

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

El Paso Natural Gas Pipeline Company

Docket No. RP05-422-002

ORDER DENYING REHEARING AND GRANTING REQUEST TO STRIKE

(Issued July 7, 2006)

1. On July 29, 2005, the Commission issued an order¹ in this proceeding (*July 29 Order*) accepting and suspending tariff sheets filed by El Paso Natural Gas Company (El Paso), subject to refund and conditions, and establishing a hearing and a technical conference. A timely request for rehearing of that order was filed jointly by Phelps Dodge Corporation and Apache Nitrogen Products (Phelps Dodge).² Phelps Dodge seeks rehearing of the Commission's ruling regarding the issue of alleged withholding of capacity by El Paso during the period of November 2000 to March 2001.³ Phelps Dodge also seeks to strike the testimony of an El Paso witness in the hearing established in the *July 29 Order*. For the reasons discussed below, the request for rehearing is denied and the request to strike is granted.

¹ *El Paso Natural Gas Co.*, 112 FERC ¶ 61,150 (2006).

² Timely requests for rehearing were also filed by Arizona Public Service Company, Blythe Energy, LLC, El Paso Electric Company, El Paso Municipal Customer Group, and Texas Gas Service Company, a division of ONEOK, Inc. Many of the issues raised in these requests for rehearing have been resolved in other orders issued in this proceeding. See *Order on Post-Settlement Issues*, March 20, 2006, 114 FERC ¶ 61,290 (2006), and *Order on Technical Conference*, March 23, 2006, 114 FERC ¶ 61,305 (2006). The Commission will address any remaining issues requiring resolution in a subsequent order.

³ Phelps Dodge raised other issues on rehearing as well, and these issues will be addressed in a subsequent order.

Background

A. Procedural Background

2. On June 30, 2005, El Paso filed a Natural Gas Act section 4 rate case in this proceeding, as required by Article 12 of a 1996 Settlement between El Paso and its customers.⁴ In its filing, El Paso proposed a number of new services, a rate increase for existing services, and changes in certain terms and conditions of service. El Paso proposed three sets of tariff sheets, *i.e.*, primary tariff sheets and first and second alternate tariff sheets. The three sets of tariff sheets proposed different treatments of Article 11.2 of the 1996 Settlement.⁵

3. In the *July 29 Order*, the Commission accepted and suspended El Paso's proposed primary tariff sheets, subject to conditions and to the outcome of a technical conference and a hearing. The Commission accepted El Paso's proposal to provide hourly and daily services, stating that it found similar hourly and daily services on other pipelines to be just and reasonable.⁶ In addition, the Commission stated that the proposed new services are optional for shippers that want to contract for added flexibility. The Commission further found that El Paso's then-current tariff did not give shippers a firm right to hourly variations in service and that, therefore, El Paso's proposal did not restrict current service.

4. The Commission established a technical conference to address, among other things, the terms and conditions of the new services. Technical conferences were held on September 20-21, 2005 and October 19-20, 2005. On November 4, 2005, El Paso submitted revised pro forma tariff sheets in response to discussion and comments at the

⁴ See *El Paso Natural Gas Co.*, 79 FERC ¶ 61,028, *reh'g. denied*, 80 FERC ¶ 61,084 (1997).

⁵ Article 11.2 of the 1996 Settlement places certain limitations on the rates that El Paso can charge to shippers that were parties to that Settlement. El Paso's primary tariff sheets reflected the termination of Article 11.2, the first alternate tariff sheets reflected the continued application of Article 11.2 for eligible contract demand shippers, and the second alternate sheets reflected the continued application of Article 11.2 for all eligible shippers.

⁶ The Commission cited *Colorado Interstate Gas Co.*, 96 FERC ¶ 61,330 (2001); *Portland Natural Gas Transmission System*, 106 FERC ¶ 61,289 (2004), *order on reh'g*, 110 FERC ¶ 61,375 (2005); and *Gulfstream Natural Gas System, L.L.C.*, 100 FERC ¶ 61,018, at P 33 (2002).

technical conference. On March 23, 2006, the Commission issued an order on the technical conference⁷ that accepted the new services, subject to certain conditions and modifications.

