August 27, 2004

Hon. Jaclyn Brilling, Secretary
Public Service Commission of the
State of New York
Three Empire State Plaza
Albany, NY 12223

Re: National Fuel Gas Distribution Corporation
Proposed Tariff Amendments and Base Rate Increase

Dear Secretary Brilling:

National Fuel Gas Distribution Corporation ("Distribution" or "the Company") submits the following amendments to its tariff, P.S.C. No. 8 - Gas:

Leaf No. 2	Revision 6
Leaf No. 3	Revision 14
Leaf No. 3.1	Revision 2
Leaf No. 24	Revision 2
Leaf No. 74	Revision 5
Leaf No. 74.2	Revision 2
Leaf No. 81	Revision 3
Leaf No. 82	Revision 5
Leaf No. 83	Revision 4
Leaf No. 84	Revision 5
Leaf No. 94	Revision 2
Leaf No. 126	Revision 1
Leaf No. 127	Revision 2
Leaf No. 128	Revision 2
Leaf No. 129	Revision 1
Leaf No. 130	Revision 1
Leaf No. 131	Revision 1
Leaf No. 133	Revision 3
Leaf No. 138	Revision 4
Leaf No. 141	Revision 4
Leaf No. 148	Revision 4
Leaf No. 148.6	Revision 3
Leaf No. 148.7	Revision 0
Leaf No. 149	Revision 5
Leaf No. 150	Revision 8
Leaf No. 151	Revision 2
Leaf No. 152	Revision 6

Leaf No. 153	Revision 7
Leaf No. 154	Revision 9
Leaf No. 155	Revision 5
Leaf No. 156.1	Revision 5
Leaf No. 156.2	Revision 3
Leaf No. 157	Revision 4
Leaf No. 158	Revision 8
Leaf No. 159	Revision 2
Leaf No. 161	Revision 2
Leaf No. 163	Revision 2
Leaf No. 164	Revision 3
Leaf No. 165	Revision 8
Leaf No. 173	Revision 3
Leaf No. 174	Revision 3
Leaf No. 175	Revision 6
Leaf No. 179	Revision 2
Leaf No. 184	Revision 6
Leaf No. 186	Revision 4
Leaf No. 187	Revision 7
Leaf No. 189	Revision 6
Leaf No. 190	Revision 5
Leaf No. 206	Revision 6
Leaf No. 207	Revision 6
Leaf No. 211	Revision 8
Leaf No. 217	Revision 4
Leaf No. 218	Revision 4
Leaf No. 219	Revision 5
Leaf No. 220	Revision 3
Leaf No. 221	Revision 5
Leaf No. 222	Revision 11
Leaf No. 224	Revision 5
Leaf No. 230	Revision 2
Leaf No. 231	Revision 1
Leaf No. 234	Revision 1
Leaf No. 235	Revision 1
Leaf No. 236	Revision 1
Leaf No. 237	Revision 3
Leaf No. 248	Revision 1
Leaf No. 255	Revision 3
Leaf No. 257	Revision 1
Leaf No. 258	Revision 3
Leaf No. 259	Revision 3
Leaf No. 262	Revision 5
Leaf No. 263	Revision 4

Leaf No. 266	Revision 5
Leaf No. 266.1	Revision 3
Leaf No. 266.1.1	Revision 0
Leaf No. 266.3	Revision 2
Leaf No. 266.4	Revision 6
Leaf No. 270.1	Revision 3
Leaf No. 271	Revision 9
Leaf No. 275	Revision 6
Leaf No. 276	Revision 8
Leaf No. 277	Revision 4
Leaf No. 278	Revision 2
Leaf No. 279	Revision 2
Leaf No. 280	Revision 2
Leaf No. 281	Revision 2
Leaf No. 282	Revision 1
Leaf No. 283	Revision 2
Leaf No. 284	Revision 1
Leaf No. 285	Revision 2
Leaf No. 286	Revision 1

These revisions are issued as of August 27, 2004 and are proposed to be effective October 1, 2004.[1] Among other things, the revised tariff leaves are designed to increase annual revenue recovered in base rates by $60.9 million. The elimination of surcharges and other changes would produce a net aggregate bill increase of $41.3 million or approximately 5.6%.

The total revenue requirement is based upon operations during the projected rate year ending July 31, 2006.

The Annual Bill Frequency Report is attached as Attachment A. Details regarding specific items which contribute to the requested increase are shown in Attachment B. Attachment C shows the bills that will be increased or decreased and the overall percentage increased by Service Class.

Also included with this filing are fifteen (15) hard copies of testimony of witnesses (Volume 1), their exhibits (Volumes II-III) and two (2) copies of their workpapers (Volume IV-V) in support of the revisions in the enclosed tariff leaves.

