand charges paid, and under Niagara Mohawk Power Corp. v. FPC,¹²⁴ the Commission has the discretion to order such refunds.

124. ONEOK recognizes that the Commission has considerable discretion in fashioning remedies.¹²⁵ Nevertheless, ONEOK argues the Commission has an obligation to grant prompt monetary refunds of impermissibly collected tariff amounts.¹²⁶ ONEOK states that the Commission has provided no explanation for its refusal to force El Paso to return to ONEOK the jurisdictional rates it collected for service it did not provide. Further, ONEOK argues that even if the Commission were to determine that the rule against retroactive ratemaking were at issue here, the courts have explained that retroactive effect of Commission's orders is appropriate for new applications of existing law, clarifications, and additions.¹²⁷

125. In addition, ONEOK argues that there are sound policy reasons to make it whole for the demand charges it paid for service it did not receive. ONEOK argues that failure to hold El Paso financially responsible for its failure to provide firm service will indicate that there are no repercussions from ignoring Commission regulations and will encourage future respondents in complaint cases to delay even if their actions are in violation of regulatory requirements because no financial remedy will be required.

126. The requests for rehearing are denied. Contrary to the assertions of these parties, the Commission did not find that El Paso engaged in wrongdoing in implementing pro rata allocations as provided for in the 1996 Settlement. The Commission found that as a consequence of demand growth and other factors and pro rata allocations as provided for in the 1990 and 1996 Settlements, firm service on El Paso had become unreliable contrary to the Commission's regulations governing firm service. Pro rata allocations are part of the 1990 Settlement agreed to by all of El Paso's shippers.

¹²⁴379 F.2d 153, 159 (D.C. Cir. 1998).

¹²⁵ONEOK cites Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153, 159 (D.C. Cir. 1967)(the breadth of Commission discretion is, if anything, at its zenith when fashioning remedies).

¹²⁶Public Utilities Commission of the State of California v. FERC, 143 F.3d 610, 617 (D.C. Cir. 1998); quoting Koch Gateway Pipeline v. FERC, 136 F.3d 810, 816 (D.C. Cir. 1998).

¹²⁷ONEOK cites Williams Natural Gas Co. v. FERC, 3 F.3d 1544, 1554 (D.C. Cir. 1993); Public Service Co. of Colorado v. FERC, 91 F.3d 1478, 1488 (D.C. Cir. 1996).

Application of the provisions of the Settlement regarding pro rata allocations does not constitute an unlawful abandonment of service. The Commission held that the current capacity allocation methodology and services on El Paso's system are unjust and unreasonable and must be changed prospectively. In these circumstances, it would not be reasonable for the Commission to penalize El Paso for implementing the terms of the Settlements agreed to by the CD customers and approved by the Commission.

127. Further, as the parties point out, the Commission stated in the May 31 order that El Paso continued to remarket firm capacity as contracts expired, irrespective of the availability of capacity on its system.¹²⁸ However, again, the remarketing of capacity from expiring contracts was permitted by the 1996 Settlement, and the shippers benefitted from such remarketing through the payment of revenue credits.¹²⁹ Additionally, the Commission approved the resale of this capacity.¹³⁰ As discussed more fully below, the Commission will prospectively permit El Paso to remarket its turnback capacity if it is not needed to meet El Paso's current firm service obligations, but it is not appropriate in these circumstances to direct El Paso to pay refunds to the CD shippers.

128. None of the cases cited by Indicated Shippers or ONEOK supports a different result. The Commission's rejection of a minimum bill is not analogous to service degradation cuts agreed to by the parties to a settlement. The decision in Atlantic Refining Co. v. Public Service Commission of New York finds that refunds are appropriate in the case of initial rates, but it does not address the application of refunds for the implementation of settlement rates and procedures. While the Commission does have the authority to provide refunds to remedy a legal wrong and place parties in the position they would have been in without the error, there is no such showing here. In these circumstances, the Commission has properly acted to remedy prospectively the unjust and unreasonable Settlement allocation methodology on El Paso, but has declined to provide monetary awards.

¹²⁸May 31 order at 62,002-3.

¹²⁹See Section 25.3 of El Paso's GT&C; Article 3.4 of the 1996 Settlement.

¹³⁰The Commission approved the resale of this capacity first to Dynegy (83 FERC ¶ 61,286 (1998), order on rehearing, 88 FERC ¶ 61,139 (1999), order on rehearing, 89 FERC ¶ 61,073 (1999), petitions for review dismissed as moot, Public Utilities Commission of the State of California v. FERC, 236 F.3d 708 (D.C. Cir. 2001)) and then to Enron (90 FERC ¶ 61,050 (2000)) and to El Paso Merchant.

H. Clarification of the Allocation Process

129. The parties also seek rehearing or clarification of the allocation process established by the Commission in the May 31 and September 20 orders. Specifically, the parties have raised issues concerning the amount of capacity allocated to the FR shippers, the inclusion of capacity from the Power-Up Project in the initial allocation, turnback capacity, the prohibition on El Paso reselling expiring contract capacity, the basis for establishing the FR customers' new CD allocations, the Block I and Block II limitations on capacity, demand charge credits, receipt point rights, treatment of basin-specific contracts, and pathing of the El Paso system. These issues are discussed below.

1. Allocation of All Available Capacity to the FR Customers

130. In the May 31 and September 20 orders, the Commission directed El Paso to allocate to its FT-1 FR customers as their new CDs the available system capacity that is not contracted for by the CD shippers or needed to serve FT-2 demand. In its request for rehearing of the September 20 order, El Paso argues that the Commission erred in requiring allocation of all the available capacity, including capacity from the Power-Up Project and capacity from contracts expiring before May 1, 2003, pro rata to the FR shippers instead of setting the FR shippers' new monthly CDs equal to the higher of each FR shipper's actual usage or its billing determinant. El Paso states that as a result, the Commission has given the FR shippers capacity significantly in excess of their current needs. El Paso attached to its request for rehearing a spreadsheet that it contends shows that the total capacity allocated to the FR shippers exceeds the higher of their aggregate billing determinants and/or current average daily usage every month of the year. El Paso states that it has no objection to including growth that has occurred to date in the initial allocation, but asks the Commission to reduce the amount allocated each month to the capacity necessary to meet the current needs of the FR shippers.

131. The FR Shippers filed an answer to El Paso's request for rehearing and clarification. The FR Shippers argue that El Paso has misrepresented the current needs of the FR shippers by defining current demands as average daily usage instead of peak usage. The FR Shippers state that new contract rights for the FR shippers, especially for captive shippers, must be sufficient to meet daily peak demands.

132. The Commission has properly directed El Paso to allocate all of its available capacity to its current customers, including capacity that will become available from the Power-Up Project and from contracts expiring before May 1, 2003. The Commission

clarifies that this ruling does not affect the right of first refusal of the customers with expiring contracts.¹³¹

133. The record is clear that El Paso does not currently have sufficient capacity to meet the peak needs of its firm customers. During the peak winter conditions of 2000-2001, El Paso was unable to meet the peak needs of its firm customers and routinely implemented pro rata capacity allocations. The FR load has continued to increase to meet the temperature sensitive residential and electric generation needs of the Southwest.¹³² The Commission was persuaded that El Paso should allocate the full available capacity to the converting FR shippers to ensure that this currently captive market has adequate capacity during its transition to contract demand service. Allocating the full amount of available capacity, after serving the existing FT-2 and CD shippers, is appropriate to ensure that El Paso can meet the peak firm requirements of its customers and is necessary to restore reliable firm service on El Paso.

134. In its December 3, 2002, filing to implement the allocation of capacity to the FR shippers, El Paso has used average daily usage data for each month of the 12-month period to determine each shipper's pro rata share of El Paso's existing capacity. The 12-month data were not intended to be used as the actual CDs for the converting FR shippers. El Paso has appropriately used the 12-month data as a starting point to develop a formula to determine each shipper's relative share of available capacity. The 12-month data are not indicative of the peak needs of the FR shippers, but are used to develop the FR shippers' pro rata share of the capacity. Thus, as we explain in our order on El Paso's December 3 filing, El Paso's approach to determining the initial allocation amounts is appropriate because it uses the recent 12-month actual data to determine each shipper's relative share and fully allocates the available capacity using those pro rata shares. It is anticipated that the initial allocation for each converting FR shipper will approach its peak needs.¹³³

¹³¹ The FR Shippers have sought clarification as to how capacity from expiring contracts will be allocated in the conversion process. Details of the conversion process are discussed in the order on El Paso's December 3, 2002 report and compliance filing in Docket No. RP00-336-010.

