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 INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Pursuant to the schedule established in the Federal Energy Regulatory Commission's ("Commission's") Proposed Policy Statement,[1] the Interstate Natural Gas Association of America ("INGAA") submits its comments in reply to various comments submitted by parties in the above-referenced proceeding.

Against the backdrop of several legislative and regulatory initiatives designed to enhance the safety of pipeline facilities and reduce emissions of greenhouse gases, the Commission has promulgated a Proposed Policy Statement to ensure that its ratemaking policies do not unnecessarily inhibit pipelines' ability to expedite needed or required upgrades and improvements. The Commission has recognized correctly that pipelines must be afforded a cost recovery mechanism that will encourage them to accelerate the significant investment required to achieve these important public policy objectives. At the same time, the Commission recognized the need to protect ratepayers and proposed several customer safeguards designed to ensure that pipeline rates remain just and reasonable.

Government agencies and various segments of the natural gas and electric industries filed comments on the Proposed Policy Statement. Several commenters agree that a different cost recovery mechanism is needed to provide the proper incentives to

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

pipelines to modernize their systems, reduce their impact on the environment and make them safer, more reliable and more efficient. For example, the Department of Energy states that offering a streamlined cost recovery mechanism will provide a long overdue incentive for pipelines to invest in new equipment and upgrades that will improve safety, boost efficiency and reduce emissions. The Office of Pipeline Safety ("OPS"), within the Department of Transportation's Pipeline and Hazardous Materials Safety Administration ("PHMSA"), stresses the need to allow for the recovery of gas pipeline modernization costs without a full rate review and, therefore, strongly supports the Proposed Policy Statement. Several environmental advocacy groups also opine that the Proposed Policy Statement "provides a viable framework for modernization expenditures and a cost recovery mechanism that is reasonable and in the public interest."[2]

On the other hand, a number of commenters oppose the recovery of the costs of upgrading pipeline facilities through a cost tracking mechanism (the "Opponents"). Various Opponents argue that (1) allowing modernization costs to be recovered through a tracker will improperly "guarantee" pipelines cost recovery; (2) incentives are not needed for pipelines to comply with safety and environmental regulations; (3) the need for a different cost recovery mechanism is based on speculation about future regulations; (4) the proposed tracker does not meet the two-part test for an exception to the general requirement that pipelines recover costs through a rate case in which in all costs and revenues can be examined; and (5) the Proposed Policy Statement is contrary to precedent established in several cases in which the Commission has rejected trackers for the recovery of safety and environmental compliance costs.

[2] Comments of the Environmental Defense Fund, Conservation Law Foundation and the Sustainable FERC Project ("EDF") at 3.

The challenges to the Commission's authority to promulgate the Proposed Policy Statement are without merit. Given the looming environmental and safety regulations that will be enacted in the near future, as well as the desirability of encouraging pipelines' voluntary efforts to improve safety and reduce emissions, the Commission clearly is acting within its statutory authority by proactively announcing policies to promote these important regulatory and societal goals.

The argument that the Proposed Policy Statement is contrary to precedent is misplaced. The proposed tracker does not impermissibly "guarantee" cost recovery because (1) pipelines still must demonstrate the costs are prudent, and (2) the Commission has proposed customer safeguards that subject pipelines to the risk of cost under-recovery. The Proposed Policy Statement is consistent with precedent on trackers generally,[3] as well as the most recent precedent regarding the tracking of modernization costs, as reflected in the Commission's order on Columbia Gas' contested settlement.[4]

In the Proposed Policy Statement, the Commission appropriately has recognized that filing successive general Natural Gas Act ("NGA") Section 4 rate cases to recover the substantial costs required to upgrade pipeline systems, which would be cumbersome, expensive and time consuming, does not provide the appropriate incentives for pipelines to modernize their systems and achieve these important public policy objectives. Contrary to the claims of the Opponents, who generally ignore the consumer safeguards proposed by the Commission, the Proposed Policy Statement strikes a fair balance between providing incentives for pipelines to undertake and accelerate the required or needed upgrades, and protecting customers from potential cost over-recovery and cost

[3] *See, e.g., ANR Pipeline* Co., 110 FERC ¶ 61,069 at P 19 (2005) ("*ANR*").

[4] *Columbia Gas Transmission, LLC*, 142 FERC ¶ 61,062 (2013) ("*Columbia Gas*").

shifts. Any narrowing of the cost recovery policies proposed in the Policy Statement will reduce these incentives and would be contrary to the goal of improving safety and reducing emissions.

A. The Proposed Policy Statement Is Lawful and Consistent with Commission Policy and Precedent.

1. The Proposed Policy Statement Does Not Guarantee Cost Recovery.

The contention of several commenters – that allowing the costs of modernization to be recovered through a tracker will guarantee cost recovery, contrary to the ratemaking scheme contemplated in the NGA – is wrong for two reasons. First, pipelines must continue to demonstrate that costs to be recovered through the proposed tracker were incurred prudently. A tracker does not guarantee the recovery of imprudently incurred costs.

