UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

El Paso Natural Gas Company  
)  
Docket No. RP08-426-000

To: The Honorable Charlotte J. Hardnett  
Presiding Administrative Law Judge

Supplemental Brief Of  
Southern California Edison Company


As explained herein, INGAA II confirms arguments previously made by Edison opposing the proposal by El Paso Natural Gas Company (“EPNG”) to charge for short-term firm transportation and interruptible services as much as 250% of its cost-based, long-term firm transportation rates. 3/ The

2/ INGAA II, slip op. at p. 13. A copy of the slip opinion used for purposes of citation here was provided as the attachment to Edison’s “Motion To Lodge Appellate Decision” submitted on August 18, 2010.
3/ Edison’s arguments opposing EPNG’s short-term rate proposal are set forth in its Initial Post Hearing Brief, filed on July 8, 2010 (hereinafter, “Edison Initial Brief”), at pp. 4-23, and its Post Hearing Reply Brief, filed on August 3, 2010 (hereinafter, “Edison Reply Brief”), at pp. 3-20.
decision also refutes EPNG’s contention that Commission policy allows it to rely on a supposedly competitive market to constrain its short-term rates to just and reasonable levels. 4/

In this proceeding, the parties have presented starkly different views of the relevance of Order No. 712 to EPNG’s short-term rate proposal. EPNG maintains that it does not have market power over short-term transportation services and that the competitive nature of the market will ensure that it cannot charge unjust or unreasonable rates – and it claims that Order No. 712 supports this view. The argument was presented in testimony at the hearing by EPNG’s lead witness on this issue, Mr. Sullivan, as reflected in the following transcript excerpt:

Q. If your proposal was approved, then there would not be any regulatory restraint that would require EPNG to charge less than [the] 250 percent rate at any time, would there be?
A. No. What EPNG is relying on is that the market, competitive market for transportation services in EPNG’s service area is competitive, as the Commission has stated so many, many times, and the competitive markets for short-term services are the best way to establish the value of transportation services.

Q. Where has the Commission stated that the market for short-term services on EPNG is competitive?
A. In Order No. 712…. 5/

Later in his testimony on the stand, Mr. Sullivan returned to this issue:

I believe short-term transportation markets are competitive enough now that we can let the market determine the value of that transportation capacity.…

* * *

I believe the value of the IT transportation should be determined by the market, by the transportation market, because the Commission has found in Order 637 and 712 we have competitive short-term markets. 6/

4/ EPNG’s proposal unquestionably is based, at least to a large degree, on its theory that a competitive market will constrain the rates it may charge. EPNG nevertheless maintains on brief it has not proposed “market-based” short-term rates because it proposes (a) to cap the prices it will charge at 250% of the cost-based rates and (2) to share with customers, in certain circumstances, some revenues from its short-term services. EPNG Initial Post-Hearing Brief at p. 35. Edison has responded to these arguments in detail in its prior briefs and INGAA II does not affect this debate; accordingly, Edison will not address these issues further here.


Mr. Sullivan also explained at the hearing that he does not think that EPNG possesses market power in the market for short-term transportation, at any time. 7/

Edison responded to these claims in some detail in its post-hearing briefs. In its initial brief, Edison explained:

[In Order Nos. 637 and 712, the Commission explicitly considered and rejected pipelines’ proposals to lift the rate cap on pipeline-supplied short-term services. The Commission reasoned that pipelines are more likely both to have market power and to exercise that power by withholding capacity than are firm shippers with capacity to release (which were allowed by the rulemakings to charge market-based rates for short-term releases). Throughout Order No. 712, the Commission repeatedly emphasized that the availability of a cost-based pipeline rate was an essential part of its determination to remove the price ceiling only for shipper-released capacity…. The Commission concluded that the cost-based limit on pipeline capacity acts as a “recourse rate” for both pipeline transactions and release transactions. The Commission did not at any time find that competition alone would assure just and reasonable rates in the capacity release market in the absence of a cost-based recourse rate requirement. Rather, it was the very combination of competition with the maintenance of the pipeline recourse rate that would assure just and reasonable rates for capacity release, and formed the basis of the Commission’s decision. 8/]

