

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Fuel Retention Practices) Docket No. RM07-20-000
of Natural Gas Companies)

**COMMENTS OF THE
NATURAL GAS SUPPLY ASSOCIATION**

Pursuant to the Notice of Inquiry (“NOI”)¹ issued by the Federal Energy Regulatory Commission (“Commission” or “FERC”) on September 20, 2007 in this proceeding, the Natural Gas Supply Association (“NGSA”) submits these comments on the fuel retention practices of natural gas companies.

I. COMMUNICATIONS

NGSA represents integrated and independent companies that produce and market domestic natural gas. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy, and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. consumers.

Notices and communications concerning these comments should be addressed as follows:

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¹ *Fuel Retention Practices of Natural Gas Companies*, “Notice of Inquiry,” IV FERC Stats. & Regs. ¶ 35,556 (2007).

II. EXECUTIVE SUMMARY

The Commission's initiative in this proceeding is a much-needed and positive step towards better rationalizing its policies pertaining to the fuel retention practices of natural gas companies. NGSA supports a uniform fuel policy that requires all interstate natural gas pipelines with fixed fuel percentages to convert to a fuel tracker that also includes a true-up mechanism. Once that conversion is completed, pipelines and their customers should have the opportunity to negotiate mutually agreeable incentive mechanisms to promote increased fuel efficiency. However, NGSA does not believe that it is appropriate for the Commission to prescribe a specific fuel incentive program.

There are two completely divergent practices for pipeline fuel retention: some pipelines have fixed fuel retention percentages that only change in the context of a full-scale rate proceeding, while others recalculate their fuel retention percentages at regular intervals through some form of a tracking mechanism. Some pipelines have trackers with true-up mechanisms while others do not. Also, there are numerous approaches taken by pipelines for calculating fuel retention percentages and true-up mechanisms, many of which need to be carefully examined. As indicated in the NOI, there are still twenty-four pipelines, which maintain fixed fuel rates; creating a significant disparity in how fuel is calculated. There is no justification for continuing this disparity.

As an association which represents producers that sell and market natural gas, NGSA is a strong advocate for improving fuel efficiency in interstate transportation. We support the use of incentive mechanisms negotiated between individual pipelines

and their customers as a means to provide pipelines with additional motivation to increase fuel efficiency.

The Commission's findings, as well as studies performed by NGSAs, clearly show significant levels of over-collection of fuel by some pipelines that have fixed fuel charges. Given that pipelines should no longer be in the merchant function, these excessive over-collections provide strong evidence that the continued use of fixed fuel percentages by pipelines is no longer just and reasonable as a matter of Commission policy.

Fuel efficiency should be promoted through the Commission's rules and regulations where it is economically feasible. However, the Commission should not allow those efforts to trump its fundamental obligation under the Natural Gas Act to protect consumers from unjust and unreasonable rates. Thus, the Commission should use its Section 5 authority to implement a policy change converting all pipelines with fixed fuel percentages to a fuel tracker with a true-up mechanism. Additionally, pipelines that have trackers without a true-up mechanism should be required to include a true-up mechanism in their tariff. Implementation of these new fuel retention requirements should be required through limited Section 4 filings without delay.²

² Pipeline companies always have the option of filing a full Section 4 rate proceeding.

III. RESPONSES TO NOTICE OF INQUIRY QUESTIONS

The Commission has raised many significant questions in the context of this NOI and NGSAs' responses are provided below.

1. Should the Commission continue to allow recovery of pipeline fuel costs through fixed fuel retention percentages?

NGSA Answer: No. Excessive revenues due to the over-collection of fuel through fixed fuel percentages cannot be considered just and reasonable. The revenue generated for some pipelines through fixed fuel charges far exceeds the economic incentive needed to encourage additional investments in more efficient pipeline infrastructure. Moreover, fixed fuel rates may put pressure on pipelines to operate their systems in a manner that may arguably lower overall fuel consumption, but may not necessarily be in the customer's best interest. Allowing pipelines to continue to assess fixed fuel charges has the potential to result in economic motivations impacting the level of service provided to shippers.

