

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

**Cost Recovery Mechanisms for Modernization
of Natural Gas Facilities**

Docket No. PL15-1-000

INITIAL COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION

The Natural Gas Supply Association (“NGSA”) hereby submits its initial comments in response to the proposed Policy Statement issued by the Federal Energy Regulatory Commission (“FERC” or “Commission”) on November 20, 2014, in the above referenced docket.¹

NGSA represents integrated and independent energy 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 supports the benefits of competitive markets. NGSA promotes increased supply and the reliable, efficient delivery of natural gas to customers.

NGSA has major concerns with the proposed Policy Statement, for the reasons set forth herein.

¹ Cost Recovery Mechanisms for Modernization of Natural Gas Facilities, “Proposed Policy Statement,” 149 FERC ¶ 61,147 (2014).

I.
INTRODUCTION AND EXECUTIVE SUMMARY

In this proceeding, the Commission is seeking comments on a proposed Policy Statement to permit interstate natural gas pipelines to file a limited Natural Gas Act (“NGA”) Section 4 rate case for the sole purpose of recovering capital costs for “modernizing” their facilities (including infrastructure replacement, enhancement, safety and environmental compliance costs),² on a guaranteed basis. The eligible costs would be tracked and recovered by means of a surcharge mechanism, to be added to the base transportation rate, which would provide for their recovery over a specified number of years. Such a surcharge would be in lieu of the traditional methodology in a general Section 4 rate case, under which a pipeline’s capital infrastructure costs would be placed into rate base, depreciated for the life of the pipeline, allowed a return and taxes, evaluated in the context of overall costs and revenues, and included in the pipeline’s base transportation rates.

NGSA strongly supports safety, modernization, and infrastructure enhancements on interstate natural gas pipelines. However, the proposal to track the costs related to such capital improvements, and recover them on a guaranteed basis in a surcharge, is questionable policy and is not based on a record demonstrating the need for such a major change in rate regulation.

² The concept of “modernization costs” is very broad and not clearly defined in the proposed Policy Statement, as discussed at pages 16-18, infra.

The proposed Policy Statement, if implemented, would represent a fundamental policy reversal in natural gas pipeline rate regulation that is inconsistent with over sixty years of rate regulation under the NGA. The fact that it would be a “policy statement,” as contrasted with a “regulation,” does not diminish the concerns because once a policy statement is implemented in a specific case, it becomes binding law. There are sufficient and balanced, rate case and settlement procedures in place today to permit pipelines the opportunity to recover modernization costs. Compliance with environmental and safety laws is mandatory for regulated entities, and the need for additional cost-recovery guarantees to “incentivize” such compliance is misplaced.

The Commission has waived its well-founded policy against cost trackers on very limited occasions, and never in the context of safety and environmental costs, outside the context of a settlement. This is for good reason. Since Order No. 436 was issued in 1985, the Commission’s regulations have required transportation rates to be based on projected units of service, so that the pipeline is at risk for cost under-recovery. This provides an incentive to minimize costs and maximize service. A cost tracker is inconsistent with this requirement because it not only eliminates all risk on the pipeline by guaranteeing cost recovery of the tracked costs, but it also fails to require an accounting of cost savings in other areas that could offset the costs that are tracked, which accounting would otherwise occur in a general Section 4 rate case.

Today, Section 4 and 5 rate cases are the primary means of ensuring that transportation rates are just and reasonable. The proliferation of limited Section 4 cost tracking mechanisms for pipeline integrity and hurricane costs in recent years has severely undermined the rate protection provided in general Section 4 rate cases. The instant proposal to guarantee recovery of modernization infrastructure costs would severely minimize the need for a Section 4 rate case. Absent a settlement, the most likely reason that a general Section 4 rate case would be filed by a pipeline is to recover the very types of modernization cost expenditures described in the proposed Policy Statement. Thus, absent a requirement for a general Section 4 rate case as a condition for a tracker, if the proposed Policy Statement allows cost recovery by means other than Section 4 rate cases, it will most likely result in the elimination of most, if not all, voluntary Section 4 rate case reviews, to the detriment of natural gas suppliers, shippers, and consumers.

While NGSA strongly supports the various conditions the Commission is considering to protect consumers, such conditions, no matter how carefully crafted and enforced, are no substitute for a full-fledged Section 4 rate case, subject to an evidentiary hearing, with an opportunity for discovery, cross-examination, and decision before an impartial fact-finder.

