UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

Trailblazer Pipeline Company Docket No. RP03-162-007

ORDER APPROVING SETTLEMENT

(Issued January 23, 2004)

1. On September 22, 2003 Trailblazer Pipeline Company (Trailblazer) filed an Offer of Settlement (Settlement) and an explanatory statement pursuant to Rule 602 of the Commission's Rules of Practice and Procedure.[1] Commission Trial Staff and Trailblazer filed comments supporting the Settlement, and Indicated Shippers[2] filed comments opposing the Settlement. The primary issue raised by the Settlement concerns whether the scope of the severance of contesting parties as defined in the Offer of Settlement is too limited under the circumstances. As discussed below, the Commission will approve the Settlement for the consenting parties, as modified. The Commission will sever the remaining contesting party, the Indicated Shippers, to litigate their direct interest, Trailblazer's rates under present and future contracts, including contracts obtained through capacity release. This order benefits customers since it provides the contesting parties an opportunity to obtain a litigated decision of the issues in which they have a legitimate interest, while preserving the benefits of the settlement for the consenting parties, including lower rates, rate certainty, and the avoidance of the costs of litigation.

I. Background

2. On November 29, 2002, Trailblazer Pipeline Company filed a rate case, as required by the settlement agreement of its prior Section 4 rate case in Docket No. RP97-408. Earlier, in May 2002, Trailblazer had placed in service a substantial expansion of its system, comprised primarily of additional compression added to the existing pipeline system. In the instant rate case, Trailblazer proposed an incremental

[1] 18 C.F.R. § 385.602 (2003).

[2] The members of the Indicated Shippers group are BP America Production Company, BP Energy Co., Burlington Resources Oil and Gas Company, and Marathon Oil Company.

FTS recourse rate for service on the expansion.[3] It proposed a second FTS recourse rate applicable to shippers with contracts prior to Expansion 2002. Trailblazer=s proposed rates reflected a decrease in jurisdictional transportation revenues of approximately $210,000 below its currently effective recourse rates: $91,946 for the existing system and $117,692 for the expansion system. On December 31, 2002, the Commission accepted and suspended the filing, to take effect on January 1, 2003, subject to the outcome of a hearing on the rate issues.[4]

3. As a result of settlement discussions, Trailblazer filed the instant Settlement on September 22, 2003. The Settlement is structured so that the Settlement rates will apply to consenting parties, and provides for the severance of the contesting parties.

4. Trailblazer's system is fully subscribed and operates at a high level of capacity year round. In the twelve-month period ending April 2003, the system operated at close to a 100 percent load factor, with interruptible volumes accounting for less than one percent of system throughput. During this twelve-month period, short-term capacity releases accounted for only about 4.6 percent of the volumes transported on the system. Long-term capacity release volumes accounted for about 18.6 percent of the volumes transported during that period. In total, somewhat less than one quarter of the system's capacity was made up of volumes which were transported other than under long-term firm primary contracts.

5. Article VII provides that the Commission may sever from this Settlement any contesting party for litigation as to its direct interest, as defined therein. Article VII defines direct interest as a "shipper with direct contractual relationship with Trailblazer arising under firm or interruptible transportation (IT) arrangements which have been entered into as of August 1, 2003. Direct interest does not include a shipper's interest with respect to capacity acquired through capacity release." If Article VII is not approved by the Commission without modification, the Settlement shall be deemed withdrawn by Trailblazer and shall have no effect ab initio.

6. According to Article VII, if the Commission on remand or any court on judicial review determines that the rates for contesting parties shall be applicable to such parties= indirect interests, Trailblazer shall have the right to establish a surcharge to recover from consenting parties the rate that took effect January 1, 2003 for the period January 1, 2004 through September 30, 2004, and that the recourse rate for such consenting parties, effective October 1, 2004, shall be 8 cents on a 100 percent load factor basis until revised under Section 4 or Section 5 of the NGA.

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[3] See Trailblazer Pipeline Company, 95 FERC ¶ 61,258 (2001).

[4] 101 FERC ¶ 61,405 (2002).