¹³²The various studies provided by El Paso in its data responses in this proceeding document projected FR shipper demand growth.

¹³³However, to the extent there is a shortfall, those shippers will have a variety of options to supplement their capacity, such as turn back capacity, capacity release, and

(continued...)

135. El Paso is incorrect, however, in concluding that the initial allocation amounts cannot or should not exceed the higher of the 12-month average usage or the billing determinants. The peak needs of the FR shippers by definition will be higher than their average daily usage. Permitting El Paso to use average usage to represent FR shippers' needs could lead to its continuing use of pro rata capacity allocation in non-force majeure situations. Through its orders in this and the Power-Up Project, the Commission is attempting to ensure that El Paso has sufficient capacity to fully serve its firm service obligations (including its management of transients).¹³⁴

136. For these reasons, we find that the allocation methodology set forth by the Commission in the May 31 and September 20 orders will not result in El Paso allocating too much capacity to the FR Shippers. It is reasonable to use the 12-month average daily usage as a starting point to derive the pro rata allocation but it is not appropriate to limit the converting FR Shippers' CDs to their average usage levels.

137. In addition, El Paso argues that the Commission erred by including in the initial allocation capacity from contracts expiring before May 1, 2003. El Paso argues that this requirement would have a significant impact on its revenue stream and would be inconsistent with the Commission's statement that El Paso would remain revenue neutral in the process adopted by the Commission.¹³⁵ El Paso states that the impact of this requirement on El Paso would be a loss of \$28 million in yearly revenues based on the assumption that El Paso could remarket this capacity at the maximum rate.

138. Under the May 31 and September 20 orders, the Commission is eliminating FR service and replacing it with CD service. This firm service is service that is not subject to pro rata reduction except in force majeure situations. The Commission required El Paso to include in the initial allocation to the FR customers, capacity that becomes available from contracts expiring between May 31, 2002 and May 1, 2003, based on the new firm service obligations that El Paso must meet.

¹³³(...continued)
service from competing pipelines, as those projects develop.

¹³⁴As is discussed below, El Paso may not contract on the basis of pipeline design capacity and then not allow shippers to schedule a portion of that capacity because of system transient management requirements.

¹³⁵El Paso cites the September 20 order at P33.

139. The portion of the September 20 order cited by El Paso merely explained that El Paso would be revenue neutral if the Commission decided to reallocate costs among the FR Shippers.¹³⁶ This was simply an explanation of the effect of one aspect of the prior order that has been changed here on rehearing. It was not a total revenue requirement guarantee to El Paso. The 1996 Settlement also did not include a revenue requirement guarantee. El Paso Pipeline has an opportunity, however, to achieve its revenue requirement through reduced costs, additional interruptible sales, enhanced or new services, or, once the reallocation of capacity to FR customers under CD contracts is completed, by marketing unsubscribed firm transmission capacity (except for the capacity reserved in the pool for FR shippers pending completion of the Power-Up Project) as firm CD with standard reservation charges.

140. The CPUC also argues that the capacity made available from expiring contracts with California delivery points must not be included in the initial conversions of the FR customers, and that this would constitute an unlawful abandonment of service. The CPUC argues that the fact that a contract has expired does not relieve El Paso of its certificated obligation to serve California.

141. Nothing in the NGA or in El Paso's contracts with its shippers establishes a "certificated obligation to serve California." When the contract of a firm shipper expires and that shipper does not exercise a right of first refusal, the contract is subject to automatic abandonment.¹³⁷ Thus, if a California shipper chooses not to exercise its right of first refusal for a contract expiring before May 1, 2003, the contract is abandoned and the capacity is available for other shippers. The capacity is not reserved for use by any California customer.

142. SoCalGas argues that the Commission erred in failing to consider the loss of risk-sharing credits under the 1996 Settlement for the capacity being included in the initial allocation to the FR customers. SoCalGas states that because El Paso will no longer be able to resell this capacity, parties to the 1996 Settlement will lose the opportunity to receive risk sharing credits from sales of this capacity. SoCalGas argues that El Paso's shippers should not lose their opportunity to receive risk sharing revenues under the 1996 Settlement to make up for El Paso's overselling of its system and its inability to provide the firm service it has contracted to provide. SoCalGas asks the Commission to keep its

¹³⁶As discussed above, the Commission has reversed this ruling on rehearing and has concluded that reallocation of costs among the FR shippers is not necessary to restore reliable firm service on El Paso.

¹³⁷18 C.F.R. § 284.221(d) (2003).

CD shippers whole for the risk sharing credits for this capacity, using the maximum rate charges for deliveries to the California border.

143. SoCalGas's request is denied. The CD Shippers are not entitled to risk sharing dollars in all circumstances, but receive them if El Paso resells the capacity under expiring contracts. As we have explained above, the capacity from expiring contracts is not available for sale on a firm service basis because that capacity is needed to serve El Paso's current firm service obligation. Because El Paso will not resell the capacity from the expiring contracts on a firm service basis, the risk-sharing credits will not apply to this capacity.

144. Panda Gila asks the Commission to clarify that its ruling that capacity from contracts expiring between May 31, 2002 and May 1, 2003 must be included in the initial allocation to the FR shippers does not abrogate contracts that Panda Gila entered in November 2000 for service commencing August 1, 2002. The Commission clarifies that the capacity under contract to Panda Gila did not become available during the relevant period, and the Commission's decision does not abrogate those contracts.

2. Inclusion of Power-Up Project Capacity in the Initial Allocation

145. In the May 31 and September 20 orders, the Commission directed El Paso to include the 320 MMcf/d of Power-Up Project capacity in the amount of capacity to be allocated to the FR shippers as their initial CD allocations.¹³⁸ In the September 20 order, the Commission stated that the capacity additions associated with the Power-Up Project should be in service by May 2003, and, therefore, the starting point in the initial allocation process should be the 5,400 MMcf/d that El Paso has stated would be available with the Power-Up Project capacity.¹³⁹ El Paso, Indicated Shippers, SoCalGas, and Kern River argue that inclusion of the Power-Up Project capacity in the initial allocation to FR shippers is inconsistent with the Commission's pricing policy and does not recognize the actual in-service dates of this project. APS/Pinnacle, on the other hand, argues that the Commission erred by not conditioning the conversion of the FR contracts on the availability of Power-Up capacity. Similarly, the FR shippers argue that

¹³⁸The Commission stated that El Paso had stated that it would be able to deliver 5,400,000 Mcf/d with the capacity to be provided by the proposed Power-Up Project on a peak day. May 31 order at 62,010. The Commission also clarified that El Paso's statement that there is 4,300,000 Mcf/d of available sustained west-flow capacity is consistent with the data in the record. September 20 order at P23.

¹³⁹September 20 order at P23.

these volumes must be included even if the Power-Up Project is not in service at the time of the conversion.

a. Issues Resolved in the Certificate Proceeding

146. The requests for rehearing raise issues concerning whether construction of the Power-Up Project is consistent with the requirements of the Commission's Pricing Policy Statement¹⁴⁰ that there must be a demonstrated need for the new capacity and that the project can proceed without subsidies from existing customers. Also, the parties ask the Commission to clarify that alternatives to the Power-Up Project may be considered. El Paso asks the Commission to clarify that it will be given the opportunity to recover the costs of the Power-Up Project in its next rate case.

147. Since the filing of these requests for rehearing, the Commission has issued a certificate authorizing the construction of the Power-Up Project.¹⁴¹ The issues raised in the instant rehearing concerning the need for the project¹⁴² and its consistency with the Pricing Policy Statement, including issues of subsidization,¹⁴³ alternatives,¹⁴⁴ and cost

¹⁴⁰Certification of New Interstate Natural Gas Pipeline Facilities (Policy Statement), 88 FERC ¶ 61,227 (1999); order clarifying statement of policy, 90 FERC ¶ 61,128 (2000); order further clarifying statement of policy, 92 FERC ¶ 61,094 (2000).

¹⁴¹El Paso Natural Gas Co., 103 FERC ¶ 61,280 (2002).

