November 21, 2014

Recent Regulations Prompt Revamped FERC Pipeline Cost-Recovery Policy

FERC proposes to establish a framework that allows pipelines to use surcharge or tracker cost-recovery mechanisms to accelerate system improvements associated with new safety and environmental compliance regulations.

On November 20, the Federal Energy Regulatory Commission (FERC) issued a proposed policy statement setting forth guidance that, if adopted, would permit natural gas pipelines to use cost trackers or surcharges to recover certain costs that pipelines incur in connection with facility and infrastructure upgrades undertaken in response to regulatory requirements.[1] Comments will be due within 30 days of the date the notice is published in the *Federal Register*.

Background

Historically, FERC has held that capital costs incurred to comply with regulatory requirements should not be included in surcharges. FERC previously determined that recovering such costs through a tracking mechanism was “contrary to the requirement to design rates based on estimated units of service” because cost trackers guarantee a pipeline a set revenue recovery.[2]

In 2013, however, FERC approved a contested settlement that included a cost tracker to recover pipeline modernization costs.[3] In *Columbia Gas*, FERC determined that approving the settlement would facilitate the pipeline’s ability to make substantial capital investments necessary to correct significant infrastructure problems, thereby enabling the pipeline to provide more reliable service.

FERC Believes Standards Are Necessary in Light of New Compliance Regulations

Because of several recent regulatory initiatives that address natural gas pipeline infrastructure safety and reliability, FERC believes that the standards set in its proposed policy statement are necessary. The Pipeline and Hazardous Materials Safety Administration (PHMSA) is in the process of implementing a multiyear Pipeline Safety Reform Initiative to comply with new legislation that requires the PHMSA to enhance its ability to reduce future pipeline failures. Additionally, the Environmental Protection Agency (EPA) is considering mandating various greenhouse gas mitigation measures for the pipelines to employ. For example, the EPA has considered mandating pipelines to upgrade centrifugal compressors to limit natural gas leaks.

FERC Seeks Comments for Proposed Pipeline Modernization Cost-Recovery Standards

Under FERC’s statement, a pipeline proposal for a cost-recovery tracker to recover pipeline modernization costs would need to satisfy five standards:

- The pipeline’s base rates must have been recently reviewed through a Natural Gas Act § 4 rate proceeding or through a collaborative effort between the pipeline and its customers.

1. *Cost Recovery Mechanisms of Natural Gas Facilities*, Docket No. PL15-1-000, 149 ¶ 61,147 (2014).
2. *Id.* at P 11.
3. *Columbia Gas Transmission, LLC*, Order Approving Contested Settlement, Docket No. RP12-1021-000, 142 FERC ¶ 61,062 (2013).

- Eligible costs must be limited to one-time capital costs incurred to meet safety or environmental regulations, and the pipeline must specifically identify each capital investment to be recovered by the surcharge.
- Captive customers must be protected from cost shifts if the pipeline loses shippers or increases discounts to retain business.
- There must be a periodic review to ensure that rates remain just and reasonable.
- The pipeline must work collaboratively with shippers to seek their support for any surcharge proposal.

FERC's proposal also seeks comments to address questions that concern the standards, including (i) the methods to use to establish that a pipeline's current base rates are just and reasonable, (ii) the types of modifications that should be eligible for recovery under a modernization surcharge, and (iii) whether capital costs incurred to minimize pipeline facility emissions should be considered for inclusion in the surcharge.

Finally, FERC also requests comment on whether it should make any adjustments to its current reservation charge crediting policy in light of the proposed policy statement. FERC explained that the regulatory requirements that may be imposed on pipelines could result in a disruption of primary firm service. Under the existing reservation charge crediting policies, FERC allows such one-time outages to be treated as force majeure events for which only partial reservation charge credits are required. Thus, FERC requests comment on whether it should modify its existing policy to require pipelines with modernization cost trackers to provide full reservation charge credits during pipeline outages that are caused by a pipeline's compliance with regulatory requirements.

Going Forward

As noted above, FERC requests that interested entities provide initial comments within 30 days after the proposed policy statement is published in the *Federal Register*. Reply comments should be filed 20 days after the deadline for initial comments.

Contacts

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