NGSA is also concerned that, in addressing a perceived potential problem for interstate natural gas pipelines, the Commission may inadvertently create problems for

other segments of the industry. For instance, in an effort to reduce risk and provide greater certainty for pipelines, increased costs could put considerable economic pressure on other segments of the natural gas industry that could then impact their investment decisions or their ability to hold firm pipeline capacity.

II. SUMMARY OF PROPOSED POLICY STATEMENT

The Commission issued the proposed Policy Statement in response to stated concerns that its existing ratemaking policies may inhibit a pipeline's ability to undertake capital projects to comply with future Pipeline and Hazardous Materials Safety Administration ("PHMSA") pipeline safety requirements, Environmental Protection Agency ("EPA") greenhouse gas limits, and comparable state laws.³ As a result, the Commission is seeking comments on a proposed policy that would establish a framework "for pipelines to accelerate the recovery of one-time capital costs necessary to make system improvements to comply with new safety and environmental requirements" that also encourages pipelines to operate their systems efficiently.⁴

Specifically, the Commission proposes to allow pipelines to establish surcharges to track and recover modernization costs, where the pipeline's proposal meets five standards, detailed below.⁵ The Commission proposes to base these standards on a

³ Proposed Policy Statement at P 9.

⁴ Id. at P 19.

⁵ Id. at PP 20-31.

recent settlement in Columbia Gas.⁶

1) **Review of existing rates:** A pipeline's rates must have been recently reviewed in a NGA Section 4 rate case, or, through a "collaborative effort" between the pipeline and its customers, the pipeline must establish that its base rates reflect its current costs and revenues.

2) **Eligible costs:** The trackers may only recover one-time capital costs required to comply with safety and environmental regulations issued by PHMSA, EPA, or other federal or state agencies, and "other capital costs shown to be necessary for the safe and efficient operation of the pipeline." The pipeline must demonstrate that the costs included in the surcharge are not "normal capital maintenance expenditures." Pipelines shall include project-specific cost and construction information, and projected capital cost limits, for each cost included in the tracker.

3) **Avoidance of cost shifting:** The pipeline must demonstrate that captive customers will not be subject to higher surcharges if the pipeline loses shippers or must offer discounts to retain business.

4) **Periodic review:** The proposal must include some method to allow periodic review of "whether the surcharge and the pipeline's base rates remain just and reasonable."

5) **Shipper support:** The pipeline must work collaboratively with shippers to seek shipper support of the surcharge proposal. However, the Commission stated it might

⁶ Id. at P 20, citing Columbia Gas Transmission, LLC, 142 FERC ¶ 61,062 (2013) ("Columbia Gas").

not require a pipeline's proposal to be approved by 100% of its customers before the Commission will accept the proposal.

The Commission requested comments on specific and general issues related to each of these five standards. NGSA will provide comments on the questions in Part IV. below. NGSA is responding to the questions on the assumption that the Commission determines to proceed with a Policy Statement to allow guaranteed recovery of eligible modernization costs by means of a surcharge. These responses should not be deemed to reflect support of this proposal on the part of NGSA.

III. STATEMENT OF POSITION

NGSA's concerns with the Commission's modernization cost surcharge proposal are based on both practical grounds and legal grounds.

From a practical perspective, a Policy Statement related to the recovery of natural gas pipeline modernization costs is both unnecessary and premature. It is unnecessary because there are numerous procedural options that exist today to achieve the Commission's goals in this policy initiative, including, but not limited to, the following:

- 1) the traditional general Section 4 rate case, in which a pipeline's prudently incurred capital expenditures can be recovered in transportation rates, at any time a pipeline chooses to make such a rate filing;
- 2) the settlement process, as evidenced in the Columbia Gas case, in which parties might agree to a tracker, subject to FERC approval;
- 3.) blanket certificate authority, and
- 4) the open-season process seeking market-support

for expansions, upgrades, and modernization, in the form of negotiated long-term firm rate contracts.⁷ Thus, a Policy Statement is not necessary and could potentially conflict with arrangements that are already in place to address such cost recovery issues.⁸

A Policy Statement would also be premature because the PHMSA of the Department of Transportation has not yet issued regulations.⁹ For example, the ANOPR (i.e., “Advanced” Notice of Proposed Rulemaking) process at PHMSA, cited in the proposed Policy Statement at Paragraph 4, has been pending since 2011, and has not even reached the NOPR stage, so there is no way to know what will be in a final rule, if one ever issues. The PHMSA workshop mentioned in the proposed Policy Statement at Paragraph 5, relates to the Integrity Verification Process and is still in the comment phase. No criteria to control corrosion have been proposed in regulations at this point.