Two sets of testimony and exhibits and a copy of the workpapers will be delivered to the Consumer Protection Board.

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[1] The revised tariff sheets are being transmitted electronically to the Commission in accordance with applicable procedures. Copies are included with this transmittal letter.

Newspaper publication will be made in accordance with the provisions of the Commission's Rules and Regulations. Copies of the filing will also be placed in a number of public libraries within the Company's service territory where they will be available for inspection by the general public.

The witnesses testifying on behalf of the Company are:

Garth D. Anderson
David P. Bauer
Rosetta C. Brocato
Thomas J. Clark
Kathleen A. Frank
Ruth M. Friedrich-Alf
Frank J. Hanley
Bruce D. Heine
Eric H. Meinl
Sarah J. Mugel
Mark D. Pijacki
David F. Rydholm
John J. Spanos
Robert W. Sprague
Regina L. Truitt

Distribution has, over the years, worked diligently to avoid increasing base rates. Case 94-G-0885 ("1994 Case") was the last in a string of litigated rate cases that stretched back almost 20 years. The Company's last base rate increase filing was made on November 2, 1995, and it resulted in a multi-year settlement. Since then, Distribution has engaged in a series of rate settlements that have brought the benefits of incentive regulation to its customers in the form of rate reductions, an eight year period of rate stability, and, within that period, bill credits that served to reduce customers' overall gas bills. Those benefits were solely the product of the Company's intense focus on cost containment and productivity gains. A measure of how indisputably successful the Company's cost containment and productivity efforts have been in recent years can be seen with reference to the last fully litigated case in 1994.

In the 1994 Case, net revenue (less gas cost) for the 12 months ended July 31, 1996 was $275,917,000. Cases 94-G-0895, 93-G-0756, National Fuel Gas Distribution Corp., Opinion No. 95-16 (issued September 15, 1995), App. A, Sheet 1. In contrast, for the 12 months ended July 31, 2006, net revenue will be only $257,374,000. Therefore, despite the passage of almost ten years, net revenue has not risen as expected; it has fallen by almost $20 million. The reason for this is simple. The Opinion in the 1994 Case assumed that the average residential customer would use 124.29 Mcf in the rate year. Ten years later, it is expected that average use per residential customer will be 110.5 Mcf for the 12 months ended July 31, 2006. Moreover, the Company's service territory is a mature market where customer growth is virtually non-existent. With over 97% of customers using natural gas for their space heating needs, there is no opportunity for growth from customer conversions from other fuels.

While the Company's revenue has fallen since the 1994 Case, its need to invest in plant to serve its customers has not been reduced. In fact, while the net plant in the 1994 Case was $594,771,000 (App. A, Sheet 13), net plant for the 12 months ended July 31, 2006 is expected to have grown to $719,287,000. This represents a 20.9% increase in investment in the Company's service territory.

With declining revenue and increasing requirements for capital additions (rate base), the most likely result for Distribution and its customers would have been a string of rate cases and ever escalating rates. Yet, quite the opposite, rates have actually declined since 1994. This is an achievement that is best illustrated by examining the expense levels in the 1994 Case and comparing them to today's expenses.

In the 1994 Case, total O&M expenses for the 12 months ended July 31, 1996 were $145,761,000. A decade later, total O&M expenses for the 12 months ending July 31, 2006 are estimated to be $159,283,000. If the Company had merely experienced normal inflation to its O&M expenses, the $145,761,000 of O&M expense in the 1994 Case would have grown to $174,476,000 by 2006. The Company, however, did take aggressive steps to contain costs – most dramatically in the Labor component. For example, labor expense in the 1994 Case was $62,871,000. For the 12 months ending July 31, 2006 labor expense is expected to be only $50,258,000. Again, in the face of wage and salary increases over the last ten years, the Company's labor expense is almost $12.6 million less than it was projected to be in 1996. This represents a drop in labor expense for this time period of approximately 20%. A similar story can be told in virtually every other cost area over which the Company has some control.

That Distribution has responded to the incentive regulation adopted by the Commission to achieve substantial productivity gains is beyond dispute. Yet the Company also sounded a cautionary note that the pace and scope of savings was to become even more difficult to achieve. Distribution observed, in urging adoption of a 2000 Agreement, that "the range of operations and maintenance activities available for cost-cutting and efficiency gains continues to shrink, while slow economic growth and a continuing trend of declining consumption per customer will combine to hold down growth in sales and net revenues." Case 00-G-1495 Order Establishing Rates for Gas Service (issued October 23, 2000) at 6-7. As this filing will demonstrate, the point upon which productivity savings can no longer mask upward cost pressures is now upon us.

