Pipeline Rate Review

One of FERC's most fundamental responsibilities is to ensure that the rates charged by interstate natural gas pipelines are just and reasonable within the meaning of the Natural Gas Act (NGA). Under the law, pipelines are entitled to an opportunity (but not a guarantee) to recover their investment and operating costs, plus a return that represents a proper balance of risk and reward for their investors.

In the past, the Federal Energy Regulatory Commission (FERC) used mechanisms designed to ensure that pipeline rates reflected costs and risks on a reasonably current basis. When the commission adopted the purchased gas adjustment (PGA) mechanism to allow pipelines to flow through the cost of purchased gas to their customers, the commission conditioned this right on pipelines filing full NGA Section 4 rate cases at regular three-year intervals. When the commission adopted Order 636 in 1992, and pipelines completely exited the gas merchant business, PGA's became obsolete and the periodic rate case requirement was discontinued.

As a consequence, the rates charged by pipelines today are the rates that were first established in each pipelines' last rate case. These cases were often decided years ago. The only exception to this is in the few cases where parties have been successful in negotiating a rate review provision in the settlement of a prior rate case.

Because pipelines' approved rates tend to reflect conditions in the market at the time they were established, their rates have, in many cases, become stale and unreflective of changed market conditions and/or changed operating conditions. The basic problem arises from a fundamental disconnect in the ratemaking process. To the extent that future changes in market conditions are detrimental to the pipeline, it can always file a rate case to increase its rates. However, to the extent that conditions are reversed, there is no mechanism, short of a major proceeding contested under Section 5 of the NGA, to achieve an appropriate rate decrease. This Section 5 process places great burdens on pipeline customers. Not only do they 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 at the expense of industry relationships.

During the past five years, NGSA has studied the returns of more than 30 major interstate pipelines, on average over a five-year period. Those studies have found that many pipelines are earning returns well above the levels deemed appropriate by the commission.

NGSA recognizes that, over the past decade, the commission has chosen not to actively review pipeline rates. Because there is no process in place to solve the rate-refreshment problem, NGSA is now working with other pipeline customer groups to determine whether there are alternative processes for improvement. NGSA and the other groups are exploring the possibility of a collaborative process whereby pipeline customers and FERC staff would evaluate pipeline data and submit a recommendation to the commission on whether further proceedings or actions are warranted.