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International Financial Standards Board
The IFRS Foundation
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RE: Request for Information, *Rate Regulation*

The Interstate Natural Gas Association of America (INGAA) welcomes the opportunity to provide comments in response to the International Accounting Standards Board's (IASB) March 2013 Request for Information, *Rate Regulation* (RFI) regarding IASB's proposal to develop a discussion paper on rate-regulated activities.

INGAA is a not for profit trade association comprised of 26 member companies, representing the vast majority of the interstate natural gas transmission pipeline companies in the U.S. and comparable companies in Canada. INGAA's members, which operate approximately 200,000 miles of pipelines in the U.S., provide natural gas transportation and storage services to gas producers/marketers, local gas utilities, industrial customers and gas-fired electric generators under tariffs approved by the Federal Energy Regulatory Commission (FERC or Commission). For purposes of these comments, INGAA is speaking on behalf of its U.S. member companies only.

Since the issuance of FERC Order No. 636 in 1992, which required natural gas pipelines to restructure their services, interstate natural gas pipelines (pipelines) only provide unbundled transportation and storage services.[1] Pipelines are not engaged in the business of buying and selling the natural gas commodity. Rather, pipelines transport and/or store natural gas owned by others. Pipelines are "open access" carriers and, as such, may not unduly discriminate in favor of one or more customers/shippers in terms of rates, services, or terms and conditions of service.[2] INGAA's member companies are committed to providing reliable transportation and storage services to their diverse customers, on a non-unduly discriminatory basis, and to maintaining a high level of customer service.

[1] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, final rule, Order No. 636, FERC Stats. & Regs. ¶ 30,939 (1992), *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950 (1992), *order on reh 'g,* Order No. 636-B, 61 FERC ¶ 61,272 (1992), *order on reh 'g,* 62 FERC ¶ 61,007 (1993), *affd in part and remanded in part sub nom. United Distribution Cos.* v. *FERC,* 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

[2] *Id*.

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U.S. interstate natural gas pipelines are private-sector entities regulated by FERC under the Natural Gas Act, the statute governing transportation of natural gas in interstate commerce.[3] The FERC requires interstate gas pipeline companies to maintain their books and records in accordance with the Commission's Uniform System of Accounts (USofA).[4] Generally Accepted Accounting Principles (GAAP) permit rate-regulated entities meeting certain criteria, as outlined in Accounting Standard Codification 980-10, Regulated Operations, to recognize the effects of rate regulation in their general purpose financial statements. The effect of rate regulation generally results in the recognition of regulatory assets and liabilities on the books of the regulated entity. The FERC has the authority to, and does, audit pipeline books and records to ensure compliance with the USofA and related FERC guidance.

The FERC authorizes the construction of interstate natural gas pipelines and approves the transportation and storage rates that pipelines may charge. By doing so, FERC ensures that these rates are "just and reasonable," which is required by the Natural Gas Act.

Natural gas pipelines are constructed in response to the evolving supply and demand dynamics of the natural gas market. A pipeline company does not have a franchised service territory or an exclusive right to operate in a specific market. In fact, often more than one pipeline competitor will serve a geographic area.

Before a pipeline company can begin construction on a pipeline project, it must obtain a "certificate of public convenience and necessity" from FERC under Section 7 of the Natural Gas Act. Accordingly, FERC's issuance of this certificate is the jurisdictional trigger for pipeline regulation. In return for this certificated permission to construct and operate a pipeline, the company submits to regulation of its rates and operations. The certificate authorizes a pipeline company to construct and operate the pipeline, outlines the terms and conditions of service, and establishes the initial rates the company may charge.

A certificate of public convenience and necessity, which is similar to a license to operate, is not purchased or subject to renewal. A pipeline commits to FERC that it will abide by the terms and conditions of the certificate. Failure to comply with the terms of the certificate could subject the pipeline to enforcement action by FERC. INGAA is not aware of any instance in which FERC has revoked a pipeline's certificate. There have been instances, however, in which FERC has vacated a certificate after the pipeline voluntarily withdrew its application to construct the pipeline.

A pipeline also can file with FERC under Section 7(b) of the Natural Gas Act to abandon a pipeline, either in place, by removal, or by sale to another entity. A natural gas company cannot abandon any portion of its facilities subject to FERC jurisdiction, or stop any services rendered by those facilities, without the permission and approval of FERC. The FERC first must determine that the available supply of natural gas is depleted to the extent that the continuance of

[3] 15 U.S.C. §§ 717 *et. seq.* (2006). By contrast, intrastate pipelines are regulated by the states.