7. The essential elements of the Offer of Settlement as it will apply to the consenting parties are set forth below.

8. Article II of the Settlement provides that the Settlement rates will become effective on January 1, 2004, subject to the Settlement itself becoming effective. The Settlement rates reflect, among other things, a continuation of the incremental pricing authorized by the Commission for the expansion facilities in Docket No. CP01-64 (2002 Expansion); continuation of the straight fixed-variable rate design; depreciation rates of 1.55 percent on the transmission facilities for the pre-expansion system (Existing System), 5.25 percent for the 2002 Expansion, and 20 percent for General Plant; negative salvage rates of .05 percent for the Existing System and .45 percent for the 2002 Expansion; a pretax overall rate of return of 14.23 percent; a rate base of $50,427,154 for the Existing System and $43,063,464 for the 2002 Expansion; and a total annual cost of service of $17,305,420 for the Existing System and $9,735,859 for the 2002 Expansion.

9. Article III of the Settlement provides for the allocation of fuel reimbursement costs. Specifically, Article III states that the Settlement rates applicable to the shippers on the Existing System include $1,646,698 in costs associated with fuel reimbursement and will remain at this level in future fuel tracking filings under Section 41 of the General Terms and Conditions in Trailblazer=s tariff. All other fuel reimbursement costs incurred for firm transportation shall be collected from the 2002 Expansion shippers.

10. Article IV provides that Trailblazer shall file a general rate case under NGA Section 4 that will be effective no earlier than January 1, 2006 and no later than January 1, 2010, and no consenting party shall have the right to file a complaint under Section 5 of the NGA seeking a revision in rates that will be effective before January 1, 2006.

II. Comments of the Parties

11. Members of the Indicated Shippers oppose the Settlement. These three members of the Indicated Shippers (Marathon Oil Company, BP America Production Company and BP Energy Company) are producers whose gas may be shipped to market over Trailblazer's pipeline. Each currently has firm capacity contracts for relatively small amounts of capacity on Trailblazer's pre-expansion system. Marathon has two contracts for capacity on the original system. One contract, for 21,200 Dths, expires in July 2007, while a second contract for 367 Dths, expires in August 2005. BP America has a capacity contract on the original system for 368 Dths, while BP Energy has a capacity contract on the original system for 367 Dths. These two contracts expire in August 2005. All these contracts are set at the recourse rate for the original capacity. Marathon also

has capacity under two contracts on the expansion system until May 2012, in the amount of 122,500 Dths. Marathon's two expansion facility contracts are negotiated rate contracts, with rates set at levels well above the recourse rate. Accordingly, neither the Settlement nor any litigated recourse rate would apply to Marathon's expansion contracts.

12. Indicated Shippers' primary objection to the Settlement is that its severance provisions are too narrow. They argue that severance must include not only their current contracts with Trailblazer, but also any future transportation contracts, including contracts obtained though capacity release. According to Indicated Shippers, the only possibility of obtaining existing firm capacity on a fully subscribed system such as Trailblazer's is through capacity release. Therefore, severance should also encompass capacity that the party acquires via capacity release.

13. Indicated Shippers further allege that severance should encompass a producer's indirect interests in Trailblazer's transportation rates as a result of the producer's sale of gas to shippers on Trailblazer. Indicated Shippers argue that a substantial amount of the production of the Indicated Shippers can flow on Trailblazer's system. They maintain that the transportation cost to move a producer's gas to markets is a key component of the revenue earned by a producer even when the producer sells at an upstream location (such as the Cheyenne Hub at the upstream terminus of Trailblazer) and the buyer is the shipper on Trailblazer. This is because a shipper compares purchasing gas from a producer at an upstream location on Trailblazer, and shipping the gas on Trailblazer to the delivery market, versus buying the gas at the delivery market. Indicated Shippers stress that this netback pricing plays a big role in determining the gas price at the upstream location, and therefore the indirect interest of Indicated Shippers in such transportation rates must be included in the scope of the issues to be severed from the Settlement. This would mean that the litigation rate would apply to any shipper that is transporting gas purchased from the Indicated Shippers.

