126 FERC ¶ 61,247
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Acting Chairman;
Suedeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

El Paso Natural Gas Company — Docket Nos. RP08-426-000

ORDER ON TECHNICAL CONFERENCE

(Issued March 19, 2009)

1. On June 30, 2008, El Paso Natural Gas Company (El Paso) filed revised tariff sheets that proposed new services, a rate increase for existing services, and changes in certain terms and conditions of service (2008 Rate Case). As part of the 2008 Rate Case, El Paso proposed to modify its fuel savings sharing mechanism.[1] On August 5, 2008, the Commission accepted and suspended the primary tariff sheets El Paso submitted in the 2008 Rate Case, subject to refund and the outcome of a hearing on the proposed rates and a technical conference on the proposed services and penalties, including the fuel savings sharing mechanism.[2] The Commission held a technical conference on September 11, 2008. On December 18, 2008, the Commission issued an order on the technical conference in which it stated that the Commission would address El Paso's proposed fuel savings sharing mechanism in a subsequent order.[3] As discussed below, the Commission accepts El Paso's fuel savings sharing proposal subject to further modifications.

I. **<u>El Paso's Filing</u>**

2. El Paso's fuel savings sharing mechanism was originally negotiated as part of a settlement in El Paso's last rate case (2006 Rate Case Settlement) and expired on December 31, 2008, the end of the term of the 2006 Rate Case Settlement.[4] Here, El

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[1] *See* El Paso Natural Gas FERC Gas Tariff, Second Revised Volume No. 1-A, Second Revised Sheet No. 324A.

[2] *El Paso Natural Gas Co.*, 124 FERC ¶ 61,124 (2008) (Suspension Order).

[3] *El Paso Natural Gas Co.*, 125 FERC ¶ 61,309, P 193 (2008).

[4] *See* the 2006 Rate Case Settlement in Docket No. RP05-422-000, Article 5.1; El Paso FERC Gas Tariff, Second Revised Volume No. 1A, Original Sheet No. 324A.

Paso is proposing to continue the fuel savings sharing mechanism negotiated in the 2006 Rate Case Settlement with a few modifications.

3. The fuel savings sharing provision allows El Paso to elect to incur the full cost of a capital project designated to reduce the amount of fuel and lost and unaccounted for fuel (LAUF)[5] consumed on its system in exchange for a share of the projected savings attributable to that project.[6] The proposed tariff language states that such projections are "to be made on the design conditions of the facility modification as applied to reasonably expected operating conditions."[7] Under its proposal, El Paso would retain 80 percent of the fuel savings as a result of the designated project for a seven-year period from the project's in-service date (irrespective of whether full recovery of the investments has occurred or has been exceeded), while 20 percent of the fuel savings would be returned to the shippers.[8] Thereafter, 100 percent of the fuel and LAUF savings would be passed on to El Paso's customers. In the fuel savings sharing mechanism negotiated as part of the 2006 Rate Case Settlement, the payback period was five years. El Paso proposes increasing the payback period to seven years to better account for the time necessary to recover its investment.

II. Comments

4. UNS Gas, Inc., Tucson Electric Power Company (collectively, UNS/Tucson), Arizona Public Service Company (APS), Southwest Gas Corporation (Southwest Gas), and Texas Gas Service Company, a division of ONEOK, Inc. (Texas) filed comments on the technical conference that included comments on El Paso's fuel savings sharing proposal. El Paso filed an answer to these comments.

5. Southwest Gas opposes El Paso's fuel savings proposal on the grounds that it does not conform to general cost of service rate requirements which specify, with limited exception, that pipelines seeking rate increases to reflect cost and revenue changes do so

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[5] Generally, LAUF is equal to total gas receipts, minus total gas deliveries including compressor fuel.

[6] While El Paso's proposed tariff language describes the sharing of fuel savings without mentioning LAUF, direct testimony filed in the 2008 Rate Case describes the sharing proposal as including LAUF. *See* Exhibit No. EPG-176 at P 18-20.

[7] *See* El Paso Natural Gas FERC Gas Tariff, Second Revised Volume No. 1A, Second Revised Sheet No. 324A.

[8] El Paso's proposed tariff language does not provide any details as to how savings will be retained by El Paso or how savings will actually be returned to shippers via El Paso's fuel rates.

by filing a general rate case.[9] Southwest Gas argues that pursuant to section 4 of the Natural Gas Act (NGA), El Paso may seek to include in rates any new plant associated with a fuel savings project and recover investment of and on its capital costs through depreciation and an allowed rate of return on investment. Southwest Gas further contends that El Paso has not shown that it cannot obtain the necessary capital for fuel savings from other sources or that the proposed provision would benefit ratepayers. In addition, Southwest Gas argues that El Paso is already under a regulatory obligation to install fuel saving equipment and under a statutory obligation to operate with all reasonable economies of service.[10] Southwest Gas asserts that in addition to these obligations, competitive pressure on El Paso's rates by other pipelines should give El Paso a sufficient incentive to install fuel savings equipment.

