120 FERC ¶ 61,208
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Philip D. Moeller,
and Jon Wellinghoff.

El Paso Natural Gas Company Docket No. RP05-422-000[1]

ORDER APPROVING CONTESTED SETTLEMENT, AS MODIFIED

(Issued August 31, 2007)

1. On December 6, 2006, El Paso Natural Gas Company (El Paso) filed an Offer of Settlement (Settlement) in this proceeding. El Paso states that, except for certain discrete issues, the Settlement resolves all the issues set for hearing and technical conference, as well as various waiver requests. The Presiding Administrative Law Judge (ALJ) certified the Settlement to the Commission as contested on January 22, 2007.[2] As discussed below, we will approve the contested Settlement for all parties, including the one contesting party, with a modification to the standard of review.

I. Background

2. On June 30, 2005, El Paso filed revised tariff sheets proposing a number of new hourly and daily services, a rate increase for existing services, and changes in certain terms and conditions of service, including its penalty structure. The new services

[1] The Settlement also addresses the following Dockets: RP05-422-000, RP05-422-001, RP05-422-002, RP05-422-003, RP05-422-004, RP05-422-005, RP05-422-006, RP05-422-007, RP05-422-008, RP05-422-009, RP05-422-010, RP05-422-011, RP05-422-012, RP05-422-013, RP05-422-014, RP05-422-015, RP05-422-016, RP05-422-017, RP05-422-018, RP06-431-000, RP06-431-001, RP06-392-000, RP06-392-001, RP06-368-000, and RP06-226-000.

[2] *El Paso Natural Gas Co.*, Presiding Judge's Certification of Contested Settlement, Docket No. RP05-422-000, *et al.* (January 22, 2007).

proposed by El Paso were designed to provide firm hourly services for shippers with a need for hourly flexibility. These new services include: (1) Hourly Entitlement Enhancement Nominations (HEEN), an enhanced scheduling right under Rate Schedules FT-1, FT-H, NNTD and NNTH to increase delivery flexibility; (2) Hourly Firm Transportation Service (FT-H), which provides defined peak hour limitations and peak hour durations in several different packages, tailored to the different hourly behavior profiles of El Paso's shippers; (3) Firm Daily Balancing Service (FDBS), a storage-like service using pipeline assets and line pack; (4) Daily and Hourly No-Notice Service (NNTD); (5) Interruptible Storage Service (ISS); and (6) Interruptible Hourly Swing Service (IHSW). El Paso also proposed to eliminate the rate cap[3] applicable to the rates of certain shippers pursuant to Article 11.2 of El Paso's 1996 Settlement.

3. On July 29, 2005, the Commission issued an order[4] (July 29, 2005 Order) accepting El Paso's primary tariff sheets[5] and suspending their effectiveness until January 1, 2006, subject to conditions and to the outcome of a hearing and technical conference. The Commission established a technical conference to address, among other

[3] Article 11 of El Paso's 1996 Settlement provides that rates for certain shippers would be subject to vintage or discounted rate levels in subsequent El Paso rate cases. In seeking to eliminate the rate cap, El Paso argued that because of the Commission's action in *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (2002), 100 FERC ¶ 61,285 (2002), *reh'g*, 104 FERC ¶ 61,045 (2003), *reh'g*, 106 FERC ¶ 61,233 (2004), *aff'd*, *Arizona Corporation Commission v. FERC*, 397 F.3d 952 (2005) (Capacity Allocation Proceeding), the rate cap no longer applied to the rates of any shippers.

[4] *El Paso Natural Gas Co.*, 112 FERC ¶ 61,150 (2005).

[5] In its June 30, 2005 filing, El Paso proposed three sets of tariff sheets: primary tariff sheets that reflected the termination of the applicability of Article 11 of the 1996 Settlement, first alternate tariff sheets that reflected the continued applicability of Article 11 for the eligible former full requirements shippers, and second alternate tariff sheets that reflected the continued applicability of Article 11 for all eligible shippers. Article 11 of the 1996 Settlement provides that rates for certain shippers would be subject to vintage or discounted rate levels in subsequent El Paso rate cases. In the July 29, 2005 Order, the Commission accepted and suspended the primary tariff sheets, subject to further Commission order. On March 20, 2006, the Commission issued an order addressing the continued applicability of Article 11 and concluding that the Commission's action in El Paso's Capacity Allocation Proceeding did not abrogate Article 11.2 of the 1996 Settlement. The Commission directed El Paso to refile tariff sheets consistent with this finding.

things, the terms and conditions of the new services and the continued applicability of the rate cap under Article 11.2 of the 1996 Settlement. The Commission also established a hearing to determine just and reasonable rates for the new services.

4. In establishing the hearing, the Commission stated that the issues to be litigated at the hearing were limited to the rate case issues raised by El Paso's filing.[6] The Commission also addressed a protest filed by Phelps Dodge Corporation (Phelps Dodge) in which Phelps Dodge stated that it intended to litigate the issue of whether El Paso was culpable for the capacity shortfall that occurred in 2000-01. The Commission responded that the capacity withholding matter was not at issue in this proceeding and was not to be addressed at the hearing.[7] Phelps Dodge sought rehearing of the Commission's ruling on the capacity withholding issues in its July 29, 2005 Order, and, on July 7, 2006, the Commission denied the request for rehearing.[8]

5. In accordance with the July 29, 2005 Order, technical conferences were held on September 20 and 21, 2005, and October 19 and 20, 2005. On November 4, 2005, El Paso submitted its revised *pro forma* tariff sheets in response to discussion and comments at the technical conference. El Paso made its November 4, 2005 filing pursuant to procedures adopted at the technical conference, and filed it so that shippers and other interested parties could address the revised tariff sheets in their comments on the technical conference.

6. On March 23, 2006, the Commission issued its order[9] addressing the technical conference issues. In that order, the Commission found that El Paso's proposed new services, penalty provisions, and other tariff changes were generally just and reasonable, and accepted those provisions, subject to conditions.[10] The Commission addressed the

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[6] *Id*. at P 31.

[7] *Id*. at P 31 n.26.

[8] *El Paso Natural Gas Co.*, 116 FERC ¶ 61,016 (2006).

[9] *El Paso Natural Gas Co.*, 114 FERC ¶ 61,305 (2006).

[10] Specifically, the Commission directed El Paso to modify its proposed tariff sheets with regard to termination of service for non-payment, Rate Schedule Operator Point Aggregation Service (OPAS), late day nominations, FT-2 service restrictions, force majeure, governing state law, negotiated rates, gas quality specifications, and flow path and point rights. The Commission rejected El Paso's proposal for daily scheduling penalties as well as its proposed elimination of sculpted contract rights.

issues related to the continued applicability of the 1996 Settlement rate cap in a separate order issued on March 20, 2006.[11]

7. The parties engaged in a number of publicly-noticed settlement conferences, as well as other meetings and discussions among El Paso, Commission Trial Staff (Staff), various customers, and other interested parties in an effort to settle the proceedings. As a result of these negotiations, El Paso submitted a Settlement to the ALJ on December 6, 2006. On January 22, 2007, the ALJ certified the Settlement to the Commission as contested.

II. The Settlement

8. Subject to the exceptions noted below, the Settlement resolves all the issues set for hearing and technical conference in this proceeding. The Settlement provides for "black box" settlement rates that are lower than El Paso's filed rates and that will remain in effect for the three-year term of the settlement, until December 31, 2008. It also resolves various cost of service and accounting issues and provides for a fuel savings mechanism. Additionally, the Settlement permits El Paso to seek to recover certain costs associated with its pipeline integrity program (PIP), notwithstanding the three-year rate moratorium. The Settlement also increases tolerance levels and eliminates the daily variance charge and hourly overrun penalties.

9. In addition, the Settlement provides for the formation of task forces and working groups to explore the possibility for mutual agreement on other outstanding rate and tariff issues. One task force will work to simplify El Paso's tariff regarding scheduling practices, contracting issues, and other practices to improve customer service. Another will address the possibility of future alternative rate designs, cost allocation methods, and fuel recovery mechanisms.

10. The settling parties were not able to reach agreement with regard to resolution of issues related to the applicability of Article 11.2 of the 1996 Settlement to the rates in this proceeding. Therefore, the Settlement provides that the pending requests for rehearing of the Commission's March 20, 2006 Order on Post-Settlement Issues regarding the continued applicability of the Article 11.2 rate cap of the 1996 Settlement will remain pending, but that any resolution of those issues on rehearing will not take effect until the end of the three-year Settlement period. The Settlement also leaves pending before the Commission the requests for rehearing of the Commission's March 23, 2006 Order on Technical Conference, as well as compliance filing protests related to those two orders.

