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UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

[Docket No. PL15-1-000]

Cost Recovery Mechanisms for Modernization of Natural Gas Facilities

(Issued April 16, 2015)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Policy statement.

SUMMARY: In this Policy Statement, the Commission provides greater certainty regarding the ability of interstate natural gas pipelines to recover the costs of modernizing their facilities and infrastructure to enhance the efficient and safe operation of their systems. The Policy Statement explains the standards the Commission will require interstate natural gas pipelines to satisfy in order to establish simplified mechanisms, such as trackers or surcharges, to recover certain costs associated with replacing old and inefficient compressors and leak-prone pipes and performing other infrastructure improvements and upgrades to enhance the efficient and safe operation of their pipelines.

DATE: This Policy Statement will become effective October 1, 2015.

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TABLE OF CONTENTS

	<u>Paragraph Numbers</u>
I. Background.....	<a href="#">4.</a>
A. Safety and Environmental Initiatives.....	<a href="#">4.</a>
B. Existing Policy.....	<a href="#">11.</a>
C. Proposed Policy Statement .....	<a href="#">19.</a>
D. Comments.....	<a href="#">22.</a>
II. Discussion.....	<a href="#">25.</a>
A. Adoption of Policy Statement.....	<a href="#">25.</a>
B. Standards for Modernization Cost Trackers or Surcharges.....	<a href="#">44.</a>
1. Review of Existing Rates.....	<a href="#">45.</a>
2. Defined Eligible Costs.....	<a href="#">54.</a>
3. Avoidance of Cost Shifting.....	<a href="#">72.</a>
4. Periodic Review of the Surcharge.....	<a href="#">83.</a>
5. Shipper Support.....	<a href="#">90.</a>
C. Additional Questions on Which the Commission Sought Comments.....	<a href="#">95.</a>
1. Accelerated Amortization.....	<a href="#">96.</a>
2. Reservation Charge Crediting.....	<a href="#">101.</a>
3. Other Issues.....	<a href="#">110.</a>
III. Information Collection Statement .....	<a href="#">119.</a>
IV. Document Availability.....	<a href="#">132.</a>
V. Effective Date and Congressional Notification.....	<a href="#">135.</a>

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FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;  
Philip D. Moeller, Cheryl A. LaFleur,  
Tony Clark, and Colette D. Honorable.

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

POLICY STATEMENT

(Issued April 16, 2015)

1. On November 20, 2014, the Commission issued a Proposed Policy Statement and sought comments regarding potential mechanisms for interstate natural gas pipelines to use to recover the costs of modernizing their facilities and infrastructure to enhance the efficient and safe operation of their systems.<sup>1</sup> The Commission proposed standards that interstate natural gas pipelines would be required to satisfy to establish simplified mechanisms, such as trackers or surcharges, to recover such costs. Historically, the Commission has required interstate natural gas pipelines to design their transportation rates based on projected units of service. Recently, however, governmental safety and environmental initiatives have raised the probability that interstate natural gas pipelines will soon face increased costs to enhance the safety and reliability of their systems. The Commission issued the Proposed Policy Statement in an effort to address these potential costs and to ensure that existing Commission ratemaking policies do not unnecessarily inhibit interstate natural gas pipelines' ability to expedite needed or required upgrades

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<sup>1</sup> *Cost Recovery Mechanisms for Modernization of Natural Gas Facilities*, Proposed Policy Statement, 104 FERC ¶ 61,147 (2014) (Proposed Policy Statement).

and improvements, such as replacing old and inefficient compressors and leak-prone pipelines.

2. After review of the comments on the Proposed Policy Statement, the Commission has determined to establish a policy allowing interstate natural gas pipelines to seek to recover certain capital expenditures made to modernize system infrastructure through a surcharge mechanism, subject to conditions intended to ensure that the resulting rates are just and reasonable and protect natural gas consumers from excessive costs. The Commission recognizes, as many commenters note, that permitting pipelines to recover these expenditures through a surcharge or tracker departs from the requirement that interstate natural gas pipelines design their transportation rates based on projected units of service. We find on balance, however, that consideration of such mechanisms is justified if they are properly designed to limit a pipeline's recovery of such costs to those shown to modernize the pipeline's system infrastructure in a manner that enhances system safety, reliability and regulatory compliance, and are subject to conditions that ensure that the resulting rates are just and reasonable and protect natural gas consumers from excessive costs. Accordingly, we are adopting this Policy Statement to provide guidance and a framework as to how the Commission will evaluate pipeline proposals for recovery of infrastructure modernization costs. The Policy Statement adopts the five guiding principles from the Proposed Policy Statement as the standards a pipeline would have to satisfy for the Commission to approve a proposed modernization cost tracker or surcharge. Those criteria are (1) Review of Existing Base Rates; (2) Defined Eligible

Costs; (3) Avoidance of Cost Shifting; (4) Periodic Review of the Surcharge and Base Rates; and (5) Shipper Support.

3. Below we review the background that led to the development of the Proposed Policy Statement and this Policy Statement, summarize the comments on the Proposed Policy Statement, and discuss the applicability of the Policy Statement in general, and of the five conditions under the new Policy Statement, in light of those comments. As discussed below, the Commission intends that the standards a pipeline must satisfy to implement a cost modernization tracker or surcharge to be sufficiently flexible so as not to require any specific form of compliance but to allow pipelines and their customers to reach reasonable accommodations based on the specific circumstances of their systems. The Commission will thus evaluate any proposal for a modernization cost surcharge against those five standards on a case-by-case basis.

## **I. Background**

### **A. Safety and Environmental Initiatives**

4. As we noted in the Proposed Policy Statement, there have been several recent legislative actions, and resulting regulatory initiatives, to address natural gas pipeline infrastructure safety and reliability. In 2012, Congress passed the Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011.<sup>2</sup> That act includes requirements for the United States Department of Transportation (DOT) to take various actions to reduce the risk of future pipeline failures. Among other things, the Pipeline Safety Act requires the DOT to (1) consider expansion and strengthening of its integrity management

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<sup>2</sup> Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011, 49 U.S.C.S. 60101 (2012) (Pipeline Safety Act).

regulations, (2) consider requiring automatic shut-off valves on new pipeline construction, (3) require pipelines to reconfirm their Maximum Allowable Operating Pressures, and (4) conduct surveys to measure progress in plans for safe management and replacement of cast iron pipelines.

5. The Pipeline and Hazardous Materials Safety Administration (PHMSA) is in the process of implementing a multi-year Pipeline Safety Reform Initiative to comply with the Pipeline Safety Act's mandate to enhance the agency's ability to reduce the risk of future pipeline failures.<sup>3</sup> Prior to the Pipeline Safety Act's enactment, on August 25, 2011, PHMSA published an Advance Notice of Proposed Rulemaking (ANOPR) titled "Pipeline Safety: Safety of Gas Transmission Pipelines," which asked all stakeholders whether PHMSA should modify its existing integrity management and other pipeline safety regulations for interstate natural gas pipelines.<sup>4</sup> The ANOPR requested public comment on a range of topics related to current industry practices, the effects of enhanced regulations on safety and cost, and the best method to implement proposed regulations. For example, PHMSA sought comments on shut-off valves and remote controlled shut-off valves. In addition, PHMSA held a public leak detection and valve workshop on March 28, 2012.

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<sup>3</sup> Written Statement of Cynthia Quarterman, Administrator, PHMSA, before the U.S. House of Representatives, Committee on Transportation and Infrastructure, Subcommittee on Railroads, Pipelines, and Hazardous Materials (May 20, 2014), available at <http://transportation.house.gov/uploadedfiles/2014-05-20-quarterman.pdf> (Quarterman Testimony) at 3.

<sup>4</sup> *Pipeline Safety: Safety of Gas Transmission Pipelines*, (RIN: 2137-AE72), 76 FR 53,086 (August 25, 2011).

6. Also as part of the ANOPR process, PHMSA is considering expanding the definition of a High Consequence Area (HCA) so that more miles of pipeline may become subject to integrity management requirements.<sup>5</sup> PHMSA is also considering potential new rules related to repair criteria, including applying the integrity management repair criteria to non-HCAs; reassessing the repair criteria in areas where the population has grown since the pipeline was constructed; requiring methods to validate in-line inspection tool performance and qualifications of personnel; and implementing risk tiering such that repairs in an HCA have priority over repairs in a non-HCA. PHMSA held a Class Location Methodology workshop on April 16, 2014. Based on the comments from the ANOPR and the workshop, PHMSA “has started drafting a report to Congress on this issue.”<sup>6</sup>

7. PHMSA is also considering changes to its requirements that pipelines perform baseline and periodic assessments of pipeline segments in an HCA through one or a combination of in-line inspection, pressure testing, direct assessment of external and internal corrosion, or other technology demonstrated to accurately assess the condition of a pipe. In June 2013, as updated in September 2013, PHMSA issued a flow chart reflecting its draft Integrity Verification Process for natural gas pipelines.<sup>7</sup> To this end, PHMSA seeks information as to what anomalies have been detected using the various

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<sup>5</sup> An HCA is a location which is defined in the pipeline safety regulations as an area where pipeline releases have greater consequences to the safety, health and environment. Basically, these are areas with greater population density.

<sup>6</sup> Quarterman Testimony at 10.

<sup>7</sup> 78 FR 56,268 (Sept. 12, 2013).



assessment methods, and proposes to include criteria in the regulations that would require more rigorous corrosion control.

8. As we further noted in the Proposed Policy Statement, in addition to pipeline safety issues, there have been growing concerns about the emissions of greenhouse gases (GHG) in the production and transportation of natural gas. On April 15, 2014, the United States Environmental Protection Agency (EPA) issued a series of technical white papers, for which it has requested input from peer reviewers and the public, to determine how to best pursue reductions of emissions from, inter alia, natural gas compressors.<sup>8</sup> The EPA Compressor White Paper discusses the most prevalent types of compressors (reciprocating and centrifugal) and compressor emission data. As relevant to this Policy Statement, the EPA lays out several “mitigation options for reciprocating compressors involve[ing] techniques that limit the leaking of natural gas past the piston rod packing, including replacement of the compressor rod packing, replacement of the piston rod, and the refitting or realignment of the piston rod.”<sup>9</sup> The EPA also describes several mitigation options for centrifugal compressors to limit the leaking of natural gas “across the rotating shaft using a mechanical dry seal, or capture the gas and route it to a useful process or to a combustion device.”<sup>10</sup> If the EPA’s white papers result in the agency

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<sup>8</sup> See EPA, *Oil and Natural Gas Air Pollution Standards, White Papers on Methane and VOC Emission* (Apr. 15, 2014), available at <http://www.epa.gov/airquality/oilandgas/whitepapers.html>

<sup>9</sup> EPA Compressor White Paper at 29.

<sup>10</sup> *Id.* at 29-42.

imposing mitigation requirements on natural gas pipelines, the cost of such controls could be significant.<sup>11</sup>

9. In 2009, the EPA published a rule for mandatory reporting of GHG from sources that, in general, emit 25,000 metric tons or more of carbon dioxide equivalent per year in the United States.<sup>12</sup> This initiative, commonly referred to as the Greenhouse Gas Reporting Program (GHGRP), collects greenhouse gas data from facilities that conduct Petroleum and Natural Gas Systems activities, including production, processing, transportation and distribution of natural gas. Moreover, on November 14, 2014, the EPA issued a prepublication version of a final rule revising the Petroleum and Natural Gas Systems source category (Subpart W) and the General Provisions (Subpart A) of the GHGRP.<sup>13</sup> The final rule, which was effective January 1, 2015, imposes new requirements for the natural gas industry to monitor methane emissions and report them annually. On that same day, the EPA issued a prepublication version of a proposed rule to add calculation methods and reporting requirements for greenhouse gas emissions, as relevant here, from blow downs of natural gas transmission pipelines between

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<sup>11</sup> For example, the Interstate Natural Gas Association of America (INGAA) comments that one of its member companies “reported capital costs of \$865,000 for replacement of a wet seal” on a centrifugal compressor. *See* INGAA Comments on EPA Compressor White Paper at 13 (filed June 16, 2014). INGAA also commented on the EPA’s Leaks White Paper and noted that many factors could affect leak repair costs and that “the cost of the repair may far exceed the benefit of eliminating a small leak.” *See* INGAA Comments on EPA Leaks White Paper at 12-13 (filed June 16, 2014).

<sup>12</sup> Mandatory Reporting of Greenhouse Gases Rule, 74 FR 56,260 (Oct. 30, 2009). *See also* 40 CFR Pt. 98 (2014).

<sup>13</sup> Greenhouse Gas Reporting Rule: 2014 Revisions and Confidentiality Determinations for Petroleum and Natural Gas Systems, Docket Nos. EPA-HQ-OAR-2011-0512 and FR:-9918-95-OAR (Nov. 14, 2014).

compressor stations. The EPA also proposed confidentiality determinations for new data elements contained in the proposed amendments.<sup>14</sup>

10. As we recognized in the Proposed Policy Statement, one likely result of the Pipeline Safety Act and PHMSA's rulemaking proceedings is that interstate natural gas pipelines will soon face new safety standards requiring significant capital costs to enhance the safety and reliability of their systems. Moreover, pursuant to EPA's initiatives, pipelines may in the future face increased environmental monitoring and compliance costs, as well as potentially having to replace or repair existing natural gas compressors or other facilities.<sup>15</sup>

### **B. Existing Policy**

11. The Commission's regulations generally require that interstate natural gas pipelines design their open access natural gas transportation rates to recover their costs based on projected units of service.<sup>16</sup> This requirement means that the pipeline is at risk for under-recovery of its costs between rate cases but may retain any over-recovery. As the Commission explained in Order No. 436, this requirement gives the pipeline an incentive both to (1) "minimize costs in order to provide services at the lowest reasonable

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<sup>14</sup> See Greenhouse Gas Reporting Rule: 2015 Revisions and Confidentiality Determination for Petroleum and Natural Gas Systems, Docket ID No. EPA-HQ-OAR-2014-0831 (issued Nov. 14, 2014).

<sup>15</sup> On July 29, 2014, the Department of Energy (DOE) announced steps to help modernize natural gas infrastructure. Moreover, on July 31, 2014, Secretary of Energy Ernest Moniz sent a letter to the Chairman of the Commission recommending the Commission explore efforts to provide greater certainty for cost recovery for new investments in modernization of natural gas transmission infrastructure as part of the FERC's work to ensure just and reasonable natural gas pipeline transportation rates.