In its reply brief, Edison again highlighted the Commission’s emphasis when eliminating the rate ceiling for short-term capacity releases on the continuing availability of cost-based rates for pipeline-supplied short-term services, and provided quotations from Order No. 712-A stressing concerns about pipelines’ market power and reiterating that the Commission did not find short-term markets to be fully competitive. 9/

In the recent proceeding before the D.C. Circuit, the pipeline petitioners made two arguments that mirror the underpinnings of Mr. Sullivan’s arguments for EPNG’s proposal. “First, Petitioners contend the short-term capacity market is a single market and argue that because FERC lifted the

7/ Id., p. 738, lines 3-6. Mr. Sullivan did not conduct a market power study to evaluate this issue. Id., at lines 7-9; see also TR, p. 736, line 24 to p. 737, line 3 and lines 9-19. EPNG’s failure to conduct a market study is an important issue that is discussed in detail in Edison’s prior briefs, but will not be addressed here because INGAA II does not affect the issue.
8/ Edison Initial Brief at pp. 9-10 (internal footnotes and citations omitted).
9/ Edison Reply Brief at pp. 15-16.
price ceilings on one category of market participants (shippers), it had to lift the ceilings for all market participants, including pipelines." 10/ “Next, Petitioners suggest FERC was obligated to remove the rate ceiling for pipelines because the Commission found the short-term capacity release market was ‘generally competitive’. 11/

The Court’s rejection of these arguments is similar to, and reinforces, points made by Edison in its briefs here:

Based on the evidence before it, FERC explained it could not conclude the short-term market would remain competitive if the price ceilings were removed from pipeline sales. See, e.g., Order No. 712 at PP 61, 88; Order No. 712-A PP 22-28. The Commission thus found it necessary to retain the price ceilings on pipeline sales because, absent the recourse rate, pipelines might take advantage of their customers by exploiting market power. Order No. 712 PP 83, 88, 91, 102. 12/

The Court held to be reasonable the Commission’s decision that it “could not give identical pricing flexibility to pipelines because of concerns the pipelines could wield market power.” 13/ The Court also acknowledged what it termed FERC’s “plausible concern, informed by economic theory” that “[i]f pipelines could charge market-based rates in the short-term market, they might withhold construction of new capacity to take advantage of the opportunity to earn scarcity rents in the short-term market.” 14/

The Court recognized that “[w]ithout the price ceilings in place, pipelines might exercise market power, and FERC might be unable to remedy the resulting harm to customers.” 15/ Accordingly, the Court held that “FERC made a reasonable judgment to ‘err on the side of enhanced protection against market power’,“ explaining that this judgment was “consistent with the NGA’s ‘fundamental purpose… to protect natural gas consumers from the monopoly power of natural gas

10/ INGAA II, slip op. at pp. 8-9.
11/ id. at p. 10.
12/ id., slip op. at p. 10.
13/ id. at p. 9.
14/ id. at p. 10.
15/ id. at p. 11.
pipelines’. On a similar note, the Court repeated its pronouncement, made in INGAA I when considering analogous issues on review of Order No. 637, that ‘‘the basic premise of the NGA is the understanding that natural gas pipeline transportation is generally a natural monopoly,’ so FERC face[s] an ‘uphill fight’ to justify market-based rates under those circumstances.”

Edison included this quotation from INGAA I in its post-hearing briefs here, and counsel for Edison questioned Mr. Sullivan about it at the hearing. Mr. Sullivan responded by contending that this was the premise at the time of enactment of the Natural Gas Act but that, in his view, the Commission has moved away from the premise more recently with “new policies that allow for the development of competitive transportation services in transportation markets and, in particular, in short-term markets.” Mr. Sullivan’s theory (advocated in EPNG’s initial post-hearing brief at pages 31-32) that the “evolution” of Commission policy warrants letting the market set rates for pipelines’ short-term services cannot be reconciled with Order No. 712, with INGAA I or, now, with INGAA II.