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[11] *El Paso Natural Gas Co.*, 114 FERC ¶ 61,290 (2006).

The Settlement provides that any Commission ruling on the merits of these filings will be effective prospectively at the end of the term of the Settlement. The Settlement also leaves unresolved issues related to the determination of Southwest Gas Corporation's (Southwest) billing determinants subject to Article 11.2 of the 1996 Settlement and, with limited exceptions, the MDO/MHO issues. The Settlement provides that the standard of review for any future change to the Settlement is the *Mobile-Sierra*[12] public interest standard, but that in the event the Commission requires that the just and reasonable standard applies to Commission-sponsored *sua sponte* changes to the Settlement, El Paso and the settling parties agree that such modification will be an acceptable modification or condition to the approval of the Settlement. A detailed section-by-section description of the Settlement is attached to this order's Appendix.

11. Initial comments in support of the Settlement were filed by Arizona Public Service Company (APS), Public Utilities Commission of the State of California (CPUC), Staff, El Paso, El Paso Electric Company (El Paso Electric), El Paso Municipal Customer Group (EPMCG), Golden Spread Electric Cooperative and GS Electric Generating Cooperative, Inc. (Golden Spread), Indicated Shippers,[13] Pacific Gas and Electric Company (PG&E), Public Service Company of New Mexico (PNM), San Diego Gas & Electric (SDG&E), Salt River Project Agricultural Improvement and Power District (Salt River), Southern California Gas Company (SoCalGas), Southwest, and UNS Gas, Inc. and Tucson Electric Power Company (UniSource).

12. In addition, the Arizona Corporation Commission (ACC) filed initial comments stating that while it does not oppose the Settlement, it is concerned that the Settlement provides for an overly complex operational system. Therefore, the ACC has designated itself as a "non-opposing" party rather than a supporting party. The ACC does not propose any specific modifications to the Settlement.

13. The parties supporting the Settlement generally state that the Settlement will provide them with significantly lower rates for the Settlement period and will eliminate the possibility of additional pancaked rate increases during the term of the Settlement. They further state that the Settlement will provide rate and service stability for El Paso's customers and allow them to adjust to the new services and new terms and conditions of

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

[13] Indicated Shippers are BP America Production Company, BP Energy Company, Coral Energy Resources, L.P., Chevron Natural Gas, Occidental Energy Marketing, Inc., and ConocoPhillips Company.

service. Further, they state that the Settlement will enable the parties to avoid the time and expense of litigation. In addition, they note that there is widespread support for the Settlement from a variety of interests including LDCs, producers, electric power generators, state commissions and others.

14. The only comments opposing the Settlement were filed by Phelps Dodge. Phelps Dodge raises five objections to the Settlement. First, Phelps Dodge objects to the Settlement's disposition of the issues related to Article 11.2 of the 1996 Settlement, and asserts that the record in this case is incomplete on that issue because there is no evidence concerning El Paso's withholding of capacity in 2000-01. Second, Phelps Dodge objects to Section 16.3 of the Settlement because it contends the provision allows the settling parties to respond to Phelps Dodge's request for rehearing of the March 20, 2006 Order. Third, Phelps Dodge objects to the Settlement's overall treatment of the Article 11.2 issues because it asserts the treatment encourages the Commission to indefinitely defer action on the March 20, 2006 Order. Fourth, Phelps Dodge objects to portions of Section 13.4 of the Settlement and alleges that this provision seeks to deny Phelps Dodge access to essential services in order to force Phelps Dodge to relinquish its legal rights. Finally, Phelps Dodge objects to Article 11.3 of the Settlement because, it alleges, by providing higher refund levels if the Settlement is uncontested, the provision is an attempt by El Paso to exercise monopoly power to coerce contesting shippers to agree to the Settlement.

15. Reply comments addressing Phelps Dodge's objections to the Settlement were filed jointly by El Paso and certain Settling Parties (Joint Reply Comments).[14] In addition, individual reply comments were filed by APS, El Paso, El Paso Electric, Electric Generators Coalition (Electric Generators),[15] Golden Spread, Indicated Shippers, PNM, Salt River, Southwest, Staff, Texas Gas, and UniSource.

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[14] The Settling Parties that joined in the Joint Reply comments are: Arizona Electric Power Cooperative, Inc.; APS; Blythe Energy Company, LLC; El Paso Electric; EPMCG; Gila River Power, L.P.; Golden Spread and GS; Indicated Shippers; LSP Arlington Valley, LLC; Mewbourne Oil Company; MGI Supply LTD; New Harquahala Generating Company, LLC; PG&E; PNM; the CPUC; Salt River; SDG&E; Sempra Global; Southern California Edison Company; SoCal Gas; Southwest; Texas Gas Service Company, a division of ONEOK, Inc. (Texas Gas Service); and UniSource.

[15] Electric Generators are Arizona Electric Power Corporation, Golden Spread Electric Cooperative, Inc., New Harquahala Generating Company, LLC, and Sempra Global.

16. On January 22, 2007, the ALJ certified the Settlement to the Commission as a contested settlement. The ALJ explained that pursuant to Rule 602 of the Commission's Rules of Practice and Procedure, there are two alternate bases upon which an ALJ may certify a contested settlement to the Commission.[16] First, a contested settlement may be certified to the Commission if the presiding officer determines that there are no genuine issues of material fact, or, second, if the presiding officer determines that omission of an initial decision is appropriate and determines that the record contains substantial evidence from which the Commission may reach a reasoned decision on the merits of the contested issues. The ALJ stated that this Settlement is certified under both criteria. First, the ALJ concluded, Phelps Dodge's objections fail to raise genuine issues of material fact. The ALJ noted that the alleged issues of material fact virtually all relate directly to El Paso's allegedly withholding capacity in 2000-01. The ALJ stated that these capacity withholding claims that Phelps Dodge wants to litigate have previously been found irrelevant in this case by the Commission.[17] In addition, the ALJ pointed out that the Commission already rejected Phelps Dodge's withholding claims on the merits, in orders affirmed by the D.C. Circuit.[18] The ALJ also held that Phelps Dodge's other asserted objections to the Settlement did not prevent the certification of the Settlement. The ALJ stated that there is an ample basis in the record upon which the Commission may find the Settlement is just and reasonable, and, further, that these are essentially legal issues, not

[16] *See* 18 C.F.R. § 382.602(h)(2)(ii) and (iii)(2007).

[17] *See e.g.* July 7 Order, *El Paso Natural Gas Co.*, 116 FERC ¶ 61,016 at P 26 (2006) (denying Phelps Dodge's request for rehearing of the suspension order, explaining that the withholding issue has no relevance to the claim that Phelps Dodge was pursuing at that time – the issue of whether the Power-Up expansion capacity was needed – because the Power-Up capacity would have been needed to serve the increased needs of Phelps Dodge and other shippers regardless of whether any withholding capacity occurred in the past) and July 29, 2005 Order, *El Paso Natural Gas Co.*, 112 FERC ¶ 61,150, at n.26 and n.29 (2005) (holding that the issue of whether El Paso was culpable for the capacity shortfall that occurred in 2000-01 is not at issue in this proceeding, regardless of the outcome of the appeal cited by Phelps Dodge, and may not be addressed at the hearing).

[18] *See Arizona Corp. Comm'n v. FERC*, 397 F.3d 952, 955 (D.C. Cir. 2005) (stating, "Nor do petitioners persuade us that El Paso improperly withheld capacity. FERC observed, and petitioners did not disprove, that El Paso operated its 'dynamic' pipelines at reasonable levels of capacity").

genuine issues of material fact. In addition, the ALJ determined that the Settlement could be certified under the criteria set forth in *Trailblazer Pipeline Co.* (*Trailblazer*).[19]

III. Discussion

17. As discussed below, after considering the objections of Phelps Dodge, the Commission finds that this Settlement may be approved for all parties, including Phelps Dodge, as a just and reasonable resolution of the issues.

A. Phelps Dodge's Objections to the Settlement

1. Issues Related to Article 11.2 of the 1996 Settlement

a. Allegations Regarding Withholding of Capacity

18. Phelps Dodge's central objection to this Settlement is that the Settlement rates calculated pursuant to Article 11.2 of the 1996 Settlement are unjust and unreasonable because they do not take into account Phelps Dodge's allegations that El Paso withheld capacity in 2000-01. Phelps Dodge asserts that it would pay substantially more under the Settlement rates than it would if there were a resolution of the issues related to the rates under Article 11.2 of El Paso's 1996 Settlement based on a complete evidentiary record. Phelps Dodge argues that the record here is incomplete because there is no evidence in the record concerning the issue of El Paso's withholding of capacity in the year 2000-01.

