126 FERC ¶ 61,235
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Texas Gas Transmission, LLC — Docket Nos. RP09-3-000
RP09-7-000
RP09-7-001
RP09-7-002

ORDER ON TECHNICAL CONFERENCE AND CONTESTED SETTLMENT

(Issued March 19, 2009)

1. On October 31, 2008, the Commission issued an order which, among other things, accepted and suspended Texas Gas's proposed tariff sheets to (a) modify its fuel tracker mechanism and (b) implement an experimental fuel savings sharing mechanism, to be effective the earlier of April 1, 2009 or a date specified in a further order of the Commission, subject to refund and conditions and the outcome of a technical conference.[1] Commission staff convened a technical conference on December 2, 2008 to discuss the issues raised by the protests to Texas Gas's proposals. Subsequently, on February 13, 2009, Texas Gas filed an offer of settlement (Settlement) in Docket No. RP09-7-000, which Texas Gas states resolves all issues set for technical conference concerning Texas Gas's proposed fuel savings sharing mechanism. For the reasons discussed below, the Commission finds that both the contested Settlement and Texas Gas's underlying proposed fuel savings sharing mechanism in Docket No. RP09-7-000 are unjust and unreasonable, and accordingly the Commission rejects the tariff sheets Texas Gas filed in that docket, without prejudice to Texas Gas filing a revised fuel savings sharing mechanism consistent with the rulings in this order. However, the Commission accepts, subject to conditions, Texas Gas's proposed changes to its fuel tracker mechanism (as subsequently revised) in Docket No. RP09-3-000.

[1] *Texas Gas Transmission, LLC*, 125 FERC ¶ 61,134 (2008) (October 2008 Order).

2. Texas Gas currently recovers its system's fuel requirements and lost and unaccounted for gas (LAUF) by retaining in-kind a percentage of gas tendered by customers.[2] Section 9.2 of the General Terms and Conditions (GT&C) of its tariff governs how Texas Gas's retention percentages are set and annually updated. Texas Gas must file annually at least 30 days before the required effective date to revise its fuel retention percentages effective November 1 of each year. Fuel retained for each transaction under Texas Gas's transmission rate schedules[3] is calculated as the product of the applicable Effective Fuel Retention Percentage and quantity of gas tendered for transportation. Fuel retained for each storage service transaction under Rate Schedules FSS and ISS[4] is calculated as the product of the applicable Effective Fuel Retention Percentage and the quantity of gas tendered for injection into storage. Texas Gas is required to establish separate Effective Fuel Retention Percentages for each of its transmission services by zone and by season.[5] The Effective Fuel Retention Percentages for storage services are calculated and established on an annual basis.

3. The Effective Fuel Retention Percentage is comprised of two components, the Projected Fuel Retention Percentage and the Fuel Adjustment Percentage. The Projected Fuel Retention Percentage is intended to compensate Texas Gas for fuel use during the year the Effective Fuel Retention Percentage is in effect, and is based on the average of the last two years of actual throughput and fuel use and the average of the last four years of LAUF volumes.

4. The Fuel Adjustment Percentage is intended to true-up over- and under-recoveries from past periods. Section 9.2.4 requires Texas Gas to maintain a Fuel Retention Deferred Account to record, on a system-wide basis, the monthly difference between the quantity of gas retained under its Effective Fuel Retention Percentages and the actual quantity of fuel used by all services. Texas Gas calculates the Fuel Adjustment Percentage in each annual fuel tracker filing in order to amortize during the current tracking period the net balance in the Fuel Retention Deferred Account as of the preceding August 31. For transportation services, a Fuel Adjustment Percentage is

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[2] Hereafter unless otherwise indicated, the term "fuel" will refer to fuel and company-use gas required for operations, as well as LAUF.

[3] Rate Schedules FT, STF, IT, NNS, SGT, SNS, NNL, and SGL.

[4] FSS – Firm Storage Service; ISS – Interruptible Storage Service.

[5] The summer season is April 1 through October 31, and the winter season is November 1 through March 31.

calculated for each zone and service on a seasonal basis.[6] For storage services, the Fuel Adjustment Percentage is applied to injections and calculated on an annual basis.

5. Below, we first discuss Texas Gas's proposal in Docket No. RP09-7-000, *et al*., to add an experimental fuel savings sharing mechanism to its fuel tracking mechanism. We then turn to Texas Gas's filing in Docket No. RP09-3-000, to establish Effective Fuel Retention Percentages for the fuel tracking period beginning November 1, 2008, and to make various changes to the tariff provisions governing its fuel tracking mechanism.

I. Docket No. RP09-7-000

A. Background

6. On October 1, 2008, in Docket No. RP09-7-000, Texas Gas filed tariff sheets, as modified on October 2, 2008 in Docket No. RP09-7-001, to implement an experimental fuel savings sharing mechanism under section 9 of its GT&C to promote fuel savings and increase long-term fuel efficiency on its system. Texas Gas maintained that one of the weaknesses of its current fuel tracker is that Texas Gas has little economic incentive to invest in capital projects for the purpose of reducing fuel use, as long as its rates are competitive, because all fuel costs and savings are passed directly through to the customers.

7. A detailed description of Texas Gas's originally proposed fuel savings sharing mechanism is provided in the October 2008 Order and will not be repeated here. Briefly, under its original proposal, Texas Gas agreed to spend between $2.5 million and $6 million during the calendar years 2008 and 2009 on projects designed to reduce fuel consumption and LAUF on its system in exchange for a share of any fuel use and LAUF savings on its system during the period September 1, 2008 through August 31, 2011. According to its proposal, Texas Gas would track the fuel savings by creating a separate Fuel Sharing Deferred Account which would track the difference between the quantity of gas retained as a result of the applicable Projected Fuel Retention Percentage and the quantity of fuel consumed for all services rendered.[7] As described previously, Texas Gas projects fuel use and LAUF based on the average of the last two years of actual throughput and fuel use, and the average of the last four years of LAUF volumes. Thus, the Fuel Sharing Deferred Account will, in essence, track the difference between Texas Gas's average fuel use and LAUF over a preceding multi-year period and its fuel use and LAUF during the current year. Initially, until Texas Gas recovers its total capital

[6] GT&C section 9.2.4(b).