Given the pipeline industry's solid track record, we have come to expect that pipelines will operate their systems in a manner that is most conducive to meeting shippers' needs. However, fixed fuel charges can put economic pressure on pipelines to favor fuel efficiency over customer service. With substantial amounts of money at stake, there will likely be more hesitancy to run compression if that is not the most economically efficient option for the pipeline. This, in turn, could contribute to artificial constraints on a pipeline system or limit capacity. Additionally, pipelines with fixed fuel rates that are benefiting from reductions in system fuel use are less likely to make investments in their system that would require a new rate proceeding, potentially

upsetting their existing fuel revenue stream. These potential consequences highlight the importance that pipelines remain relatively fuel neutral.

Prior to the elimination of pipeline triennial rate reviews, the Commission and pipeline shippers had the opportunity to regularly examine fixed fuel charges as part of a pipeline's overall rate proceeding. However, in the current regulatory environment, fixed fuel percentages have often remained untouched for years without any Commission review. This has led to some pipelines retaining much more fuel than their systems need to operate, resulting in unjust enrichment of pipelines as they make the resulting fuel gas sales a primary profit center.

The Commission's own analysis in this proceeding clearly illustrates that those pipelines with fixed fuel percentages have over-collected fuel valued at \$427 million in a single year. NGSAs analysis shows similar results with those pipelines collecting excess fuel valued at over \$2.1 billion over a five-year period ending 2005.³ Pipeline over-collections of fuel under fixed rates are magnified by the fact that many pipeline's fuel rates have remained untouched for many years. For instance, both Tennessee Gas Pipeline Company ("Tennessee") and Natural Gas Pipeline Company of America ("NGPL") have each over-recovered more than \$400 million over the past five years on excess fuel retention alone while their rates, including fuel, have not been examined in over 12 years.

As the Commission stated in an order on rehearing in an ANR Pipeline Company proceeding, interstate pipelines are "required under the long-standing

³ NGSAs Pipeline Cost Recovery of 32 Major Pipelines, 2001-2005, annual excess fuel volumes and average fuel prices reflected in individual pipeline Form 2 reports.

principle of pipeline regulation to operate [their] system[s] efficiently and [have] a duty to minimize all costs. Variable costs such as fuel are not intended to be a profit center.”⁴ The sale of excess retained natural gas fuel as a profit-center by pipelines also counters the unbundling of the gas industry in which transporters exited the merchant function and were only intended to make minor, incidental sales of gas. Yet our analysis shows, in some instances, pipeline companies are now profiting more from sales of fuel gas than from their primary transportation business.⁵ Thus, many of the fixed fuel percentage rates now exceed any realistic gas fuel consumption level and can no longer be considered just and reasonable.

Shippers should not carry the burden to challenge a pipeline’s fuel rates. In *National Fuel*, the pipeline argued that alteration of one pipeline cost element should not be considered in isolation of a pipeline’s rates. Although the Commission rejected summary disposition on the pipeline’s fuel charges based on insufficient facts and asked the judge to consider a phased approach for earlier relief on fuel, this case does cast some doubt on whether the Commission would permit fixed fuel retention percentages to be reviewed separately from the rest of the pipeline’s system rates.⁶

⁴ *ANR Pipeline Co.*, 110 FERC ¶ 61,069, at P 41 (citations omitted), *order on reh’g*, 111 FERC ¶ 61,290 (2005) (hereinafter, “*ANR*”).

⁵ For instance, in NGS’s Pipeline Cost Recovery study, NGPL consistently retained more revenue from fuel than from pipeline transportation. For 2005, NGS’s study estimated approximately \$145 million in fuel revenue while the company made over \$107 million on other pipeline-related services.

⁶ *Public Service Commission of New York, et al. v. National Fuel Gas Supply Corp.*, 115 FERC ¶ 61,299, at PP 27, 41-42 (2006).

