McDILL, J. S.

BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

IN THE MATTER OF THE	)	Docket No.
APPLICATION OF ATMOS ENERGY	)	
CORPORATION FOR REVIEW AND	)	
ADJUSTMENT OF ITS NATURAL GAS	)	16-ATMG-_____-RTS
RATES		

DIRECT TESTIMONY OF

JOHN S. McDILL

FOR ATMOS ENERGY CORPORATION

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JOHN S. McDILL

FOR ATMOS ENERGY CORPORATION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is John S. McDill. I am Vice President, Pipeline Safety for Atmos Energy Corporation ("Atmos Energy" or the "Company"). My business address is 3697 Mapleshade Lane, Plano, Texas.

I. EXECUTIVE SUMMARY

Atmos Energy takes the safety of its pipeline system seriously. When a natural gas pipeline fails, the repercussions can be catastrophic. Federal and state regulations were passed to propel pipeline operators to better understand the condition of their assets. This process assists operators to understand threats on their system and to take appropriate steps to repair or replace pipelines proactively. Balancing safety and cost is important. However, the goal of maintaining low-cost service should not jeopardize initiatives required to maintain a safe and reliable system.

In that regard, Atmos Energy carefully monitors its system, devotes additional resources when necessary and accelerates work when appropriate. This includes the replacement of pipelines made of materials prone to leaks and potential failure. This approach is intended to proactively protect our customers and the public in general from property damage and personal injuries (including fatalities) and permits Atmos Energy to monitor and inspect its system and renew pipe when needed, rather than doing so reactively. Given the age of some of the Company's pipelines, along with the increased expectations at the federal and state level, the Kansas Corporation Commission ("Commission") should encourage utilities to implement and fund new programs that will improve the safety and reliability of their natural gas infrastructure.

II. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I graduated in December 1986 from Mississippi State University with a Bachelor of Science degree in Petroleum Engineering. In terms of my professional background, I joined Mississippi Valley Gas Company in April 1987 as a graduate engineer. Early in my career, I participated in a training program where I spent a number of weeks, and in many cases months, working in meter reading, service and the construction areas of our company. I have held various positions of increasing responsibility since 1987 in natural gas operations, measurement and customer service. These include Manager of Measurement Service, Jackson District Superintendent, Assistant District

Manager, Jackson District Manager. In January 2003, I became Vice President of Operations for the Southern Region of Mississippi when Mississippi Valley Gas was acquired by Atmos Energy. For a majority of my 28 years of service, I have been directly responsible for the service, construction, compliance and operational activities of approximately 150 employees while serving approximately 70,000 customers while in the roles of District Superintendent and District Manager of Jackson, Mississippi. In 2003, my role expanded with my promotion to Vice President of Operations to include the southern operating region of Mississippi, providing service to approximately 130,000 customers. This included the development, execution and monitoring of O&M and capital budgets. I served in that role until the time of my promotion to my current position in May 2012.

From September 2009 until October 2011, I served as Chair of Atmos Energy's Utility Operating Council. Within the industry, I have served on the Southern Gas Association's ("SGA") Distribution Operation and Engineering Committee and the American Gas Association's ("AGA") Managing Committee. I currently serve as Co-Chair of the SGA Pipeline Safety Council and I am a member of the AGA Board Safety Committee.

Q. WHAT ARE YOUR DUTIES IN YOUR CURRENT ROLE?

A. In my position as Vice President, Pipeline Safety I provide strategic direction and plan oversight for pipeline safety and compliance, employee safety, and physical security activities for our eight state operation. I monitor the effectiveness of enterprise pipeline safety activities and seek opportunities for continuous improvement. I monitor federal and state pipeline safety activities as well as external incident investigations, and work with industry associations and regulators on pipeline safety activities.

I also serve as the executive sponsor for Atmos Energy's Utility Operating Council ("UOC"). The UOC is a governing body of enterprise leaders that is responsible for the activities that are core to delivering safe and reliable service and adhering to our customer service objectives. The UOC works to ensure we meet or exceed compliance, operational, and jurisdictional standards, and oversees our written procedures, plans and policies.

Q. HAVE YOUR EVER SUBMITTED TESTIMONY BEFORE THE COMMISSION?

A. No.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I describe the federal and state regulations governing pipeline safety and our federally-mandated Distribution Integrity Management Program ("DIMP"), provide background regarding Atmos Energy's prior requests for approval of investments in the integrity of the Company's system and mechanisms to recover those investments, and explain why, from a policy perspective, the Company's proposed System Integrity Program ("SIP") is in the public interest. Atmos Energy witness, Gary Smith, describes how the SIP would work and will explain how the Company operates under formula rates in other states in which it operates. Atmos Energy witness, Troy Paige, provides a detailed description of the state of Atmos Energy's distribution assets within the State of Kansas and where those assets require replacement.

Q. ARE YOU PROVIDING ANY EXHIBITS IN THIS PROCEEDING?

A. Yes. I am providing the following Exhibits:

- Exhibit JSM-1 is a letter from the Pipeline and Hazardous Materials Safety Administration ("PHMSA") to the National Association of Regulatory Utility Commissioners ("NARUC") dated December 19, 2011, and the White Paper on State Pipeline Infrastructure Replacement Programs.
- Exhibit JSM-2 is the resolution adopted by the NARUC on July 24, 2013.
- Exhibit JSM-3 is AGA's Commitment to Enhancing Safety.
- Exhibit JSM-4 is United States Secretary of Transportation Secretary La Hood's Call to Action.
- Exhibit JSM-5 is United States Secretary of Transportation Secretary La Hood's March 28, 2011 letter to the states.
- Exhibit JSM-6 is the FERC Policy Statement entitled "Cost Recovery Mechanisms for Modernization of Natural Gas Facilities".

III. ATMOS ENERGY'S SYSTEM INTEGRITY PROGRAM

Q. WHAT IS ATMOS ENERGY'S BASIC MISSION?

A. Atmos Energy's basic mission is to provide safe and reliable gas service to our Kansas customers.

Q. PLEASE DESCRIBE ATMOS ENERGY'S COMMITMENT TO SAFETY.

A. Throughout the Atmos Energy system, our employees are responsible for nearly 72,000 miles of natural gas pipelines, serving about three million natural gas distribution customers in more than 1,400 communities of varying sizes in eight states. For each mile of pipe we maintain and for every community we serve, ensuring the safety and reliability of our gas transmission and distribution infrastructure stands as our Company's core commitment and highest goal.

Q. WHY IS SAFETY AND RELIABILITY ATMOS ENERGY'S HIGHEST GOAL?

A. Atmos Energy is deeply committed to the safety of our customers, communities and employees; it is our highest priority. Our commitment to safety and reliability is threaded throughout our corporate culture. We have worked and continue to work with regulators, industry associations, and other stake holders to take proactive measures to strengthen safety in Kansas and our industry.

Additionally, against the backdrop of recurring natural gas incidents, Atmos Energy must continually seek and assess opportunities to improve upon the safety of our operations in an effort to reduce, wherever feasible, the potential for system integrity threats.

Q. IS THE COMPANY'S ONLY GOAL TO PROVIDE SAFE AND RELIABLE SERVICE?

A. No, we must be fiscally responsible as well. Under principles of utility regulation, utilities provide customers with utility service at reasonable rates, utility shareholders are allowed the opportunity to earn a fair rate of return on their investments, and the utility in turn has the duty or obligation to provide safe and reliable service. However, it is very important that neither Atmos Energy nor this Commission allow the goal of providing low-cost service to jeopardize the undertaking of initiatives to maintain a safe and reliable system.

Q. YOU MENTION ABOVE THAT THE MONITORING OF EXTERNAL INCIDENT INVESTIGATIONS IS ONE OF YOUR CURRENT JOB RESPONSIBILITIES. DURING YOUR TENURE WITH ATMOS ENERGY AND ITS PREDECESSOR COMPANIES, HAVE YOU BEEN INVOLVED IN COMPANY INCIDENT INVESTIGATIONS?

A. Yes. The incident that serves as a reminder to me happened in July 2006, in a city we serve. The feelings and emotions I felt during that time are still very fresh today. I even keep the front page headlines from the local newspaper in my desk to serve as a reminder of the importance of maintaining a safe pipeline system. The front page has a picture of the debris from a home that exploded as well as an article about the events of that night.

Early one evening, I received a call from our local manager telling me there had been an explosion and fire and we had employees on the scene investigating with local officials. During the course of the investigation, it became clear that natural gas was likely involved and there was tragically one fatality. We proceeded with our regulatory reporting requirements and made plans for a team, including myself, to arrive first thing the next morning. When we arrived at the scene, I was not prepared to see the complete devastation of the home. Only portions of the exterior walls of the house remained and debris was scattered in parts of trees and in nearby neighbors' yards. I could only think about the person who lost her life and the surviving family.

As we conducted our investigation, we determined that the cause of the incident was due to corrosion leak as a result of a small section of a steel service line that was isolated from cathodic protection. Cathodic protection is a means that is used to help protect steel pipe from the effects of corrosion. The corrosion of the pipe caused a hole to develop, which in turn allowed natural gas to migrate under the foundation and into the structure of the home where an ignition source created an explosion. When we excavated the portion of service line and discovered the hole in the service line, many people were on the scene including family members of the person who died. My heart sank even further when I learned that the natural gas which fueled the explosion came from the system we had the responsibility of operating and maintaining.

The investigation also revealed that the service line to the house was constructed in the early 1960s and this section was joined in a way that isolated a short section of the service line from cathodic protection, thereby increasing the potential for corrosion to occur.

Everything we were doing as an operator was in full compliance with regulations based on known conditions. We were performing regular cathodic protection readings in that area, conducting prescribed leak surveys, and conducting regular odor readings. Yet even being in full regulatory compliance based on the conditions we knew about, this incident was not prevented.

Q. HAVE YOUR EXPERIENCES WITH INCIDENT INVESTIGATION INFLUENCED HOW YOU APPROACH YOUR PIPELINE SAFETY RESPONSIBILITIES?

A. Yes. I remember meeting with the local mayor shortly after the explosion and one of the questions he asked me was, "John, how can you reassure the residents of my city and even my mother that when they go to sleep tonight, their house will not explode?" My explanation to him felt empty, but I tried to reassure him that incidents such as this were rare, and I affirmed our commitment to finding the cause and taking all actions to prevent a similar incident from occurring again.

In our industry, we always have to ask ourselves if we are doing enough and have we considered all the possibilities. We are entrusted to operate a safe and reliable system and we always have to challenge ourselves to think about conditions that may exist but we do not know about. We have to be relentless in our efforts and take all reasonable means in our daily activities while remaining vigilant in the pursuit of operating a safe and reliable system.

Q. IS ATMOS ENERGY'S PIPELINE SYSTEM IN JEOPARDY?

A. No. Atmos Energy's natural gas pipeline system in Kansas is not in imminent danger of catastrophic failure. However, as pipe ages, the incidence of failure will become more frequent, and more frequent failures increase the probability of at least one of the failures being catastrophic in nature. Delaying pipe replacement until there is a threat to public safety is obviously not good public policy.

Q. IS THE ATMOS ENERGY PIPELINE SYSTEM IN KANSAS SAFE?

A. Yes. We are very proud that, overall, our system has proven to be safe and reliable. While no one can guarantee there will never be an incident, we can and do monitor and inspect our system, identify risks, and implement remedies when appropriate. However, past success is not a guarantee of future safety and Atmos Energy must remain vigilant in monitoring, inspecting, maintaining, and improving the system. Failure to do so will inevitably lead to a less safe system.

Q. CAN ATMOS ENERGY ENSURE CONTINUED SYSTEM SAFETY AND RELIABILITY IN KANSAS?

A. Yes. By being proactive with our maintenance, monitoring, and replacement activities, Atmos Energy can minimize the risks of incidents. We are continuing to focus on maintaining and improving our safety and reliability record. At the same time, our industry is being driven to be even more proactive in identifying and mitigating risks. Atmos Energy's goal is to work with our regulators to implement a safety program that best serves the interests of our customers, the communities in which they live, and the Kansas public. The System Integrity Program is a critical component of Atmos Energy's ability to achieve that goal.

Q. WHY IS THE SIP MECHANISM CRITICAL TO ATMOS ENERGY'S REPLACEMENT PROGRAM?

A. Atmos Energy's proposed SIP is critical to the Company's ability to comply with federal pipeline safety regulations and maintain an effective pipe replacement program. Under the regulatory requirements discussed in more detail below, Atmos Energy must regularly inspect its system and proactively identify risks. Part of this proactive identification of risks involves acknowledging and investigating the known risks identified by the gas utility industry, not merely those identified through inspections of the Company's system. Once those risks are identified, Atmos Energy must implement and fund a systematic program designed to mitigate or, where possible, eliminate those risks. The SIP mechanism provides the funding necessary to make our safety program work. Specifically, the SIP is intended to timely recover system safety and integrity costs associated with gas utility capital investments.

Q. WHY IS COMMISSION APPROVAL OF THE SIP IMPORTANT?

A. Atmos Energy does not restrict capital to address safety considerations and make certain that identified risks are mitigated. However, Commission approval of recovery mechanisms such as the SIP and the Annual Review Mechanism ("ARM"), facilitates a regulatory environment where safety concerns receive their appropriate priority. As discussed in more detail below, this regulatory environment is necessary to allow the utility to invest capital to mitigate risks while eliminating the frequent or annual rate case filings that would otherwise be required to recover that investment.