19. Phelps Dodge argues that the affidavit of Gregory M. Lander in Support of Phelps Dodge Corporation (Lander Affidavit) demonstrates that evidence regarding El Paso's culpability, if considered by the Commission, would raise genuine issues of material fact with regard to this Settlement. Specifically, Phelps Dodge argues that there are genuine issues of material fact in dispute with regard to the Settlement's determination of the level of capacity subject to Article 11.2(a) and 11.2(b) rates. Phelps Dodge asserts that the Lander Affidavit demonstrates that evidence regarding El Paso's withholding of capacity in 2000-01, if considered, would result in Article 11.2 treatment for essentially all of Phelps Dodge's Rate Schedule FT-1 capacity, including most of the capacity currently designated as expansion capacity.[20] Further, Phelps Dodge argues that this

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[19] *See Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 at 62,342-45 (1998), *order on reh'g*, 87 FERC ¶ 61,160 (1999), *reh'g denied* 88, FERC ¶ 61,168 (1999).

[20] El Paso cites the Lander Affidavit at 22.

culpability evidence, in conjunction with evidence produced in discovery in this case,[21] would result in finding that the capacity threshold presumption should be set at 4,234 MMcf/d, a higher level than the 4,000 Mcf/d evidentiary presumption preliminarily adopted, but also set for hearing, in the March 20, 2006 Order.[22] Phelps Dodge argues that the Settlement ignores these facts and therefore cannot be found to be just and reasonable.

20. APS, El Paso, El Paso Electric, Indicated Shippers, Joint Commenters, PNM, Southwest, and Staff filed reply comments opposing Phelps Dodge's objection. These parties argue that the Commission has already addressed the issue of El Paso's alleged withholding of capacity and determined that the issue is not relevant to this proceeding. Therefore, they assert, Phelps Dodge's objection is not a basis for rejecting the Settlement.

21. As parties point out in the reply comments, the Commission has already addressed and rejected on the merits Phelps Dodge's assertion that the issue of whether El Paso withheld capacity during the period from November 2000-March 2001 is relevant in this proceeding. Phelps Dodge raised this issue in its protest to El Paso's June 30, 2005 tariff filing, and stated that it intended to litigate the capacity withholding contention in this proceeding. In the July 29, 2005 Order, the Commission stated that the capacity withholding allegation is not an issue in this case and could not be addressed at the hearing.[23] Phelps Dodge sought rehearing of the Commission's ruling on this issue, and argued that because El Paso was seeking to roll-in the costs associated with the Power-Up Project,[24] any determination whether El Paso should be permitted to roll-in these costs must address whether El Paso was culpable for the shortfall in the first place.

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[21] Phelps Dodge does not specify what this evidence is.

[22] In the March 20, 2006 Order, the Commission determined that the rate cap did not apply to expansion capacity that was added to the system after December 31, 1995. For the purpose of determining whether specific capacity was part El Paso's system in 1995 or is expansion capacity, the Commission stated that it would presume that the first 4,000 MMcf/d of firm subscribed capacity on El Paso's system is 1995 capacity. March 20, 2006 Order at P 59-60.

[23] July 29, 2005 Order at P 31 and n.26.

[24] Phelps Dodge's August 29, 2005, Joint Request for Rehearing and Request for Clarification, or in the Alternative, Rehearing at 14-16.

22. On July 7, 2006, the Commission issued an order denying Phelps Dodge's request for rehearing. The Commission carefully considered Phelps Dodge's allegations and found that the issue of whether El Paso withheld capacity during the five-month period from November 2000-March 2001 is irrelevant to whether it was prudent for El Paso to construct expansion projects in 2003 or whether the costs of expansion projects should be afforded rolled-in treatment in this proceeding. The Commission explained that in the Capacity Allocation Proceeding, it ruled on the issue of El Paso's culpability for capacity shortfalls, and determined that the capacity shortfall problems on El Paso were caused primarily by growth in full requirements (FR) shippers' demands, and that additional firm capacity was needed on the system to serve the current and future needs of El Paso's firm shippers. The Commission further explained that this decision was based on a determination that the total capacity of El Paso's system in 2002 was not sufficient to meet the contracted capacity requirements of its firm shippers. Whether or not El Paso withheld a portion of this capacity in a prior period would not change this determination. Thus, even if Phelps Dodge were to show that El Paso had withheld capacity during the limited period of time at issue,[25] this would not change the fact that El Paso lacked sufficient capacity to meet the firm needs of its shippers in 2002, and that the Power-Up Project was necessary to meet those firm needs. Any alleged withholding by El Paso during a past period, therefore, would not affect the prudence of the construction of the Line 2000 and the Power-Up Projects and could not affect the Commission's determination that these projects provided system benefits.

23. More importantly, as the July 7, 2006 Order explained, the Commission determined in the Capacity Allocation Proceeding that demands for capacity under the FR contracts would increase significantly into the future. This determination was based in part on the projections from the FR shippers themselves concerning their future demands through December 2006, which showed that their demands would increase to 2.8 Bcf. Thus, in the Capacity Allocation Proceeding, the Commission considered and rejected the arguments of the FR shippers, including Phelps Dodge, that the routine cuts in firm service were not caused by growth in the FR contracts, but by transient events. The Commission noted that concerns over the unreliability of firm service on El Paso had been brought to the Commission's attention by all of El Paso's customers over a long period of time, and it specifically rejected arguments that the impact of El Paso's

[25] The Commission specifically rejected the allegations that El Paso withheld capacity by not operating its system at MAOP and/or by selling capacity to its affiliate. *See El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 62-80.

contracts with its affiliates[26] led to the capacity shortfall. The Commission also rejected the allegation that El Paso withheld capacity by not operating its system at the Maximum Allowable Operating Pressure (MAOP).[27]

24. The Commission also pointed out in the July 7, 2006 Order that the FR shippers themselves, including Phelps Dodge, argued to the Commission in the Capacity Allocation Proceeding, that there was insufficient capacity on El Paso's system to meet core customer needs. Specifically, the FR shippers argued that El Paso lacked up to 1.1 Bcf of capacity needed to service its existing firm shippers. Further, the FR Shippers argued that El Paso should be required to expand its system to meet their growing demands. Several of these shippers argued that El Paso should be required to both dedicate its Line 2000 entirely to FR shippers and construct the additional Power-Up capacity and allocate that capacity entirely to the FR shippers. In addressing the concerns of the FR customers, including Phelps Dodge, the Commission explained that while it does not have the authority to order a pipeline to expand its system, the concerns of the FR shippers should be alleviated because of the additional capacity provided by El Paso's Line 2000 and Power-Up Projects. However, the former FR Shippers, including Phelps Dodge, took the position in the Capacity Allocation Proceeding that El Paso lacked sufficient firm capacity to meet the needs of its customers and that all of the capacity on El Paso, including the new capacity provided by the Power-Up Project, would not be sufficient to meet their demands. The Commission ruled on the merits of Phelps Dodge's allegations in the Capacity Allocation Proceeding, and rejected Phelps Dodge's contentions. The Commission's orders in that proceeding were affirmed by the court.[28]

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[26] The Lander Affidavit alleges that assuming the Line 2000 and the Power-Up capacity were added to the system to replace capacity withheld by El Paso to economically benefit its affiliates, then "as the record in Docket No. RP00-241-000 would reasonably demonstrate, … such expansions would not have been needed to remedy the capacity shortfall identified in the Capacity Allocation Proceeding but for El Paso's unlawful actions." Lander Aff. at 6-7. However, that is not what the record in the California complaint case shows. The Commission also rejected this argument in the July 9, 2003 Order in the Capacity Allocation Proceeding. *See El Paso Natural Gas Co.,* 104 FERC ¶ 61,045 at P 62-80 (2003).

[27] *See El Paso Natural Gas Co.,* 104 FERC ¶ 61,045 at P 62-80.