[7] In essence, any overcollections for an annual fuel tracking period would be attributed to Texas Gas's capital investments and would be deemed savings.

investments, Texas Gas would receive 80 percent of any fuel savings and customers would receive in-kind the remaining 20 percent. Thereafter, and until the end of the experimental period, Texas Gas and its customers would share 50-50 in any fuel savings. After the end of the experimental period, 100 percent of the fuel and LAUF savings are passed on to Texas Gas's customers. Texas Gas would not be able to include any projects included in the sharing mechanism in any future rate cases.

8. A number of parties either did not oppose Texas Gas's proposal or expressed general support while requesting clarifications or modifications to the proposal. Other parties protested the proposal and asked the Commission to reject it. Generally, they objected to Texas Gas's (a) implementation of the fuel savings sharing mechanism outside of a general section 4 rate case; (b) method for measuring savings; (c) inclusion of metering-related improvements; and (d) inclusion of projects completed or in-service prior to Texas Gas's October 1, 2008 filing.

9. The October 2008 Order accepted and suspended Texas Gas's proposed tariff sheets implementing the experimental fuel savings sharing mechanism to be effective the earlier of April 1, 2009 or further order of the Commission, subject to refund and conditions and the outcome of a technical conference. Commission staff convened a technical conference on December 2, 2008 to discuss the issues raised by the protests to Texas Gas's proposed experimental fuel savings sharing mechanism.

10. Following the technical conference, on December 12, 2008, Texas Gas filed a revised position statement in Docket No. RP09-7-000. In its revised position statement, Texas Gas, among other things, revised its proposal to cap the total dollar amount it could recover under the fuel savings sharing mechanism at 125 percent of the dollar cost of its investments, provided that capital projects it installed before its October 1, 2008 filing be included in the fuel savings sharing mechanism. Texas Gas stated that it offered the cap to allay the concerns of certain shippers that the mechanism might lead to substantial over-recovery as a quid pro quo for including the 2008 capital projects.[8]

11. Pursuant to the procedural schedule agreed to by the parties at the technical conference, initial comments on the technical conference were due January 9, 2008, with reply comments due January 16, 2008. The following parties submitted initial comments: Texas Gas, the Associations,[9] the Cities,[10] Constellation Energy Commodities Group,

[8] Texas Gas January 16, 2009 Reply Comments at 4.

[9] The Associations include the American Forest & Paper Association, the American Iron and Steel Institute, and the Process Gas Consumers Group.

[10] The Cities include the Western Tennessee Municipal Group, the Jackson Energy Authority, City of Jackson, Tennessee, and the Kentucky Cities. The Western Tennessee

(continued…)

Inc. (Constellation), the Indicated Shippers,[11] Louisville Gas and Electric Company (Louisville), Memphis Light, Gas, and Water Division, City of Memphis, Tennessee (Memphis), the National Grid Delivery Companies[12], the Peoples Natural Gas Company and Hope Gas, Inc. (Dominion LDCs), ProLiance Energy, LLC, and PSEG Energy Resources and Trade LLC (PSEG). The following parties submitted reply comments: Texas Gas, Duke Energy Corporation (Duke), the Cities, Constellation, PSEG, and Tennessee Valley Authority (TVA).[13]

12. While the majority of parties filing comments after the technical conference either did not oppose Texas Gas's revised proposal or expressed general support, several parties continued to object to Texas Gas's proposal. Their objections were similar to the protests raised earlier in the proceeding.

Municipal Group consists of the following municipal distributor-customers of Texas Gas Transmission Corporation (Texas Gas Transmission): City of Bells, Gas & Water, Bells, Tennessee; Brownsville Utility Department, City of Brownsville, Brownsville, Tennessee; City of Covington Natural Gas Department, Covington, Tennessee; Crockett Public Utility District, Alamo, Tennessee; City of Dyersburg, Dyersburg, Tennessee; First Utility District of Tipton County, Covington, Tennessee; City of Friendship, Friendship, Tennessee; Gibson County Utility District, Trenton, Tennessee; Town of Halls Gas System, Halls, Tennessee; Humboldt Gas Utility, Humboldt, Tennessee; Martin Gas Department, Martin, Tennessee; Town of Maury City, Maury City, Tennessee; City of Munford, Munford, Tennessee; City of Ripley Natural Gas Department, Ripley, Tennessee. The Kentucky Cities are the Cities of Carrollton, Henderson, and Murray, Kentucky. They are municipal distributor-customers of Texas Gas.

[11] The Indicated Shippers include BP America Production Company, BP Energy Company, ConocoPhillips Company, and Marathon Oil Company.

[12] The National Grid Delivery Companies include The Brooklyn Union Gas Company, Keyspan Gas East Corporation; Boston Gas Company, Colonial Gas Company, Essex Gas Company, EnergyNorth Natural Gas, Inc., Niagara Mohawk Power Corporation, and the Narragansett Electric Company.

[13] J.P. Morgan Ventures Energy Corporation (JPMVEC), BG Energy Merchants, LLC (BGEM), and Columbia Gulf Transmission Company (Columbia Gulf) each filed a motion to intervene in Docket No. RP09-7-000, *et al.*, after the October 2008 Order. The Commission finds that granting the unopposed motions of JPMVEC, BGEM, and Columbia Gulf will not adversely affect this proceeding, nor harm the other parties. Accordingly, the Commission accepts their motions to intervene.

B. The Settlement

13. On February 13, 2009, Texas Gas filed its Offer of Settlement, stating its belief that it resolves all issues set for technical conference in Docket No. RP09-7-000. Texas Gas included with the Settlement an explanatory statement containing a summary of the Settlement, revised *pro forma* tariff sheets reflecting the terms of the Settlement, and a request for a shortened period for filing comments.