14. Trial Staff and Trailblazer state that the Settlement results in an almost 25 percent decrease in the rates originally filed by Trailblazer in this proceeding, from the currently effective level of 11.95 cents to 9 cents.[5] Trial Staff adds that the Settlement provides that these lower rates will become effective on January 1, 2004, rather than prospectively under Section 5 at some point in the distant future after litigation. Given the benefits of the Settlement -- immediate rate relief and significantly lower rates than Trailblazer filed for, rate certainty, the avoidance of the costs of litigation, and continued effective oversight of Trailblazer's rates -- the Trial Staff and Trailblazer maintain, and the

[5] Trailblazer states that there is a similarly substantial reduction in the recourse rate applicable to expansion shippers.

presiding administrative law judge agrees in his October 3, 2003 certification, that there is an adequate basis to find that the Settlement satisfies the standard of Section 385.602(g)(3) and could therefore be approved by the Commission were it an uncontested settlement.

15. On October 3, 2003 the ALJ certified the Settlement as to the consenting parties, and severed Indicated Shippers from the Settlement.[6] In the certification order, the ALJ concluded that the appropriate rates to apply to released capacity or to future contracts were policy and legal issues for resolution by the Commission.[7] However, the ALJ approved the Settlement without modification as appearing fair and reasonable, and in the public interest. The ALJ found that the scope of the severance was not a bar to certification of the uncontested Settlement as regards the consenting parties.[8]

III. Discussion

16. The Commission may approve an uncontested settlement upon a finding that the settlement "appears to be fair and reasonable and in the public interest."[9] Thus, the Commission need not find an uncontested settlement to be "just and reasonable." By contrast, in order to approve a contested settlement, the Commission must make "an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates."[10] When a settlement is contested and the Commission lacks an adequate record to make a finding on the merits that the settlement rates are just and reasonable, the Commission may sever the contesting parties and approve the settlement as uncontested for the consenting parties.[11] However, the severance must provide the contesting parties an opportunity to obtain a litigated decision of the issues in which they have a legitimate interest.[12]

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[6] 105 FERC ¶ 63,001 (2003).

[7] 105 FERC ¶ FERC 63,001 at P 40 (2003).

[8] Id. at P 47-48.

[9] 18 C.F.R. § 385.602(g)(3).

[10] Mobil Oil Corp. v. FERC, 417 U.S. 283, 314 (1974).

[11] 18 C.F. R. § 385.602(h)(1)(iii); United Municipal Distributors Group v. FERC, 732 F.2d 202, 209-210 (D.C. Cir. 1984); Arctic Slope Regional Corp. v. FERC, 832 F.2d 158 (D.C. Cir. 1987).

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

17. The Commission approves the Settlement, as modified, as fair and reasonable for the consenting parties and severs the Indicated Shippers from the Settlement. However, the Commission modifies the severance provision in the Settlement to permit Indicated Shippers to litigate the rate applicable to any contracts in which they have a direct interest, including any future contract they enter into directly with the pipeline and any contracts they obtain through capacity release from another shipper.

18. The Commission has reviewed the Settlement and concludes it may be approved for consenting parties as fair and reasonable and in the public interest. The Settlement results in an almost 25 percent decrease in the rates originally filed by Trailblazer in this proceeding, from the currently effective level of 11.95 cents to 9 cents, with a similarly substantial reduction in the recourse rate applicable to expansion shippers. These lower rates will become effective on January 1, 2004, rather than prospectively under Section 5 at some point in the future after litigation. The benefits of the Settlement include immediate rate relief and significantly lower rates than Trailblazer filed for, rate certainty, and the avoidance of the costs of litigation. Thus, the Commission will approve the Settlement, as modified, for the consenting parties under Section 385.602(g), as fair and reasonable and in the public interest.

19. However, since the Settlement was filed before a hearing was conducted in this case, there is no record that would permit the Commission to find, based on substantial evidence, that the Settlement rates are just and reasonable. Indeed, no party requests that we do that. Rather, the supporting parties ask that we sever Indicated Shippers, in the manner provided in Article VII of the Settlement, so as to permit the Settlement to be approved as uncontested for the consenting parties. The Indicated Shippers are also willing for the Settlement to be approved for consenting parties, if they are severed in a manner that permits them to litigate all matters that affect their interest as owners of gas reserves that may be shipped to market across Trailblazer's system. They assert that the severance provided for in Article VII of the Settlement is too narrow for this purpose.

