

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Duke Energy Guadalupe Pipeline, Inc.

Docket No. PR05-17-003

ORDER ON REHEARING

(Issued July 21, 2006)

1. Duke Energy Guadalupe Pipeline, Inc. (Guadalupe) has requested rehearing of the Commission's June 2, 2006 Order,¹ which granted rehearing of the Commission's approval of a contested settlement and instituted staff panel procedures. Guadalupe also requests that the Staff Panel be held in abeyance until the Commission has acted on the rehearing request. For the reasons discussed below, we deny rehearing in part and grant rehearing in part. Because all issues raised on rehearing are addressed in this order, we reject the request to hold the Staff Panel in abeyance as moot.

Background

2. Guadalupe operates approximately 500 miles of pipelines in Texas, extending from Katy in the Gulf Coast area of Texas to Waha in West Texas. On August 1, 2005, Guadalupe filed in Docket No. PR05-17-000 a petition for rate approval for the firm and interruptible transportation services rendered under section 311 of the Natural Gas Policy Act of 1978 (NGPA).² Guadalupe proposed, among other things, a maximum system-wide base rate for firm and interruptible transportation service \$.1906 per MMBtu, plus a 1.85 percent Fuel and Lost and Unaccounted For charge. A settlement (Settlement) of the issues was reached by Guadalupe and the Commission staff (Staff), and Guadalupe filed the settlement offer on November 18, 2005. The settlement provided for a maximum system-wide base rate for firm and interruptible transportation service and lending service of \$.1810 per MMBtu, plus the same 1.85 percent Fuel and Lost and

¹ Duke Energy Guadalupe Pipeline, Inc., 115 FERC ¶ 61,289 (2006) (June 2, 2006 Order).

² 15 U.S.C. § 3371 (2000).

Unaccounted For charge Guadalupe had proposed in its initial filing in this case. Mewbourne Oil Co. (Mewbourne), a producer, filed comments opposing the Settlement.

3. In the December 29, 2005 Order approving the Settlement,³ the Commission stated that no party objected to the Settlement's maximum base rate of \$.1810 per MMBtu. However, the Commission stated that Mewbourne opposed the settlement's fuel charge. Mewbourne pointed out that the Settlement's fuel charge exceeded the discounted fuel charge that Guadalupe recovers from its intrastate customers, and asserted that, as a result, the Settlement improperly required the interstate customers to subsidize the fuel use of the intrastate customers. The December 29, 2005 Order rejected this contention, on the ground that the record showed that Guadalupe had calculated the fuel charge in a manner that did not take into account the discounts given to the intrastate customers, and therefore Guadalupe would be solely at risk for any undercollection of fuel costs as a result of discounts offered to intrastate customers.

The June 2, 2006 Order

4. On rehearing, Mewbourne argued that the Commission erred in finding that no party objected to the settlement's maximum base rate of \$.1810 per MMBtu, stating that its comments on the Settlement had opposed the settlement's maximum base rate on the ground that that rate would provide Guadalupe an excessive return on equity. Mewbourne also stated that Guadalupe, in its reply to Mewbourne's comments on the Settlement, had asserted that its fuel charge for both intrastate and interstate customers are based on the fuel use calculated for the various operational segments of Guadalupe's system. Mewbourne stated that it took this to mean that Guadalupe offers lower rates to intrastate customers who are moving their gas a shorter distance than other shippers. Mewbourne contended that Guadalupe should similarly offer interstate customers distance-sensitive fuel charges.

5. The Commission granted rehearing of its approval of the Settlement. The Commission agreed that Mewbourne had opposed the Settlement's base rate, as well as the fuel charge. The Commission stated that, under Rule 602 of its Rules of Practice and Procedure,⁴ the Commission may approve an uncontested settlement upon a finding that the Settlement is fair and reasonable and in the public interest. However, where a settlement is contested the Commission must make an independent finding supported by substantial evidence on the record as a whole that the proposal will establish rates consistent with the statutory standard, here that the rate be "fair and equitable." NGPA

³ Duke Energy Guadalupe Pipeline, Inc., 113 FERC ¶ 61,326 (2005) (December 29, 2005 Order).