5. The Commission also established a hearing to determine just and reasonable rates for the new services. In establishing the hearing, the Commission stated that the issues that may be litigated at the hearing are limited to the rate case issues raised by El Paso's filing.⁸ The Commission addressed a protest filed by Phelps Dodge in which Phelps Dodge stated that it intended to litigate in this proceeding 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 is not at issue in this proceeding and may not be addressed at the hearing.⁹

B. Related Proceedings

6. A brief summary of three related El Paso proceedings, *i.e.*, the *Capacity Allocation Proceeding* (*El Paso Natural Gas Co.*, Docket No. RP00-336-000),¹⁰ the *Power-Up Project Certificate Proceeding* (*El Paso Natural Gas Co.*, Docket No. CP03-1-000),¹¹ and the *California Complaint Case* (*Public Utilities Commission of the State of California v. El Paso Natural Gas Co.*, Docket No. RP00-241-000),¹² will provide helpful background to Phelps Dodge's request for rehearing.

7. **The Capacity Allocation Proceeding.** As stated above, in 1996, El Paso entered into a Settlement with its shippers that established the rates and terms and conditions of service on its system for a ten-year period, *i.e.*, until January 1, 2006. At the time the 1996 Settlement was filed, there was substantial excess capacity on El Paso's system, as California customers had turned back capacity rights in accordance with their contracts. This capacity turnback threatened to increase substantially the rates of the remaining

⁷ *El Paso Natural Gas Co.*, 114 FERC ¶ 61,305 (2006).

⁸ *July 29 Order* at P 31.

⁹ *July 29 Order* at P 31 and n.26.

¹⁰ *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (2002), *order on clarification*, 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).

¹¹ 103 FERC ¶ 61,280 (2003), *reh'g*, 105 FERC ¶ 61,202 (2003).

¹² 105 FERC ¶ 61,201 (2003), *reh'g*, 106 ¶ 61,315 (2004), *appeal dismissed*, *Arizona Corporation Commission v. FERC*, No. 04-1123 (D.C. Cir. October 20, 2005).

El Paso customers. The 1996 Settlement resolved the capacity turnback problem through an agreed-upon sharing of the risk of unsubscribed or undersubscribed capacity. The 1996 Settlement further provided for rate certainty for the ten-year period in the form of a rate cap.

8. At the time of the 1996 Settlement, El Paso served its customers under two types of contracts, contract demand (CD) contracts and full requirements (FR) contracts. CD contracts provide specific delivery rights up to specified quantity limitations at delivery points designated in the contracts. FR contracts provided that El Paso must deliver and the customer must take from El Paso, the customer's full gas requirements each day; there was no limit on the amount of gas the FR customers could take other than the capacity of their delivery points.

9. In approving the 1996 Settlement, the Commission stated that the Settlement was a reasonable resolution of the excess capacity crisis facing El Paso's system at that time.¹³ However, in the first several years of the Settlement period, circumstances on El Paso's system changed dramatically. The turned-back capacity was resold, and the full requirements shippers' load grew substantially.¹⁴ There was no longer sufficient capacity to meet the demands of all firm shippers, causing routine reductions to firm customers' service requests. Firm service on El Paso's system was no longer reliable.

10. In response to the routine cuts in firm service that were taking place on the El Paso system, three shipper groups filed complaints concerning capacity allocation issues. Specifically, in *KN Marketing, L.P. v. El Paso*, Docket No. RP00-139-000, KN Marketing filed a complaint on December 16, 1999, alleging that El Paso's allocation of firm mainline capacity on the east end of its system was unjust and unreasonable because El Paso sold firm capacity in excess of the available capacity. On July 13, 2001, in *Joint Complainants v. El Paso*, Docket No. RP01-484-000, a group of El Paso's California CD customers alleged that El Paso had oversold its firm capacity and that this, combined with the growth of the demand of the FR customers, had resulted in unjust and unreasonable services on the El Paso system. And, on July 17, 2001, in *Texas, New Mexico, and Arizona Shippers v. El Paso*, Docket No. RP01-486-000, a group of El Paso's FR customers, including Apache Nitrogen and Phelps Dodge, alleged that El Paso had violated the NGA by failing to maintain its facilities in a manner that allowed it to provide firm service up to certificated levels. The complaints in Docket Nos. RP01-484-000 and RP01-486-000 asked the Commission to order El Paso to construct

¹³ See *El Paso Natural Gas Co.*, 79 FERC ¶ 61,028, *reh'g denied*, 80 FERC ¶ 61,084 (1997).

¹⁴ *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 at 62,002-03.

new facilities to expand the capacity of its system to enable it to meet its contractual responsibilities to its shippers. In addition, the Commission directed El Paso to file a systemwide capacity allocation proposal in El Paso's Order No. 637 proceeding.

