128 FERC ¶ 61,196
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Company Docket No. RP08-426-008

ORDER ON TECHNICAL CONFERENCE

(Issued August 27, 2009)

1. On April 20, 2009, El Paso Natural Gas Company (El Paso) submitted a filing clarifying its fuel savings sharing proposal in compliance with the Commission's March 19, 2009 Order.[1] In that order, the Commission accepted the fuel savings sharing mechanism that El Paso proposed in its 2008 Rate Case, subject to conditions and a further order of the Commission. As discussed below, the Commission accepts El Paso's fuel savings sharing proposal, subject to further modifications.

I. Background

2. El Paso recovers its cost of fuel use and lost and unaccounted for gas (LAUF) by retaining a percentage of the volumes it transports for its customers. El Paso establishes its fuel retention percentage in annual limited section 4 rate filings which track its actual fuel and LAUF costs, with revised fuel retention percentages to be effective on January 1 of each calendar year. As a general matter, section 26 of El Paso's General Terms and Conditions (GT&C) requires it to calculate its fuel retention percentages for various parts of its system[2] by (1) projecting the fuel it will require during the next calendar year,[3] 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.

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[1] *El Paso Natural Gas Co.*, 126 FERC ¶ 61,247 (2009) (March 19 Order).

[2] Section 26.4 of El Paso's GT&C provides for the fuel charges to be separated into various categories, including mainline fuel, production area fuel, Permian to Anadarko fuel, and Interruptible Storage Service fuel.

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

3. The 2006 settlement of El Paso's Docket No. RP05-422-000 general section 4 rate case (2006 Rate Case Settlement) added a "Fuel Savings Sharing Mechanism" to El Paso's fuel tracker.[4] That mechanism is set forth in section 26.7 of El Paso's GT&C. As agreed to in the 2006 Rate Case Settlement, section 26.7 allowed El Paso during the term of the settlement (i.e. through December 31, 2008) to elect to incur the full cost of a capital project designated to reduce the amount of fuel and LAUF[5] consumed on its system in exchange for a share of the projected savings attributable to that project.[6] El Paso was required to 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."[7] Section 26.7 permitted El Paso to retain 80 percent of the projected annual fuel savings from each designated project placed into service before January 1, 2009 for a five-year period from the project's in-service date (irrespective of whether full recovery of the investments had occurred or had been exceeded). Twenty percent of the fuel savings would be reflected in the fuel retention percentages paid by El Paso's shippers. Thereafter, 100 percent of the fuel and LAUF savings would be passed on to El Paso's customers. Section 26.7 required that El Paso be solely responsible for all capital costs in a qualifying project and prohibited El Paso from including such costs in its rates in future rate proceedings.

4. On June 30, 2008, El Paso filed its 2008 Rate Case, proposing new services, a rate increase for existing services, and changes in certain terms and conditions of service. As part of the 2008 Rate Case, El Paso proposed to continue the fuel savings sharing mechanism negotiated in the 2006 Rate Case Settlement with a few modifications.[8] El Paso proposed increasing the payback period during which El Paso retains 80 percent of the fuel savings from five years to seven years to better account for the time necessary to recover its investment. El Paso also proposed to revise section 26.7 to require it to designate any capital improvement project to be included in the incentive mechanism in

[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.

[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] *Id*.

an annual fuel tracker filing, while removing the requirement that such projects be placed into service by January 1, 2009.

5. 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.[9] 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.[10]

6. In the March 19 Order, the Commission accepted El Paso's fuel savings sharing mechanism, subject to conditions. The Commission explained that it accepted El Paso's proposal because it furthers the Commission's goals of encouraging pipelines to reduce their fuel and LAUF gas and improving the efficiency of our existing infrastructure. The Commission found that El Paso's proposal to lengthen the payback period from five to seven years 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. However, the Commission ordered El Paso to clarify several elements of its fuel savings proposal in a compliance filing. The Commission stated that El Paso must explain how fuel savings will be retained by El Paso or returned to shippers through fuel rates. Specifically, the Commission required El Paso to clarify how its existing fuel tracker and true-up calculations will be modified to implement the sharing of the fuel savings between El Paso and its shippers. The Commission stated that it was unclear from El Paso's proposal whether the adjustment to allow El Paso to retain 80 percent of the projected fuel savings would 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. The Commission also directed El Paso to explain whether the fuel savings projections for each project will be static over the seven-year payback period or updated annually.

II. <u>Filing</u>

7. On April 20, El Paso submitted a filing clarifying its fuel savings sharing mechanism in compliance with the March 19 Order. In its filing, El Paso explains that when it undertakes a fuel savings project, it will estimate the annual fuel consumption savings through an engineering analysis based on the design conditions of the facility addition or modifications as applied to reasonably anticipated operating conditions. El Paso states that because the projection for each fuel savings project is based on design

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

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

analysis, the projected savings amount will remain static for the duration of the seven-year payback period unless an event occurs that would result in the need to terminate all or a portion of the projected fuel savings.