[28] In its July 9, 2003 order in the Capacity Allocation Proceeding, the Commission addressed and resolved on the merits arguments advanced by Phelps Dodge and others that El Paso had improperly withheld capacity, including 210 MMcf/d to manage

(continued)

25. Thus, as the Commission explained in the July 7, 2006 Order, its decision that El Paso lacked sufficient capacity to meet its shippers' needs was based on its evaluation of the physical capacity of the pipeline system, the current and projected needs of its customers, and the statements of shippers, including Phelps Dodge, that additional capacity was required to meet their needs. The Commission determined that El Paso's total capacity was 5.4 Bcf/d, with the capacity to be provided by the Power-Up Project, and determined that that capacity was required to meet the needs of El Paso's shippers. Even if a portion of this 5.4 Bcf/d had been withheld for several months in a prior period, that would not change the fact that the capacity provided by the Power-Up Project is needed for El Paso to meet its firm service requirements. Accordingly, the Commission properly concluded in the July 7, 2006 Order that Phelps Dodge's withholding allegations were irrelevant in this case.

26. Thus, the Commission has thoroughly analyzed Phelps Dodge's withholding arguments and has found that they lack merit, and further, has concluded that even if their allegations could be proven, they are irrelevant to this proceeding. In fact, Phelps Dodge acknowledges that the argument it now advances has already been presented to and rejected by the Commission. Phelps Dodge states that the genuine issues of material fact that are allegedly in dispute and that relate to the Settlement's disposition of Article 11.2 issues "are virtually all facts that relate directly to El Paso's withholding of capacity in

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transients, *i.e.*, intraday system flow and pressure requirements. The parties referenced the decision of the ALJ in *Public Utilities Commission of the State of California v. El Paso Natural Gas Co.*, 97 FERC ¶ 63,004 (2001), 100 FERC ¶ 63,041 (2002) (California Complaint Case), which held that the amount of available capacity on El Paso should have been calculated based on El Paso operating that system at MAOP. The parties argued, consistent with the finding of the ALJ in the California Complaint case, that El Paso withheld capacity, including the 210 MMcf/d to manage transients, because it did not operate its system at MAOP.

In the July 9, 2003 Order in the Capacity Allocation Proceeding, the Commission specifically rejected this argument on the merits. The Commission held that El Paso was not required to operate its system at MAOP and further held that it was not unreasonable for El Paso to rely on a portion of its capacity to manage transient conditions, caused in large part by the demand of FR shippers. *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 62-80. In affirming these holdings, the court stated, "nor do petitioners persuade us that El Paso improperly withheld capacity." FERC observed, and petitioners did not disprove, that El Paso operated its 'dynamic' pipelines at reasonable levels of capacity." *ACC v. FERC*, 397 F.3d 952, 955 (D.C. Cir. 2005).

2000-01."[29] Phelps Dodge also acknowledges that "there is no record evidence regarding El Paso's culpability shortfalls *due to the Commission's decision to exclude this evidence* from this case."[30] Phelps Dodge's argument, therefore, recognizes that the Settlement is consistent with the prior rulings in this case. Even if the Commission were to reject the Settlement and send the proceeding back to the ALJ, Phelps Dodge would not have the right to litigate the capacity withholding issue at the hearing. Phelps Dodge is, therefore, not impacted in any way by the Settlement with regard to the withholding issue. Phelps Dodge's real objection is not to the Settlement, but to the Commission's prior decisions finding that evidence of El Paso's withholding is not relevant here. However, those decisions are now final and are not subject to collateral attack here.

b. Other Issues Regarding Rate Level

27. The Settlement provides that El Paso may collect through a volumetric surcharge the cost of service effect of capital and related Operation and Maintenance expenses in connection with its pipeline integrity program (PIP). The Settlement also provides for a half cent usage-charge adder, effective May 1, 2007, through the end of the Settlement term.

28. Phelps Dodge states that these charges are not permitted under Article 11.2(a) of the 1996 Settlement. Phelps Dodge states that of greatest importance to it, though, is the fact that the Settlement would accord Article 11.2(a) plus the PIP and usage rates only to about two-thirds of its Rate Schedule FT-1 capacity, while the remaining one-third would not be subject to Article 11.2(a) because of the finding in the March 20, 2006 Order that the rate cap does not apply to expansion capacity.

29. In response, the Joint Commenters and Indicated Shippers state that these costs are *de minimis*, and Phelps Dodge simply ignores the other benefits provided by the Settlement, such as lower rates, more flexible scheduling provisions, the avoidance of future pancaked rate filings that would otherwise apply to Phelps Dodge's non-Article 11.2 rates, the impact of litigation costs, the broader penalty tolerance levels, and the point allocation/aggregation features. These parties state that these features are more favorable to Phelps Dodge than the features the Commission approved in the March 23, 2006 Order.

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[29] Comments of Phelps Dodge at 18-19.

[30] *Id*. at 1-2 (emphasis added).

30. Phelps Dodge fails to allege any harm from these *de minimis* add-ons. In fact, Phelps Dodge only mentions these small charges in passing, and primarily emphasizes that its real concern with the Settlement is the capacity withholding issue. As such, Phelps Dodge's objection does not warrant rejection of the Settlement. These small charges are outweighed by the other benefits of the Settlement, including lower overall rates, avoidance of additional rate increases during the settlement period, lower penalties, and avoidance of litigation expenses.

c. The Effect of Article 16.3 of the Settlement on the Rehearing of the March 20, 2006 Order

31. Article 16.3 of the Settlement provides in pertinent part:

> All requests for rehearing and compliance filing protests associated with the March 20, 2006 Order will remain pending for FERC action (unless EPNG or any Settling Party seeks to withdraw any such pleading as to any issue). Nothing in this Stipulation shall preclude EPNG or any Settling Party from arguing before the FERC by motion (and in any subsequent proceedings on judicial review) for any disposition of these issues, including but not limited to: (1) dismissal of the issues as moot; (2) deferral of the issues for future decision; and/or (3) disposition of the issues by the FERC on the merits, subject to Articles 16.4 and 16.5. EPNG and the Settling Parties agree to defer making any such arguments until 60 days after the Presiding Judge certifies the Stipulation to the Commission under Rule 602, except as necessary to respond to arguments made by any Contesting Party, consistent with this Stipulation. If FERC issues an order addressing any issue on the merits pertaining to the March 20, 2006 Order, such disposition shall not have any effect on EPNG's tariff, contracts or rates before January 1, 2009.

32. Phelps Dodge raises two objections to this provision. First, Phelps Dodge argues that it is structured to discourage Commission action on rehearing of the March 20, 2006 Order and, second, that it would permit the parties to respond to Phelps Dodge's pending request for rehearing of the March 20, 2006 Order. The Commission finds no basis for either of these concerns.

33. First, Phelps Dodge argues that Article 16.3 leaves unresolved the Article 11.2 implementation issues set for hearing by the March 20, 2006 Order. Further, Phelps

Dodge states, to the extent that the Settlement does address any Article 11.2 issues, the resolution is limited to the next two years only and is of no precedential value. Phelps Dodge states that if the Settlement is approved, none of the Article 11.2 issues are likely to be resolved, leaving all legal and factual issues in a continued state of suspense. Phelps Dodge therefore submits that an Order on Rehearing of the March 20, 2006 Order is essential to ensure that El Paso and all shippers are provided with clearly articulated Article 11.2 ground rules for the next rate case, and that simultaneous rejection of the Settlement is also required.

34. Staff, PNM, El Paso Electric, and Electric Generators state in their reply comments that, contrary to Phelps Dodge's assertions, the Settlement does not seek to encourage the Commission to indefinitely defer action on the March 20, 2006 Order.

35. The Commission finds that the Settlement does not discourage the resolution of the pending requests for rehearing of the March 20, 2006 Order. Rather, the Settlement leaves open for Commission determination the timing of a decision on the pending rehearing requests. The Commission determines its own agenda and its own timetable for ruling on pleadings pending before it, and nothing in the Settlement prevents the Commission from acting on the March 20, 2006 Order at any time it deems appropriate. Section 16.3 in no way dictates when the Commission should act on the pending rehearing of the March 20, 2006 Order or encourages postponement of such action.

36. Second, Phelps Dodge argues that Article 16.3 violates Rule 713(d) of the Commission's Rules of Practice and Procedure, which states that the Commission will not permit answers to requests for rehearing. Phelps Dodge asserts that this provision gives El Paso and the settling parties the ability to answer the pending requests for rehearing of the March 20, 2006 Order, and that it would be a violation of Phelps Dodge's due process rights for parties adverse to its position to be given an opportunity to answer its request for rehearing at this juncture. Phelps Dodge argues that, as a matter of public policy, the Commission should not set a new precedent of allowing parties to unilaterally modify the Commission's Rules of Practice and Procedure to the detriment of parties who have relied on the rules.

37. El Paso, Electric Generators, Indicated Shippers, PNM, Southwest, and Staff respond that Phelps Dodge has misconstrued this provision. These parties assert that Article 16.3 does not give parties the right to file a response to Phelps Dodge's request for rehearing and does not affect the Commission's Rules of Practice and Procedure.