¹⁴²We recognize that the Commission's finding in the certificate proceeding that there is a need for the capacity to be provided by the Power-Up Project is based on the Commission's conclusion in this proceeding that El Paso lacks sufficient capacity to serve the needs of its current customers, and the two proceedings are therefore interrelated. This order affirms the Commission's conclusion that El Paso lacks sufficient capacity to meet the needs of its current shippers and that the 5.4 Bcf of capacity, including the capacity to be provided by the Power-Up Project, is needed to satisfy the entitlements of the current customers. Therefore, the basis for the finding in the certificate proceeding that the capacity to be provided by the Power-Up Project to serve El Paso's existing customers is affirmed here.

¹⁴³The order issuing the certificate found that because the Power-Up Project will benefit all of El Paso's existing customers, El Paso met the "no subsidization" requirement of the Pricing Policy Statement. 103 FERC 61,280 at P20-26.

¹⁴⁴The order issuing the certificate for the Power-Up Project found that there were
(continued...)

recovery¹⁴⁵ have been appropriately resolved in the certificate proceeding and will not be revisited here. Issues concerning the allocation of the Power-Up Project capacity, however, are appropriately addressed in this proceeding and are discussed below.

b. Capacity Rationalization

148. El Paso, Indicated Shippers, and the FR Shippers argue that the Commission should rationalize capacity on El Paso through capacity turnback before allocating the Power-Up Project capacity. El Paso asserts that including the Power-Up Project in the initial allocation phase removes any incentive for the FR Shippers to purchase additional turnback capacity that they might need because they receive far more capacity in the initial allocation than their current needs. El Paso refers to the spreadsheet attached to its request for rehearing that shows that even after removal of the Power-Up Project capacity from the initial allocation process there will still be enough capacity to serve the current needs/billing determinants of the FR shippers, and, therefore, removal of the Line 2000 Power-Up Project capacity from the initial allocation on rehearing would not frustrate the basic goals the September 20 order sought to achieve. However, as discussed above, El Paso should allocate all available capacity, not just the capacity necessary to meet billing determinants. Indicated Shippers argue that FR Shippers should contract for turnback capacity before the Power-Up Project capacity is allocated. FR Shippers, on the other hand, state that if turnback capacity can be used as a substitute for the Power-Up Project, then El Paso should propose to purchase turnback capacity for use in the initial allocation without additional cost to converting FR shippers until the next rate case.

149. El Paso has committed to build the Power-Up Project to serve the needs of its existing customers, and the Commission has found that the capacity from the Power-Up Project is necessary to enable El Paso to meet these needs. Therefore, it is appropriate to allocate all of this capacity before the converting customers purchase additional capacity to meet their needs, and in so doing, relieve the shippers turning back capacity of their contract demand charge obligations.

¹⁴⁴(...continued)

no reasonable alternatives to the Power-Up Project. Id. at P34-36.

¹⁴⁵The certificate order concluded that, absent changed circumstances, El Paso may roll-in the costs of the Power-Up Project in its next rate case. Id. at P41-45.

c. In-Service Date

150. The September 20 order states that the Power-Up Project should be in service Summer 2003. However, on rehearing, El Paso states that the projected in-service dates for the three phases of the project are February 2004 (120 MMcf/d), April 2004 (100 MMcf/d), and April 2005 (100 MMcf/d).

151. El Paso and Indicated Shippers argue that the Commission should not require El Paso to allocate firm capacity rights when the capacity associated with those rights is not yet in service. Indicated Shippers assert that allocating Power-Up Project capacity to FR shippers that will not be available until 2004 will exacerbate capacity cuts among the firm shippers in the interim, in violation of the goals of the May 31 order.

152. At the time of the September 20 order, the Commission understood that the Power-Up Project capacity would be available by May 1, 2003. The Commission concluded that El Paso must provide 5.4 Bcf/d of capacity to meet the needs of its existing customers, and therefore El Paso must include the 320 MMcf/d associated with the Power-Up Project in the initial allocation to the FR shippers. However, it is now clear that the Power-Up Project capacity will not be available on the date of the conversion of the FR contracts to CD contracts. The Commission believes that until the Power-Up Project is operational, it is necessary for El Paso to hold in reserve additional replacement capacity available to the converting FR shippers as a safety net to ensure El Paso can meet its service obligations.

153. During the turnback process, current CD shippers offered for turnback approximately 521 MMcf/d that continues to remain available. El Paso is directed to accept from that turnback capacity 110 MMcf/d and place that capacity in a converting FR shipper capacity pool. The 110 MMcf/d is equal to one half of the capacity that will be added by the first two phases of the Power-Up Project. The capacity in this pool must be held in reserve to serve the converting FR shippers. El Paso may sell this capacity as interruptible service, but it must be recallable to meet the converting FR shippers' demand. As the additional capacity from the Power-Up Project comes on line, El Paso may remarket portions of the capacity in the converting FR capacity pool. Thus, when the first phase of the Power-Up Project comes on line in 2004, El Paso may remarket 60 MMcf/d of the capacity in the pool, and may remarket the remaining 50 MMcf/d when Phase II of the Project is built, and it commits to completing Phase III of the Power-Up Project.

154. The Commission finds that the establishment of this capacity pool for the converting FR shippers is appropriate to ensure that the firm service that the converting

FR shippers receive under their new CDs will be reliable firm service. Prior to the conversion of the FR contracts to CD contracts, the quantity of capacity that El Paso was obligated to provide to its firm shippers was unclear because there was no limit on the FR demand. With conversion of the FR contracts to CD contracts, El Paso knows the amount of capacity that is committed to its firm shippers and must structure its operations to meet that firm demand. In order to ensure that El Paso can meet the FR shippers' new CDs pending completion of the Power-Up Project, El Paso must reserve capacity in the FR capacity pool.

155. Contrary to Indicated Shippers' assertion, the CD shippers will not be in the same position as they are today with regard to pro rata allocations. After September 1, 2003, the FR shippers will have discrete contract demands and specific receipt point and delivery point rights. The total firm CDs will correspond to the existing system capacity. As a result, the CD shippers will be in a better position than they are today.

3. Turnback Process

156. In the May 31 order, the Commission directed El Paso to initiate a capacity rationalization process in which current shippers could turn back unneeded capacity and converting FR shippers could purchase that capacity to augment their initial allocations. El Paso has provided two opportunities for the FR customers to purchase turnback capacity. Only one shipper bid in either of the turnback opportunities.¹⁴⁶

157. Several parties have raised concerns about the turnback process. For example, the CPUC and some of the California shippers argue that capacity turnback should not be made available only to the FR shippers, but should be available to the California shippers as well. In addition, the CPUC, PG&E, SoCalEdison, and SoCalGen argue that making capacity certificated to California available to the FR shippers constitutes an unlawful abandonment of service. However, as discussed above, the time provided by the Commission for the FR shippers to bid for the turned-back capacity has passed. Several

¹⁴⁶MGI bid for and was awarded 14,663 Mcf/d. Because the opportunity to acquire turnback capacity occurred before the FR shippers received their initial allocation, the Commission directed in the September 20 order that El Paso provide a second opportunity for FR shippers to acquire turned back capacity. Specifically, the Commission directed El Paso to complete the initial allocation to the FR customers by October 15, 2002 and to accept bids for turnback capacity through October 31, 2002. No FR customer submitted a bid for the turned back capacity during this second opportunity.

California shippers bid on and were awarded turnback capacity,¹⁴⁷ and only one FR shipper signed up for any of the capacity. The issues raised by the California shippers, therefore, have become moot.

158. To the extent that turnback capacity may be available in the future, purchase of that capacity by or on behalf of former FR shippers, is not an unlawful abandonment of service to California. A pipeline's service obligation is defined by, among other things, its contracts with its shippers. As contracts are amended or terminated over time, the pipeline's service obligation changes accordingly. For example, when the California LDCs turned back capacity to El Paso prior to the 1996 Settlement, new shippers acquired some of that capacity. When the contracts shifted from the California LDCs to an EOC shipper, an abandonment of the service obligation to the California point was implemented automatically. Similarly, here, when capacity turned back by California shippers is acquired by east of California customers, the service obligation to the former customer is automatically abandoned.¹⁴⁸ Nothing in the NGA or in El Paso's contracts with its shippers establishes a "certificated obligation to serve California," and it is not an unlawful abandonment of service for a customer east of California to acquire turnback or expired contract capacity from a California shipper.