Therefore, the only recourse for any party overpaying its fuel rate is the burden of filing a full Section 5 proceeding.⁷

Some may view fixed fuel rates as an attractive approach for encouraging pipeline efficiency. However, it is grossly inefficient in terms of ratemaking to allow the pipeline, as the middleman between suppliers and gas users, to continually retain more fuel than necessary. The better alternative is to structure a fuel recovery mechanism that properly charges the shipper the actual cost of providing the transportation service. Fixed fuel rates may, arguably, provide an incentive for pipelines to use less fuel, but if the shipper must inherently pay a significantly higher price for this added efficiency, as a matter of policy, the rates cannot be just and reasonable. Instead of allowing the continuation of fixed fuel percentages, more appropriate ways should be sought to achieve increased pipeline fuel efficiency, which are also consistent with the Commission's broad policies and goals.

Relying on fixed fuel rates to provide efficiency incentives presupposes that there is no limit to the number of efficiency gains that can be wrung out of a pipeline system. While a fixed fuel rate remains constant year-to-year, the number of potential system upgrades to improve efficiencies obviously will decrease over time and, at some point, there is little economic efficiency to be gained. In fact, one could assume that many of the economic efficiency gains for pipelines with fixed fuel rates would already have been completed, given that those pipelines receive all the benefits associated with fuel

⁷ The Section 5 process places significant burdens on pipeline customers. Not only do shippers carry the burden of proof to demonstrate that the pipeline's rates are not just and reasonable, but this burden can only be undertaken at an enormous expenditure of resources and often, at the expense of industry relationships.

reductions. On those systems in which most of the economic efficiency investment has already been made, the revenues acquired in association with over-collections from fixed fuel rates are potentially unlimited. Thus, allowing these gas sales based on fixed fuel charges subverts the Commission's intent to remove pipelines from the merchant function.

It is difficult to envision a scenario in which the investment in efficiency-related upgrades could even begin to approach the level of revenues generated by some pipelines from the sale of excess fuel gas collected under fixed fuel charges. For example, the cost of a new system compressor station is typically less than \$25 million,⁸ yet some pipelines with fixed fuel rates are recovering nearly \$150 million in just a single year.⁹ Over time, this can lead to billions of dollars in profits for a single pipeline; making, in our opinion, the price of fixed cost "efficiency" inducements unjustified and unacceptable. The evidence strongly suggests that pipelines with fixed fuel recovery mechanisms have already recovered significantly more than the value of whatever related capital investments they may have made.

Moreover, it should be noted that there is no requirement that pipelines spend any of their fuel-related revenue on efficiency upgrades. For those pipeline companies that have reorganized as distribution-driven Master Limited Partnerships, there is

⁸ An average compressor unit (3,590hp) would cost \$6,063,510. On average then, an entire compressor station (4 units) would cost about \$24,254,040 based on 2006 data. See "US Compressor-Construction Costs, Estimated," p. 52, Table 5, *Oil & Gas Journal*, Week of September 3, 2007 (average US price for compression (land) is \$1,689/hp); see also "Natural Gas Compressor Stations on the Interstate Pipeline Network: Developments Since 1996," p. 2 n.4, Energy Information Administration, U.S. Dept. of Energy (Nov. 2007) (In 2006, the 1,201 operational natural gas compressor stations located on the U.S. interstate natural gas pipeline network contained more than 4,700 individual compressor units, or about 4 units per station, averaging about 3,590 horsepower per unit.)

⁹ The Commission came to a similar conclusion in the ANR proceeding in which it concluded that it did not "see any reason to believe that allowing ANR to over recover fuel from its customers with a value approaching \$100 million was a necessary incentive for it to minimize its use of fuel use and L&U gas." 110 FERC ¶ 61,069, at P 37.

added uncertainty about whether cash-flows from any over-recovery associated with fuel retention will ever be re-invested as capital improvements in the pipeline system itself; much less in more efficient infrastructure. Additionally, to the extent a pipeline makes capital improvements to increase fuel efficiency, these expenditures can be recovered as part of the pipeline's rate base. Pipelines always have the option to refresh their rates by filing for a section 4 rate case.

For the reasons cited above, NGSAs believe it is no longer appropriate for the Commission to continue to allow pipelines to have fixed fuel retention percentages that change only in the context of a full rate proceeding. Instead, the Commission needs a uniform policy that eliminates fixed fuel rates and requires pipelines to regularly track and recalculate their fuel percentages as well as to include a mechanism for reconciling over- and under-collections. As detailed more fully in response to Question 3, to promote enhanced fuel efficiency, once all pipelines have moved to a tracker type fuel mechanism with a true-up, the pipelines and their customers should have the opportunity to negotiate an incentive mechanism that meets the needs of that particular system.