38. The Commission finds that nothing in Article 16.3 of the Settlement affects the Commission's Rules of Practice and Procedure or gives parties the right to respond to Phelps Dodge's request for rehearing. Article 16.3 merely states that nothing in the Settlement precludes a party from filing a motion with the Commission providing its

view of how the Commission should dispose procedurally of the pending requests for rehearing, including dismissing those requests as moot, deferring a ruling on those requests for rehearing, and/or ruling on the requests on the merits. The Commission does not interpret this provision as giving any parties the right to file a substantive answer addressing issues raised in Phelps Dodge's or any other party's rehearing request, and apparently the other parties to the Settlement share this view since no answers to any of the requests for rehearing were filed pursuant to Article 16.3. In fact, none of the parties have filed any pleading with the Commission advocating any course of action with regard to the requests for rehearing of the March 20, 2006 Order.[31] Nothing in Article 16.3 affects the Commission's Rules of Practice and Procedure or gives parties any rights that they would not otherwise have,[32] and Phelps Dodge's argument provides no basis for disapproving the Settlement. The Commission finds that the objections that Phelps Dodge raises with regard to the Settlement's treatment of the rates pursuant to Article 11.2 of the 1996 Settlement are without merit.

2. Issues Related to Article 13.4 of the Settlement

39. Article 13.4 of the Settlement provides in pertinent part:

> If the Commission finds that a Contesting Party shall not be bound by the Stipulation, EPNG and the Settling Parties request the Commission to sever the Contesting Party and not make any provision of this Stipulation effective as to the Contesting Party, except as provided below. If any Contesting Parties are severed, such Contesting Parties may subscribe to any new service approved in the orders in this proceeding or any other service under the terms of EPNG's

[31] On December 5, 2006, Salt River submitted a Notice of Withdrawal of its individual Request for Rehearing of the March 20, 2006 Order. Previously, Salt River joined with APS and submitted a Joint Request for Rehearing of the March 20, 2006 Order. Salt River stated that nothing in its Notice of Withdrawal affects the issues raised in the Joint Rehearing Request it submitted with APS.

[32] Rule 212 provides that parties may file procedural motions with the Commission at any time. Therefore, Article 16.3 does not give parties any procedural rights they do not already have. In addition, the Commission has the discretion to allow an answer that would otherwise be prohibited, if it finds the circumstances warrant such an answer. At this juncture, the Commission has not done so with respect to the March 20, 2006 Order.

> tariff; provided, however, that the rates applicable to any such services subscribed to by Contesting Parties shall be the rates filed by EPNG in its July 10, 2006 compliance filing in this proceeding, pending final resolution by the Commission of the rates for such Contesting Parties. EPNG and the Settling Parties agree that severed Contesting Parties shall be allowed to benefit from the following provisions of the Stipulation: Article IV (Accounting Issues); Article 5.1 (Fuel Savings Sharing Mechanism); Article 5.2 (Fuel Rates); Article 6.1(a) (Penalties); Article 6.1(c) (SOC and COC Daily Penalties); Article 6.2 (HEEN), except for Articles 6.2(b), 6.2(d), and 6.2(f); Article 6.3 (Critical Condition No-Notice Rights); Article 6.4 (Critical Condition FDBS Rights); Article 6.6 (Crediting of Penalty Revenues); Article 7.3 (Hourly Overruns); Article 7.4 (Delivery Point Flexibility and Computation of Tolerance Level under NAESB Swing Allocation Methodologies); Article 7.5 (IHSW); Article IX (MDO MHO Issues); Article XII (Refund Floor); and Article 16.1 (FT Priority in Later Cycles). All other provisions of this Stipulation shall not apply to Contesting Parties.

40. Phelps Dodge argues that Article 13.4 is unlawful because it prevents a severed party from benefiting from Sections 7.1(a) and (b), Sections 7.2(a) and (b), and Section 11.3 of the Settlement. The Joint Reply Comments, Staff, Electric Generators, El Paso, Southwest, and El Paso Electric respond that Article 13.4 of the Settlement does not deny Phelps Dodge access to essential services. These parties assert that Article 13.4 properly provides contesting parties with many service benefits despite their opposition to the Settlement, while preventing contesting parties from unfairly benefiting from some provisions of the Settlement and challenging others.

41. As discussed below, the Commission concludes that severance of Phelps Dodge is not appropriate in these circumstances. Therefore, Phelps Dodge's concern regarding this provision is moot.

3. Issues Related to Article 11.3 of the Settlement

42. Article 11.3 of the Settlement provides:

> EPNG agrees to refund all hourly overrun and hourly scheduling penalty charges for the period January 1, 2006 through January 31, 2007, or, if this Stipulation is

> uncontested, through the Effective Date of the Stipulation. In the event that Stipulation is contested, for the period of February 1, 2007, through the Effective Date of the Stipulation, EPNG will compute any refunds of hourly overrun or hourly scheduling penalty amounts by comparing the penalties actually collected to the penalties that would have been collected had the following safe harbor tolerances been in effect: (1) 13% or 200 dth per hour in non-critical conditions; (2) 4-10% (as determined by EPNG's SOC posting) or 100 dth per hour in SOC conditions; (3) 3% or 100 dth per hour in COC conditions. For purposes of computing such refunds, EPNG will also assume that the point aggregation features of Articles 7.2 and 7.4 of this Stipulation had been in effect for refund periods for the contracts and Delivery Points for which the NAESB swing method was selected during the refund period.

43. Phelps Dodge argues that Article 11.3 of the Settlement is unlawful because it provides that El Paso's customers will get larger refunds if the Settlement is uncontested than if it is contested. Phelps Dodge argues that this provision is an attempt by El Paso to exercise its monopoly power by having its shippers coerce the contesting parties into settlement. Phelps Dodge argues that this provision should be struck from the Settlement as contrary to the public interest.

44. Staff, El Paso, Southwest, and El Paso Electric respond that Article 11.3 does not attempt to coerce contesting parties to join the Settlement. Rather, they assert, by providing different refunds if the Settlement is contested versus uncontested, Article 11.3 is simply acknowledging the reality that uncontested settlements are usually approved sooner than contested settlements, and therefore, the new rates and tariff provisions will be implemented sooner under an uncontested settlement.

45. The Commission rejects Phelps Dodge's argument. Article 11.3 places into effect penalty provisions that will maintain system reliability and that we found to be just and reasonable elsewhere in this order. The provision also provides certainty as to the date that penalty provisions will take effect. Further, Article 11.3 did not in fact deter Phelps Dodge from contesting the Settlement. In addition, no other party objected to this provision of the Settlement.

46. In sum, the Commission finds that none of the objections raised by Phelps Dodge present genuine issues of material fact, but instead involve legal or policy issues that can be resolved by the Commission on the merits. Phelps Dodge's concerns regarding El Paso's alleged withholding of capacity have already been thoroughly addressed and

rejected by the Commission in the Capacity Allocation Proceeding and in the prior orders in this proceeding, and are not within the ambit of this proceeding. Further, the Commission finds that Phelps Dodge's concern that Article 16.3 of the Settlement will discourage Commission action on the requests for rehearing of the March 20, 2006 Order is without merit, as is Phelps Dodge's allegation that it would allow parties to respond to Phelps Dodge's request for rehearing. Phelps Dodge's concerns about Article 13.4 of the Settlement are moot because those provisions would apply only if Phelps Dodge were severed to litigate the issues it contests, and the Commission concludes that severance is not appropriate here. The Commission further finds, contrary to Phelps Dodge's contention, that Article 11.3 of the Settlement is not unreasonably coercive. The Commission will now address the standards for approving contested settlements in light of these findings.

B. Standard of Review for Contested Settlements

47. The Commission has broad authority under section 385.602(h) of its regulations to address contested settlements.[33] The Commission may decide the merits of the contested issues if the record contains substantial evidence on which to base a reasoned decision, or if the Commission determines there is no genuine issue of material fact. If the Commission finds that the record lacks substantial evidence or that the contesting parties or issues cannot be severed, the Commission may establish hearing procedures to supplement the record, or it may take other appropriate action.

48. In *Trailblazer Pipeline Co.,*[34] the Commission explained the standards and procedures it employs in ruling on contested settlements. In reviewing a contested settlement, the Commission must first determine whether the settlement presents an acceptable outcome for the case that is consistent with the public interest. Some cases may involve an overriding public interest that outweighs the interest in achieving a settlement. In such instances, the Commission has modified those settlements to be consistent with Commission policy.[35]

49. If the Commission concludes that a contested settlement provides an acceptable outcome for a case, it must next determine the approach it will employ to address the

[33] 18 C.F.R. § 385.602(h) (2007).