Second, the claim that the proposed tracker guarantees cost recovery by failing to place pipelines at risk for under-recovery between rate cases ignores one of the Commission's proposed customer safeguards. In a general NGA Section 4 rate case, rates are designed on the basis of actual contract demand ("CD") and throughput in the test period.[5] If the pipeline's CD or throughput declines after the rates go into effect or the pipeline is required to discount to a greater degree as compared to the test period, the pipeline will under-recover its costs between rate cases. Conversely, if the pipeline is able to sell additional service or increase throughput, it is permitted to retain the resulting revenues.[6]

[5] *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017 at 61,084 (2000); *Williston Basin Interstate Pipeline Co.*, 87 FERC ¶ 61,264 at 62,012 (1999).

[6] Proposed Policy Statement at P 27.

In the Proposed Policy Statement (at P 27), the Commission acknowledged that in the case of a tracker, if a pipeline loses shippers or must offer increased discounts to retain business between tracking periods, the tracking mechanism automatically may shift costs to other shippers when the costs are trued up in the next tracking period. The Commission proposed to require pipelines to propose a rate mechanism, such as the billing determinant floor included in the *Columbia Gas* settlement, to protect a pipeline's customers from such automatic cost shifts. While the details of these rate mechanisms need to be worked out in individual pipeline cases, the Proposed Policy Statement does in fact place a pipeline at risk for full cost recovery if it loses customers or must discount to a greater extent than assumed in the design of the surcharge.[7] Thus, the proposed tracker does not guarantee pipelines cost recovery.[8]

2. The Proposed Policy Statement Properly Provides Needed Incentives.

The Opponents of the Proposed Policy Statement argue that pipelines do not need any further incentive to do what they legally are required to do. This argument misses the point. The Commission's objective is to provide the maximum incentive for

[7] American Forest & Paper Association ("AF&PA") notes (at 6) that the Proposed Policy Statement does not address how trackers will be designed and suggests that costs be spread as widely as possible, including to interruptible shippers. *See also* Comments of the Natural Gas Supply Association ("NGSA") at 12. INGAA submits that issues relating to the design of the surcharge, including whether to allocate costs to interruptible shippers and how to apply a discount adjustment should be left to the individual pipeline proceedings. As to AF&PA's suggestion (at 6) that replacement shippers pursuant to a release of capacity be responsible for costs recovered through a tracker, INGAA submits that the Commission's capacity release policies should apply: except for permanent releases, a releasing shipper remains liable on its contract but will receive a credit against its bill for the capacity resold. *See Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. ¶ 30,939 at 30,419 (1992); 18 C.F.R. § 284.8(f).

[8] Because pipelines will in fact be placed at risk for cost recovery under the proposed tracker, requests to lower pipeline returns on equity in light of an alleged guaranteed cost recovery are unwarranted. Other more draconian proposals, such as American Public Gas Association's ("APGA") attempt to use the Proposed Policy Statement as a vehicle to require retroactive refunds in Section 5 proceedings (at 20) or to change the entire natural gas transportation ratemaking scheme to formula rates (at 11-12) are beyond the scope of the Proposed Policy Statement and should be disregarded.

pipelines to upgrade their systems "expeditiously" and "efficiently" by making voluntary improvements to their systems, in addition to complying with imminent regulatory requirements.[9] Moreover, by providing pipelines with advance notice of a policy that provides a viable mechanism for the recovery of costs incurred voluntarily and prior to any mandatory requirements, the Proposed Policy Statement (at P 19) is designed to accelerate needed upgrades to pipeline systems and encourage innovation and efficiency. The Proposed Policy Statement also will remove uncertainty as whether certain upgrades technically are required by a particular regulation or were performed voluntarily, and properly recognizes that system upgrades to improve safety and reduce environmental impacts are in the public interest regardless of whether the upgrades were undertaken voluntarily or in compliance with legal requirements.

The Opponents also confuse the incentive to reduce operating costs between rate cases with the incentive to upgrade and modernize pipeline systems to reduce emissions and address pipeline safety risks proactively. For example, Indicated Shippers contend (at 21) that by "guaranteeing" costs, the Proposed Policy Statement will cause pipelines to lose the incentive to provide efficient and effective service between rate cases. Similarly, Process Gas Consumers Group ("PGC") argues (at 10) that allowing these costs to be tracked will reduce pipelines' incentive to reduce costs between rate cases because pipelines will not benefit from such "cost-cutting" efforts. While reducing operation and maintenance ("O&M") costs, such as labor costs, in an effort to operate more efficiently between rate cases is to be encouraged and will not be affected by the

[9] The Commission has proposed that costs eligible for inclusion in a tracker include capital costs of complying with safety and environmental regulations, *as well as other capital costs shown to be necessary for the safe or efficient operation of the pipeline*. Proposed Policy Statement at P 23 (emphasis added). *See also* Proposed Policy Statement at P 9 (Commission seeks to ensure that its ratemaking policies do not inhibit pipelines' ability to expedite *needed or* required upgrades and improvements (emphasis added)).