<sup>16</sup> 18 CFR 284.10(c)(2) (2014).

costs consistent with reliable long-term service”<sup>17</sup> and (2) “provide the maximum amount of service to the public.”<sup>18</sup>

12. Before the Pipeline Safety Act, the Commission held that capital costs incurred to comply with the requirements of pipeline safety legislation or with environmental regulations should not be included in surcharges,<sup>19</sup> except in the context of an uncontested settlement.<sup>20</sup> Noting that pipelines commonly incur capital costs in response to regulatory requirements intended to benefit the public interest, the Commission stated that recovering those costs in a tracking mechanism was contrary to the requirement to design rates based on estimated units of service because the use of cost-trackers undercuts the referenced incentives by guaranteeing the pipeline a set revenue recovery.

13. As we stated in the Proposed Policy Statement, however, the Commission recently approved, as part of a contested settlement, a tracker mechanism to recover substantial pipeline modernization costs that Columbia Gas Transmission, LLC (Columbia Gas)

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<sup>17</sup> *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, FERC Stats. & Regs., Regulations Preambles 1982-1985 ¶ 30,665, at 31,534 (1985).

<sup>18</sup> *Id.* at 31,537.

<sup>19</sup> See *Granite State Gas Transmission, Inc.*, 132 FERC ¶ 61,089, at P 11 (2010) (*Granite State*); *Florida Gas Transmission Co.*, 105 FERC ¶ 61,171, at PP 47-48 (2003) (*Florida Gas*).

<sup>20</sup> See e.g., *Granite State Gas Transmission, Inc.*, 136 FERC ¶ 61,153 (2011); *Florida Gas Transmission Co.*, 109 FERC ¶ 61,320 (2004). In 2012, the Commission again rejected a protested proposal that would allow a pipeline to recover regulatory safety costs through a tracker, but noted that PHMSA was in the early stages of developing regulations to implement the Pipeline Safety Act, and that the Commission would consider the need for further action as PHMSA’s implementation process moved forward. *CenterPoint Energy – Mississippi River Transmission, LLC*, 140 FERC ¶ 61,253, at P 65 (2012) (*MRT*).

demonstrated were necessary to ensure the safety and reliability of its pipeline system.<sup>21</sup> The Columbia Gas settlement outlined significant operational and safety issues resulting from the age and condition of Columbia Gas' system and the corresponding inability to monitor and maintain the system using efficient modern techniques.<sup>22</sup> The Commission found that approving the settlement would facilitate Columbia Gas' ability to make substantial capital investments necessary to correct significant infrastructure problems, and thus provide more reliable service while minimizing public safety concerns.

14. The Commission's determination in *Columbia Gas* thus established general parameters for pipelines to consider when seeking recovery of pipeline investments for modernization costs related to improving system safety and reliability. The tracker approved in that case was designed to recover pipeline modernization capital costs of up to \$300 million annually over a five year period. The Commission found that Columbia Gas' settlement included numerous positive characteristics that distinguished its cost tracking mechanism from those the Commission had previously rejected and that work to maintain the pipeline's incentives for innovation and efficiency. The key aspects of the settlement upon which the Commission relied to approve the tracker included the following.

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<sup>21</sup>*Columbia Gas Transmission, LLC*, 142 FERC ¶ 61,062 (2013) (*Columbia Gas*).

<sup>22</sup> Columbia Gas stated in that proceeding that over fifty percent of its regulated pipeline system was over 50 years old, that a significant portion of its system contained dangerous bare steel pipeline, that many of its compressors were also outdated, that many of its control systems were running on obsolete platforms, and that it was only able to inspect a small percentage of its system using modern in-line inspection tools.

15. First, Columbia Gas worked collaboratively with its customers to ensure that its existing base rates, to which the tracker would be added, were updated to be just and reasonable. This included a reduction in Columbia Gas' base rates and a refund to its customers.

16. Second, the settlement specifically delineated and limited the amount of capital costs that may go into the cost recovery mechanism. Moreover, the eligible facilities for which costs would be recovered through that mechanism were specified by pipeline segment and compressor station. Further, the pipeline agreed to spend \$100 million in annual capital costs as part of its ordinary system maintenance during the initial term of the tracker, which would not be recovered through the tracker. The Commission found that these provisions should assure that the projects whose costs are recovered through the tracker go beyond the regular capital maintenance expenditures the pipeline would make in the ordinary course of business and are critical to assuring the safe and reliable operation of Columbia Gas' system.

17. Third, the Commission found that a critically important factor to its approval of the settlement was the pipeline's agreement to a billing determinant floor for calculating the cost recovery mechanism, together with an agreement to impute the revenue it would achieve by charging the maximum rate for service at the level of the billing determinant floor before it trues up any cost underrcoveries. The Commission found these provisions should alleviate its historic concern that surcharges, which guarantee cost recovery, diminish a pipeline's incentive to be efficient and to maximize the service provided to the public. The Commission also found that these provisions protect the pipeline's shippers

from significant cost shifts if the pipeline loses shippers or must provide increased discounts to retain business.

18. Fourth, the surcharge was temporary and would terminate automatically on a date certain unless the parties agreed to extend it and the Commission approved the extension. Finally, the tracker was broadly supported by the pipeline's customers.

### **C. Proposed Policy Statement**

19. In the Proposed Policy Statement, the Commission found that the ultimate implementation of the recent initiatives described above, to improve natural gas infrastructure safety and reliability and to address environmental issues related to the operation of natural gas pipelines, is likely to lead to the need for interstate natural gas pipelines to make significant capital investments to modernize their systems. The Commission stated that in light of these developments, the Commission has a duty to ensure that interstate natural gas pipelines are able to recover the costs of these system upgrades in a just and reasonable manner that does not undercut their incentives to provide service in an efficient manner and protects ratepayers from unreasonable cost shifts.

20. Accordingly, the Commission proposed to establish a policy outlining the analytical framework for evaluating pipeline proposals for special rate mechanisms to recover infrastructure modernization costs necessary for the efficient and safe operation of the pipeline's system and compliance with new regulations. The Commission proposed to base the policy on the guiding principles established in *Columbia Gas*.

Pursuant to the Proposed Policy Statement, a pipeline proposal for a cost recovery tracker to recover pipeline modernization costs would need to satisfy five standards:

(1) **Review of Existing Rates** - the pipeline's base rates must have been recently reviewed, either by means of an NGA general section 4 rate proceeding or through a collaborative effort between the pipeline and its customers; (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 PHMSA, 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; (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; (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; and (5) **Shipper Support** – the pipeline must work collaboratively with shippers to seek shipper support for any surcharge proposal.

21. The Commission sought comments on the Proposed Policy Statement in general and on the five standards noted above. We also sought comments on several related issues, including whether if the Commission were to implement the instant modernization cost recovery policy, it should revise its policy on reservation charge crediting.<sup>23</sup>

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<sup>23</sup> Other questions included whether the costs of modifications to compressors for



#### **D. Comments**

22. The Commission received a variety of comments in response to the Proposed Policy Statement.<sup>24</sup> Generally, interstate pipelines and other natural gas facility owners and operators favor the proposed policy, commenting that the criteria for collecting modernization costs through a surcharge should be more flexible than contemplated in the Proposed Policy Statement. Shippers varied in supporting or opposing the proposal, with LDCs conditionally supporting it provided that surcharges are tailored to the individual circumstances of the pipeline, and are designed so as not to impose unreasonable cost burdens or risks on natural gas customers. Some marketers also favored a program allowing the implementation of surcharges for modernization costs. Other shippers, however, including industrials, municipals and supply end entities, oppose the proposed policy statement. Producers are especially opposed to the recovery of any modernization costs through a surcharge mechanism, claiming that to allow such

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the purpose of waste heat recovery should be eligible for recovery under a modernization surcharge, whether there are any capital costs associated with the expansion of the pipeline's existing capacity or its extension to serve new markets that may reasonably be included in the surcharge as necessary one-time capital expenditures to comply with safety and environmental regulations, whether capital costs incurred to minimize pipeline facility emissions be considered for inclusion in the surcharge, even if those costs are not expressly required to comply with environmental regulations, whether non-capital maintenance costs associated with environmentally sound operation of a compressor be considered for inclusion in the surcharge, and under what circumstances should the Commission permit a pipeline to include in the tracking mechanism the costs of additional projects not identified in the pipeline's original filing to establish the tracking mechanism?

<sup>24</sup> See Appendix for a list of those entities and persons that filed comments and/or reply comments to the Proposed Policy Statement.

recovery is contrary to the NGA and longstanding Commission policy. The individuals filing comments also oppose the Proposed Policy Statement for varying reasons.

23. Numerous entities from a wide spectrum of industry interests filed in favor of the Proposed Policy Statement, supporting properly limited tracker or surcharge mechanisms to recover modernization costs.<sup>25</sup> Some advocate granting pipelines added flexibility to comply with the five standards necessary to establish such trackers.<sup>26</sup> Others filing in favor of the Commission's proposed policy state that pipeline cost recovery mechanisms must be tailored to the individual circumstances of the pipeline, and be designed so as not to impose unreasonable cost burdens or risks on natural gas customers.<sup>27</sup> Various pipeline customers generally support the development of simplified mechanisms for the recovery of costs of modernizing pipeline assets to enhance safety and reliability subject to conditions, commenting that the costs to be recovered should be limited to capital improvements for safety purposes and for compliance with environmental regulations.<sup>28</sup>

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<sup>25</sup> Those commenting in favor include the DOE; PHMSA; the Interstate Natural Gas Association of America (INGAA); Kinder Morgan Interstate Pipelines (Kinder Morgan); Southern Star Central Gas Pipeline, Inc. (Southern Star); Boardwalk Pipeline Partners, LP (Boardwalk); American Midstream (AlaTenn), LLC (American Midstream); the American Gas Association (AGA); the North Carolina Public Utility Commission (NCUC); the Kansas Corporation Commission (KCC); the Michigan Public Service Commission (Michigan PSC); the Tennessee Valley Authority (TVA); and the Environmental Defense Fund, the Conservation Law Foundation, and Sustainable FERC Project (collectively Environmental Commenters).

<sup>26</sup> See, e.g., INGAA Comments at 2, Boardwalk Comments at 4, Kinder Morgan Comments at 5.

<sup>27</sup> See, e.g., AGA Comments at 1 Laclede Comments at 1.

<sup>28</sup> Xcel Energy Services (XES) Comments at 2; Wisconsin Electric and Wisconsin Gas Comments at 4.

Others state that modernization cost recovery trackers should include safeguards to ensure that pipelines are not permitted to pass through costs while evading shipper protections traditionally afforded by NGA section 4 rate review.<sup>29</sup> Others support the Proposed Policy Statement as a method for enhancing certainty and the ability of interstate pipelines to recover costs for augmenting the efficient and safe operation of their respective systems.<sup>30</sup>

24. In contrast to the pipelines' and other comments in support of the proposed policy, other commenters, particularly those representing producers, marketers, municipal gas companies, and industrial users of natural gas, expressed strong opposition to the recovery of modernization costs through a tracker.<sup>31</sup> Opponents' claims that additional cost-recovery guarantees to incentivize compliance with mandatory environmental and

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<sup>29</sup> Calpine Corporation (Calpine ) Comments at 1.

<sup>30</sup> Environmental Commenters Comments at 3-5.

<sup>31</sup> Those filing comments opposing the Proposed Policy Statement include the Natural Gas Supply Association (NGSA ), Industrial Energy Consumers of America (IECA), the American Forest and Paper Association (AF&PA), Process Gas Consumers (PGC), the American Public Gas Association (APGA), the Independent Petroleum Association of America (IPAA), Indicated Shippers (Anadarko Energy Services Company, Apache Corporation, BP Energy Company, Chevron U.S.A. Inc., ConocoPhillips Company, Cross Timbers Energy Services, Inc., Direct Energy Business, LLC, ExxonMobil Gas & Power Marketing Company, a division of Exxon Mobil Corporation, Fieldwood Energy LLC, Hess Corporation, Marathon Oil Company, Noble Energy, Inc., Occidental Energy Marketing, Inc., Shell Energy North America (US), L.P., SWEPI LP, and WPX Energy Marketing, LLC), the El Paso Municipal Customer Group (EPMCG), Western Tennessee Municipal Group, the Jackson Energy Authority, City of Jackson, Tennessee, and Kentucky Cities (together, Cities), Independent Oil & Gas Association of West Virginia, Inc. (IOGA), the Municipal Defense Group (MDG), Deep Gulf Energy LP (Deep Gulf), Energy XXI (Bermuda) Ltd. (Energy XXI), EPL Oil & Gas, Inc. (EPL), and M21K, LLC (M21K) (collectively Energy XXI), and Helis Oil & Gas, LLC (Helis) and Walter Oil & Gas Corporation (Walter).

safety laws is misplaced, and that cost trackers are inconsistent with section 284.10(c)(2) of the Commission's regulations, which requires that transportation rates be based on estimated units of service so that the pipeline is at risk for cost under-recovery.<sup>32</sup>

Opponents also claim that a cost modernization surcharge would be contrary to longstanding Commission policy and precedent, noting that the Commission has consistently rejected maintenance, compliance, and safety cost trackers, because they guarantee cost recovery without taking into account the benefits of cost reductions in other areas and/or increases in throughput affecting base rate revenues.<sup>33</sup> Those opposing the Proposed Policy Statement further claim that the five standards do not provide the consumer protections afforded under section 4 of the Natural Gas Act (NGA), and that the record lacks a showing that pipelines cannot recover such costs through NGA section 4 rate cases.<sup>34</sup> Opponents also claim that the Proposed Policy Statement is premature, because PHMSA and the EPA have not yet issued new regulations.<sup>35</sup>

## **II. Discussion**

### **A. Adoption of Policy Statement**

25. After reviewing the comments filed on the Proposed Policy Statement, the Commission has determined to establish a policy allowing interstate natural gas pipelines to seek to recover certain capital expenditures made to modernize system infrastructure in

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<sup>32</sup> See, e.g., NGSA Comments at 3.

<sup>33</sup> NGSA Comments at 10-11, APGA Comments at 2-4, Indicated Shippers Comments at 5-18 .

<sup>34</sup> APGA Comments at 2-4, NGSA Comments at 7-8.

<sup>35</sup> NGSA Comments at 8-9.

a manner that enhances system reliability, safety and regulatory compliance through a surcharge mechanism, subject to conditions intended to ensure that the resulting rates are just and reasonable and protect natural gas consumers from excessive costs. While we recognize that allowing pipelines to recover these expenditures through a surcharge or tracker departs from the requirement that interstate natural gas pipelines design their transportation rates based on projected units of service, we find on balance that consideration of such mechanisms is justified in order to provide an enhanced opportunity to recover the substantial capital costs some pipelines are likely to incur to replace aging, unsafe and leak-prone facilities. The Policy Statement provides a framework for how the Commission will evaluate pipeline proposals for recovery of infrastructure modernization costs, and guidance as to how it will evaluate such proposals in accordance with the five adopted standards.