[4] 18 C.F.R. Part 201 (2012), *Uniform System of Accounts Prescribed for Natural Gas Companies Subject to the Provisions of the Natural Gas* Act.

service is unwarranted, or that the present or future public convenience and necessity permit such abandonment.[5]

The basic methodology interstate natural gas pipelines use to establish just and reasonable rates is cost-of-service ratemaking. Pipeline rates are set through rate case proceedings in which the pipeline has the burden of proof to justify its rates. The rates must be approved by FERC. A pipeline may not unilaterally increase its rates without FERC authorization.

The FERC requires that the maximum tariff rates for each service provided by a pipeline be designed to recover the pipeline's cost of providing that service.[6] The pipeline's cost-of-service includes the product of the pipeline's rate base (which is the pipeline's investment) and the overall rate of return, plus its operation and maintenance expenses, administrative and general expenses, depreciation expenses and taxes less revenue credits. These rates reflect the costs and revenues of the pipeline over a representative 21-month time period.[7] These costs are then divided by a representative level of pipeline throughput (design level), which creates a unit rate. The Commission's regulations require pipelines to design rates based on estimated units of service.[8] A pipeline may not charge more than its maximum cost-of-service rate.[9] The FERC establishes such rates in order to restrict a pipeline's monopoly power.

A pipeline may not achieve its designed rate of return if, for instance, the designed costs use to set the approved rates are exceeded or the designed throughput is not attained. On the other hand, a pipeline's actual earned rate of return may exceed the designed rate of return if, for instance, designed costs used to set the approved rates are not realized or the designed throughput is exceeded.

Pipeline customers frequently need to reserve sufficient pipeline transportation and/or storage capacity to serve their peak gas needs. Pipeline tariffs include a two-part rate (straight-fixed variable) for their firm services, including a "reservation charge" imposed on each unit of the customer's contractual entitlement to service and a "usage charge" imposed on each unit of service actually provided to the customer pursuant to its scheduling requests. The FERC requires that a pipeline's reservation charge must recover all fixed costs attributable to the firm transportation service, unless FERC permits the pipeline to recover some of the fixed costs in the volumetric portion of the two-part rate, which is very rare. A pipeline's fixed costs are those costs that do not vary with the volume of gas it actually transports or stores on a particular day. The FERC considers most of a pipeline's costs to be fixed, including its return on its equity investment, a depreciation allowance to recover that investment, and most of the pipeline's

[5] 15 U.S.C. § 717f(b)(2006).

[6] 18 C.F.R. § 284.10(b)(4)(2012).

[7] 18 C.F.R. § 154.303(2012).

[8] 18 C.F.R. § 284.10(c)(2)(2012).

[9] FERC permits pipelines to negotiate rates with individual shippers which vary from the tariff rate, but each such negotiated rate must be filed for FERC approval. The pipeline customer that chooses to negotiate rates must always have the option to select the straight-fixed-variable, cost-of-service recourse rate.

operation and maintenance costs. Thus, the reservation charge component may be analogized to a lease payment for a facility, which is designed to fully compensate the lessor for all of its fixed costs. A pipeline's variable costs primarily include the cost of fuel used to run the pipeline's compressor stations.

A pipeline is permitted to discount its rates below the cost-of-service maximum rate. A pipeline may not surcharge its other customers for any discount provided to one or more customers.

Once established, FERC-approved rates remain in effect until such rates are re-determined by (1) the pipeline filing under Section 4 of the Natural Gas Act to increase its rates and FERC approves the new rates or (2) a customer or FERC filing under Section 5 of the Natural Gas Act challenging that the pipeline's rates are no longer just and reasonable and justifies new, lower rates that the Commission then approves as just and reasonable. If the complainant is successful, any rate reductions are prospective only.[10]

The Natural Gas Act prohibits pipelines from increasing their rates or seeking to recover rates on a retroactive basis, called retroactive ratemaking. Once a rate is in effect, it can only be changed prospectively, not retrospectively. If a pipeline under-recovers costs, the pipeline is at risk for those costs and may not surcharge its customers for the under-recovery. Similarly, if a pipeline over-recovers its cost-of-service, for example, by contracting with additional customer(s) and transporting more volumes of natural gas than anticipated or by reducing its costs, the pipeline does not share those revenues with its customers unless there is an express agreement in a pipeline-customer settlement.

In certain circumstances, FERC permits pipelines to track and flow through to customers certain costs, such as fuel costs to operate compressor stations or to maintain pipeline operations.[11] These costs, which typically are significant and vary greatly, may be tracked at regular intervals without a pipeline having to file a general rate proceeding in which all of its costs and revenues are reviewed. In its simplest form, tracked costs are identified, deferred when incurred and recovered in rates through the use of a surcharge in customer billings. The deferred amounts are recorded either as regulatory assets (receivables from customers) or a regulatory liability (payables to customers). The FERC pre-approves the pipeline's tracking mechanism, including what costs may be tracked and subsequently reviews and approves each tracker filing as just and reasonable.