8. El Paso states that it will add a schedule or schedules to its annual Recomputation of Fuel and LAUF Retention filing to support its calculation of the projected annual fuel savings for each project. El Paso asserts that the pertinent engineering analysis and operational assumptions for each fuel savings project will be included on this schedule. El Paso states that it will also include an analysis that appropriately allocates the projected fuel savings to the various fuel retention areas (i.e. mainline, production areas, etc.) if a fuel savings project benefits more than one area of El Paso's system.

9. El Paso explains that in its implementation, El Paso will add 80 percent of the projected design-based fuel or LAUF savings to the actual fuel consumption total in its annual fuel and LAUF filing for each of the seven years of the payback period. El Paso states that for purposes of volumetric true-up calculations and for adjustments to the fuel retention percentage, the fuel consumption component of the calculations will include El Paso's 80 percent share. El Paso states that the customers' share of the fuel savings is already incorporated in the fuel computations, because 100 percent of the fuel savings from a project is already reflected in the actual fuel consumption total. Therefore, El Paso states there is no need to separately state the shippers' share of the fuel savings. El Paso states that it must, however, add back to the actual fuel consumption totals the 80 percent share of the projected design-based savings so that it receives its share of the fuel savings.

10. For example, sections 26.3 and 26.6 of El Paso's GT&C require that it project its fuel use for the next calendar year based upon its actual fuel consumption during the 12 months ending the preceding September 30. If a fuel savings project was in service during that 12-month period, El Paso would project its fuel use for the next calendar year based on its actual fuel use during the earlier period, plus 80 percent of the projected fuel savings from the project. Similarly, for purposes of its true-up mechanism, El Paso would calculate the over- and under-recoveries to be trued up by comparing the fuel it collected from its customers during the true-up period with its actual fuel use during that period, plus 80 percent of the projected fuel savings from the project.

11. El Paso states that its fuel savings retention must also be included in the Operational Purchases and Sales report to properly account for the monthly system gas balance for the period under review. El Paso states that because the amounts of fuel savings retention on a monthly basis are likely to be quantities which would be impractical to sell into the markets, and the only regular monthly sales activity is shipper imbalance cashouts, El Paso will assume that the first "sales" activity each month is attributable to the fuel savings amount. El Paso states that the fuel savings sales-related amount will be attributed to shipper imbalance cashouts and will be valued at the index price.

III. Comments

12. Notice of El Paso's filing was issued on April 30, 2009. Interventions and protests were due as provided in section 154.210 of the Commission's regulations.[11] Pursuant to Rule 214,[12] all timely filed motions to intervene and any motion to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. The El Paso Municipal Customer Group (the Municipals) and the Indicated Shippers[13] filed protests.

13. El Paso filed an answer to the protests. The Indicated Shippers filed an answer to El Paso's answer. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure[14] prohibits an answer to a protest or an answer unless otherwise ordered by the decisional authority. We will accept the answers filed by El Paso and the Indicated Shippers because they provided information that has assisted us in our decision-making process.

14. In their protest, the Municipals oppose El Paso's proposal to use static fuel savings projections. They argue that, if accepted, El Paso's proposal would permit El Paso to make one fuel savings projection prior to the in-service date of a project and apply that same projection for the entire seven-year payback period, regardless of whether the projection turns out to be correct. The Municipals contend that El Paso's tariff should require El Paso to make adjustments to the projections based on evidence that its projections were incorrect. As an example, the Municipals state that, if fuel use remains level or increases despite the installation of a designated facility, El Paso should not be permitted to continue taking a share of the phantom "savings," with the result that shipper rates increase, absent a valid explanation for the lack of fuel savings. The Municipals argue that this situation would be inconsistent with Commission policy which prohibits fuel trackers from over-recovering costs "under any circumstances."[15]

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[11] 18 C.F.R. § 154.210 (2009).

[12] 18 C.F.R. § 385.214 (2009).

[13] The Indicated Shippers: are BP America Production Company and BP Energy Company; Chevron Natural Gas, a Division of Chevron U.S.A. Inc.; ConocoPhillips Company; Shell Energy North America (US), L.P.; and Occidental Energy Marketing, Inc.

[14] 18 C.F.R. § 385.213(a)(2) (2009).

[15] *Citing ANR Pipeline Co.*, 110 FERC ¶ 61,069, at P 22 (2005).

