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UNITED STATES OF AMERICA 100 FERC 63, 041
FEDERAL ENERGY REGULATORY COMMISSION

Public Utilities Commission of the
State of California

v. Docket No. RP00-241-006

El Paso Natural Gas Company
El Paso Merchant Energy Gas, L.P.
El Paso Merchant Energy Company

INITIAL DECISION

(Issued September 23, 2002)

APPEARANCES

Harvey Y. Morris, Esq., Gary M. Cohen, Esq., Arocles Aguilar, Esq., and Jonathan Bromson, Esq. on behalf of Public Utilities Commission of the State of California

Daniel F. Collins, Esq., Stephen P. Freccero, Esq., Kenneth Minesinger, Esq. and Christopher Cobb, Esq. ,on behalf of El Paso Natural Gas Company

David J. Hill, Esq., Douglas G. Robinson, Esq., William Scherman, Esq., and Greg Jones, Esq. on behalf of El Paso Merchant Energy

Kevin Lipson, Esq., Patrick Nevins, Esq., Douglas Beresford, Esq., and Douglas Porter, Esq., on behalf of Southern California Edison Company

Frank R. Lindh, Esq., Charles Middlekauff, Esq., Joshua Bar-Lev, Esq., Paul B. Mohler, Esq. and Michael Stosser, Esq. on behalf of Pacific Gas and Electric Company

Regina Y. Speed-Bost, Esq, Kellie Donnelly, Esq., Edward J. Perez, Esq. and Richard J. Delgadillo, Esq. on behalf of The City of Los Angeles
Barbara S. Jost, Esq. on behalf of Apache Nitrogen Company and Phelps

Dodge Corporation

Douglas Canter, Esq. on behalf of Southwest Gas Corporation

Roger Berliner, Esq. and Megan M. Grant, Esq. on behalf of the County of Los Angeles

John R. Ellis, Esq. on behalf of Southern California Gas Company

James H. McGrew, Esq. on behalf of El Paso Electric Company

John Kroeger, Esq., Peter Simonyi, Esq., and John Roddy, Esq. on behalf of the Federal Energy Regulatory Commission

CURTIS L. WAGNER, JR., CHIEF ADMINISTRATIVE LAW JUDGE:

Statement of the Case

1. The history of these complaint proceedings was set forth in prior orders and in the Chief Judge's Initial Decision issued herein on October 9, 2001, and will not be repeated here.[1]

2. These proceedings arise out of a complaint filed on April 4, 2000, by the Public Utilities Commission of the State of California (CPUC) under section 5 of the Natural Gas Act (NGA) (15 U.S.C. § 717d (1994)) against El Paso Natural Gas Company (El Paso Pipeline), El Paso Merchant Energy-Gas, L.P., and El Paso Merchant Energy Company[2] (jointly, El Paso Merchant). The complaint asserts, inter alia, that three transportation contracts between El Paso Pipeline and El Paso Merchant for approximately 1,220 MMcf/day of firm capacity to California (El Paso Contracts)[3] raise issues of possible affiliate abuse, of anti-competitive impact on the delivered price of gas and the

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[1]Public Utilities Commission of the State of California v. El Paso Natural Gas Company, 97 FERC ¶ 63,004 (2001).

[2]Effective January 1, 2001, El Paso Merchant Energy Company changed its name to El Paso Merchant Energy, L.P.

[3]The El Paso Contracts are attached as Exhibit N to CPUC's complaint.

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wholesale electric market in California, and of the effectiveness of the Block II recall rights established in El Paso Pipeline's 1996 settlement with its transportation customers (El Paso Settlement).

3. On March 28, 2001, the Commission issued an Order Denying Motion for Summary Disposition, Dismissing Complaint in Part, and Setting it for Hearing in Part (March 28, 2001 order).[4] In that order the Commission ruled that the fact that El Paso Merchant controls a large volume of capacity does not, in an of itself, render the El Paso Contracts unjust, unreasonable, or unduly discriminatory. The March 28, 2001, order also found that El Paso Pipeline and El Paso Merchant did not violate the Commission's Standards of Conduct for Interstate Pipelines with Marketing Affiliates (Affiliate Standards)[5] in negotiating and entering into the El Paso Contracts. The Commission further found that the record in these proceedings was incomplete with respect to the question of whether El Paso Pipeline and/or El Paso Merchant had market power, and if so, exercised it so as to drive up the price of natural gas at the California border and directed the Administrative Law Judge to supplement the record on this issue.

4. On June 11, 2001, the Commission issued its Order on Rehearing (June 11, 2001 order)[6] granting in part and denying in part the requests for rehearing of the March 28, 2001, order filed by CPUC, Pacific Gas & Electric Company (PG&E) and Southern California Edison Company (Edison) and setting for hearing the allegations of affiliate abuse and violations of the Affiliate Standards raised by complainants. The June 11, 2001, order also denied the requests for rehearing of the March 28, 2001, order filed by El Paso Pipeline and El Paso Merchant. The Commission determined to set for hearing the issues raised by the CPUC's complaint concerning allegations of affiliate abuse and violation of the Affiliate Standards, pointing out that the Commission now believes that these allegations raised factual issues that are best resolved in an evidentiary hearing.

5. The hearing in the prior phase of these proceedings commenced on April 3, 2001, and concluded on August 6, 2001. The record consisted of 32

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[4]Public Utilities Commission of the State of California v. El Paso Natural Gas Co., 94 FERC ¶ 61,338 (2001).

[5]18 C.F.R. Part 161 (2000).

[6]Public Utilities Commission of the State of California v. El Paso Natural Gas Co., 95 FERC ¶ 61,368 (2001).

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volumes of transcript and comprised 5,573 pages. A total of 515 exhibits were admitted into evidence. Initial briefs were filed on August 24, 2001, and reply briefs were filed on September 14, 2001.