26. As the comments in support of the Commission's Proposed Policy Statement indicate, establishment of a policy to permit enhanced recovery of modernization costs is in the public interest and necessary to address concerns regarding the safety of the Nation's natural gas infrastructure and the safe operation of natural gas pipelines, as well as environmental issues related to emissions. With regard to safety and reliability, as OPS comments, recent pipeline accidents, including the September 2010 pipeline rupture in San Bruno, California, demonstrate the potential consequence of aging pipeline facilities that are not properly repaired, rehabilitated or replaced. OPS states that 59 percent of existing natural gas pipelines were built before 1970 and 69 percent of existing natural gas pipelines were built before 1980. DOE notes that more than half of

the country's natural gas transmission and gathering infrastructure is over 40 years old. As OPS points out, while aging pipelines are not inherently risky, older facilities have been exposed to more threats and were likely constructed without the benefit of today's safety standards or quality materials.

27. To address these concerns, Congress passed the Pipeline Safety Act mandating that DOT take various actions to improve the safety of interstate natural gas pipelines, including requiring testing to verify natural gas pipelines' maximum allowable operating pressure, considering expansion and strengthening of its integrity management regulations, and considering requiring automatic shut-off valves on new pipeline construction. The need to address pipeline safety is also supported by OPS' comments that multiple recommendations from the National Transportation Safety Board and the General Accounting Office reinforce the need to ensure that the Nation's pipeline infrastructure is sound and reliable. The DOE states in its comments that the Commission's proposal is "aligned with goals of DOE's Initiative to Help Modernize Natural Gas Transmission and Distribution Infrastructure as well as government-wide efforts to improve pipeline safety and enhance the resilience of our nation's critical infrastructure."<sup>36</sup> DOE asserts that offering streamlined cost recovery options will provide an overdue incentive for pipelines to invest in new equipment and upgrades that will improve safety, boost energy efficiency and reduce emissions.

28. In addition to pipeline safety issues, there have been growing concerns about the emissions of GHG in the production and transportation of natural gas. As we noted in the

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<sup>36</sup> DOE Comments at 1.

Proposed Policy Statement, in 2014, the EPA issued a series of technical white papers to determine how to best pursue reductions of emissions from, inter alia, natural gas compressors. The EPA Compressor White Paper lays out several “mitigation options for reciprocating compressors and centrifugal compressors to limit the leaking of natural gas....”<sup>37</sup> Further, in 2009, the EPA published its rule for mandatory reporting of greenhouse gas emissions. The resulting GHGRP collects greenhouse gas data from facilities that conduct Petroleum and Natural Gas Systems activities, including production, processing, transportation and distribution of natural gas. Moreover, the EPA issued a final rule effective January 1, 2015, imposing new requirements for the natural gas industry to monitor methane emissions and report them annually.

29. Further, the use of natural gas as a fuel for compressors adds to the amount of carbon dioxide emissions.<sup>38</sup> DOE also estimates that over 110 Bcf of natural gas is lost annually through routing venting and equipment leaks. DOE states that a streamlined cost recovery mechanism such as that proposed here for voluntary emissions reductions can benefit pipelines and their customers. According to DOE, infrastructure improvements that will increase compressor efficiency and reduce venting and leaking of methane emissions will also result in product conservation and thus cost savings.<sup>39</sup>

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<sup>37</sup> EPA *Oil and Natural Gas Sector Compressors* (Apr. 2014) at 29, available at <http://www.epa.gov/airquality/oilandgas/2014papers/20140415compressors.pdf> at 29.

<sup>38</sup> See DOE Comments at 4, stating that EIA estimates that 728 billion cubic feet (Bcf) of natural gas was used as fuel by compressor stations operating at natural gas transmission and storage facilities in the United States in 2012, resulting in 39 million metric tons of CO<sub>2</sub> emissions.

<sup>39</sup> DOE Comments at 5.

30. The safety and reliability of the nation's natural gas infrastructure, and the operation of those facilities in an efficient manner that minimizes environmental impact, are issues of public interest, and the development of mechanisms to encourage investments in infrastructure improvements and upgrades to enhance the efficient and safe operation of natural gas pipeline furthers that interest. As we recognized in the Proposed Policy Statement, one likely result of the recent regulatory safety and environmental initiatives is that interstate natural gas pipelines will face increased costs related to those rules and programs. Notably, while the opponents of the policy assert its implementation is premature because the amount of those costs is still unknown, they do not dispute that pipelines are likely to incur substantial costs to address these issues. In light of the referenced regulatory developments, the Commission has a duty to ensure that interstate natural gas pipelines are able to recover the costs of these required system upgrades in a just and reasonable manner that does not undercut their incentives to provide service in an efficient manner and also protects ratepayers from unreasonable cost shifts.

31. In an effort to ensure that consumers are protected against potential effects of any modernization cost trackers or surcharges, the Final Policy adopts the five guiding principles proposed in the Proposed Policy Statement as the standards a pipeline would have to satisfy for the Commission to approve a proposed modernization cost tracker or surcharge. Those standards are (1) a requirement for a review of the pipeline's existing base rates by means of an NGA general section 4 rate proceeding, a cost and revenue study, or through a collaborative effort between the pipeline and its customers; (2) a



requirement that the costs eligible for recovery through the tracker or surcharge must generally be limited to one-time capital costs incurred to modify the pipeline's existing system to comply with safety or environmental regulations or other federal or state government agencies, or other capital costs shown to be necessary for the safe, reliable, and/or efficient operation of the pipeline, and the pipeline must specifically identify each projects' costs or capital investment to be recovered by the surcharge;<sup>40</sup> (3) a prohibition against cost shifting, requiring that the pipeline design any 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; (4) a requirement that 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; and (5) a requirement that the pipeline work collaboratively with shippers to seek shipper support for any surcharge proposal. These standards will act as protections against pipelines unilaterally recovering costs through a tracker that do qualify as the type intended to meet the goals of the policy. They will also require any pipeline seeking a modernization cost tracker to demonstrate to the Commission and its customers that its current base rates are just and reasonable, and provide flexibility for the parties to pursue options to reach agreement on processes to ensure that those rates and the surcharge rate remain just and reasonable. They will also prevent shifting of additional costs to captive customers.

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<sup>40</sup> As discussed below, the Commission may consider pipeline proposals to include certain limited non-capital maintenance costs in a modernization cost tracker.

32. Opponents of the proposed policy argue that adopting the Proposed Policy Statement would be contrary to the NGA, longstanding Commission policy and rate regulation principles, and that the Commission has neither justified this departure from current policy nor demonstrated why it is necessary. NGSA, Indicated Shippers, the IPAA and others argue that the NGA requires that pipelines be afforded an “opportunity” to recover their reasonable costs but that trackers guarantee cost recovery in violation of that principle.<sup>41</sup> They assert this guaranteed cost recovery, absent any accounting of cost savings, is the reason Commission has for years disfavored cost recovery trackers, because it eliminates the pipeline’s risk and correspondingly any incentive for the pipeline to be efficient and to provide effective service. They note that the Commission’s rejections of such mechanisms include proposals addressing circumstances very similar to those that would be covered under the new policy, and that the Commission itself has stated that it has only approved the use of trackers that were agreed to in settlements.<sup>42</sup> They further claim that there has been no change in the law or the rationale underlying the Commission’s longstanding position that would warrant the policy modification proposed.

33. As we stated above, the Commission acknowledges that the policy adopted in this Policy Statement departs from the general rate policy in our regulations that interstate natural gas pipelines design their transportation rates based on projected units of service. We disagree, however, that there have been no changes that may result in tracker

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<sup>41</sup> See, e.g., NGSA Comments at 10, Indicated Shippers’ Comments at 3.

<sup>42</sup> See, e.g., Indicated Shippers’ Comments at 5– 11, and cases cited therein.

mechanisms being just and reasonable in certain circumstances and subject to appropriate controls.<sup>43</sup> As discussed above, the increased concerns with pipeline safety reflected in the Pipeline Safety Act, together with the recent DOE, PHMSA, and EPA initiatives to improve natural gas infrastructure safety and reliability and to address environmental issues will result in certain increased capital and compliance costs for pipelines. In light of these developments the Commission has a duty to ensure that interstate natural gas pipelines are able to recover the reasonable cost of these system upgrades in a just and reasonable manner that does not undercut their incentives to provide service in an efficient manner and protects ratepayers from unreasonable cost shifts.

34. We also disagree with commenters' contentions that allowing modernization cost trackers will eliminate the pipeline's risk of cost under-recovery and thereby reduce pipelines' incentives to be efficient and to provide effective service, contrary to goals of our general policy of requiring that rates be based on projected units of service. As discussed in more detail below, the costs included in a modernization cost tracker will generally be limited to one-time capital costs to improve the safe, reliable, and/or efficient operation of the pipeline. Thus, pipelines will continue to recover all other costs in their base rates pursuant to the Commission's ordinary ratemaking policies. Therefore, pipelines will continue to be at risk between rate cases for recovery of their operating and maintenance (O&M) costs, the overall return on non-modernization capital costs, the depreciation allowance related to those costs, and all other costs included in their base

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<sup>43</sup> Proposed Policy Statement, PP 18-20.

rates.<sup>44</sup> This will give pipelines an incentive to operate their systems as efficiently as possible, consistent with Commission policy. Moreover, the pipelines will have the burden of showing that all costs included in a modernization cost tracker are prudent and consistent with the Commission's eligibility standards for including costs in such a tracker. This will give the Commission and all interested parties an opportunity to review whether the subject capital investments are prudent and required for the safe and efficient operation of the pipeline.

35. Several commenters, including Indicated Shippers, contend that the Proposed Policy Statement is contrary to Commission precedent prohibiting tracker mechanisms for regulatory obligations, and discuss a number of cases where we had rejected pipeline proposals for regulatory compliance cost trackers.<sup>45</sup> As noted above, the Commission does not disagree that we have previously rejected proposed tariff provisions that would establish trackers to recover costs not wholly dissimilar to those contemplated by the Policy Statement. None of those proposals, however, included conditions and safeguards to protect shippers and consumers of the sort that the *Columbia* settlement did, and which we adopt here as conditions for a modernization cost tracker.

36. As we noted in our order approving Columbia Gas' surcharge, Columbia Gas' proposal contained numerous benefits and protections agreed to with its shippers that

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<sup>44</sup> This fact distinguishes surcharges that may be approved under the Policy Statement from *ANR Pipeline Co.*, 70 FERC ¶ 61,143 (1995), where we rejected ANR's proposed base rate cost-of-service tracker, which sought to recover all of the pipeline's cost of service, as contrary to our regulations.

<sup>45</sup> See, e.g., Indicated Shippers' Comments at 5– 11.

distinguished it from our orders rejecting tracker proposals.<sup>46</sup> Notably the development of Columbia Gas' tracker for costs to make necessary improvements and upgrades to its system began with Columbia Gas and its shippers engaging in a collaborative effort to review Columbia Gas' current base rates, leading to Columbia Gas' agreement to make significant reductions to its base rates and to provide refunds to its shippers.<sup>47</sup> Further the settlement identified by pipeline segment and compressor station, the specific Eligible Facilities for which costs may be recovered, and limited the amount of capital costs and expenses for each such project.<sup>48</sup> It also established a billing determinant floor for calculating the surcharge imputing the revenue it would achieve by charging the maximum rate for service at the level of billing determinant floor before it trues up any cost under-recoveries.<sup>49</sup> Further, Columbia Gas' tracker is temporary, and terminates by

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<sup>46</sup> *Columbia Gas*, 142 FERC ¶ 61,062 at PP 22-27.

<sup>47</sup> *Id.* P 22.

<sup>48</sup> We noted that this distinguished *Columbia Gas* from the surcharge mechanisms we rejected in *Florida Gas*, 105 FERC ¶ 61,171 at PP 47-48 and *MRT*, 140 FERC ¶ 61,253, which contained only general definitions of what type of costs would be eligible for recovery, leaving the pipeline considerable discretion as to what projects it would subsequently propose to include in the surcharge and creating the potential for significant disputes concerning the eligibility of particular projects.

<sup>49</sup> As we also noted, the surcharge mechanisms proposed in *Florida Gas*, *MRT*, and *Granite State Gas Transmission, Inc.*, 132 FERC ¶ 61,089 (2011), did not include a comparable mechanism to protect captive customers from significant cost shifts. The surcharges proposed in the other cases cited by Indicated Shippers as examples of the Commission's policy against surcharges and trackers, including *ANR Pipeline Company*, 70 FERC ¶ 61,143, and *El Paso Natural Gas Co.*, 112 FERC ¶ 61,150 (2005), also did not contain the safeguards or customer protections included in the Columbia Gas settlement and implemented for the Final Policy. Similarly, the greenhouse gas cost recovery mechanism we rejected as premature in *Southern Natural Gas Co.*, 127 FERC ¶ 61,003 (2009), did not provide safeguards of the type required by this Policy Statement. Likewise, our rejection in *Tennessee Gas Pipeline Co., LLC* and *Kinetica Energy*

its terms subject to extension requiring the consent of all parties, and thus will not become a permanent part of Columbia Gas' rates. Finally, the tracker settlement was supported or not opposed by virtually all of Columbia Gas' shippers.

37. The Commission's approval of any modernization cost tracker or surcharge will require a showing by the pipeline of the same types or benefits that distinguished Columbia Gas' tracker from those we had rejected, and thus comments that the Policy Statement would represent a complete reversal of Commission policy are exaggerated. This Policy Statement does not provide pipelines with any ability to establish a modernization surcharge other than in the manner and with the same protections Commission has already approved in *Columbia Gas*. The analysis to be performed under this Policy Statement will be substantially similar to that undertaken to find that Columbia Gas' modernization cost recovery mechanism was just and reasonable and benefitted all interested parties. It will be incumbent on a pipeline requesting a modernization cost tracker to demonstrate that its proposal includes the types of benefits that the Commission found maintained the pipeline's incentives for innovation and efficiency, and distinguished Columbia Gas' modernization cost tracking mechanism from those the Commission had previously rejected.

38. Further, the requirements that a pipeline proposing a tracker mechanism must establish that its base rates are just and reasonable and that there be provision for a

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*Express, LLC*, 143 FERC ¶ 61,196 (2013) of a proposed hurricane surcharge that we found to be overly broad because it sought to recover costs outside those caused by hurricanes, storms or other natural disasters, did not include any of the referenced protections. *Id.* P 225.

periodic review of surcharge and base rates should alleviate concerns that the Final Policy will result in pipelines not filing NGA section 4 rate proceedings and thus being insulated from rate review. APGA points to examples of interstate pipelines having not filed NGA section 4 rate cases in over a decade and asserts that pipelines generally file rate cases very infrequently, thus depriving customers of an opportunity to review all the pipeline's rates for lengthy periods. However, the fact that a pipeline desiring a modernization cost surcharge must establish that its existing base rates are just and reasonable should increase customer opportunities to obtain review of all the pipeline's rates. As discussed in more detail below, if a pipeline's shippers protest a filing to establish a modernization cost tracker on the ground that the pipeline has not shown that its base rates are just and reasonable, the Commission will establish appropriate procedures to enable it to make a finding, based on substantial evidence, whether the base rates are just and reasonable. Moreover, while offsetting decreases in cost items will not be reflected in rates during the time between the effective date of the surcharge and the first periodic review, that periodic review will provide an opportunity for any offsetting cost reductions to be reflected in rates in order to assure that the base rates and any continued surcharge are just and reasonable.