20. The premise of severance is that it will give contesting parties a full opportunity to litigate their interests. However, while the severance provision in Article VII permits Indicated Shippers to litigate the maximum rate applicable to their existing contracts, the severance provision prevents the Indicated Shippers from litigating the maximum rate that would apply to any contract they may enter into with Trailblazer in the future, whether directly with the pipeline or through capacity release.[13] Trailblazer is currently fully subscribed for firm services, making it unlikely that Indicated Shippers will be able to enter into new firm contracts directly with Trailblazer. However, Trailblazer does

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[13] Article VII excludes from the definition of direct interest, and therefore excludes from the scope of severance, any firm or interruptible contracts entered into with Trailblazer after August 1, 2003.

perform some IT services and firm shippers do engage in capacity releases. So there is a possibility that the Indicated Shippers will enter into interruptible contracts or take capacity releases in the future. We find that, in order to approve the instant Settlement as uncontested for consenting parties, we must sever Indicated Shippers for an opportunity to litigate their entire direct interest in Trailblazer's maximum rates. This includes an opportunity to litigate the maximum rate that would be applicable to any contract the Indicated Shippers may enter into with Trailblazer, either directly or as a result of a capacity release. When the Commission has severed contesting parties in the past, it has never limited severance to parties' existing contracts. For example, in Wyoming Interstate Pipeline Company, Ltd.[14] and Trailblazer Pipeline Company,[15] the Commission approved settlements while severing the direct interests of the contesting parties, but the definition of direct interest under those settlements included all future contracts the contesting parties might enter into including through capacity releases.

21. Furthermore, limiting the severance to existing contracts would be inconsistent with Arctic Slope Regional Corp. v. FERC, 832 F.2d 158 (D.C. Cir. 1987) (Arctic Slope). There, the Commission severed a producer (Arctic) who was not a current shipper on an oil pipeline, but stated that the producer could challenge any future rates when it started to have its oil reserves shipped on the pipeline. In upholding the Commission's approval of the settlement and the severance of Arctic, the court stated: "The Commission has thus safeguarded Arctic's future interest, while saying that it will not be permitted to torpedo a fair and reasonable settlement as to all who have the most direct and immediate interest in these long-lived proceedings."[16]

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[14] Wyoming Interstate Pipeline Company, Ltd., 92 FERC ¶ 61,256 at 61,813-61,814 (2000) (WIC) (approving settlement for consenting parties by severing only Amoco's direct interest, including capacity obtained in the future though capacity release); see also WIC, 87 FERC ¶ 61,339 at 62,305, 62,310 (1999) (approving settlement for consenting parties by severing Amoco to litigate both the firm and the interruptible rate, including capacity obtained in the future though capacity release).

[15] Trailblazer Pipeline Company, 88 FERC ¶ 61,168 (1999) (approving the settlement while severing the direct interests of the contesting party, in which Article VI, Section 6.5 of the amended settlement states that for purposes of the amended settlement, "the term 'direct interest as shipper' means a shipper's relationship with Trailblazer arising under firm, interruptible and/or capacity release transportation arrangements."

[16] Arctic Slope at 167.

22. Accordingly, the Commission's approval of the Settlement for consenting parties is subject to the condition that the severance provision is modified to permit Indicated Shippers to litigate the rate applicable to any contracts in which they have a direct interest, including any future contract they enter into directly with the pipeline and any contracts they obtain through capacity release from another shipper.

23. Indicated Shippers also seek the severance of their indirect interests in rates paid by other shippers. The Commission finds that in the circumstances of this case, Indicated Shippers' interest in Trailblazer's rates can be adequately protected by severance of only their direct interest. The Commission has recognized that to the extent a producers' gas is transported by other shippers to the market, the rates paid by those shippers could affect the netback prices the producer receives for its gas.[17] However, producer netbacks are generally affected only by volumetric transportation rates paid on a current basis -- the IT rate and the firm usage charge. When interruptible service is involved, the Indicated Shippers can choose whether their gas is transported directly and in their own name over Trailblazer or is transported by a third party. The fact that other IT shippers have settled their IT rates should not affect producers. If the litigation in the severed proceeding results in an interruptible rate lower than the settlement interruptible rate, the Indicated Shippers can structure their interruptible transaction so as to take advantage of the litigated rate. On the other hand, if the litigation results in a higher rate, the Indicated Shippers could take advantage of the lower Settlement rate by arranging for interruptible transportation though a marketer or other third party.