6. On October 9, 2001, the Chief Judge issued the Initial Decision in the prior phase of these proceedings.[7] The Chief Judge in his Initial Decision found that El Paso Pipeline and its affiliates were guilty of affiliate abuse and violations of the Commission's Standards of Conduct for Interstate Pipelines with Marketing Affiliates, 18 C.F.R. Part 161 (2001). The Chief Judge reaffirms that finding in all respects. The Chief Judge further found that, while El Paso Pipeline and El Paso Merchant had the ability to exercise market power, the record in this case is not clear that they did in fact exercise market power during the term of the three contracts for the transportation of natural gas into California, and he held that the market power issue should be dismissed. However, as will be discussed in detail later herein, the evidence presented in this new phase of the proceeding shows that El Paso Pipeline failed to post and make available at least 345 MMcf/d of available capacity at its California delivery points. Consequently, the record in this case now demonstrates an exercise of market power by El Paso Pipeline.

7. Briefs on Exceptions to the Initial Decision were filed on November 15, 2001, and briefs opposing exceptions were filed on December 12, 2001.

8. On October 30, 2001, the Commission's Market Oversight and Enforcement Section of the Office of the General Counsel (MOE) filed comments asserting that the public portion of the record in this proceeding suggests possible violations of section 284.9 of the Commission's regulations. However, MOE stated that the record is insufficient to draw a conclusion that a violation occurred because there may be valid explanations for the existence of unused capacity on the pipeline for the period from November 2000 through March 2001.

9. On November 1, 2001, El Paso Pipeline and El Paso Merchant filed a motion to strike MOE's comments, arguing that MOE's filing is an abuse of process and violates the due process rights of the El Paso companies. On November 9, 2001, Pacific Gas and Electric Company (PG&E) and the Public Utilities Commission of the State of California (CPUC) filed a joint answer opposing the motion to strike. On the same date, Edison filed a similar answer. Both answers urged the Commission to provide for further investigation into

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[7]Public Utilities Commission of the State of California v. El Paso Natural Gas Co., 97 FERC ¶ 63,004 (2001).

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the question of whether El Paso Pipeline made all of its capacity available during the period from November 2000 through March 2001.

10. On December 27, 2001, the Commission denied El Paso Pipeline's and El Paso Merchant's motion to strike MOE's comments and remanded the instant proceeding to the Chief Judge for a limited supplemental hearing (December 27, 2001 order)[8]. The Commission directed the Chief Judge to reopen the record to conduct a further hearing on the limited issue of whether, during the period from November 1, 2000, through March 31, 2001, El Paso Pipeline made all of its capacity available at each of its California delivery points and whether it provided non-discriminatory access to such capacity. The Commission pointed out that the issue of whether El Paso Pipeline made all of its capacity available at its California delivery points is an important issue because gas spot prices during the relevant period were elevated to the $20 to $30 per MMBtu level, with price spikes as high as $60 per MMBtu. The Commission directed the Chief Judge to develop a record for each day from November 1, 2000 through March 31, 2001, of the available capacity at El Paso Pipeline's California delivery points, daily postings of capacity, interruptible transportation nominations for the capacity, the shippers making the nominations, an explanation for any such nomination that was denied, and all other issues related thereto.

11. By order issued on February 27, 2002, 98 FERC ¶ 61,210, the Commission denied El Paso Pipeline's and El Paso Merchant's January 28, 2002, requests for rehearing and reaffirmed its December 27, 2001 order in all respects.

12. The hearing in this phase of the proceedings commenced on March 21, 2002 and concluded on April 10, 2002. The record consists of 14 volumes of transcript and comprises 2,181 pages. There were a total of 219 exhibits admitted in evidence and three items by reference. Initial briefs were filed on May 8, 2002 by: El Paso Pipeline; El Paso Merchant; the CPUC, the City of Los Angeles, California, Edison, and PG&E (jointly); and the Commission Staff. Reply briefs were filed on June 5, 2002, by El Paso Pipeline; El Paso Merchant; the CPUC, the City of Los Angeles, California, Edison, and PG&E (jointly); Southern California Gas Company (SoCalGas); Apache Nitrogen Products, Inc., Arizona Division of Citizens Communications Company, El Paso Electric Company, El Paso Municipal Customer Group, Phelps Dodge Corporation, Public Service Company of New Mexico, Salt River Project,

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

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Southern Union Gas Company, and Southwest Gas Corporation (Jointly); and by the Commission Staff.

Motions to Take Official Notice

13. On June 17, 2002, El Paso Pipeline and El Paso Merchant filed a joint motion to take official notice of (1) documents prepared by Edison and (2) The June 6, 2002 final CPUC decision. The documents involved were filed in a proceeding before the CPUC dealing with a CPUC program called the "Gas Cost Incentive Mechanism" ("GCIM"), as applied to SoCalGas. The first two documents requested to be officially noticed (Attachments A and B of the motion), are written presentations made by Edison to members of the CPUC and their advisors on April 17, 2002, and on April 25, 2002, respectively. The third document (Attachment C of the motion to take official notice), is the CPUC's final decision in the GCIM case, adopted on June 6, 2002, and publicly released on June 10, 2002. The two Edison presentations allege that SoCalGas' conduct caused high prices in California and were intended to persuade the CPUC to alter the findings and rulings in the administrative law judge's proposed decision issued on March 5, 2002. El Paso Pipeline and El Paso Merchant allege that the presentations are relevant to this proceeding because in the GCIM proceeding Edison accused SoCalGas of constraining the "interstate system, resulting in skyrocketing prices" for natural gas during the winter of 2000-2001.

14. El Paso Pipeline and El Paso Merchant allege that the June 6, 2002, CPUC decision is relevant in part because the CPUC found that factors other than hub repayments, such as an explosion on the El Paso Pipeline in August 2000, colder than normal winter weather in Southern California, and the increased electric generation load contributed to high prices in the winter of 2000–2001.