11. On May 31, 2002, the Commission issued an order in the *Capacity Allocation Proceeding* that addressed the complaints and established a framework for resolving the capacity allocation problems that had rendered firm service on El Paso unreliable.¹⁵ The Commission found that El Paso did not have sufficient capacity to meet the needs of its firm customers. To restore reliable firm service on El Paso, the May 31, 2002 Order, among other things, directed that El Paso convert service under full requirements contracts to service under contracts with specific contract demand limits up to El Paso's total capacity so that service to one firm shipper would not adversely affect firm service to others. In response to the arguments of Phelps Dodge and other shippers that El Paso should be required to expand its system to meet their needs,¹⁶ the Commission explained that it does not have the authority under the NGA to order a pipeline to expand its capacity. However, to help alleviate the crisis on its system, El Paso agreed to expand its capacity by an additional 320 MMcf/d through its Power-Up Project. The Commission found that this additional capacity was necessary for El Paso to meet its obligations to its existing customers and allocated all of the additional capacity provided by the Project to the converted FR customers, including Phelps Dodge, at no additional charge through the end of the Settlement period.

12. Specifically, the Commission determined that, with the additional capacity provided by the Power-Up Project, El Paso would have 5.4 Bcf/d of total capacity. Of this 5.4 Bcf/d, approximately 3.9 Bcf/d was needed to serve the existing firm CD contracts.¹⁷ This left approximately 1.5 Bcf/d to serve the firm needs of the FR shippers. The Commission found that the FR firm demands in 2001 were 1.5 Bcf/d.¹⁸ Thus, the Commission concluded that, without the construction of the Power-Up Project, El Paso would have insufficient capacity to meet the contract demand of its CD shippers and the existing full requirements of its FR shippers. In addition, the Commission noted that the

¹⁵ *El Paso Natural Gas Company*, 99 FERC ¶ 61,244 (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 (D.C. Cir. 2005).

¹⁶ *Texas, New Mexico, and Arizona Shippers v. El Paso*, Docket No. RP01-486-000, filed July 17, 2001.

¹⁷ September 26, 2001 El Paso Data Response, Docket No. RP00-336, *et al.*

¹⁸ May 31, 2002 Order at 62,002; July 9, 2003 Order at P 58 and P 64 n.62 .

total 2001 non-coincidental peak demand of the FR shippers was 2.124 Bcf/d¹⁹ and that the FR shippers' peak demands were projected to grow to over 2.8 Bcf/d by 2006.²⁰ These facts supported the Commission's determination that the Power-Up Project was needed for El Paso to provide firm service to its CD and FR shippers.

13. The conversion of FR service to CD service became effective on September 1, 2003. The Commission's decision in the *Capacity Allocation Proceeding* was affirmed by the court in *Arizona Corporation Commission v. FERC (ACC I)*.²¹

14. **The Power-Up Project Certificate Proceeding.** Consistent with its commitment in the Capacity Allocation Proceeding, El Paso filed its application to add additional capacity to its system through its Power-Up Project. In granting the application and issuing a certificate for the Power-Up Project, the Commission cited its finding in the Capacity Allocation Proceeding that El Paso does not have sufficient capacity to meet growing demand for firm service and that firm service had been curtailed through pro rata allocations on a routine basis.²² The order stated that the project would improve service for existing customers and that the project was necessary to restore reliable firm service on El Paso.²³ The order found that the Project will benefit all of El Paso's customers, regardless of their location on the system or their initial contract status.²⁴ The order further held that because the project is specifically designed to enhance existing system operations, flexibility and service, the costs of the Project should be rolled-in to El Paso's rates in its next rate case.²⁵ The Commission's decision in that proceeding is final and was not appealed.

15. **The California Complaint Case.** In April 2000, the California Public Utilities Commission (CPUC) filed a complaint against El Paso and its Marketing Affiliates, El Paso Merchant Energy - Gas, L.P. and El Paso Merchant Energy Company (El Paso Merchant), challenging the justness and reasonableness and effects on competition of three contracts between El Paso and El Paso Merchant. The CPUC also raised issues

¹⁹ July 9, 2003 Order, Appendix B.

²⁰ September 26, 2001 El Paso Data Response, Docket No. RP00-336, *et al.*

²¹ 397 F.3d 952 (D.C. Cir. 2005).

²² 103 FERC ¶ 61,280 at P 5 (2003).