4. Prohibition Against El Paso Reselling Capacity

159. In the May 31 order, the Commission held that El Paso must reasonably ensure the quality of firm service on its system. Therefore, the Commission stated that El Paso may not enter into new firm service contracts unless it can demonstrate that it has available capacity to provide the service. Further, the Commission stated that during the pendency of the Settlement, El Paso must first offer existing capacity that becomes available to its firm shippers.

160. El Paso seeks rehearing of this ruling to the extent that the Commission intends the restriction to extend beyond the end of the capacity rationalization process. El Paso asserts that the 1996 Settlement not only permits it to remarket the 1.6 Bcf/d of capacity turned back by shippers, but requires it to do so and to share the revenues received from

¹⁴⁷Five California utilities bid on and were awarded 206,145 Mcf/d at various California receipt points. September 3, 2002 Report of El Paso Pipeline Co. in Compliance with May 31, 2002 Order at 4.

¹⁴⁸18 C.F.R. § 284.221(d) (2003).

the resales with its firm shippers.¹⁴⁹ On the other hand, SoCalGas states that during the pendency of the settlement, El Paso should be prohibited from offering for sale any additional capacity that is not derived from new construction.

161. The requests for rehearing are denied. The Commission has not prohibited El Paso from reselling capacity,¹⁵⁰ but has required that El Paso show that resales of existing capacity will not degrade service to its existing firm customers. El Paso cannot sell as firm service, capacity for which there is a prior commitment; this includes capacity reserved to manage transients.¹⁵¹ The sale, on a firm service basis, of capacity that is required to serve firm shippers under their current contracts or needed for system purposes would violate the Commission's regulations¹⁵² and El Paso's current contracts. Except as discussed above regarding the capacity pool for converting FR shippers, El Paso may remarket its turnback capacity, if that capacity is not needed to serve current firm service obligations. Further, given the Commission's remedy in this proceeding, *i.e.*, conversion of FR contracts to CD service, allocation of primary receipt point capacity and the authorization to construct and operate sufficient capacity to meet its customers' firm service needs, El Paso will no longer be permitted to allocate or curtail firm service, except for force majeure and required maintenance. We clarify that this restriction on the sale of capacity is not a prohibition against all sales not related to new construction, but is appropriate and will protect the quality and quantity of service to El Paso's current firm shippers. Further, El Paso must revise its tariff consistent with this discussion.

5. Using the Last 12 Months as the Basis for Conversions

162. In the September 20 order, the Commission directed El Paso to apportion the available capacity on its system to the FR shippers using the individual shipper's monthly demand over the twelve months ending August 31, 2002, to determine each shipper's pro rata share of monthly capacity. The Commission stated that this would reflect each shipper's current use of the system.

¹⁴⁹El Paso cites its tariff, (Item A by reference), Sheet Nos. 218 and 219.

¹⁵⁰The only exception to this is with regard to the FR capacity pool. The prohibition on the FR capacity pool is to be phased out as the Power-Up Project comes on line.

¹⁵¹As discussed above, we have concluded that 210 MMcf/d is a reasonable amount for El Paso to reserve for management of transients.

¹⁵²18 C.F.R. § 284.7(a)(3) (2003).

163. BHP Copper (BHP) and Phelps Dodge argue that this methodology is unjust and unreasonable and arbitrary and capricious because it does not use data reflecting their demonstrated needs. Both these parties are engaged in copper mining and smelting, and state that because of economic conditions, their operations have been temporarily suspended, and, therefore, this 12-month period is not representative of their use of the system.¹⁵³ In addition, they argue that the method is unduly preferential and discriminatory because it allows the new CD entitlements of other FR shippers to be established by reference to their needs based on actual usage, but fails to take into account the particular circumstances of industrial gas users for whom the test period was unrepresentative of actual and historic needs.

164. Similarly, APS/Pinnacle argues that because the conversion process will be based on current demands, the Commission has made no provision to serve the needs of the Redhawk Power Plant which has been under construction since 1999, but would not come on line until 2002. They argue that denying capacity for Redhawk based solely on its start-up date is unduly discriminatory.¹⁵⁴ APS/Pinnacle argues that it justifiably relied on its TSA and the 1996 Settlement in expending resources on the Redhawk Power Plant, and that in not recognizing the demands of the Redhawk Power Plant in the conversion process, the Commission unlawfully discriminated among similarly situated shippers that were signatories to the 1996 Settlement.

165. The requests for rehearing are denied. 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. BHP Copper and Phelps Dodge will receive capacity at least equal to their billing determinants as their

¹⁵³BHP's suspension of operations, while stated to be temporary, has extended over three years to date. BHP will continue to be able to release the unneeded portion of its new CD until such time as its operations are resumed.

¹⁵⁴On the other hand, Panda Gila is concerned that volumes from Pinnacle's Redhawk facility may be included in the allocation to APS. As reflected in APS/Pinnacle's argument, the Redhawk facility was not fully operational during the relevant period for determining allocations, and had little impact on the allocation to APS.

new CDs.¹⁵⁵ The Commission has made additional capacity on El Paso available to the converting FR shippers, and these shippers will be able to obtain additional service at just and reasonable rates. In these circumstances, the Commission concludes that the converting FR shippers will be able to meet their native load demands with the capacity that has been allocated to them under their new CD contracts.

166. APS/Pinnacle had no reasonable basis on which to assume a prior Commission commitment for service to the Redhawk plant. The Commission did not issue a certificate to El Paso authorizing construction or service to Pinnacle's Redhawk facility. El Paso withdrew its prior notice filing to construct and operate delivery point facilities and lateral pipeline facilities to provide service to the Redhawk plant, and stated that it would construct the project under the automatic authority provided by its Section 157 blanket construction certificate.¹⁵⁶ In accepting El Paso's withdrawal of its prior notice filing, the Commission specifically stated that its order did not address service under the contract.¹⁵⁷ Therefore, the Commission's order did not address El Paso's service obligation to serve the Redhawk facility, did not address whether El Paso had sufficient capacity to serve Redhawk nor indicate from where the gas would be obtained to serve the facility.

167. APS/Pinnacle is being treated in the same manner as all other FR shippers with regard to its future growth. If APS/Pinnacle requires additional capacity to serve future growth beyond its allocation in this proceeding, it must purchase that capacity from El Paso or another pipeline. This will assure that there will be the proper economic incentives for expansion of the infrastructure.

6. Block I and Block II Capacity Limitations

a. Usefulness of Capacity with Block I and II Restrictions

168. In the September 20 order, the Commission stated that nothing in the May 31 order changed the 1996 Settlement with regard to any limitations on Block I and Block II

¹⁵⁵See Appendix B. All converting FR shippers are being allocated capacity amounts that are equal to or in excess of their 2001 non-coincident peak demands.

¹⁵⁶El Paso Natural Gas Co., 95 FERC ¶ 61,461 (2001), reh'g denied, 96 FERC 61,343 (2001).

¹⁵⁷95 FERC at 62,664.

capacity.¹⁵⁸ The Commission stated that because this capacity is under contract to CD shippers, none of it will be allocated in the initial step of the allocation process, but could be made available during the capacity turnback process. Therefore, the Commission stated, the FR shippers would have the option of determining whether to supplement their initial allocation by purchasing additional capacity with these limitations.

169. In its request for rehearing and clarification of the September 20 order, El Paso states that the Commission misunderstands the contract status of some of the Block I and Block II capacity. El Paso states that substantial volumes of Block II and some Block I capacity will be included in the initial allocation because all of the capacity received back from Enron is Block II, as is all the capacity under contracts that will expire prior to May 1, 2003. In addition, El Paso states that there is 6,450 Mcf/d of Block I capacity included in the initial allocation. El Paso asks whether, in light of this factual misunderstanding, the Commission now wants this capacity to be included in the initial allocation. If it does not, El Paso seeks clarification that it can resell the capacity in the open market, subject to the FR shippers' preferential right to acquire it.