15. On July 2, 2002, SoCalGas filed an answer to the June 17, 2002, motion to take official notice objecting to the first two documents set forth in the motion on the grounds that they are "lobbying materials" consisting of extra-record allegations and arguments concerning the GCIM proceeding. SoCalGas does not object to the Chief Judge taking official notice of the CPUC decision in the GCIM proceeding.

16. Edison filed an answer to El Paso Pipeline and El Paso Merchant's June 17, 2002 motion asserting that none of the complainants in these proceedings has ever maintained that market manipulation by El Paso Pipeline and El Paso Merchant was the sole reason for the California price spikes in 2000-2001.

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Edison further states that it has maintained in these proceedings and in the CPUC proceedings that SoCalGas, as well as El Paso Pipeline and El Paso Merchant, were responsible for the high California border prices. Edison also points out that contrary to El Paso Pipeline and El Paso Merchant's assertion that the CPUC's GCIM decision is inconsistent with the positions that Edison and the CPUC have taken before this Commission; the GCIM decision reinforces what complainants have argued before the FERC. Edison cites the following excerpt from the CPUC GCIM decision appearing at 14, n.1:

> We take official notice that the Commission has argued before the Federal Energy Regulatory Commission (FERC) that the spike in price was caused in large measure by the withholding of capacity on the El Paso system by a marketing affiliate of more than one-third of the pipeline's capacity. The Commission told FERC that spot prices at the California border began returning to more historical levels following the expiration of El Paso's contract with its affiliate in May 2001.

17. On June 21, 2002, El Paso Pipeline and El Paso Merchant jointly requested the Chief Judge to take official notice of a June 13, 2002, motion of Southwest Gas Corporation (SGC) requesting expeditious clarification of the Commission's May 31, 2002, order in Docket Nos. RP00-336-002, et al.[9] Edison filed an answer to El Paso Pipeline and El Paso Merchant's joint motion to take official notice of the SGC pleading. Edison does not object to the Chief Judge taking official notice of the SGC pleading but points out that it adds nothing to the record in this matter.

18. The Chief Judge finds that El Paso Pipeline and El Paso Merchant's motions to take official notice are appropriate. All of the involved documents are public documents either filed with or issued by this Commission or by the CPUC. The Chief Judge hereby takes official notice of the documents referred to by El Paso Pipeline and El Paso Merchant in its June 17, 2002 motion to take official notice. The Chief Judge also takes official notice of the SGC pleading referred to in El Paso Pipeline and El Paso Merchant's June 21, 2002 motion.

The El Paso Merchant Market Power Allegations

[9]El Paso Natural Gas Co., Order on Capacity Allocation and Complaints, 99 FERC ¶ 61,244 (2002).

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19. The Chief Judge's finding in his October 9, 2001, Initial Decision that the record is not clear that El Paso Merchant exercised market power during the term of the three contracts for the transportation of natural gas into California is reaffirmed, and the issue concerning the exercise of market power by El Paso Merchant should be dismissed by the Commission.

20. These proceedings were returned to the Chief Judge by the Commission for a very limited hearing and decision on the new issue of whether El Paso Pipeline made all of its capacity available at its California delivery points during the period November 1, 2000 through March 31, 2001 (the relevant period). The Commission did not remand any issues or allegations from the earlier phases of this case with respect to El Paso Merchant.

21. While El Paso Merchant is not at issue in this phase of the proceedings, the Chief Judge will briefly discuss the allegations made by the Complainants during the hearing. The Complainants offered evidence through Edison's expert witness, Dr. Paul Carpenter, that during a 15-day period in January 2001 when El Paso Merchant did not nominate all of its entitlements, other shippers fully nominated. The Complainants argue that this was anticompetitive conduct. However, the facts in the record of this proceeding are now clear that this 15-day period is the period where the basis differentials in California were at their lowest for the entire 151 days of the relevant period herein (the basis differential is the difference between the price at the basin and the price at the border). If El Paso Merchant was exercising market power during these 15 days, why did the price not go up? No explanation was offered for this. In fact, new evidence in this phase of the proceedings shows that throughout the involved 15-day period other shippers' nominations also dropped by approximately 58 percent (El Paso Merchant Exhibits 238 and 239) on the Permian Basin to PG&E Topock path because they were not fully in the money (transactions are in the money when a shipper can purchase the gas at the basin and sell it at a profit after adding the cost of transportation). Other shippers were able to shift from the Permian Basin path to the San Juan Basin, including El Paso Merchant. However, other shippers had the ability to shift from the PG&E Topock delivery point, which was out of the money, into the San Juan Basin SoCal Gas system path, which was in the money, but El Paso Merchant could not do that with either Bock I or Block II rights because Block II would have been subject to recall and Block I rights were only to PG&E Topock. El Paso Merchant took the exact same measures and options that other shippers took during the involved 15-day period, except where it was prevented from doing so on its Block I and Block II capacity.

22. Again, the Chief Judge finds an absence of any new evidence in this phase of the proceedings to require a change in his ruling in the October 9,

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2001, Initial Decision nor to show in any way an exercise of market power by El Paso Merchant. In fact, the new evidence made available in this phase of the proceeding tends to show that El Paso Merchant acted no different from any other shipper.

Overall Finding

23. The Chief Judge finds that El Paso Pipeline failed to schedule all of the capacity that it posted, and that El Paso Pipeline failed to post all of the capacity that it had available.

Available Capacity and Dispatch During the Relevant Period

The Commission Requirement

24. The Commission's regulations require a pipeline to fully schedule its system and to transport volumes up to its certificated capacity. The Commission's open access rules require a pipeline to make all available capacity available to the market.[10] A pipeline is not permitted to withhold capacity if it receives requests for service that it can fulfill. In other words, if a pipeline receives requests for capacity, it is not enough to offer the capacity by posting, it must also honor those requests.[11] Section 284.9 of the Commission's regulations establishes this requirement.