24. The Commission recognizes that there may be situations when Trailblazer does not have capacity available for interruptible service and Indicated Shippers cannot obtain firm capacity through capacity release. In these situations, Indicated Shippers' gas must be transported over Trailblazer pursuant to the firm transportation contracts of settling parties. However, the Indicated Shippers' contentions as to why the Settlement firm rates are too high go to the fixed costs reflected in the reservation charge, rather than the variable costs in the usage charge. The Commission finds that producer netbacks are not affected by reservation charges. As the Commission explained in WIC:

> [T]he reservation charges paid by firm shippers are a sunk cost which should not affect the price they are willing to pay for gas purchases on a current basis.[18]

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[17] Trailblazer, 88 FERC ¶ 61,168 at 61,569 (1999).

[18] See WIC, 92 FERC ¶ 61,256 at 61,814 (2000).

25. In addition, modification of the severance provision to include the indirect interests of Indicated Shippers (such that the litigated rate will apply to any contract under which the Indicated Shippers' gas is shipped, even if the shipper is not one of the Indicated Shippers) would significantly reduce the benefits of the Settlement for the settling parties. In WIC, the Commission accepted the proposed settlement while severing only Amoco's direct interest because it found that severance of the producer's indirect interest in the direct shippers' rates could completely undermine the benefits of settlement for the consenting contractual customers:

> The Amoco companies [indirect customers] could fill WIC's system with their produced and purchased gas and obtain the lower rate for that gas, even though WIC's own customers were in agreement with the settlement rate. This would leave WIC with few if any customers paying the settlement rate . . . and would represent a major disincentive to settlement from WIC's standpoint. There would be little or no value in a rate settlement, even one with 100% of WIC's customers, if as a result of litigation with a non-customer, all or a major portion of WIC's throughput would potentially be reduced to the rate determined through litigation.[19]

It is the Commission's long-standing policy to encourage, not discourage, settlements. Rate case settlements almost always involve compromise, as well as a considerable amount of time and expense of all parties, to resolve a multitude of contentious issues. Although we must protect the interests of the nonconsenting party, we must do so in a manner that allows the consenting parties to enjoy the benefits of their bargain.

26. Therefore, allowing Indicated Shippers to litigate the rate applicable to any contracts in which they have a direct interest, including any future contract they enter into directly with the pipeline and any contracts they obtain through capacity release from another shipper, while excluding from the scope of severance Indicated Shippers' indirect interests, provides the best balance between the conflicting interests of the consenting and contesting parties. The severance provision as proposed, with such a narrow definition of "direct interests," inadequately provides the contesting parties an opportunity to obtain a litigated decision of the issues in which they have a legitimate interest. Further, the exclusion from severance of Indicated Shippers' indirect interests in the rates paid by other shippers allows the consenting parties with the more direct and immediate interests to achieve the benefits of the Settlement rate decrease, without the entire agreement being undermined by the more tenuous indirect interests of contesting producers.

[19] WIC, 92 FERC ¶ 61,256 at 61,814 (2000).

27. The ALJ conducted a hearing for Indicated Shippers pursuant to the Settlement severance provision in October 2003. The ALJ issued his initial decision on January 21, 2004. In this order, we have held that the rate determined in that hearing must apply to additional transactions beyond those provided for in the Settlement severance provision. The level of the rate that applies will be based upon our review of the ALJ's initial decision.

The Commission orders:

(A) The Settlement is approved, as modified, for consenting parties.

(B) The Indicated Shippers are severed to litigate the reasonableness of the rate applicable to any contracts in which they have a direct interest, including any future contract they enter into directly with the pipeline and any contracts they obtain through capacity release from another shipper.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.