39. Accordingly, given the heightened sensitivity to pipeline safety and environmental related concerns, and based on the benefits realized from the *Columbia Gas* settlement, which enabled the pipeline to efficiently make necessary upgrades and repairs to maintain the safety and reliability of its system while ensuring that its shippers were protected against cost shifts and other potential pitfalls commonly associated with trackers, the

Commission has determined to modify its policy to permit the use of a tracker mechanism in the limited circumstances provided for under the Policy Statement, which will inure to the public interest.

40. As noted, several commenters advocate that the Commission's modernization cost recovery policy contain narrowly drawn conditions and require strict adherence to those conditions to obtain approval for such a mechanism. As many others comment, however, the Policy Statement will be most effective and efficient if designed according to flexible parameters that will allow for accommodation of the particular circumstances of each pipeline's circumstances. Maintaining a transparent policy with flexible standards will best allow pipelines and their customers to negotiate just and reasonable, and potentially mutually agreeable, cost recovery mechanisms to address the individual safety, reliability, regulatory compliance and other infrastructure issues facing that pipeline. For example, while we will require that any pipeline seeking a modernization cost tracker demonstrate that its existing base rates are just and reasonable, as some commenters point out, there may not be a need in all circumstances for a pipeline to file and litigate an NGA section 4 rate proceeding to make such a showing. There may be less costly and less time consuming alternatives. As we stated in the Proposed Policy Statement, the Commission proposed the new policy to "ensure that existing Commission ratemaking policies do not unnecessarily inhibit interstate natural gas pipelines' ability to expedite needed or required upgrades and improvements."<sup>50</sup> Thus, while we are imposing specific conditions on the approval of any proposed modernization cost tracker, leaving the

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<sup>50</sup> Proposed Policy Statement at P 9.



parameters of those conditions reasonably flexible will be more productive in addressing needed and required system upgrades in a timely manner. Further, consistent with this approach, the Commission will be able to evaluate any proposals in the context of the specific facts relevant to the particular pipeline system at issue.

41. Accordingly, the Commission finds that modification of our previous policy is warranted to allow for consideration of pipeline proposals for modernization cost tracking mechanisms as a way for pipelines to recover those costs in a timely manner while maintaining the safe and efficient operation of pipeline systems. As we discuss more fully below, however, the Commission's approval of any such mechanism will be subject to the Commission's scrutiny of the proposal and its evaluation of the stated conditions, which will work to protect the pipeline's customers and ratepayers against potential adverse effects of any tracker. That analysis will be on a case-by-case basis, and thus will take into account the specific circumstances of the individual pipeline and its customers. Any shippers opposing the pipeline's proposal will have a full opportunity to express their position on specific aspects of the proposed mechanism at that time, and the pipeline will need to engage in a collaborative effort to garner significant shipper support before the Commission will approve a tracker proposal.

42. Opponent commenters also claim that there is no need for the Proposed Policy Statement because there are sufficient longstanding procedural options and mechanisms in place to achieve the Commission's cost recovery goals in this initiative, including NGA rate cases and the Commission's settlement process. Again, the Commission does not dispute that there are existing procedures that provide pipelines an opportunity to

recover their just and reasonable costs. The instant Policy Statement, however, is meant to address imminent and foreseeable developments related to the safety and reliability of the natural gas interstate pipeline system. Thus, we find it warranted in the limited circumstances under which the Commission would approve a modernization cost surcharge, to allow recovery through a tracker of those costs expended to replace old and inefficient compressors and leak-prone pipes and performing other infrastructure upgrades and improvements to enhance efficient and safe operation of their pipeline systems.

43. We disagree with comments that the Policy Statement is premature because the regulatory initiatives prompting the new policy are not yet finalized, and thus the projected increased costs are unknown and speculative. Although the commenters are correct that the regulatory initiatives that are the impetus for the Final Policy are not final, there is little debate that some form of them will be in place eventually, and that they will result in increased costs to pipelines. It will take pipelines a significant amount of time to review and analyze their systems to determine if there are portions that need immediate attention, and whether the projects they identify in their review are of the sort that would be eligible for a cost modernization tracker. It is reasonable for the Commission to establish this policy in advance of the final initiatives to provide guidance to the industry as to how the Commission will analyze pipeline's proposals to address these questions. Further, this Policy Statement will be beneficial to those pipelines that decide to take a

proactive approach to ensuring system safety and reliability by conducting system and rate reviews prior to governmental mandates requiring them to do so.<sup>51</sup>

**B. Standards for Modernization Cost Trackers or Surcharges**

44. As discussed, this Policy Statement permits pipelines to seek Commission approval of modernization cost trackers or surcharges to recover costs associated with performing infrastructure upgrades and replacements in a manner that will enhance the efficient and safe operation of their pipelines. The Commission's evaluation and approval of any proposed modernization cost tracker will require the proposing pipeline to satisfy the five standards from the Proposed Policy Statement. We discuss the application of those standards under the Policy Statement below.

**1. Review of Existing Rates**

45. Under the first standard proposed by Commission, a pipeline proposing a tracker mechanism must establish that the base rates to which any surcharges would be added are just and reasonable and reflect the pipeline's current costs and revenues as of the date of the initial approval of the tracker mechanism. The Commission proposed that the pipeline could do this in various ways, including (1) making a new NGA general section 4 rate filing, (2) filing a cost and revenue study in the form specified in section 154.313 of the Commission's regulations showing that its existing rates are just and reasonable, or (3) through a collaborative effort between the pipeline and its

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<sup>51</sup> For the same reasons, we decline to adopt NGSA's suggestion in its reply comments that we defer issuing this Policy Statement until after PHMSA and EPA issue final regulations.

customers. The Commission sought input on these or other acceptable approaches for pipelines to demonstrate that existing base rates are just and reasonable.

**a. Comments**

46. Some commenters suggested that the Commission require pipelines to file an NGA section 4 rate case as part of any proposed capital cost tracker. IPAA and the NGSA argue that adoption of a capital cost tracker must require a comprehensive review of the pipeline's base rates and cost of service through an NGA general section 4 rate filing with hearing procedures that include discovery and the Commission's Office of Administrative Litigation staff. TVA states that it feels strongly that any such review would be best accomplished through the thorough and objective analysis of a section 4 rate filing. PEG argues that pipelines should be required to restate all of their rates under NGA section 4 within three years prior to a surcharge. Laclede also argues that a cost and revenue study is not a reasonable substitute for an NGA section 4 filing.

47. The NYPS, the NCUC and the KCC agree that a pipeline's base rates must be reviewed through a full NGA general section 4 rate proceeding or through a collaborative effort between the pipeline and its customers, and oppose allowing pipelines to only file a cost and revenue study. Cities and Municipals commented that the collaborative effort standard should be abandoned in favor of a clear standard based on a section 4 general rate case where all the pipeline's costs can be reviewed. Others comment that the pipeline's rates should have been reviewed and approved within a certain time-frame (3 or 4 years) prior to the implementation of a surcharge, and that the Commission should require pipelines with such surcharges to file rate cases on a regular basis (every 3 years).

48. Others comment, however, that a full NGA section 4 rate case review would be too cumbersome for the purpose of efficiently implementing appropriate cost modernization surcharges. INGAA argues that the Commission should remain open to alternative approaches to justifying existing base rates. Recognizing that rate cases, cost and revenue studies and recent rate settlements are all appropriate methods for determining that existing base rates are just and reasonable, INGAA asserts that these are not the only circumstances in which relevant rates may be reviewed and approved by the Commission, and that the Commission should remain open to other possibilities. For example, INGAA argues that the Commission should allow a pipeline to introduce a cost recovery mechanism when such a proposal is broadly supported by shippers, regardless of whether the settlement addresses other rate issues, or when the pipeline has an upcoming obligation to file a general NGA section 4 rate filing, a cost and revenue study, or restatement or re-justification of its rates as the result of a settlement provision. INGAA further states that a recent review of a pipeline's base rates may be irrelevant to the analysis of a cost tracker when all, or the vast majority, of a pipeline's shippers have entered into long-term negotiated rate agreements accepted by the Commission. INGAA asserts that a cost recovery mechanism also may be appropriate when the Commission recently has reviewed and approved a pipeline's base rates in an NGA section 7 proceeding to ensure that new pipelines are not placed at a disadvantage.

49. Calpine recommends the review of a pipeline's base rates occur through an informal collaborative process and not a general section 4 rate case. APGA argues that permitting the rate review to occur through a new NGA general section 4 rate filing or a

cost and revenue study, as opposed to requiring a pre-negotiated base rate settlement, would eliminate the benefit of the *Columbia Gas* case, namely negotiations among the pipeline and its customers regarding substantial rate reductions and refunds, which led to agreement on a just and reasonable rate level. XES suggests having pipelines file a cost and revenue study because it would allow pipeline to file an ‘unadjusted’ report so that current costs and revenues may be determined. The Environmental Commenters express concern that requiring a general section 4 rate filing as a prerequisite could be inapposite to the regulatory efficiency purposes of a cost tracker.

50. American Midstream requests that the Commission clarify that to be eligible for the special cost recovery mechanism through a limited section 4 filing, pipelines or at least small pipelines like American Midstream need only demonstrate that they are not recovering their reasonable costs under their existing recourse rates, and will not be required to file testimony specifically supporting and explaining each of the schedules required by section 154.313 of the Commission’s regulations.

**b. Determination**

51. Under this Policy Statement, any pipeline seeking a modernization cost recovery tracker must demonstrate that its current base rates to which the surcharge would be added are just and reasonable. This is necessary to ensure that the overall rate produced by the addition of the surcharge to the base rate is just and reasonable, and does not reflect any cost over-recoveries that may have been occurring under the preexisting base rates.

52. In the Proposed Policy Statement, we stated that the pipeline could demonstrate its base rates are just and reasonable by filing a NGA section 4 general rate proceeding, a cost and revenue study in the form specified in section 154.313 of the Commission's regulations, or through some other collaborative effort between the pipeline and its customers. In applying the Final Policy we decline to require that such rate review be conducted only through an NGA section 4 rate proceeding. The type of rate review necessary to determine whether a pipeline's existing rates are just and reasonable is likely to vary from pipeline to pipeline. For example, it may be possible for some pipelines to demonstrate that their existing base rates are under-recovering their full cost of service and that a section 4 rate filing would likely lead to an increase in their base rates through a showing short of filing an NGA section 4 rate proceeding. Therefore, we remain open to considering alternative approaches for a pipeline to justify its existing rates.

53. We note, however, that any pipeline seeking a modernization cost surcharge will need to satisfy the Commission that its current base rates are no higher than a just and reasonable level. To that end, we encourage any pipeline seeking approval of a modernization cost tracker to engage in a full exchange of information with its customers to facilitate that process. If a voluntary exchange of information fails to satisfy interested parties that a pipeline's base rates are just and reasonable, the Commission will establish appropriate procedures to enable resolution of any issues of material fact raised with respect to the justness and reasonableness of the pipeline's base rates based upon substantial evidence on the record. In this regard, the Commission notes that, if the pipeline files a contested settlement concerning its base rates, the Commission would

consider whether to approve the settlement pursuant to the approaches discussed in *Trailblazer Pipeline Co.*<sup>52</sup>

## 2. Defined Eligible Costs

54. In the Proposed Policy Statement, we stated that to qualify as “eligible costs” for recovery under a cost modernization tracker, costs must be limited to one-time capital costs incurred to modify the pipeline’s existing system or to comply with safety or environmental regulations issued by PHMSA, 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. The Commission also recognized that interstate natural gas pipelines routinely make capital investments related to system maintenance in the ordinary course of business, and the Commission stated that such routine capital costs could not be included in a cost modernization tracker.

55. The Commission also proposed to require that each pipeline specifically identify each capital investment to be recovered by the surcharge, the facilities to be upgraded or installed by those projects, and an upper limit on the capital costs related to each project to be included in the surcharge. The Commission stated that this would allow an upfront determination that the costs are eligible for recovery through the tracker and avoid later disputes about which costs or facilities qualify for such recovery.

56. The Commission also asked several questions concerning what costs should be eligible for recovery in a tracker.

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<sup>52</sup> 87 FERC ¶ 61,110, at 61,438-41 (1999). *See e.g.*, *Texas Gas Transmission, LLC*, 126 FERC ¶ 61, 235 (2009); *Devon Power LLC*, 117 FERC ¶ 61,133 (2006).



**a. Comments**

57. The majority of commenters agree that proponents of a modernization cost recovery tracking mechanism should specify the costs and identity of projects to be recovered pursuant to any such mechanism and limit the recovery of those costs. AGA argues that pipelines should be required to clearly specify the investments which will be recovered through the tracking mechanism, and that shippers should have the ability to challenge the inclusion of projects or costs as part of the collaborative process. Several commenters, including NGSAs, IOGAs, XES, and Environmental Commenters note that facilities eligible for cost recovery under a capital cost tracker should be limited to modification of the pipeline's existing system for reliability, safety, or environmental compliance, and that there be a strict distinction between such facilities and maintaining the pipeline system in the ordinary course of business. NGSAs argue that eligible tracked costs for recovery in a surcharge should be strictly limited to one-time capital costs related solely to compliance with the incremental requirements of future PHMSA and EPA regulations, as opposed to the inclusion of ordinary capital maintenance costs. EPMCG states the Proposed Policy fails to explain how the Commission could distinguish between such normal expenditures and those "necessary to address, safety, efficiency or similar concerns." Southern Companies suggests using an Eligible Facilities Plan, comparable to that used in the *Columbia Gas* settlement.

58. Wisconsin Electric and Wisconsin Gas suggest that pipelines be required to specify the regulation that resulted in the requirement to construct each project and to either file for approval of each project under the NGA section 7(c) certificate application

process or in the event that a section 7(c) certificate application is not required, then provide all information about the project in a manner similar to a section 7(c) application.

Wisconsin Electric and Wisconsin Gas also suggest the Commission establish clear criteria for an “eligible modernization project” and create a clear distinction between routine maintenance projects versus modernization projects undertaken to comply with safety and/or environmental regulations.