²³ *Id.* at P 23.

²⁴ *Id.* at P 24.

²⁵ *Id.* at P 25.

regarding whether El Paso had engaged in affiliate abuse or violated the Commission's Standards of Conduct for Transmission Providers in bidding for or awarding the El Paso contracts. The Commission set the complaint for hearing.

16. The Chief ALJ presided over three hearings and issued two Initial Decisions, the Phase I ID²⁶ and the Phase II ID.²⁷ In the Phase I ID, the Chief ALJ found that, while El Paso Pipeline and El Paso Merchant had the ability to exercise market power during the term of the El Paso Contracts, the record was not clear that they had done so. The Chief ALJ also found that El Paso Corporation, El Paso Pipeline, El Paso Merchant, and Mojave Pipeline Company had violated the Standards of Conduct in the process leading to the award of the capacity.

17. On the basis of comments filed by the Market Oversight and Enforcement Section of the Commission's Office of the General Counsel (MOE) following issuance of the Phase I ID, the Commission remanded the proceeding to the Chief ALJ for the purpose of reopening the record to conduct a limited supplemental hearing on the issue raised by MOE: whether El Paso Pipeline violated section 284.9 of the Commission's regulations²⁸ by failing to make interruptible transportation (IT) service available during the period from November 1, 2000, through March 31, 2001.²⁹

18. In the Phase II ID, the Chief ALJ affirmed his previous findings of violations of the Standards of Conduct, and he also found that complainants had failed to show that El Paso Merchant had exercised market power. However, the Chief ALJ found that, during the limited period at issue in the Phase II hearing, El Paso Pipeline had failed to schedule all of the capacity that it had posted on its electronic bulletin board and also had failed to post all of the capacity that it had available.

19. While the Commission was reviewing the IDs, El Paso and other parties to the proceeding asked the Commission to defer action pending the outcome of settlement discussions, which culminated with the filing in June 2003 of a Settlement (2003 Settlement) between the CPUC, El Paso, Pacific Gas and Electric Company, Southern

²⁶*Public Utilities Commission of the State of California v. El Paso Natural Gas Co.*, 97 FERC & 63,004 (2001).

²⁷*Public Utilities Commission of the State of California v. El Paso Natural Gas Co.*, 100 FERC ¶ 63,041 (2002).

²⁸18 C.F.R. § 284.9 (2003).

²⁹*Public Utilities Commission of the State of California v. El Paso Natural Gas Co.*, 97 FERC ¶ 61,380 (2001).

California Edison Company, and the City of Los Angeles. The Commission approved the 2003 Settlement, after considering the merits of the contested issues and requiring certain modifications.³⁰ Thus, the Commission never issued an order on exceptions to the two IDs.

20. The Arizona Corporation Commission and a number of former FR shippers, including Phelps Dodge,³¹ petitioned the United States Court of Appeals for the District of Columbia Circuit for judicial review of the Commission's decision approving the 2003 Settlement. *Arizona Corporation Commission v. FERC*, No. 04-1123 (ACC II). These parties argued, inter alia, that the Commission erred in concluding that the Settlement was in the public interest because the Commission did not address the ALJ's findings that El Paso had exercised market power (during the period November 2000- March 2001).

21. On October 20, 2005, the court issued a Judgment in *ACC II* dismissing the petition. The court ordered that:

the petition be dismissed without prejudice to the ability of the petitioners to argue in El Paso Natural Gas Company's pending rate proceeding, F.E.R.C. Docket No. RP05-422-000, that neither the commission's order in the Capacity Allocation Proceeding, *see El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (2002); *El Paso Natural Gas Co.*, 104 FERC, ¶ 61,045 (2003), nor the decision of this court in *Arizona Corp. Commission v. FERC*, 397 F.3d 952 (2005), precludes the argument that El Paso caused the capacity shortfall in 2000-01 by exercising market power to withhold capacity.³²

The court explained that "Petitioners' chief concern in bringing this case is that if they do not prevail with respect to their non-preclusion argument, then they may be estopped from arguing in the subsequent rate proceeding that El Paso acted to withhold capacity on its pipeline." The court stated that, as a matter of prudence, "this issue should not be resolved by the court unless it arises and is of consequence in the subsequent rate

³⁰ *Public Utilities Commission of the State of California v. El Paso Natural Gas Co.*, 105 FERC ¶ 61,201 (2003), *reh'g*, 106 FERC ¶ 61,315 (2004).