Q. HAVE OTHER JURISDICTIONS IN WHICH ATMOS ENERGY OPERATES ALSO CREATED SUCH A REGULATORY ENVIRONMENT?

A. Yes. Texas has a mandate to replace a certain percentage of high relative risk assets on an annual basis and has enacted ways to recoup costs. Additionally, Louisiana and Kentucky have also enacted similar standards to mitigate risks.

Q. HAS ATMOS ENERGY HISTORICALLY REPLACED PIPE?

A. The assessment, rehabilitation and replacement of aging pipelines has been a normal part of the utility business; however, it has become more of a significant focus as we implement a regulatory framework that changes the way we respond to and mitigate risk.

The new federal regulations and directives make the systematic and proactive assessment and replacement of pipelines essential. In turn, this systematic and proactive approach requires the commitment of capital at significantly higher levels than previously included in our rate structure. This is a nationwide phenomenon and is not limited to either Atmos Energy or the State of Kansas.

Q. HAS ATMOS ENERGY PREVIOUSLY REQUESTED IMPLEMENTATION OF AN ALTERNATE RATE RECOVERY MECHANISM IN KANSAS?

A. Yes. In Docket No. 14-ATMG-320-RTS, the Company requested approval of an accelerated natural gas pipeline replacement program. The Commission denied that proposal, but in its Final Order in that docket expressed its willingness to consider future proposals. The Commission's Order stated:

> "The Commission would . . . entertain the possibility of roundtable discussions with industry to discuss proposing to the legislature either an adjustment to the GSRS Act or an additional system integrity RA [Regulatory Asset] as well as any specific projects, goals and concerns it would address. Additionally, the Commission finds its decision on the RA in this case does not prevent its consideration of other infrastructure improvement mechanisms which Atmos or other utilities may propose in the future. [14-320 Order ¶56]."

As a follow-up to that Final Order, on March 12, 2015, the Commission initiated a General Investigation in Docket No. 15-GIMG-343-GIG regarding the acceleration of replacement of natural gas pipelines. The purpose of the investigation is to address a number of questions related to this issue including the Commission's jurisdictional authority to establish alternate rate making methodologies for pipe replacement that go beyond parameters established under GSRS.

Q. HAS THE COMMISSION STAFF OFFERED AN OPINION ON THE IMPORTANCE OF ACCELERATION OF REPLACEMENT OF PIPELINES IN THE GENERAL INVESTIGATION?

A. Yes. On February 2, 2015, the Staff issued a memorandum to the Commission recommending the initiation of General Investigation. The Staff's memorandum stated on page 2:

> "Regular leak surveys and ongoing pipe replacement projects indicate the pipeline systems in Kansas are not in imminent danger of failing. However, as time and corrosion continue, the probability of leaks and subsequent safety fails will increase."

The memorandum went on to state:

> "Staff believes accelerating the rate of replacement for all utilities would be in the public interest because it would provide the public with the benefit of achieving these safety goals sooner than a program that simply replaces pipe based on the current leak rate. It seems equitable to Staff that any alternate ratemaking treatment which provides a benefit to the utility also should benefit the customer as well by achieving a safer gas delivery system sooner than is being provided by the present replacement programs." (p.3) [1]

The Staff further stated that the potential disincentive to utilities to accelerate infrastructure replacements may be contrary to the public interest for two reasons: First, if a utility is putting off accelerating the replacement of aging infrastructure, important safety benefits to customers and the public are not being realized. Second, if the only option available to utilities to counter the negative effects of regulatory lag is to file more frequent rate cases, the costs of processing these rate cases may be higher to the customers.[2]

Q. WHAT DID STAFF CONCLUDE IN ITS MEMORANDUM TO THE COMMISSIONERS?

A. Staff stated that it believes that accelerated replacement of obsolete natural gas pipe to reduce the risk to public safety is in the public interest and recommended that the Commission initiate a General Investigation addressing various questions related to the parameters of an accelerated natural gas replacement program.

Q. WHAT IS THE CURRENT STATUS OF THE GENERAL INVESTIGATION?

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[1] Docket No. 15-GIMG-343-GIG, Staff Memorandum attached to Order dated March 12, 2015, pages 2-3.
[2] ID. At page 4.

A. On June 18, 2015, the Commission issued an Order on Jurisdictional Issue. The issue of the Commission's jurisdictional authority to establish alternate ratemaking methodologies for pipeline replacement beyond the parameters established by the legislature in GSRS is one of the questions addressed in the General Investigation.

Q. WHAT DID THE COMMISSION'S ORDER CONCLUDE?

A. The Commission's Order noted in Paragraph 11 that GSRS is an optional mechanism for cost recovery and does not limit the Commission's authority to implement alternate ratemaking methodologies for recovery of costs for accelerated infrastructure replacement. The Commission concluded that "it has jurisdictional authority to establish alternative ratemaking mechanisms, including both surcharges and deferred cost recovery mechanisms, for recovery of costs associated with accelerated replacement of natural gas pipelines constructed of obsolete materials considered to be a safety risk."[3]

IV. ATMOS ENERGY'S PROPOSED SIP IS IN THE PUBLIC INTEREST

Q. IS ATMOS ENERGY'S PROPOSED SIP IN THE PUBLIC INTEREST?

A. Yes. Inherent in the federal regulations, the integrity rules, and the associated directives, is the requirement that pipeline operators do what is reasonably necessary for the public good. The assessment, rehabilitation and proactive replacement of aging infrastructure are essential to enhancing the safety and integrity of the system. In light of the changes discussed previously, the replacement projects are essential and reasonable to ensure the continued safe and reliable operation of our system.

[3] Docket No. 15-GIMG-343-GIG Order on Jurisdictional Issues dated June 18, 2015, page 5, para.11.

Promoting safety and investing in the integrity of our system in a systematic manner is in the public interest. In addition, implementing and funding a safety and reliability program in a manner consistent with the federal requirements and directives will afford our customers and the public the continued security of benefits associated with a safe and reliable natural gas distribution system.

Q. DO FEDERAL REGULATORS AGREE THAT ALTERNATE RATE RECOVERY MECHANISMS LIKE THE PROPOSED SIP ARE IN THE PUBLIC INTEREST?

A. Yes. In December of 2011, in connection with the introduction of a White Paper on State Pipeline Infrastructure Replacement Programs sponsored by the PHMSA, the PHMSA Administrator promoted the public's interest in infrastructure replacement programs in a letter to the President of the National Association of Regulatory Utility Commissioners ("NARUC"), stating:

> "[Pipeline infrastructure replacement] programs play a vital role in protecting the public by ensuring the prompt rehabilitation, repair, or replacement of high-risk gas distribution infrastructure."

Q. HAS THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) ADDRESSED THIS ISSUE?

A. Yes. On April 16, 2015, FERC issued a Policy Statement addressing cost recovery mechanisms for modernization of interstate natural gas facilities in FERC Docket No. PL15-1-000. The Policy Statement states that FERC has established a policy allowing interstate natural gas pipelines to seek recovery of certain capital expenditures made to replace infrastructure through a surcharge mechanism. On page 1 of its Policy Statement, FERC stated that its intent is to "provide 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 operations of their systems."

The FERC's Policy Statement outlined the standards that FERC will require interstate pipelines to satisfy to establish alternate ratemaking mechanisms such as surcharges or trackers to allow them to recover the costs of replacing obsolete infrastructure and thereby enhance the efficient and safe operations of their pipeline systems. A copy of FERC's Policy Statement is attached to my testimony as Exhibit JSD-6.

Q. DID FERC'S POLICY STATEMENT ADDRESS THE ISSUE OF SAFETY AS A DRIVER FOR THE NEED TO REPLACE AGING INFRASTRUCTURE?

A. Yes. In Paragraph 26 of the Policy Statement, FERC stated:

> With regard to safety and reliability . . . 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% of existing natural gas pipelines were built before 1970 and 69% of existing natural gas pipelines were built before 1980. DOE notes that more than half of the country's natural gas 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.

Q. HAS NARUC RECOGNIZED THIS NEED FOR ACCELERATED INVESTMENT IN GAS INFRASTRUCTURE?

A. Yes. In response to PHMSA's letter, NARUC issued a resolution on July 24, 2013 encouraging state commissions to "consider adopting alternative rate recovery mechanisms as necessary to accelerate the modernization, replacement and expansion of the nation's natural gas pipeline systems."[4]

Q. HAVE OTHER STATES APPROVED MECHANISMS TO FUND SAFETY AND RELIABILITY PROGRAMS FOR NATURAL GAS UTILITIES?

A. Yes. In June 2012, the AGA published a study entitled "Infrastructure Cost Recovery Update."[5] In that update, the AGA reported that as of 2007, 15 natural gas utilities in 11 states serving eight million residential customers were using "innovative rate structures" that allowed the expedited recovery of investment made in utility infrastructure replacement between rate cases. As of June 2015, those numbers have grown to 38 states, including the District of Columbia. Atmos Energy witness Gary Gregory has attached to his direct testimony Exhibit GLS-7 listing the states which have approved infrastructure replacement mechanisms.

Q. IS APPROVAL OF ATMOS ENERGY'S PROPOSED SIP MECHANISM APPROPRIATE?

A. Yes. Natural gas pipeline safety and reliability are issues of state-wide concern, and Kansas residents, regardless of where they reside, deserve to have natural gas systems that are safe and reliable. As described in more detail by Mr. Paige, Atmos Energy is assessing its system and updating its GIS mapping.

In addition to the integrity risks associated with aging infrastructure and continued degradation of pipeline materials, many of our distribution systems traverse areas with greater populations than existed when the pipes were constructed,

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[4] See Exhibit JSM – 2 – NARUC Resolution dated July 24, 2013.

[5] *Available at:* http://www.aga.org/our-issues/RatesRegulatoryIssues/ratesregpolicy/Issues/infrastructure-investment-cost-recovery-mechanisms/Pages/2012-june-infrastructure-cost-recovery-mechanisms.aspx

potentially resulting in an increased risk of injury and property damage if there is an incident. These issues and concerns directly result in a significant increase in the capital investment and O&M needed to comply with federal requirements.

V. PIPELINE SAFETY REGULATIONS

Q. IN YOUR POSITION, ARE YOU FAMILIAR WITH FEDERAL AND STATE REGULATIONS REGARDING PIPELINE SAFETY AND INTEGRITY?

A. Yes.

Q. IS ATMOS ENERGY SUBJECT TO THE PHMSA'S RULES AND REGULATIONS REGARDING GAS DISTRIBUTION PIPELINE SAFETY?

A. Yes. Atmos Energy is subject to the PHMSA rules and regulations as those are promulgated by the U.S. Department of Transportation ("DOT") and adopted by the Commission for Kansas natural gas local distribution companies.

Q. DO PIPELINE SAFETY REGULATIONS SPECIFY THE FULL EXTENT OF ACTIONS A PRUDENT OPERATOR IS EXPECTED TO UTILIZE WHEN OPERATING THEIR SYSTEM?

A. No. The pipeline safety regulations, or code (including the federal code and complementary codes adopted by the states), were never meant to be all inclusive. In other words, the federal code prescribes the minimum that should be done to construct, operate, and maintain a natural gas system. As described previously, inherent in the code and the integrity rules is the requirement that pipeline operators do what is reasonably necessary for the public good.

Q HOW HAVE INDUSTRY GROUPS RESPONDED WITH RESPECT TO GAS OPERATORS GOING BEYOND MINIMUM CODE?

A. Atmos Energy is an active member of the AGA and has provided input on the development of the AGA's "Commitment to Enhancing Safety" which was released in May 2012.[6] The report was prepared at the request of federal and state officials having oversight of pipeline safety. Atmos Energy fully supports the Commitment to Enhancing Safety and is implementing actions that the report lays out as a part of our ongoing commitment to providing safe and reliable service to our Kansas customers.

Q. PLEASE SUMMARIZE THE PHMSA REGULATIONS APPLICABLE TO ATMOS ENERGY IN KANSAS.

A. The PHMSA regulations applicable to our Kansas operations are codified at Code of Federal Regulations ("CFR") Title 49 (Transportation), Part 192 (Transportation of Natural Gas and Other Gas by Pipeline: Minimum Federal Safety Standards). These regulations prescribe minimum safety requirements for pipeline facilities and the transportation of gas (Section 192.1); define "pipeline facilities" as "new and existing pipeline, rights-of-way, and any equipment, facility, or building used in the transportation of gas..." (Section 192.3); define the "transportation of gas" as "the gathering, transmission, or distribution of gas by pipeline or the storage of gas, in or affecting interstate or foreign commerce (Section 192.3); and define an "operator" as an entity that "engages in the transportation of gas" (Section 192.3). Atmos Energy is an "operator" under Part 192 of PHMSA's regulations.

Q. WHAT IS THE "PIPES ACT" AND HOW DID THAT IMPACT PIPELINE SAFETY REGULATIONS FOR DISTRIBUTION SYSTEMS?

6 Exhibit JSM-3 is a copy of the AGA's Commitment to Enhancing Safety.

A. In 2006, Congress passed the Pipeline Inspection, Protection, Enforcement and Safety Act ("PIPES Act"). Pursuant to the PIPES Act, in 2009 PHMSA published the Integrity Management Program for Gas Distribution Pipelines Rule (49 CFR Part 192, Subpart P) ("2009 Final Rule").