25. The Commission has historically ruled that pipelines have an affirmative obligation to provide information to shippers regarding available capacity on their systems.[12] Moreover, in Order No. 636, the Commission

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[10] 18 C.F.R. § 284.7(a)(a) and 284.9(a)(1)(2001. Sections 284.7 and 284.9 of the Commission's regulations require interstate pipelines providing service under Part 284 to offer available capacity on a firm or interruptible basis, respectively.

[11] See Order No. 637A, FERC Stats. & Regs., Regulations Preambles July 1996 – December 2000, ¶ 31,099 at 31,564 (2000).

[12] See, *KO Transmission Company*, 74 FERC ¶ 61,101, at 61,320 (1996).

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required pipelines to inform by electronic means all interested persons regarding the availability of capacity at receipt points.[13] Again, in Order No. 637 the Commission reemphasized the importance of providing the market information on available capacity to help shippers structure gas transactions. The Commission explained:

> The free flow of information regarding the natural gas market is critical to the successful creation of a competitive and efficient marketplace. Access to relevant information is necessary for shippers to make informed decisions about capacity purchases, and for the Commission and shippers to monitor transactions to determine if market power is being exercised.[14]

The El Paso Pipeline Capacity

26. El Paso Pipeline had a certificated capacity during the relevant period of 3,290 MMcf/d to its California delivery points. El Paso Pipeline never requested authority to abandon any portion of that certificated capacity. Under these circumstances, El Paso Pipeline was under an obligation to make 3,290 MMcf/d available to its California delivery points.

27. Further, under Section 16.3 of El Paso Pipeline's ten-year settlement approved by the Commission (El Paso Pipeline Exhibit No. EPNG 14), El Paso Pipeline committed to no decrease in the quality or the quantity of gas during the term of the settlement. That service obligation was 3,290 MMcf/d to California.

28. By not making the 3,290 MMcf/d available El Paso Pipeline not only violated § 284.7 and § 284.9 of the Commission's regulations, but also its commitment under the ten-year settlement. Since the average flow during the relevant period was only 2,594 MMcf/d, there was a withholding of 696 MMcf/d of capacity to the California delivery points. While some of the 696 MMcf/d of capacity is unaccounted for, the evidence is clear that an average of 210 MMcf/d of capacity was not made available because El Paso Pipeline did

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[13] Order No. 636, FERC Stats. And Regs., Regulations Preambles, January 1991 – June 1996, ¶ 30,939, at 30,415 (1992).

[14] Order No. 637, FERC Stats. & Regs., Regulations Preambles July 1996 – December 2000, ¶ 31,091, at 31,320 (2000).

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not operate its pipeline at the Maximum Allowable Pressure (MAOP) as it very well could have. The MAOP issue will be discussed further herein. Another 35 MMcf/d was not made available because non-essential maintenance was performed during the relevant period, which could have been performed at any time during the heating season, and because large amounts of capacity were not made available after scheduling Run 2 and Cycle 4 which will be discussed later herein. It also appears that El Paso Pipeline could have flowed an additional 100 MMcf/d through the Pecos node to California by using its Lea County receipt point which is located upstream from the Pecos station, which it chose not to do, even though it had a capacity shortage in its system.

29. The Commission in its December 27, 2001, order directed that the hearing in this phase of the proceedings ". . . address available capacity at El Paso Pipeline delivery points, daily postings of capacity (including intraday postings), interruptible transportation nominations for the capacity, the shippers making the nominations, an explanation for any such nomination that was denied, and all issues related thereto."[15]

30. El Paso Pipeline produced 11,000 pages (El Paso Pipeline Exhibit No. EPNG 53 through 58) which catalogued every nomination to California, both firm and interruptible, day by day for the relevant period, cycle by cycle, every action taken, and every reduction made. This evidence produced by El Paso Pipeline was not challenged.

31. The Complainants' experts took these 11,000 pages of information and discovered that during the period November 1, 2000 through March 31, 2001 (Edison Exhibit No. SCE-198), El Paso Pipeline's average flow to California was only 2,594 MMcf/d. This would indicate that 696 MMcf/d of El Paso's capacity was not utilized during the relevant period. On the other hand, El Paso Pipeline alleges that averages do not result in an accurate showing since actuals have a large variance every day. However, the fact remains from El Paso Pipeline's own records, that El Paso Pipeline failed to flow 696 MMcf/d of gas as it was required to do to its California delivery points.

32. The evidence here shows that El Paso Pipeline had a capacity of 4,500 MMcf/d, as pointed out before herein, that its certificate capacity to California is 3,290 MMcf/d (PUC Exhibit No. PUC-55), that El Paso Pipeline only made 3,925 MMcf/d available on its system, including the gas it carried to Mexico and East of California, and that its <u>average system flow</u> was only 3,825 MMcf/d. EL Paso Pipeline claimed a 97% load factor. However that 97% is

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[15] Public Utilities Commission of the State of California v. El Paso Natural Gas Co., 97 FERC ¶ 61,380**,** at 62,740 – 62,741.

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based on the 3,925 MMcf/d El Paso Pipeline actually made available on its system and not on its capacity of 4,500 MMcf/d. In reality, El Paso Pipeline only delivered 79% of its certificated design capacity.

The Scheduling Issue

The Four Cycle Nomination Schedule

33. El Paso Pipeline adheres to the Gas Industry Standards Board (GISB) standards adopted by this Commission which establish a uniform scheduling system for the transportation of natural gas. The GISB standards establish a uniform gas day. Cycles 1 and 2 occur on the day prior to the gas flow day and Cycles 3 and 4 occur on the gas flow day. Each cycle has deadlines. El Paso Pipeline does two computer runs during each cycle, *i.e.*, "Run 1" and "Run 2." These runs process nominations and confirmations and allocate capacity in accordance with El Paso Pipeline's tariff. Run 1 allocates capacity and communicates results to upstream and downstream operators. Operators respond by confirming whether they can deliver or accept the volumes. Run 2 applies any confirmation reductions.