⁷ See, e.g., Docket No. CP14-70-000, “Abbreviated Application of National Fuel Gas Supply Corporation For Order Issuing Certificate of Public Convenience and Necessity,” (filed Feb. 6, 2014) (seeking certificate and abandonment authority for the West Side Expansion and Modernization Project supported by two precedent agreements).

⁸ See, e.g., Ruby Pipeline, L.L.C., FERC Gas Tariff, Part IV: General Terms and Conditions at Section 29 “Greenhouse Gas Costs” (permitting Ruby to include costs associated with voluntary greenhouse gas offset measure in its Electric Power Cost Calculations), and Part VII: Non-Conforming Agreements (providing contractual authority to recover greenhouse gas costs).

⁹ See, e.g., CenterPoint Energy – Mississippi River Transmission, LLC, 140 FERC ¶ 61,253, at P 65 (2012) (rejecting a “regulatory compliance cost surcharge (to collect security safety, and environmental costs identified by PHMSA, the EPA, and the Department of Homeland Security) because it is premature in that PHMSA is in the early phases of implementing the Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011). PHMSA still has not issued regulations, and thus the surcharge concept to recover such costs is still premature.

In addition, the Commission noted that the EPA has only issued whitepapers related to greenhouse gas emissions seeking advice as to how best to pursue reductions of emissions. Comments were due in June 2014, and, although EPA has indicated its intent to propose regulations, no action has been taken. The Commission also refers to the 2009 EPA reporting rule, and a new EPA monitoring rule, to be effective January 1, 2015.¹⁰ On November 14, 2014, the EPA issued a proposed rule to revise the reporting requirements by adding calculation methods and new data requirements, which are not final.¹¹ Most recently, the White House announced its methane strategy, which will require EPA to develop regulations for new and modified sources of emissions. However, the EPA will need to go through a full rulemaking process before the regulations are final.¹² Thus, the only relevant regulations that are in place are for “monitoring” and “reporting,” and not substantive compliance requirements requiring changes to pipeline infrastructure. It is an inefficient use of the Commission’s and industry’s time and resources to attempt to develop standards for cost recovery and define eligible costs in a vacuum, before it is even known what types of cost expenditures will be required.

¹⁰ Proposed Policy Statement at P 7.

¹¹ Id.

¹² See White House announcement: <http://www.whitehouse.gov/the-press-office/2015/01/14/fact-sheet-administration-takes-steps-forward-climate-action-plan-anno-1>.

From a legal perspective, the proposed Policy Statement is inconsistent with precedent. The NGA is designed to allow an interstate pipeline the “opportunity” to recover just and reasonable costs. The Commission and the courts have been clear that an “opportunity” is not a “guarantee.”¹³ The Commission’s policies and regulations have been based on this principle. The regulations at 18 C.F.R. § 284.10(c)(2), which were promulgated as a part of Order No. 436, require that rates must be designed on estimated units of service to give a pipeline an incentive, both to be efficient and to provide effective service by putting the pipeline at risk for under-recovery.¹⁴ The Commission has consistently rejected maintenance, compliance, and safety cost trackers for this reason, -- that they would “guarantee” cost recovery without taking into account the benefits of cost reductions in other areas and/or increases in throughput impacting base rate revenues.¹⁵ The only exception to this well-founded policy has been where such maintenance trackers were agreed to in a settlement.

¹³ See, e.g., FPC v. Natural Gas Pipeline Co. of America, 315 U.S. 575, 590 (1942) (regulation does not insure that the business shall produce net revenues); Mississippi River Transmission Corp. v. FERC, 759 F.2d 945, 955 at n.13 (D.C. Cir. 1985) (nothing in the Act requires that pipelines be insulated from risk or competition through a guarantee of total fixed cost recovery); Pioneer Transmission, LLC, 130 FERC ¶ 61,044 at P 28 (citing FPC v. Natural Gas Pipeline Co. of America, “this is consistent with the principle that the Commission’s rate determinations must allow an opportunity to recover reasonable costs, but are not a guarantee of cost recovery”).

¹⁴ Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, FERC Stats. & Regs., Regulations Preambles 1982-1985 ¶ 30,665, at 31,534 (1985) [subsequent history omitted].

