



# FERC Approves Pipeline Modernization Policy Statement

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On April 16, 2015, the Federal Energy Regulatory Commission (FERC) adopted a policy statement on Cost Recovery Mechanisms for Modernization of Natural Gas Facilities (Policy Statement). The Policy Statement is based on the [Proposed Policy Statement issued in November 2014](#), modified slightly to account for over fifty commenting parties. It allows interstate natural gas pipelines to establish a surcharge or tracker mechanism to recover certain safety, environmental, or reliability capital expenditures made to modernize pipeline system infrastructure outside of a Natural Gas Act (NGA) Section 4 rate case provided that five guiding principles are met: (1) Review of Existing Rates; (2) Eligible Costs; (3) Avoidance of Cost Shifting; (4) Periodic Review of the Surcharge and Base Rates; and (5) Shipper Support. These principles are based off of the Columbia Gas Transmission LLC (Columbia) Capital Cost Recovery Mechanism (CCRM), which the Commission approved in 2013 following a contested settlement between Columbia and its shippers (Van Ness Feldman represented Columbia in the CCRM settlement proceeding before FERC). The Policy Statement takes effect on October 1, 2015.

## Adoption of the Five Guiding Principles in Light of Comments

1. **Review of Existing Rates** - the pipeline's base rates must have been recently reviewed in either an NGA general section 4 rate proceeding or through a "collaborative effort" with customers.

FERC declined to limit the rate review requirement to an NGA section 4 rate proceeding, despite certain comments in favor of that action. FERC instead noted that the type of just and reasonable rate review would vary among pipelines, and could include a cost and revenue study or a settlement process. FERC explained that it would establish appropriate procedures when a pipeline's base rates were challenged similar to its approaches to address contested settlements.

2. **Eligible Costs** – the eligible costs must be limited to one-time capital costs incurred to modify the pipeline's existing system to comply with safety or environmental regulations issued by the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA), the U.S. Environmental Protection Agency (EPA), or other federal or state government agencies, and other capital costs shown to be necessary for the safe or efficient operation of the pipeline, and the pipeline must specifically identify each capital investment to be recovered by the surcharge.

The Policy Statement notes that capital costs to replace existing facilities, such as old compressors that do not comply with new EPA emission requirements, are eligible for inclusion in a modernization cost tracker, but that capital costs the pipeline incurs as part of its ordinary, recurring system maintenance requirements are ineligible for inclusion in a modernization cost tracker. The Policy Statement also opens the door to cost recovery for voluntary action that is not mandated by a specific compliance program, but furthers the goals of the safety and environmental agencies.

3. **Avoidance of Cost Shifting** – the pipeline must design the proposed surcharge in a manner that will protect the pipeline's captive customers from cost shifts if the pipeline loses shippers or must offer increased discounts to retain business.

FERC acknowledged that the potential for direct cost shifting is one of the reasons it historically disfavored trackers. It reiterated that a pipeline must design a surcharge in a manner that will protect shippers from cost shifts and impose upon it some risk of under-recovery. FERC cited as one example the CCRM's billing determinant floor, which designs the surcharge on the greater of actual billing

determinants or the established floor, and imputes the revenue the pipeline would achieve by charging the maximum rate for those determinants.

4. **Periodic Review of the Surcharge and Base Rates** – the pipeline must include some method to allow a periodic review of whether the surcharge and the pipeline’s base rates remain just and reasonable.

FERC noted that it will not require pipelines to file a full NGA section 4 rate case with specified regularity once a tracker mechanism is implemented—FERC remains open to other reasonable means of accomplishing periodic review. However, periodic reviews will require pipelines to furnish sufficient information to satisfy FERC that both base rates and surcharges remain just and reasonable if the surcharge is permitted to continue.

5. **Shipper Support** – the pipeline must work collaboratively with shippers to seek shipper support for any surcharge proposal.