Proposed Policy Statement, "cost-cutting" in the context of needed system upgrades for safety and environmental reasons is neither desirable nor in the public interest. The Proposed Policy Statement properly encourages pipelines to incur the cost of these needed system improvements and replacements, while maintaining the incentive to operate efficiently and reduce O&M costs not associated with these needed upgrades.

APGA also suggests (at 12) that pipelines do not need the incentive to make needed upgrades because they already are collecting in rates O&M costs to maintain their systems in "good operating condition." APGA questions whether pipelines are spending these dollars to maintain their systems, and suggests that upgrades would not be needed if existing facilities were maintained properly. APGA's veiled accusation that pipelines are not adequately maintaining their systems is wholly unsupported and erroneous. Despite proper maintenance, pipelines may need to replace facilities to continue to ensure the safe and reliable operation of their systems. Furthermore, advances in technology offer the opportunity to improve the safety and efficiency of pipeline facilities and reduce their environmental impact. Thus, despite the fact that pipeline facilities have been maintained properly, they may need to be upgraded or replaced.

The Opponents also claim that the Proposed Policy Statement will reduce pipelines' incentives to file full-blown rate cases. This argument, however, erroneously assumes the filing of successive rate cases are beneficial and should be encouraged over the other alternatives referenced in the Proposed Policy Statement for testing the reasonableness of a pipeline's existing rates. As noted by a few commenters, however, unless authorized to track these costs as proposed in the Policy Statement, pipelines will be required to file pancaked rate cases to recover these costs. Due to test period requirements, successive rate cases would be needed for pipelines to recover costs of modernization efforts that could be expected to occur over several years. As EDF recognizes, a tracker would:

> allow pipelines to prospectively undertake significant system modernization work that will maintain safe operations, abate emissions and adverse public impacts, improve pipeline system integrity, and enhance flexibility and reliability of service to its shippers without the time and expense that would be involved in the preparation and litigation of successive rate cases that would otherwise be required.[10]

Absent the incentive provided by the Proposed Policy Statement, the requirement to seek recovery of these costs in successive rate cases would result in cost recovery uncertainty, less incentive for pipelines to accelerate their investments in modernization projects that benefit consumers, industry and the economy, and a drain on Commission resources.[11]

3. The Proposed Tracker Meets the Conditions Previously Required by the Commission for the Tracking of Costs Outside of a General Section 4 Rate Case.

Indicated Shippers contend that modernization costs should not be permitted to be tracked because such costs do not meet the two-part test the Commission applies to determine if costs are eligible to be tracked. Indicated Shippers rely on a few electric cases for the proposition that costs must be (1) volatile and (2) a significant component of a company's cost of service to be eligible for cost recovery through a tracker.[12] As a

[10] Comments of EDF at 4-5.

[11] Relying on the annual study of pipeline returns prepared by NGSA, Opponents such as APGA and PGC recite their claims that some pipelines are over-recovering their costs. These contentions, even if true, do not suggest the Proposed Policy Statement should be discarded. First, the NGSA study does not take into account several factors that impact pipeline cost recoveries. The NGSA study reflects one advocate's position and does not demonstrate over-recoveries. Second, shippers are free to file a complaint under NGA Section 5 to address concerns with over-recoveries. And third, and most importantly, the possibility that a particular pipeline's existing rates are over-recovering costs is addressed in the Proposed Policy Statement by requiring a recent review of existing rates or cost-revenue study before a tracker can be employed.

[12] Indicated Shippers' Comments at 5, *citing Florida Power Corp,* 70 FERC ¶ 61,321 at 61,979 (1995), *Public Service Co. of Oklahoma,* 70 FERC ¶ 61,321 at 61,979 (1995) (sic) and *Detroit Edison Co.,* 62

threshold matter, the standard enunciated in gas cases is different. In gas cases, the Commission has allowed the tracking of costs that are (1) subject to significant changes from year to year and (2) difficult to project.[13] In any event, the substantial costs that pipelines will incur to modernize their systems meet both tests.

The Commission correctly found in the Proposed Policy Statement that the costs of modernizing pipeline and compression facilities will be substantial. As noted by OPS (at 2), almost 60 percent of pipeline systems are over 45 years old, and 12 percent are over 50 years old. The Commission noted (at P 13), for example, that Columbia Gas estimated it would spend $300 million annually over a five-year period under the modernization program provided for in its settlement. These costs will vary significantly from year to year depending on the amount of work performed in any given year as compared to the next. Clearly, the costs that will be incurred by pipelines in the first year of a modernization program will be significantly greater than the total costs incurred by the pipeline in the prior year, and the costs incurred in the first year after the upgrades have been installed will be significantly lower than in the prior year.