59. Those opposed to the Policy Statement in general advocate strict limits on the “eligibility” of modernization costs that can be recovered through a surcharge. The AF&PA for example, opposes recovery of modernization costs through a surcharge and states that the costs the pipeline seeks to recover through the tracker/surcharge must be one time capital costs incurred to comply with safety or environment regulation issued by a governmental entity and such costs are necessary for the safe or efficient operations of the pipeline. AF&PA states to the extent that the Commission allows trackers, the Commission should only permit trackers related to costs that are specifically tied to laws that have already been enacted or regulations that are currently effective. AF&PA comments that the pipeline should be required to demonstrate that the costs are incremental to the costs imposed under existing laws and regulations. Laclede, who also opposes the Proposed Policy Statement, echoes the notion that modernization costs should only be recoverable through rate trackers if the costs are tied to new safety or health requirements. Additionally, the Industrial Energy Consumers of America (IECA) opposes surcharges and trackers as a way for pipeline companies to recover regulatory safety and environmental costs, arguing that it should be a requirement for pipeline

companies to file a new tariff that includes regulatory costs. IECA recommends strict guidelines as to what costs pertain to eligible facilities for special cost recovery.

60. Several commenters stated that the Commission needs to ensure that pipelines do not recover costs related to the safe and efficient operation of their systems that they should have already been spending. NCUC states that pipelines should not be provided incentives to make the investments it already should have made. Calpine also states pipelines should already be complying with safety and reliability requirements imposed by existing regulations and should not be incented to recover such costs through a modernization cost mechanism. PEG opposes the Commission's involvement in the mandates of other agencies such as EPA and PHMSA. According to PEG, "it is presumptuous of the Commission to describe such expenditures as being in 'advancement of the public interest' when first, the public interest is yet to be defined by regulatory action and second, such actions are outside of the Commission's purview."<sup>53</sup> PEG fails to see any reason to provide an incentive for pipelines to take actions that they must take under penalty of law.

61. Other commenters found the Commission's proposal with regard to eligible facilities too restrictive, and stated that costs should not be limited to "one-time, capital costs." INGAA argues that limiting the tracker mechanism only to capital costs is an unnecessary limitation on the type of costs that should be eligible for inclusion into the tracker mechanism, and urge expansion of the scope of the definition of eligible facilities. WBI Energy likewise comments that a one-time capital cost limitation may preclude a

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<sup>53</sup> PEG Comments at 7.

pipeline from recovering non-routine non-capital expenses which were prudently incurred to address system safety or efficiency. WBI Energy thus argues the final policy should be flexible enough to address each pipeline's situation.

62. Boardwalk states that the policy should be flexible so that if as a result of the modification process a pipeline discovers other actions that need to be taken in order for a pipeline to be in compliance with the new PHMSA rules, the costs of those activities may be included in the tracker. Boardwalk states the Commission should provide clear and rational guidance as to categories of costs eligible for inclusion in the tracker. Columbia Gas argues that the Commission should allow pipelines and shippers to include the cost of projects intended to increase the reliability or safety of existing facilities, including those facilities not necessarily impacted by regulations, provided that pipelines make a clear showing of net benefits to its stakeholders. Columbia Gas suggests such potential benefits may include improved safety, reduced emissions, increased efficiency or reliability, reduced costs, improved fuel, or reduced lost-and-unaccounted-for quantities.

**b. Determination**

63. Consistent with the Proposed Policy Statement, costs proposed to be recovered through a modernization cost surcharge (Eligible Costs) should generally be limited to (1) one-time capital costs incurred to modify or replace existing facilities on the pipeline's system to comply with safety or environmental regulations issued by PHMSA, EPA, or other federal or state government agencies, or (2) other one-time capital costs shown to be necessary for the safe or efficient operation of the pipeline.<sup>54</sup> The

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<sup>54</sup> In the Proposed Policy Statement, at P 23, the Commission proposed to define eligible costs as "one-time capital costs to *modify* the pipeline's existing system . . ."

Commission does not intend that capital costs the pipeline incurs as part of its ordinary, recurring system maintenance requirements should be eligible for inclusion in a modernization cost tracker. The Commission is modifying its rate policies to permit modernization cost trackers primarily for the purpose of allowing pipelines to recover capital costs incurred to upgrade the older parts of their systems (1) to comply with new, more stringent regulatory requirements and/or (2) take advantage of new technologies that reasonably increase safety and/or efficiency, such as reductions in methane leaks, system modifications to allow the use of advanced in-line inspection tools in lieu of hydrostatic testing, or replacement of old compressors with newer more energy efficient ones.<sup>55</sup>

64. By contrast, the Commission believes that pipelines should continue to recover in their base rates ordinary capital costs of the type they routinely incur as part of their regular system maintenance. The Commission recognizes the potential difficulty in distinguishing between ordinary capital costs for system maintenance, which should be excluded from a modernization cost tracker, and capital costs for system upgrades, which are reasonably included in such a tracker. In order to address this concern, the parties may, as INGAA and others suggest,<sup>56</sup> consider including in a modernization cost tracker a mechanism for ensuring that a representative level of ordinary system maintenance (emphasis supplied). Some commenters have interpreted our use of the word “modify” to exclude the costs of facility replacement projects from eligibility. We clarify 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.

<sup>55</sup> See, e.g., INGAA Comments at 13.

<sup>56</sup> INGAA reply comments at 18-19. Environmental Commenters at 12-13.

capital costs are excluded from the tracker. For example, the Columbia Gas settlement includes a provision that Columbia Gas will continue to make capital expenditures of \$100 million annually for system maintenance and those expenditures will not be included in its modernization cost tracker. If Columbia Gas spends less than that amount in any year, the difference must be used to reduce the plant investment included in the modernization cost tracker.<sup>57</sup> In developing such a mechanism, the parties could use the pipeline's recent history of capital expenditures incurred for routine maintenance as a basis for determining a representative level of ordinary system maintenance capital costs to be excluded from the modernization cost tracker.

65. Some commenters have suggested that the Commission should permit certain non-capital expenses to be included in a modernization cost tracker, if they are non-routine and required by regulation or a voluntary program adopted by a pipeline as a best practice.<sup>58</sup> Commenters cite as examples the costs of in-line inspections by running smart tools through various pipeline segments or programs to detect and repair leaks on parts of the system most prone to leaks. To the extent such testing uncovers the need to incur one-time capital costs that satisfy the eligibility standards described above, such capital costs could be included in the modernization cost tracker. However, the Commission is reluctant to permit non-capital testing costs of the type described by the commenters to be recovered through a modernization cost tracker. The cost of service reflected in a pipeline's existing base rates presumably includes a projection of the pipeline's recurring

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<sup>57</sup> Section 7.3 of the Columbia Gas settlement.

<sup>58</sup> See, e.g., INGAA Comments at 5-7, AGA Comments at 7.

costs of routine testing as part of the pipeline's O&M costs. The testing described by the commenters would appear to be a best practice for pipeline maintenance that the Commission would expect pipelines to conduct on an ongoing basis. As such it would appear difficult to distinguish any particular type of testing from the testing whose costs are already included in the O&M costs reflected in the pipeline's base rates. Therefore, while the Commission will not impose a blanket prohibition on the inclusion of such non-capital costs in a modernization cost tracker, particularly where supported by the pipeline's shippers, any proposal to include such non-capital costs in the tracker would need to demonstrate that such non-capital costs are special non-recurring costs not reflected in the O&M costs included in the pipeline's base rates and are directly related to the modernization projects whose costs are included in the modernization cost tracker. Furthermore, when determining whether a cost is a capital or non-capital cost, a pipeline's determination must be consistent with the Commission's accounting regulations and precedent.<sup>59</sup>

66. Some commenters also suggest that the Commission should allow eligible costs to include a portion of the capital costs incurred in a pipeline expansion project, if the project not only expands the pipeline's system but also modifies or replaces existing facilities to comply with safety or environmental regulations or make other improvements necessary for the safe and efficient operation of the pipeline.<sup>60</sup> The Commission

<sup>59</sup> See, e.g., 18 CFR pt. 201 (2014); see also, *Jurisdictional Public Utilities and Licensees Natural Gas Companies, and Oil Pipeline Companies, order on accounting for pipeline assessment costs*, 111 FERC ¶ 61,501 (2005).

<sup>60</sup> See, e.g., INGAA Comments at 11-12, Columbia Gas Comments at 14-16, Berkshire Hathaway Comments at 11, Wisconsin Electric and Wisconsin Gas Comments

recognizes that some expansion projects may include modifications to a pipeline's existing system that would be eligible for recovery in a modernization cost tracker if not done in conjunction with an expansion. In such circumstances, the Commission will consider reasonable proposals for a method of cost allocation between the expansion project and the modifications eligible for inclusion in such a tracker.<sup>61</sup>

67. Some commenters state that the costs of modifications to compressors for the purpose of waste heat recovery should be eligible for recovery under a modernization surcharge subject to conditions,<sup>62</sup> while others<sup>63</sup> oppose the inclusion of such costs because they assert that investments in modifications of compressors for purpose of waste heat recovery are discretionary and within control of the pipeline and should thus be subject to the normal rate review process.<sup>63</sup> According to the DOE, expanded use of waste heat recovery by natural gas compressors could be beneficial to overall system efficiency, and while there is a general lack of good information on the scale of heat losses from many sectors of the economy, research published in 2008 and 2009 found substantial opportunities for additional waste heat recovery investment at natural gas compressor stations. Accordingly, the Commission will consider proposals for recovery of such costs

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at 9,

<sup>61</sup> The *Columbia Gas* settlement includes such a provision at section 7.5 of that settlement.

<sup>62</sup> See, e.g., DOE Comments at 3, Wisconsin Electric and Wisconsin Gas Comments at 8, Michigan PSC Comments at 15.

<sup>63</sup> See, e.g., PGC Comments at 17-18, NGSAs Comments at 18-19, KCC Comments at 12.



in a modernization cost tracker proposal, subject to the standards of this Policy Statement.

68. The Commission rejects the proposals of some commenters that eligible costs be limited to those costs which the pipeline demonstrates are specifically tied to laws that have already been enacted or regulations that are currently effective. The Commission sees no reason for pipelines to wait to make needed improvements to their systems until a regulation is adopted requiring them to do so. In fact, the Department of Transportation has encouraged pipeline operators to undertake voluntary initiatives to improve pipeline safety.<sup>64</sup> Permitting pipelines to recover in a modernization cost tracker the costs of voluntary initiatives to improve safety, as well as minimize methane emissions, will help encourage such initiatives and thereby benefit the public. Accordingly, the Commission finds that all prudent one-time capital costs that satisfy the eligibility requirements may be included in a cost modernization tracker, regardless of whether PHMSA, EPA or some other government agency has adopted a regulation requiring the incurrence of the cost.

69. In the Proposed Policy Statement, the Commission proposed to require a pipeline proposing a modernization cost tracker to identify each capital investment to be recovered by the surcharge, the facilities to be upgraded or installed by those projects, and an upper limit on the capital costs related to each project to be included in the surcharge. INGAA requests that the Commission permit pipelines either to propose a list

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<sup>64</sup> United States Department of Transportation Call to Action to Improve the Safety of the Nation's Energy Pipeline System (Apr. 2011), *available at* [http://www.phmsa.dot.gov/staticfiles/PHMSA/DownloadableFiles/110404%20Action%20Plan%20Executive%20Version%20\\_2.pdf](http://www.phmsa.dot.gov/staticfiles/PHMSA/DownloadableFiles/110404%20Action%20Plan%20Executive%20Version%20_2.pdf).

of eligible projects or a list of categories of future projects that would be considered eligible for recovery. Other commenters also contend that, even if the pipeline includes an upfront list of specific projects to be included in the modernization cost tracker, the Commission should permit subsequent modifications, additions, or subtractions to the listed projects. They state that this is necessary so that the tracking mechanism can adapt to changing circumstances including newly adopted regulations.

70. The Commission expects that, before the pipeline makes a tariff filing with the Commission proposing a modernization cost tracking mechanism, it will conduct a comprehensive review of its existing system to determine what capital investments it believes are needed to ensure the safe and efficient operation of its system, based on the information available to it at the time of the review. Such a review should be comparable to the comprehensive review conducted by Columbia Gas before it submitted its Settlement. The Commission continues to find that the pipeline must include in its filing a description of the facilities which its review of its system has identified as needing upgrading and/or replacement, together an upper limit on the capital costs projected to be spent and a schedule for completing the projects. This detailed information will allow for a more transparent and upfront determination of the project costs that are eligible for recovery through the tracker so as to avoid later disputes on which facilities qualify, than any description of general categories of eligible costs could. This requirement will also help ensure that normal capital or other expenditures to maintain the pipeline's system in the ordinary course of business are not eligible for recovery through a surcharge mechanism. Consistent with this requirement, the filing should also include the

accounting controls and procedures that the pipeline will use to ensure that only identified eligible costs are included in the tracker.

71. At the same time, however, the Commission recognizes the need for flexibility to make changes in the projects whose costs will be included in the tracker, after the modernization cost tracking mechanism is adopted. For example, the pipeline may discover unanticipated problems with certain facilities during the course of its modernization activities or may discover more effective solutions to existing problems. Also, changes in its shippers' utilization of its system may cause certain projects to become more critical to the safe and efficient operation of the pipeline than originally anticipated. Therefore, the Commission will be open to considering proposals to include in a modernization cost tracker a mechanism pursuant to which the parties could later modify the list of eligible projects, or the schedule for those projects, or the cost limits, based on changing priorities and other reasons.<sup>65</sup> The Commission also recognizes that pipelines may wish to begin modernizing their systems before PHMSA, EPA, and other Federal or state agencies complete their various ongoing regulatory initiatives. Therefore, the Commission will be open to considering proposals to add new projects to a tracking mechanism which may be required by new regulations adopted after the initial approval of the tracking mechanism or for other reasons.

### **3. Avoidance of Cost Shifting**

72. The Proposed Policy Statement contemplated that a pipeline must design any proposed surcharge in a manner that will protect the pipeline's captive customers from

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<sup>65</sup> See section 7.2 of the Columbia Gas Settlement setting forth such a mechanism.

costs shifts if the pipeline loses shippers or must offer increased discounts to retain business. The Commission suggested that one method of accomplishing this would be to establish a billing determinant floor requiring the pipeline to design the surcharge based on the greater of its actual billing determinants or the floor.

**a. Comments**

73. Virtually all commenters favored the avoidance of cost shifts to the pipeline's captive customers that may result from the implementation of a cost modernization surcharge. AGA, for example, supports the need to ensure that existing shippers are protected from substantial cost shifts, and comments that pipelines should be required, in consultation with their shippers, to develop appropriate measures to protect customers from cost shifts.