Q. AS A GENERAL MATTER, WHAT IS REQUIRED UNDER THE 2009 FINAL RULE?

A. The 2009 Final Rule requires each operator, including Atmos Energy, to create and maintain a written distribution pipeline safety and integrity management program or "DIMP." The integrity management approach is "designed to promote continuous improvement in pipeline safety by requiring operators to identify and invest in risk control measures <u>beyond core regulatory requirements</u>."[7] Indeed, the "basic principle underlying integrity management" is that "operators should identify and understand the threats to their pipelines and apply their safety resources commensurate with the importance of each threat."[8]

Q. PLEASE FURTHER DESCRIBE A DIMP.

A. A DIMP specifies how the utility will identify, assess, prioritize, and evaluate risks to the integrity of distribution lines and the manner in which those risks will be mitigated or eliminated. As explained above, Atmos Energy is subject to the DIMP regulations, and required to have a DIMP in place. Additionally, Atmos Energy submits annual reports to the Commission, as further required by the PHMSA and Commission's rules.

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7 Pipeline Safety: Integrity Management Program for Gas Distribution Pipelines, 74 Fed. Reg. 63906 at 63906 (Dec. 4, 2009) (emphasis supplied) ("2009 Final Rule").

8 2009 Final Rule, 74 Fed. Reg. at 63906.

Q. WHY DID THE PHMSA PROMULGATE THE 2009 FINAL RULE?

A. The history behind the 2009 Final Rule, and the studies that lead up to it, are well discussed in the Notice of Proposed Rulemaking for the 2009 Final Rule.[9] In short, the 2009 Final Rule was the end result of the gas distribution industry's, elected officials', and state and federal regulators' recognition that the "integrity management" approach, already in place for transmission pipelines, should be extended to distribution pipelines. PHMSA recognized the special nature of distribution pipelines, and stated:

> "Incidents on distribution pipelines kill and injure more people than incidents on gas transmission pipelines. As noted above, nearly two million miles of distribution pipelines are in operation in the U.S., compared with approximately 300,000 miles of gas transmission pipelines. In addition, distribution pipelines are almost all located in populated areas. Large portions of gas transmission pipelines traverse rural areas where there are few people. Largely because of these differences, incidents on distribution pipelines in 2006 resulted in five times as many fatalities (16 vs. 3) and six times as many serious injuries (25 vs. 4) as those on gas transmission pipelines, even though the total number of incidents on each type of pipeline was about the same (141 vs. 134). Because of the much larger number of miles of distribution pipeline, the normalized rate of fatalities and injuries (i.e., the number per 100,000 miles) is similar for the two types of lines, with a slightly lower rate for distribution lines. As described further below, the trend in gas distribution incidents involving fatalities and serious injuries (those requiring hospitalization) was downward from 1990–2002. In the years since, however, the number has again started to increase.[10]"

These appear to have been some of the PHMSA's core concerns in promulgating the 2009 Final Rule.

Q. DOES THE 2009 FINAL RULE PROVIDE ANY ADDITIONAL INFORMATION?

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9 Notice of Proposed Rulemaking, 73 Fed. Reg. 36015.

10 Notice of Proposed Rulemaking, 73 Fed. Reg. 36015 at 36017.

A. Yes, it does. PHMSA's 2009 Final Rule (74 Fed. Reg. 63906) notes:

> PHMSA has considered these comments [regarding the necessity of the rule] but still considers it necessary to issue a rule requiring integrity management for distribution pipelines. While accidents may continue to occur, that does not mean that reasonable actions should not be taken to avoid those accidents that could be prevented. PHMSA concludes that the flexibility inherent in the rule, as modified in response to other comments (described below), adequately addresses concerns based on differences among distribution pipelines. PHMSA also concludes that the changes made in response to other comments will reduce implementation costs and that the rule will be cost-beneficial. PHMSA is working with State pipeline safety agencies to increase the level of Federal financial support provided for State programs. PHMSA notes that the vast majority of distribution pipeline operators and State regulators, and the associations that represent them, supported the proposed rule. The existing rules help assure an admirable safety level. Still, significant accidents continue to occur, if infrequently. Experience has shown that incidents are most often caused by a combination of circumstances. These circumstances represent risks for the pipeline involved, but may not affect other pipelines. It is thus not practical to create additional prescriptive requirements to address these pipeline-specific risks. This rule (as the integrity management requirements for other types of pipelines that preceded it) requires that operators evaluate their pipelines to identify the risks important to their circumstances and take appropriate actions to address those risks.
>
> This...[integrity management ("IM")] regulation for distribution operators requires an operator to conduct a comprehensive evaluation of its system to better identify threats to the system, to implement additional measures to help prevent accidents from occurring and to mitigate the consequences if an accident does occur. IM provides for a more systematic and comprehensive approach to preventing failures. Accordingly, PHMSA considers this the most effective means to effect further reductions in the number of pipeline incidents. The regulatory analysis supporting this rule considers the improvement in safety that is expected to result and explicitly recognizes the current low frequency of serious accidents.

Q. DID THE RULEMAKING PROCESS PROVIDE ANY INSIGHT INTO THE STATES' ROLES IN DISTRIBUTION PIPELINE SAFETY MEASURES?

A. Yes. PHMSA emphasized the importance of oversight performed directly by the States. PHMSA stated specifically:

> States must implement the minimum standards established by PHMSA but have a variety of ways in which they can oversee distribution pipeline safety. They can simply mirror the Federal pipeline safety program; they can impose additional requirements, beyond the Federal minimum; they can engage in special oversight programs with individual operators or groups of operators; or finally, they can provide incentives for safety improvements, often through their rate-setting authority. (emphasis added)
>
> It is appropriate that the principal actions for regulating distribution pipeline safety rest with the States. States need to balance safety and affordability. They need to ensure that the particular needs of their citizenry are fulfilled....[11]

Q. HAVE FEDERAL REGULATORS PROVIDED ANY ADDITIONAL GUIDANCE ON PIPELINE INTEGRITY, SUBSEQUENT TO THE PASSAGE OF THE DIMP REGULATIONS?

A. Yes, after the passage of the 2009 Final Rule, but prior to the August 2, 2011 deadline for gas distribution operators to develop their DIMPs, the United States Department of Transportation (DOT) took further action. In response to fatal explosions caused by natural gas pipeline failures in Allentown, Pennsylvania and San Bruno, California, the Secretary of Transportation Ray LaHood issued a Call to Action.[12] That Call to Action sought to engage state partners, technical experts, and pipeline operators in identifying pipeline risks and repairing, rehabilitating, and replacing the highest risk infrastructure. Additionally, the Call to Action called on pipeline operators and owners to review their pipelines and quickly repair and replace sections in poor condition.

This was a significant action by DOT. It also served as an acknowledgment that rulemakings alone were not sufficient to mitigate risks and it would require

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11 Notice of Proposed Rulemaking, 73 Fed. Reg. 36015 at 36017.

12 Exhibit-JSM-4 is a copy of the Call to Action.

collaborative actions by regulators and operators to develop rate mechanisms to accelerate the repair, rehabilitation and replacement of the nation's aging pipelines. While current infrastructure replacement programs and regulations are making enhanced safety improvements, in the opinion of the DOT they just quite simply are not making the necessary improvements at a fast enough rate.

Q. PLEASE CONTINUE.

A. In the Call to Action, Secretary LaHood provided additional information on the 2009 Final Rule, which as I discussed above created the DIMP regulations. Secretary LaHood stated that the DIMP regulations:

> require[] operators of local gas distribution pipelines to evaluate the risks on their pipeline systems to determine their fitness for service and take action to address those risks. <u>For older gas distribution systems, the appropriate mitigation measures could involve major pipe rehabilitation, repair, and replacement programs.</u> At a minimum, these measures are needed to requalify those systems as being fit for service. <u>While these measures may be costly, they are necessary to address the threat to human life, property, and the environment.</u>
>
> In addition to the many pipelines constructed with obsolete materials, there are also early vintage steel pipelines in high consequence areas that may pose risks because of inferior materials, poor construction practices, lack of maintenance or inadequate risk assessments performed by operators. The lack of basic information or incomplete records about these systems is also a contributing factor. The U.S. DOT is seeking to make sure these risks are identified, the pipelines are assessed accurately, and preventative steps are taken where they are needed.

Q. DID SECRETARY LaHOOD'S CALL TO ACTION SPECIFICALLY ADDRESS THE STATES?

A. Yes, it did. Secretary LaHood sent a March 28, 2011 letter to State Governors,[13] which stated among other things:

[13] Exhibit JSM-5 is a copy of Secretary LaHood's March 28, 2011 letter.

> "We appreciate your State's partnership on pipeline safety inspection and enforcement. In 2009, the Pipeline and Hazardous Materials Safety Administration provided the majority of the funding for your pipeline safety program, trained your State's inspectors alongside our own, and worked with them to enforce your State pipeline safety laws.
>
> "Now, we want to partner with you again to ensure that all pipeline companies in your State, both public and private, are correctly analyzing the risk to their pipeline systems and using the appropriate assessment technologies. Your pipeline safety staff can help make this happen. <u>We ask you to urge your staff to encourage companies and the State utility commission to accelerate pipeline repair, rehabilitation, and replacement programs for systems whose integrity cannot be positively confirmed.</u> This is one of the best ways to help protect your citizens from accidents like those in Allentown, Marshall, and San Bruno."

<u>VI. ATMOS ENERGY'S IMPLEMENTATION</u>

Q. HAVE THE FEDERAL AND STATE PIPELINE SAFETY CHANGES DISCUSSED PREVIOUSLY IMPACTED THE WAY THAT NATURAL GAS COMPANIES MONITOR AND MANAGE THE SAFETY OF THEIR DISTRIBUTION SYSTEMS?

A. Absolutely. The federal changes and the Call to Action have resulted in an increasingly proactive approach to pipeline safety.

Q. HOW HAVE THE CHANGES IMPACTED ATMOS ENERGY?

A. Atmos Energy is also implementing a more proactive approach to pipeline safety. Atmos Energy's intention is not only to repair identified leaks but also to proactively identify pipes where the risks of leaks developing are unacceptably high and to then design and implement a plan to mitigate those risks. As a result, Atmos Energy is investing capital into our system at a much higher annual rate than we have historically done to address safety and integrity issues identified through the risk assessment process.

As I have noted, the previously accepted approach to integrity management is no longer sufficient. Prudent integrity management now requires operators to more proactively identify and invest in risk control measures beyond minimum requirements. Atmos Energy's proposed accelerated pipeline replacement program is an example of such a proactive measure. Through its accelerated pipeline replacement program, Atmos Energy would be better able to identify and mitigate system risks rather than simply reacting once an accident has occurred.

Q. IS THERE ANY REASON FOR ATMOS ENERGY TO CONTINUE REPLACING PIPE IN KANSAS?

A. Absolutely. Going forward, we must focus on maintaining and improving our safety and reliability record in a manner consistent with the approach to pipeline safety which demands our industry to be even more proactive in identifying and mitigating risks, in the collective interest of improving safety and reliability. There is no room for complacency or error. In that vein, Atmos Energy's SIP mechanism is an example of reasonable actions taken to avoid future accidents.

VII. CONCLUSION

Q. WHY IS ATMOS ENERGY ASKING THE COMMISSION TO APPROVE THE SIP AT THIS TIME?

A. Integrity programs were intended to drive pipeline operators to better understand the threats to and the condition of their assets in order to repair or replace the pipeline proactively. In that regard, where Atmos Energy determines increased risks on our system, we must be able to carefully monitor the issues, devote additional resources, and accelerate work when needed. This includes the removal of materials prone to leaks and potential failure. These steps are necessary to allow Atmos Energy to monitor and inspect its system and renew pipe when needed, rather than doing so in a crisis mode.

The natural gas industry is undergoing dramatic changes in the way we approach safety and reliability and reexamining the way we evaluate what is the appropriate balance of safety and cost. Today our customers are reaping the benefits of low-cost and plentiful natural gas. At the same time, we must face the reality that our infrastructure is aging and expectations about safety and reliability are being raised in light of recent tragic incidents that have led to fatalities, injuries, and property damage. Given these factors, this rate case provides the Commission with an excellent opportunity to approve a new mechanism designed to implement and fund our investment in the safety and reliability of our natural gas infrastructure. In my view, these factors properly led Staff to conclude in its February 2, 2015, Memorandum to the Commission that accelerated replacement of obsolete natural gas piping to reduce the risk to public safety is in the public interest.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

VERIFICATION

STATE OF TEXAS)
)
COUNTY OF COLLIN)

John S. McDill, being duly sworn upon his oath, deposes and states that he is VP Pipeline Safety for Atmos Energy Corporation; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information and belief.

John S. McDill

Subscribed and sworn before me this 27th day of July, 2015.