14. The fuel savings sharing mechanism described in the Settlement is substantially similar to Texas Gas's fuel savings sharing mechanism proposed on October 1st, and subsequently modified by Texas Gas's revised position statement and initial and reply comments following the technical conference.

15. Article I of the Settlement provides that Texas Gas will implement the experimental fuel savings sharing mechanism for a limited three-year term and include the mechanism in its annual fuel tracker filings on November 1, 2009, November 1, 2010, and November 1, 2011. Article II of the Settlement describes the nature and amount of capital investments that Texas Gas will make. According to the Settlement, Texas Gas will expend between $2.5 and $6 million in total Capital Investments between 2008 and 2009 on projects designed to promote fuel savings and increase long-term fuel efficiency on its pipeline system. At least one of the projects will consist of installing facilities to provide high pressure fuel to reciprocating compressor engines or installing fuel gas recovery systems.[14] Article III specifies the types of eligible projects under the fuel savings sharing mechanism. Such projects include upgrading/replacing old meters with more accurate meters, installing facilities to provide high pressure fuel to reciprocating compressor engines, installing verification measurement at high volume meter, installing monitoring for compressor rod packing leakage on reciprocating engines, and installing fuel gas recovery systems.

16. Article IV describes how fuel savings will be shared between Texas Gas and its customers during the three-year term of the program. As originally proposed, Texas Gas and its customers will share any savings that occur during the period September 1, 2008 through August 31, 2011. Until Texas Gas recovers its total capital investments, Texas Gas will receive 80 percent of any fuel savings and customers will receive the remaining 20 percent. Once Texas Gas recovers its total capital investments, Texas Gas and its customers will share any fuel savings 50-50. However, as proposed in Texas Gas's revised position statement, Texas Gas's share of fuel savings will be capped at 125 percent of it total capital investments. After the end of the experimental period or upon

[14] The requirement that Texas Gas's investments would include at least one project related to fuel efficiency as described in Article II is a new proposal.

Texas Gas reaching the cap, whichever is earlier, 100 percent of the fuel and LAUF savings will be passed on to Texas Gas's customers.

17. Article V describes the Fuel Sharing Deferred Account, which will track the difference between the quantity of fuel retained as a result of the applicable Projected Fuel Retention Percentage and the quantity of fuel consumed for all services rendered. Article VI describes the procedures for handling prior period adjustments (PPAs) or measurement-related settlements in the context of the sharing mechanism. As proposed in its revised position statement, Texas Gas will file a report containing information on PPAs and settlements applied after the fuel savings sharing mechanism terminates, if those PPAs and settlements were applied during the North American Energy Standards Board (NAESB) established six month PPA window. The report will be for informational purposes only and will not result in any adjustment in the sharing of the fuel savings. However, the report will not preclude any party, including Texas Gas, from taking future action.

18. Article VII specifies the information that Texas Gas will provide regarding its fuel savings sharing mechanism in its annual fuel tracker filings for the years 2009, 2010, and 2011 in order provide Texas Gas's customers and the Commission the opportunity to analyze and comment upon the method in which Texas Gas is implementing the fuel savings sharing mechanism. Article VIII sets forth the effective date of the Settlement and the date for filing tariff sheets implementing the terms of the Settlement and fuel saving sharing mechanism. Article IX establishes that the Settlement reflects a negotiated resolution of the issues set for a technical conference and sets forth the parties' general reservations under the Settlement. The Settlement is silent as to the standard of review against which future modifications will be judged. However, the explanatory statement Texas Gas filed with the Settlement states that the Settlement is subject to the "just and reasonable" standard of review and does not contain any language applying the *Mobile-Sierra* public interest standard.[15]

19. The Commission granted Texas Gas's request for a shortened comment period and accordingly, initial comments were due on February 20, 2009 and reply comments were due on February 27, 2009. Texas Gas, Anadarko Energy Services Company, the Dominion LDCs, Duke, National Grid, and PSEG filed initial comments in support of the Settlement. The Associations filed comments opposing the Settlement. The Associations state that some of their members are shippers on the Texas Gas system. Many other members receive gas which has been shipped on Texas Gas. The Associations continue to oppose Texas Gas's proposed fuel savings sharing mechanism for three reasons,

[15] See *United Gas Pipe Line Co. v. Mobile Gas Service Corp*., 350 U.S. 332 (1955); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1955).

including: (a) it fails to accurately measure the fuel savings created by the pipeline's investments under the fuel savings sharing mechanism; (b) the proposal will perpetuate Texas Gas's incentive not to file a general section 4 rate case by permitting it to overrecover its fuel costs; and (c) the proposal violates the filed rate doctrine. Duke shares the concern of the Associations that allowing a pipeline to obtain a return on limited investments outside of a general rate case creates a disincentive to make a voluntary general rate case filing and an opportunity to avoid examination of potentially offsetting reductions in the cost of service. However, Duke believes, given that Texas Gas is under no obligation to file another general rate case, the customer benefits that would not be realized in the absence of the experimental mechanism along with the fact that Texas Gas cannot recover the costs of its capital investments in a future rate case, warrant approval of Texas Gas's proposal.

20. Texas Gas, TVA, and the Independent Petroleum Association of America (IPAA) submitted reply comments. In its reply comments, Texas Gas maintains that creating a fuel savings sharing mechanism in a limited section 4 rate proceeding does not eliminate a pipeline's incentive to file a rate case. Texas Gas states that pipelines simply do not file rate cases to recover a $6.5 million investment because rate cases are extraordinarily time consuming and expensive for customers and pipelines. Also, unlike traditional ratemaking methodologies, Texas Gas states that under its proposed mechanism it will be solely at risk for the cost of installing the capital projects and there is no guarantee that it will recover its expenditures. Regarding the Associations' claim that the proposal violates the filed rate doctrine, Texas Gas states that the mechanism only dictates how recovery will occur in the future, starting with the 2009 fuel tracker, and it does not change Texas Gas's currently effective fuel rate. Finally, Texas Gas acknowledges that its method for evaluating fuel savings may not be perfect, but insists that it has attempted to create the most accurate mechanism possible, given its highly complex pipeline system.