6. Texas argues that El Paso took no steps to reduce fuel costs on its system when it had the 2006 Settlement fuel incentive mechanism in place, so it is not clear that continuing the mechanism would do any good. Texas further argues that El Paso's fuel savings proposal would only motivate El Paso to do something it should do anyway, i.e., reduce its costs to be competitive. Texas states that if the fuel savings proposal is accepted, to protect against over-recovery by El Paso, the payback period should be the lesser of seven years or the period over which the fuel savings pay for the capital project which produced the fuel savings. UNS/Tucson also support this modification.

7. APS argues that El Paso's proposal to change the payback period from five to seven years shifts the balance previously negotiated in the fuel savings mechanism in the 2006 Rate Case Settlement. APS asserts that El Paso has made no demonstration that such a shift is necessary or reasonable and thus the proposal should be rejected or set for hearing for further investigation.

8. El Paso responds that permitting it to retain a portion of the savings from any designated project gives El Paso an additional incentive to incur the cost of projects that will reduce the fuel and LAUF charges paid by its shippers. El Paso contends that shippers would also benefit from the proposal because the cost of any fuel savings projects would be eliminated from rate base, requiring El Paso to take the risk it will be able to recover costs within the seven-year period. El Paso explains that it proposes to extend the payback period to seven years because five years is too restrictive. El Paso asserts that it did not designate any projects under the fuel savings provision negotiated in the 2006 Rate Case Settlement largely because the five-year period unduly limited the projects that would qualify.

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[9] Southwest Gas' September 26, 2008 Comments on Technical Conference Issues at 25 (citing 15 U.S.C. § 717c(d); *ANR Pipeline Co.*, 110 FERC ¶ 61,069, at P 26 (2005), *order on reh'g and compliance filing*, 111 FERC ¶ 61,290 (2005) (*ANR Pipeline*)).

[10] *Id.* at 26 (citing *ANR Pipeline*, 110 FERC ¶ 61,069 at P 41).

III. Discussion

9. El Paso's proposal is one of the first opportunities the Commission has had to review a fuel incentive mechanism since terminating its Notice of Inquiry on fuel retention practices last fall.[11] In the Notice of Inquiry, the Commission sought comments on whether it should change its current policy to provide pipelines a greater incentive to reduce their fuel use and LAUF gas and to minimize pipeline over-recoveries of these costs.[12] The Commission ultimately terminated the Notice of Inquiry and stated that it would develop its fuel retention policies on a case-by-case basis.[13]

10. Under El Paso's proposal, El Paso may elect to incur the full cost of a capital project designated to reduce the amount of fuel and LAUF consumed on its system in exchange for a share of the projected savings attributable to that project. As the Commission explained in the order terminating the Notice of Inquiry, the operation of the interstate pipeline system involves a significant amount of fuel use and LAUF to deliver supplies to market.[14] Fuel gas charges now make up a greater percentage of the overall interstate transportation rate than they have in the past.[15] Such considerations reinforce the need to improve the efficiency of our existing infrastructure.[16] We believe that El Paso's fuel savings sharing proposal will help achieve this goal. Therefore, the Commission accepts El Paso's proposal, subject to the conditions described below.

11. The commenters argue that El Paso's proposal is unnecessary and that El Paso should recover the cost of any fuel savings project through the base rates it establishes in general section 4 rate cases. While including the costs of such facilities in its cost of service in a general rate case is one way to recover both the actual costs of fuel savings projects together with a return on the investment, the Commission disagrees that this should be the only way.

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[11] *Fuel Retention Practices of Natural Gas Companies,* FERC Stats. & Regs. ¶ 35,556 (2007) (Notice of Inquiry).

[12] *Id.*

[13] *Fuel Retention Practices of Natural Gas Companies,* FERC Stats. & Regs. ¶ 35,560 (2008).

[14] *Id.* P 12.

[15] *Id.*

[16] *Id.*

12. El Paso has on its pipeline a fuel tracker, which tracks the actual use of fuel on the system in limited section 4 rate filings outside of a general section 4 rate case.[17] El Paso's tariff also provides for a true-up mechanism, which reconciles fuel collections with actual pipeline needs at regular intervals.[18] Fuel trackers and true-up mechanisms permit pipelines to recover their exact fuel costs and no more. This reduces any incentive for a pipeline to make capital improvements to reduce fuel usage and LAUF, because the pipeline is guaranteed to recover all its fuel costs regardless of how efficiently (or inefficiently) it operates and it cannot retain any of the cost savings resulting from fuel savings projects. El Paso's proposal remedies this issue by creating an incentive mechanism under which El Paso and its customers share the cost savings from various specified types of capital improvements intended to reduce fuel usage and LAUF.