³¹ The other petitioners were El Paso Electric Co.; Salt River Project Agricultural Improvement and Power District; UNS Gas, Inc.; City of Mesa Arizona; City of Las Cruces, New Mexico; the Navajo Tribal Utility Authority; Texas Gas Service Co., a division of Oneok Inc.; and Public Service Company of New Mexico.

³² *Arizona Corporation Commission v. FERC*, No. 04-1123.

proceeding. To the extent the Commission later precludes petitioners from raising arguments they have raised in this proceeding under review, they may seek redress in this court at that time.”³³

Discussion

22. Phelps Dodge seeks rehearing of the Commission’s ruling on the capacity withholding issues. As discussed below, the Commission has carefully considered Phelps Dodge’s capacity withholding allegations, and finds them irrelevant to the issue of whether it was prudent for El Paso to construct the Power-Up Project. Accordingly, Phelps Dodge’s request for rehearing is denied.³⁴

Capacity Withholding

23. Phelps Dodge requests rehearing of the Commission’s conclusion in the *July 29 Order* that the issues that may be litigated in the current hearing are limited to the rate case issues raised by El Paso’s filing, and that the issue of whether El Paso was culpable for the capacity shortfall that occurred in 2000-01 may not be raised here. Phelps Dodge argues that El Paso is seeking in this rate case to roll-in approximately \$400 million in costs associated with the new Power-Up Project facilities, and that any determination whether El Paso should be permitted to roll-in these costs must address whether El Paso’s unlawful activities caused the shortfall in the first place. In its request for rehearing, Phelps Dodge asked that the Commission condition its ruling on the outcome of the appeal in *ACC II*. Phelps Dodge asserted that if the Court of Appeals should find that the Commission did not rule on the issue of El Paso’s culpability in the *Capacity Allocation Proceeding* and/or rule that any such decision is not entitled to *res judicata* effect, there would be no legitimate basis for the Commission to refuse consideration of this issue as part of a prudence inquiry in this rate proceeding. After the court issued its Judgment in *ACC II*, Phelps Dodge filed a motion to supplement its request for rehearing, and argues that based on the Judgment, the Commission should rule that all parties are free to address, as part of the hearing’s prudence inquiry, the issue of El Paso’s culpability for the 2000-01 shortfall.

³³ *Id.*

³⁴ Parties also seek rehearing of the Commission’s acceptance of El Paso’s primary tariff sheets, rather than accepting the second alternate tariff sheets, as well as the Commission’s acceptance of hourly and daily services on El Paso. To the extent not already addressed in other orders in this proceeding, the Commission will address these requests in a subsequent order.

24. El Paso responds that the Commission has previously rejected Phelps Dodge's claims that El Paso withheld capacity and thereby caused the curtailments that occurred on the system in 2000-01. El Paso further states that nothing in the court's Judgment requires the Commission to conduct evidentiary hearings in this rate case regarding whether El Paso was at fault for any capacity curtailments.

25. Phelps Dodge answers that, contrary to El Paso's argument, the court rejected the assertion that the Commission previously ruled in the *Capacity Allocation Proceeding* on the issue of El Paso's culpability for capacity shortfalls. Further, Phelps Dodge argues that any explanation given by the Commission at this time regarding how its decision in the *Capacity Allocation Proceeding* resolved the withholding issue would be a *post hoc* explanation and beyond the scope of the Commission's jurisdiction. El Paso responds that the court's dismissal of petitioners' claims did not reach the merits of the case and that the court did not, as suggested by Phelps Dodge, reject the assertion that the Commission had previously ruled on the issue of El Paso's culpability.

26. After carefully considering Phelps Dodge's capacity withholding allegations, we find that the issue of whether El Paso withheld capacity during the relevant five-month period, *i.e.*, from November 2000- March 2001, is irrelevant to whether it was prudent for El Paso to construct the Power-Up Project in 2003 or whether the costs should be accorded rolled-in treatment. As explained below, the Commission found in the *Capacity Allocation Proceeding* that the capacity shortfall problems on El Paso were caused primarily by growth in the FR 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 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 entitlements of its firm shippers. Whether or not El Paso withheld a portion of its capacity in a prior period does not change this determination. Thus, even if Phelps Dodge were to prove that El Paso withheld a portion of this capacity during the limited period at issue (*i.e.*, five months in 2000-2001), this would not change the fact that El Paso lacked sufficient capacity to meet the firm needs of its firm shippers in 2002, and that the Power-Up Project was necessary to meet those firm needs. Any alleged withholding by El Paso in a past period, therefore, would not affect the prudence of El Paso's determination to construct the Power-Up Project nor would it affect the Commission's determination that the project provided system benefits and was eligible for rolled-in rate treatment.