¹⁵ See, e.g., Tennessee Gas Pipeline Co., L.L.C. and Kinetica Energy Express, LLC, 143 FERC ¶ 61,196, at P 223 (2014) (rejecting infrastructure investment surcharge

NGSA's concerns with a surcharge mechanism to track costs are the following:

1) there will be no incentive to control such cost expenditures; 2) it will be difficult to define and contain what would qualify as an eligible modernization cost, as compared, for example, with everyday maintenance costs and discretionary enhancements; 3) it will allow for the potential of double recovery of the same costs, to the extent they have been, or will be, recovered in existing rates and/or other long-term contractual arrangements;¹⁶ and 4) there will be no recognition of cost savings in other areas in designing rates that would offset the increased costs recovered in a tracker or surcharge.

However, assuming arguendo that the Commission determines to move forward with a Policy Statement, it is essential that stringent safeguards not only be implemented initially, but also be maintained over time, to ensure that pipeline transportation rates remain just and reasonable. Such conditions include the following:

because it would guarantee cost recovery in violation of FERC policy); Granite State Gas Transmission, Inc., 132 FERC 61,089, at PP 10-11 (2010) (rejecting Capital Cost Surcharge to recover reliability, compliance, safety and integrity, and relocation costs because it would guarantee cost recovery in violation of FERC policy); El Paso Natural Gas Co., 112 FERC ¶ 61,150 at P 72-75 (2005) (rejecting Navajo ROW, maintenance, and system integrity cost of service tracker because it would guarantee cost recovery in violation of FERC policy); and Florida Gas Transmission Co., 105 FERC ¶ 61,171, at PP 45-48 (2003) (rejecting Capital Cost Tracker that would recover non-security related costs, such as compliance, safety and system enhancement costs because it would guarantee cost recovery in violation of FERC policy).

¹⁶ For example, many negotiated contracts today require the shipper to pay for 100% of a pipeline's compliance costs for greenhouse gas emissions. Moreover, a negotiated rate does not always specify the cost components embedded in the negotiated rate; therefore, it may be difficult to determine whether the relevant costs are already being recovered in the negotiated rate.

- Pipelines should be required to file a general Section 4 rate case concurrently with an initial surcharge proposal to ensure that existing rates are just and reasonable and that all relevant incremental costs and savings are fully identified. Additionally, a general Section 4 rate case should be filed every five years thereafter as long as the surcharge is in place.
- Eligible tracked costs for recovery in a surcharge should be strictly limited to one time “capital” costs related solely to compliance with the incremental requirements of future PHMSA and EPA regulations (e.g., no expansion or maintenance costs, no discretionary enhancements, and no related expenses, and no costs related to compliance with existing PHMSA, EPA, or other federal, state or local regulations, which should already be embedded in the base rates).
- Eligible capital costs collected through a surcharge should be limited to those that have been prudently incurred and/or that can be accurately measured as known and measurable.
- There should be a rebuttable presumption that eligible costs to be recovered in a surcharge cannot exceed a defined cap (for example, 10 percent of the pipeline’s rate base). Any additional eligible costs could be filed for in the initial or subsequent general Section 4 rate case and given traditional rate base treatment, with such costs to be embedded in base rates.
- There should be a rebuttable presumption against including additional eligible costs after the initial surcharge is established, with a heavy burden on the pipeline to demonstrate why the costs were not included in the initial filing. If such costs are not included in the initial tracker, the pipeline may file for a new tracker under the full provisions of this policy statement.
- To avoid cost shifts, the initial surcharge (and subsequent periodic true-ups) should be designed with a floor on billing determinants, applicable to all throughput (or storage service) in the facilities and under the rate schedules impacted by the surcharge-related costs, equal to the greater of actual billing determinants or an agreed upon floor. Given that the surcharge should apply to all throughput in the facilities and under the rate schedules impacted by the surcharge-related costs, the “agreed upon floor” should be greater than the firm billing determinants (so as to include interruptible throughput, for example).
- The rate design of the surcharge should be based on an amortization model, with carrying costs, over a defined period, with such period to be dependent upon the

level of the costs, on a case-by-case basis consistent with this policy statement. A return on equity should not be provided in any situation in which there is no rate base treatment.¹⁷