21. TVA states in its reply comments that it does not oppose the approval of the Settlement due to the fuel savings sharing mechanism's experimental nature and its limited 3-year duration. TVA believes, however, that the 25 percent rate of return for Texas Gas under the mechanism is overreaching, and would likely oppose this type of mechanism if it were intended to be a long-term, fixed program. TVA also believes that allowing a pipeline to obtain rates of return on its investments as part of an incentive mechanism would be more appropriate in a general section 4 rate case where it would be afforded greater scrutiny.

22. IPAA is concerned with the Commission's ad-hoc approach to pipeline fuel over-recovery. It maintains that only pipelines with fuel trackers and true-ups designed to prevent over-recovery are likely to file new incentive proposals that would allow them to keep a share of any incremental fuel efficiencies, while pipelines currently over-recovering their fuel costs will likely maintain the status quo.

C. Discussion

23. In the notice terminating the Notice Of Inquiry concerning the Commission's policies on the in-kind recovery of fuel and lost and unaccounted-for gas by natural gas pipeline companies,[16] the Commission recognized that "the operation of the interstate pipeline system involves a significant amount of fuel use and lost and unaccounted for gas to deliver supplies to market," and "[f]uel gas charges now make up a greater percentage of the overall interstate transportation rate than they have in the past." [17] The Commission believed, as did many of the parties in that proceeding, that fuel savings incentive mechanisms could be helpful in ultimately reducing such fuel gas charges, and the Commission determined that case-by-case consideration of incentive proposals would assist in the development of the Commission's policies concerning pipelines' recovery of fuel costs. Here, Texas Gas proposed a fuel savings sharing mechanism, now included in its Settlement offer, the stated purpose of which is to reduce fuel costs on Texas Gas's system.

24. While the Settlement is supported, or not opposed by most parties in this proceeding, the Associations oppose the Settlement. In order to approve a contested settlement, the Commission must make "an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates." [18] Moreover, the courts have held that the Commission must give sufficient consideration to the interests of contesting parties, even if the settlement has wide support and there are only one or very few contesting parties.[19] Here, as discussed in more detail below, we find that Texas Gas's proposed Settlement, and its original incentive savings proposal, are unjust and unreasonable for two reasons. First, the proposed fuel savings sharing mechanism lacks any reasonably accurate standard for measuring the savings

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[16] *Fuel Retention Practices of Natural Gas Companies*, 120 FERC ¶ 61,255 (2007).

[17] *Fuel Retention Practices of Natural Gas Companies*, 125 FERC ¶ 61,213, at P 12 (2008).

[18] *Trailblazer Pipeline Co.*, 87 FERC ¶ 61,110, at 61,438 (1999) (*Trailblazer*) (*citing Mobil Oil Corp. v. FERC*, 417 U.S. 283, 314 (1974) (*Mobil*), *United Municipal Distributors Group v. FERC*, 732 F.2d 202, 207 n.8 (D.C. Cir. 1984), and 18 C.F.R. § 385.602(h)(1)(i), respectively).

[19] *Tejas Power Corp. v. FERC*, 908 F.2d 998 (D.C. Cir. 1990), *LaClede Gas Company v. FERC*, 997 F.2d 936 (D.C. Cir. 1993), *NorAm Gas Transmission v. FERC*, 148 F.3d 1158 (D.C. Cir. 1998), and *Southern California Edison Co. v. FERC*, 162 F.3d 116 (D.C. Cir. 1998).

attributable to Texas Gas's capital investments. Second, Texas Gas proposes to consider as incentivized investments projects that were either completed or in-service prior to Texas Gas's October 1, 2008 filing for Commission approval of the program. Accordingly, we reject the Settlement. We also reject the tariff sheets related to the proposed fuel savings sharing mechanism that were accepted and suspended subject to condition and identified in Exhibit C of the October 2008 Order. [20] However, we disagree with the Associations' contention that pipelines should only be permitted to implement fuel savings sharing mechanisms in general section 4 rate cases. Therefore, our action here is without prejudice to Texas Gas filing a revised fuel savings sharing mechanism in a limited section 4 filing, consistent with the policies established in this order.

1. Texas Gas's Method for Measuring Savings

25. Article II of the Settlement provides that Texas Gas will spend between $2.5 and $6 million on projects designed to promote fuel savings and increase long-term fuel efficiency on its system in exchange for a share of the fuel savings. Article V provides Texas Gas will track fuel savings by creating a Fuel Sharing Deferred Account, which will track the difference between (a) the quantity of gas retained as a result of the applicable Projected Fuel Retention Percentage and (b) the quantity of fuel consumed for all services rendered. Texas Gas calculates its Projected Fuel Retention Percentage based on the average of the last two years of actual throughput and fuel use, and the average of the last four years of LAUF volumes. Thus, any system-wide reduction in fuel use and LAUF as compared to past periods is considered a saving attributable to Texas Gas's capital investments. Under Article IV, Texas Gas, during the three-year experimental program, will receive 80 percent of any such savings until it recovers the total cost of its

[20] *Trailblazer* explained four approaches for approving contested settlements. These are: Approach No. 1, where the Commission renders a binding merits decision on each of the contested issues; Approach No. 2, where approval of the contested settlement is based on a finding that the overall settlement as a package provides a just and reasonable result; Approach No. 3, where the Commission determines whether the benefits of the settlement outbalance the nature of the objections, in light of the limited interest of the contesting party in the outcome of the case; and Approach No. 4, where the Commission approves the settlement as uncontested for the consenting parties, and severs the contesting parties to litigate the issues. *Trailblazer*, 87 FERC ¶ 61,110 at 61,439. The parties supporting the Settlement all seek to have us approve the Settlement under Approach No. 1. However, we find on the merits that the Settlement is unjust and unreasonable as to two of the contested issues. None of the parties suggest that the Settlement could be approved under any of the other three approaches.

investments, after which it will receive 50 percent of any further savings until Texas Gas recovers an amount equal to 25 percent of its total capital investments.