Furthermore, the extent to which pipelines will be required to upgrade their systems from year to year also is difficult to predict. Like the cost to repair facilities damaged by hurricanes and security costs, the costs of a modernization program are unique one-time costs that are incurred in furtherance of the public interest and are

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FERC ¶ 61,246 at 62,628 (1993).

[13] *See, e.g., ANR, supra.* While the Commission's general policy is that rates should be based on projections of future costs based on test period experience, the Commission permits certain costs that are volatile and thus particularly difficult to project, to be tracked. *Fuel Retention Practices of Natural Gas Companies*, Notice of Inquiry, 120 FERC ¶ 61,255 at P 21 (2007).

permitted to be recovered outside of a general rate case through a cost tracker.[14]

4. Prior Cases in which the Commission Rejected Trackers for the Recovery of Costs of Compliance with Government Regulations Are Not Current Commission Policy.

Several of the Opponents of the Proposed Policy Statement cite to cases in which the Commission has rejected trackers for the costs of compliance with safety and environmental regulations, and argue the Commission has not justified a departure from this precedent.[15] The cases cited by the Opponents are distinguishable and are not controlling. The major differences between the circumstances of those cases and the circumstances that exist today are that (1) the costs are no longer speculative, and (2) the Commission has proposed customer protections that were not included in those rejected proposals.

Contrary to PGC's claim (at 6-7) that "nothing has changed," the Commission's policy has evolved over the last several years due to changes in the regulatory and public policy environment. In the 2009 *Southern* order, for example, the Commission found the potential for legislative and regulatory requirements to be too speculative.[16] Three years later in 2012, although the Commission rejected MRT's proposal to track security, safety and environmental costs, the Commission foreshadowed that recovery of these costs through a tracker may be appropriate in the future as these regulatory initiatives progress.

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[14] *See Extraordinary Expenditures Necessary to Safeguard National Energy Supplies*, 96 FERC ¶ 61,229 (2001) (security costs); *Florida Gas Transmission Co.*, 109 FERC ¶ 61,320 at PP 19-23 (2004) (security costs); *Sea Robin Pipeline Co.*, 144 FERC ¶ 61,008 (2013) (hurricane costs); *High Island Offshore System, L.L.C.*, 135 FERC ¶ 61,105 (2011) (hurricane costs).

[15] Opponents cite *Florida Gas Transmission Co.*, 105 FERC ¶ 61,171 (2003); *El Paso Natural Gas Co.*, 112 FERC ¶ 61,150 (2005); *Southern Natural Gas Co.*, 127 FERC ¶ 61,003 (2009); ("*Southern"); Granite State Gas Transmission, Inc.*, 132 FERC ¶ 61,089 (2010); *CenterPoint Energy – Mississippi River Transmission, LLC*, 140 FERC ¶ 61,253 (2012) ("*MRT").*

[16] *Southern*, 127 FERC ¶ 61,003 at P 29.

The Commission stated:

> We understand that MRT will be facing increased regulatory requirements concerning the safe operation of its pipeline. However, PHMSA is in the early stages of implementing the statute. The Commission is tracking the impacts of the Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011 concerning the safe operation of pipelines. The Commission understands the importance of investment and other expenditures to improve the safe operation of the nation's pipeline infrastructure, and will consider the need for further action as PHMSA's implementation process moves forward.[17]

As the Commission was monitoring these regulatory initiatives, the government also was encouraging pipelines to develop voluntary programs to improve the safety of the nation's pipeline network. In response to the Transportation Secretary's "Call to Action" on pipeline safety, INGAA developed a framework and guidelines for establishing best practices for safe operation of its members' pipelines. As part of this initiative, INGAA's board of directors adopted voluntary commitments in the form of its Integrity Management Continuous Improvement ("IMCI") initiative to improve the industry's safety performance.

In addition, the White House has signaled its keen interest in these environmental issues by sponsoring a series of methane emissions reduction roundtables in 2014 and with its announcement in early 2015 of actions to cut methane emissions.[18] To address greenhouse gas emissions, INGAA is developing programs to detect and repair leaks that could release methane emissions.

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[17] *MRT*, 140 FERC ¶ 61,253 at P 65. It also is noteworthy that in *MRT*, intervenors argued specifically that MRT's proposal did not contain any ratepayer protections, whereas the proposed Policy Statement does contain such protections. *Id.* at P 44.