Both EPNG and Southern California Gas Company with San Diego Gas & Electric Company (“SoCalGas/SDG&E”) also pointed on brief to the heading in Order No. 712 stating that “Short-Term Customers Are Not Captive.” SoCalGas/SDG&E went on to claim that the Commission concluded there that short-term customers are not “subject to the exercise of market power by a seller.” Yet, the first sentence under that heading in Order No. 712 is: “The releasing shippers’ ability to exercise market power in the short-term capacity release market also is limited because

16/ Id. at p. 5. The first internal quotation is from Order No. 712 at P 108; the second quotation is from Nat’l Fuel Gas Supply Corp. v. FERC, 468 F.3d 831, 833 (D.C. Cir. 2006). Id.
17/ INGAA II, slip op. at p. 5, quoting Interstate Natural Gas Ass’n of America v. FERC, 285 F.3d 18, 30-31 (D.C. Cir. 2002) (“INGAA I”) (upholding the Commission’s decision in Order No. 637 to lift the rate-ceiling on short-term capacity releases while rejecting pipelines’ arguments that the cost-based ceiling on pipeline-provided short-term services also should be eliminated).
18/ Edison Initial Brief at p. 7 & n. 7; Edison Reply Brief at pp. 4-5 & n. 10.
19/ TR, pp. 731-35.
20/ Id. at p. 734, lines 8-18.
21/ EPNG Initial Brief at p. 40; SoCalGas/SDG&E Reply Brief at p. 6.
22/ Id.
short-term customers are not captive.”\textsuperscript{23} Read in context of the entire order, and now in light of \textit{INGAA II}, this heading and the related discussion in Order No. 712 clearly apply only to the capacity release market and options available to shippers seeking capacity released by other shippers, including the alternative of the pipeline’s cost-based service. The Commission most definitely did not conclude that the short-term customers of a pipeline are not susceptible to the exercise of market power: to the contrary, the concern with pipelines’ market power drove the Commission’s decision to maintain the cost-based price caps on pipeline services and the Court’s decision to affirm the Commission’s approach. See \textit{INGAA II}, slip op. at pages 9-12.

EPNG’s argument based on this portion of Order No. 712 is slightly more subtle, but just as baseless. EPNG maintains that the Commission held in Order No. 712 that short-term customers have alternatives to short-term service from the pipeline, notably capacity released by other shippers. Mr. Sullivan testified on this point as follows:

In light of the recently-issued Order No. 712, allowing shippers to release capacity in short-term transactions at market-based prices for short-term capacity releases, capacity release will provide a fully competitive alternative to EPNG’s short-term service. The elimination of the price ceilings along with the other steps take by Order No. 712 to relax restrictions on capacity release transactions will ensure that prices for EPNG’s short-term capacity will not exceed competitive levels.\textsuperscript{24}

and

I believe that Order No. 712 provides strong support for EPNG’s contention that capacity release competes with its own short-term services. Given that capacity release and short-term firm services are good alternatives, the evidence that capacity release rates are generally below the equivalent cost-based long-term firm recourse rate suggests that removing the rate cap on short-term firm services would not raise a market power issue. That is, shippers would not pay a higher rate for short-term firm services than the rate on short-term capacity releases.\textsuperscript{25}