34. El Paso Pipeline states that capacity not scheduled in a particular cycle is posted in the very next scheduling cycle. The capacity not scheduled at the end of Run 2 in Cycle 4, however, was not posted nor made available to shippers.

35. One of the reasons why El Paso Pipeline did not flow all of its capacity is the manner in which it operated the four cycle nominations schedule. At the conclusion of the Run 2 cycle El Paso Pipeline does not reinstate nominations that are not honored in Run 1 (Staff Exhibit No. Staff-13). The capacity that has been posted and nominated is left unscheduled after Run 2 and is carried over into the following cycle, until completion of the fourth cycle, when the unscheduled capacity is no longer subject to nomination and it remains unused (See El Paso Pipeline Exhibit No. EPNG-76). The evidence here shows that the unused capacity on the El Paso Pipeline system was approximately 1 percent of the capacity that the pipeline posted as available. (Staff Exhibit No. Staff-13). This 1 percent amounts at least to 23.5 MMcf/d of additional capacity that could have been made available to the California delivery points.

36. Interconnected operators provided confirmations by telephone, by electronic file, and by "autoconfirm." El Paso Pipeline followed up on confirmations but it did not have a procedure for following up on under-confirmations. If El Paso Pipeline had not received a confirmation by the

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intra-cycle deadline – 3:30 p.m., Central Time – the El Paso Pipeline personnel telephoned the operator. El Paso Pipeline did not have a system in place that would have permitted additional time to fully schedule its system during Run 2 of the cycle, as good business practice would indicate it should have in order to fully utilize its capacity. This resulted in El Paso Pipeline underutilizing its capacity. If El Paso Pipeline had reinstated its posted capacity in Run 2 of each scheduling cycle, as noted above, approximately 23.5 MMcf/d of additional capacity would have been available during the relevant period. Staff Witness Flanders testified that this amount of capacity would be sufficient to serve 100,000 homes in California. El Paso Pipeline argues that within an hour after receiving knowledge of an under-confirmation becomes known, it is posted on the El Paso Pipeline board and is available to shippers in the next cycle, but not in Run 2. El Paso Pipeline also argues that this is a small amount of capacity and that in any event, natural gas gets to California households through California natural gas systems and not through the El Paso Pipeline system. Again, as pointed out above, this capacity was enough to serve 100,000 homes in California.

37. El Paso Pipeline concedes in its initial brief that when it receives confirmations that differ from quantity nominated, "GISB Standards require that the 'lesser' quantity is to be scheduled unless the parties agree to a different quantity." (El Paso Pipeline Initial Brief at 38-39). However, El Paso Pipeline provided no explanation in the record as to why it failed to work with its customers to use the idled capacity, despite its good relations with its interconnected operators (*See* Tr. pp. 1299-1322, Walker). The Chief Judge believes that El Paso Pipeline could have found a way to use the capacity if it had tried to. As Edison's Witness Santerre testified, El Paso Pipeline could have performed only a single run that included a reinstatement process and by not starting the single run until after all confirmations were received, it would have eliminated the defect that existed in not reinstating, *i.e.*, the absence of the reinstatement step in Run 2; or El Paso Pipeline could have performed a Run 2 reinstatement without a reallocation. Witness Santerre also testified that El Paso Pipeline could have started the Run 1 process after all non-confirmations had been received, which would have allowed interstate reinstatements in Run 1. El Paso Pipeline did not see fit to directly address Witness Santerre's suggested alternatives.

38. El Paso Pipeline also asserted that the Commission's Northwest Pipeline[16] order prevented it from fully scheduling its system. Contrary to El

[16] *Northwest Pipeline Corporation*, 91 FERC ¶ 61,005 (2000); El Paso Pipeline Exhibit No. EPNG-77).

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Paso Pipeline's assertion, the Commission in *Northwest Pipeline* put the responsibility on individual pipelines to schedule efficiently.

El Paso Pipeline Violated its Contractual and Certificate Obligations

39. El Paso Pipeline violated Section 284.7 and 284.9, of the Commission's regulations[17] which require pipelines to make all of their capacity available to the market. The Commission's regulations require El Paso Pipeline to offer its transportation service on a firm basis. Firm basis means that transportation receives the same priority as any other class of firm service and that service must be provided "without undue discrimination or preference in the quality of service provided, the duration of the service, categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind."[18] Section 284.9(b) applies the requirement of non-discriminatory access to interruptible transportation service as well as firm transportation service. The Commission's regulations also provide that pipelines need not provide requested transportation service for which capacity is not available.[19] However, it is pointed out that pipelines must honor valid nominations for which capacity is available.

40. Section 7(e) of the Natural Gas Act (Act), states that a pipeline must be "able and willing properly to do the acts and to perform the service" it proposes in its certificate application.[20] The Commission has previously informed El Paso Pipeline that its service obligations cannot be modified even if customers agree to the modifications, but they "can only be changed by amendments to El Paso's certificates."[21] Section 7(b) of the Act states that after a certificate has been issued, a natural gas company may not abandon all or any portion of a service without the permission and approval of the

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[17] 18 C.F.R. § 284.7(a)(2) and §284.7(a)(3).

[18] 18 C.F.R. § 284.7(b)(1).

[19] 18 C.F.R. § 284.7(f).

[20] 15 U.S.C. §717f(e) (1994).

[21] *El Paso Natural Gas Company*, 54 FERC ¶ 61,316, at 61,955 (1991).