[18] The White House, Office of the Press Secretary, *Fact Sheet: Administration Takes Steps Forward on Climate Action Plan by Announcing Actions to Cut Methane Emissions*, January 14, 2015, available at: http://www.whitehouse.gov/the-press-office/2015/01/14/fact-sheet-administration-takes-steps-forward-climate-action-plan-anno-1.

Coincident with these regulatory initiatives and voluntary programs designed to address safety and environmental concerns, the Commission issued its order on the *Columbia Gas* settlement in 2013. In this order, the Commission approved a contested settlement that included a cost tracker covering the costs of upgrade and replacement projects. The Commission rejected a protest to the settlement based on many of the same arguments being made by the Opponents in comments on the Proposed Policy Statement in this proceeding. The Commission found that unlike the prior rejected proposals, the tracker agreed to in the *Columbia Gas* settlement did not guarantee cost recovery and would not diminish the pipeline's incentive to be efficient and maximize service.

The Commission found:

> In this case, the Commission finds that the Settlement and the CCRM provide a reasonable means for Columbia to recover the substantial costs of addressing urgent public safety and reliability concerns, without undercutting Columbia's incentives to operate efficiently and to maximize service to the extent that previously proposed and rejected surcharges would have done.[19]

Now, two years after *Columbia Gas*, during which time PHMSA and the Environmental Protection Agency ("EPA") have advanced initiatives focusing on the need for pipelines to inspect and, if necessary, upgrade their facilities to address safety and environmental concerns, the Commission has issued a policy statement patterned after the polices it announced in the order approving the contested *Columbia Gas* settlement. Notably, the Commission has proposed to include the customer safeguards that were absent from the proposals previously rejected.

In the Proposed Policy Statement (at P 8), the Commission reviewed recent regulatory initiatives in PHMSA rulemakings taken pursuant to the Pipeline Safety Act

[19] *Columbia Gas*, 142 FERC ¶ 61,062 at P 22.

and found that "interstate natural gas pipelines will soon face new safety standards requiring significant capital cost expenditures to enhance the safety and reliability of their systems." The Commission further found (at P 14) that these and other legislative and regulatory initiatives recently undertaken result in a "high probability" that pipelines will be subject to significant compliance costs. Indeed, even Opponents of the Proposed Policy Statement acknowledge that an EPA rulemaking based on the EPA's White Papers could be expected in the summer of this year, with a final rule in 2016.[20]

Moreover, as PGC acknowledges (at 12-13), 34 states (as of 2013) already have enacted separate rate mechanisms for pipeline operators to recover the costs of replacing aging distribution pipeline infrastructure. The important take-away from these state-implemented cost recovery mechanisms is that rather than being premised on speculation as the Opponents contend, the Commission's Proposed Policy Statement is overdue. Finally, while PGC references some isolated instances of pipelines over-collecting costs under these state mechanisms, a true-up mechanism as proposed in the Policy Statement will prevent any over-collections by interstate pipelines.

In sum, the fact that pipelines will need to incur substantial costs to comply with these safety and environmental requirements is not speculative. Rather, it is imminent. Clearly, the Commission acted reasonably by proactively announcing policies to address the recovery of costs incurred to comply with these imminent regulatory requirements, as well as upgrade their systems voluntarily, to achieve these important policy objectives.

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[20] *See* Indicated Shippers' Comments at 16.

5. The Proposed Policy Statement Does Not Depart from Precedent, and Even If It Were to Be Determined that It Did, the Commission Has Justified a Departure.

For the reasons discussed above, the tracker proposals rejected in the cases cited by the Opponents are distinguishable from the tracker the Commission has proposed in the Policy Statement. There is no departure from precedent. Indeed, the most recent precedent on the issue is the *Columbia Gas* settlement that was approved on the merits of the proposal over the objection of a protestor. Contrary to the claims of the Opponents, an order on a contested settlement is precedent.[21] The Commission is following the precedent established in *Columbia Gas* in the Proposed Policy Statement.

Moreover, even if the Proposed Policy Statement is deemed to represent a departure from precedent, the Commission has justified a departure for the reasons discussed above. The heightened focus on the need for modernizing facilities, the evolution and imminence of regulatory requirements requiring substantial expenditures to modernize, the encouragement of voluntary action and the consumer protections included in the Proposed Policy Statement all justify promulgation of the Commission's Policy Statement.

B. The Five Standards Intended to Protect Customers Should Not Be Interpreted in a Manner that Eliminates the Incentives the Proposed Policy Statement Is Designed to Provide.

1. A Requirement that a General Section 4 Rate Case Be Filed as the Only Means to Review Existing Rates Before a Tracker Could Be Implemented Would Frustrate the Very Purpose of the Proposed Policy Statement and Should Not Be Adopted.