⁴ 18 C.F.R. § 385.602(g)(3)(2006).

section 311(a)(2)(B). Therefore, the Commission found that, because the entire settlement is contested, including the Settlement's maximum base rate, the Commission could only approve the Settlement if the Commission could find on the merits that the overall \$.1810 MMBtu settlement transportation rate is less than or equal to the fair and equitable transportation rate the Commission would approve based on a merits resolution of all issues concerning Guadalupe's cost of service and rate design volumes. The Commission found that the present record was insufficient to make such merits holdings. Accordingly, the Commission granted rehearing of its approval of the Settlement and instituted a Staff Panel proceeding pursuant to section 284.123(b)(2)(ii) of its regulations. The Commission stated that in that proceeding, parties may raise all issues concerning whether Guadalupe's proposed rates are fair and equitable, including not only issues concerning Guadalupe's proposed base transportation rate but also issues concerning its proposed fuel retention percentage.⁵

Request for Rehearing

6. Guadalupe argues that the Commission applied the wrong standard for considering contested settlements. It argues that in the June 2, 2006 Order, the Commission applied too stringent a standard when it stated that because the Settlement is contested, the Commission could only approve it if the Commission could make a merits finding that the overall settlement transportation rate is less than or equal to the fair and equitable transportation rate the Commission would approve based on a merits resolution of all issues concerning Guadalupe's cost of service and rate design volumes.

7. Guadalupe argues that, in reaching this conclusion, the Commission improperly relied on *Indicated Shippers v. Sea Robin Pipeline Co.*⁶ It contends that in that order the Commission stated that "settlement rates may be found just and reasonable if they are no higher than the rates which the Commission would have approved based on a merits resolution of all the contested issues in this proceeding."⁷ It argues that the June 2, 2006 Order stands *Sea Robin* on its head by transforming "may be found" into "can only be found" and effectively establishes a new standard for evaluating contested settlements. It argues that this is an impossibly high standard for settlement of any proceeding that had not been set for hearing and proceeded at least through the discovery phase.

⁵ June 2, 2006 Order at P 12.

⁶ 81 FERC ¶ 61,146 (1997) (*Sea Robin*).

⁷ Guadalupe Request for Rehearing at 7 (citing *Sea Robin*, 81 FERC ¶ 61,146 at 61,653).

8. Guadalupe argues that the Commission's finding that the present record is insufficient to support the Settlement is not based on reasoned decision making. It argues that the Commission had an ample record to support its December 29, 2005 Order, including sufficient evidence to support a 12 percent return on equity, which Mewbourne identifies as underlying the base settlement rate. Guadalupe contends that the Commission should be aware from experience that a 12 percent rate of return on equity is well within the range of returns approved for other pipelines, and that it is fully supported in the record as the basis for a fair and equitable rate.

9. Guadalupe also argues that the Commission erred to the extent that it relied on Mewbourne's *ex parte* allegations, which Guadalupe contends are groundless. Guadalupe states that footnote 7 of the June 2, 2006 Order seems to suggest that the decision to establish staff panel procedures may have been influenced by these allegations. It argues that the alleged communications were part of informal settlement negotiations with Staff, and contends that Staff conducted settlement negotiations in this proceeding no differently than it has in any other NGPA section 311 proceeding.

10. Guadalupe argues that the Commission disregarded its own precedent in allowing Mewbourne to incorporate by reference its prior protest into its request for rehearing, a practice that it contends the Commission has rejected as a matter of law. Guadalupe asserts that Mewbourne raised no arguments in its rehearing request, and instead referred only to its prior protest. Guadalupe argues that the Commission provided no rationale for departing from its prior practice, and provided no rational explanation.

11. Guadalupe argues that if the Commission cannot approve the overall settlement based on the objection of the sole protestant, it should sever Mewbourne to litigate its concerns separately. It notes that Rule 602 provides that when presented with a contested settlement, the Commission can "take other action which the Commission determines to be appropriate."⁸ Guadalupe further notes that in *Trailblazer Pipeline Co.*⁹ the Commission stated that severance of a contesting party and approval of a settlement for the consenting parties is within the Commission's broad discretion.¹⁰

12. Guadalupe argues that this would be an equitable approach that would give Guadalupe the benefit of its bargain, which involved concessions by Guadalupe to the benefit of its shippers, while affording Mewbourne with a forum for its concerns. It notes

⁸ 18 C.F.R. § 602(h)(1)(ii)(B) (2005).