This testimony by Mr. Sullivan cannot be reconciled with \textit{INGAA II} (or with Order No. 712 itself for the matter). The Commission eliminated the rate ceiling on capacity release based, in part,\textsuperscript{23} Order No. 712 at P 50 (emphasis added).
\textsuperscript{24} Prepared Direct Testimony of Mr. Sullivan, Exh. No. EPG-149 at p. 21.
\textsuperscript{25} Prepared Rebuttal Testimony of Mr. Sullivan, Exh. No. EPG-337 at p. 36.
on evidence that release rates were generally below the cost-based rate, while maintaining the cap on pipeline services precisely because of concerns about pipelines’ market power. 26/ Moreover, “FERC explained it could not conclude the short-term market would remain competitive if the price ceilings were removed from pipeline sales.” 27/ As the Commission stated in Order No. 712, “[r]emoving the rate ceiling for pipeline transactions would therefore remove an important protection both for pipeline customers and for replacement shippers on capacity release transactions.” 28/ EPNG perversely and fallaciously reverses this reasoning when claiming that short-term capacity release, at unlimited market-based rates, will serve as a competitive alternative that will limit the rates that EPNG itself may charge. EPNG’s proposal would free both the pipeline and releasing shippers to charge whatever the market will bear, limited only by the arbitrary and excessive 250% cap. This result would be contrary to the regulatory structure established in Order No. 712 and upheld by the D.C. Circuit in INGAA II under which pipelines’ short-term rates must continue to be cost-based, 29/ and where the availability of that cost-based alternative provides a check on capacity release prices.

The final area where Order No. 712 was raised in the briefs is EPNG’s argument that the Commission in that order “expressly acknowledged the continuing viability” of “the policies supporting short-term value-based rates as expressed in Order No. 637.” 30/ This argument is not

26/ INGAA II, slip op. at p. 9 (“FERC explained it could not give identical pricing flexibility to pipelines because of concerns that pipelines could wield market power.”).
27/ Id. at p. 10.
28/ Order No. 712 at P 83. See also Order No. 637, “Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services,” FERC Stats. & Regs. ¶ 31,091, at 31,382 (“Firm shippers cannot successfully withhold capacity from the market to raise price above the existing maximum just and reasonable rate because, if the firm shippers do not use their capacity, the pipeline has the incentive to sell the capacity as interruptible service. Moreover, the Commission is continuing to protect against the possibility that, in an oligopolistic market structure, the pipeline and the firm shippers will have a mutual interest in withholding capacity to raise price because the Commission is continuing cost-based regulation of pipeline transportation transactions. The pipelines will be required to sell both short-term and long-term capacity at just and reasonable cost-based rates.”)
29/ Mr. Sullivan acknowledged that EPNG has not proposed cost-based short-term rates. TR, p. 710, lines 20-21. His theory (explored during cross-examination reflected at TR, pp. 711-718) that any multiple of cost-based rates (here, arbitrarily set at 2 and a ½ times) is a “cost-based derivative” that limits market rates should be rejected out of hand.
30/ EPNG Initial Post-Hearing Brief at p. 41.
affected by INGAA II, and Edison agrees with EPNG that Order No. 712 did not alter the Commission’s policies established in Order No. 637 allowing for the filing of seasonal rates and term-differentiated rates as. The fact is, however, that EPNG’s proposal fails to comply with the established parameters for either of those types of rates, as detailed in the previously filed briefs of Edison, the Commission Staff, and other opponents of EPNG’s short-term rate proposal. Since EPNG’s proposal does not comply with the parameters required for such rates set forth in Order No. 637, the fact that Order No. 712 acknowledges the continuing viability of those policies is immaterial and certainly provides no support to EPNG’s proposal.

WHEREFORE, for all the reasons set forth herein and in Edison’s two previously filed post-hearing briefs, Edison respectfully urges the Presiding Judge to issue an Initial Decision holding that EPNG’s proposed rate design for short-term firm and IT service is unjust and unreasonable and contrary to Commission policy, including Order No. 712 as affirmed in Interstate Natural Gas Association of America v. FERC, Case No. 09-1016 (D.C. Cir., Aug. 13, 2010).

Respectfully submitted,

/s/ J. Patrick Nevins

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CERTIFICATE OF SERVICE

I hereby certify that I have this 27th day of August, 2010, caused to be served a copy of the forgoing pleading upon all parties listed on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

/s/ J. Patrick Nevins

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