1. The Causes of the Capacity Shortfall on El Paso

27. In the *Capacity Allocation Proceeding*, the Commission addressed at length the causes of the capacity shortfall on the El Paso system at the time the Power-Up Project was proposed.³⁵ The Commission recognized that there was not just one single cause of

³⁵ 99 FERC ¶ 61,244 (2002).

firm service unreliability.³⁶ However, the Commission concluded that the exponential growth in demand of the FR shippers was the most significant cause of the capacity shortfall problem and that El Paso did not have sufficient capacity to meet these growing demands.³⁷ The Commission analyzed data submitted by the parties showing that FR demand on the system had increased significantly from 1995 to January 2001.³⁸ The data showed that the increase in demand was relatively small and steady during the first years after the Settlement, but began to increase significantly in 1998. The FR shippers acknowledged that their demand had grown by approximately 9.5 percent per year since the 1994-1995 test period,³⁹ and stated that there has been a significant growth in the population and economy of the area they serve in the Southwest.⁴⁰ The Commission calculated that the growth in demand under the FR contracts was 72 percent for the period 1994-95 to 2000.⁴¹ The Commission stated that there was no disagreement that volumes demanded under the FR contracts had increased significantly, and concluded that this was the most significant cause of the capacity shortfall on El Paso.⁴²

28. Moreover, and more important to the issue raised by Phelps Dodge, the Commission found that firm demand under the FR contracts would continue to increase significantly into the future. The Commission analyzed data responses by all parties including studies containing FR shippers' own projected demand on El Paso's system through December 2006 that showed that FR shippers' peak demands would grow to in excess of 2.8 Bcf.⁴³ A number of the CD shippers stated that additional planned electric

³⁶ May 31 Order at 62,002, July 9 Order at P 54.

³⁷ May 31 Order at 62,001-02; July 9 Order at PP 32, 54, and 103 n.103. In addition, El Paso's tariff allows it to not construct capacity without compensation.

³⁸ *Id.* at 62,002.

³⁹ *Id.*

⁴⁰ *Id.* at 62,003.

⁴¹ This was based on the FR shippers' statement that in the 1994-1995 test period, the aggregate FR non-coincidental peaks were 969,961 Dth, which multiplied by 9.5 percent over 6 years equals 1,672,011 Dth, which is approximately equal to the 2000 aggregate FR of 1,664,294 Dth. This calculated to a growth in demand of 72 percent for the period 1994-95 to 2000. *Id.* n.27

⁴² *ACC I* at 955.

⁴³ September 26, 2001 El Paso Data Response, Docket No. RP00-336, *et al.*

generation projects in the Southwest, if constructed, would require an additional 2.2 - 2.9 Bcf/d of capacity by 2004.⁴⁴ The Arizona Corporation Commission (ACC) cited the “extraordinary growth” in Arizona’s need for natural gas. The ACC stated that Arizona’s population grew 40 percent from 1990 to 2000, and that Arizona continued to experience high levels of growth in population, economic activity and the resulting demand for utility services. (Comments April 15, 2002 at 3.) The ACC stated that nearly 4,000 additional megawatts of electrical generation capacity were scheduled to be completed within a year, and an additional 4,000 megawatts had been approved or was under construction for completion by the end of 2003.⁴⁵ The ACC stated that most, if not all, of this new generation was projected to be fueled with natural gas.⁴⁶ The Commission found that plans for new gas-fired power plants indicated that future FR growth would be substantial,⁴⁷ and that FR shippers had projected that their need in aggregate would total over 3 BCF over the next few years. The Commission concluded that due to the growth in FR contracts, there was insufficient capacity on El Paso’s system to meet the current demands of its firm shippers, and that El Paso did not have sufficient capacity to meet the growing demands for firm service.⁴⁸

29. The Commission considered and rejected arguments of the FR shippers (including Phelps Dodge) that the routine cuts in firm service were not caused by the growth in FR contracts, but were caused by transient events, including “the pipeline rupture at Carlsbad, New Mexico, an exceptionally dry hydro-electric year, *the controversial El Paso Merchant contracts*, a Topock delivery point problem, and the price differential between the California border and the production basin.”⁴⁹ In rejecting these arguments, the Commission found that there had been *pro rata* reductions in firm service over a long period of time on El Paso, and that El Paso's firm service obligations exceeded its peak day system capacity. The Commission further stated that concerns over the unreliability of firm service were brought to the Commission’s attention by all of El Paso's customers,

⁴⁴ Joint Complainants, pp.19-20 and Exhibit E.