74. Those opposed to the Proposed Policy Statement, however, claim that the very implementation of cost modernization tracker necessarily shifts costs. MDG, for example, states that trackers shift costs to captive customers due to discounting and lost business without taking into account offsetting cost reductions, and thus even the best implementation of the Proposed Policy Statement would raise rates to captive customers unfairly. MDG claims that a billing floor will not alleviate the inherent cost shift in a policy that allows the recovery of one set of costs absent a review of all the pipeline's costs and revenues. MDG suggests that to the extent substantial pipeline capital costs are recovered through a tracker there should be a reduction in that pipeline's return on equity to reflect the pipeline's reduced risk. The NYPSC similarly claims that while requiring a

billing determinant floor for a surcharge does allow some risk to remain with the pipeline, a tracker mechanism still reduces a pipeline's risk and transfers it to shippers.

75. While NGSA, APGA, and IPAA oppose the modernization surcharge tracker, if surcharges are allowed they all support the requirement that pipelines must design the surcharge in a manner that will protect the pipeline's shippers from significant cost shifts. IPAA, NGSA, and KCC contend that at a minimum, any modernization surcharge tracker must provide for a minimum level of billing determinants to design the surcharge as in *Columbia Gas*. NGSA adds that any surcharge should apply to all throughput in the facilities and under the rate schedules impacted by the surcharge-related costs, so that an agreed upon floor on the billing determinants should be greater than the firm billing determinants (so as to include interruptible throughput, for example). AF&PA agrees that interruptible shippers should share the costs incurred through trackers to the extent that they are related to safety and environmental compliance, as these costs are not related only to firm service. IECA states costs recovered through a tracker should be limited to no more than 5 percent of the costs recovered through the pipeline's tariff.

76. AF&PA submits that if the Commission implements the Proposed Policy Statement, the policy should spread the costs as widely as possible because environmental and safety costs are incurred for all shippers. AF&PA cautions, however, that a shipper that has released certain capacity should not bear any new costs related to that capacity and recovered through the tracker.

77. NGSAs argue that if shippers are already paying for eligible costs in negotiated contracts, or existing negotiated contracts prohibit recovery of these costs, they should not be subject to the modernization surcharge.

**b. Determination**

78. The third standard for approval of a cost modernization tracker adopted by the Policy Statement is that the pipeline must design any 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 beyond those reflected in their base rates.

79. As we stated in the Proposed Policy Statement, our regulations require that a pipeline's rates recover its costs based on projected units of service,<sup>66</sup> thereby putting the pipeline at risk for any cost under-recovery between rate cases, incentivizing the pipeline to minimize costs and maximize service. Recovery of costs approved for inclusion in a tracker, however, would be guaranteed, thereby reducing the pipeline's incentives. Moreover, a tracker mechanism can shift costs to the pipeline's captive customers. If a pipeline recovering costs through a tracker or surcharge loses shippers or must offer increased discounts to retain business, a tracker mechanism may shift the amounts previously paid by those shippers directly and automatically to the pipeline's remaining shippers. This direct cost shifting is one of the reasons the Commission has generally disfavored trackers, namely that the cost shifting described would occur without

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<sup>66</sup> 18 CFR 284.10(c)(2) (2014).

consideration of any offsetting items that would generally be considered in a section 4 rate proceeding, and which the pipeline would normally need to justify to recover.<sup>67</sup>

80. Thus, as a prerequisite to the Commission allowing such a tracker, the Commission will require that the pipeline design the surcharge in a manner that will protect its shippers from cost shifts and impose on the pipeline some risk of under-recovery. As we noted in the Proposed Policy Statement, one method to accomplish this would be that adopted by Columbia Gas, namely that the pipeline agree to a billing determinant floor such that the pipeline must design the surcharge on the greater of its actual billing determinants or the established floor, and impute the revenue it would achieve by charging the maximum rate for those determinants. While the Commission found this to be a just and reasonable approach to preventing cost shifts in *Columbia Gas*, we remain open under the Final Policy to considering alternative methods of protecting the pipeline's existing customers from cost shifts if the pipeline loses customers or has to offer increased discounts of its rates to retain business during the period the modernization cost tracker is in effect.

81. The Commission believes that issues concerning how a modernization cost surcharge should be allocated among a pipeline's services and what billing determinants should be used to design the surcharge are best addressed on a case-by-case basis when each pipeline files to establish a modernization cost tracking mechanism. However, as a

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<sup>67</sup> For example, in order to recover costs associated with discounted rates the pipeline may have offered to certain shippers, the pipeline must demonstrate that the discount was required to meet competition. *Policy for Selective Discounting by Natural Gas Pipelines*, 113 FERC ¶ 61,173 (2005). In the case of a tracker, no such showing is required by the pipeline to recover the covered costs from its remaining customers.

general matter, the Commission believes that it would be reasonable for the billing determinants used to design the surcharge to reflect a discount adjustment comparable to any discount adjustment reflected in the pipeline's base rates. Otherwise, a pipeline's modernization cost tracking mechanism would be designed in a manner that would likely lead to the pipeline under-recovering its prudently incurred modernization costs. That would be contrary to the Commission's goal of encouraging pipelines to expedite needed safety and environmental upgrades. The Commission's concern about protecting the pipeline's existing customers from cost shifts relates to cost shifts that would occur if a pipeline were permitted to true up any modernization cost under-recoveries resulting from the loss of customers after its modernization cost tracker goes into effect or a need to offer increased rate discounts to retain business after that date.<sup>68</sup>

82. Finally, with respect to the issue of the pipeline's ability to impose a modernization cost surcharge on discounted or negotiated rate shippers, that is a contractual issue between the pipeline and its discounted or negotiated rate shippers. If a particular shipper's discount or negotiated rate agreement with the pipeline permits the pipeline to add the surcharge to the agreed-upon discounted or negotiated rate, the

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<sup>68</sup> The Commission notes that section 154.109(c) of the Commission's regulations (18 CFR 154.109 (2014)), requires that the pipeline's tariff contain a statement of the order in which the pipeline discounts its rates and charges. Therefore, pipelines with modernization cost surcharges will have to revise their statements of the order in which they discount rates to include the modernization cost surcharge. Treating that surcharge as the last rate component discounted would minimize the need for trueing up any under-recoveries due to discounting. *See Natural Gas Pipeline Co. of America*, 70 FERC ¶ 61,317 (1995).



pipeline will be permitted to do so.<sup>69</sup> Otherwise, the pipeline may not impose the surcharge on a discounted or negotiated rate shipper.

#### **4. Periodic Review of the Surcharge**

83. In the Proposed Policy Statement, the Commission proposed that pipelines be required to include in a modernization cost recovery mechanism some method to allow a periodic review of whether the surcharge and the pipeline's base rates remain just and reasonable. As an example of such a method, the Commission cited the *Columbia Gas* settlement, in which the pipeline agreed to make the surcharge a temporary part of its rates (the surcharge expires automatically after five years), and included a requirement that the pipeline make a new NGA section 4 filing if it wants to continue the surcharge. However, the Commission stated it was open to other methods.

##### **a. Comments**

84. Virtually all commenters, including AGA, INGAA, NGSA, APGA, PGC, IPAA, Southern, KCC, and TVA support the proposed standard requiring a pipeline proposing a modernization cost tracker to include a method to allow a periodic rate review of the surcharge. While participants generally agreed such a condition was necessary, the recommended method and frequency of review differed.

85. Numerous commenters advocate requiring a pipeline with a cost modernization tracker to periodically file a full NGA section 4 rate case. NGSA for example, commented that a pipeline should have to file a rate case with its application for a tracker and every five years thereafter. IECA and Cities agree that a minimum 5 year rate case

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<sup>69</sup>See, e.g., *Sea Robin Pipeline Co., LLC*, Opinion No. 516-A, 143 FERC ¶ 61,129, at PP 85-213 (2013).

filing obligation is warranted. KCC and PGC espouse refresher requirements of 3 to 5 years, with a condition the pipeline not file to change rates for at least 3 years after implementation of a tracker. IPAA also supports the requirement for a full rate case refresher, and MDG suggests a rate case filing as a condition of extending any tracker beyond its initial term. Calpine commented that any surcharge have a minimum 3 year initial term that is subject to extension and renegotiation. Several commenters also advocated annual filings for pipelines to justify the projects for which costs were collected and to true-up such costs.

86. Opponents of the Proposed Policy Statement commented that a periodic review methodology was critical, though still not sufficient to justify the use of trackers. They strongly advocate a requirement that the review methodology involve a full blown NGA section 4 rate case. APGA would add the requirement that, if during the period that a surcharge mechanism is in effect, an NGA section 5 complaint is initiated against the pipeline, then the pipeline must agree to make refunds retroactive to the date of the complaint to the extent its rates are determined to be unjust and unreasonable. The NYPS&C and TVA comment that the periodic review should ensure that the surcharge does not produce earnings above authorized rates of return.

**b. Determination**

87. In this Policy Statement, the Commission adopts a policy of requiring the pipeline to include some method for a periodic review of whether the surcharge and the pipeline's base rates remain just and reasonable. Potential methods for satisfying this standard may include making the surcharge temporary and/or requiring the pipeline to file an NGA

section 4 rate case to the extent it wants to extend the surcharge beyond the initial temporary term. Because we intend the Policy Statement to be flexible enough to meet the particular circumstances of each pipeline's system, we will not require that a pipeline seeking approval of a cost modernization tracker propose to file a full NGA section 4 rate case with some specified regularity and remain open to other reasonable means of accomplishing this goal.

88. Similar to the review of the pipeline's existing base rates at the beginning of the tracker proposal analysis, during the periodic review the pipeline will have to provide sufficient information to satisfy the Commission that both its base rates and the surcharge amount remain just and reasonable if the surcharge is to continue. If shippers raise any issues of material fact with respect to the continued justness and reasonableness of the pipeline's base rates or the surcharge, the Commission will establish appropriate procedures to enable resolution of those issues based upon substantial evidence on the record.

89. If a modernization cost tracking mechanism is terminated before the pipeline has fully recovered the costs included in that mechanism, the pipeline may reasonably propose in a subsequent general section 4 rate case to include the unrecovered costs in its base rates. For example, if eligible costs have been treated as rate base items in the modernization cost tracker, the undepreciated portion of those costs as of the time of the NGA section 4 rate filing could be included in the rate base used to calculate the pipeline's proposed base rates in the same manner as any other investment made between rate cases, unless the pipeline's modernization cost tracker mechanism includes some

other provision concerning the treatment of unrecovered costs upon termination of the mechanism.

**5. Shipper Support**

90. The fifth condition proposed for a cost recovery surcharge was that the pipeline must work collaboratively with shippers to seek shipper support for any such proposal.

**a. Comments**

91. The vast majority of commenters support this condition but differ on the degree of shipper support the pipeline must have. On one end, INGAA suggests that the Commission could approve a proposed surcharge mechanism that it deems just and reasonable even if it lacks shipper support at the outset. NGSAA and APGA, on the other hand, comment that pipeline should have the support of shippers representing 90 percent of the firm billing determinants. AGA comments that while unanimity should not be required, any approved modernization cost recovery tracking mechanism should be established through a robust, ongoing, collaborative process between the pipeline and its shippers that has widespread shipper support.

92. IECA is more pessimistic and contends that it is completely unrealistic for any pipeline to collaborate and work with its shippers. The KCC supports collaboration among the pipeline and its shippers but comments that the condition should be expanded to include support of “interested parties,” including state public utility commissions.

**b. Determination**

93. The fifth standard for an acceptable cost modernization surcharge adopted in this Policy Statement is that the pipeline must work collaboratively with shippers and other

interested parties to seek support for any such proposal. As part of this collaborative process, pipelines should meet with their customers and other interested parties to seek resolution of as many issues as possible before submitting a modernization cost recovery proposal to the Commission. At such meetings, pipelines should share with their customers the results of their review of their systems concerning what system upgrades and improvements are necessary for the safe and efficient operations of their systems. Pipelines should also be responsive to customer requests for specific cost and revenue information necessary to determine whether their existing base rates are just and reasonable. Additionally, pipelines should provide customers and interested parties an opportunity to comment on draft tariff language setting forth their proposed modernization cost recovery mechanism.

94. As we noted in the Proposed Policy Statement, however, while we strongly encourage the pipeline to attempt to garner support for its proposal from all interested parties, we do not intend to require unanimity of shipper support before approving a cost modernization surcharge. Nor will we establish any minimum level of shipper support required before a pipeline's proposal can be accepted. This Policy Statement will provide pipelines and their customers wide latitude to reach agreements incorporating remedies for a variety of system safety, reliability and/or efficiency issues. Despite comments that mutual collaboration is futile or impractical, the *Columbia Gas* settlement is evidence that a system-wide collaboration between a pipeline and its customers can work to produce a reasonable modernization cost recovery mechanism that benefits all sides. The Commission continues to favor settlements, and notes that the negotiation of a

modernization cost tracker to address critical infrastructure issues is exactly the type of issue that lends itself to pipeline customer negotiation and agreement because it will benefit all involved. However, if a pipeline satisfies its burden under NGA section 4 to show that its proposed modernization cost recovery mechanism is just and reasonable, including showing that its proposal is consistent with the guidance herein, the Commission may accept that proposal, even if some parties oppose it.

### **C. Additional Questions on Which the Commission Sought Comments**

95. The Commission also sought comments on several additional issues, including: accelerated amortization, reservation charge crediting, and any other factors or issues commenters believed should be included in the Policy Statement as a prerequisite for approving a modernization cost recovery mechanism.

#### **1. Accelerated Amortization**

96. In the Proposed Policy Statement, the Commission pointed out that the capital costs included in the modernization cost tracking mechanism approved in *Columbia Gas* are treated as rate base items, and thus Columbia Gas is allowed to recover a return on equity on the portion of those costs financed by equity. Consistent with the rate base treatment of those costs, they are depreciated over the life of Columbia Gas' system.<sup>70</sup> The Commission requested comments on whether pipelines should also be allowed to use accelerated amortization methodologies, akin to that approved by the Commission for hurricane repair cost trackers,<sup>71</sup> to recover the costs of any facilities installed pursuant to a

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<sup>70</sup> *Columbia Gas*, 142 FERC ¶ 61,062 at P 9.

<sup>71</sup>See, e.g., *Sea Robin Pipeline Co., LLC*, Opinion No. 516, 137 FERC ¶ 61,201, at PP 16-65 (2011), *reh'g den*, Opinion No. 516-A, 143 FERC ¶ 61,129 at PP 17-80.

modernization cost recovery mechanism. The Commission stated that under such a methodology the costs would not be included in the pipeline's rate base, and the pipeline would not recover any return on equity with respect to the costs financed by equity. Instead, the pipeline would only be allowed to recover the interest necessary to compensate it for the time value of money.