- The surcharge should terminate automatically at the earlier of the end of the specified term or when the total costs are collected, with a final accounting for over- or under-recoveries. If the pipeline desires a surcharge to continue, the pipeline should be required to file a new Section 4 rate case.
- Support by those representing 90 percent of the firm billing determinants is a reasonable indication of support for a settlement, and the Commission should ensure there is sufficient support from shippers other than those that can pass through the surcharge to downstream customers.
- Pipelines with trackers should be required to file true-up reports (at least annually) demonstrating tracked cost and revenue and billing determinant updates during the term of the surcharge, so that the surcharge rate can be adjusted accordingly for that period.
- The Commission should continue to carefully scrutinize the pipelines' Form No. 2 filings and proactively initiate NGA Section 5 proceedings where there is evidence of cost over-recoveries.
- The Commission should clarify its reservation charge crediting policy to provide for full reservation charges credits for outages related to modernization projects, as a quid pro quo for allowing the pipeline guaranteed recovery of eligible costs.
- If shippers are already paying for eligible costs in negotiated contracts, or existing negotiated contracts prohibit recovery of these costs, or otherwise, they should not be subject to the surcharge.

IV. RESPONSES TO QUESTIONS

1. **What methods are appropriate for a pipeline to establish that its current base rates are just and reasonable (e.g., pre-negotiated settlement, a general Section 4 rate case filing, cost-revenue study, etc.)?**¹⁸

¹⁷ No "return" should be permitted in an amortization model given that a return on **equity** is allowed only for rate base.

The only way to ensure that customers get the benefit of any cost savings in rates and that existing rates are just and reasonable is to require a general Section 4 rate case to be filed in conjunction with a surcharge filing, such that any modernization cost surcharge mechanism that results from such a rate case filing is based upon a fully informed record. An initial general Section 4 rate case is required to 1) ensure that base transportation and storage rates are just and reasonable at the time the surcharge is implemented (by taking into account any reductions in costs and/or increases in throughput); and 2) to differentiate the costs that are included in the base transportation and storage rates from the costs that are included in the surcharge to prevent double cost-recovery. A Section 4 rate case would also permit interested parties and the Commission to review cost over-recoveries associated with a fixed fuel rate for those pipelines that do not have a fuel tracker. Furthermore, a concurrent Section 4 rate case would allow consideration of potential rate design implications associated with the type and location of specific tracker expenditures and any related cost incurrence/benefit responsibility.

A cost/revenue study filing is inadequate to support existing rates. Experience gained in the Commission's Section 5 proceedings, where cost/revenue studies were required to be filed, (as well as in pre-filing settlement negotiations), demonstrated that cost/revenue studies are often incomplete, the data can be manipulated (e.g. with

¹⁸ Proposed Policy Statement at P 22.

assumed base/test periods, assumed rate of return, estimated costs and revenues, etc.), discovery is inadequate (if permitted at all), there is no independent fact-finder or arbiter of discovery disputes, and it raises burden of proof issues.

With regard to a negotiated settlement, the Commission's policy is generally to encourage settlements. Moreover, there is nothing that would preclude such a negotiated settlement filing in the context of a Section 4 rate case and associated proposal to allow recovery of eligible modernization costs by a surcharge or other means. However, if after the filing of a general Section 4 rate case, such a settlement were filed, the Commission would still need to apply extra scrutiny and independently ensure that the settlement was just and reasonable based upon sufficient facts in the settlement record. The courts have held that even if a settlement is supported by all of the customers, the Commission must still make an independent determination on the record that the settlement is fair and equitable.¹⁹

2. What types of costs would be eligible for recovery in a surcharge?

The Commission proposes that only "one-time capital costs to modify the pipeline's existing system to comply with safety and environmental regulations, such as those being considered by PHMSA and by the EPA, as well as other capital costs shown

¹⁹ See, e.g., NorAm Gas Transmission Co. v. FERC, 148 F.3d 1158, at 1165 (D. C. Cir. 1998) ("even if customers unanimously support the proposed settlement, "the Commission would still have the responsibility to make an independent judgment as to whether the settlement is 'fair and reasonable and in the public interest'").

to be necessary for the safe or efficient operation of the pipeline.”²⁰ The Commission states an intention to disallow the inclusion of ordinary capital maintenance costs. The Commission reasoned that “[p]ermitting normal system capital maintenance costs to be recovered through a surcharge mechanism would inhibit a pipeline’s incentives to minimize costs and maximize service because it would guarantee a certain level of cost recovery.”²¹

It is significant that the Commission is proposing that only “capital” costs can be included (i.e., not expenses), and that only “one-time” capital cost expenditures be includable. NGSA agrees with these restrictions, which are essential to contain the tracked cost levels included in a surcharge.