15. The Municipals also assert that El Paso's proposal contradicts the Commission's *Incentive Ratemaking Policy Statement* which requires performance standards and an evaluation method.[16] The Municipals state that El Paso's proposal does not contain any method of routine evaluation to determine whether the fuel savings projections are correct or whether the investments are producing fuel savings. The Municipals assert that the Commission rejected a fuel savings mechanism proposed by Texas Gas Transmission, LLC (Texas Gas) because it lacked reasonable standards for measuring fuel savings and a method for evaluating whether such standards are being met, and thus, would have impermissibly allowed Texas Gas to share in fuel savings that were the result of factors other than Texas Gas' investments.[17] The Municipals argue that El Paso's proposal is worse than Texas Gas' proposal because it would give El Paso the ability to benefit from fuel savings that do not even exist.

16. The Municipals request that the Commission reject El Paso's proposal to use static fuel savings projections and require El Paso to include a method of evaluating whether the savings projections are reasonably correct and provide for an annual revision of such projections to the extent they are incorrect. As an alternative, the Municipals suggest that the Commission place a cap on the amount of fuel savings that El Paso would be entitled to recover equal to the amount that El Paso invested in the facility. The Municipals argue that under this approach, El Paso should be required to return to customers any revenues in excess of costs at the end of the seven-year payback period.[18]

17. The Indicated Shippers argue that El Paso's fuel savings methodology is one-sided because it guarantees El Paso's recovery of 80 percent of projected fuel savings but leaves shippers at risk for the recovery of their 20 percent share. The Indicated Shippers state that they support a properly designed fuel savings incentive mechanism but that El Paso's proposal is never trued-up or correlated with actual fuel savings. The Indicated Shippers assert that, if El Paso's projections are incorrect, shippers may receive less than their 20 percent share or end up paying more for fuel than they would have paid absent the fuel savings project because El Paso will retain its 80 percent share, regardless of actual savings. The Indicated Shippers state that this proposal is inconsistent with the *Incentive Ratemaking Policy Statement*, which requires performance standards and a

[16] *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076, at 61,238 (1996) (*Incentive Ratemaking Policy Statement*).

[17] *Texas Gas Transmission, LLC*, 126 FERC ¶ 61,235 at P 28-30 (2009) (*Texas Gas*).

[18] The Municipals state that this is consistent with Colorado Interstate Gas' (CIG) fuel savings sharing mechanism, which permits CIG to share in fuel savings only if it experiences an identifiable reduction in fuel consumption that is directly related to a new qualifying capital project. *Citing* CIG FERC Gas Tariff, Sheet No. 380L.

method for evaluating the fuel savings proposal. The Indicated Shippers state that El Paso should be required to calculate actual fuel savings by comparing the current year's usage and LAUF (after the fuel savings project has taken effect) against the prior year's usage and LAUF (before the fuel savings project took effect) as a benchmark year (a performance standard). The Indicated Shippers assert that fuel consumption and LAUF for each subsequent year should be compared against the benchmark year in order to calculate fuel savings for that year. The Indicated Shippers argue that El Paso's proposal to use static fuel savings projections for the full seven years should be rejected.

18. The Indicated Shippers assert that a determination regarding El Paso's proposal to account for monthly sales of fuel savings by assuming that the first sales activity each month in the shipper imbalance account is attributable to the fuel savings amount should be subject to the outcome of El Paso's fuel tracker proceeding in Docket No. RP09-117-000.

19. El Paso replies that the calculation of fuel savings based on a benchmark and adjustments from a benchmark is not a feasible option because of the complexity of El Paso's system and the myriad of factors that affect fuel usage at any given location. El Paso explains that fuel savings at a specific location can be affected by contract terminations or changes, as well as changes in pathing, throughput, fuel efficiency curves, and other factors. El Paso states that this complexity makes it impossible to precisely identify and attribute any year-to-year fuel reduction or increase to a specific project. El Paso explains it is for this reason that El Paso proposed to calculate the projected savings through a detailed engineering and design analysis, and then allocate those projected savings over a seven-year period. El Paso contends that any shipper may challenge El Paso's designation of a fuel savings project, including the savings projections and calculations associated with the project, when El Paso submits the proposal in its annual fuel filing. El Paso states that at that time, the Commission will be able to adjust the savings projections if it deems any of the engineering analysis or assumptions to be invalid.

20. As for the proposed accounting treatment for fuel savings, El Paso states that it must include in its fuel retention computation any fuel units it did not burn and then must dispose of that gas source as a gas balance transaction in order for El Paso to collect its portion of fuel savings from shippers. El Paso concludes that the only reasonable and reliable method for El Paso to collect its portion of the fuel savings is through the shipper imbalance cashouts, which occur monthly.

21. The Indicated Shippers respond that the complexity of El Paso's system should not be used as a rationale for accepting El Paso's proposal, which would result in unjust and unreasonable rates. The Indicated Shippers further assert that its proposal to compare fuel savings in a given year to a benchmark year is no more complex than the annual accounting underlying a fuel tracker calculation, which makes essentially the same comparison, and which El Paso performs annually.