170. The FR Shippers argue that it is not appropriate for El Paso to include Block II capacity in the initial allocation because it will not be usable unless the Commission removes the restrictions. They assert that they cannot rely on secondary or recallable capacity that is less firm than firm, primary point capacity or is interruptible because other shippers have recall rights. Similarly, the FR Shippers object to retaining the Block I and Block II restrictions on turnback capacity available for purchase. They state that the availability of turnback capacity to meet the needs of the FR customers is a vital component of the reallocation plan and provides support for the Commission's conclusion that FR shippers could convert to CDs and continue to meet their current needs. They assert that the Commission has failed to explain how the FR shippers can meet their load requirements with an option for what in reality would be only interruptible service.

¹⁵⁸The 1996 Settlement divides turned back capacity into three blocks: Block I capacity has alternate receipt point rights unless the capacity is sold for maximum tariff rates and, in that event, it has primary receipt point rights only to the Permian and Anadarko Basins, but not to the San Juan Basin. Block II capacity is a block of 614 MMcf/d of turned back capacity designated for primary point deliveries to Topock for PG&E or other shipper(s) serving a market in PG&E's service territory (collectively Block II shippers), and has primary access rights to all system receipt points; the Block II shippers have recall rights. Block III has primary access rights to all receipt points.

171. The Commission affirms that it is appropriate for El Paso to include capacity with Block I and Block II limitations in the initial allocation to the FR shippers. This capacity is not interruptible service capacity. It is firm service capacity and is scheduled as firm service capacity. The recall rights on this capacity are limited.¹⁵⁹ In addition, the Block restrictions will terminate with the 1996 Settlement in 2005, so the restrictions will apply for a limited period. There is a finite amount of capacity on El Paso to be allocated among the converting FR shippers, and removing the capacity with Block restrictions would merely reduce the total capacity that can be allocated to the FR customers. Providing the converting FR shippers with new CDs that include capacity with Block restrictions provides these shippers with a higher CD level than they otherwise would have been able to receive. In any event, as explained above, the actions taken by the Commission in this proceeding to make all of El Paso's capacity, after reserving capacity under contract to the CD and FT-2 shippers, including the capacity that will be provided by the Power-Up Project, available to the FR shippers will minimize any potential harm to FR shippers from the continuation of these limitations on the capacity through the end of the 1996 Settlement.

b. Settlement Modification

172. El Paso asserts that it is not appropriate to remove the restrictions from this capacity until the 1996 Settlement has expired. The FR Shippers, on the other hand, argue that the Commission's decision to retain the Block I and Block II service limitations is another example of the Commission upholding portions of the 1996 Settlement that prejudice their interests and invalidating the protections in the Settlement applicable to them. To validate this discrimination, the FR Shippers assert, the Commission should have found that the Block I and II restrictions are in the public interest, and erred because it did not affirmatively make this finding.

173. In resolving the capacity allocation problems on El Paso, the Commission has attempted to retain the bargains in the 1996 Settlement to the greatest extent possible, and has modified only those portions that clearly have become unjust and unreasonable and no longer in the public interest. This is consistent with the Commission's policy on settlements and with the Mobile-Sierra Doctrine discussed above. The Commission has explained the reasons for its conclusion that continued growth under the FR contracts is

¹⁵⁹A Block II Shipper may recall the Block II capacity when it is not being used to serve northern California markets if the Block II Shippers requesting the recall at least match the rate in the contract covering the capacity to be recalled and subscribe to the capacity for a term of longer than one month; if the Block II Shipper seeks to recall the capacity for a term of less than one month, it must agree to pay the maximum rate.

no longer just and reasonable and modification is compelled by the public interest. Contrary to the FR Shippers' assertion, the Commission is not required to make an affirmative finding that Block I and Block II restrictions are in the public interest in order to allow those provisions of the Settlement to remain in effect. Instead, the Commission would have to conclude that those provisions are not in the public interest to support a finding that the restrictions should be removed.

174. Under the terms of the 1996 Settlement, PG&E agreed to pay an exit fee of \$58.4 million in connection with its turning back the Block II capacity. In return for this payment, PG&E retained the right to recall the capacity in certain circumstances to serve northern California markets. The Commission will not remove the recall rights associated with this capacity for which PG&E has already paid. There is no factual basis for concluding that this part of the earlier bargain produces unjust and unreasonable results.

175. The FR Shippers state that while the Commission clarified that the May 31 order did not alter the 1996 Settlement limitations on Block I and Block II capacity, it did not address the status of expiring capacity contracts formerly subject to Block II restrictions. The FR Shippers ask the Commission to clarify that the Block I and Block II rights are extinguished when the underlying contract expires. The Commission clarifies that the Block I and Block II restrictions remain on this capacity through the end of the Settlement, not merely through the term of existing contracts for that capacity. As explained above, the Commission will not modify the Settlement to eliminate the Block I and Block II restrictions, and the FR Shippers' request for clarification is denied.

7. Demand Charge Credits

176. In the May 31 order the Commission held that after conversion of the FR contracts to CD contracts, El Paso must pay its firm shippers demand charge credits whenever it is unable to deliver those shippers' nominated volumes for reasons other than force majeure. In the September 20 order the Commission extended the date for conversion of the FR contracts from November 1, 2002 to May 1, 2003, and on April 24, 2003, the Commission further extended the conversion date until September 1, 2003. In order to mitigate any hardship that this postponement of the effective date might cause for the CD shippers, the Commission directed El Paso to pay partial demand charge credits to its CD customers during the interim period from November 1, 2002 to May 1, 2003 whenever El Paso is unable to deliver at least 95 percent of the CD shipper's nominated quantity out of any basin for reasons other than force majeure. The Commission stated that the pro rata allocations of firm service are not the fault of either El Paso or the CD shippers, and that partial demand charge credits during this period will appropriately balance the

risk of non-delivery between El Paso and its shippers. The Commission explained that because the partial demand charge credit will consist only of the return on equity and income tax portion of the demand charge, El Paso will collect the costs associated with the service, but the CD shippers will not be required to provide El Paso with a profit on service that is subject to pro rata allocation.

177. The Commission further held that demand charge credits should be paid for volumes nominated but not scheduled in Cycles 2 and 3 of the nomination scheduling cycles, but not for Cycles 1 or 4. Finally, the Commission held that, for both the interim period and after the conversion date, demand charge credits would not be required where the non-delivery was due to force majeure. El Paso, Indicated Shippers, the CPUC, ONEOK, and SoCalEdison seek rehearing and clarification of the Commission's rulings on these issues.

a. Partial vs. Full Demand Charge Credits During the Interim Period

178. The CPUC, Indicated Shippers, ONEOK, PG&E, and SoCalEdison argue that the Commission erred in ordering partial rather than full demand charge credits during the interim period. Indicated Shippers assert that this is unfair to the CD shippers because CD shippers will continue to pay most of the costs associated with their firm service that cannot be scheduled by El Paso. Indicated Shippers argue that this is not an appropriate balancing of interests because the CD shippers continue to be harmed while the status quo is maintained for all other shippers and El Paso continues to collect costs for service it does not provide. These parties argue that an equitable solution would require full demand charge credits during this interim period and prospectively.

179. In addition, the CPUC, PG&E, and SoCalEdison dispute the premise of the Commission's ruling, *i.e.*, that the pro rata allocations are no-fault occurrences. The CPUC argues that El Paso's failure to meet its certificated capacity requirements to California cannot be excused on the basis that El Paso was following the procedures in the 1996 Settlement. The CPUC asserts that El Paso is at fault for meeting FR shippers' requests for capacity well in excess of their billing determinants and that the FR shippers are responsible for the additional costs imposed on El Paso due to the expansion of FR usage above their billing determinants and by their failure to pay amounts commensurate with the service they were receiving. SoCalEdison alleges that El Paso oversold its system and withheld capacity and is therefore responsible for the problems on its system and for the pro rata curtailments. Similarly, PG&E refers to the initial decisions in the Docket No. RP00-241-000 proceeding and states that the pro rata allocations are not no-fault occurrences because El Paso withheld capacity.

180. All of the parties to this proceeding have interests that must be balanced by the Commission in restoring reliable firm service to the El Paso system, *i.e.*, El Paso's interest in having an opportunity to recover its cost of service, the FR customers' interest in having sufficient time to make adjustments in preparation for conversion of their contracts, and the CD shippers' interest in receiving their firm service. The Commission will not protect any one group of shippers from the consequences of the bargain that it made when it agreed to the 1996 Settlement at the expense of the pipeline or other shippers.