26. The Associations argue that, under Texas Gas's proposed method for calculating savings, Texas Gas will be entitled to fuel savings regardless of their relationship to Texas Gas's capital investments. The Associations are also concerned that because Texas Gas, in its sole discretion, will decide if, when, and what projects will be completed under its proposal, Texas Gas will have the opportunity to game the fuel savings sharing mechanism. For example, the Associations believe that Texas Gas can likely foresee fuel savings that result from normal maintenance and may time that maintenance to capture the greatest fuel savings during the measuring period.

27. Texas Gas acknowledges that its method for calculating fuel savings may not be perfect, but states that it is the best known way to evaluate fuel usage on its highly complex system. Texas Gas states that part of the reason the fuel savings mechanism is being proposed as an experiment is so that Texas Gas can gain experience in tracking fuel savings on its system while concurrently providing immediate benefits to customers. Texas Gas also argues that, to the extent it can create savings through maintenance, or any other factor within its control, such fuel savings directly benefit customers by achieving lower fuel rates. On the other hand, Texas Gas maintains that if it is unable to effectuate any fuel savings the cost of any facilities installed under the mechanism will be borne solely by it and the customers will not be harmed.

28. The Commission finds that Texas Gas's proposed method for calculating savings under the Settlement is unjust and unreasonable. To determine fuel savings, Texas Gas proposes a simple comparison of system-wide fuel use and LAUF after installation of capital improvements with system-wide fuel use and LAUF during prior periods. There is nothing in Texas Gas's proposal that requires it to make any estimate of the savings that can be expected from each of its capital improvement investments or indicate on what parts of its system those savings are expected to occur. Under its proposed method for calculating savings, Texas Gas will necessarily have the opportunity to share in fuel savings that result from factors other than Texas Gas's capital investments. For example, under the mechanism, Texas Gas will have the opportunity to share fuel savings resulting from reductions in fuel use attributable to normal maintenance, weather, changes in operations and other reasons unrelated to Texas Gas's capital investments. In addition, Texas Gas could share savings from fuel use reductions on parts of its system far distant from, and unaffected by, any of its capital improvement investments. Texas Gas will also

have the opportunity under its proposal to share in non-LAUF fuel savings based upon metering-related investments that by their very nature could only reduce LAUF.[21]

29. We believe this is inappropriate and inconsistent with the requirements in the Commission's 1996 Incentive Ratemaking Policy Statement, [22] that an incentive ratemaking proposal must specify the performance standards it defines and a method for evaluating whether those standards were being met. Because Texas Gas's proposal does not include any reasonable standards for measuring fuel and LAUF savings specifically attributable to Texas Gas's capital improvements, or method for evaluating whether such standards are being met, it will be impossible to determine with reasonable accuracy if Texas Gas's investments are in fact reducing fuel use and LAUF on its system or whether such reductions are due to factors other than Texas Gas's capital improvements. As a result, it will be impossible to determine with any reasonable accuracy if Texas Gas's fuel incentive mechanism is fulfilling its stated purpose, promoting fuel savings and increasing fuel efficiency on its system. 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 the pipelines to share savings reasonably attributable to those investments.

30. Further, other operationally complex pipelines have developed fuel savings sharing tariff mechanisms that would calculate fuel savings using performance standards and evaluation methods that are more consistent with the 1996 Incentive Ratemaking Policy Statement, based upon the savings generated by the pipeline's investments. For example, in a contemporaneous order, we are approving El Paso Natural Gas Company's fuel savings sharing mechanism, under which projected fuel savings are based upon the design conditions of the capital improvement adjusted for reasonably expected operating conditions.[23] Another example is Colorado Interstate Gas Company's (CIG) mechanism. Under CIG's fuel savings sharing mechanism, CIG shares in fuel consumption savings if

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[21] As Texas Gas has stated, metering-related improvements do not reduce fuel use. They improve meter accuracy, thereby reducing LAUF.

[22] *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 Co*., 110 FERC ¶ 61,069, at P 39 (2005), *order on reh'g and compliance filing*, 111 FERC ¶ 61,290 (2005) (leaving open the possibility that a pipeline could include an incentive fuel savings mechanism in a fuel tracker pursuant to the Incentive Ratemaking Policy Statement).

[23] *See El Paso Natural Gas Company*, 120 FERC ¶ 61,208 (2007); El Paso FERC Gas Tariff, Second Revised Volume No. 1A, Original Sheet No. 324A.

CIG "experiences an identifiable reduction in fuel consumption on its system (excluding [LAUF] savings or other changes) that is directly related to a new qualifying capital project placed into service under th[e] mechanism...."[24] In light of these examples, we believe that Texas Gas should be able to create a method for calculating fuel and LAUF savings that is based upon the savings generated by its capital investments.[25]

2. Inclusion in Fuel Savings Sharing Mechanism Projects Completed Prior to Texas Gas's October Filing

31. Under the Settlement, the fuel savings sharing mechanism will include projects installed by Texas Gas during 2008 and 2009. Accordingly, Texas Gas intends to include in the mechanism approximately $2.3 million worth of new ultrasonic meters installed in May, June, and July of 2008, before its October 1, 2008 filing of its fuel savings sharing mechanism.[26] The Associations object to Texas Gas's inclusion of these projects in the fuel saving sharing mechanism. The Associations contend that Texas Gas's inclusion of such costs violates the filed rate doctrine and rule against retroactive ratemaking. Texas Gas maintains that the Associations are incorrect because the mechanism only dictates how recovery will occur in the future, starting with the 2009 fuel tracker, and it does not change Texas Gas's currently effective fuel rate.