Pamela L. Perry
Notary Public

My appointment expires: 10-29-16

PAMELA L. PERRY
My Commission Expires
October 29, 2016

U.S. Department
of Transportation

**Pipeline and Hazardous
Materials Safety
Administration**

Administrator

1200 New Jersey Avenue SE
Washington, DC 20590

DEC 19

Mr. Tony Clark
Chairman of the Board and President
National Association of Regulatory Utility Commissioners
1101 Vermont Avenue, NW
Suite 200
Washington, DC 20005

Ms. Collette Honorable
Chair, NARUC Pipeline Safety Task Force
National Association of Regulatory Utility Commissioners
1101 Vermont Avenue, NW
Suite 200
Washington, DC 20005

Dear Mr. Clark and Ms. Honorable:

As U.S. Department of Transportation (DOT) and the National Association of Regulatory Utility Commissioners (NARUC) continue to support efforts to accelerate the repair, rehabilitation, and replacement of high-risk infrastructure in pipeline systems, we appreciate the NARUC's continued diligence in promoting rate mechanisms that will encourage and will enable pipeline operators to take reasonable measures to repair, rehabilitate or replace high-risk gas pipeline infrastructure. We have prepared, and attached, a white paper on state pipeline infrastructure replacement programs in the hope that you will share it with your members as a resource for encouraging more States to adopt alternative or more flexible rate mechanisms that will facilitate the replacement or repair of high-risk pipelines.

As you know, the Pipeline and Hazardous Materials Safety Administration (PHMSA) has regulatory authority in regard to the safety of our nation's pipelines. PHMSA, however, does not have the authority to determine the routing, rates, or other terms and conditions of service for gas pipelines. The Federal Energy Regulatory Commission makes these determinations for interstate gas pipelines, and the State public utility commissions you represent typically do the same for intrastate gas pipelines. Most State commissions are also responsible for oversight of intrastate pipeline safety through certifications or agreements with PHMSA.

Many State public utility commissions have encouraged the timely repair, rehabilitation, and replacement of high-risk gas pipeline infrastructure through special rate mechanisms. Some legislatures have also provided their State public utility commissions with specific statutory authority to approve such programs for intrastate gas lines. A comprehensive list of these programs is available at http://opsweb.phmsa.dot.gov/pipelineforum/pipeline-systems/state-pipeline-system/state-replacement-programs/.

We believe that the timely repair, rehabilitation, and replacement of high-risk gas pipeline infrastructure are critical to ensuring public safety. A series of recent gas pipeline accidents, including the September 9, 2010 San Bruno, California accident, the January 19, 2011 Philadelphia, Pennsylvania accident, and the February 10, 2011 accident, show the terrible loss of life and property that can occur without adequate attention to the integrity of pipeline infrastructure.

PHMSA believes that an effective program for ensuring the timely rehabilitation, repair, or replacement of high-risk gas pipelines might have helped prevent these accidents. Accordingly, we recommend that State public utility commissions consider accelerating work on the following kinds of high-risk intrastate gas infrastructure in the future:

- Cast iron gas mains, which can be prone to failure as a result of graphitization or brittleness;
- Plastic pipe manufactured in the 1960s to the early 1980s, which is susceptible to premature failures as a result of brittle-like cracking;
- Mechanical couplings used for joining and pressure sealing pipe, which are prone to failure under certain conditions;
- Bare steel pipe without adequate corrosion control (i.e., cathodic protection or coating);
- Copper piping;
- Older pipe, if it is vulnerable to failure from time-dependent forces, such as corrosion, stress corrosion cracking, settlement, or cyclic fatigue factor; and
- Pipelines with inadequate construction records or assessment results to verify their integrity.

PHMSA requests your support in ensuring that State commissions implement effective programs for the timely repair, replacement, and rehabilitation of high-risk gas pipeline infrastructure.

I look forward to continuing to work with the NARUC on pipeline safety and welcome any thoughts that you have on the issues discussed in this letter. Please send your response to Jeffrey Wiese, Associate Administrator for Pipeline Safety, or to contact me if you have any questions or concerns.

Regards,

Cynthia L. Quarterman

Enclosure: White Paper

UNITED STATES DEPARTMENT OF TRANSPORTATION
PIPELINE AND HAZARDOUS MATERIALS SAFETY ADMINISTRATION

White Paper on State Pipeline Infrastructure Replacement Programs

Prepared for

National Association of Regulatory Commissioners

December 2011

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Introduction

Under the leadership of Transportation Secretary Ray LaHood and Administrator Cynthia Quarterman, the Pipeline and Hazardous Materials Safety Administration (PHMSA) has issued a Call to Action with the goal of accelerating the rehabilitation, repair, and replacement of high-risk pipeline infrastructure. This effort comes on the heels of several high profile pipeline accidents, including two recent gas distribution line explosions in Pennsylvania that resulted in multiple deaths.

As part of Secretary LaHood's Call to Action, PHMSA has prepared this white paper to urge State public utility commissions to expand the use of pipeline infrastructure replacement programs. It includes an overview of natural gas ratemaking, a discussion of the need to take prompt action to remediate high-risk pipeline infrastructure, and a description of the various State programs that are being used for that purpose.

Executive Summary

Public safety requires prompt action to repair, remediate, and replace high-risk gas pipeline infrastructure, including cast iron mains, certain vintages of plastic pipe and mechanical coupling installations, bare steel pipe without adequate corrosion control, and copper piping. Several recent gas pipeline accidents show the terrible consequences that can occur if such action is not taken.

The Federal Energy Regulatory Commission establishes rates for interstate natural gas pipeline service under the "just and reasonable" standard provided in the Natural Gas Act of 1938. State public utility commissions (and in some cases local authorities) establish rates for intrastate natural gas pipeline service. While based on State and local laws, those determinations are generally made on the basis of a formula that is similar to the "just and reasonable" standard.

Pipeline infrastructure replacement programs for gas distribution systems exist in nearly 30 States. Some State Public utility commissions have used their traditional ratemaking authority to approve these programs, the terms and conditions of which are established under a generally applicable statutory provision. Other State public utility commissions have specific authority to approve such programs. The terms, conditions, and cost recovery mechanisms of these programs vary by statute. Whether as part of the traditional ratemaking process or in a separate proceeding, PHMSA is encouraging the States to accelerate the remediation of high-risk gas pipeline infrastructure.

PHMSA intends to focus on this issue in implementing the new Gas Distribution Pipeline Integrity Management Program Rule and as part of the annual certification process for State pipeline safety programs. PHMSA is also willing to provide other assistance to State public utility commissions who are seeking to establish or improve programs for the repair, rehabilitation, and replacement of high-risk pipeline infrastructure.

I. General Ratemaking Principles

Federal Ratemaking

The Federal Energy Regulatory Commission (FERC) regulates the interstate sale and transportation of natural gas under the Natural Gas Act of 1938 (NGA). The NGA imposes a "just and reasonable" requirement on the rates charged for interstate pipeline services, a standard that requires FERC to consider both the interests of pipeline operators and ratepayers. FERC utilizes varying ratemaking methodologies to meet the "just and reasonable" standard, such as selective discounting, market-based rates, and negotiated rates. However, the underlying premise that ratemaking should be based on the cost of providing service remains a strong principle in rate-making proceedings. Accordingly, cost-of-service ratemaking is the primary method that FERC uses to establish rates.

Cost-of-service ratemaking bases rates on the cost of service and affords the pipeline a reasonable rate of return. The Cost-of-Service:

> Includes the product of the pipeline's Rate Base (which is the pipeline's investment) and the Overall Rate of Return, plus its Operation and Maintenance Expenses (O&M), Administrative and General Expenses (A&G), Depreciation Expense, Non-Income Taxes and Income Taxes, less Revenue Credits.

In this equation, the Rate Base captures the total amount invested in the pipeline and is used to calculate the permissible return on investment. The Overall Rate of Return is a product of the pipeline's capitalization ratio, the cost of debt, and the rate of return that is allowed on the pipeline's equity. Total cost-of-service captures the amount of rate revenue that a pipeline company must charge in order to maintain profitability and remain an attractive prospect for future investment.

FERC applies cost-of-service and other rate methodologies in rate proceedings to set initial rates for new or expanding pipelines, increase rates for existing pipelines, and require prospective changes to existing rates. Applications to establish new or expanded pipeline service must be approved by FERC and are required to meet a "public convenience and necessity" standard. In a certificate proceeding, FERC authorizes initial rates that remain in effect until a further rate proceeding is held. In a general Section 4 rate case, a pipeline files to increase rates and is required to prove that its proposal is "just and reasonable." Alternatively, in a Section 5 rate proceeding, FERC may require prospective rate changes, if it is determined that a pipeline's rates no longer meet the "just and reasonable" standard.[1]

State Ratemaking

[1] Cost-of-Service Rates Manual, Federal Energy Regulatory Commission, June 1999.

State public utility commission (PUCs) regulate the intrastate sale of natural gas, which includes establishing rates for the end user. State PUCs evaluate ratemaking proposals according to a variety of legislative mandates, policy objectives, and consumer interests, but have traditionally set rates according to the "just and reasonable" standard. As articulated by the National Regulatory Research Institute, these rates share four general characteristics. First, rates are reflective of "an efficient or prudent utility" and, therefore, do not include those costs that a utility could eliminate without impairing efficiency or profitability. Second, rates incorporate the natural consequences of a utility's provision of service at different levels and to different classes of customers. Third, rates are set at a level that provides the utility with an acceptable return to ensure that it remains an attractive candidate for new capital investment. Lastly, the utility's provision of service should be nondiscriminatory. Within these general principles, the States use varying methods to establish rates, some of which are outlined below.

Rates for Investor-Owned Local Gas Distribution Companies

Local distribution companies are privately-owned utilities and are required to provide distribution of natural gas to any customer within its geographic franchise area upon reasonable request. These utilities own the natural gas being distributed for their "sales customers" and get paid a fee for the distribution service. Local distribution companies do not earn any money from the sale of the natural gas itself, whether the utility owns the natural gas or transports it on behalf of the customer. The companies simply pass the cost of the gas straight through to the customer. Customers who have purchased their natural gas from a third party supplier or market and wish the distribution company to transport the gas to their business or home, commonly referred to as "transportation customers," pay a fee for the transport of natural gas over the local distribution company's pipeline.

State PUCs regulate the rates, terms, and conditions of service for investor-owned natural gas distribution systems. Local agencies generally perform that regulatory function for publicly-owned distribution utilities. These State and local authorities are also responsible for ensuring that the operation of these utilities serves the public interest. In some cases, that may require prohibiting a utility from turning off a residential customer's gas service for nonpayment during cold weather, asking for safety-driven changes beyond those required by the Federal and State safety regulators, or requiring utilities to offer energy conservation programs.

Natural gas utilities are required to post the rates, terms, and other conditions of service with their State PUCs, and customers must pay the posted rates to obtain the applicable service. Utilities also have information on file with State PUCs on the current "purchased gas adjustment charge." These charges account for market-driven changes in the price the utility pays for the gas supplied to its customers.

Rates for Publicly-Owned Local Gas Utility Systems

Publicly-owned gas utility systems are non-profit enterprises that are owned by the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. These utilities own the natural gas that is provided to their customers and charge a fee for the distribution service. Publicly-owned utilities also pass through and recover the cost of acquiring the natural gas that is distributed.

Unlike privately-owned pipeline systems, most State PUCs do not establish rates for publicly-owned gas distribution systems. That function is typically performed by a local body, like a city or county council or utility board. There is no requirement that the rate charged by the utility be based on the cost of service, and the utility may charge whatever rate is established by its governing body.

Rates for publicly-owned utilities do not include costs for return on investment or profit, and any necessary capital is raised by issuing bonds. Customers of municipal utilities pay the purchased gas adjustment charge for the amount of gas the utility distributes during the billing period. Rate changes must be approved by the city council or the utility board.

II. Need for Repair, Rehabilitation, and Replacement of High-Risk Gas Pipeline Infrastructure

The safety of natural gas distribution systems has improved significantly since the enactment of the Natural Gas Pipeline Safety Act of 1968, which provided DOT with the authority to establish safety standards for natural gas systems. A number of serious incidents in natural gas distribution systems, however, still occur each year, and many of those incidents are caused by failures of high-risk pipeline infrastructure. Thus, there is a need to improve pipeline safety by repairing, rehabilitating and replacing high risk pipe.

High-risk pipeline infrastructure is piping or equipment that is no longer fit for service. As discussed below, that lack of fitness can be the product of a variety of factors.