FERC reiterated its Proposed Policy Statement position that unanimous shipper support is not required for it to approve a cost modernization surcharge. FERC did not establish a minimum level of shipper support required to accept a pipeline proposal.

### **A Case-By-Case Basis Approach Adopted for Accelerated Amortization and Inclusion of Reservation Charge Credits in a Tracker Mechanism**

The Commission also sought comments on use of accelerated amortization to recover tracker costs and whether it was appropriate to recover reservation charge credits in the tracker mechanism. On accelerated amortization, which FERC has permitted in hurricane repair cost trackers, the Policy Statement permits pipelines and their shippers to negotiate which recovery method is appropriate for their specific systems. The Policy Statement also makes available on a case-by-case basis the recovery of reservation charge credits paid for disruption of primary firm service due to voluntary or mandatory system improvements. This could be recovery of such costs through the tracker, or a partial reservation charge crediting method tailored to the circumstances of the projects included in the tracker. FERC noted that pipelines should have some relief from the payment of reservation charge credits if a modernization project unavoidably causes an outage of primary firm service.

FERC declined to adopt any catchall issue proposals raised by commenters. These included: whether ROE should be adjusted downward to reflect the decreased risk that the pipeline has to recover its cost of investment given the existence of a tracker; whether FERC should apply the principles of a tracker mechanism to the pipeline’s entire cost of service, similar to the transmission formula rates that FERC has approved for electric utilities; whether FERC should include additional transparency measures to require pipelines to identify and track all costs associated with each project or project phase; and whether certain certificate policy modifications need to be made concerning replacement of older pipelines.

### **Analysis**

Rather than a source of specific rules, the Policy Statement is a framework for how FERC will evaluate pipeline proposals for recovery of infrastructure modernization costs. The Columbia CCRM appears to be the yardstick FERC will use to measure future proposals. The Policy Statement is still a distinct shift from the policy under which the CCRM was approved. The prior policy rejected pipeline safety and environmental cost trackers unless agreed to as part of a near-unanimous settlement with the pipeline’s customers. Pipelines and other natural gas facility owners and operators that provided comments to FERC generally supported the policy shift while certain shippers, particularly producers, opposed the proposal as contrary to the NGA and longstanding FERC policy.

The Policy Statement also represents coordinated federal action. FERC acknowledges the necessity to interpret its statutory ratemaking mandate with other federal programs focusing on pipeline safety and climate change in particular. FERC’s action adopting the Policy Statement is part of President Obama’s

“blueprint” to [cut methane emissions, as VNF reported](#). As the White House announced on January 14, 2015, federal agencies are taking comprehensive steps intended to reduce methane emissions from the oil and gas industry, including actions from PHMSA, EPA, the Bureau of Land Management (BLM), and the Department of Energy (DOE). The Administration’s blueprint notes that DOE is taking action by working with FERC to modernize natural gas infrastructure, presumably acknowledging the Policy Statement. Significantly, FERC explicitly recognizes that pipelines could take advantage of new technologies in order to reduce methane leaks and that voluntary efforts to improve pipeline safety and minimize methane emissions may satisfy the eligibility requirements to be included in a cost modernization tracker. Similarly, the Policy Statement is an example of FERC taking action to address pipeline safety matters subsequent to the September 2010 pipeline rupture in San Bruno, California, and the response by Congress in the Pipeline Safety Act, mandating that the Department of Transportation take various actions to improve the safety of interstate natural gas pipelines.

### **For more information**

Van Ness Feldman closely monitors federal and state developments on natural gas pipeline regulation and safety issues, as well as climate change, air quality, and energy policy. Our professionals provide expert analysis and advice on the implications of emerging legislation and regulatory activity, and the surrounding policy and political debate. For more information on FERC’s Proposed Policy Statement, please contact any member of the firm’s [Pipeline & LNG](#), [Pipeline Safety](#), or [Environment, Air or Climate Change](#) practices at (202) 298-1800.

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