32. We find that the inclusion of projects in the mechanism that were completed or in-service prior to Texas Gas's October 1, 2008 filing is unjust and reasonable.[27] The

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[24] *See Colorado Interstate Gas Company*, 116 FERC ¶ 61,126 (2006); Colorado FERC Gas Tariff, First Revised Volume No. 1, First Revised Sheet No. 380L.

[25] The Commission recognizes that the methods for measuring fuel and LAUF savings under a fuel incentive mechanism may differ while still being consistent with the 1996 Incentive Ratemaking Policy Statement.

[26] Texas Gas November 1, 2008 Answer at 7.

[27] We do not agree with the Association's assertion that inclusion of the costs of projects installed before Texas Gas filed its incentive proposal would violate the filed rate doctrine and amount to retroactive ratemaking. This is not a situation where the pipeline would be recovering in current rates past costs which it incurred solely to provide past service. Rather, Texas Gas will be using the facilities at issue to provide future service, and thus, as is true of all a pipeline's investments in used and useful facilities, the costs are related to all current and future service performed using the relevant facilities. Also the proposed mechanism would only affect the rates to be charged for such future service. It does not change rates provided for service before the effective date of the mechanism. *See Public Utilities Commission of the State of California v. FERC*, 988 F.2d 154, 160-61

(continued…)

purpose of an incentive mechanism is to provide the pipeline with an incentive to make investments in order to provide service in a more efficient manner. Here, Texas Gas had already installed certain of the fuel saving projects before filing its fuel savings sharing mechanism for Commission approval. Texas Gas states that it began installing the projects only after it appeared that a consensus was being developed regarding the fuel savings sharing mechanism.[28] The record in this case, including comments and protests, does not support Texas Gas's consensus claim. Because Texas Gas completed the subject projects before even seeking Commission approval of its fuel savings sharing mechanism, there is nothing to show that the incentives in that mechanism were necessary to encourage its investment in those projects. The Commission finds that projects placed in service before the filing of an incentive mechanism should not be eligible for the incentives provided by such a mechanism. Disallowing Texas Gas's projects completed before its October filing is also consistent with the Commission's policy concerning incentives for electric transmission projects.[29]

3. Conclusion

33. Based on the findings above, the Commission rejects the Settlement and the tariff sheets filed in this docket to implement Texas Gas's proposed fuel savings sharing mechanism. Our rejection of the instant proposal is without prejudice to Texas Gas filing a new incentive savings sharing proposal in a limited section 4 rate case. In this regard, we reject the Association's contention that pipelines should only be permitted to implement such a sharing mechanism in a general section 4 rate case, where all the pipeline's costs and revenues may be reviewed. The Commission has a longstanding policy of permitting pipelines to track their fuel and LAUF costs in periodic limited section 4 filings, outside of a general section 4 rate case.[30] Consistent with that fact, we believe it is appropriate to permit pipelines to propose improvements and revisions to their tracking mechanisms in limited section 4 rate cases, rather than requiring that such changes await the filing a general section 4 rate case. We want to encourage pipelines to develop fuel incentive mechanisms that contribute to pipeline fuel efficiency and we believe that requiring pipelines to implement fuel incentive mechanisms only in a general

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(D.C. Cir. 1993), and *Western Resources, Inc. v. FERC*, 72 F.3d 147, 152 (D.C. Cir. 1995).

[28] Texas Gas December 12, 2008 Revised Position Statement at 6.

[29] *Commonwealth Edison Co*., 122 FERC ¶ 61,037, P 32 (2008) (*ComEd*) (denying ComEd's request for incentives for projects that were completed before ComEd filed its request).

[30] *See* 18 C.F.R. §154.403 (2008).

section 4 rate case may discourage Texas Gas, and other pipelines, from proposing such mechanisms. Moreover, we are not convinced that allowing implementation of a fuel incentive mechanism outside of Natural Gas Act (NGA) general section 4 rate case will discourage Texas Gas, or other pipelines for that matter, from filing a general section 4 rate case.

II. Docket No. RP09-3-000

A. Background

34. Texas Gas currently recovers its system's fuel requirements and lost and unaccounted for gas (LAUF) by retaining in-kind a percentage of gas tendered by customers.[31] Texas Gas annually updates its fuel retention percentages in fuel tracker filings based upon fuel use and LAUF projected in the next year,[32] adjusted for over- or under-recoveries during past periods. Section 9.2 of the General Terms and Conditions (GT&C) of Texas Gas's tariff governs how Texas Gas's retention percentages are set and annually updated.

35. In its October 1, 2008 filing in Docket No. RP09-3-000, Texas Gas filed to establish Effective Fuel Retention Percentages for the fuel tracking period beginning November 1, 2008. In the same filing, Texas Gas proposed modifications to its fuel tracking mechanism. In these modifications, Texas Gas sought to reduce the number of fuel zones from five to three. Texas Gas also proposed to institute a fuel rate for both the injection and the withdrawal of storage gas under Rate Schedules FSS and ISS, a change from Texas Gas's current tariff provisions which impose a fuel rate only on storage injections and not withdrawals. Texas Gas further submitted tariff language to implement a new "hybrid" fuel retention rate applicable to customers using the swing allocation methodology to transfer excess quantities of gas at no-notice delivery points into storage. Additionally, whereas Texas Gas currently charges seasonal fuel rates, Texas Gas proposed to implement annual fuel rates while retaining for some transportation services the option for shippers to select either seasonal rates or annual rates. Texas Gas also submitted minor changes to its tariff sheets in order to provide clarification and to correct typographical errors.

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[31] Hereafter unless otherwise indicated, the term "fuel" will refer to fuel and company-use gas required for operations, as well as LAUF.

[32] Texas Gas projects fuel use for the next year based on average fuel use during the preceding two years and projects LAUF based on actual LAUF during the preceding four years.