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Commission (*See* Section 717f(b)). This regulatory obligation overrides private contractual arrangements.[22]

The El Paso Pipeline Settlement

41. El Paso Pipeline's certificate obligation is to deliver 3,290 MMcf/d to California customers (See PUC Exhibit No. PUC-55). The 1996 ten-year settlement, approved by this Commission, required El Paso Pipeline not to reduce its commitment to deliver 3,290 MMcf/d to its California delivery points. Section 16.3 of the 10-year settlement states:

> 16.3 Service Obligations. El Paso agrees and confirms that, during the effectiveness of the Stipulation and Agreement, it will maintain and operate facilities sufficient to satisfy and perform the service obligations with respect to both quality and quantity of service imposed upon it by, and subject to the conditions applicable to, the provisions of this Stipulation and Agreement and its firm TSAs in effect on December 31, 1995.[23]

42. Witness Shelton confirmed on the record that El Paso Pipeline's contractual obligation to deliver gas to California customers as of December 31, 1995, was 3,290 MMcf/d (Tr. p. 1054, Shelton). However, El Paso Pipeline provided only 79% of the certificated capacity to its customers during the relevant period (*See* Edison Exhibit No. SCE-198, Yoho Answering Testimony at 5). This resulted in 21% of El Paso Pipeline's capacity being unutilized. The Chief Judge points out that the 79% figure takes into account the effects of the Carlsbad Rupture and the "sick compressors". El Paso Pipeline Witness Somerhalder alleges other reasons why capacity was not made available to California such as diversion of gas to serve east of California loads, reductions in the mainline pressures below maximum allowable pressure, maintenance activities, shipper scheduling frictions, and other interconnection and demand-related reasons. However, the Chief Judge does not find Mr. Somerhalder's reasoning persuasive. El Paso Pipeline was very much aware of its growing East of California and Mexican markets (*See* PUC

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[22] *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979*); California v. Southland Royalty Co.*, 436 U.S. at 525 (1978).

[23] El Paso Pipeline Exhibit EPNG-14 at 40-41.

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Exhibit Nos. PUC-56 and PUC-57) and should have taken steps to increase its capacity accordingly, which it did not.

El Paso Pipeline did not Operate at MAOP

43. As the Chief Judge pointed out before herein, El Paso Pipeline's failure to operate at MAOP reduced its available capacity by 210 MMcf/d. Edison's Witness Yoho, Staff Witness Flanders, and even El Paso Pipeline experts Hereth and Zurcher agreed that a pipeline should at least attempt to operate at MAOP. Witness Yoho's examination of the actual records of four important compressor stations on El Paso Pipeline's system demonstrated that they were operating at levels significantly below MAOP and that none of the stations operated at MAOP during the relevant period.

44. In Wyoming-California Pipeline Company[24], this Commission addressed the question concerning whether pipelines can operate at MAOP as follows:

> With regard to operation at MAOP, we note that, contrary to Wycal's position, pipeline proposals filed with the Commission routinely show pipeline operating pressures at MAOP. Also, we do not understand that the pertinent regulations of the Department of Transportation prohibit MAOP operation. To the contrary, they implicitly allow for fluctuations above MAOP by requiring pressure relief devices which are to be set such that the "maximum allowable operating pressure of the station piping and equipment is not exceeded by more than 10 percent." (49 C.F.R. § 192.169(a)). This allowable fluctuation is well within the 2 percent tolerance cited by WyCal as the accuracy of its pressure control equipment.

45. Further, the regulations of United States Department of Transportation, which has exclusive jurisdiction over interstate natural gas pipeline safety, provide that large pipeline can be safely operated at MAOP plus 10 percent.[25]

46. El Paso Pipeline argues that it is not acceptable to run in excess of MAOP. It also argues that pipelines run on transients and not a steady flow. El Paso Pipeline further argues that Complainants' assertion that 210 MMcf/d

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[24] *Wyoming-California Pipeline Company*, 45 FERC ¶ 61,234 at 61,686 (1988).

[25] 49 C.F.R. § 192.201(a)(2)(i) (2001).

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of additional capacity would be available if El Paso Pipeline operated at MAOP was based on average pipeline pressure over the 151-day relevant period. El Paso Pipeline contends that it operated close to MAOP on many days. Its Witness Healy testified that the pipeline operated at MAOP whenever it could if operating conditions existed. El Paso Pipeline states that transients prevent operation at MAOP on a sustained basis. The transients referred to by El Paso Pipeline include imbalances on even hourly takes, reduced head station pressures, and changes in receipt and delivery points. At the same time, Edison Witness Yoho pointed out that El Paso Pipeline is not unique and that transient flow conditions are continually occurring on all pipelines and that transient conditions do not prevent pipelines from operating at, or at least very near MAOP. The Chief Judge finds that transient conditions occur on all pipelines and that El Paso Pipeline should have operated its pipeline in such a manner that would have permitted it to meet its certificate obligation, while taking into account possible transients.

47. The record is clear that El Paso Pipeline could have operated at or near MAOP without violating the Department of Transportation's regulations and could have made available an additional 210 MMcf/d of capacity to its California delivery points. Not doing so was a violation of El Paso Pipeline's certificate obligation to transport 3,290 MMcf/d to the California border. The Chief Judge can understand a reluctance to run a pipeline at the allowable and expected MAOP when it has just suffered a rupture in its pipeline which resulted in deaths. At the same time, he finds that El Paso Pipeline was under a duty to maintain its pipeline in a condition that would permit operation at or close to MAOP, if necessary, to meet its certificate obligations.

48. Again, the Chief Judge finds that El Paso Pipeline could have made and posted an additional 210 MMcf/d of capacity available to its California delivery points had it operated at or near MAOP as it was permitted to do and which it should have. The Chief Judge finds this failure to operate at or near MAOP constitutes a clear withholding of available capacity by El Paso Pipeline, and is a clear violation of its duty to fulfill its certificate obligation.