- Cast iron gas mains and service lines can be prone to failure as a result of graphitization or brittleness. The installation of cast iron pipe dates to the 1830s, and remained prevalent until the post-World War II period. Many major urban areas, including Philadelphia, PA; Boston, MA; Baltimore, MD; Washington, DC; Detroit, MI; Chicago, IL; and San Francisco, CA, still have cast iron pipe in their natural gas distribution systems.[2]

- Certain vintages of plastic pipe are susceptible to premature failures as a result of brittle-like cracking. In April 1998, the National Transportation Safety Board (NTSB) released a Special Investigation Report on Brittle-Like Cracking in Plastic Pipe for Gas Service. NTSB found that the long-term strength and resistance of plastic pipe to brittle-like cracking may have been overrated for much of the plastic pipe manufactured and installed from the 1960s through the early 1980s. The NTSB

[2] http://opsweb.phmsa.dot.gov/pipelineforum/reports-and-research/cast-iron-pipeline/

also found that any potential public safety hazards from these failures are likely to be limited to locations where stress intensification exists. In response to the NTSB report and subsequent investigations, PHMSA issued four advisory bulletins on the susceptibility of certain kinds of older plastic pipe to brittle-like cracking.[3]

- Mechanical coupling installations are devices that are used for the joining and pressure sealing of two pieces of pipe. These devices are prone to failure under certain conditions. In March 2008, PHMSA issued an Advisory Bulletin (ADB) on the use of mechanical couplings in natural gas distribution systems. The ADB noted that these devices are more likely to fail when there is inadequate restraint for the potential stresses on the two pipes, when the couplings are incorrectly installed or supported, or when components experience age-related deterioration. The ADB also noted that inadequate leak surveys can fail to detect a coupling in need of repair and lead to more serious incidents.[4]

- Pipelines lacking adequate construction records or assessment results to verify their integrity. In January 2011, PHMSA issued an ADB on the need to use traceable, verifiable, and complete records in establishing the maximum allowable operating pressures and developing and implementing integrity management programs for natural gas pipelines. The ADB responded to an NTSB recommendation, which resulted from its investigation of the September 2010 intrastate natural gas transmission line rupture in San Bruno, California, which is discussed below.

- Other kinds of pipe installations, including bare steel pipe without adequate corrosion control (i.e., cathodic protection or coating) and copper piping, are also more susceptible to failure.

- Age of pipe should be considered in determining whether pipeline infrastructure is vulnerable to failure from time-dependent forces, like corrosion, stress corrosion cracking, settlement, or cyclic fatigue.

Several recent gas pipeline accidents show the grave consequences that can occur if high-risk gas pipeline infrastructure is not properly repaired, rehabilitated, or replaced. For example,

- On September 9, 2010, an intrastate natural gas transmission line ruptured in San Bruno, California. The ensuing explosion and fire resulted in 8 fatalities, multiple injuries, and destroyed 38 homes. NTSB has released a final report on the cause of the accident and concluded that the failure was the result of an improperly-welded section of pipe that had been installed in 1956 and never subjected to hydrostatic pressure testing.

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[3] 72 FR 51301.

[4] 73 FR 11695.

- On January 19, 2011, a natural gas explosion and fire in a natural gas distribution system killed one person and injured five others in Philadelphia, Pennsylvania. The cause of the accident remains under investigation, but preliminary reports indicate that the source of the gas leak was a 12-inch cast iron gas main installed in the 1920s.

- On February 10, 2011, another natural gas explosion and fire in a natural gas distribution system killed five people and destroyed several homes in Allentown, Pennsylvania. The cause of the accident remains under investigation, but preliminary reports indicate that the source of the gas leak was an 83-year-old, 12-inch cast iron gas main.

Recognizing that prompt action to replace these high-risk gas pipelines might have prevented each of these accidents, Transportation Secretary Ray LaHood issued a Call to Action in April 2009 encouraging the States to expand and accelerate the use of such programs.[5] Twenty-two States responded to the Secretary's initiative by providing PHMSA with information on their efforts to remediate high-risk pipeline infrastructure.

After reviewing that information and performing additional research, PHMSA decided to prepare the following overview of the State pipeline infrastructure replacement programs. PHMSA urges the appropriate regulatory authorities will use this information to accelerate their efforts to repair, rehabilitate, and replace high-risk gas pipeline infrastructure in their jurisdictions. In addition to the analysis provided below, a comprehensive list of all of these programs is included in Appendix I.

III. Using Traditional Ratemaking Authority to Establish Infrastructure Replacement Programs

Several state public utility commissions have used their traditional ratemaking authority to approve pipeline infrastructure replacement programs. The examples discussed below show how that authority can be used to ensure the timely repair, rehabilitation, and replacement of high-risk pipeline infrastructure without additional legislation.

New Jersey

Originally established in 1911 as the Department of Public Utilities, the mission of the New Jersey Board of Public Utilities (BPU) is "[t]o ensure the provision of safe, adequate and proper utility and regulated service at reasonable rates, while enhancing the quality of life for the citizens of New Jersey and performing these public duties with integrity, responsiveness and efficiency."[6] The Division of Energy is responsible for regulating the State's four natural gas

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[5] http://opsweb.phmsa.dot.gov/pipelineforum/

[6] http://www.nj.gov/bpu/about/index.html.

service providers: Elizabethtown Gas, New Jersey Natural Gas (NJNG), PSE&G, and South Jersey Gas.[7]

As part of then-Governor Jon Corzine's economic stimulus plan, BPU approved accelerated pipeline infrastructure replacement programs using its plenary authority to require or enable natural gas companies to provide safe, adequate, and proper service to its customer.[8] In a December 22, 2009 provisional order, BPU approved Elizabethtown Gas's petition to implement a Utility Enhancement Infrastructure Rider (i.e., a rate increase to allow for an accelerated recovery of the costs associated with performing certain gas-distribution infrastructure related projects). The list of qualifying projects included the replacement of 29 miles of 10- and 12-inch and 41.9 miles of 4-inch cast iron gas mains; the installation of 6 miles of 8-inch main and 20 miles of 12-inch main in certain locations. In a subsequent filing, Elizabethtown petitioned BPU to approve an additional rate increase to cover greater-than-anticipated costs for each of these projects.[9]

Likewise, in an April 29, 2009 order, BPU approved NJNG's petition to implement an Accelerated Infrastructure Investment Program (AIIP), i.e., a rate increase to allow for an accelerated recovery of the costs associated with performing 14 infrastructure projects. In a March 30, 2011, BPU approved NJNG's petition to add 9 additional projects to the AIIP. The total anticipated cost for these projects is approximately 130 million dollars.[10]

Kentucky

Created in 1934, the Kentucky Public Service Commission (KPSC) is a three member administrative body with authority to regulate investor-owned natural gas companies. KPSC does not regulate natural gas utilities subject to the control of cities or political subdivisions, or those served by the Tennessee Valley Authority.[11]

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[7] http://www.state.nj.us/bpu/index.shtml

[8] Specifically, § 48: 2-23 states:

The board may, after public hearing, upon notice, by order in writing, require any public utility to furnish safe, adequate and proper service, including furnishing and performance of service in a manner that tends to conserve and preserve the quality of the environment and prevent the pollution of the waters, land and air of this State, and including furnishing and performance of service in a manner which preserves and protects the water quality of a public water supply, and to maintain its property and equipment in such condition as to enable it to do so.

The board may, pending any such proceeding, require any public utility to continue to furnish service and to maintain its property and equipment in such condition as to enable it to do so.

[9] *See* http://www.elizabethtowngas.com/Universal/RatesandTariff/RegulatoryInformation.aspx

[10] *See* http://www.njng.com/regulatory/filings.asp

[11] http://psc.ky.gov/

In a January 31, 2002 order, KPSC approved a petition filed by Duke Energy Kentucky, Inc. (Duke) for approval of an Accelerated Main Replacement Program (AMRP) Rider, which was designed to allow Duke to reduce the time for replacing its cast iron and bare steel mains from 15 years to 10 years. The Kentucky Attorney General appealed that order, arguing that KPSC lacked the authority to approve such a program outside of the confines of a general rate case. The Kentucky Supreme Court later ruled that KPSC had the power to approve the AMRP Rider under its plenary authority to ensure that rates are "fair, just and reasonable."[12]

Indiana

Established in the early 20th century, the Indiana Regulatory Utility Commission (IRUC) is comprised of five Commissioners who are appointed by the Governor to staggered four-year terms. The Gas Division is responsible for regulating the rates and terms and conditions of service for intrastate gas utilities.[13]

IRUC uses a deferred accounting alternative to allow eligible infrastructure investment costs to be diverted to a special deferred account. In the next rate case, the costs are amortized, recovered in rates, and the balance in the special deferred account is either reduced or eliminated. Gas utilities must establish, through the ratemaking proceeding, that all infrastructure investment costs in such accounts are properly accounted for. The assets in these deferred accounts may accrue interest, which isamortized and recoverable. The amount and type of infrastructure costs may be limited and are subject to state approval.

IRUC has approved Vectren Corporation's program to target 90 miles of pipeline replacements per year, as part of a broader, 20-year effort to replace 1,700 miles of aging bare steel and cast iron mains in Indiana and Ohio.[14]

IV. Using Specific Ratemaking Authority to Establish Infrastructure Replacement Programs

Several states have provided their public utility commissions with specific statutory authority to approve pipeline infrastructure replacement programs. Some states, like Missouri, Kansas, and Nebraska, have enacted statutes with detailed eligibility requirements and cost-recovery formulas. Other states, like Ohio, have adopted statutes that provide their commissions with far more flexibility and discretion. Still other states, like Texas and Virginia, fall somewhere in between.

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[12] *Kentucky Public Service Commission v. Commonwealth of Kentucky*, 324 S.W.3d 373 (KY 2010).

[13] http://www.in.gov/iurc/

[14] *http://www.enengineering.com/pdf/p&gj4_05.pdf*

Infrastructure Replacement Surcharge: Missouri, Kansas, and Nebraska

Missouri, Kansas, and Nebraska have adopted statutes that authorize the approval of infrastructure replacement surcharges. Local distribution companies are allowed to charge current customers for the cost of replacing existing infrastructure through the performance of certain projects. A specific formula is provided for determining the permissible amount of the surcharge; procedural requirements are also included to facilitate commission review and approval.

Missouri and Kansas

Established in 1913, the Missouri Public Service Commission (MPSC) regulates local gas distribution companies and is composed of five commissioners who are appointed by the governor.[15] Founded two decades later, the Kansas Corporation Commission (KCC) regulates natural gas companies and is composed of three commissioners who are appointed by the Governor for 4-year terms with the approval of the Senate.[16]

On July 9, 2003, the Missouri General Assembly enacted a statute allowing gas corporations to petition MPSC for approval of an infrastructure system replacement surcharge (ISRS) as of August 28, 2003. Using Missouri's ISRS statute as a model, the Kansas Legislature enacted the Gas Safety and Reliability Act (GSRA) three years later, on April 12, 2006. The GSRA provided that as of July 1, 2006, a natural gas public utility could petition the KCC to establish or change gas system reliability surcharge (GSRS) rate schedules.

These two statutes are similar in many respects and include provisions that define the kinds of gas utility projects which are eligible for a cost recovery surcharge, establish a formula for determining and limiting the amount of that surcharge, and prescribe the procedural requirements that must be met before a surcharge can be imposed.

Both statutes generally limit eligible infrastructure system replacements to gas utility plant projects that:

- Do not increase revenues by directly connecting the infrastructure replacement to new customers;
- Are in service and used and useful;
- Were not included in the gas corporation's rate base in its most recent general rate case; and
- Replace, or extend the useful life of an existing infrastructure.

The statutes also list the kinds of "gas utility plant projects" that are eligible for the surcharge:

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[15] http://psc.mo.gov/

[16] http://www.kcc.state.ks.us/index.htm

- Mains, valves, service lines, regulator stations, vaults, and other pipeline system components installed to comply with State or Federal safety requirements as replacements for existing facilities that are in deteriorated condition;

- Main relining projects, service line insertion projects, joint encapsulation projects, and other similar projects extending the useful life, or enhancing the integrity of pipeline system components for compliance with State or Federal safety requirements; and

- Facility relocations as a result of construction or improvement of a highway, road, street, public way, or other public work by or on behalf of the United States, the State (or political subdivision thereof), or another entity having the power of eminent domain provided that the costs related to such projects have not been reimbursed to the gas corporation.

The two statutes also prescribe a formula for determining the maximum amount and duration of the surcharge:

- MPSC and KCC cannot approve a surcharge that produces a total annualized surcharge revenue below the lesser of $1,000,000 or 1/2 percent of the gas company's base revenue level or exceeds 10 percent of the base revenue approved at the gas company's most recent general rate proceeding.

- A surcharge cannot be approved for a gas company that has not had a general rate proceeding decided or dismissed within a certain number of months (the past 36 months for Missouri and the past 60 months for Kansas), unless the gas company has filed for one or is the subject of a new proceeding.[17]

Finally, there are also procedural requirements that must be met to authorize the surcharge:

- Gas companies that petition MPSC or KCC for a surcharge must submit a proposed ISRS or GSRS and supporting documentation.

- MPSC and KCC must publish notice of that filing, and their respective staffs are required to confirm underlying costs and submit a report within 60 days.

- MPSC and KCC may hold a hearing on the petition but must issue an order that is effective no later than 120 days after the filing.

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[17] As originally enacted, the GSRA prohibited a utility from collecting a GSRS for any period exceeding 60 months unless a filing had been made or was subject to a new proceeding. However, on April 13, 2011, the Kansas Legislature amended the GSRA to allow the KCC, on motion from a natural gas public utility, to extend that 60-month deadline for up to 12 months.

- A gas company cannot effectuate a change in its rates more often than twice every 12 months.

Nebraska

The Nebraska Public Service Commission (NPSC) regulates the rates and quality of service for investor-owned natural gas public utilities and is composed of five elected commissioners who serve 6-year terms.[18] On August 30, 2009, the Nebraska legislature enacted a statute allowing a jurisdictional utility to file an application and proposed rate schedule with NPSC to establish or change "infrastructure system replacement cost recovery charge rate schedules." Through this process, utilities may request an adjustment of their rates to recover costs for eligible infrastructure system replacements. Nebraska's legislation is largely bifurcated: utilities are treated differently depending on whether or not their prior rate filings were subject to negotiation.