In the Proposed Policy Statement, the Commission stated that pipelines would be required to show that their existing rates were just and reasonable prior to adding a

[21] *See, e.g., Enbridge Pipelines (KPC),* 102 FERC ¶ 61,310 at n.74 (2003) (a Commission order approving a contested settlement is a legal precedent of the Commission).

surcharge to recover the costs of modernization. The Commission stated this showing could be made by either the filing of a new NGA Section 4 rate case, the filing of a cost and revenue study in the form specified in Section 154.313 of the Commission's regulations, or a different acceptable approach.

Some of the Opponents contend that the only reasonable avenue for establishing that a pipeline's rates are just and reasonable is to file a new general NGA Section 4 rate case. These Opponents argue that a cost and revenue study is not sufficient to make this showing because the data can be either incomplete or manipulated. INGAA submits that the Commission should not narrow the options in which pipelines can demonstrate that their existing rates are just and reasonable. Mandating the filing of a general NGA Section 4 rate case as a prerequisite to including modernization costs in a tracker will eliminate the incentives the Proposed Policy Statement is intended to create and effectively will defeat its purpose.

The notion that a cost and revenue study is inadequate to review the justness and reasonableness of base rates lacks merit. First, the Proposed Policy Statement requires a cost and revenue study to be based on Section 154.313 of the Commission's regulations, which requires the filing of 15 schedules including data on all cost and revenue elements of a rate case. Second, customers have access to Form 2, which requirements were updated a few years ago to better reflect current market and cost information. Specifically, pipelines now are required to report on Form 2 additional information on costs and revenues related to the disposition of shipper-supplied gas, affiliate transactions, discounted and negotiated rate services, and deferred income tax and state tax issues.[22] The combination of the Form 2 data along with the required schedules supporting a cost and revenue study will allow interested persons to determine whether a pipeline is over-recovering its costs. Opponents' assertion that they cannot analyze the data contained in a cost and revenue study to determine whether pipelines are over-recovering their costs rings hollow, because the historical data included in a cost and revenue study is the same historical data included in rate filings with respect to overall levels of costs and revenues.

The argument that a cost and revenue study is insufficient because it is subject to "manipulation" does not withstand scrutiny. For example, NGSA contends (at 14-15) that pipelines can manipulate data with "assumed base/test periods, assumed rate[s] of return, estimated costs and revenues, etc." Yet, these are the same assumptions and estimates that would be made in a rate case filing under NGA Section 4. PGC's concern (at 15-16) that it lacks the technical expertise to thoroughly examine and comprehend a cost and revenue study lacks merit. Any party has the option of retaining experts or counsel to review cost and revenue studies. Indeed, the alternative advocated by these Opponents of requiring a general rate case would present shippers with the same choice.[23]

In short, a cost and revenue study enables customers to analyze adequately pipelines' existing rates, and obviates the filing of a full-blown rate case. Prohibiting pipelines from filing a cost and revenue study as a means to satisfy the Commission's

[22] *Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines*, Order No. 710, 122 FERC ¶ 61,262; *order on reh'g*, Order No. 710-A, 123 FERC ¶ 61,278 (2008).

[23] In a similar vein, the Kansas Corporation Commission contends that extensive discovery on cost and revenue studies would be needed to evaluate a pipeline's existing rates. Not all cost and revenue studies would require extensive discovery, while general Section 4 rate cases almost always do. A cost and revenue study is simply an effective streamlined vehicle for examining a pipeline's existing rates that avoids the time and expense of a full-blown rate case.

proposed standard, that the pipeline's base rates must have been recently reviewed, would frustrate the objective of the Proposed Policy Statement.

2. The Cost of Any Upgrades Needed or Required for Safety, Efficiency or Environmental Reasons Should Be Eligible for Recovery under a Tracker without Unnecessary Limitations or Restrictions.

Some of the Opponents seek to severely limit the types of facility costs that would be eligible for recovery under the tracker. One or more Opponents argue that eligible costs should be limited to: (1) costs identified up-front in a filing; (2) capital costs; and (3) costs incurred to comply with regulatory mandates. Opponents also request the Commission to exclude: (1) any costs of an upgrade that also would create incremental capacity; (2) costs associated with compressor modifications to recover waste heat; and (3) and the costs of compliance with anticipated regulations.

Other Opponents propose to place arbitrary restrictions or conditions on the recovery of eligible costs, including (1) a cost recovery limit of 10 percent of a pipeline's rate base or 5 percent of a pipeline's base tariff rates; and (2) conditions on recovering costs not identified in an initial filing, including a rebuttable presumption against such inclusion, or a requirement to file a rate case or obtain settlement or consensus to add such costs.

Proposals to limit or place restrictions on the costs that are eligible for recovery under the tracker should be rejected. Such limitations or restrictions would undermine the objective of providing incentives for pipelines to perform needed or required upgrades to make their facilities safer, more efficient and to reduce emissions. The guiding principle for determining whether costs are eligible should be whether they further the goals of the Proposed Policy Statement to enhance and upgrade pipeline systems to make them safer, more efficient and/or reduce their environmental impact.