El Paso Pipeline's Failure to Bring Mothballed Compressors On-Line

49. Prior to the relevant period, El Paso Pipeline mothballed many of its mainline compressors and reduced the available capacity to its California delivery points and tightened the supply. El Paso Pipeline bought some of the compressors back on line before the relevant period herein, but it did not bring the Florida A and B compressors back on line until March 2001, and the Deming B compressor and the Tucson B compressor until June 2001 – after

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the relevant period. The Complainants allege that these three compressors were necessary to meet El Paso Pipeline's increased demand, that they would have provided significant additional capacity on El Paso Pipeline's southern mainline, and that the recommissioning of these compressors was wholly within El Paso Pipeline's discretion. El Paso Pipeline points out that as a result of the Carlsbad rupture, which occurred upstream of the Florida, Deming, and Tucson compressors, there was a constraint upstream of those compressors that precluded El Paso Pipeline from making more capacity available from activating those units. Under these circumstances, it does not appear to the Chief Judge that bringing these three compressors on-line earlier would have increased the flow to California.

The Pecos River/Washington Ranch/Lea County Issue

50. The Commission Staff and the Complainants contend that El Paso Pipeline could have flowed at least an additional 100 MMcf/d through the Pecos station to California. El Paso Pipeline disputes this claim arguing that it could not have flowed more gas through the Pecos station during the relevant period because of the pressures at the Pecos station, its limited ability to use the Washington Ranch storage field, and the limited nominations from Lea County.

51. During the relevant period El Paso Pipeline flowed only 820 MMcf/d at its Pecos compressor station. El Paso Pipeline Witness Zurcher testified that flows through the Pecos station "in the 920 to 930 range" would have been sustainable volumes (Tr. p. 1478). El Paso Pipeline Witness Wilcox testified that his work papers showed the Pecos station could have flowed 1,024 MMcf/d (Tr. p. 1358). Staff Witness Flanders produced a model of the pipeline system using Witness Wilcox's pipeline data. Witness Flanders' model demonstrated that capacity existed to flow 1,095 MMcf/d to California during winter conditions through the station. Staff Witness Flanders, using the 920 to 930 figure of El Paso Pipeline's expert Witness Zurcher referred to above, concluded that El Paso Pipeline kept 100 MMcf/d of usable capacity off of the market during the relevant period. He reached this conclusion by subtracting the 820 actual flow from the 920 that Witness Zurcher testified was sustainable. El Paso Witness Wilcox testified that as a result of the "state of constant flux" from transient conditions the pipeline was achieving maximum pressure for the Pecos station during the relevant period. Staff Witness Flanders did not agree with El Paso Witness Wilcox and testified that by adjusting downstream stations pressure the Pecos station could have handled the additional 100 MMcf/d within the pressure limits. El Paso Witness Wilcox disagreed stating that Valves 5 and 6 located upstream of the Pecos station

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prevented the suction pressure at the Pecos station to rise to the maximum, but Staff Witness Flanders pointed out that the pressure at the valves was eight to ten pounds higher than at the Pecos station and should not cause the upstream valves to shut down if the valves were properly calibrated which was El Paso Pipeline's responsibility to remedy if they were not. The Chief Judge agrees with Staff Witness Flanders that El Paso Pipeline could have operated the Pecos station at a higher suction pressure without any problem if it properly operated the system and made adequate adjustments to its valves.

52. The Commission Staff contended that El Paso Pipeline should have used its Washington Ranch Storage field to manage transients at the 920 MMcf/d average level Staff Witness Flanders testified was reasonable and feasible. Washington ranch is located 20 miles downstream from the Pecos station and could have provided natural gas when transients precluded the Pecos station from flowing an average of 920 MMcf/d (Staff Exhibit No. Staff-22). El Paso Pipeline contends that Washington Ranch was intended and used for line pack management and not for supplementation of gas supply or capacity. El Paso Pipeline Witness Wilcox testified that whether Washington Ranch could be used to supplement volumes because of transients would depend upon the conditions and the operations on a daily basis (Tr. p. 1353). El Paso Pipeline Witness Healy testified that the pipeline could handle volumes at the Pecos station as high as 1,095 MMcf/d and have managed transients by using line pack at Washington Ranch, but it could have done this for only several days at a time (El Paso Pipeline Exhibit No. EPNG-91). The evidence shows that rather than flowing the maximum amount of gas possible during the tight supply relevant period, El Paso Pipeline actually injected 3 Bcf more natural gas than it withdrew from Washington Ranch storage (Staff Exhibit No. Staff-23). Washington Ranch contained about 27 Bcf of natural gas on November 1, 2000, and approximately 30 Bcf on March 31, 2001. This was a further withholding of available capacity.

53. El Paso Pipeline, in order to flow the additional 100 MMcf/d through the Pecos node to California delivery points proposed by Staff Witness Flanders would have had to nominate additional volumes using Lea County as a receipt point. El Paso Pipeline could have easily flowed additional capacity from Lea County because the proximity of Lea County to the Pecos station required only a small amount of additional compression through the Pecos station. Staff Witness Flanders pointed out that El Paso Pipeline under-utilized the Lea County receipt point because El Paso Pipeline did not inform shippers that if they nominated from Lea County additional volumes would be transported to California. Staff Witness Flanders testified at Transcript p. 1946 – 1947 that El Paso Pipeline was

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> uniquely situated to know what those optimal sourcing locations are, uniquely situated to know what the pressure requirements and general flow parameters are to achieve maximum operations under general operating situations, and it's incumbent in my view o[n] the pipeline to advise their shippers of those conditions, post capacity in such a way that it provides an incentive for shippers to nominate in an optimal fashion, and it's under that kind of careful coordination of pipeline operations and shipper behavior that enables a pipeline to achieve a maximum design capacity.

54. El Paso Pipeline Witness Healy did not agree that it was the pipeline's responsibility to inform customers how to obtain additional capacity. He testified at Transcript p. 1641:

> We're there to transport what our shippers tell us they want transported. They have their own view of the world. They have reasons why they bought gas where they did, sold that [g]as where they did. <u>It's not really my place to tell them where they should go [to] get gas. (Emphasis supplied)</u>

55. The Chief Judge finds that it is clear from the foregoing discussion that El Paso Pipeline could have scheduled an additional 100 MMcf/d of natural gas through the Pecos station and transported it to the California delivery points.