However, NGSA has concerns with the Commission’s suggestion that “other capital costs shown to be necessary for the safe or efficient operation of the pipeline” could be included in the surcharge. This proposed standard is overly broad and subjective. For example, NGSA completely agrees with the Commission’s suggestion in the proposed Policy Statement that normal maintenance costs should not be includable in a surcharge (of course, the pipeline would be free to file to recover maintenance costs at any time in a general Section 4 rate case). But a pipeline might argue that “normal maintenance” is the same as what is “necessary for the safe or efficient operation of the

²⁰ Proposed Policy Statement at P 23.

²¹ Id. at P 24.

pipeline.”²² By 1) limiting the cost recovery to compliance with future, incremental PHMSA and EPA requirements, 2) requiring the pipeline to specifically identify the projects up-front as part of the filing that are required, and 3) explain why they are required by PHMSA and EPA, it would establish a brighter line test that would be less vulnerable to subjective interpretation.²³ Without such specificity, as the Commission has presupposed, pipelines would be incentivized to use the tracker as a means essentially to recapitalize their rate bases through unnecessary and discretionary projects, under the guise of a “safe or efficient operation of the pipeline.”

3. Should the Commission require an upper cost recovery limit on each project in a surcharge filing?

Yes. The Commission proposes that when a pipeline files to establish a surcharge mechanism, it should specifically identify the projects eligible for recovery, and provide an upper limit on the capital costs related to each project to be included in

²² To be clear, “normal maintenance costs” would include costs for such activities as hydrostatic testing, meter and chromatograph calibrations and testing, testing of cathodic protection equipment and electric current, system leak testing, including flyovers and walking the pipeline, pipeline integrity pigging, maintenance and pipe or other facility replacement associated with existing integrity management requirements, draining liquids from low spots in pipeline, compressor station lubricant replacement, application of desiccants, compressor station engine overhaul, compressor station turbine replacements, updating the software in compressor control panels, maintenance of cooling towers (including vent cleaning), maintenance of back-up generators, maintenance of right of way, bridge or water-span maintenance (painting, rust repair, silt replacement), etc.

²³ Experience with hurricane cost trackers has demonstrated the difficulty in monitoring costs included in the surcharge to ensure they are “eligible” costs for inclusion, as defined in the tariff.

the surcharge.²⁴ NGSAs believe this requirement for a cost cap is essential to ensure that only eligible costs are included, and that the resulting surcharge rate is reasonable in relation to the pipeline's base rates.

Moreover, to ensure that goal, NGSAs suggest that the Commission consider establishing a rebuttable presumption that the total capital costs to be included over time in a surcharge filing must not exceed a cap, for example, 10 percent of the pipeline's rate base. If the eligible "modernization" compliance costs were to exceed this 10 percent threshold, then the pipeline would be free to file for the recovery of the excess in the initial, or subsequent, general Section 4 rate case, and include the excess costs in rate base with traditional depreciation, and taxes and return treatment. Such a 10 percent threshold requirement would create a fair balance of interests between the pipeline and its customers by 1) providing to the pipeline the ability of accelerated cost recovery for a portion of compliance costs, and 2) ensuring for the customers that the surcharge would be at a reasonable level to avoid rate shock.

4. Should the cost of modifications to compressors for the purpose of waste heat recovery be eligible?²⁵

No. Only compliance costs required by PHMSA and EPA regulations should be eligible for recovery through a surcharge. A pipeline would be free to file for recovery of costs related to modifications to compressors for waste heat recovery in the initial, or

²⁴ Proposed Policy Statement at P 25.

²⁵ Id. at P 26.

subsequent, general Section 4 case, in which it would have the opportunity to demonstrate efficiencies and other system benefits and the prudence of such expenditures. In addition, most of these projects involve heat to generate electricity, which could generate additional revenues or cost savings. Thus, a rate case would allow participants the ability to assess the related costs and revenues to guard against windfall profits, ensure just and reasonable rates, and avoid cross-subsidies.

5. Should capital costs associated with a pipeline expansion be included in the surcharge as necessary one-time capital expenditures to comply with safety and environmental regulations?

