

this discussion these volumes will be referred to collectively as system gas. In our view, the character of the accounting for system gas needs falls into three categories: (1) A fixed asset for those volumes needed to provide for pressure maintenance, (2) a fixed asset for those volumes needed to meet imbalances, including no-notice transportation, and (3) operating expenses for volumes used for compression, line losses, and other operational uses.

The first fixed asset category includes line pack gas,⁹ LNG "heel",¹⁰ and gas held in underground or other natural gas storage facilities for purposes of pressure maintenance.¹¹ The cost to the pipeline of these volumes, taken collectively, represents its fixed investment in the gas necessary to operate the pipeline transportation system. Under the current Uniform System of Accounts, the investment cost of these volumes is recorded as gas plant in service except for recoverable base storage gas which is recorded in Account 117, Gas Stored Underground-Noncurrent.

Aside from these volumes, however, pipelines as merchants have also traditionally maintained "investments" in additional volumes of gas that were needed for system balancing¹² or to provide gas sales service at the city gate on demand during peak periods. These additional volumes were included in the pipeline's system as additions to line pack and/or underground storage. When the additional volumes were added to line pack, many pipelines charged the cost of the gas to expense at that time, even though the gas was not physically delivered to a customer until a later period. When the additional volumes were injected into underground storage, the cost of the gas was charged to either Account 164.1 or Account 117. As the volumes were withdrawn from inventory for load balancing or sales service, the related cost was charged to expense. The cost of gas withdrawn from storage would be

determined in accordance with a generally accepted inventory method, consistently applied. The accounting costs were then recovered from sales customers through purchased gas adjustments (PGAs).

In the post-Order No. 636 period, there is a need to measure and recognize the additional volumes of gas needed for load balancing and no-notice transportation service, as well as the recoverable base gas volumes, differently from how they have been measured and recognized in the past. This is because such investments are necessary to perform a transmission function whether there continue to be sales services or not. Further, with the implementation of unbundled services, pipelines generally discontinued their PGAs. Most pipelines that continue to provide sales service do so at market-based prices. It is obviously important to identify and aggregate the costs of transportation service separately from the costs of providing sales service, in order to avoid inappropriate allocations of costs between the two.

Under Order No. 636, pipelines were required to relinquish most of the capacity of their transmission system, including storage, to their customers. The Commission permits pipeline companies to retain for their own use only a designated volume of storage capacity on their systems for use in load balancing and no-notice transportation service. These volumes, in general, are intended to represent the maximum volume needed to maintain reliability and continuity of transportation service during peak periods. It would be inappropriate to classify these volumes as gas held for resale in the ordinary course of business, i.e. inventory; instead, they represent permanent investments that a pipeline must make for providing transportation service. The Commission believes that the use of this gas provides further support for no longer viewing the costs incurred to provide this transportation function as inventory (or expended when acquired in the case of some line pack). To account for this gas in such a manner, which would be more appropriate for an enterprise engaged in a merchant type of business activity, is no longer the best financial statement representation.

Even if a pipeline receives payment for system gas delivered to meet an imbalance or no-notice transportation requirement, the Commission does not believe that it should account for the transaction as if a sale has occurred. Simultaneously with the gas delivery, the transportation pipeline has an obligation, in order to maintain the integrity of the transportation system, to

replenish the designated volumes that make up system supply. The obligation to replace these volumes would more appropriately be accounted for as if "owed to system gas" rather than as a sale. There is no expectation by the pipeline of realizing a profit from this type of gas transaction. It is merely a loan that is to be repaid by the shipper through either providing gas in kind or through cash-out provisions.

The primary difference between the fixed asset accounting model and the inventory model for system gas is in the carrying value of the asset. Under the inventory model, the carrying value of the asset will change over time as withdrawals of system gas are made and replacements are brought back into the system. The inventory model would permit various methods of pricing these withdrawals. For instance, an entity could assign a cost to these withdrawals using LIFO, FIFO, or a weighted average inventory method, or specific identification, provided that the method is consistently applied. Replacements would be priced at their acquisition cost. Under the fixed asset model, as we view it, the carrying value for system gas would not change except for recognition of changes in designated volumes. Instead, the carrying value would be locked-in the same way that plant investments are to historical cost. Further, the fixed asset model would permit only one method for assigning cost to the temporary "owed to system gas" account—current market price. Gain or loss recognition, if any, would be limited to any differences between the actual replacement cost of system gas and reimbursements from customers on a cash-out basis where the differences are not required to be passed along to customers.

The Commission believes that the fixed asset model is superior for several reasons.

First, it more accurately reflects the economics of transportation transactions. If the withdrawal/replacement transaction is satisfied by gas in kind, it is obvious that there should be no economic gain or loss realized. Since the cash-out provisions are intended to be substitutes for gas deliveries, it should likewise be obvious that no economic gain or loss occurred from the basic transaction. However, the inventory method would result in a gain or loss being recognized to the extent that the accounting cost of gas withdrawn from storage (historical cost) differs from the cash-out price (generally current spot market prices). On the other hand, the fixed asset model would not show a gain or loss from the withdrawal/replacement activity. Both

⁹ Gas Plant Instruction 3(20).

¹⁰ Gas Plant instruction 3(21).

¹¹ The gas needed to maintain pressure requirements refers to those volumes needed to maintain the system at its design operating capacity. It includes the volumes of gas held in natural gas storage facilities in order to maintain pressure and deliverability requirements. These storage volumes are often referred to as base or cushion gas.

¹² System balancing, as used here, refers to those situations where the pipeline provided gas from its own source of supply in order to meet deficiencies caused by a shipper tendering less volumes to the pipeline at the receipt point than it took from the systems at the delivery point. The term can also be used to refer to situations where the shipper tenders more volumes than it takes from the system.