NPSC is specifically disallowed from approving rate schedules that produce total annualized infrastructure system cost recovery charge revenue either:

- Below the lesser of one million dollars or one-half percent of the utility's base revenue level, as approved by the commission in the most recent general rate proceeding; or

- Exceeding ten percent of the utility's base revenue level, as approved by the commission in the most recent general rate proceeding.

Furthermore, NPSC cannot approve any rate schedules for a utility that has not had a general rate proceeding decided or dismissed by order within the 60 months immediately preceding the application for a infrastructure system replacement cost recovery charge. Utilities cannot collect a recovery rate for a period exceeding 60 months after the initial approval, unless that utility has filed for or is the subject of a new general rate proceeding within the 60-month period. (The rate may be collected until the effective date of a new rate schedule established as a result of a new general rate proceeding or until the rate proceeding is otherwise decided or dismissed by issuance of a commission order without new rates being established).

Two processes exist for establishing or changing a rate schedule. If the utility's last general rate filing was not subject to negotiation, the utility must submit to NPSC:

- A list of eligible projects;

- A description of the projects;

- The location of the projects;

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[18] http://www.psc.state.ne.us/index.htm

- The purpose of the projects;
- The dates construction began and ended;
- The total expenses for each project at completion; and
- The extent to which such expenses are eligible for inclusion in the calculation of the infrastructure system replacement cost recovery charge.

After the public advocate conducts an examination of this information to verify the underlying costs, NPSC must require a report on this examination to be prepared and filed not later than 60 days after the application. NPSC must hold a hearing on the application and issue an order that is effective not later than 120 days after the application is filed (there is a good-cause 30-day extension). If NPSC finds that an application complies with the applicable requirements, an order is issued authorizing the utility to recover appropriate pretax revenue. Utilities may apply for a change in any infrastructure system replacement cost no more than once in any 12-month period.

If a utility's last general rate filing was subject to negotiation, it must submit to NPSC the schedules, supporting documentation, and a written notice for each city that will be affected by the charge. The notice must identify the cities that will be affected by the filing and copies must be provided to each such city. Affected cities have 30 days from that filing to adopt a resolution of intent to negotiate a charge rate with the utility. A copy of the resolution in support, or a resolution of rejection, of the offer to negotiate must be provided to the utility and NPSC within seven days of adoption.

If NPSC receives timely resolutions from cities that represent more than 50 percent of the ratepayers within the affected cities, to negotiate a recovery rate with the utility, the commission will certify the case for negotiation and will take no action until the negotiation period has expired. If agreement is reached, it must be put in writing and filed with the commission, which then must enter an order either approving or rejecting the rate within 30 days of the filing of the agreement. If agreement is not reached, the affected cities and the utility must submit all documentation within 14 days after the commission receives notice that the negotiations have failed. A hearing must be held not later than 35 days after the receipt of this report. If the commission receives resolutions from cities representing more than 50 percent of ratepayers that expressly reject negotiations, the rate review proceeds immediately.

Interim Rate Adjustment: Texas and Virginia

<u>Texas</u>

Established in 1891, the Texas Railroad Commission (TRC) has primary regulatory authority over various aspects of the oil and natural gas industry. The Gas Services Division regulates the day-to-day activities of approximately 200 natural gas utilities and is responsible for ensuring that a continuous, safe supply of natural gas is available to local consumers at the lowest, reasonable price. TRC has exclusive authority over the rates and terms of service for gas utilities in unincorporated areas and original jurisdiction over utilities at a city gate. TRC is composed of three members who are elected to serve 6-year terms.[19]

On May 16, 2003, the Texas Legislature enacted the Gas Reliability Infrastructure Program (GRIP) statute, which allows gas utilities to recover a return on capital expenditures made during the interim period between general rate cases.[20] Specifically, a gas utility may file a tariff or rate schedule with TRC providing for an interim rate adjustment within two years of the utility's last general rate case. That tariff or rate schedule must be filed at least 60 days before the proposed implementation date of the new rates. During that 60-day period, implementation of the new rates may be suspended by the TRC or an affected municipality for up to 45 days.

The allowable amount of the interim rate adjustment is based on values associated with the utility's return on investment, depreciation expenses, ad valorem taxes, revenue-related taxes, and incremental federal income taxes. The reasonableness and prudence of the investments recovered by an interim rate adjustment is subject to review in the utility's next general rate case. Until the TRC issues a final order approving the interim rate adjustment in that rate case, all amounts collected under the tariff or rate schedule before the filing of that rate case are subject to refund (including with interest, if appropriate). Any utility that implements an interim rate adjustment is required to file a general rate case no later than 180 days after the fifth anniversary of the date its interim rate became effective. The regulatory authority itself may also initiate a rate case at any time to review the reasonableness of the utility's rates.

It should also be noted that TRC has issued regulations mandating the removal, rehabilitation, or replacement of gas distribution pipeline facilities as part of their state pipeline safety program.[21] That includes requirements for the removal of compression couplings and, more recently, for the submission of a written risk-based program, by August 1, 2011, for the removal or replacement of all other distribution facilities.

Virginia

Established in 1902, the Virginia State Corporation Commission (VSCC) is composed of three commissioners who are elected by the General Assembly for 6-year terms. Its Division of Energy Regulation is responsible for providing assistance in regulating investor-owned natural gas utilities.[22]

On April 11, 2010, the SAVE Act (Steps to Advance Virginia's Energy Plan) was enacted, authorizing certain natural gas utilities to petition the State Corporation Commission

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[19] http://www.rrc.state.tx.us/

[20] Tex. Util.Code Ann. § 104.301.

[21] http://info.sos.state.tx.us/pls/pub/readtac$ext.ViewTAC?tac_view=5&ti=16&pt=1&ch=8&sch=C&rl=Y

[22] http://www.scc.virginia.gov/pue/index.aspx

(SCC) for a separate rider ("SAVE rider"), allowing for the recovery of certain costs associated with eligible infrastructure replacement projects. While utilities are still required to apply for the SAVE rider, the statute places restrictions on the VSCC approval process, ostensibly to wall off this process from traditional ratemaking.

Under the Act, an eligible "natural gas utility" is any investor-owned public service company that furnishes natural gas service to the public. Natural gas utilities may apply for "eligible infrastructure replacement" projects that:

- Enhance safety or reliability by reducing system integrity risks associated with customer outages, corrosion, equipment failures, material failures, natural forces, or other outside force damage;

- Do not increase revenues by directly connecting the infrastructure replacement to new customers;

- Reduce or have the potential to avoid greenhouse gas emissions; and

- Are not included in the natural gas utility's rate base in its most recent rate case or in the rate base filed with a performance based regulation plan.

Specifically, eligible "natural gas utility facility replacement projects" are intended to replace storage, peak shaving, transmission or distribution facilities used in the delivery of natural gas, or supplemental or substitute forms of gas sources by a natural gas utility. The act specifically delineates recoverable costs, including return on investment, depreciation, property taxes, and carrying costs of the eligible infrastructure replacement projects.

In order to qualify for the SAVE rider, utilities must file a petition with VSCC to establish a plan, which must include a completion timeline, a schedule of cost recovery, and a certification that the plan is "prudent and reasonable." Prior to approval, VSCC must provide notice and an opportunity for a hearing on the plan. SAVE plans must be approved or denied within 180 days; in the case of a denial, VSCC must specifically detail the reasons for the denial and the utility may refile, without prejudice, an amended plan within 60 days, at which point the Commission has an additional 60 days to approve or deny. VSCC is specifically prohibited from requiring the filing of rate case schedules in conjunction with the consideration of a SAVE plan. In addition, no other revenue requirement or ratemaking issues may be examined in conjunction with the consideration of an application filed pursuant to the SAVE Act.

At the end of each 12-month period that a SAVE rider is in effect, the utility must reconcile the difference between the eligible replacement costs and the amounts recovered under the SAVE rider. This reconciliation provides the basis for an adjustment to the SAVE rider, which VSCC must approve or deny within 90 days, whether it is an additional recovery or a refund. Finally, the Act states that this rider is in addition to all other costs that a utility is permitted to recover and cannot be considered as an offset to other VSCC-approved cost of service or revenue requirements. In addition, the rider cannot be included in the computation of a performance based regulation plan revenue-sharing mechanism.

In summary, the Virginia SAVE Act:

- Uses a rider for the recovery of certain eligible infrastructure costs;
- Uses a statutorily prescribed process that is separated from the ratemaking process;
- Includes an amendment process to incorporate increased project costs, but also requires refunds;
- Requires approval or denial within specific timeframe; and
- Restricts VSCC from considering any costs that the utilities are already allowed to recover in the consideration of whether a utility should be able to recover infrastructure costs.

Alternative Rate Plan: Ohio

Established in 1913, the Public Utilities Commission of Ohio (PUCO) regulates various public utilities in Ohio, including more than two dozen natural gas companies. Those companies provide gas service to more than 3 million users and operate a network of approximately 54,000 miles of regulated distribution lines. PUCO is composed of 5 commissioners who are appointed by the Governor for 5 year terms.[23]

Ohio Chapter 4901: 1-19 governs the filing and consideration of an alternative rate case by a natural gas company. Alternative rate plans may include automatic adjustments based on a specified index or changes in a specified cost. In its "alternative rate plan filing," the applicant must notify the commission and the consumer services department of its intent to file at least 30 days prior to the expected date of filing. The application (sample is included in rule appendix) must include the proposed rates, a summary of the proposed plan, a comparison of the typical "before" and "after" customer bill, and any waiver requests. In addition, the applicant must fully justify any proposal to deviate from the traditional rate of return regulation, including the rationale for the alternative plan, including "how it better matches actual experience of performance of the company in terms of costs and quality of service to its regulated customers."

PUCO may grant alternative rate regulation on the basis of this application. However, PUCO may subsequently determine that the natural gas company is not in substantial compliance with state policy, or on the motion of an adversely affected party, abrogate any order when (1) the commission determines that the findings are no longer valid and that modification or abrogation is in the public interest; and (2) the modification or abrogation is not made more than eight years after the effective date of the order, unless the affected natural gas company consents.

California

[23] http://www.puco.ohio.gov/puco/

The California Public Utilities Commission (CPUC) is responsible for regulating intrastate natural gas pipelines in the State of California, except for municipal gas systems.[24] CPUC is composed of five commissioners who are appointed by the Governor.

On October 7, 2011, the Governor approved a package of pipeline safety bills with several new mandates for gas pipeline operators and CPUC. The relevant provisions include:

- Requiring operators of intrastate gas transmission lines to prepare and submit to CPUC a plan for pressure testing each line segment and to replace each segment that is not tested. Plans must include a timeline for completing all testing and replacements as soon as practicable with interim safety measures during implementation. Where warranted, segments must also be capable of accommodating inline inspection devices.

- Requiring gas pipeline operators to submit to CPUC for approval a plan for the safe and reliable operation of their gas pipeline facilities. Plans must be consistent with Federal pipeline safety laws and must address specific criteria, including: minimizing hazards and systemic risks; identifying safety-related systems that may be deployed; patrolling and inspecting for leaks; responding to reports of leaks; determining MAOP; ensuring qualified and adequately-sized workforce; and meeting applicable pipeline safety standards.

- Requiring gas pipeline operators to report to CPUC twice per year on the strategic planning and decisionmaking approach that is used to determine and rank pipeline safety, integrity, reliability, operations and maintenance activities, and inspections.

- Establishing that is the policy of the State and CPUC for each gas pipeline operator to place safety as its top priority. CPUC must take reasonable and appropriate action to carry out this policy, including through ratemaking.

- Requiring gas pipeline operators who recover expenses for integrity management program and related pipeline maintenance and repairs to have a balancing account, with any unspent money being returned to ratepayers at the end of each rate cycle.

In a June 2011 order, CPUC had previously used its general authority to require operators of intrastate natural gas transmission lines to submit comprehensive pressure testing implementation plans. The purpose of these plans is to achieve the orderly and cost effective replacement or testing of all natural gas transmission lines in the State. The plans permit the use of alternatives that achieve the same standard of safety, but must include a prioritized schedule based on risk assessment and maintaining service reliability, as well as cost estimates with proposed ratemaking. The plans also address the retrofitting of pipelines to accommodate the use of in-line inspection tools and, where appropriate, automated or remotely controlled shut off valves.

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[24] CA PUB UTIL §§ 2101 *et seq.*, 4351-61, 4451-64.

V. CONCLUSIONS

Nearly 30 State public utility commissions have established pipeline infrastructure replacement programs as part of the ratemaking process. These programs play a vital role in protecting the public by ensuring the prompt rehabilitation, repair, or replacement of high-risk gas distribution infrastructure.

Several state public utility commissions, including those in New Jersey, Kentucky, and Indiana, have used their traditional ratemaking authority to approve such programs. Other States, like Missouri, Kansas, and Nebraska, have provided their public utility commissions with specific statutory authority to approve pipeline infrastructure replacement programs based on detailed eligibility requirements and cost-recovery formulas. Ohio has a statute in place that provides its commission with far more flexibility and discretion. California recently enacted a statutory scheme requiring the implementation of a comprehensive program for pressure testing and replacement of gas pipelines.