2. Should the Commission mandate that all pipelines must have a tracker mechanism for the recovery of fuel?

NGSA Answer: Yes. In order to ensure that shippers are charged just and reasonable fuel rates, a general policy should be implemented that requires a tracker to calculate fuel retention rates at regular intervals. Consistent with current Commission policy, a true-up mechanism should also be required in conjunction with the tracker.

Recalculating pipeline fuel percentages at regular intervals ensures that rates

reflect the true cost of transportation and that shippers only supply gas that is actually needed for system use. As the Commission stated in *ANR*, “[w]ith the recent escalation in natural gas prices, fuel has not only become a more significant factor in a pipeline’s operating costs but also a more significant excess revenue producer absent a true-up mechanism.¹⁰” Additionally, the amount of over-collections from fuel will be significantly minimized in the period between tracking filings because the resulting fuel rates will be based on periodically updated system use.

The Commission has previously found that, although it does not generally permit pipelines to change any single component of their cost-of-service outside of a general section 4 rate case, an exception to this policy should be granted for fuel because it “may be more volatile than most and thus more difficult to project than typical cost items in the pipeline’s cost of service.”¹¹ Given difficulties in projecting fuel use and prices, it is much more appropriate for all pipelines to implement tracker/ true-up provisions, than it is for shippers to continue to face the burden of seeking changes to pipeline fuel charges in the context of Section 5 proceedings.¹²

3. If the Commission requires pipelines to use a tracker, should it require a true-up mechanism?

NGSA Answer: Yes. The Commission should require pipelines with a tracker to implement a true-up. However, once the trackers and true-up mechanisms are in place, pipelines and shippers should have the opportunity to negotiate a mechanism to share

¹⁰ 110 FERC ¶ 61,069, at P 24. In *ANR*, the Commission also stated that, “as natural gas prices rise...producers and marketers who are at risk for the higher fuel prices have an even greater interest in minimizing those costs” relative to regulated LDCs. *Id.* at P 40.

¹¹ *Id.* at P 23.

¹² Additionally, pipelines are less likely to file a Section 4 rate case when revenues associated with excess fuel retention provides a substantial amount of annual income.

fuel savings resulting from increased efficiencies.

The Commission's reasoning in *ANR* was correct when it required a true-up in conjunction with the pipeline's tracker stating that, allowing a tracker gives the pipeline the opportunity to increase that cost item without regard to other offsetting cost reductions. As such, in return for that opportunity, "there should be an assurance that the individual cost item is, in fact, tracked accurately."¹³

The Commission found that pipelines should be fuel neutral when it stated that fuel retention percentages are "only supposed to return to [the pipeline] its actual used fuel, and is not intended to generate income."¹⁴ More recently, Commission Staff supported a true-up mechanism in initial comments in Mojave's rate case settlement. In its comments, Staff stated that "[t]he Settlement's Fuel Retention true-up mechanism is intended to ensure that Mojave and its shippers remain economically neutral as to the gas flows on Mojave's system" and that "the revenues that exceed the reasonable expectations of the parties will be shared with Mojave's customers."¹⁵ Retaining fuel above the amount required to operate the pipeline system permits a pipeline to unfairly profit from its shippers' gas; unlike an incentive sharing mechanism negotiated by the pipeline and its shippers. A true-up mechanism provides fuel neutrality by eliminating these unintended gas sales.

Some parties argue that a true-up mechanism eliminates the incentive for a pipeline to become more fuel efficient. However, as the Commission recognized in

¹³ *Id.* at P 22.

¹⁴ *Id.* at P 27 (quoting *Northern Natural Gas Co.*, 80 FERC ¶ 61,332, at 62,106 (1997)).

¹⁵ *Mojave Pipeline Co.*, Docket No. RP07-310-000, "Initial Comments of the Commission Trial Staff In Support of Offer of Settlement," at 7-8 (filed Oct. 19, 2007).

