UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Cost Recovery Mechanisms for Modernization of Natural Gas Facilities	**Docket No. PL15-1-000**

REPLY COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION AND REQUEST FOR TECHNICAL CONFERENCE

The Natural Gas Supply Association ("NGSA") hereby submits its reply 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] In addition, NGSA requests the Commission to 1) defer issuing an order in this proceeding until the pertinent Pipeline and Hazardous Materials Safety Administration ("PHMSA") and Environmental Protection Agency ("EPA") regulations have actually been issued, so that all stakeholders are aware of the substance of any new compliance requirements; and 2) afterwards, convene a technical conference proceeding, in which all stakeholders can discuss and file comments in light of any new PHMSA and EPA regulations, related to what should constitute "eligible" costs for recovery in a tracker mechanism. In short, the Commission should not issue a policy in a vacuum.

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

I.
REQUEST FOR TECHNICAL CONFERENCE

Predictably, the initial comments reflect a divide between pipelines and most pipeline shippers. Producers, industrials and other end-users, including municipalities, are shippers opposed to allowing pipelines to recover so-called "modernization" costs in a tracker because it violates FERC regulations and precedent and significantly stands to change the fundamental landscape for pipeline cost recovery at the federal level. Pipelines are supportive of a tracker mechanism, but argue it should be broadened and applied with "flexibility." Local distribution companies ("LDCs") appear more accepting of a surcharge approach as long as customers are able to negotiate solutions for customer-protection and agree on the types of costs to be collected in individual proceedings.

But all comments concede, either directly or indirectly, that the regulatory compliance requirements are unknown at this point in time. Even the pipelines concede this, and are therefore asking for the ability to be able to identify costs to be included in a tracker by "category," rather than with specificity.[2]

In order for the Commission to make a well-informed decision on the appropriate policy in this area, it is incumbent upon the Commission and industry

[2] "Comments of the Interstate Natural Gas Association of America," at 10 (allowing pipelines to propose a list of eligible projects by category "is especially relevant when the regulations dictating many of these costs are under development but not yet in effect.").

participants to have a fundamental understanding of the scope of what will be encompassed under the proposed policy. Issuance of a new policy before the PHMSA and EPA requirements are known is premature and without greater knowledge of what will be encompassed, such a premature policy is likely to create industry-wide uncertainty, increased risks of legal challenges, as well as the possibility of unintended rate shock for pipeline shippers. Accordingly, NGSA respectfully requests the Commission to 1) defer action in this proceeding until PHMSA and EPA regulations have actually been issued, so that all stakeholders are aware of the substance of any new compliance requirements; and 2) convene a technical conference proceeding thereafter, in which all stakeholders can discuss and file comments in light of any new PHMSA and EPA regulations, related to what should constitute "eligible" costs and the appropriateness of such an unprecedented tracker mechanism.

II. EXECUTIVE SUMMARY

For the reasons explained in its initial comments, NGSA continues to have major concerns with the proposed Policy Statement. The initial comments of the pipelines have reinforced those concerns, in that the comments of the pipelines generally seek to: 1) liberalize the conditions precedent under which a surcharge could be approved, for example, by eliminating mandatory, customer-protection conditions for a tracker surcharge, under the guise of the need for "flexibility"; 2) broaden the types of "eligible" costs that could be included in a surcharge; and 3) avoid reservation charge

crediting obligations. The pipeline comments demonstrate that the proposed Policy Statement has a great potential to be exploited by pipelines in an effort to recover all possible costs that can be forced into a "modernization" surcharge, in circumvention of the general rate case process under Section 4 of the Natural Gas Act ("NGA"). Such efforts can expose shippers to unnecessary or unwarranted expenditures by broadening "flexibility" and "eligible" costs. Moreover, if the cost categories are broadened as advocated by the pipelines, FERC would reduce pipeline incentives to be efficient and effectively condone pipelines practices to shelter cost over-recoveries, which would otherwise be disallowed in a Section 4 rate case.