IV. Discussion

22. In the March 19 Order, the Commission directed El Paso to provide a more detailed explanation of its fuel savings sharing proposal. In compliance with that order, El Paso provided clarification and several examples demonstrating how its fuel savings proposal works. For the reasons discussed below, the Commission finds that El Paso must make several changes to its fuel savings sharing mechanism in order for that mechanism to be just and reasonable.

23. As the Commission pointed out in the March 19 Order, the *Incentive Ratemaking Policy Statement* requires that an incentive ratemaking proposal must specify the performance standards it defines and a method for evaluating whether those standards were being met.[19] El Paso's proposal includes a requirement that, at the outset of a project, El Paso estimate the anticipated fuel savings associated with that project through an engineering analysis based on the design conditions of the facility modifications as applied to reasonably anticipated operating conditions. El Paso states that it will submit the engineering analysis and associated fuel savings projections with its annual fuel filing to the Commission for review. This required estimate of fuel savings at the outset of a project provides a reasonable performance standard for permitting a project to be included in the fuel savings sharing mechanism.

24. However, the Commission agrees with the protestors and finds that, contrary to Commission policy and precedent, El Paso's proposed fuel savings mechanism lacks any method for evaluating whether the performance standard is being met. In its compliance filing, El Paso clarified its intent that the fuel savings projections determined at the outset of the project will remain static for the seven-year period during which El Paso and its shippers share the savings. In other words, El Paso will simply presume that the projected fuel savings occur and adjust its calculations of its fuel retention percentage for the next seven years so that it can retain 80 percent of those projected savings. In the *Incentive Ratemaking Policy Statement*, the Commission stated that an incentive ratemaking proposal must specify the performance standards it defines and a method for evaluating whether those standards were being met.[20]

25. As such, El Paso's proposal fails to meet the Commission's standard because it permits El Paso to retain 80 percent of the fuel savings projections, without any evaluation of whether the projected fuel savings truly occurred or are attributable to the

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[19] *El Paso Natural Gas Co.*, 126 FERC ¶ 61,247 at P 13, *citing Incentive Ratemaking Policy Statement*, 74 FERC ¶ 61,076, at 61,237-38 (1996).

[20] *Incentive Ratemaking Policy Statement*, 74 FERC ¶ 61,076, at 61,237-38 (1996).

project.[21] Therefore, the Commission directs El Paso to revise its proposal to include a method for evaluating whether its fuel savings projects have resulted in actual savings and whether those savings are attributable to the project. The Commission recognizes that many factors affect a pipeline's fuel usage at any particular location on its system, and therefore it will not be possible to determine with precision the actual fuel savings attributable to a fuel savings project. As El Paso explains, fuel savings at a specific location can be affected by changes in throughput, pathing, efficiency curves, and other factors. However, it does not follow that El Paso should be permitted to implement a fuel savings sharing mechanism without any requirement for an evaluation of whether its fuel savings projects are achieving the projected savings. El Paso should still be able to present evidence indicating whether the project has produced savings approximating the original projection of such savings. It can also explain what other factors affected its fuel usage during the relevant period. For example, it can state whether actual throughput varied from the throughput it assumed in making its initial projection of fuel savings, and how that variation in throughput affected its fuel usage. If a project appears to be achieving approximately the anticipated savings then El Paso will be permitted to retain 80 percent of the projected fuel savings in the manner it has proposed.

26. In addition, as described above, El Paso provided in its compliance filing an explanation and examples of how its existing fuel tracker and true-up calculations will be modified to implement the sharing of the fuel savings between El Paso and its shippers. However, El Paso did not propose any revisions to section 26 of its GT&C to include those clarifications in its tariff. Therefore, the Commission directs El Paso to incorporate the clarifications it provided in the instant compliance filing, as well as the revisions ordered here, into its tariff.

27. The Indicated Shippers argue that any determination regarding the accounting section of El Paso's proposal should be subject to the outcome of the proceeding on El Paso's fuel tracker mechanism in Docket No. RP09-117-000. Because the Commission is ordering El Paso to modify its fuel savings mechanism, we will reserve our review of the accounting portion of the proposal until El Paso submits its revisions.

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[21] *See Texas Gas*, 126 FERC ¶ 61,235, at P 29 (2009) wherein the Commission explained that, without performance standards and a method for evaluating whether these standards have been met, it is impossible to determine with any reasonable accuracy whether a fuel incentive mechanism is fulfilling its stated purpose, promoting fuel savings and increasing fuel efficiency on the system. The Commission further stated that, because the purpose of a fuel incentive mechanism is to encourage a pipeline to make investments to reduce fuel use, the mechanism should only allow pipelines to share savings reasonably attributable to those investments.

<u>The Commission orders:</u>

(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 submit a compliance filing within 30 days of this order's issuance, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.