ANR, collection of revenues associated with the retention of fuel, such as a true-up mechanism, should not be the only motivating factor for pipelines to operate their businesses efficiently. Rather, interstate pipelines are “required under the long-standing principle of pipeline regulation to operate [their] system[s] efficiently and [have] a duty to minimize all costs.”¹⁶ Nor should it remove all incentives to increase fuel use efficiency. As the Commission pointed out in that case:

Requiring a true-up mechanism does not remove all incentives for the pipeline to reduce its fuel use. Pipelines do face at least some competitive pressures in obtaining marginal throughput, for example obtaining customers with access to alternate fuels. Because the Commission has held that pipelines may not discount their fuel use and L&U retention percentages since those costs are variable, the only way a pipeline can reduce its fuel retention percentages in order to help obtain marginal business is by reducing its fuel usage. This contrasts with most of the other cost items underlying the pipelines’ rates, which are fixed and thus can be discounted in order to obtain marginal business. Moreover, in *Northern Natural*, the Commission has already rejected a pipeline’s contention that true-up mechanisms should not be required in fuel tracking mechanisms, since a true-up would eliminate its incentive to reduce fuel costs through capital improvements. The Commission stated, “the true-up should also not result in disincentives to Northern Natural making capital improvements on its system, since the PRA is only supposed to return to Northern Natural its actual used fuel, and is not intended to generate income.” The Commission concludes that, at least with respect to fuel use and L&U gas, the benefits of requiring a true-up provision as part of any periodic tracking mechanism outweighs any disadvantages.¹⁷

Given our country’s need to conserve all of our energy resources, NGSA does believe that providing additional economic motivation for improved efficiency is important. However, there is simply no evidence to conclude that a pipeline must be allowed to retain 100% of the benefits of the realized efficiency gain in order to have an

¹⁶ *ANR*, 110 FERC ¶ 61,069, at P 41 (citations omitted).

¹⁷ *Id.* at P 27 (citation omitted).

incentive to undertake a fuel efficiency program. To that end, fixed fuel recovery mechanisms should be terminated and replaced with a mechanism that properly charges shippers the true cost of transportation. Once a tracker/true-up mechanism is in place, parties should be allowed to negotiate a mutually agreeable sharing mechanism that provides additional motivation for increased fuel efficiency on a particular system. In recent years, we have seen pipelines and their shippers, including producers, devise a variety of methods to: (1) reduce fuel use, (2) encourage capital improvements, (3) defray risk, (4) reward investments in new technology, and (5) provide benefits to both the pipeline and its shippers.

While one size does not fit all, a number of mutually acceptable fuel-sharing mechanisms have been developed by pipelines and shippers that have brought increased fuel efficiency to individual systems. For example, in the recent CIG case, shippers and the pipeline agreed to an incentive program that would encourage tangible capital improvements through a fuel sharing mechanism for “qualified facilities.”¹⁸ El Paso has a similar mechanism in place.¹⁹ Other pipelines, such as Questar and Southern, have negotiated incentive mechanisms in recent years that permit the pipelines and their shippers to share over-collections of fuel.²⁰ Although each of these examples is different, as the cases cited above clearly demonstrate,

¹⁸ See *Colorado Interstate Gas Co.*, Docket Nos. RP06-397-000 and RP01-350-015, “Stipulation and Agreement,” Article 3.8 (filed June 20, 2006), approved at *Colorado Interstate Gas Co.*, 116 FERC ¶ 61,126 (2006).

¹⁹ See *El Paso Natural Gas Co.*, 120 FERC ¶ 61,208, Appendix, Article V (2007), *reh’g pending*.

²⁰ See *Southern Natural Gas Co.*, Docket No. RP04-523-000, “Stipulation and Agreement,” Article IX, First Revised Sheet No. 210 (filed Apr. 29, 2005), approved at *Southern Natural Gas Co.*, Docket Nos. RP04-523-000, *et al.* (Letter Order issued July 13, 2005)(unpublished); see also *Questar Pipeline Co.*, Docket Nos. RP04-91-000, *et al.*, “Stipulation and Agreement,” Article II (filed June 17, 2005), approved at *Questar Pipeline Co.*, 112 FERC ¶ 61,119 (2005).

shippers, including producers, have shown their willingness to devise creative new ways to ensure that pipeline companies have the capital and incentive to improve the efficiency of their system's infrastructure.