Untimely Maintenance Activities

56. As indicated before herein, at least 35 MMcf/d on average would have been available for transportation to California delivery points if El Paso Pipeline had not performed non-essential maintenance at Window Rock and Cornudas stations during the heating season. The November 2000 maintenance at Window Rock reduced El Paso Pipeline's capacity between 100 to 480 MMcf/d for 14 days. To the same extent, the Cornudas maintenance performed in March 2001 reduced El Paso Pipeline's capacity between 70 – 150 MMcf/d for 21 days (Edison Exhibit No. SCE-243). Edison Witness Yoho testified that both instances were non-essential and could have been postponed and accomplished during times of low throughput. El Paso Pipeline did <u>not</u> dispute this fact, but rather argued that of the 344 maintenance operations undertaken by the pipeline during the relevant period, complainants only challenged two. Non-essential maintenance is discretionary and totally under the control of the pipeline. El Paso Pipeline could have postponed this

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non-essential maintenance to times of low throughput and could have made more capacity available, at least 35 MMcf/d, to its California delivery points.

Intent to Withhold Capacity

57. El Paso Merchant's Witness Dr. Joseph Kalt in Phase I of these proceedings testified that one way El Paso Pipeline could exercise market power would be for it to "choke off . . . transportation facilities . . ." and thus withhold natural gas from the market (Phase I Transcript p. 2600).

58. In a white paper dated June 22, 2000, prepared by Mr. Al Clark, El Paso Pipeline's Vice President of Marketing, which was circulated to every transportation marketing representative employed by El Paso Pipeline, he stated (Edison Exhibit No. SCE 233 (public version)):

> We need to play-out the ROFR held by EPME in a manner that will be responsive to the needs of the IPP requirements and time frames. If the Block I capacity can be sold to these EOC IPP projects, and thus taken out of the California market, the value of Block II and Block III to California may be enhanced.
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> . . . .
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> Recommendations
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> . . . .
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> 1. EPME relinquishes ROFR on Blocks I, II, and III immediately. This action would also have the benefit of ameliorating the concern that has been expressed by a number of parties, including the CPUC, about an affiliate controlling such a large block of capacity.
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> . . . .
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> 3. EPME relinquishes the ROFR on Block I only immediately. This action would make available an additional 452,002 Mcf/d of Block I that could be sold from the Permian Basin to the IPP's planned on our system.

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59. El Paso Pipeline Witness Shelton, President of El Paso Pipeline, testified that these recommendations were never approved by her, which would have been necessary for them to have been acted upon. While Mr. White's recommendations were never acted upon they do tend to show the thinking of at least one of El Paso Pipeline's top executives, and the dissemination of that thinking to all of El Paso Pipeline's transportation marketing representatives.

60. The record is clear that El Paso Pipeline withheld at least the 345 MMcf/d as discussed in detail before herein, and perhaps much, much more. Mr. Clark's white paper indicates that at least El Paso Pipeline officials were giving thought to diverting gas from the Permian Basin away from California. This would tend to demonstrate an exercise of market power as described by the testimony of Dr. Kalt set forth above.

What this Proceeding is About and Conclusion

61. This proceeding was remanded to the Chief Judge for the purpose of reopening the record to conduct a supplemental hearing on the limited issue of whether, during the period from November 2000 through March 31, 2001, El Paso Pipeline made all of its capacity available at its California delivery points as required by the Commission's regulations. It is not a new hearing on the earlier phases of the case concerning a violation of the Commission's Standards of Conduct for Pipelines With Marketing Affiliates. That issue is before the Commission on the Chief Judge's Initial Decision issued herein on October 9, 2001. Nor is this a proceeding concerning whether El Paso Merchant exercised market power. That issue is also before the Commission in the Chief Judge's October 9, 2001, Initial Decision. As pointed out above, this phase of the proceedings deals with whether El Paso Pipeline failed to make all of its capacity available at its California delivery points. The Chief Judge finds that El Paso Pipeline did in fact withhold substantial capacity that it could have made available to its California delivery points – a clear exercise of market power. Under these circumstances, the Chief Judge would be remiss if he did not modify his October 9, 2001, Initial Decision finding that El Paso Pipeline had the ability to exercise market power, but the record in the case was not at all clear that it had in fact exercised market power. The new evidence produced in this phase of the case shows a clear withholding of substantial capacity during the relevant period, which clearly indicates an exercise of market power by El Paso Pipeline. El Paso Pipeline tightened its capacity to its California delivery points by not operating at or near MAOP; with untimely, non-essential maintenance actions at least at two stations; by consciously looking to expand the East of California market and markets in Mexico when it did not have sufficient capacity to meet its certificated

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obligation to California; by failing to advise its customers that there would be additional capacity available if they nominated through Lea County, to point out a few concrete examples.

Findings of the Chief Judge, Modification of Initial Decision, and Recommendations

62. The Chief Judge finds that El Paso Pipeline withheld extremely large amounts of capacity that it could have flowed to its California delivery points in violation of its certificate obligation and in violation of its 10-year settlement agreement which substantially tightened the supply of natural gas at the California border significantly broadening the basis differential.

63. The Chief Judge further finds, and modifies his October 9, 2001, Initial Decision to the effect that El Paso Pipeline had the ability to exercise market power and that El Paso Pipeline did in fact exercised market power by withholding substantial volumes of capacity to its California delivery points, which tightened the supply and broadened the basis differential.

64. The Chief Judge recommends that the Commission institute penalty procedures, both for violation of the Commission's Standards of Conduct for Pipelines With Marketing Affiliates by El Paso Natural Gas Company and El Paso Merchant Energy Gas, L.P., and El Paso Merchant Energy Company, and for the unlawful exercise of market power by El Paso Natural Gas Company.

Curtis L. Wagner Jr.
Chief Administrative Law Judge

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