⁴⁵ May 31, 2002 Order at 62,001.

⁴⁶ *Id.*

⁴⁷ *Id.* at 62,003.

⁴⁸ *Id.* at 61,998, 62,001, and 62,008.

⁴⁹ July 9, 2003 Order at P 50 (Emphasis added).

both FR and CD, including Phelps Dodge.⁵⁰ Southwest Gas stated that it had been complaining about firm service degradation on El Paso for 10 years.⁵¹ El Paso stated that it did not have capacity to serve the aggregate needs of the FR and CD customers without the turnback capacity that was made available through the capacity rationalization process and further stated that it lacked the capacity to serve continued FR growth.⁵² The Commission also rejected the ALJ's finding in the CPUC Complaint Case that El Paso withheld capacity by failing to operate its system at the Maximum Allowable Operating Pressure.⁵³

30. The Commission specifically rejected the argument that transient events, including the impact of El Paso's contracts with its marketing affiliates, created a need for additional capacity, and rejected the argument that El Paso withheld capacity by not operating its system at Maximum Allowable Operating Pressure.⁵⁴

2. The Need for Additional Capacity on the El Paso System

31. The FR shippers, 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.⁵⁵ As the court pointed out in *ACC I*, these parties argued that El Paso lacked up to 1.1 Bcf of capacity needed to serve its existing firm

⁵⁰ *Id.* at P 51. The Commission cited *Amoco Energy Trading Corp., Amoco Production Co., and Burlington Resources Oil & Gas Co. v. El Paso Natural Gas Co.*, 93 FERC & 61,060 (2000), and the complaints filed in Docket Nos. RP01-484-000 and RP01-486-000.

⁵¹ July 9, 2003 Order P 51. The Commission cited *Renewed Emergency Request of Southwest Gas Corporation For Extension of Full Requirements Customers Conversion Date and Answer of Southwest Gas Corporation to El Paso Natural Gas Co.* at p. 16 (August 13, 2002). *ACC I* at 954.

⁵² July 9, 2003 Order at P 51. The Commission cited the September 3 Report of El Paso Natural Gas Company in compliance with May 31, 2002 Order at p. 6.

⁵³ July 9, 2003 Order at P 66-80.

⁵⁴ El Paso, as a result of the 1996 Settlement, was under an obligation to market and sell all available firm capacity. Accordingly, the capacity sold to its affiliate was posted and sold as it became available to the market in accordance with the Commission's rules.

⁵⁵ May 31, 2002 Order at 62,025.

customers.⁵⁶ The FR shippers argued in their complaint that El Paso should be required to expand its system to meet their growing demands. In addition, El Paso Electric Company argued that El Paso should be required to dedicate its Line 2000 entirely to FR shippers and to build more capacity to meet growing shipper demands. Southwest Gas argued that El Paso should be required to construct the Power-Up capacity and allocate that capacity to the FR shippers.

32. These shippers also argued that any limitations on the capacity they could take from El Paso and any limitations on their future growth would have dire consequences. The FR shippers, including Phelps Dodge, stated that they are captive customers serving human needs customers, and that limiting FR service would result in severe shortfalls in service to residential customers. Further, the FR shippers asserted that limiting the amount of capacity they could demand from El Paso would result in blackouts and curtailments to human needs customers,⁵⁷ as well as in significant adverse financial impact on the southwestern economy as a whole. Arizona Public Service Company stated that lack of adequate transportation capacity could cause its generation capacity to remain idle during periods of peak demand. The Arizona Corporation Commission stated that reduced access to pipeline capacity would deprive Arizona of essential supplies of natural gas to generate electricity to heat and cool homes, and that any change in allocation must recognize Arizona's growth in population and energy use.

33. In response to these concerns, the Commission explained that it does not have authority under section 5 of the NGA to order a pipeline to expand its capacity,⁵⁸ and that El Paso's Settlements with its customers do not place an obligation on El Paso to expand its system in these circumstances.⁵⁹ In any event, the Commission stated, El Paso had recently expanded its system by adding capacity on its Line 2000 for its existing customers and had made a commitment to further expand its system by implementing its Line 2000 Power-Up Project.⁶⁰ The Commission found and issued a certificate of public convenience and necessity for this additional capacity as necessary for El Paso to meet the needs of its existing customers.⁶¹

⁵⁶ 397 F.3d at 955.