No. The Commission has appropriately proposed to limit the eligibility of capital cost recovery through a surcharge to costs incurred to modify the pipeline's existing system.²⁶ However, it may be difficult to separate modernization of existing pipeline facilities where such a modernization project would also create additional capacity. If incremental capacity is concurrently created by what is determined to be an eligible modernization project, then the pipeline should be required to credit any additional revenues to its shippers who are paying for the project, given that the pipeline is guaranteed recovery of its project costs or alternatively, recover the expansion-related costs of the project in base rates through a limited or general Section 4 rate case. If the expansion project is independent of any modernization project, it should be handled separately through the Commission's current expansion policy. This

²⁶ Id.

is yet another reason why a general Section 4 rate case is required in order to determine how the costs should be allocated and who is benefitting from the expansion.

6. Should capital costs incurred to minimize pipeline facility emissions be considered for inclusion in the surcharge, even if those costs are not expressly required to comply with environmental regulations?²⁷

No. As set forth above, tracked costs to be included in a surcharge should be strictly limited only to those required to comply with incremental requirements of future changes to PHMSA and EPA regulations. A pipeline would be free to file for recovery of costs related to recovery of costs incurred to minimize facility emissions in an initial, or subsequent, general Section 4 case, in which it would have the opportunity to demonstrate efficiencies and other system benefits and the prudence of such expenditures.

7. Should non-capital maintenance costs associated with environmentally sound operation of a compressor be eligible?²⁸

This question is not altogether clear, but it appears that by “non-capital” costs the Commission may be referring to “expenses.” Further, it is not clear what types of costs the Commission has in mind in referring to expenses related to environmentally sound “operations.” But in any case, the answer is no. Both non-capital costs (i.e., expenses), as well as normal “maintenance costs” (whether capital or non-capital), should be

²⁷ Id.

²⁸ Id.

excluded, as the Commission appears to have suggested.²⁹ To the extent a pipeline wishes to recover costs associated with such “non-capital maintenance,” it may do so in an initial, or subsequent, general Section 4 case.

8. Under what circumstances should the Commission permit a pipeline to include costs of additional projects not identified in the pipeline’s original filing to establish the tracking mechanism?³⁰

The Commission should establish a rebuttable presumption against allowing a pipeline to add additional costs (assuming they would, in fact, qualify as eligible costs) to its tracker after the original filing, with a heavy burden on the pipeline to demonstrate why the additional costs were not included in the initial filing. This is especially relevant if inclusion of such costs would significantly increase the level of the current surcharge (*i.e.*, rate shock), if, for example, the new incremental costs were recovered over the shorter remaining term of the existing tracker. In such cases, it could be more effective to have these new costs filed under a general Section 4 rate case, or a separate tracker, using the full provisions of this Policy Statement.

9. How should the surcharge be designed to protect captive shippers from cost shifts?³¹

The Commission suggested the possibility of a floor on billing determinants, as in the Columbia Gas settlement, where the surcharge was based on the greater of actual

²⁹ Id. at PP 23- 24.

³⁰ Id. at P 26.

³¹ Id. at P 29.

(not projected) annual billing determinants or the agreed upon floor. Thus, the pipeline (and not captive customers) would be at risk if costs were not recovered.³²

However, any surcharge should be applicable to all throughput in the facilities and under the rate schedules impacted by the surcharge-related costs, i.e., firm and interruptible, so that an “agreed upon floor” would need to be greater than firm billing determinants (which would only measure firm transportation commitments), to include throughput from all services in the facilities and under the rate schedules impacted by the surcharge-related costs.

10. What is the best way to ensure periodic rate reviews?³³

Periodic rate reviews should be **required** expressly by requiring a general Section 4 rate case to be filed initially in conjunction with an application for a surcharge, and every five years thereafter, for so long as a surcharge is in place. There may be system benefits and efficiencies as systems are modernized, and a subsequent rate case filing requirement after the surcharge has been in place, will enable recognition of any associated cost savings or throughput additions, and ensure against windfall profits to the pipeline, and cross-subsidies among its customers. The surcharge should automatically terminate at the earlier of end of its term, or when the total costs are recovered (with a final period true-up). The pipeline should be required to file a new

³² Id.

³³ Id. at P 30.

Section 4 rate case if it wants to continue the surcharge.³⁴ The pipeline should also be required to file a periodic true-up of costs and revenues (at least annually) so that tracker costs and revenues and effective billing determinants (with a floor) could be actively monitored on an on-going basis, and for the surcharge to be adjusted as necessary.