13. El Paso's proposal requires it to designate in an annual fuel tracker filing any capital improvement project to be included in the incentive mechanism. El Paso must project the annual fuel consumption savings from each such project based upon design conditions of the facility modification as applied to reasonably expected operating conditions. In each annual fuel tracker filing where El Paso makes such a projection, the parties and the Commission will have an opportunity to review the reasonableness of the projection. This is generally consistent with the requirement in the Commission's 1996 Incentive Ratemaking Policy Statement,[19] that an incentive ratemaking proposal must specify the performance standards it defines and a method for evaluating whether those standards were being met.[20] Accordingly, the Commission finds that upon a finding by the Commission that a projection for a project is just and reasonable, El Paso may retain 80 percent of these savings for a seven-year period from the in-service date of the project,

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[17] *See* El Paso Natural Gas FERC Gas Tariff, Second Revised Volume No. 1A, Section 26, Fuel and L&U, General Terms and Conditions.

[18] *See id*.

[19] *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines* (1996 Incentive Ratemaking Policy Statement), 74 FERC ¶ 61,076, at 61,237-38 (1996). *See ANR Pipeline*, 110 FERC ¶ 61,069 at P 39 (leaving open the possibility that a pipeline could include an incentive fuel savings mechanism in a fuel tracker pursuant to the *1996 Incentive Ratemaking Policy Statement*).

[20] The 1996 Incentive Ratemaking Policy Statement eliminated two requirements included in the Commission's earlier 1992 Policy Statement on Incentive Regulation, *Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities*, 61 FERC ¶ 61,168 (1992). Those requirements were that the incentive rates (1) be no higher than the pipeline's rates would have been under traditional cost-of-service regulation and (2) result in quantifiable benefits to consumers.

and El Paso may not include any of the capital costs of the project in its rates in any future rate proceeding.

14. The commenters point out that there is a chance El Paso may over-recover its investment during the seven-year payback period. However, there is also a chance that El Paso may fail to recover the cost of its investment during the payback period. In either scenario, shippers will benefit from the fuel savings generated by the projects, both immediately and throughout the life of the projects, while never bearing any costs. We acknowledge, as APS points out, that El Paso's proposal to change the payback period from five to seven years shifts the balance of the previous 2006 Rate Case Settlement's fuel savings mechanism in this case. However, that settlement expired with the filing of El Paso's current rates case, thus permitting El Paso to propose a revised or different fuel savings mechanism in this case. El Paso argues that it revised the proposal because it believed it might not be able to recover the cost of its investments under the five-year mechanism agreed to in the settlement. El Paso states that the five-year period was too restrictive because it unduly limited the projects that would qualify and that El Paso did not designate any projects under the settlement.[21] While the proposal does shift the balance from the negotiated settlement, we do not agree it is an improper shift. The seven-year time frame will provide a better opportunity for El Paso to recover its investment, and provide proper incentives to El Paso to add efficient fuel savings facilities. Additionally, we find that customers will receive benefits from excluding the cost of these projects from the rate base and from lower, more efficient fuel charges. Therefore, we find that El Paso's proposal strikes a reasonable balance between providing an adequate incentive for El Paso to pursue fuel savings projects and avoiding an unreasonable over-recovery of costs. For these reasons, the Commission finds El Paso's proposal is just and reasonable.

15. However, El Paso's proposal must be clarified in several respects. El Paso's proposal does not explain how the fuel savings will be retained by El Paso or returned to shippers through El Paso's fuel rates. Specifically, it is not apparent how El Paso's existing fuel tracker and true-up calculations will be modified to implement the sharing of the fuel savings between El Paso and its shippers. As a general matter, section 26 of El Paso's tariff requires it to calculate its fuel retention percentage by (1) projecting the fuel it will require during the next calendar year[22] and (2) determining its actual over- or under-recovery during the 12 months ending the preceding September 30. El Paso adds these two amounts together, and then divides them by projected gas receipts during the next calendar year. It is unclear from El Paso's proposal whether the adjustment to allow

[21] El Paso Oct. 10, 2008 Reply Comments, Docket No. RP08-426-000, at 49 (citing Exhibit No. EPG-176 at 19-20).

[22] This projection is based on its actual fuel use during the 12 months ending the preceding September 30.

El Paso to retain 80 percent of the projected fuel savings will occur through an adjustment to the determination of over- and under-recoveries for purposes of the true-up calculation or through the projection of fuel to be required for the next year or a combination of the two. It is also unclear whether the fuel savings projections for each project will be static over the seven-year payback period or updated annually. As such, the Commission requires that El Paso clarify these aspects of its proposal in a compliance filing within 30 days of the issuance of this order.

The Commission orders:

(A) El Paso's fuel savings sharing mechanism is accepted, subject to conditions and a further order by the Commission.

(B) El Paso is directed to make a compliance filing within 30 days, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.