181. If full demand charge credits were required during the interim period before conversion of the FR contracts, El Paso might not be able to recover the portion of its cost of service that is allocated to the CD shippers. El Paso's fixed costs are allocated to the demand charge portions of its SFV rate, and a portion of these costs is allocated to the CD shippers. If El Paso is not able to recover the portion of its cost of service contained in the CD customers' demand charge, it may not be able to recover its fixed costs.¹⁶⁰ This is not an equitable result for the interim period prior to the conversion of the FR contracts. During this period, the current Settlement allocation methodology, including the provisions for pro rata allocation, will remain in effect. Because the pro rata allocation procedures were implemented by settlements between El Paso and its customers and the states, it would be inequitable to place the entire burden of the allocations on El Paso at least until the system is rationalized. The Commission affirms that partial demand charge credits that will allow El Paso to recover the costs associated with the service, but will not require the CD shippers to provide El Paso with a profit on service that it is unable to provide is an equitable balancing of the interests during the interim period, which extends until the conversion date of September 1, 2003. After the date of conversion, the provisions of the Settlements and Tariff for pro rata allocation will not longer be in effect, and El Paso must meet its obligations under its CD contracts

¹⁶⁰SoCalEdison states there is no reasonable way to determine what El Paso's cost of service is because El Paso's rates were established by the Settlement negotiated over seven years ago, and since then, everything on its system has changed, including pipeline costs, entitlements, service mix, and facilities. In the September 20 order, the Commission directed El Paso to compute the portion of the demand charge that represents its cost of service. El Paso made its compliance filing in response to the September 20 order on October 7, 2002, which the Commission accepted subject to conditions (101 FERC ¶ 61,379 (2002)). The appropriate computation of the partial demand charge credit and other details concerning the implementation of the demand charge credit are at issue in El Paso's compliance filing and will be addressed in that order.

to schedule nominated quantities up to the shipper's CD amount. Therefore, after conversion, El Paso will be responsible for full demand charge credits when it fails to deliver nominated volumes.

182. Contrary to the allegation of the CPUC, El Paso was and is obligated to provide service to the FR shippers up to their full requirements, irrespective of whether those requirements exceed the 1996 Settlement billing determinant levels. The 1996 Settlement billing determinants are not limitations on service, and El Paso would have been in violation of the 1996 Settlement and its tariff if it had refused to provide the FR shippers their nominations. The 1996 Settlement and tariff provide that service to full requirements customers will be scheduled before service to CD customers. The pro rata reductions in firm service nominations were part of the 1996 Settlement agreed to by El Paso and all of its shippers, including the Indicated Shippers and the other CD customers. The Commission approved that settlement as well as El Paso's remarketing of the relinquished Block I, II, and III capacity to Dynegy and Enron. The Commission's actions here and in the Power-Up Project proceeding are intended to restore reliable firm service on the El Paso system.

b. Threshold Percent of Capacity Scheduled During the Interim Period

183. Indicated Shippers argue that the Commission erred in providing that demand charge credits are applicable during the interim period when 95 percent, rather than 100 percent, of the capacity is not scheduled. Indicated Shippers state that there is no rationale given for this ruling, and that demand charge credits should be provided when 100 percent of the capacity is not scheduled during a month.

184. The Commission will grant Indicated Shippers' request for rehearing. The Commission agrees that in these circumstances it is an equitable balancing of the risks to require El Paso to pay partial demand charge credits when it is unable to deliver 100 percent of a CD shipper's nominated volumes. The Commission is requiring only partial demand charge credits equal to El Paso's return on equity and the income tax associated with it that are included in the demand charge. This allows El Paso to recover its costs associated with the service, but will not require the CD shippers to provide El Paso with a profit on service it does not provide. The Commission concludes that it is not appropriate for the CD shippers to be required to provide El Paso with a profit on any portion of the service that is not scheduled due to pro rata allocations. Requiring El Paso to provide partial demand charge credits when 100 percent of nominated volumes are not delivered also resolves PG&E's concern that demand charge credits should be determined on a daily rather than a monthly basis.

c. Force Majeure

185. Indicated Shippers also argue that the Commission erred in allowing a waiver of demand charge credits during periods of force majeure. Indicated Shippers argue that it is unjustified under the consumer protection precepts of the NGA to keep the regulated utility whole at the cost of its customers during a force majeure event. They assert that force majeure is not the fault of the shippers, and that it is unfair to place the burden of these events on them. Indicated Shippers argue that the Commission has rejected a force majeure exception to demand charge credits in other cases¹⁶¹ and should do so here.

186. The Commission will grant Indicated Shippers' request for rehearing and direct El Paso to modify its tariff to provide for a partial demand charge credit equal to the return on equity and income tax portion of the demand charge for service interruptions caused by force majeure. This ruling applies to demand charge credits during the interim period as well as after September 1, 2003.

187. Force majeure events and the resulting service interruptions are, by definition, no-fault occurrences. Therefore, all the parties, including the pipeline should share the burdens that a force majeure interruption imposes. Where the pipeline has a non-SFV rate design, such as an MFV rate design, that places a portion of the fixed costs in the usage charge, the pipeline would automatically share the risks of the force majeure interruption because it would not collect the fixed costs contained in the usage charge for the service. However, where the pipeline has an SFV rate design, as does El Paso, all the fixed costs are included in the reservation rate, and without a demand charge credit, the pipeline will not share the risks of a force majeure event. Therefore, the Commission has held that a pipeline with an SFV rate design must share the risks of a force majeure event, and that a partial demand charge credit is an appropriate way to share that risk.¹⁶² In addition, the Commission has stated that sharing the risks of force majeure

¹⁶¹Indicated Shippers cite Tennessee Gas Pipeline Co., 76 FERC ¶ 61,022 at 61,088-89 (1996).

¹⁶²Opinion No. 406-A, 80 FERC ¶ 61,070 at 61,199-200 (1997).

occurrences provides the pipeline with an incentive to act expeditiously to cure the force majeure interruption.¹⁶³

d. Applicability of Demand Charge Credits to the Scheduling Cycles

188. Indicated Shippers further argue that the Commission erred in failing to apply demand charge credits to cuts in all four scheduling cycles when the nominated gas cannot be scheduled, not just in Cycles 2 and 3. Indicated Shippers assert that it is unclear why demand charge credits would not also apply to capacity that is not scheduled in Cycle 1 or Cycle 4. Indicated Shippers assert that whether scheduled gas can be bumped is irrelevant to whether demand charge credits should apply, and that demand charge credits should apply to all nominated firm volumes within the shipper's CD that El Paso is unable to schedule regardless of whether capacity has been scheduled to some other shipper in the scheduling process, and regardless of when cuts occur in the scheduling process. Thus, they argue, if nominated firm gas is cut in Cycle 1 and cannot be rescheduled in any subsequent cycle, demand charge credits should apply.

189. Demand charge credits should apply only when the pipeline is unable to provide service. If, as in Indicated Shippers' example, nominated firm gas is cut in Cycle 1 and cannot be rescheduled in Cycle 2 or 3, the shipper would receive a partial demand charge credit for being cut in Cycle 2 or 3.¹⁶⁴ It would not receive a credit unless it renominated the volumes in one of the next cycles to use available capacity. Similarly if a shipper waits until Cycle 4 to nominate volumes for the first time, it must bear the risk that those volumes cannot be scheduled.

e. Demand Charge Credits for Basin-Specific Contracts

¹⁶³80 FERC at 61,200.

¹⁶⁴The North American Energy Standards Board (NAESB) standards provide for four nomination cycles. Cycle 1, timely nominations, are due at 11:30 a.m. and Cycle 2, evening nominations, are due at 6 p.m. for gas flow at 9 a.m. the following day. Cycle 3, the first intra-day nominations, are due at 10 a.m. for gas flow at 5 p.m. the same day. Cycle 4, the second intra-day nominations, are due at 5 p.m. for gas flow at 9 p.m. the same day.

190. Indicated Shippers ask the Commission to clarify that demand charge credits would be applicable to shippers who cannot ship gas from alternate basins for contractual reasons, *i.e.*, basin-specific transportation contracts. Indicated Shippers state that the Commission determined that demand charge credits would not be available to shippers who choose for economic reasons not to ship gas from the Permian or Anadarko basins when there is insufficient capacity in San Juan to schedule the amount nominated, but did not address whether demand charge credits are available to shippers who have no contractual right to take gas from the Permian or Anadarko Basin because that shipper has a basin-specific contract.