It is clear that the ability of the Company to achieve significant annual cost reductions is dwindling and is now being overwhelmed by rising costs in those areas over which the Company has little or no control. Although Distribution's cost containment efforts have produced positive results, these efforts have masked the ongoing, upward pressure on rates from costs that are not within the Company's control.[2]

For example, pension expense, which was projected to be just $2.8 million in 1996, has ballooned to $12.3 million for 2006 due in part to general economic conditions. OPEBs, which were $8.5 million in 1996, have jumped to $18.6 million for 2006. Hospitalization, which was just under $3.8 million in 1996, will grow to over $6.8 million for 2006. While these cost increases have been masked for a long time by the Company's overall cost containment efforts, they cannot be avoided

[2] For example, the single largest expense component in customers' bills is the cost of natural gas. While the Company can play a minor role in that expense by maximizing various cost containment strategies, it is captive to the larger, national market for natural gas that determines the price of the commodity. The run-up in natural gas prices in the last few years has affected all distributors of the commodity, regardless of the region of the country or whether they are utilities or marketers.

forever. As the opportunities for cost-effective savings became ever more difficult to achieve without diminishing service, it became apparent that the time would come where expenses that are not within the Company's control would necessitate a need for earnings relief. Despite the Company's best efforts, that time has finally come.

After so many years of aggressive efforts, the range of Distribution's operations and maintenance activities available for cost-cutting and efficiency gains continues to shrink. At the same time, as the Commission is aware, revenue continues to contract as usage per customer continues to trend downward.

This rate filing demonstrates that these cost pressures "have finally caught up" to the Company's ability to generate productivity savings. In reflection of its need for revenue relief, Distribution made several attempts to develop a settlement with other interested parties that would offer an alternative to the filing of a base rate case. Unfortunately, none of these attempts bore fruit. While Distribution would have preferred a different result, the filing made today is a reflection of the harsh reality that cost cutting and containment simply cannot continue to keep the many other upward pressures on our costs at bay.

Nevertheless, even with the rate increase necessitated by this filing, the Company's non-gas rates would still be less than inflation since 1997, when Distribution entered the current period of rate stability. This can be seen by comparing the average contribution from residential customers from rates in 1997 to the proposed base rates. Applying 1997's rates to the 12 months ended December 1997 average volumes would generate an average contribution to non-gas costs for residential customers of $485.53. Adjusting that amount for the increase in inflation since 1997 would yield an average contribution to non-gas costs of $573.51. The Company's entire rate increase requested in this filing, however, would only produce a total contribution to non-gas rates of $526.76 for the 12 months ended July 31, 2006. Therefore, even in the face of declining usage per customer and increases in costs and capital spending, the Company's aggressive cost containment efforts have permitted the impact of the proposed rate increase sought herein to be below the increase in consumer prices since the Company's last adjustment in rates.

This filing also includes rate design changes and modifications to competitive services that will permit growth without compromising reliability. These changes are more particularly described as follows:

- The Company is not proposing renewal of its ineffective Low Income Residential Assistance rate classification (scheduled to expire on September 30, 2004) and plans to instead design a flexible low income service that can offer larger discounts where there is a demonstrated need;

- Transportation and aggregation services (for end-use customers and Energy Service Companies ("ESCOs")) will be simplified by providing that all ESCOs serve retail choice customers (large and small volume) through the Company's general aggregation service. This will bring the Company's retail competition offerings closer to the model utilized across the state;

- We are proposing a capacity release program to insure that any further migration to retail competition would not compromise reliability;

- We are proposing to significantly liberalize existing rules regarding indigenous gas producers' access to the Company's retail competition market; and

- Costly subsidies previously thought to aid competition have been removed.

It bears repeating that we regard this filing as an unfortunate necessity. Necessary because the Company has a clear revenue requirement. Unfortunate because as we have often observed in the past, rate cases are a blunt and inelegant means of producing modern utility rates and services, especially in New York where utility service offerings are increasingly complex and varied. It is no accident that all of the Company's competitive services, low income programs and other specialized offerings were developed in settlements with Distribution's and other parties' consent.

Thank you for your attention to this matter.

Very truly yours,

Ronald J. Tanski

Attachments

cc: William M. Flynn, Chairman (letter only)
Thomas J. Dunleavy, Commissioner (letter only)
Neal N. Galvin, Commissioner (letter only)
Leonard A. Weiss, Commissioner (letter only)
Teresa A. Santiago, Chairperson and Executive Director
Consumer Protection Board (letter only)