Parties should be permitted to consider all forms of incentives (e.g. efficiency formulas, qualifying facilities, as well as specific percentages of efficiency gains, whatever the parties agree upon). However, efficiency incentives should not be considered that would preclude the use of a tracker/true-up mechanism. Specifically, the formula RPI-X is not readily conducive to implementation in the context of a tracking mechanism. Additionally, if parties mutually agree to use the formula RPI-X, as a means to provide an efficiency incentive, the Commission should be mindful that the inflation component inherent in RPI-X does not negate the efficiency gain incentives of the "X" variable in the equation and also that, the percentage "X" applied is appropriate in that it will provide measured gains in efficiency, which can be passed on as savings to shippers and ultimately, consumers.

4. Should the Commission retain its current policy?

NGSA Answer: No. As detailed more fully below, all pipelines that retain fixed fuel charges should convert to a tracker/true-up mechanism without delay. Also, the Commission should consider expanding the scope of this proceeding to include a set of parameters or standards that specify how trackers and true-up mechanisms should be devised and what steps must be taken to ensure that the tariff provisions for all pipelines are consistent with these standards.

Tariff Standards for Trackers and True-up Mechanisms

In the context of a limited Section 4 filing, pipeline tariffs should be examined to ensure that they include a fuel tracker and true-up mechanism, that the formulas are appropriate for the calculations, and that they comply with the standards set forth by the Commission. Some of those standards are set forth below.

Projections of future fuel use should not be permitted in the formulas utilized by pipelines when recalculating or reconciling their fuel charges. Some pipelines include projections of future gas use in their calculations of fuel percentages in addition to the actual volumes used in the previous period. However, because pipelines are not at risk for under-collection when a true-up mechanism is in place, the pipeline should be entirely fuel-neutral. As there is no risk of under-collection with true-ups, projections no longer serve a purpose.²¹

Moreover, the Commission itself has found that fuel is “subject to significant changes from year to year and [is] thus particularly difficult to project.”²² The Commission has held that fluctuations in fuel use are to be expected and changes are not easily predictable “even if there may not be a specific reason for expecting a change in fuel usage.”²³ Excluding projections from the calculation of fuel charges would eliminate many of the uncertainties and complexities experienced when tracking filings are submitted. Therefore, during the compliance and review process, the Commission

²¹ If a pipeline believes that there are extraordinary circumstances between tracking filings that will cause significant losses that can not await the next regularly scheduled reconciliation of costs, the Commission could permit the pipeline to file out-of-period tracking filings to recalculate that rate at an earlier time.

²² *ANR*, 110 FERC ¶ 61,069, at P 19.

²³ *Id.* at P 23.

should ensure that the formulas used to calculate fuel as well as to true-up those calculations are based on the actual volumes of gas used in the prior period and not projections.

Pipelines should account for the various types of fuel use separately and should assess separate charges for each. Pipeline fuel rates are charged to recover fuel for system use, lost and unaccounted for gas, gas used to balance the system, as well as cash-outs. Each of these types of fuel use serves a fundamentally different purpose, yet a number of pipelines include them all in the same account. Combining the various fuel accounts can complicate the assessment of proper accounting and pipeline operations as well as potentially provide unfair customer subsidization.

When two separate uses of fuel are accounted for in aggregate and one overall “fuel” charge is assessed, parties will find it more difficult to assess whether this fuel cost is being handled properly by the pipeline. Looking at these fuel cost items separately, however, allows parties to target where problem areas may exist—given that different issues tend to arise depending on the type of fuel account. For instance, if fuel consumption for system operations is unusually high, this may be due to lacking management practices, including a failure to upgrade equipment or inadequate maintenance. By contrast, a high level of lost and unaccounted for gas may be due to simple accounting issues or a problem with the pipeline’s measurement equipment.