191. The request for clarification is granted. If a shipper has a basin-specific contract, it has no contractual right to take gas from the other basins. Therefore, it would not be reasonable to require the shipper to nominate from the other basins, and the shipper should receive demand charge credits when its basin-specific capacity is constrained.

192. In addition, Indicated Shippers ask the Commission to clarify that demand charge credits would be applicable to producer/shippers who cannot ship gas from alternate basins for physical reasons, *i.e.*, to shipper/producers who are unable to ship gas from the Permian or Anadarko Basins because the producer/shipper has no production in the Permian or Anadarko Basins. Indicated Shippers assert that under this circumstance, the producer/shipper has stranded demand charges because the producer has no supplies in the alternate basin to correlate with the capacity that would be assigned from the alternate basin, and the Commission should clarify that producer/shippers without production in the alternate basins should receive demand charge credits when capacity is unavailable in the basin where the producer does produce gas.

193. This request for clarification is denied. If a shipper has receipt points in more than one basin, it must be unable to obtain deliveries from any of the basins before demand charge credits will be applicable. (Shippers should consider arranging for supplies at alternate basins where they have receipt rights.)

f. Demand Charge Credits for Nominations to Alternate Points

194. El Paso argues that the Commission erred in requiring demand charge credits for El Paso's inability to schedule to or from alternate points. El Paso states that shippers on its system may claim a priority right to service only at primary points, and should have no expectation of service certainty at alternate points because shippers with primary rights to those points have priority in the scheduling process and under the Commission's regulations. Accordingly, El Paso argues, a shipper should be eligible for a demand

charge credit only when El Paso is unable to schedule service at primary points. El Paso states that in Tennessee Gas Pipeline Co.,¹⁶⁵ the Commission stated that if a shipper wants to be eligible for a demand charge credit at a particular point, it should seek to designate that point as a primary point in its service agreement.

195. The Commission clarifies that demand charge credits will not apply if shippers nominate to alternate points. If Shipper One chooses to nominate at an alternate point rather than a primary point, its priority of service is secondary to shippers using that point as a primary point, and Shipper One cannot be guaranteed service from that alternate point. Therefore, a demand charge credit is not appropriate.

8. Allocation of San Juan Receipt Points to Line 2000 Capacity

196. Indicated Shippers, ONEOK, PG&E, and SoCalGas argue that none of the Line 2000 capacity should be allocated pro rata out of the San Juan Basin. They assert that the receipt points serving Line 2000 are physically located in the Permian Basin, and the addition of Line 2000 adds no incremental capacity out of the San Juan Basin. Issues regarding El Paso's implementation of the iterative receipt point allocation process will be addressed in a separate order on El Paso's compliance filing submitted December 3, 2002.

9. Issues Concerning Receipt Point Rights

a. Clarification of Specific Receipt Point Priority

197. Indicated Shippers ask the Commission to clarify specific receipt point priorities. They argue that where a receipt point is constrained, the shipper with specific primary receipt point rights at that point should have priority over other shippers holding only pool rights or primary rights at another point. Indicated Shippers quote the statement in the May 31 order that "in the allocation process ordered in another section of this order, El Paso would only assign an individual receipt point to a shipper after any pro-rata election process assuming that the shipper's election was at the closest pool. No additional priority is awarded the shipper because of its more narrow election."¹⁶⁶ They ask the Commission to clarify that this statement applies to the one-time initial allocation

¹⁶⁵73 FERC ¶ 61,083 at 61,206 (1995). El Paso also cites Tennessee Gas Pipeline Co., 71 FERC ¶ 61,339 at 62,580 (1985) as stating that customers pay demand charges based on primary points.

¹⁶⁶May 31 order at 62,016 n.102.

process and not the daily scheduling process. Indicated Shippers state that the Commission's statement that the shipper with the individual receipt point rights "would have no additional priority" requires clarification to ensure that the primary receipt point rights are afforded a priority, as they are on virtually all other pipelines, in the scheduling process.

198. The Commission clarifies that in the daily nominating and scheduling process, shippers with primary receipt point rights have priority over other shippers. The language cited by Indicated Shippers refers to the initial allocation process, not the daily scheduling process.

b. System-wide Alternate Receipt Rights

199. SoCalGas states that the May 31 order directs El Paso to assign specific primary receipt points among the CD and converting FR shippers, based on the finding that system-wide flexible point rights are unjust and unreasonable in their operation on the El Paso system. SoCalGas states that the order does not specifically address the issue of retention of system-wide alternate rights, although the order does provide that the remainder of the Settlement will remain in place. SoCalGas asks the Commission to clarify that El Paso should continue to provide system-wide alternate receipt point rights. SoCalGas states that the availability of system-wide alternate receipt point rights provides a means for shippers to optimize San Juan supplies, leaving El Paso revenue neutral with respect to these transactions.

200. The Commission clarifies that El Paso should continue to provide system-wide alternate receipt point rights. This is consistent with the Settlement and the Commission's flexible receipt point policy under Part 284 of the regulations.

10. Basin-Specific Contracts

201. In the September 20 order, the Commission clarified that in the allocation process, El Paso shall honor basin-specific contracts. Thus, the Commission explained, where a contract provides for system-wide receipt point rights, El Paso will use the iterative process to assign receipt point rights to the shipper in the various pools nominated by the shipper. However, the Commission stated, if the contract provides for receipt point rights in a specific basin, the shipper will be assigned receipt point capacity only in the basin specified in the agreement, and will not be included in the iterative receipt point allocation process.

202. On rehearing, the FR Shippers and PG&E argue that the Commission erred by honoring basin-specific contracts in the receipt point allocation process. The FR Shippers state that the Commission's decision to abrogate some contracts, but not others is arbitrary and capricious and prejudicial to the FR shippers. They assert that the same public interest that the Commission concluded requires abrogation of the FR contracts also requires abrogation of the basin-specific contracts. The FR Shippers assert that the original reason for the restricted basin aspects of some of the forward haul capacity designated as Blocks I, II, and III was to achieve a primitive receipt capacity allocation outcome without going to the level subsequently required by Order No. 637. The FR Shippers argue that making those restrictions permanent advantages to certain shippers with basin-specific contracts is unfair. The FR Shippers argue that if the Commission is effectively reallocating the receipt rights of the El Paso shippers, it should reallocate the receipt rights of all of the shippers.

203. As discussed above, the Commission rarely modifies contracts, and does so only in extraordinary circumstances where the public interest so requires. Nothing in the basin-specific contracts has resulted in pro rata allocations which have eroded firm service on the El Paso system. Basin-specific contracts have not caused the degradation of firm service on El Paso, and there is no basis for the Commission to abrogate those contracts. The FR Shippers have not alleged any basis for finding that basin-specific contracts have degraded firm service on El Paso or that the public interest requires that basin-specific contracts must be changed to contracts with system-wide receipt rights.

204. PG&E argues that the Commission erred in honoring basin-specific contracts because until the conversion of the FR contracts, the basin-specific contracts were an inferior form of contract than the contracts with system-wide receipt point rights.¹⁶⁷ PG&E argues that by allowing shippers with San Juan-only rights to get 100 percent of their primary receipt point rights off-the-top in the San Juan Basin, the Commission

¹⁶⁷PG&E states that shippers with system-wide receipt point rights and those with San Juan-only rights currently have equal contract entitlements to nominate from the San Juan Basin. A shipper with system-wide rights can nominate all of its gas from the San Juan Basin, as can a shipper with San Juan receipt rights only. But, PG&E states, the shipper with flexible receipt point rights currently has a superior form of contract because that shipper also has the right to nominate on a primary basis from other supply basins. In contrast, the shipper with San Juan-only rights has only secondary receipt point rights in other basins.

would grant these shippers¹⁶⁸ unduly preferential treatment and that a shipper with system-wide receipt point rights will end up receiving a smaller portion of its capacity receipt rights in the San Juan Basin.

205. The price of gas in the three basins (which can change over time) is not relevant to the Commission's ruling. 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. The basin-specific contracts, on the other hand, entitle the shipper to gas from only the basin specified in the contract.