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[10] 15 U.S.C. § 717d (2006).

[11]Following the events of September 11, 2001, the Commission issued a Policy Statement on Security Costs providing for recovery of expenses necessary to safeguard energy infrastructure via a surcharge. *Extraordinary Expenditures Necessary to Safeguard National Energy Supplies*, 96 FERC ¶ 61,299 (2001). The surcharge allows a pipeline to recover security related costs from their customers prospectively outside of a Natural Gas Action section 4 general rate case proceeding.

The FERC also has allowed a pipeline to surcharge its customers hurricane-related costs via a tracker. *See e.g., Sea Robin Pipeline Company, LLC*, Order on Tariff Filing, 128 FERC ¶ 61,286 (2009); Order on Request for Rehearing, 130 FERC ¶ 61,191 (2010).

For those pipelines with fuel trackers, fuel costs generally either are (1) not included in a pipeline's transportation rates, and all fuel costs are tracked via a surcharge/refund mechanism, or (2) there is a certain cost level associated with fuel in the transportation rates, and the pipeline tracks costs above or below that set amount.[12] The FERC's justification for the tracker is that these costs, by their nature, may be large and vary tremendously over time. The tracker allows the pipeline to remain revenue neutral and either to surcharge or refund the cost of fuel to its customers on an annual or other, more frequent, basis. Pipelines generally recognize a regulatory asset for the value of any under-recovered fuel and a regulatory liability for the value of any over-recovered fuel. Trackers are cost-based, which FERC approves as just and reasonable. These tracker mechanisms are very effective in ensuring that the pipeline remains revenue neutral (neither profits nor loses) and the pipeline's customers pay what the pipelines actually incurred.

These receivables and payables either are collected from or paid to types of customers (by pipeline service/rate schedule) as opposed to specifically identifiable customers. Nevertheless, we believe them to be a necessary and appropriate accounting convention in order for the user of a pipeline company's financial statements to properly understand the operations of the pipeline company.

In addition to fuel trackers, other actions by FERC can create timing differences between cost incurrence and cost recognition. For example, a pipeline can incur substantial incremental costs associated with filing a rate proceeding. The FERC usually allows a pipeline to defer these costs and amortize them over the time period in which the costs are recovered from customers via FERC-approved transportation and storage rates. These actions generally give rise to regulatory assets on the pipeline's books. Current GAAP and FERC regulations allow a pipeline to defer costs and recognize them over a period of future cost recovery if it is likely that the cost will be recovered based on the future action of the regulatory body.

The International Financial Standards Board (IFRS) fair value accounting for an asset can be significantly different than GAAP and ASC 980 (formerly SFAS 71) historical cost-basis accounting that U.S. interstate pipeline companies currently follow for interstate pipeline entities. First, IFRS rules for the FERC-regulated interstate pipeline industry would in effect overstate the balance sheet and understate the income statements for FERC-regulated interstate pipelines. Second, pipelines are able to capitalize pipeline integrity program costs for IFRS purposes but must expense certain of these costs under GAAP and FERC accounting rules. Depending on the size of a pipeline's integrity program, it could have a significant impact to the IFRS presentation. Third, pipelines do not capitalize overhead costs or burdens under IFRS, yet pipelines capitalize such costs under GAAP and FERC accounting rules. This may or may not have a significant impact on the IFRS statements. Finally, regulatory assets and liabilities currently are not recognized for IFRS reporting purposes, yet may be recognized by GAAP and FERC accounting rules. Depending on the size of these types of assets, this may have a significant effect on the pipeline company's financial statement presentations. Inclusion of regulated accounting as part

[12] Some pipelines may set a fixed fuel rate in the tariff or include a representative fuel cost in their rates and, therefore, do not track fuel costs. Such a fixed fuel rate or cost does not change until the pipeline justifies a new rate through a new rate proceeding.

of the overall IFRS rules and guidance will provide better information to the user of interstate pipelines' financial statements.

INGAA further believes that regulatory assets and liabilities approved by FERC satisfy the IFRS definition of assets and liabilities. INGAA believes that FERC-approved assets and liabilities belong, and should remain, on a pipeline's balance sheet.

In conclusion, INGAA members believe that it is important to maintain the concept of regulatory-created assets and liabilities. INGAA believes this concept preserves the proper matching of costs with the future recovery of such costs. Absent a mechanism to properly match currently incurred costs with future revenue recoveries will lead to significant distortions in the financial results of FERC-regulated entities, and not represent the underlying economic activity of the enterprise.

Respectfully submitted,

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