Whether as part of the traditional ratemaking process or in a separate proceeding, PHMSA urges State public utility commissions to accelerate the repair, rehabilitation, and replacement of high-risk pipeline infrastructure. The recent pipeline accidents in San Bruno, Philadelphia, and Allentown show the tremendous cost in terms of fatalities, injuries, and property damage that can result in the absence of such action.

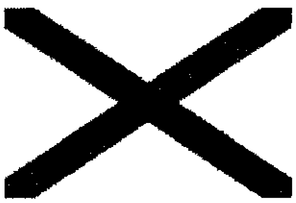
PHMSA is focused on this issue in implementing its integrity management requirements for natural gas transmission and distribution lines and as part of the state certification process. PHMSA is willing to provide assistance to State public utility commissions who are seeking to establish or improve programs for the repair, rehabilitation, and replacement of high risk pipeline infrastructure. Such assistance could include offering testimony at legislative hearings or in state proceedings, providing technical expertise in identifying high-risk pipeline infrastructure, and ensuring that state pipeline safety regulators are effectively implementing the integrity management requirements for natural gas transmission and distribution lines.

Appendix I:

Additional Information on State Pipeline Infrastructure Replacement Programs

Hyperlinks Confirmed as of Date of Publication and Available for Use in Electronic Version Only

Alabama



STATE AUTHORITY: Alabama Public Service Commission

PROGRAM: Rate Stabilization and Equalization Plan

PARTICIPANTS: Mobile Gas

Alabama Gas

Arkansas

STATE AUTHORITY: Arkansas Public Service Commission

PROGRAM: Main Replacement Program Rider

PARTICIPANTS: CenterPoint Energy

California

STATE AUTHORITY: California Public Utilities Commission

PROGRAM: Comprehensive Implementation Plan

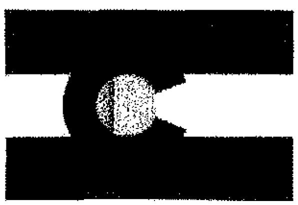
PARTICIPANT: San Diego Gas and Electric

PROGRAM: Pipeline Safety Enhancement Plan

PARTICIPANTS: Southern California Gas

Pacific Gas & Electric

Colorado

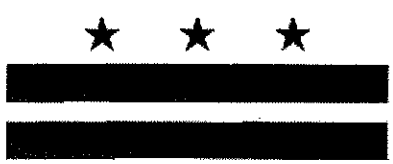


STATE AUTHORITY: Colorado Public Service Commission

PROGRAM: Pending

PARTICIPANT: Colorado Public Service Company

District of Columbia

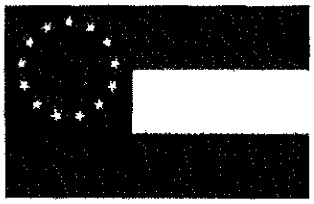


STATE AUTHORITY: District of Columbia Public Service Commission

PROGRAM: Pending

PARTICIPANT: Washington Gas

Georgia



STATE AUTHORITY: Georgia Public Service Commission

PROGRAM: Pipeline Replacement Program

PARTICIPANT: Atlanta Gas Light

PROGRAM: Pipeline Replacement Surcharge

PARTICIPANT: Atmos Energy

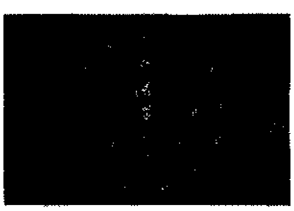
Illinois

STATE AUTHORITY: Illinois Commerce Commission

PROGRAM: Infrastructure Cost Recovery Rider

PARTICIPANT: Integrys Peoples Gas

Indiana



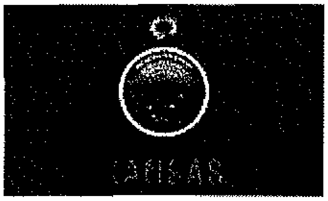
STATE AUTHORITY: Indiana Utility Regulatory Commission, Gas Division

PROGRAM: Pipeline Safety Adjustment

PARTICIPANT: Vectren Energy Delivery of Indiana, Inc.

Vectren South – SICEGO

Kansas



STATE AUTHORITY: Kansas Corporation Commission

PROGRAM: Accelerated Pipeline Replacement Rider

PARTICIPANT: Black Hills Energy

PROGRAM: Gas System Reliability Surcharge Rider

PARTICIPANT: Kansas Gas Service

Atmos Energy

LAWS: Gas Safety and Reliability Policy Act

Kentucky

STATE AUTHORITY: Kentucky Public Service Commission

PROGRAM: Accelerated Main Replacement Program Rider

PARTICIPANT: Columbia Gas Kentucky

PROGRAM: Pipeline Replacement Program

PARTICIPANT: Delta Natural Gas

PROGRAM: Accelerated Main Replacement Program

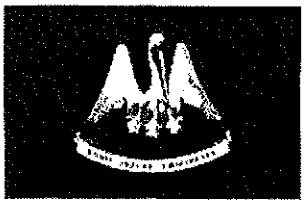
PARTICIPANT: Duke Energy Kentucky

PROGRAM: Pipeline Replacement Program Rider

PARTICIPANT: Atmos Energy

LAWS: KRS 278.509

Louisiana



STATE AUTHORITY: Louisiana Public Service Commission

PROGRAM: Rate Stabilization Tariffs

PARTICIPANTS: Atmos Energy – LA

Entergy

CenterPoint Energy

Maryland

STATE AUTHORITY: Maryland Public Service Commission

PROGRAM: Pending

PARTICIPANTS: Washington Gas

Massachusetts

STATE AUTHORITY: Massachusetts Department of Public Utilities, Pipeline Engineering and Safety Division

PROGRAM: Targeted Infrastructure Reinvestment Factor

PARTICIPANTS: Columbia Gas Massachusetts

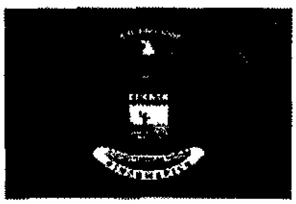
National Grid Massachusetts

New England Gas

PROGRAM: Pending

PARTICIPATNT: Fitchburg Gas and Electric

Michigan

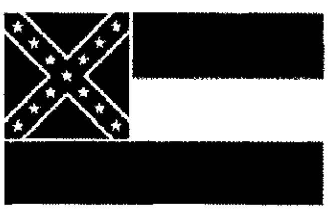


STATE AUTHORITY: Michigan Public Service Commission

PROGRAM: Main Replacement Program Rider

PARTICIPANT: SEMCO Energy

Mississippi



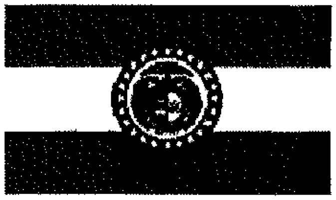
STATE AUTHORITY: Mississippi Public Service Commission

PROGRAM: Rate Stabilization Tariffs

PARTICIPANTS: Atmos Energy – MS

CenterPoint Energy

Missouri



STATE AUTHORITY: Missouri Public Service Commission

PROGRAM: Infrastructure System Replacement Surcharge

PARTICIPANTS: Ameren Missouri

Laclede Gas

Missouri Gas Energy

Atmos Energy - MO

LAWS: MO ST 393.1009 *et seq.*

Nebraska

STATE AUTHORITY: Nebraska Public Service Commission

PROGRAM: Infrastructure System Replacement Cost Recovery Charge

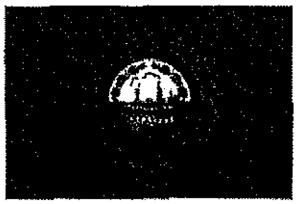
PARTICIPANT: Black Hills Energy

LAWS: NE ST 66-1865

NE ST 66-1866

NE ST 66-1867

New Hampshire

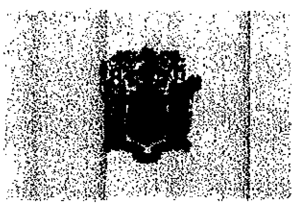


STATE AUTHORITY: New Hampshire Public Utilities Commission

PROGRAM: Cast Iron Bare Steel Replacement Program

PARTICIPANT: National Grid Energy North

New Jersey



STATE AUTHORITY: New Jersey Board of Public Utilities

PROGRAM: Utility Enhancement Infrastructure Rider

PARTICIPANT: Elizabethtown Gas

PROGRAM: Accelerated Infrastructure Investment Program

PARTICIPANT: New Jersey Natural Gas

PROGRAM: Capital Adjustment Charge

PARTICIPANT: Public Service Electric and Gas

PROGRAM: Capital Investment Recovery Tracker

PARTICIPANT: South Jersey Gas

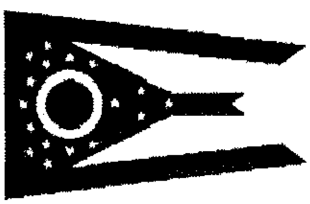
New York

STATE AUTHORITY: New York State Public Service Commission

PROGRAM: LIMITED INFRASTRUCTURE REPLACEMENT

PARTICIPANTS: National Grid Long Island, Niagara Mohawk, and NYC
Corning Natural Gas

Ohio



STATE AUTHORITY: Ohio Public Utility Commission

PROGRAM: Infrastructure Replacement Program

PARTICIPANTS: Columbia Gas Ohio

PROGRAM: Pipeline Infrastructure Replacement Cost Recovery Charge

PARTICIPANT: Dominion East Ohio

PROGRAM: Accelerated Main Replacement Program Rider

PARTICIPANT: Duke Energy Ohio

PROGRAM: Distribution Replacement Rider

PARTICIPANT: Vectren Energy Delivery of Ohio, Inc.

Oklahoma

STATE AUTHORITY: Oklahoma Corporation Commission

PROGRAM: Rate Stabilization Tariffs

PARTICIPANTS: Oklahoma Natural Gas

CenterPoint Energy

Oregon

STATE AUTHORITY: Oregon Public Utility Commission

PROGRAM: Replacement Projects

PARTICIPANT: Avista Corp

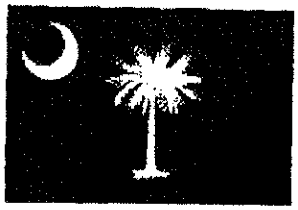
Rhode Island

STATE AUTHORITY: Rhode Island Public Utilities Commission

PROGRAM: Capital Expenditure Tracker Factor, Accelerated Replacement Program

PARTICIPANT: National Grid Narragansett Gas

South Carolina



STATE AUTHORITY: South Carolina Office of Regulatory Staff

PROGRAM: Rate Stabilization Tariff

PARTICIPANTS: Piedmont Natural Gas
South Carolina Electric and Gas

Texas

STATE AUTHORITY: Texas Railroad Commission

PROGRAM: Gas Reliability Infrastructure Program

PARTICIPANTS: CenterPoint Energy
Atmos Energy – TX
Texas Gas Service

PROGRAM: Rate Stabilization Tariffs

PARTICIPANTS: Atmos Energy – TX
CenterPoint Energy

LAWS: Tex. Util.Code § 104.301

Utah

STATE AUTHORITY: Utah Public Service Commission

PROGRAM: Infrastructure Rate Adjustment Tracker

PARTICIPANT: Questar Gas

Virginia

STATE AUTHORITY: Virginia State Corporation Commission

PROGRAM: Pending

PARTICIPANT: Washington Gas

LAWS: SAVE Act

Resolution Encouraging Natural Gas Line Investment and the Expedited Replacement of High-Risk Distribution Mains and Service Lines

WHEREAS, NARUC and its members have long focused on pipeline safety, led by the Committee on Gas, established in 1964, the Staff Subcommittee on Pipeline Safety, the Task Force on Pipeline Safety, and the newly created Subcommittee on Pipeline Safety; *and*

WHEREAS, NARUC enjoys a close working relationship with the National Association of Pipeline Safety Representatives (NAPSR), a national organization representing the State pipeline inspection workforce throughout the country; *and*

WHEREAS, NAPSR in November 2011 released an exhaustive compendium of State pipeline safety programs which exceed the minimum federal standards States must meet in order to receive funding from the U.S. Pipeline and Hazardous Materials Safety Administration (PHMSA); *and*

WHEREAS, NARUC and the Committee on Gas maintain a strong cooperative partnership with PHMSA, which is essential to ensure State and federal safety regulators work closely on pipeline safety; *and*

WHEREAS, More than two million miles of natural gas distribution pipelines crisscross the United States, connecting homes and businesses with one of America's most important energy resources. These pipelines are the safest, most reliable and cost-effective way to transport this essential fuel across the country; *and*

WHEREAS, The safe and reliable delivery of natural gas to homes and businesses and its use in providing new products and services is vital to the U.S. and of paramount importance to members of NARUC; *and*

WHEREAS, By law, the utilities are charged with knowing the location, material, age and condition of their systems. Developing essential data to evaluate the integrity of the systems is the foundation for any determination over what regulators need to fund in rates, as well as what rate recovery methodology best suits a particular case; *and*

WHEREAS, Many States and distribution utilities are undergoing significant pipeline replacement programs to replace aging pipe; *and*

WHEREAS, Many distribution companies are being proactive about replacing their aging pipelines through a risk-based approach focusing on prioritizing safety, asset replacement, and rate impact; *and*

WHEREAS, Alternative rate-recovery mechanisms may help expedite the replacement and expansion of the pipeline systems by promoting more timely rate recovery for investments in infrastructure, safety and reliability; *and*

WHEREAS, Alternative rate recovery mechanisms may help eliminate near-term financial barriers of traditional ratemaking policies such as "regulatory lag" and promote access to lower-cost capital; *and*

WHEREAS, The adoption of alternative rate policies may be very effective for advancing critical safety and reliability infrastructure upgrades, *and*

WHEREAS, Notwithstanding the positive advances in innovative ratemaking and proactive remediation by many distribution companies, utility management bears ultimate responsibility for their respective systems and should seek to work, in ways permissible under their respective State rules and law, collaboratively with Commissioners and/or Commission staff to prioritize asset replacement based upon asset risk, available technology, public safety risk, rate impact, *and*

WHEREAS, Ensuring pipeline safety is about more than just replacement and cost recovery. It is also about effective communication, enforcement, risk sharing, and establishing a long range strategic plan that ensures a safe and reliable gas pipeline system; *and*

WHEREAS, As evidenced in the NAPSR 2011 Compendium, State commissions and inspectors are best suited to determine how best to finance system improvements because each State is different and the needs and financial circumstances of each utility system are unique; *now, therefore be it*

RESOLVED, That the Board of Directors of the National Association of Regulatory Utility Commissioners, convened at the 2013 Summer Committee Meetings, in Denver, Colorado, encourages regulators and industry to consider sensible programs aimed at replacing the most vulnerable pipelines as quickly as possible along with the adoption of rate recovery mechanisms that reflect the financial realities of the particular utility in question; *and be it further*

RESOLVED, That State commissions should explore, examine, and consider adopting alternative rate recovery mechanisms as necessary to accelerate the modernization, replacement and expansion of the nation's natural gas pipeline systems, *and be it further*

RESOLVED, That NARUC encourages its members to reach out to PHMSA, NAPSR, industry, State and local officials, and the general public about pipeline safety and replacement programs.