The Commission should take heed of the cautionary comments of its sister state regulatory commissions.[3] While these agencies did not oppose the proposed Policy Statement outright, they all argued for mandatory limitations and conditions to ensure that the proposed Policy Statement would not open the floodgates to questionable investments and cost over-recoveries.

[3] See, e.g., "Initial Comments of the Michigan Public Service Commission;" "Comments of the North Carolina Public Utilities Commission;" "Comments of the Kansas Corporation Commission In Support of Proposed Policy Statement;" and "Comments of the New York State Public Service Commission."

III. REPLY COMMENTS

A. The Pipelines' Alleged Need For Flexibility In Applying The Proposed Policy Statement Should Be Disregarded.

A constant theme running through the comments of the Interstate Natural Gas Association of America ("INGAA") and individual pipeline companies is that the Commission should be "flexible" in applying its proposed new policy with regard to the five standards that a pipeline would need to comply with in order to establish a cost modernization tracker. The pipelines argued that the Commission should be flexible in 1) the means by which pipelines are permitted to demonstrate that their rates are just and reasonable; 2) determining what constitutes an "eligible" cost for recovery under a tracker; 3) determining how to avoid cost shifts; 4) determining an appropriate form of periodic rate review; and 5) determining what constitutes sufficient shipper support to approve a settlement.

Pipelines have also argued that the Commission should relax its abandonment standards under Section 7(b) of the NGA, in order to allow a pipeline to abandon facilities that are no longer economic to operate.[4] NGSA believes that this is entirely inappropriate, is beyond the scope of this policy statement docket, and an example of pipelines attempting to use the proposed Policy Statement as a means to avoid their statutory, certificated, service obligations under Section 7(c) of the NGA.

[4] See, e.g., "Initial Comments of Boardwalk Pipeline Partners, LP," at 18-19.

While flexibility may be appropriate to some extent in designing a tracker, e.g., in the specific rate design of a tracker mechanism or the term of an amortization structure (based on the data pertinent to that pipeline), the Commission should not waiver from the two most fundamental consumer protection standards required to qualify for a tracker: 1) an initial Section 4 rate case filing requirement and periodic rate reviews to ensure the existence of, and continuation of, just and reasonable rates; and 2) the limitation of "eligible" costs for inclusion in a tracker to only those one-time, mandatory capital costs, incurred to comply with specific PHMSA and EPA requirements. For example, the Michigan Public Service Commission appropriately stressed the importance of requiring an initial Section 4 rate case in order to implement a tracker, stating that such standards should be "mandatory conditions and not simply…optional guidelines."[5]

The alleged need for flexibility argued by the pipelines, if built into a Policy Statement (assuming, arguendo, that a Policy Statement is issued), would simply provide a pipeline with additional leverage to argue in an individual case that one or more of the standards should not be applied to that pipeline. If the Commission steps out into this uncharted cost recovery territory, which as NGSA demonstrated in its initial comments would be a major and ill-advised change in traditional rate regulation, then the Commission should not broaden the scope of the proposed policy statement,

[5] "Initial Comments of the Michigan Public Service Commission," at 5.

which would otherwise provide the opportunity to abuse the intent of the tracker mechanism.

B. The Need For Section 4 Rate Cases And Additional Transparency To Qualify For A Tracker, And/Or Continue A Tracker Beyond Its Initial Term, Is Paramount.