⁵⁷ July 9, 2003 Order at P 81.

⁵⁸ May 31 Order at 62,011.

⁵⁹ July 9 Order at P 101-108.

⁶⁰ May 31 Order at 62,012; July 9 Order at P 109.

⁶¹ 103 FERC ¶ 61,280 at P 23 (2003).

34. The Commission took a number of actions to address the concerns of the FR shippers that they would not have sufficient capacity to meet their needs and the needs of their customers. Thus, the Commission directed El Paso to allocate all of the available and newly provided capacity on its system, after reserving capacity necessary to meet the needs of the CD and FT-2 shippers,⁶² to the FR shippers using each shipper's monthly demand over the last twelve months. This initial allocation included new capacity available from El Paso's Line 2000 (230 MMcf/d) and capacity that would become available through the Power-Up Project (320 MMcf/d) with no added reservation charges to the FR shippers for the remainder of the Settlement period. The Commission further directed El Paso to use monthly demand allocations to meet as much of the customers' non-coincidental demands as possible. The FR shippers continued to argue that this allocation of capacity was not adequate to meet their growing needs. Thus, the 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 that would be provided by the Power-Up Project, would not be sufficient to meet their demands.

3. Phelps Dodge's Withholding Argument is Irrelevant to the Prudence Inquiry in This Rate Case

35. As explained above, the Commission has determined that the capacity shortfall on El Paso was caused primarily by growth in the FR contracts and that the Power-Up capacity was necessary to increase El Paso's total capacity to levels required to enable El Paso to meet the needs of its firm customers. Therefore, even if Phelps Dodge were to prove at the hearing that El Paso had withheld some of the total physical capacity of El Paso's system (5.4 Bcf/d with the capacity from the Power-Up Project) during the limited period from November 2000 to March 2001 at issue, this would not have undercut the Commission's rationale for or the prudence of the Power-Up Project nor the Commission's determination that the project was eligible for rolled-in rate treatment. The pro rata capacity allocations on El Paso took place over a long period of time.⁶³ As the records in the *Capacity Allocation* and Power-Up Project certificate proceedings establish, without the addition of the Power-Up Project capacity, El Paso's capacity was not sufficient to meet the needs of its firm customers.

36. As explained above, El Paso's total system capacity, with the addition of the Power-Up Project capacity, was 5.4 Bcf/d. Of this 5.4 Bcf/d of capacity, 1,480 MMcf/d was available for the FR shippers which approximated the 1,500 MMcf/d of FR shipper

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

⁶³ May 31, 2002 Order.

demand.⁶⁴ Thus, the Commission concluded that, without the construction of the Power-Up Project, El Paso would have insufficient capacity to meet the contract demand of its CD shippers and the existing full requirements of its FR shippers. In addition, the Commission noted that the total 2001 non-coincidental peak demand of the FR shippers was 2.124 Bcf/d⁶⁵ and was projected to grow to in excess of 2.8 Bcf/d in 2006, which indicated that FR demand growth would further strain available capacity. These facts supported the Commission's determination that the Power-Up Project was needed for El Paso to provide firm service to its CD and FR shippers and its determination that the project was eligible for rolled-in rate treatment.

37. The Commission's 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 firm contracted needs of its shippers, 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, Phelps Dodge's withholding allegations are irrelevant to the prudence inquiry in this case.

4. Other Issues

38. Phelps Dodge also requests that the Commission provisionally strike the testimony of El Paso witness Adams, which addresses the issue of El Paso's culpability, subject to the right of El Paso to seek restoration of this testimony should a Court of Appeals ruling restore the issue of El Paso's culpability in a remanded Docket No. RP00-241-000 proceeding and in the prudence inquiry to be conducted in this rate proceeding. The Commission is granting the request. Because, as stated above, the withholding allegations are irrelevant to the prudence inquiry, there is no need for testimony on the issue of El Paso's culpability for withholding.

⁶⁴ May 31, 2002 Order at 62,002; July 9, 2003 Order P 58, P 64 n.62 and P 58.

⁶⁵ July 9, 2003 Order, Appendix B.

The Commission orders:

The request for rehearing is denied and the request to strike is granted.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.