**a. Comments**

97. The Commission received a range of comments on this issue. Wisconsin Electric and Wisconsin Gas support using an accelerated amortization of costs of facilities installed pursuant to eligible modernization projects.<sup>72</sup> IECA also supports accelerated amortization for safety and environmental compliance costs but argues for the amortization to be set at a rate that would require the pipeline to come back for a rate case in five years.<sup>73</sup> NGSAs argue that accelerated amortization, with carrying costs, over a specified term, is the most appropriate rate design structure for recovering all approved costs under a tracker, with the length of any amortization period determined on a case-by-case basis, dependent upon the level of costs.<sup>74</sup> NGSAs argue that it is not appropriate for the pipeline to earn a rate of return and taxes on these types of tracked expenditures because these would be incremental costs, with guaranteed cost recovery (i.e., no risk on the pipeline) under the tracker.<sup>75</sup>

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<sup>72</sup> Wisconsin Electric and Wisconsin Gas Comments at 14.

<sup>73</sup> IECA Comments at 21.

<sup>74</sup> NGSAs Comments at 12-13, 24.

<sup>75</sup> NGSAs Comments at 24.

98. NCUC opposes the proposal on the grounds that the accelerated amortization allowed for storm damage repair costs would be inappropriate for modernization costs, because accelerated amortization would raise intergenerational cross –subsidization issues and could magnify rate shock. Similarly, Laclede opposes recovery of capital costs through accelerated amortization methodologies, and argues that any costs not recovered through tracker rates should be rolled into rate base.<sup>76</sup>

99. CAPP recommends that the consultative process by which individual pipelines formulate their respective proposals include the opportunity for stakeholders to evaluate the preferred accelerated amortization methodology.<sup>77</sup> Calpine also does not object to allowing pipelines and their shippers to consider accelerated amortization methodologies as part of their modernization surcharge negotiations.<sup>78</sup> Columbia Gas states the Commission should consider permitting pipelines to use accelerated amortization methodologies but allow pipelines and their customers the discretion to negotiate the appropriate method of amortization, which should include the possibility of earning a reasonable return.<sup>79</sup> INGAA requests that the Commission provide each pipeline that

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<sup>76</sup> Laclede Comments at 20. See also PGC Comments at 19-20 (PGC opposes accelerated amortization for modernization upgrades, contending that it will only give pipelines additional latitude to increase their profits.).

<sup>77</sup> CAPP Comments at 9. See also KCC Comments at 24, 27 (KCC does not oppose extension of the use of accelerated amortization methodologies for recovering approved costs under a modernization cost tracker if the costs subject to accelerated amortization are not included in rate base, and a pipeline is not able to recover any return on equity for costs financed by equity).

<sup>78</sup> Calpine Comments at 30.

<sup>79</sup> Columbia Gas Comments at 34. See also APGA comments at 22 (to the extent the Commission permits pipelines to implement the modernization cost tracker,



proposes a modernization cost tracker the ability to propose either accelerated amortization methodologies or depreciation over the life of the facilities, because each pipeline faces different competitive circumstances.<sup>80</sup>

**b. Determination**

100. The Commission agrees with the commenters who suggested that pipelines should be allowed to negotiate with their customers concerning whether modernization costs should be treated as (1) a rate base item to be depreciated over the life of the pipeline with the pipeline recovering a return on equity on the portion of those costs financed by equity together with associated income taxes or (2) a non-rate base item to be amortized over a shorter period with the pipeline recovering the interest necessary to compensate it for the time value of money but no return on equity or associated income taxes. These two cost recovery options have varying advantages and disadvantages. For example, rate base treatment is likely to lead to a lower per unit daily or monthly surcharge, because it spreads the pipeline's recovery of the costs over a substantially longer period. Such lower per unit rates should help mitigate any rate shock. However, over the long run, rate base treatment is likely to be more expensive for shippers, because the surcharge will be in effect for a longer period and the return on the equity portion of the rate base will be greater than the interest rate on the costs being amortized.<sup>81</sup> In light of these varying

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customers of the requesting pipeline should make the decision as to whether rate base treatment or some sort of reasonable amortization period works best for them under the circumstances).

<sup>80</sup> INGAA Comments at 19-20.

<sup>81</sup> See Opinion No. 516-A, 143 FERC ¶ 61,129 at PP 35-56.

advantages and disadvantages, the Commission will permit pipelines and their shippers to negotiate which recovery method is appropriate for each pipeline, based upon the circumstances of its system.

## 2. Reservation Charge Crediting

101. The Commission requires pipelines to provide full reservation charge credits for outages of primary firm service caused by non-*force majeure* events, where the outage occurred due to circumstances within the pipeline's control, including planned or scheduled maintenance.<sup>82</sup> The Commission also requires the pipeline to provide partial reservation charge credits during *force majeure* outages, so as to share the risk of an event for which neither party is responsible.<sup>83</sup> Partial credits may be provided pursuant to: (1) the No-Profit method under which the pipeline gives credits equal to its return on equity and income taxes starting on Day 1; or (2) the Safe Harbor method under which the pipeline provides full credits after a short grace period when no credit is due (i.e., 10 days or less).<sup>84</sup> The Commission permits pipelines to reflect the recurring cost of providing reservation charge credits during non-*force majeure* events in their rates.<sup>85</sup>

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<sup>82</sup> See, e.g., *Tennessee Gas Pipeline Co.*, Opinion No. 406, 76 FERC ¶ 61,022 (1996), *order on reh'g*, Opinion No. 406-A, 80 FERC ¶ 61,070 (1997), *as clarified by*, *Rockies Express Pipeline LLC*, 116 FERC ¶ 61,272, at P 63 (2006) (*Rockies Express I*), and *North Baja Pipeline, LLC*, 109 FERC ¶ 61,159 (2004), *reh'g denied*, 111 FERC ¶ 61,101 (2005), *aff'd*, *North Baja Pipeline, LLC v. FERC*, 483 F.3d 819 (D.C. Cir. 2007) (*North Baja v. FERC*).

<sup>83</sup> The Commission has defined *force majeure* outages as events that are both unexpected and uncontrollable. Opinion No. 406, 76 FERC at 61,088. *North Baja v. FERC*, 483 F.3d at 823.

<sup>84</sup> The Commission has also stated that pipelines may use some other method that achieves equitable sharing reasonably equivalent to the two specified methods.

102. In the Proposed Policy Statement, the Commission stated that the pipelines' performance of facility upgrades and replacements required by recent legislative and other actions to address pipeline efficiency, safety, and environmental concerns may result in disruption of primary firm service. The Commission also cited recent Commission orders clarifying that one-time outages of primary firm service, if necessary to comply with government orders, may be treated as *force majeure* outages, for which only partial reservation charge credits are required.<sup>86</sup> The Commission requested comments on whether it should make any adjustments to its current reservation charge crediting policy in light of the Proposed Policy Statement.<sup>87</sup>

**a. Comments**

103. The pipeline industry generally advocated that the Commission modify its policy requiring pipelines to pay reservation charge credits starting on Day One for disruption of primary firm service required by either voluntary or mandatory system improvements eligible for surcharge cost recovery. They contend that the pipeline modernization programs under consideration are not representative of pipeline mismanagement and are significantly different than conducting routine maintenance,<sup>88</sup> and thus the Commission

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<sup>85</sup> See, e.g., *Northern Natural Gas Co.*, 137 FERC ¶ 61,202, at P 36 (2011), *order on reh'g and compliance*, 141 FERC ¶ 61,221, at PP 45-50 (2012) (*Northern*). The Commission has stated this could be accomplished by a reduction in the billing determinants used to design a pipeline's rates or by including the cost of the full reservation charge credits as an item in the pipeline's cost of service. *Gulf South Pipeline Co., LP*, 144 FERC ¶ 61,215, at P 34 (2013) (*Gulf South*).

<sup>86</sup> See, e.g., *TransColorado Gas Transmission Co. LLC*, 144 FERC ¶ 61,175 (2013) (*TransColorado*); *Gulf South*, 144 FERC ¶ 61,215.

<sup>87</sup> Proposed Policy Statement at P 34.

<sup>88</sup> INGAA Comments at 15-18.

should not impose any reservation charge crediting requirement or at least treat any resulting outages as *force majeure* events requiring only partial reservation charge credits. INGAA also argued that the Commission should explicitly provide that costs to comply with other statutory and regulatory requirements, such as hydrostatic testing to confirm maximum pressure levels, are not subject to reservation charge credits.<sup>89</sup>

INGAA also argues, however, that to the extent that a pipeline must pay reservation charge credits for a service outage required by a system improvement eligible for surcharge cost recovery, it should be permitted to recover such crediting costs through the modernization cost recovery tracker.<sup>90</sup> Columbia Gas urges the Commission to extend its policy of granting partial reservation charge credits to outages due to construction of eligible modernization projects.<sup>91</sup>

104. Shippers and various state commissions encourage the Commission to require pipelines with modernization cost trackers to provide full reservation charge credits during periods that the pipeline must interrupt primary firm service to replace or install

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<sup>89</sup> INGAA Comments at 18.

<sup>90</sup> INGAA Comments at 18-19. KM Comments at 8 (agreeing with INGAA that reservation charge crediting not apply for interruptions of firm service when pipelines are performing either voluntary or mandatory maintenance to improve safe and efficient operations.).

<sup>91</sup> Columbia Gas Comments at 36. Boardwalk suggests the Commission should modify its current reservation charge crediting policy to allow for a more equitable balancing of the risks between pipelines and their customers for service disruptions caused by testing, repair or replacement activities taken to comply with the new PHMSA rules. (Boardwalk Comments at 24.).

eligible facilities under the provisions of the modernization tracker.<sup>92</sup> NCUC states that full reservation charge credits will provide pipelines a stronger incentive to schedule any necessary construction or modification of facilities required to comply with any new regulations in an efficient manner.<sup>93</sup> Likewise, while PGC, APGA, IPAA, and NGSAs oppose the implementation of modernization cost trackers, they request that to the extent the Commission chooses to allow their implementation, it modify its reservation charge crediting policy to require pipelines with modernization cost trackers to provide full reservation charge credits to firm customers during any period that the pipeline must interrupt primary firm service to replace or install eligible facilities.<sup>94</sup>

**b. Determination**

105. The Commission's current reservation charge crediting policies require pipelines to provide some level of reservation charge credits whenever the pipeline is unable to schedule reserved primary firm service because of a government action. The level of credits to be provided turns on whether the government action is considered a *force majeure* event.<sup>95</sup>

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<sup>92</sup> Michigan PSC Comments at 20. IECA and American Midstream do not support changes to the existing reservation charge credits. IECA Comments at 21; American Midstream Comments at 8.

<sup>93</sup> NCUC Comments at 34.

<sup>94</sup> PGC Comments at 20, APGA Comments at 22, IPAA Comments at 3, 26-27, NGSAs Comments at 13, 25.

<sup>95</sup> *Tennessee Gas Pipeline Co., L.L.C.*, 139 FERC ¶ 61,050, at PP 80-82 (2012). *Texas Eastern Transmission, LP*, 149 FERC ¶ 61,143, at PP 121-123 (2014).

106. The Commission has defined *force majeure* outages as events that are both “unexpected and uncontrollable.” In *TransColorado*<sup>96</sup> and *Gulf South*,<sup>97</sup> the Commission clarified the basic distinction as to whether outages resulting from governmental actions are *force majeure* or non-*force majeure* events. The Commission found that outages necessitated by compliance with government standards concerning the regular, periodic maintenance activities a pipeline must perform in the ordinary course of business to ensure the safe operation of the pipeline, including PHMSA's integrity management regulations, are non-*force majeure* events requiring full reservation credits. Outages resulting from one-time, non-recurring government requirements, including special, one-time testing requirements after a pipeline failure, are *force majeure* events requiring only partial crediting.

107. In *Gulf South*, the Commission explained that this distinction is reasonable for two reasons. First, the pipeline is likely to have greater discretion as to when it performs regular, periodic maintenance on particular pipeline segments than when the government orders special one-time testing, for example after a pipeline failure. Thus, regular, periodic maintenance required by government regulation may be considered reasonably within the control of the pipeline and expected, in contrast to one-time, non-recurring government requirements, which the pipeline may have to implement within a short timeframe. Second, the recurring costs of regular, periodic maintenance performed in the ordinary course of business may be included in a pipeline's rates in a general NGA

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<sup>96</sup> *TransColorado*, 144 FERC ¶ 61,175 at PP 35-43.

<sup>97</sup> *Gulf South*, 144 FERC ¶ 61, 215 at PP 31-34.

section 4 rate case, whereas one-time, non-recurring costs are generally not eligible for inclusion in a pipeline's rates in a section 4 rate case. The Commission explained that because the full crediting policy is premised on the ability of the pipeline to recover the costs associated with that policy through its rates, it follows that eligibility for such cost recovery is an important factor in distinguishing between the types of government testing and maintenance requirements that trigger the full crediting requirement and those that only trigger a partial crediting requirement.<sup>98</sup> Thus, under *TransColorado* and *Gulf South*, outages resulting from one-time non-recurring government requirements that (1) are not part of the pipeline's routine, periodic maintenance programs and (2) provide the pipeline little discretion as to when the outage occurs, qualify as *force majeure* events.

108. Against this background, we recognize that facility upgrade and replacement projects whose costs would be eligible for recovery under a modernization tracker do not lend themselves easily to the governmental action *force majeure*/non- *force majeure* distinction described above. On the one hand, such projects do not constitute routine periodic maintenance of the type for which the Commission requires full reservation charge credits; in fact, the Commission has held that such routine maintenance costs are not eligible for inclusion in a modernization cost tracker. Moreover, because each project constitutes a one-time, non-recurring event, any reservation charge credits provided by the pipeline would not be a recurring cost eligible for recovery in a pipeline's NGA section 4 general rate case. On the other hand, pipelines will likely have considerable

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<sup>98</sup> *Texas Eastern*, 149 FERC ¶ 61,143 at P 123.

discretion as to the timing of when they perform each project, with projects likely to be scheduled and performed over a multi-year period. Therefore, the projects are not unexpected in the sense ordinarily required for treatment as a *force majeure* event.

109. In these circumstances, the Commission believes the issue of reservation charge credits for projects included in a modernization cost tracker is best addressed, at least initially, on a case-by-case basis in each proceeding in which a pipeline proposes such a tracker. In its filing to establish a tracker, the pipeline should state the extent to which it anticipates that any particular project will disrupt primary firm service, explain why it expects it will not be able to continue to provide firm service, and describe what arrangements the pipeline intends to make to mitigate the disruption or provide alternative methods of providing service. To the extent a pipeline incurs costs to make temporary alternative arrangements to provide service while a project is under construction, such as through temporary line bypasses or natural gas tankers, such costs may be considered for inclusion in the tracker. However, if a modernization project unavoidably causes an outage of primary firm service, the Commission believes that pipelines should provide some relief from the payment of reservation charge to shippers directly affected by that outage. To the extent the pipeline provides such shippers full reservation charge credits, the Commission would consider proposals for the pipeline to recover such costs through the tracker, consistent with the Commission's policy that pipelines may recover the costs of full reservation charge credits in rates. Alternatively, the Commission would consider partial reservation charge crediting methods tailored to the circumstances of the projects included in the tracker.