[34] *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345 (1998), *reh'g*, 87 FERC ¶ 61,110 (1999), *reh'g*, 88 FERC ¶ 61,168 (1999) (*Trailblazer*).

[35] 85 FERC at 62,341.

contested issues. In *Trailblazer*, the Commission explained four approaches it has taken for approving a contested settlement despite the objections of the contesting party. Under the first approach, if there is an adequate record, the Commission can address each of the contesting party's issues on the merits, approving the settlement if the Commission finds that each of the contesting party's contentions lacks merit. This approach is appropriate where the issues are primarily policy issues or the parties have agreed that the record is sufficient to decide the issues on the merits, but is not appropriate where some of the contesting party's contentions have merit. However, the Commission explained that, even where the settlement cannot be approved under the first approach, it may be approved under other approaches.

50. Thus, under the second approach, even if some individual aspects of a settlement may be problematic, the Commission still may approve a contested settlement as a package if the overall result of the settlement is just and reasonable. Under this approach, the Commission will not render a merits decision on whether each element of the settlement package is just and reasonable and will determine whether the overall package falls within a zone of reasonableness.[36] When the Commission takes this approach, it need not find that the settlement rate is exactly the rate the Commission would find just and reasonable on the merits after litigation and need only find that the settlement rate falls within a zone of reasonableness. The Commission will include a finding under this approach that the contesting party would be in no worse position under the settlement than if the case were litigated.

51. Under the third approach, if the settlement is not found to satisfy the just and reasonable standard, the Commission still may approve the settlement where the benefits of the settlement outweigh the elements of the objection, and the contesting party's interest is too attenuated such that the settlement may be approved under the fair and equitable standard applicable to uncontested settlements.[37] The third alternative usually has included a finding that the contesting party would have another forum in which to

[36] *Id.* at 62,342; 87 FERC at 61,440.

[37] On rehearing, the Commission clarified that under the third approach, it would not preclude approving a settlement based on an analysis that the interests of the consenting parties are "congruent" with those of the ultimate consumers. 87 FERC at 61,441.

raise its contentions, such as through the pipeline's agreement to file a new rate case by a date certain.[38]

52. As a last resort, the fourth alternative is severance of the contesting party, permitting that party to obtain a litigated result, and approving the settlement as to the consenting parties. The Commission's broad discretion in determining whether to sever contesting parties or contested issues has been affirmed by the courts.[39] However, the Commission is obligated to give sufficient consideration to the interests of the contesting parties, even if the settlement has wide support and only one or very few contesting parties oppose the settlement.[40] In a decision involving El Paso's 1996 Settlement, the court held that the Commission can satisfy that obligation in one of three ways: (1) deciding on the merits the issues raised by the contesting parties, (2) if possible, executing a severance that fully protects the contesting parties, or (3) at a minimum, addressing the question of whether the contesting parties' interests are sufficiently likely to be congruent with those of the settling parties so that the Commission can determine that the settling parties' agreement is dispositive of the contesting parties' interests.[41]

53. The Commission explained in *Trailblazer* that it views severance as the option of last resort and the Commission will try to honor a request by the settling parties to approve the settlement as a package.[42] Thus, in considering severance, the Commission determines whether (1) the settlement can be approved on the merits as to both consenting and contesting parties, or (2) the contesting parties have raised a valid concern such that the settlement should be modified for all parties including the consenting parties, in which case severance is inappropriate, and the Commission should issue a merits order applicable to all parties.[43]

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[38] *Id.* at 62,342-43.

[39] *Id*. at 62,340.

[40] *Id*.

[41] *Id*. at 62,341, *citing Southern California Edison Co. v. FERC*, 162 F.3d 116 (D.C. Cir. 1998).

[42] *Id*. at 62,347.

[43] *Id*. at 62,344-45.

C. Application of the Trailblazer Standards to this Settlement.

54. In applying these criteria to Phelps Dodge's objections to this Settlement, the Commission concludes that the Settlement can be approved for all parties, including Phelps Dodge, consistent with both the first and second approach authorized under *Trailblazer*.

55. As an initial matter, the Commission finds that the Settlement reaches an acceptable outcome that is consistent with the public interest. The Settlement provides El Paso's shippers with substantially lower rates than El Paso's filed rates, and eliminates the possibility that El Paso will pancake additional rate increases on top of the Settlement rates during the Settlement period. Therefore, the Settlement provides shippers with rate stability for the term of the Settlement. The Settlement also provides shippers with broader penalty tolerance levels, and the point allocation/aggregation features afforded by the Settlement are more favorable to shippers than the provisions accepted by the March 23, 2006 Order. In addition, the Settlement establishes working groups to address additional areas of concern, including tariff simplification, rate design, cost allocation and fuel recovery. This will benefit El Paso's customers, as indicated by the Settlement's wide-spread support. Specifically, the Settlement is supported by both California and East-of-California shippers, producers, LDCs, a state Commission, and end-users, including electric utilities and generators.

56. Phelps Dodge does not contest any of this. Instead, it argues that it would receive even lower rates than the Settlement rates if the Commission were to permit it to litigate the issue of whether El Paso withheld capacity from November 2001-March 2002.

1. First *Trailblazer* Option

57. As discussed above, under the first *Trailblazer* approach, if the Commission can resolve each of the contesting party's objections on the merits, and if it finds that each of the contesting party's objections lacks merit, it can approve the settlement for all parties over the objections. The Commission has analyzed the objections of Phelps Dodge and has concluded that each lacks merit and does not provide a basis for rejecting the Settlement.

58. As explained above, Phelps Dodge's central objection to the Settlement is that the Settlement rates do not take into account El Paso's alleged withholding of capacity during the period from November 2000 to March 2001, and that the record in this proceeding is incomplete because it does not contain evidence of such withholding. This objection is without merit because, as we have explained, the Commission has previously ruled that Phelps Dodge's allegations regarding withholding are not relevant to this proceeding, and that this issue could not be litigated at the hearing. Thus, the Settlement

is consistent with the Commission's prior rulings on this issue. Moreover, even if the Commission were to reject the Settlement and remand the proceeding to the ALJ for further hearings, Phelps Dodge would not be able to litigate the withholding issue.[44] Further, Phelps Dodge provides no basis for its statement that the *de minimis* PIP charge and usage charge should not be permitted, and alleges no harm from the application of those charges. Instead, Phelps Dodge emphasizes that its real concern with regard to the Settlement rates is that they do not consider whether El Paso withheld capacity in 2000-01.

59. Similarly, Phelps Dodge's other objections are also without merit. As explained above, its concern that section 16.3 of the Settlement would defer issuance of an order on rehearing of the March 20, 2006 Order and would give the settling parties the right to file answers to Phelps Dodge's request for rehearing of that order lack merit. Phelps Dodge's concern that, if severed, it would be denied essential services by Article 13.4 of the settlement is moot because the Commission is not severing Phelps Dodge. The Commission has found that nothing in Article 11.3 is improper or unreasonably coerces contesting parties to join the Settlement.

2. The Second *Trailblazer* Approach

60. Under the second approach, even if some individual aspects of a settlement may be problematic, the Commission still may approve a contested settlement as a package if the overall result of the settlement is just and reasonable. While the Commission finds that the Settlement can be approved under the first *Trailblazer* approach, it is also true that the overall result of the Settlement is just and reasonable, and that Phelps Dodge would be in no worse position under the Settlement than if the case were litigated.

61. As explained above, even if the Commission rejected the Settlement and remanded it to the ALJ for further hearings, Phelps Dodge would not be able to address the issue of El Paso's alleged withholding. It therefore could be in no worse position under the Settlement than if the case were litigated, since, consistent with the Commission's final orders on this issue, the withholding issue could not be raised at the hearing. Moreover, the Settlement provides substantial benefits to all of El Paso's shippers in the form of

[44] *See* The Presiding Judge's Certification of Contested Settlement, Docket No. RP05-422-000, *et al.* at 28-29 (January 22, 2007) (stating that the capacity withholding claims that Phelps Dodge seeks to litigate, and which by its own admission are central to its opposition to the Settlement, have previously been found irrelevant in this case by the Commission in the July 7, 2006 Order, and the Commission has already rejected Phelps Dodge's claims on the merits in orders affirmed by the D.C. Circuit).

lower rates, rate stability, broader penalty tolerance levels, more favorable point allocation/aggregation features, and the establishment of a forum for resolving additional areas of concern. These benefits will place Phelps Dodge in a better position than if the case were litigated.