NGSA cannot emphasize enough the importance of the initial Section 4 rate case filing requirement and periodic rate cases during the term of a surcharge, as conditions for implementing a tracker, or for the extension of a tracker beyond its initial term. Such conditions are critical to ensure that the surcharge and base rates remain just and reasonable and that pipelines are not over-recovering their costs while a tracker remains in effect. The majority of the non-pipeline initial comments supported the requirement that a Section 4 rate case be filed, as a means for ensuring just and reasonable rates. In addition to the benefits of a Section 4 rate case demonstrated in NGSA's initial comments and those of other producers, state commissions, and end-users, it would also allow the Commission and pipeline shippers a forum to consider the appropriateness of a pipeline's rate of return on equity ("ROE"). For example, the New York State Public Service Commission suggested that the ROE should be reduced for a pipeline that has a cost tracker mechanism in recognition of its reduced risk.[6] NGSA supports this suggestion, because, all else being equal, a pipeline with a cost tracker will

[6] "Comments of the New York State Public Service Commission," at 3. The Canadian Association of Petroleum Producers also endorsed this suggestion. "Comments of the Canadian Association of Petroleum Producers," at 3.

have less cost-recovery risk than a pipeline that does not. At a minimum, the ROE associated with the specific tracker costs should be reduced, to reflect the lowered risk of cost recovery.[7]

Furthermore, certain commenters have expressed concern that without a tracker mechanism, pipelines will need to file multiple rate cases over a short period of time. NGSA believes that the threat of pancaked rate cases is exaggerated. Pipelines generally try to avoid filing Section 4 rate cases (as evidenced by their efforts in this proceeding to include as many costs as possible into a tracker, so as to avoid the need to file to increase base rates). If a pipeline knows that it must file an initial and periodic Section 4 rate cases in order to institute and maintain a tracker, then it will have an incentive to ensure that the costs to be recovered in a tracker are fully identified and supported, in order to minimize pancaked rate case filings.

Finally, NGSA supports the proposal of Xcel Energy Services Inc. ("XES") to update and modify the annual Form 2 reporting requirements, such that pipelines would be required to separately identify tracker costs and revenues in a consistent manner.[8] In addition to a true-up mechanism, this additional transparency and reporting consistency in Form 2 submissions will assist the Commission and participants to more closely monitor tracked costs and revenues on an industry-wide

[7] In initial comments, NGSA stated that, "It is not appropriate for the pipeline to earn a rate of return and taxes on these types of tracked expenditures." "Initial Comments of the Natural Gas Supply Association," at 24.

[8] "Comments of Xcel Energy Services Inc.," at 5.

basis, calculate annual pipeline returns more accurately, and also help to ensure that there are no cross-subsidies between, or over-recoveries of, tracked and non-tracked costs and revenues.[9]

C. The Definition Of "Eligible" Costs Must Be Strictly Defined And Contained.

The pipelines generally argued that the Commission's proposed definition of "eligible" costs that could be included in a tracker is too narrow. Pipelines argued that the costs should 1) not be limited to PHMSA and EPA compliance costs; 2) include all pipeline replacement, certain expansion, and facility upgrade costs; 3) not be required to be defined up-front, but simply be identified by category; 4) not be limited to one-time expenditures; 5) include costs for voluntary as well as mandatory projects; 6) include any "non-routine" costs (however that might be defined); 7) include non-capital expenses; and 8) most broadly, as Columbia Gas Transmission, LLC requested, include any project expenditures "that provide quantifiable benefits to existing shippers."[10]

These suggestions reflect the proverbial "camel's nose under the tent." Even with the limitation of "eligible" costs to one-time capital costs related to PHMSA and EPA compliance, there is a large risk that the definition could be expanded well beyond

[9] NGSA requests that the Commission undertake a review of the Form 2 data on an industry-wide basis after one or two annual submissions of Form 2 are filed that includes modernization surcharge data. After this data is analyzed, the Commission should hold a technical conference to ensure that customers are adequately protected and are not experiencing rate shock that requires further Commission action.

[10] "Comments of Columbia Gas Transmission, LLC," at 5. It is particularly instructive to note that Columbia, after approval of a $1.5 billion modernization tracker, seeks additional, virtually unlimited tracker authority.

what is originally intended through a series of various waiver requests, and other pleas for special consideration. As NGSA and others have emphasized, a tracker with a true-up is a guaranteed cost recovery mechanism that the Commission has permitted only under very limited circumstances, and which generally runs counter to the Commission's regulations and NGA ratemaking principles.