⁹ 88 FERC ¶ 61,168 (1999).

¹⁰ *Id.* at 61,564.

that the Commission has used this approach in similar circumstances, such as the *Trailblazer* case cited above.

13. Guadalupe argues that if the Staff Panel goes forward, it should be limited to the specific issues that Mewbourne raised in its protest. It notes that the June 2, 2006 Order establishing staff panel procedures opened the proceeding to “all issues concerning whether Guadalupe’s proposed rates are fair and equitable, including not only issues concerning proposed rates but also issues concerning its proposed fuel retention percentage.”¹¹ Guadalupe notes that it filed its initial petition in this case nearly a year ago, has responded to all of Staff’s data requests, and negotiated in good faith to reach a fair and equitable resolution of all issues. It argues that under these circumstances, it serves no purpose to throw the proceeding open to start over entirely. Guadalupe argues that allowing all issues, including any cost of service element, to be revisited at this stage is prejudicial to Guadalupe, gives Mewbourne an unfair advantage in any subsequent negotiations, and undermines the Commission’s settlement process.

Motion to Hold Proceedings in Abeyance

14. Guadalupe requests that the Commission hold the staff panel proceedings in abeyance. Guadalupe states that since last year, it has expended significant resources preparing its rate filing, responding to data requests, and negotiating the settlement that the Commission approved on December 29, 2005. Guadalupe states that in order to avoid committing additional resources to a staff panel that may prove unnecessary if its petition for rehearing is granted, Guadalupe requests that the Commission hold the Staff Panel in abeyance and suspend the 90 day deadline to certify the record of that proceeding until after the Commission acts on Guadalupe’s rehearing request.

Discussion

15. The Commission rejects Guadalupe’s contention that the Commission erred in granting rehearing of the December 29 Order’s approval of the Settlement in this proceeding. As Guadalupe points out, in *Trailblazer*, the Commission held that the Commission can approve a contested settlement by rendering “a merits decision on each

¹¹ Guadalupe Request for Rehearing at 16 (citing June 2, 2006 Order at P 13).

contested issue.”¹² Guadalupe asserts that the Commission did just that in the December 29 Order approving the Settlement, making merits findings on each issue contested by Mewbourne. Guadalupe accordingly contends that the Commission should reinstate the Settlement under that analysis or explain why it no longer considers such an analysis an appropriate method of approving a contested settlement.

16. The flaw in Guadalupe’s argument is that the December 29 Order did not make merits findings on each of the contested issues. Rather, the December 29 Order approved the Settlement’s base transportation rate on the ground that no one objected to that rate. In other words, the December 29 Order treated the Settlement’s base transportation rate as *uncontested*, and thus never reached the merits of whether the settlement base rate was fair and equitable under NGPA section 311. However, the December 29 Order erred in finding that no one objected to the Settlement’s base transportation rate. As we stated in the June 2, 2006 Order, it is clear from Mewbourne’s comments opposing the settlement that it is contesting not only the settlement’s fuel retention rate, but also the \$.1810 per MMBtu base rate for transportation services. This is the fundamental reason that rehearing was granted in the June 2, 2006 Order.

17. Rule 602(h)(1)(i) of the Commission’s settlement rules provides that, if the Commission determines that an offer of settlement is contested in whole or in part, the Commission may decide the merits of the contested settlement issues, only if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines there is no genuine issue of material fact.¹³ Mewbourne contends that the Settlement transportation rate reflects an excessive return on equity. Because the Settlement proposed in this proceeding is a black box settlement, it does not reflect any agreement on the individual components of Guadalupe’s cost of service, including return on equity. In these circumstances, the Commission could not determine on the merits

¹² See *Trailblazer Pipeline Co.*, 85 FERC ¶ 61,345, at 62,342 (1998), *order on reh’g*, 87 FERC ¶ 61,110 (1999), *order on reh’g*, 88 FERC ¶ 61,168 (1999). *Trailblazer* discussed four methods of approving contested settlements. Rendering a binding merits decision on each of the contested issues is referred to in *Trailblazer* as Approach No. 1. The other approaches are Approach No. 2, where approval of the contested settlement is based on a finding that the overall settlement as a package provides a just and reasonable result; Approach No. 3, where the Commission determines whether the benefits of the settlement outbalance the nature of the objections, in light of the limited interest of the contesting party in the outcome of the case; and Approach No. 4, where the Commission approves the settlement as uncontested for the consenting parties, and severs the contesting parties to litigate the issues.