3. Severance

62. As discussed above, the Commission may sever the contesting party, permitting that party to obtain a litigated result, and approve the settlement as to the consenting parties. However, the Commission views severance as the option of last resort. Given the circumstances of the case, the severance of Phelps Dodge to litigate its claims regarding Article 11.2 is not appropriate. As Phelps Dodge itself points out, severance would be useless since the issues of material fact that are in dispute are "virtually all facts which relate directly to El Paso's withholding of capacity in 2000-01," and in the July 29, 2005 Suspension Order and the July 7, 2006 Order, the Commission held that such evidence was not to be considered in this case. Accordingly, severing Phelps Dodge to permit a hearing on such excluded factual issues is not a lawful option.

D. Standard of Review

63. The settling parties have agreed that the standard of review for any changes to the Settlement will be the *Mobile-Sierra* public interest standard. Section 15.5 of the Settlement further provides:

> In the event the Commission modifies the application of or rejects the "public interest" standard and instead requires that the "just and reasonable" standard applies to Commission-proposed *sua sponte* changes to this Stipulation, EPNG and the Settling Parties agree that such modification or rejection will be an acceptable modification or condition to the approval of Stipulation.

In these circumstances, the Commission modifies the settlement to provide that in the event of Commission-proposed *sua sponte* changes to the settlement, the Commission will apply the just and reasonable standard.

E. Other Matters

64. While the ACC does not oppose the Settlement and proposes no specific modifications to the Settlement, it is concerned that the Settlement provides for an overly complex operational system. The Commission believes that one of the benefits of the Settlement is that it establishes working groups to address shippers' concerns, including

the ACC's concern. The Commission encourages El Paso and its shippers to use these working groups to resolve such concerns.

The Commission orders:

The Settlement is hereby approved, with the modification of the standard of review, as discussed in the body of this order.

By the Commission. Chairman Kelliher and Commissioner Moeller concurring with a separate statement attached.
Commissioner Spitzer not participating.

(S E A L)

Kimberly D. Bose,
Secretary.

APPENDIX: Details of the December 6, 2006 Settlement

Article I of the Settlement describes the factual background and procedural history of these proceedings.

Article II of the Settlement describes the agreement the participants reached as to El Paso's rates for the term of the Settlement. Article 2.1 states that Base Settlement Rates have been agreed to on a "black box" basis. The Settling Parties agree that the term "Base Settlement Rates" shall mean those rates which shall apply for service during the term of the Settlement, with the maximum rates set forth in Appendix B. Furthermore, pro forma Statement of Rates tariff sheets that will be submitted as actual tariff sheets within 30 days of the Effective Date of the Settlement are attached as Appendices D and E. Rates, including the escalation of such rates during the term of the Settlement, have also been agreed to for contracts that are currently eligible for different rate treatment pursuant to Article 11.2(a) of the 1996 Settlement under the March 20 Order.

Article 2.2 provides for a Pipeline Integrity Program (PIP) Surcharge, which will allow El Paso to recover through a volumetric surcharge the cost of service effect of capital and related O&M expenditures in connection with its PIP. Article 2.2 further describes the filings that El Paso will make to implement the surcharge, the costs that will qualify for inclusion in such surcharge, the calculation of the surcharge, true-up procedures, limitations on the level of the surcharge, the amount of costs that can be recovered through the surcharge, and the Settling Parties' rights to challenge the costs subject to specified limitations. Finally, Article 2.3 provides for the sharing of revenues received by El Paso over specified threshold levels during the term of the Settlement. Furthermore, this section specifies the different threshold levels, the percentages of such shared revenues to be provided to El Paso and the customers, the revenues to be included and excluded, eligible shippers and crediting procedures.

Article III describes the resolution of certain cost issues and establishes a pretax rate of return of fifteen (15) percent for purposes of establishing the PIP Surcharge under Article 2.3. Article 3.2 provides depreciation rates as set forth in Appendix C of the Settlement, including a 2.2 percent transmission plant rate and a 0.1 percent negative salvage rate. In addition, Article 3.3 requires El Paso to establish a separate sub-account of Account 108 for negative net salvage, and sets forth the accounting treatment for negative salvage balances.

Article IV describes the resolution of accounting issues relating to FAS 106 obligations and costs, El Paso's *South Georgia*/FAS 109 regulatory asset, and future cost recovery related to these regulatory assets. Specifically, Article 4.1 states that during the term of the Settlement and beginning January 1, 2006, El Paso will amortize the December 31, 2005 net regulatory asset of $8,128,430 related to Post Retirement Benefits

other than Pensions (PBOP) using an amortization period of fifteen years based on the estimated actuarial life of the retiree population. Article 4.2 states that beginning January 1, 2006, and during the term of this Settlement, El Paso will amortize its *South Georgia*/FAS 109 net regulatory asset of $3,919,488 using an amortization period of thirty years based on the estimated remaining plant life. Article 4.3 provides that the foregoing amortization periods are without prejudice to any position El Paso or any Settling Party or Trial Staff may wish to take on FAS 106 or *South Georgia*/FAS 109 issues in any future rate cases. The Settling Parties therefore expressly agree that future cost recovery related to these regulatory assets may be revisited by any participant in El Paso's next general rate case.

Article V of the Settlement addresses fuel issues. Article 5.1 contains a Fuel Savings Sharing Mechanism, under which El Paso may elect to construct facilities to reduce fuel consumption and in return would receive a share of the savings from the project for the first five years that the project is in service. After the first five years, customers would retain all actual fuel savings. Furthermore, costs of projects El Paso elects to construct under this provision would not be recovered in future rates. Article 5.2 provides that El Paso's fuel and lost and unaccounted for (L&U) rates will be determined under the tracking mechanism proposed in El Paso's June 30, 2005 rate filing in this proceeding and approved in the July Suspension Order, as modified by Article 5.1.

Article VI contains provisions regarding daily balancing penalties, critical operation condition (COC) and strained operating condition (SOC) issues. Specifically under the Settlement, El Paso may not charge daily scheduling or variance penalties, except when El Paso has declared COC or SOC and the Settling Parties and El Paso will develop a proposal to refine the conditions under which El Paso may declare COC or SOC. Furthermore, this article provides: (1) for modifications to the HEEN feature of El Paso's tariff, including procedures for addressing certain outstanding HEEN issues; (2) for a no-notice quantity of 10 percent of Transportation Contract Demand (TCD) under Rate Schedule NNTH in both critical and non-critical conditions; (3) for a contract quantity of 10 percent of TCD under Rate Schedule FDBS in both critical and non-critical conditions; (4) procedures for attempting to develop a premium hourly services offering for interruptible transportation similar to premium firm hourly services; and (5) procedures for crediting penalty revenues.

Article VII of the Settlement addresses penalty tolerance levels and computations under El Paso's tariff. Article 7.1 sets forth the computation of daily unauthorized overrun penalties, including associated safe harbor tolerance levels. Article 7.2 sets forth the computation of hourly scheduling penalties and charges under Rate Schedule IHSW, including associated safe harbor levels. Article 7.3 provides that hourly overruns will be stricken from the tariff for simplification purposes and that the hourly scheduling penalty

will apply to any quantities that exceed a shipper's Hourly Scheduled Entitlement, plus the safe harbor tolerance level and quantities under the IHSW Rate Schedule, if applicable. Article 7.4 sets forth provisions governing the allocation of delivery quantities under Section 38 of El Paso's tariff. Finally, Article 7.5 provides for certain rights for shippers and replacement shippers to use service under Rate Schedule IHSW.

Article VIII establishes procedures for the Settling Parties and El Paso to address a number of outstanding issues and initiatives to simplify El Paso's tariff prospectively (Article 8.1), and to address the possibility of alternative rate designs, cost allocations, and fuel recovery mechanisms (Article 8.2). Both Article 8.1 and Article 8.2 include a non-exclusive list of tariff and rate issues, respectively, to be explored.

Article IX addresses MDO/MHO issues. Specifically, Article IX establishes procedures for outstanding issues related to MDO/MHO issues to be resolved informally or by the Commission, for El Paso to file status reports with the Commission until these issues are resolved, and for any MDO/MHO violation penalties to be paid subject to refund.

Article X provides shippers with certain rights to re-contract subject to available capacity. They may move to a higher level premium service at any time, may re-contract for capacity among premium services at any time, or may move to or from Rate Schedule FT-1 to or from premium services, with appropriate notice by June 1, 2008 to become effective on January 1, 2009 (the effective date of El Paso's next rate case). Article 10.3 allows shippers with seasonal total contract demand levels for summer to choose a different total contract demand level for April and/or October. Article 10.4 also provides that El Paso and affected shippers will attempt to resolve issues related to small contract volumes.