Also, combining fuel accounts can create situations where customers that should have received refunds do not get them. For instance, a customer may otherwise be due a refund because it provided more system gas than needed during the period being

reconciled. Other customers may have used more gas for system balancing during that same period. Thus, if both system use gas and imbalance gas are combined into the same charge and reconciliation, the two can negate and offset each other; leaving one customer compensating for another's actions. Additionally, because current policy does not permit pipelines to discount below the level of lost and unaccounted for gas, separate fuel charges will aid shippers in ascertaining what level can be discounted in terms of fuel and what cannot. If a total fuel charge includes multiple fuel components, it is the shipper's best guess as to what level discount can be granted.

Given current market conditions and the substantial costs associated with supplying fuel to the pipeline, additional Commission support and review of cost increases has become increasingly important. The slightest increase in fuel rates can translate into hundreds of thousands of dollars a day to a single shipper, depending on their size. For that reason, NGSA urges the Commission to require more uniform and consistent tracking mechanisms and to provide shippers with a more thorough review of proposed fuel percentages. Given the significant impact that a change in the fuel rate can have on shippers, discovery procedures should be provided if the fuel rate or the lost and unaccounted for gas charges increase more than ten percent above the current rate.²⁴ Also, in those instances, the pipeline should be required to submit more detailed supporting documentation that provides the basis for the rate increase.

²⁴ For example, if a pipeline's current fuel loss recovery was 2.5%, an increase of 10% would translate into an incremental cost of 2 cents per MCF at a gas cost of \$8.00. This is a relevant portion of the shipper's total transportation cost, and it is a rate increase that is typically thoroughly investigated in pipeline proceedings.

Conversion to Tracker/True-Up Mechanisms

Given the reasons cited in our responses above, collection of fuel by pipelines through fixed fuel percentages should no longer be permitted to continue. Instead, the Commission should use its Section 5 authority to convert all pipelines with fixed fuel percentages to a fuel tracker that also includes a true-up mechanism.²⁵ Additionally, those pipelines that have trackers without a true-up mechanism should be required to have a true-up mechanism in their tariff. Compliance filings for implementation the Commission's new requirements should be reviewed under limited Section 4 filings.

For pipelines that have moratoriums as part of their last rate case settlement, conversions to a tracker with a true-up mechanism should be required immediately once the moratorium expires. Future pipeline settlements should allow negotiated incentive mechanisms, but should not permit parties to negotiate fuel retention methods that are inconsistent with the Commission's requirement that all pipelines have trackers and true-up mechanisms. It is not necessary for the Commission to require a full-blown rate proceeding to implement fuel trackers unless the pipeline believes it is the right time to do so. Other pipeline rates (e.g. transportation, storage services) can be addressed at a later time.

Once a tracker/true-up mechanism is in place, NGSAs believe there will be opportunities for negotiating fuel efficiency incentives between pipelines and their shippers. Given that system configurations and the level of potential efficiency gains

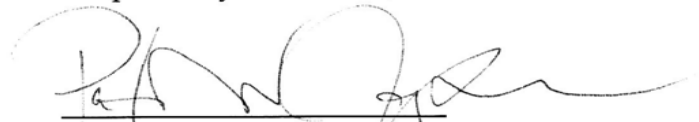
²⁵ The Commission can make generic section 5 findings in a rulemaking proceeding. *Interstate Natural Gas Association of America v. FERC*, 285 F.3d 18, 37 (D.C. Cir. 2002); *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 688 & 711 (D.C. Cir. 2000) (citation omitted).

vary tremendously among pipelines, it would not be wise to dictate a generic incentive mechanism for all pipelines. Rather, individual pipelines and their shippers should work together to tailor the incentive mechanisms that meet their specific needs.

IV. CONCLUSION

NGSA shares the Commission's goal for pipeline systems to operate as efficiently as possible. However, this efficiency goal must be delicately balanced with the Commission's fundamental obligation to ensure that rates reflect the cost of providing the service and are just and reasonable under the Natural Gas Act. Fortunately, it is possible to achieve that balance by first converting interstate natural gas pipelines to trackers with true-up mechanisms and subsequently, permitting pipelines and their shippers the opportunity to craft incentive mechanisms for increased fuel efficiency.

Respectfully submitted,



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