¹³ 18 C.F.R. § 385.602(h)(1)(i) (2005).

whether the Settlement reflected an excessive return on equity without addressing all issues concerning Guadalupe's cost of service and rate design volumes on the merits.

18. In addition, Guadalupe's concern that the Commission relied on the *ex parte* allegations made by Mewbourne are unwarranted. These allegations played no role in the Commission's decision to grant rehearing and establish staff panel procedures.

19. While Guadalupe is correct that the Commission's standard practice is not to allow parties to incorporate by reference arguments made in prior pleadings, in this case the key issue on rehearing was whether the Settlement base rate was contested. We approved the base rate in the December 29, 2005 Order on the basis that the base rate was uncontested. Once we determined that the base rate was protested, it became necessary to make a merits determination as to all issues affecting the base rate. In this case it was permissible for Mewbourne to point to its prior pleadings to demonstrate that the base rate was, in fact, contested. In the June 2, 2006 Order, we did not grant rehearing due to the specific content of any merits arguments made in Mewbourne's prior protest concerning Guadalupe's return on equity, since we have not made a merits decision on that issue. Rather, we granted rehearing based on the fact that the base rate was protested at all. Therefore any concerns Guadalupe has about arguments in Mewbourne's prior pleadings being incorporated are moot as to our decision to grant rehearing in the June 2, 2006 Order.

20. With regards to Guadalupe's request that Mewbourne be severed, we will permit the issue of severance to be raised at the Staff Panel. The Commission has allowed severance of contesting parties in the past.¹⁴ However, severance must provide the contesting parties an opportunity to obtain a litigated decision of the issues in which they have a legitimate interest.¹⁵ Mewbourne has an interest in Guadalupe's rates, since the gas it produces can be transported to market over Guadalupe's pipeline. Severance may be an option if Mewbourne can transport all its production under its own contracts with Guadalupe.¹⁶ If so, the merits resolution it obtains through staff panel procedures could

¹⁴ As the Commission stated in *Trailblazer Pipeline Co.*, severance puts the pipeline at risk for the recovery of their cost of service. Therefore, the Commission has generally severed parties from settlements only where the pipeline has included a provision in the settlement authorizing contesting parties to be severed. The settlement in this case does not contain such a provision.

¹⁵ *Southern California Edison Co. v FERC*, 162 F.3d 116 (D.C. Circ. 1998) (holding that severance should "fully protect the objecting party's interest").

¹⁶ See, e.g., *Trailblazer Pipeline Co.*, 106 FERC ¶ 61,034, at p 20 (2004), and cases cited.

apply to the transportation of all its production, thus leaving it unaffected by the Settlement. However, the current record does not indicate whether Mewbourne currently holds sufficient capacity on Guadalupe to transport all its production or whether Guadalupe has additional unsubscribed capacity available to sell to Mewbourne. By allowing severance to be raised before the Staff Panel, Guadalupe will have an opportunity to explore these issues and to demonstrate that severance will not hinder Mewbourne's ability to obtain a litigated remedy from this proceeding that will protect all its interests.

21. Guadalupe also argues that the Staff Panel should be limited to the specific issues Mewbourne raised in its protest. However, all issues underlying the base rate have to be open because all we have for a record is the black box settlement. Without more, it becomes necessary to provide an opportunity to examine all of the factors underlying the base rate. Guadalupe does make a valid point in footnote 34 of its request for rehearing, in which it notes that Mewbourne raised the issue of stating fuel charges to reflect consumption on distinct operational pipeline segments for the first time in its request for rehearing.¹⁷ Nevertheless, because Mewbourne could raise the issue at any time in a complaint, we will allow Mewbourne to raise it before the Staff Panel if they so choose.

22. Lastly, Guadalupe asks that we place the staff panel procedures in abeyance until their request for rehearing has been considered. Because this order addresses all the issues raised by Guadalupe on rehearing, the request is now moot. Accordingly, we decline to place the staff panel procedures in abeyance.

The Commission orders:

Rehearing is denied in part and granted in part as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

¹⁷ Guadalupe Request for Rehearing at 14 n.34.