Article XI sets forth the amount of refunds that shippers will be due for amounts paid for services and penalties for the period commencing January 1, 2006 through the effective date of the Settlement, subject to some exceptions detailed in Article XI.

Article XII provides for the treatment of certain rates, rate escalations, and surcharges in the calculation of a refund floor for prospective rate-making purposes. The PIP Surcharge and the Usage rate increase that will become effective on May 1, 2007 are to be excluded from the rates in determining the refund floor. They also will be excluded from the escalation calculation for Article 11.2 rate caps under the 1996 Settlement. In determining the refund floor for the next rate case, El Paso will be permitted to use the Article 11.2(a) rates under the 1996 Settlement and the escalation permitted under the 1996 Settlement for such rates, even if lower Article 11.2(a) rates are included in this Settlement.

Article XIII defines Contesting and Settling Parties and governs the rights and obligations of these parties. This Article provides the Settling Parties' requests for Commission disposition of the Settlement if it is contested, and specifically requests the Commission to approve the Settlement over the objection of any Contesting Party if the Commission can make any of the findings enumerated in Article XIII that would allow for such approval in a manner consistent with the Commission's settlement policies. These findings include: (1) the Contesting Party failed to raise a genuine issue of material fact; (2) the Commission can make a merits determination on policy or legal issues raised by the Contesting Party; (3) the Settlement produces an overall just and reasonable result; (4) the Contesting party's interest was sufficiently attenuated so that the Commission could approve the Settlement as an uncontested settlement; or (5) there is substantial evidence that the Settlement is just and reasonable and may be applied to all of El Paso's customers (in which case the Contesting Party would become a Settling Party).

Article 13.4 provides that a Contesting Party may be severed as a last resort if the Commission finds that the Contesting Party is not bound by the Settlement. In that case, a Contesting Party would be subject to the higher rates originally filed by El Paso in its July 10, 2006 Compliance Filing, pending the outcome of the proceeding. However, certain Settlement benefits would apply to the severed Contesting Party, as listed in Article 13.4. Furthermore, the Contesting Party would be permitted to pursue its claims, and El Paso and the Settling Parties would be free to litigate all issues with the Contesting Party, consistent with the Settlement remaining effective for its full term.

Article XIV establishes the Effective Date of the Settlement. Article 14.2 contains procedures for Settling Parties and El Paso to ratify or terminate the Settlement, including provisions for rates and surcharges, in the event that the Commission accepts the Settlement with modifications or conditions. Article 14.3 establishes procedures to ratify or terminate the Settlement, including provisions for rates and surcharges, in the event the Commission issues an order that modifies the Settlement after its effective date. In the Explanatory Statement accompanying the Settlement, El Paso notes that the settlement negotiations among dozens of active parties, including customers, state commissions and Trial Staff were the subject of many publicly-noticed conferences and open to all parties and involved very delicate exchanges of consideration on many complex issues. El Paso represents that any modifications or conditions present significant risks that the settlement would fail, resulting in extensive litigation.

Article XV provides the term of the Settlement, rate and operational issue moratoriums, and exceptions to such moratoriums. Article 15.1 states that the term of the Settlement shall be from the Effective Date of the Settlement through December 31, 2008, and Article 15.3 requires El Paso to file another rate case on June 30, 2008, with the rates to become effective on January 1, 2009. Article 15.2 includes a moratorium on

changes to rates and service/operational issues, as more fully described therein, subject to El Paso's right in Article 15.4 to propose daily penalties to be effective no sooner than January 1, 2008, and Settling Parties' right in Article 15.6 to propose to institute prospectively a short-haul rate that does not reduce the rate and/or revenue responsibility of any Settling Party prior to January 1, 2009. Article 15.5 provides that except as specifically permitted by the Settlement, any changes to the Settlement should be subject to the *Mobile-Sierra* public interest standard of review. The *Mobile-Sierra* public interest standard would also apply to any changes to the services and operational issues addressed by the Settlement, except where El Paso and 80 percent of the Settling Parties mutually agree to a change.

Article XVI addresses matters that are pending before the Commission. Article 16.1 states that the March 20 and March 23 Orders shall not be vacated, and that vacatur of these matters would constitute a material modification of the Settlement. Article 16.2 states that no party shall be required to withdraw a pending request for rehearing or other pleading, but that parties may withdraw pleadings at any time. Under Article 16.3, with respect to the March 20 Order, requests for rehearing and compliance filing protests remain pending for Commission action. Parties may argue that the issues are moot, should be deferred, or should be decided on the merits but not until 60 days after the Settlement is certified to the Commission (unless necessary to respond to Contesting Party). That article further states that if the Commission issues an order addressing any issue on the merits pertaining to the March 20 Order, such disposition shall not have any effect on El Paso's tariff, contracts or rates before January 1, 2009, and that any arguments made before FERC under this Article for disposition of any of these issues on the merits will be accompanied by a request that such disposition not have any effect prior to January 1, 2009.

Article 16.4 discusses a pending issue regarding the level of Southwest Gas Corporation's billing determinants subject to Article 11.2 rates. Under Article 16.5, requests for rehearing, technical conference comments and compliance filing protests on MDO/MHO issues will remain pending for Commission action. Article 16.6 states that, with respect to the March 23 Order, requests for rehearing and compliance filing protests remain pending for Commission action. Under this article, parties are permitted to argue before the Commission that the issues are moot, should be deferred, or should be decided on the merits, but not until 60 days after the Settlement is certified to the Commission, unless necessary to respond to a Contesting Party. The Article further provides that any Commission decision on the merits would not become effective before January 1, 2009, unless otherwise allowed under the Settlement.

Article 16.7 contains provisions related to Phelps Dodge's right to advance certain arguments notwithstanding the Settlement. However, this provision is void if Phelps Dodge opposes the Settlement.

Article XVII contains several miscellaneous provisions concerning: clarification of the tariff regarding FT scheduling priority over new IT nominations in later cycles; an agreement to finalize a Monthly Imbalance Settlement within 35 days; an agreement regarding the rates for alternate point deliveries in upstream zones; El Paso's agreement to provide advance drafts of its tariff filings to Settling Parties and to consider their comments before filing; an agreement that if there is any inconsistency between the tariff sheets and the Settlement, the tariff sheets will control; an agreement to cooperate in preparing corrections if any mistakes in the tariff are later found; rules of construction for the Settlement language; a statement that the Settlement provisions are not severable; a statement that Commission approval constitutes requisite approval to implement its provisions and any waivers necessary to carry out the Settlement provisions; a statement regarding acceptance of pending tariff sheets in relation to the Settlement tariff sheets; a statement that there are no additional remedies to customers except as provided in or reserved under the Settlement; and provisions regarding successors, integration, and the obligations of EPNG and the Settling Parties.

Article XVIII contains reservations of rights with respect to (1) Article 11.2 of the 1996 Settlement; (2) nothing in the Settlement constituting a "settled practice"; (3) the privilege under Rule 602; (4) matters expressly provided for; and (5) parties' retention of rights if the Settlement terminates or is not approved.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

El Paso Natural Gas Co. Docket No. RP05-422-000

(Issued August 31, 2007)

KELLIHER, Chairman, and MOELLER, Commissioner, concurring:

We approve this settlement and find it is in the public interest. We are writing separately to discuss the modification to the settlement concerning the standard of review. The settling parties had included a *Mobile-Sierra* clause providing that the public interest standard of review would govern future changes to the settlement proposed by settling parties, third parties, or the Commission acting *sua sponte*. We recognize the importance of contract certainty, and generally agree that when parties manifest their intent to be bound to an agreement, the Commission should allow itself to be bound to the public interest standard. The Commission will not always allow itself to be bound to the public interest standard, however. *See Maine Public Utilities Commission, et al. v. FERC*, 454 F.3d 278 (D.C. Cir. 2006) (not accepting the public interest standard under limited circumstances).

We agreed to the settlement because timely Commission action is important to preserving the benefit of the bargain the parties entered into. Certain important benefits would be lost to shippers if we do not act today. Moreover, the parties indicated they had no objections to the Commission modifying the standard of review to the just and reasonable standard. We see no reason to deny settling parties the benefit of their bargain, so we support this modification under these unique circumstances.

_____
Joseph T. Kelliher
Chairman

_____
Philip D. Moeller
Commissioner