36. A number of parties filed protests and comments requesting clarification or objecting to aspects of the proposal. In its October 2008 Order, the Commission accepted and suspended the tariff sheets setting forth Texas Gas's revised fuel retention percentages to be effective November 1, 2008, subject to refund and conditions and subject to Texas Gas's re-filing the tariff sheets consistent with its existing fuel tracker methodology. The Commission also accepted and suspended the tariff sheets containing the proposed modifications to the fuel tracking mechanism, subject to refund and conditions, to be effective April 1, 2009, or some earlier date specified in a further order of the Commission. The order also directed Commission staff to convene a technical conference.

37. On November 6, 2008, in RP09-03-001, Texas Gas filed fuel retention percentages for the period starting November 1, 2008, that were consistent with its then currently effective fuel retention mechanism without the proposed modifications in this docket. By delegated letter order dated December 16, 2008, the Commission accepted Texas Gas's filing in RP09-3-001.[33]

38. On December 2, 2008, a technical conference was held to discuss the issues raised by the protests and comments. On December 12, 2008, Texas Gas filed a revised position statement in Docket No. RP09-3-000. Pursuant to the procedural schedule agreed to by the parties at the technical conference, initial comments on the technical conference were due January 9, 2009, with reply comments due January 16, 2009.

39. On January 9, 2009, the following parties submitted initial comments in Docket No. RP09-3-000 pursuant to the procedural schedule: Texas Gas; PSEG; Louisville; the Cities; Dominion LDCs; and ProLiance. On January 16, 2009, the Cities and Texas Gas filed reply comments.

B. Discussion

40. The October 2008 Order accepted and suspended,[34] subject to conditions, tariff sheets filed by Texas Gas modifying its fuel tracker mechanism in Docket No. RP09-3-000. These modifications included adoption of annualized fuel rates for certain services, reduction in the number of fuel zones from five to three, implementation of a hybrid rate applicable to swing allocations, and implementation of fuel rates for both the injection and the withdrawal of storage gas. In its initial post-technical conference comments, Texas Gas submitted *pro forma* tariff sheets reflecting further modifications of its

[33] *Texas Gas Transmission, LLC*, Docket No. RP09-3-001 (Dec. 16, 2008) (unpublished letter order).

[34] Identified in Appendix B of the October 2008 Order.

proposals. In its subsequent reply comments, Texas Gas further revised these pro forma tariff sheets. The Commission approves Texas Gas's proposed modifications of its fuel tracker mechanism as reflected in the *pro forma* tariff sheets and directs Texas Gas to file corresponding actual tariff sheets in accordance with the discussion below.

1. Texas Gas's Proposal to Adopt Annual Fuel Rates

41. Texas Gas currently charges fuel rates calculated on a seasonal basis. In its October 1, 2008 filing, Texas Gas proposed to implement annual fuel rates while retaining, for certain services that Texas Gas characterized as seasonal in nature,[35] an option allowing shippers to choose between annual and seasonal rates. In protests and comments, various shippers expressed opposition to this proposal.

42. Following the technical conference, Texas Gas proposed in its revised position statement and comments to eliminate the option for shippers to select seasonal rates and to require an annual rate for all services. Texas Gas states that this modification should address the concerns expressed in protests and comments with its earlier proposal to allow shippers to elect either seasonal rates or annual rates for certain services. Texas Gas states that an annual rate ensures that customers are treated equally, simplifies the fuel tracker matrix, and reduces volatility. Texas Gas states that several other pipelines use similar annual rates.[36]

43. Dominion LDCs and ProLiance filed comments supporting Texas Gas's proposal for annual rates as described in the revised position statement and Texas Gas's initial comments. PSEG states that although it sees no reason to shift from seasonal to annual rates, it has received assurances from the pipeline that the proposed changes will not cause PSEG to subsidize any other shipper. Only one party, Louisville, objects to Texas Gas's proposal for annual rates. Louisville emphasizes that winter fuel use percentages have historically exceeded summer fuel use percentages on Texas Gas's system. Thus, Louisville asserts that the shift from seasonal to annualized rates is discriminatory and will cause shippers with relatively high summer loads (like Louisville) to subsidize shippers with comparatively high winter loads. Louisville asserts that any forecasting errors in seasonal fuel use can be offset by the true-up process. Louisville further notes

[35] These services included NNS, NNL, SGT, SGL, SNS, and STF service.

[36] Citing ANR Pipeline Company, FERC Gas Tariff, General Terms and Conditions § 37; Columbia Gas Transmission Corp., FERC Gas Tariff, General Terms and Conditions § 35; El Paso Natural Gas Co., FERC Gas Tariff, General Terms and Conditions § 26; Transcontinental Gas Pipe Line Corp., FERC Gas Tariff, General Terms and Conditions § 38.

that the Commission has previously rejected a proposal by Texas Gas to use annualized rates.[37]

44. In reply comments, Texas Gas responds to Louisville that summer usage has increased and that, in the future, summer fuel rates may equal or eventually exceed winter rates. Texas Gas further states that while the true-up process allows the pipeline to correct discrepancies between projected and actual fuel usage, in the past, the true-up process has been the primary cause of volatility in Texas Gas's fuel rates. Texas Gas further contends that annual rates, as opposed to seasonal rates, lessen the likelihood of such discrepancies and thus reduce volatility and the need for significant true-ups. Texas Gas distinguishes the Commission's previous rejection of proposed annualized rates on Texas Gas system because, in the prior case, the Commission merely held that Texas Gas failed to explain adequately why annual rates were proposed for only certain rate schedules.[38] Texas Gas further emphasizes that, under section 4 of the NGA, the pipeline has broad authority to propose rates, changes or modifications to its tariff provided a proposal is just and reasonable.