Except for the principle that the costs of routine maintenance should not be eligible, there should be no categorical prohibitions or restrictions on the costs that can be included. There is no reason to exclude the costs of voluntary projects, operating costs, costs unknown or difficult to project at the time of a pipeline's initial filing or waste heat recovery costs to the extent these costs are incurred to modernize the pipeline's facilities and render them safer and/or to produce lower emissions. Similarly, there is no rational basis to exclude costs of a needed upgrade simply because an incidental and desirable consequence of the upgrade would be to also create incremental capacity.[24] These issues should be discussed by the pipeline and its customers with a view toward reaching consensus on costs that will be included, subject to Commission oversight to resolve disputes.

Finally, several Opponents contend that it may be difficult to distinguish between eligible costs and ineligible costs of routine maintenance. The potential difficulty in distinguishing between eligible costs and ineligible costs of routine maintenance, however, does not negate the need for the Policy Statement. There are various mechanisms that could be discussed and implemented to address this issue consistent with the particular circumstances of each pipeline. On some systems, it may not be difficult to determine that the projects identified by the pipeline are related to system upgrades contemplated by the Proposed Policy Statement.

On others, where there may appear to be an overlap, mechanisms can be explored to make the distinction. In the *Columbia Gas* settlement, for instance, the

[24] Any issues relating to the need for, and manner of, allocating costs between existing and incremental shippers can be resolved in the applicable certificate proceeding, with the costs allocated to existing shippers recovered through the tracker.

pipeline agreed to an annual capital expenditure that it would recover through base rates. This expenditure would be in addition to the costs of the modernization program that would be tracked. Absent extenuating circumstances, a pipeline's history of capital expenditures incurred for routine maintenance, for example, could be used as a rough guide for the amount of such routine maintenance capital costs that will continue to be recovered through base rates.[25] The pipeline and its customers could discuss whether such past expenditures do or do not represent a reasonable yardstick of such expenditures in the future. Other mechanisms for making the distinction could also be proposed.

3. The Commission Should Permit Pipelines to Work with All Interested Parties to Develop Creative Solutions that Satisfy the Commission's Other Three Standards.

The Commission's proposed customer safeguard standards three through five would require a pipeline to (1) 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 shippers; (2) include some method to allow a periodic review of whether the tracker and the pipeline's base rates remain just and reasonable; and (3) work collaboratively with its shippers to seek shipper support for the proposal.

Importantly, the Proposed Policy Statement is not prescriptive as to how a pipeline could address each of these standards. In fact, while the Commission points to the *Columbia Gas* settlement as an example of how a pipeline could satisfy each of these standards, the Commission made clear that it is "open to considering other methods [than

[25] NGSA argues (at n.16 & page 26) that it may be difficult to determine whether costs that may be included in a tracker are already included in a settlement or negotiated rate contracts. There can be no such overlap as to costs incurred after the execution of such settlements or contracts. To the extent that a pipeline seeks to recover costs incurred prior to a filing pursuant to the Proposed Policy Statement, such issues can be reviewed in the individual proceedings.

that approved in the *Columbia Gas* settlement] that may similarly protect a pipeline's customers" from cost shifting (at P 29) and that it "remain[s] open to, and seeks comments on, reasonable methods of accomplishing [the periodic review] goal aside from that approved in *Columbia Gas*" (at P 30). Further, the Commission does not mandate how much shipper support a pipeline must garner among interested parties but notes (at P 32 and n.25) that the support does not need to be one-hundred percent shipper agreement and that Columbia Gas "had the support of a broad spectrum of the pipeline's shippers."

Several commenters address how pipelines should meet these three standards and either support how Columbia Gas met these standards or offer other minimum requirements that pipelines must meet in order to satisfy these standards. INGAA agrees with the Commission that it should remain flexible in allowing a pipeline to work collaboratively with its customers to develop creative solutions that meet the Commission's standards. The Commission should not adopt a one-size-fits all prescriptive means to achieve these standards since, as the Commission noted, *Columbia Gas* is only one means to meet these standards and there are other ways to address cost shifting, periodic rate review and shipper support.

Permitting a pipeline to work collaboratively with its shippers on an individual solution facilitates a pipeline's ability to craft a cost recovery surcharge that is tailored to the individual pipeline and its customers. As noted earlier, requirements that would expose pipelines to a significant risk of under-recovery of costs associated with modernization programs would frustrate the Commission's goal of encouraging pipeline investments to improve safety and efficiency. Therefore, INGAA requests that the

Commission continue to allow pipelines the flexibility to meet these standards without limiting, in a final policy statement, the ways in which pipelines must meet the standards.