11. How much shipper support is necessary to justify a surcharge proposal?³⁵

Support by shippers representing 90 percent of the firm billing determinants is a reasonable indicator of shipper support of a settlement, including a tracker. Moreover, in evaluating shipper support, the Commission should consider the type of customers that are providing support to a settlement. For example, on a pipeline that is dominated by local distribution company (“LDC”) shippers, who can pass through their costs to downstream customers, there is less of an incentive to contest a settlement than for a producer or end-user shipper who must absorb the increased costs as a cost of doing business. Thus, the Commission should require substantial support by non-LDC entities when it is evaluating shipper support and be sensitive to avoid any unfair cram-down of settlements to unwilling customers.

³⁴ Id.

³⁵ Id. at P 31.

12. Should costs be included in a pipeline's rate base and depreciated over the life of the facilities with an opportunity to earn a return on rate base, or should costs be recovered under an accelerated amortization period, allowing interest for the time value of money?³⁶

In the Columbia Gas case the capital costs subject to the tracker were treated as rate base items (separate from the underlying rate base), and allowed to earn a return and taxes.³⁷ In contrast, in certain hurricane surcharge tracker proceedings, costs have been amortized for a defined period and allowed to recover only the time value of money.³⁸

NGSA believes that the latter amortization model, with carrying costs, over a specified term, is the most appropriate rate design structure for recovering all approved costs under a tracker. It is not appropriate for the pipeline to earn a rate of return and taxes on these types of tracked expenditures. Under a tracker, these would be incremental costs, with guaranteed cost recovery, *i.e.*, no risk on the pipeline. Thus, there is no rationale for allowing a rate of return on equity. In addition, the length of any amortization period should be determined on a case-by-case basis, dependent upon the level of the costs, so as to prevent rate shock to existing shippers, and prevent intergenerational inequities whereby existing shippers would fund improvements that will inure to the benefit of future shippers.

³⁶ Id. at P 33.

³⁷ Id.

³⁸ Id.

13. Should there be any adjustments to the current reservation charge crediting policy given that facility repairs and upgrades may disrupt primary firm service?³⁹

Yes. NGSAs support full reservation charge credits during any service outages (in contrast to partial credits that currently would apply in a force majeure situation) and the Commission's policy should be clarified to make that clear to the extent that there are tariff force majeure provisions, which would otherwise allow outages associated with facility repairs and upgrades to be treated as force majeure events. The outages necessitated by the repairs and upgrades at issue in this proceeding may be ongoing, and not the one time outages typical of a force majeure event. Moreover, the pipeline is in control of when to schedule the repairs and upgrades, unlike in a force majeure situation. Full reservation charge crediting will provide an incentive for repairs and upgrades to be made as quickly as possible, and would be a fair trade-off for allowing a pipeline guaranteed recovery of its eligible costs in a surcharge mechanism.

14. Are there other standards that should be included as a prerequisite for approving a modernization cost recovery mechanism?⁴⁰

Yes. NGSAs have included in its Statement of Position at Part III above, a list of the conditions that should be required if the Commission determines to issue a Policy Statement to allow modernization costs to be recovered by means of a tracker surcharge

³⁹ Id. at P 34.

⁴⁰ Id. at P 35.

mechanism. NGSAs incorporate that list of conditions by reference in response to this last question. But the fundamental message is that a Policy Statement is not necessary, is premature at best, given that there are no substantive PHMSA and EPA regulations in place, and in any event, a tracker should not be allowed to preempt the general Section 4 rate case process.

The Commission should take note of the commercial realities today. One of the problems with super-imposing a new surcharge policy to track eligible modernization costs, on existing settlement and/or negotiated contract rate provisions, is overlap. The industry has already begun addressing the potential of PHMSA and EPA compliance issues in contracts and settlements, as noted above. It would be unduly burdensome to modify the Commission's cost recovery policies in ways that may be inconsistent with these settlements and contracts. This is an additional reason why the proposed Policy Statement is ill advised and unnecessary.

**V.
CONCLUSION**

For the foregoing reasons, NGSAs respectfully requests the Commission to withdraw its proposed Policy Statement and terminate this proceeding. However, if the Commission determines to issue a Policy Statement to allow certain PHMSA and EPA compliance costs to be tracked and recovered through a surcharge, the Commission should require the conditions and provisions listed in Parts III and IV of these comments.

Respectfully submitted,

Respectfully submitted,

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