45. The Commission accepts Texas Gas's tariff revision as proposed in its revised position statement to use annual rates, notwithstanding Louisville's objections. Under section 4 of the NGA, "[i]f the pipeline's proposal is just and reasonable, the Commission must accept it, regardless of whether other just and reasonable rates may exist."[39] Many pipelines have annualized fuel rates, and it has not been the Commission's practice to require the pipelines to offer seasonal fuel rates, even if, in theory, these rates might lead to a more precise allocation of costs. Although the Commission previously rejected a proposal by Texas Gas to adopt annualized rates for some of its services, the Commission's prior decision was based upon Texas Gas's failure to justify the application of annual rates for certain services and seasonal rates for other services.[40] In this filing, Texas Gas has addressed the Commission's concerns by proposing annual rates for all services. The annualized rates proposed by Texas Gas are consistent with just and reasonable practices previously approved by the Commission, and, thus, the Commission accepts Texas Gas's proposal to implement annualized fuel rates.

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[37] *Citing Texas Gas Transmission, LLC,* 120 FERC 61,186, at P 39 (2007).

[38] *Citing Texas Gas Transmission, LLC,* 120 FERC 61,186, at P 39 (2007).

[39] *Tennessee Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,223 (1997) *aff'd, Consolidated Edison Co. v. FERC,* 165 F.3d 992 (D.C. Cir. 1999).

[40] *Texas Gas Transmission, LLC*, 120 FERC ¶ 61,186, at P 39 (2007).

2. Texas Gas's Proposal to Adopt a Hybrid Rate

46. Texas Gas proposes to calculate a "hybrid" fuel retention rate that will apply to excess gas that is transferred into storage from a no-notice delivery point by customers using the swing allocation methodology. Texas Gas asserts that the hybrid rate is necessary to avoid the under-collection of fuel for no-notice service. Texas Gas explains that under its current tariff, an under-collection is likely to occur because, for customers with multiple transportation contracts, some of the excess gas transferred into no-notice storage by the swing allocation may have been delivered to the no-notice delivery point under FT, STF, or IT transportation rate schedules. However, Texas Gas states that fuel rates for FT, STF, and IT service are generally less than the applicable no-notice fuel rate and no additional charge is assessed for placing this gas into the no-notice storage account via the swing allocation.

47. In its revised position statement and its comments, Texas Gas proposes to modify its methodology for calculating the hybrid rate. In Texas Gas's October 1, 2008 filing, Texas Gas proposed to calculate the hybrid rate for each zone of delivery by subtracting the lowest forward haul FT/STF/IT Effective Fuel Retention Percentage from the applicable no-notice Effective Fuel Retention Percentage. Texas Gas explains that if this calculation results in a negative number, it is rounded to zero. Texas Gas states that in response to concerns that this method may cause an over-recovery, Texas Gas now proposes to use a weighted average forward haul FT/STF/IT Effective Fuel Retention Percentage instead of the lowest forward haul FT/STF/IT Effective Fuel Rate Percentage in the hybrid rate formula. Texas Gas states that this revised hybrid fuel rate alleviates any concerns that the hybrid rate may cause over-collection of fuel.

48. No party has expressed opposition to Texas Gas's proposal to implement a hybrid rate using a weighted average forward haul FT/STF/IT Effective Fuel Retention Percentage. ProLiance, Dominion LDCs, and the Cities state that they support the proposed language implementing the hybrid fuel rates for no-notice swing allocations. The Cities further urge expedited implementation of this provision because the Cities state that Texas Gas has suspended use of the no-notice swing allocation methodology pending implementation of the hybrid fuel rate. Dominion LDCs also state that Texas Gas has provided assurance that neither FT nor STF services would be affected by the implementation of the revised hybrid rate proposal. PSEG states that it does not oppose Texas Gas's changes because it has received assurance from the pipeline that the changes will not cause PSEG to subsidize other shippers.

49. The Commission approves Texas Gas's proposal for a hybrid rate based on the use of a weighted average forward haul FT/STF/IT Effective Fuel Retention Percentage. This proposal addresses concerns that the originally proposed hybrid rate could cause over-recovery of fuel. Texas Gas is ordered to file revised tariff sheets consistent with this proposal.

3. Other Proposed Modifications to Texas Gas's Tariff

50. In its filing, Texas Gas also proposed to reduce the number of fuel zones from five to three and to implement a fuel charge for withdrawals as well as injections under the ISS and FSS rate schedules. Texas Gas also proposed other minor modifications to its tariff to clarify its terms and to correct typographical errors. Following the technical conference, no party filed comments opposing these modifications to Texas Gas's tariff.[41] The Commission finds that these proposed changes are just and reasonable and thus accepts these proposed modifications.

4. Implementation of the Proposed Changes

51. In its initial comments, Texas Gas proposes to implement the swing allocation methodology hybrid rate on the first day of the month after the Commission approves Texas Gas's hybrid rate methodology. However, Texas Gas states that it does not plan to adjust its fuel rates to reflect the other modifications until November 1, 2009, the first day of the next fuel tracker year.

52. The Commission accepts Texas Gas's proposal to implement the swing allocation methodology hybrid rate effective on the first day of the month following this order. The Commission also accepts Texas Gas's proposal to continue using its current fuel tracker rates rather than to change its rates for the current fuel tracker year. Texas Gas is ordered to file tariff sheets consistent with these proposals.

The Commission orders:

(A) The settlement filed in RP09-7-000, on February 13, 2009, in this proceeding is rejected, without prejudice, as unjust and unreasonable for the reasons set forth in this order.

(B) The Commission approves Texas Gas's proposed modifications of its fuel tracker mechanism in Docket No. RP09-3-000, subject to Texas Gas filing revised tariff sheets consistent with the discussion in the body of this order on or before 30 days from the date of this order.

[41] Dominion LDCs and PSEG state that they have received assurances from Texas Gas that these other modifications will not adversely affect certain services provided by them or lead to subsidization. In its filings, Texas Gas also states that it provided these assurances to these parties.

(C) The tariff sheets conditionally accepted in the October 2008 Order are rejected as moot.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.