C. Other Issues.

1. The Commission Should Reject Recommendations to Provide Full Reservation Charge Credits for Outages Caused by Actions Taken Pursuant to a Modernization Program.

In *TransColorado Gas Transmission Co. LLC,* 144 FERC ¶ 61,175 (2013) and *Gulf South Pipeline Co., LP,* 144 FERC ¶ 61,215 (2013), the Commission explained how its reservation charge crediting policy applied to two different types of outages that could result from compliance with government requirements. Outages necessitated by compliance with government standards concerning the regular, periodic maintenance activities a pipeline must perform in the ordinary course of business are considered to be non-*force majeure* events requiring full reservation charges. As the Commission acknowledged in the Proposed Policy Statement (at 34), however, one-time outages resulting from facility upgrades and replacements that likely will be required given recent legislative and other action may be treated as *force majeure* outages, for which partial reservation charge credits are required. It is clear that upgrades and replacements made pursuant to a modernization program contemplated by the Proposed Policy Statement fall in the latter *force majeure* category for which only partial reservation credits would be required.

In its initial comments, INGAA recommended that reservation charge crediting not apply when pipelines are performing either voluntary or mandatory activities to improve safe and efficient pipeline operations. As INGAA explained, requiring reservation charge credits when pipelines make needed system improvements that are required or urged by the Administration, Congress and regulatory agencies penalizes efforts that should be encouraged by the Commission. The unique nature of these costs, as well as the public policy considerations underlying the Proposed Policy Statement, strongly supports exempting pipelines from reservation charge crediting for outages caused by activities taken in furtherance of these important objectives.

Not surprisingly, several Opponents recommend that the Commission change its reservation charge crediting policy in the opposite direction by requiring full reservation charge crediting for all outages caused by upgrades or improvements taken pursuant to a modernization program. The adoption of this recommendation would be a significant step backwards and, like other Opponent proposals, would diminish the incentive for pipelines to perform needed upgrades, contrary to the entire purpose of the Proposed Policy Statement.

As INGAA has noted, applying the Commission's existing reservation charge crediting policy of requiring partial credits for outages caused by compliance with regulations requiring upgrades and replacements would run counter to the intent of the Proposed Policy Statement. Requiring full reservation charge credits would exacerbate the penalty to pipelines for undertaking voluntary actions to reduce emissions and improve safety that are not only strongly encouraged by the Administration, but rather are contemplated and expected by it. For example, pipelines may be discouraged from performing voluntary work or may opt to delay such work in order to avoid the immediate financial impact of providing reservation charge credits. The Commission's existing reservation charge crediting policy should encourage and not burden these important decisions and public policy goals and should not be an impediment to the success of the Proposed Policy Statement. Rather, the Commission should, as part of its Proposed Policy Statement, embark on a different approach as recommended by INGAA and eliminate penalties for performing this work in an efficient and timely manner.

If the Commission nonetheless determines that reservation charge crediting should apply in some way to voluntary and mandatory efforts to modernize and improve pipeline systems to enhance reliability, safety and environmental compliance, then at a minimum, the Commission should establish a new category for this special work and establish an appropriate safe harbor period during which reservation charge credits would not be required. In other words, regardless of whether upgrades or replacements could be considered *force majeure* or non-*force majeure*, the Commission should recognize the unique, one-time nature of these costs and exempt pipelines from reservation charge crediting for an appropriate safe harbor period (*e.g.*, 30 days) following an outage caused by any upgrades, replacements or repairs made pursuant to a pipeline's efforts to modernize its system. Such a safe harbor period would limit the circumstances in which pipelines are penalized for performing needed or required work to ensure safe and reliable operations over the long term. It also would encourage pipelines to group projects that make sense from an engineering standpoint, prioritize projects that complement each other and achieve efficiency benefits in a timely manner.

2. The Commission Should Allow the Parties to Attempt to Reach Consensus on Whether to Depreciate the Capital Costs of Modernization or Provide for Accelerated Amortization.

The comments on the issue of whether the costs of modernization should be depreciated or be amortized over a shorter period reflect disparate positions among the various customer groups. NGSA (at 24) and Wisconsin Electric Power Company and

Wisconsin Gas Company (at 6-7) support an amortization model. PGC supports (at 19-20) the depreciation of these costs over the life of the facilities, and AF&PA recommends (at 5-6) a middle ground of a 20-year depreciation period. APGA argues (at 22) that a pipeline's customers should make this decision and Calpine (at 12) more appropriately agrees that this issue should be discussed as part of the negotiations between pipelines and their customers.

The comments suggest several approaches, and illustrate that no one methodology should be mandated. INGAA submits that pipelines and their customers be permitted to discuss the issue and attempt to reach consensus on the best approach for each pipeline system.

D. Conclusion.

WHEREFORE, INGAA requests the Commission promptly issue a final policy statement consistent with INGAA's comments above.

Respectfully submitted,

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