206. As the Commission explained in the September 20 order, honoring basin-specific contracts is consistent with the approach taken by the Commission in Amoco Energy Trading Co. v. El Paso Natural Gas Co. (Topock).¹⁶⁹ In Topock, shippers with aggregate rights to the Topock delivery points were required to make an election as to how their delivery point rights should be distributed among the Topock delivery points. On the other hand, shippers with rights to specific Topock delivery points were assigned rights to those specific points only. This approach is consistent with the Commission's policy of preserving shippers' contracts unless abrogation of those contracts is necessary in the public interest. The Commission explained in the May 31 order why abrogation of the FR contracts is required by the public interest. There are no similar concerns here that require abrogation of the basin-specific contracts, and El Paso should honor those contracts in the allocation process.

11. Limitations on Nominations out of San Juan

207. In its request for rehearing of the May 31 order, SoCalGas states that at present, FR shippers can overnominate at San Juan in order to receive a higher percentage of the preferred San Juan gas after prorationing of nominations. SoCalGas asserts that there is no reason to permit FR shippers to continue to game the system until the conversion of the FR contracts to CD contracts becomes effective. SoCalGas states that El Paso could limit overnominations at San Juan by, for example, cutting an FR shipper's nomination at San Juan that exceeds the highest amount of that shipper's actual deliveries for any one of the preceding three days.

¹⁶⁸BP Energy and Burlington are the two shippers with basin-specific receipt points.

¹⁶⁹93 FERC 61,060 (2000), order on clarification, 93 FERC 61,222 (2000), order on reh'g, 94 FERC 61,225 (2001), aff'd, Southern California Gas Co. v. FERC, 2002 U.S. App. LEXIS 15040 (9th Cir. 2002).

208. Similarly, Indicated Shippers ask the Commission to clarify that FR shippers' nominations out of San Juan should be capped at the FR shippers' billing determinants. Indicated Shippers state that SoCalGas's Answer documented cuts out of San Juan exceeding 40 percent and that FR shippers overnominated by 25 percent of their actual needs in 2001, and received 85 percent of their supplies from the San Juan Basin, compared with 62 percent received by CD shippers from the San Juan Basin. Indicated Shippers state that capping FR nominations out of San Juan would put FR shippers on the same nominating basis as CD shippers for purposes of being allocated supplies out of San Juan since nominations for both would be capped at the quantity for which the shippers are paying demand charges.

209. There is no basis for limiting the FR shippers' nominations out of San Juan to their billing determinants or any other level. As discussed above, billing determinants were never intended to limit the service the FR shippers could receive. Further, there is no evidence in this record that the FR shippers have gamed the system or overnominated at San Juan in order to gain additional volumes out of that basin. The Commission expects all shippers, including the FR shippers, to comply with their contracts and nominate only what they need. Until the conversion of their contracts to CD contracts, the FR shippers must operate in accordance with their contracts. After conversion of the contracts, the potential for gaming the nomination process will be removed.

12. Establishing Contract Paths

210. In its request for rehearing, Indicated Shippers argue that the Commission erred in not requiring El Paso to establish contract paths on its system. In the September 20, 2002 order the Commission stated that it would address this issue in the next phase of El Paso's Order No. 637 compliance proceeding. The Commission finds that it is appropriate to resolve the capacity allocation problems on El Paso in this proceeding before moving to the next step of the process and establishing contract paths on the system, and will exercise its discretion to proceed in this manner.

13. Ability of FR Shippers to Enter into Contracts with Other Pipelines

211. Kinder Morgan asks the Commission to clarify that it did not intend to limit the timing as to when the FR customers of El Paso are able to contract with other parties for future service. Kinder Morgan states that while the FR customers are contractually bound to their current contracts until the date of conversion, there should be no bar to their contracting with potential competitors of El Paso about future service.

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212. The Commission clarifies that once the FR contracts are converted to CD contracts, the converted FR shippers may purchase transportation service from other pipelines and may negotiate, prior to September 1, 2003, for service to commence after the date of conversion.

The Commission orders:

(A) The requests for rehearing and clarification are granted and denied as set forth in the body of this order.

(B) El Paso is directed to refile tariff sheets on or before August 1, 2003 as directed in the body of this order and the order in Docket No. RP00-336-010 to become effective September 1, 2003.

(C) El Paso must remove from its tariff provisions authorizing pro rata allocations of capacity.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.

APPENDIX A

Timely requests for rehearing and clarification of the May 31 order were filed by:

Aquila Merchant Services (Aquila)
Arizona Corporation Commission (ACC)
Arizona Electric Power Cooperative, Inc. (Arizona Electric)
Arizona Public Service Company and Pinnacle West Energy Corporation (APS/Pinnacle)
BP Energy and Burlington Resources Oil and Gas Co. (BP)
California Public Utilities Commission (CPUC)
Duke Energy Trading and Marketing
El Paso Natural Gas Company (El Paso)
Full Requirements Shippers (FR Shippers)

The FR Shippers are ASARCO Inc., Arizona Electric Power Cooperative, Inc., Arizona Gas Division of Citizens Energy, APS/Pinnacle, El Paso Municipal Customer Group, Phelps Dodge Corporation (Phelps Dodge), Public Service Company of New Mexico, Salt River Project, Southern Union Gas Company, and Southwest Gas Corporation. The Full Requirements Shippers state that the ACC joins in their request for rehearing and clarification

Indicated Shippers

Indicated Shippers are Aera Energy, LLC, BP America Production Company, Burlington Resources Oil and Gas Co., Coral Energy Resources, LP, ExxonMobil Corp., Marathon Oil Co., Occidental Energy Marketing, Inc., and Texaco Inc.

Kinder Morgan Interstate Gas Transmission LLC (Kinder Morgan)
ONEOK Energy Marketing and Trading Co., LP (ONEOK)
Navajo Tribal Utility Authority
Pacific Gas and Electric Co. (PG&E)
Southern California Edison Co. (SoCalEdison)
Southern California Gas Company (SoCalGas)
Southwest Gas Company

Timely requests for rehearing or clarification of the September 20 order were filed by:

ACC and the FR Shippers (jointly)
APS/Pinnacle
BHP Copper
CPUC
El Paso
Indicated Shippers
Kern River Gas Transmission Company (Kern River)
ONEOK
PG&E

Panda Gila
Phelps Dodge
SoCalEdison
SoCalGas
Southern California Generation Coalition (SoCalGen)

APPENDIX B

**Comparison of FR Shipper Billing Determinants, 2001 NCP
and Initial Allocation by Shipper's Peak Month
(Mcf/d)**

<u>FT-1 FR Shippers *</u>	<u>Billing Determinants</u>	<u>2001 NCP</u>	<u>NCP Allocation***</u>	<u>12/3/02 report Shipper's peak month</u>
Arizona Electric Power	17,478	47,996	48,516	September
Arizona Public Service	64,557	294,097	375,888	August
ASARCO	2,926	8,747	9,404	November
ASARCO	5,828	5,557	5,828	BD
BHP Copper	12,910	387	12,910	BD
Citizens Utilities	36,765	120,354	157,429	April
City of Las Cruces, NM	12,395	25,504	34,257	January
City of Mesa, AZ	13,927	32,711	43,269	January
El Paso Electric	36,479	139,148	171,004	October
MGI Supply	22,483	67,265	212,776	November
Navajo Tribal Utility **	12,140	24,860	19,462	January
Phelps Dodge Corp.	23,908	66,347	95,851	Sep/Oct/Nov
PNM Gas Services	32,469	128,075	172,046	January
Salt River Project	47,254	372,722	405,703	May
Southern Union Gas	76,919	164,494	222,625	February
Southwest Gas	329,754	625,975	727,950	January
Total	748,192	2,124,239	2,714,918	

* Several of the original FT-1 FR shippers converted to FT-2 service and are not included, i.e., Chemical Lime, City of Lordsburg, and Southdown

** Navajo has westflow and east end deliveries. The 12/3/02 report shows that Navajo's westflow allocation of 9,661 Mcf/d exceeds its westflow BD of 2,339 Mcf/d. Allocations of east end capacity to Navajo and others are based on shipper elections, not current usage.

*** Each FR shipper's peak month allocation from the 12/3/02 report. Each shipper's peak month is shown in the right column. BD indicates that the shipper's peak month allocation was its billing determinant.