The Commission should not broaden this historic tracker exception to include additional costs. "Eligible" costs should be defined as one-time, capital costs related solely to compliance with the specific requirements of future PHMSA and EPA regulations. As NGSA noted in its initial comments, such costs would exclude expansion or maintenance costs, discretionary enhancements and related expenses and costs related to compliance with existing PHMSA, EPA, or other federal, state or local regulations, which are already embedded in base rates and collected from pipeline shippers.[11]

Finally, NGSA would like to reemphasize the need for a cap on eligible costs to be included in a tracker. NGSA proposed a cap, such as 10% of rate base, in order to prevent a surcharge that would result in rate shock to customers.[12] Notably, the Michigan Public Service Commission independently arrived at that same suggestion, after experience within its own state.[13]

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[11] See "Initial Comments of the Natural Gas Supply Association," at 12, 15-20.
[12] Id. at 12, 17-18.
[13] "Initial Comments of the Michigan Public Service Commission," at 4-5.

D. Pipeline Efforts To Eliminate And/Or Diminish Reservation Crediting Obligations Should Be Disregarded.

INGAA (and other pipeline comments) argued there should be no reservation charge crediting when service is suspended because of modernization work.[14] Alternatively, INGAA argued that if reservation charge credits are required, then a pipeline should be able to recover them in the surcharge.[15] Essentially, INGAA and the pipelines argued that they should not be "penalized" for maintaining safe and reliable facilities.

This argument does not withstand scrutiny, and turns the inquiry on its head. It is the shippers who would be penalized if full reservation charge credits are not required in instances in which a firm shipper has fully paid for service that was not provided. If trackers are allowed, then there is no logical basis for allowing a pipeline to avoid its reservation charge crediting obligations when firm transportation service is fully paid for by the customer but not provided. Keeping your customer's money without providing service simply defies common sense, especially when the timing of such activities can be controlled by the pipeline.

As noted by NGSA and others in this proceeding, a pipeline has a public service obligation to provide service and maintain safe and reliable facilities. Thus, no additional incentives should be necessary for a regulated entity to comply with

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[14] "Comments of the Interstate Natural Gas Association of America," at 15-16.
[15] Id. at 18.

government regulations. This is true whether an "incentive" is provided through a tracker that guarantees cost recovery, and/or whether it is provided through a waiver of reservation charge crediting obligations when service is not provided.[16]

Firm shippers have paid for firm service by means of up-front demand charges. Unlike a typical force majeure situation, the pipeline has discretion and control over when to schedule maintenance projects and actions required to comply with PHMSA and EPA. It is patently unreasonable to allow a pipeline guaranteed cost recovery of certain costs by means of a tracker, and also to avoid its obligations to reimburse shippers when service is not being provided. The Commission should require 100% reservation charge crediting if service is interrupted due to a project, where the costs of the project are being recovered by means of a tracker.[17]

[16] INGAA suggests that, "Should the Commission wish to **encourage pipelines** to perform remediation…then pipelines also should be able to track the costs of the testing that identifies the need to remediate." (emphasis added) Pipelines should not have to be encouraged to maintain safe system operations. See "Comments of the Interstate Natural Gas Association of America," at 6.

[17] See, e.g. "Initial Comments of Calpine Corporation," at 12-14.

IV. CONCLUSION

For the foregoing reasons, NGSA respectfully requests the Commission to withdraw its proposed Policy Statement and terminate this proceeding. However, if the Commission moves forward with issuing a Policy Statement, then at a minimum, the Commission should defer action until PHMSA and EPA compliance regulations are actually issued, and the impacts can be analyzed in a technical conference. Finally, the Commission should minimize the scope of any tracker and require the conditions listed in Part III of NGSA's initial comments, as conditions precedent for a tracker.

Respectfully submitted,

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