### 3. Other Issues

110. The Commission sought comments on any other issues or factors interested parties though the Commission should consider for inclusion in the Policy Statement as a prerequisite for approving a modernization cost recovery mechanism.<sup>99</sup> The Commission received comments on a variety of proposals on additional items to include in the Policy Statement, including return on equity, and formula rates.

#### a. Return on Equity

111. EPMCG, MDG, APGA and the NYPSC argue that if the portion of capital investment subject to a tracker is significant to the pipeline's rate base, then the Commission should adjust downward the pipeline's allowed rate of return on equity to reflect the decreased risk that the pipeline has to recover its cost of investment given the existence of a tracker.<sup>100</sup> IPAA and NGSa also argue that the plant facilities to be constructed pursuant to the proposed modernization surcharge should not be eligible to earn a rate of return and taxes, because these facilities are not included in a pipeline's rate base through an NGA general section 4 rate filing.<sup>101</sup>

112. The Commission will not mandate an automatic ROE reduction for pipelines that have a modernization surcharge or tracker. We do agree, however, that a modernization

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<sup>99</sup> Because the Policy Statement would address issues pertaining to the Commission's review of natural gas rate filings, the statement is categorically excluded from the requirements of the National Environmental Policy Act (NEPA), thus neither an environmental assessment nor an environmental impact statement is required. See 18 CFR 380.4(a)(25) (2014).

<sup>100</sup> EPMCG Comments at 43, APGA Comments at 22-23, and MDG Comments at P 2, NYPSC Comments at P 1-3.

<sup>101</sup> IPAA Comments at 3, 26, NGSa Comments at 13.

tracker or surcharge could be a factor that is considered as to the appropriate level of a pipeline's ROE. We agree that considerations of return on equity reduction may be considered during shipper and pipeline negotiations.

**b. Formula Rates**

113. APGA argues that, if the Commission wants a tracker mechanism that ensures just and reasonable rates, it must apply to the pipeline's entire cost of service, similar to the transmission formula rates that the Commission has approved for electric utilities under the Federal Power Act.<sup>102</sup> APGA states that the advantage of such formula rates, most of which allow projected capital additions to be included in a given year's formula rate and are trued up for actuals, are that the electric utilities are assured timely recovery of capital outlays and customers are assured that rates are premised on full and updated cost-of-service data, including throughput, so that the over-recovery problem associated with tracker mechanisms applicable to only a portion of the pipeline's cost of service is obviated.

114. The Commission will not adopt APGA's proposal. In the instant proceeding the Commission is adopting a policy permitting pipelines to recover a limited category of one-time costs through a tracker mechanism, namely the costs of making needed upgrades for the safe and efficient operation of the pipeline. For the reasons discussed above, the Commission can permit this limited exception to our general policy of requiring pipelines to design their rates based on projected units of service, without undercutting the benefits of that policy of providing pipeline an incentive to minimize

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<sup>102</sup> APGA Comments at 11-12.

costs and maximize the service they provide. APGA's proposal to require pipelines to track all changes in their cost of service, on the other hand, would eliminate both those incentives.

**c. Transparency**

115. Wisconsin Electric and Wisconsin Gas propose that the Commission include additional transparency measures to require pipelines to identify and track all costs associated with each project or project phase and file a quarterly summary report detailing the progress and completion of the projects included in the tracker. In addition, Wisconsin Electric and Wisconsin Gas state existing service customers should have the right to validate the premise and the projected results of a pipeline's modernization and to audit costs. Finally, Wisconsin Electric and Wisconsin Gas submit that the pipeline should be required to quantify current costs that are reduced or avoided as a result of the and net those costs out of the total eligible cost.<sup>103</sup>

116. The Commission will not adopt a policy requiring pipelines to submit reports on its projects based on any particular schedule, or specify the content of those reports in this Policy Statement. These are issues that should be addressed in the individual proceedings where each pipeline proposes a modernization cost tracker. Likewise, the validation and quantification of costs and projects may be negotiated. Nevertheless, a pipeline's compliance with its tariff to implement a modernization cost tracker may be subject to scrutiny through a Commission audit.

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<sup>103</sup> Wisconsin Electric and Wisconsin Gas Comments at 15.

**d. Proposed Certificate Policy Modifications**

117. Columbia Gas proposes that the Commission undertake a review and implement a “fast track” processing for NGA 7(c) projects that involve replacement of older vintage pipelines, like bare steel replacement, or involve an important public safety aspect.<sup>104</sup>

Columbia Gas also comments that not all pipeline facilities are appropriate for replacement or upgrade because some facilities may have reached or are close to the end of their useful life. Therefore, Columbia states a full replacement of certain facilities may be cost prohibitive, even with a tracker, because shippers on the facilities are unwilling or unable to support the costs of the replacement.<sup>105</sup> Similarly, Boardwalk states abandonment of facilities that will no longer be economic to operate because of substantial costs necessary to modify the facilities in order to achieve compliance with new requirements may be the best option and in the public interest.<sup>106</sup>

118. Columbia Gas’ and Boardwalk’s proposals are beyond the scope of this Policy Statement, and thus we will not address them here.

**III. Information Collection Statement**

119. The collection of information discussed in the Policy Statement is being submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the

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<sup>104</sup> Columbia Gas Comments at 37.

<sup>105</sup> Columbia Gas Comments at 21.

<sup>106</sup> Boardwalk Comments at 18-19.

Paperwork Reduction Act of 1995<sup>107</sup> and OMB's implementing regulations.<sup>108</sup> OMB must approve information collection requirements imposed by agency rules.

120. The Commission solicits comments from the public on the Commission's need for this information, whether the information will have practical utility, the accuracy of the burden estimates, recommendations to enhance the quality, utility, and clarity of the information to be collected, and any suggested methods for minimizing respondents' burden, including the use of automated information techniques. The burden estimates are for implementing the information collection requirements of this Policy Statement. The Commission asks that any revised burden estimates submitted by commenters include the details and assumptions used to generate the estimates.

121. The collection of information related to this Policy Statement falls under FERC-545A (Gas Pipeline Rates: Rate Change (Non-Formal), Modernization Tracker).<sup>109</sup> The following estimate of reporting burden is related only to this Policy Statement.

122. Public Reporting Burden: The estimated annual burden and cost follow.

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<sup>107</sup> 44 U.S.C. 3507(d) (2012).

<sup>108</sup> 5 CFR 1320.

<sup>109</sup> The information collection requirements in this Policy Statement would normally be included in FERC-545 (OMB Control No. 1902-0154) which covers rate change filings made by natural gas pipelines, including tariff changes. However, another item is pending OMB review under FERC-545, and only one item per OMB Control Number can be pending review at OMB at a time. Therefor in order to submit this timely to OMB, we are using a temporary collection number (FERC-545A) to cover the requirements implemented in PL15-1-000.

<b>FERC-545A, as implemented in Policy Statement in PL15-1-000</b>					
	<b>Number of Respondents<sup>110</sup> (1)</b>	<b>Number of Responses per Respondent (2)</b>	<b>Average Burden Hours Per Response (3)</b>	<b>Total Annual Burden Hours (1)x(2)x(3)</b>	<b>Total Annual Cost (\$) <sup>111</sup> [rounded]</b>

<sup>110</sup> An estimated 165 natural gas pipelines (Part 284 program) may be affected by this Policy Statement. Of the 165 pipelines, Commission staff estimates that 3 pipelines may choose to submit an application for a modernization cost tracker per year.

<sup>111</sup> The most recent hourly wage figures are published by the Bureau of Labor Statistics, U.S. Department of Labor, *National Occupational Employment and Wage Estimates, United States*, Occupation Profiles, May 2014 (available 4/1/2015) at

provide information to shippers for any surcharge proposal, and prepare modernization cost tracker filing <sup>112</sup>	3	1	750	2,250	\$147, 578
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<http://www.bls.gov/oes/home.htm>, and the benefits are calculated using BLS information, at <http://www.bls.gov/news.release/ecec.nr0.htm>.

The average hourly cost (salary plus benefits) to prepare the modernization cost tracker filing is \$65.59. It is the average of the following hourly costs (salary plus benefits): manager (\$77.93, NAICS 11-0000), Computer and mathematical (\$58.17, NAICS 15-0000), Legal (\$129.68, NAICS 23-0000), Office and administrative support (\$39.12, NAICS 43-0000), Accountant and auditor (\$51.04, NAICS 13-2011), Information and record clerk (\$37.45, NAICS 43-4199), Engineer (\$66.74, NAICS 17-2199), Transportation, Storage, and Distribution Manager (\$64.55, NAICS 11-3071).

The average hourly cost (salary plus benefits) to perform the periodic review is \$67.04. It is the average of the following hourly costs (salary plus benefits): manager (\$77.93, NAICS 11-0000), Legal (\$129.68, NAICS 23-0000), Office and administrative support (\$39.12, NAICS 43-0000), Accountant and auditor (\$51.04, NAICS 13-2011), Information and record clerk (\$37.45, NAICS 43-4199).

<sup>112</sup> The pipeline’s modernization cost tracker filing is expected to include information to:

- demonstrate that its current rates are just and reasonable and that proposal includes the types of benefits that the Commission found maintained the pipeline’s incentives for innovation and efficiency;
- identify each capital investment to be recovered by the surcharge, the facilities to be upgraded or installed by those projects, and an upper limit on the capital costs related to each project to be included in the surcharge, and schedule for completing the projects;
- establish accounting controls and procedures that it will utilize to ensure that only identified eligible costs are included in the tracker;
- include method for periodic review of whether the surcharge and the pipeline’s base rates remain just and reasonable; and
- state the extent to which any particular project will disrupt primary firm service, explain why it expects it will not be able to continue to provide firm service, and describe what arrangements the pipeline intends to make to mitigate the disruption

perform periodic review and provide information to show that both base rates and the surcharge amount remain just and reasonable	3	0.60 <sup>113</sup>	350	630	\$42,235
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123. Title: FERC-545A (Gas Pipeline Rates: Rate Change (Non-Formal), Modernization Tracker).

124. Action: Proposed information collection

125. OMB Control No.: To be determined

126. Respondents: Business or other for profit enterprise (Natural Gas Pipelines).

127. Frequency of Responses: Ongoing.

128. Necessity of Information: The Commission is establishing a policy to allow interstate natural gas pipelines to seek to recover certain capital expenditures made to modernize system infrastructure through a surcharge mechanism, subject to certain conditions. The information that the pipeline should share with its shippers and submit to the Commission is intended to ensure that the resulting rates are just and reasonable and protect natural gas consumers from excessive costs

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or provide alternative methods of providing service.

<sup>113</sup> Based on the Columbia case, we estimate that a review may be required every 5 years, triggering the first pipeline reviews to be done in Year 6 (for the pipelines which applied and received approval in Year 1).



129. Internal Review: The Commission has reviewed the guidance in the Policy Statement and has determined that the information is necessary. These requirements conform to the Commission's plan for efficient information collection, communication, and management within the natural gas pipeline industry. The Commission has assured itself, by means of its internal review, that there is specific, objective support for the burden estimates associated with the information requirements.

130. Interested persons may obtain information on the reporting requirements by contacting the following: Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426 [Attention: Ellen Brown, Office of the Executive Director, e-mail: [DataClearance@ferc.gov](mailto:DataClearance@ferc.gov), phone: (202) 502-8663, fax: (202) 273-0873].

131. Comments concerning the collection of information and the associated burden estimate should be sent the Commission by [insert 60 days from publication in the Federal Register] .

#### **IV. Document Availability**

132. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, NE, Room 2A, Washington DC 20426.

133. From FERC's Home Page on the Internet, this information is available on eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft

Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

134. User assistance is available for eLibrary and the FERC's website during normal business hours from FERC Online Support at (202) 502-6652 (toll free at 1-866-208-3676) or email at [ferconlinesupport@ferc.gov](mailto:ferconlinesupport@ferc.gov), or the Public Reference Room at (202) 502-8371, TTY (202) 502-8659. E-mail the Public Reference Room at [public.referenceroom@ferc.gov](mailto:public.referenceroom@ferc.gov).

**V. Effective Date and Congressional Notification**

135. This Policy Statement will become effective October 1, 2015.

The Commission orders:

The Commission adopts the Policy Statement and supporting analysis contained in the body of this order.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.

**Note: The following appendix will not appear in the *Code of Federal Regulations*.**

### **Appendix - List of Commenters**

American Forest & Paper Association  
American Gas Association  
American Midstream, LLC  
American Public Gas Association  
Beatrice Gahman  
Berkshire Hathaway Energy Company  
Boardwalk Pipeline Partners, LP  
Calpine Corporation  
Canadian Association of Petroleum Producers  
CenterPoint Energy Resources Corp.  
Clean Air Task Force  
Columbia Gas Transmission, LLC  
Deep Gulf Energy LP  
El Paso Municipal Customer Group  
Elizabeth Balogh  
Energy XXI Ltd.  
Environmental Defense Fund, Conservation Law Foundation and the Sustainable FERC Project  
Ernest J. Moniz, Secretary. United States Department of Energy  
Fairfax Hutter  
Helis Oil and Gas Company, L.L.C.  
Independent Oil & Gas Association of West Virginia, Inc.  
Independent Petroleum Association of America  
Indicated Shippers  
Industrial Energy Consumers of America  
Interstate Natural Gas Association of America  
Kansas Corporation Commission  
Karen Feridum  
Kinder Morgan Interstate Pipelines  
Laura Pritchard  
Michigan Public Service Commission  
Missouri Public Service Commission  
Municipal Defense Group  
Natural Gas Supply Association  
New York Public Service Commission  
Norman W. Torkelson  
North Carolina Utilities Commission  
Patriots Energy Group  
Pipeline Safety Coalition

Docket No. PL15-1-000

Process Gas Consumers Group and the American Forest & Paper Association  
Secretary of Energy  
Southern Company Services  
Southern Star Central Gas Pipeline, Inc.  
Tennessee Valley Authority  
Teresa Ecker  
The Laclede Group, Inc.  
U.S. Department of Energy  
U.S. Department of Transportation, Pipeline and Hazardous Materials Safety  
Administration  
WBI Energy Transmission, Inc.  
Western Tennessee Municipal Group  
Wisconsin Electric Power Company and Wisconsin Gas LLC  
Xcel Energy Companies