Sponsored by the Committee on Gas and the Committee on Critical Infrastructure
Adopted by the NARUC Board of Directors July24, 2013

AGA American Gas Association www.aga.org

AGA's Commitment to Enhancing Safety

AGA and its members are dedicated to the continued enhancement of pipeline safety. As such, we are committed to proactively collaborating with public officials, emergency responders, excavators, consumers, safety advocates and members of the public to continue to improve the industry's longstanding record of providing natural gas service safely and effectively to 177 million Americans. AGA and its members support the development of reasonable regulations to implement new federal legislation as well as the National Transportation Safety Board safety recommendations.

Below are voluntary actions that are being addressed by AGA or individual operators to help ensure the safe and reliable operation of the nation's 2.4 million miles of pipeline which span all 50 states representing diverse regions and operating conditions. In addressing these actions, AGA and its individual operators recognize the significant role that their state regulators or governing body will play in supporting and funding these actions.

It is the consensus of AGA members that the actions listed below enhance safety and gas utility operations when implemented as an integral part of each operator's system specific safety actions. However, both the need to implement and the timing of any implementation of these actions will vary with each operator. Each operator serves a unique and defined geographic area and their system infrastructures vary widely based on a multitude of factors, including facility condition, past engineering practices and materials. Each operator will need to evaluate the actions in light of system variables, the operator's independent integrity assessment, risk analysis and mitigation strategy and what has been deemed reasonable and prudent by their state regulators. It is recognized that not all of these recommendations will be applicable to all operators due to the unique set of circumstances that are attendant to their specific systems.

Building Pipelines for Safety

Construction

- Expand requirements of the Operator Qualification (OQ) rule to include new construction of distribution and transmission pipelines.
- Review established oversight procedures associated with pipeline construction to ensure adequacy and confirm that operator construction practices and procedures are followed.

Emergency Shutoff Valves

- Support the use of a risk based approach to the installation of automatic and/or remote control sectionalizing block valves where economically, technically and operationally feasible on transmission lines that are being newly constructed or entirely replaced. Develop guidelines for consideration of the use of automatic and/or remote control sectionalizing block valves on transmission lines that are already in service. Work collaboratively with appropriate regulatory agencies and policy makers to develop these criteria.
- Expand the use of excess flow valves to new and fully replaced branch services, small multi-family facilities, and small commercial facilities where economically, technically and operationally feasible.

Operating Pipelines Safely

Integrity Management

- Continue to advance integrity management programs and principles to mitigate system specific risks. This includes operational activities as well as the repair, replacement or rehabilitation of pipelines and associated facilities where it will most improve safety and reliability.
- Collaborate with stakeholders to develop and promote effective cost-recovery mechanisms to support pipeline assessment, repair, rehabilitation, and replacement programs.
- Develop industry guidelines for data management to advance data quality and knowledge related to pipeline integrity.
- Support development of processes and guidelines that enable the tracking and traceability of new pipeline components.

Excavation Damage Prevention

- Support strong enforcement of the 811 – Call Before You Dig program through state damage prevention laws.
- Improve the level of engagement between the operator and excavators working in the immediate vicinity of the operator's pipelines.

Enhancing Pipeline Safety

Safety Knowledge Sharing

- Review programs currently utilized for the sharing of safety information. Identify and implement models that will enhance safety knowledge exchange among operators, contractors, government and the public.

Stakeholder Engagement and Emergency Response

- Evaluate methods to more effectively communicate with public officials, excavators, consumers, safety advocates and members of the public about the presence of pipelines. Implement tested and proven communication methods to enhance those communications.
- Partner with emergency responders to share appropriate information and improve emergency response coordination.

Pipeline Planning Engagement

- Work with a coalition of Pipelines and Informed Planning Alliance (PIPA) Guidance stakeholders to increase awareness of risk based land use options and adopt existing PIPA recommended best practices.

Advancing Technology Development

- Increase investment, continue participation, and support research, development and deployment of technologies to improve safety. Evaluate and appropriately implement new technological advances.

Gas Utility Industry Actions To Be Implemented	Target Dates *
Confirm the established MAOP of transmission pipelines ***Note:*** Confirmation of established MAOP utilizes the guidance document developed by AGA, *"Industry Guidance on Records Review for Re-affirming Transmission Pipeline MAOPs,"* October 2011.	On an aggregate basis of AGA member companies, complete > 50% of class 3 & 4 locations + class 1&2 HCAs: 7/3/12 Remaining class 3&4 + 1&2 HCAs, based on PHMSA guidance: 7/3/13 Remaining class 1&2 by 7/3/15
Review and revise as necessary established construction procedures to provide for appropriate (risk-based) oversight of contractor installed pipeline facilities.	Trans: 12/31/12 Dist: 12/31/13
Under DIMP, evaluate risk associated with trenchless pipeline techniques and implement initiatives to mitigate risks	12/31/12
Under DIMP, identify distribution assets where increased leak surveys may be appropriate	12/31/12
Integrate applicable provisions of AGA's emergency response white paper and checklist into emergency response procedures	12/31/12
Extend Operator Qualification program to include tasks related to new main & service line construction	6/30/13
Expand EFV installation beyond single family residential homes	6/30/13
Incorporate an Incident Command System (ICS) type of structure into emergency response protocols	6/30/13
Extend transmission integrity management principles outside of HCAs using a risk-based approach	70% of population within PIR by 2020; 1&2 by 2030
Implement applicable portions of AGA's technical guidance documents: 1) Oversight of new construction tasks to ensure quality; 2) Ways to improve engagement between operators & excavators	Within 1 yr of AGA guidance
Begin risk-based evaluation on the use of ASVs, RCVs or equivalent technology on transmission block valves in HCAs	Within 6 months of Comptroller General study
Implement appropriate meter set protection practices identified through the Best Practices Program	Within 6 months of program results

* Target dates are based on an operator's evaluation of these actions in light of system variables, the operator's independent integrity assessment, risk analysis, and mitigation strategy. Target dates also assume state regulatory approval that action is prudent and reasonable and therefore recoverable in rates.

Gas Utility Industry Actions That Exceed 49 CFR Part 192
Incorporate systems and/or processes to reduce human error to enhance pipeline safety
Advocate programs to accelerate the risk-based repair, rehabilitation and replacement of pipelines
Support development of processes and guidelines that enable tracking and traceability of pipeline components
Encourage participation in One-Call by all underground operators and excavators
Influence and/or support state legislation to strengthen damage prevention programs
Use industry training facilities and evaluate opportunities to expand outreach and education programs to internal and external stakeholders
Support and enhance damage prevention programs through outreach, education, intervention and enforcement
Use a risk-based approach to improve excavation monitoring
Develop, support, enhance and promote CGA initiatives targeted at damage prevention, including data submission and 811
Support public awareness programs targeted at damage prevention
Continue AGA Safety Committee initiatives, such as sharing lessons learned through the Safety Information Resource Center, safety alerts through the AGA Safety Alert System, safety communications with customers and supporting AGA's Safety Culture Statement
Explore ways to educate, engage and provide appropriate information to stakeholders to increase pipeline public awareness
Conduct organizational response drills to improve emergency preparedness
Participate in state, regional and national multi-agency emergency response training exercises
Reach out to emergency responder community in order to enhance emergency response capabilities
Verify participation in a mutual assistance program, if appropriate; integrate into emergency response plans
Collaborate with stakeholders near existing transmission lines to increase awareness/adoption of appropriate PIPA recommended best practices
Promote benefits of R&D funding. Support R&D investment, pilot testing and technology implementation
Support technology development and deployment in critical applications
Collaborate on R&D

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AGA American Gas Association

AGA's Commitment to Enhancing Safety: AGA Actions

ACTIONS COMPLETED

- ✓ Implement discussion groups to address safety issues including discussion groups for employee technical training, material supply chain issues, DIMP implementation, public awareness, work management and GPS/GIS
- ✓ Participate in 2012 DOT Automatic Shut-off Valve and Remote Control Valve Workshop
- ✓ Develop, with INGAA and API, a public document to explain ratemaking mechanisms used for pipeline infrastructure
- ✓ Create a Safety Information Resources Center for the sharing of safety information
- ✓ Hold regional operations executives' roundtables to discuss safety initiatives
- ✓ Sponsor workshop with INGAA and National Association of State Fire Marshals (NASFM) on emergency response
- ✓ Develop a technical note on industry considerations for emergency response plans
- ✓ Develop Emergency Response Resource center with a streamlined mutual assistance program
- ✓ Develop a task group comprised of AGA staff and members that will work closely with Pipelines and Informed Planning Alliance (PIPA) to ensure AGA member concerns are addressed in joint PIPA initiatives
- ✓ Work with INGAA, research consortiums and other pipeline trade associations to provide the NTSB with a compilation of the progress that has been made in advancing in-line inspection technology
- ✓ Host a roundtable focused on operator experience and lessons learned: 2012 Operations Conference
- ✓ Work with INGAA, API, AOPL, Canadian Gas Association and Canadian Energy Pipeline Association on a comprehensive safety management study that explores initiatives currently utilized by other sectors and the pipeline industry.

ONGOING ACTIONS

- Promote the use of innovative rate mechanisms for faster repair, rehabilitation or replacement.
- Maintain a clearinghouse on effective cost-recovery mechanisms that states have used to fund infrastructure repair, replacement and rehabilitation projects.
- Support legislation that strengthens enforcement of damage prevention programs and 811
- Support the Common Ground Alliance, use of 811 and other programs that address excavation damage
- Continue the work of the AGA Best Practices Programs to identify superior performing companies and innovative work practices that can be shared with others to improve operations and safety.
- Continue the Plastic Pipe Database Committee's work to collect and analyze plastic material failures
- Promote the AGA Safety Culture Statement and a positive safety culture throughout the natural gas industry
- Conduct workshops, teleconferences and other events to share information including pipeline safety reauthorization, DIMP/TIMP, fitness for service, records, in-line inspection, emergency response, and other key safety initiatives
- Hold an annual executive leadership safety summit.
- Recognize statistical top safety performers, promote safety performance and encourage knowledge sharing through AGA Safety Awards
- Support PHMSA and NAPSR workshops and other events
- Search for new and innovative ways to inform, engage and provide appropriate information to stakeholders, including emergency responders, public officials, excavators, consumers and safety advocates, and members of the public living in the vicinity of pipelines
- Participate in the Pipeline Safety Trust's annual conference to provide information on distribution and intrastate transmission pipelines, AGA and industry initiatives, and receive input
- Work with PHMSA to establish time limits for telephonic or electronic notice of reportable incidents to the National Response Center after the time of confirmed discovery by operator that an incident meets PHMSA incident reporting requirements
- Build an active coalition of AGA member representatives to work with PHMSA and other stakeholders to implement PIPA recommended practices pertaining to encroachment around existing transmission pipelines
- Advocate to state commissioners the inclusion of research funding in rate cases in an effort to increase overall funding for R&D
- Work with PHMSA and other stakeholders on opportunities to increase R&D funding and deployment of technologies
- Advocate acceptance of technologies that can improve safety

AGA's Commitment to Enhancing Safety: AGA Actions Continued

ACTIONS WITH TARGET DATES

- Develop guidance to determine a distribution or transmission pipeline's fitness for service and MAOP, and the critical records needed for that determination. **(5/30/12)**
- Create a Safety Alert Notification System that will allow AGA or its members to quickly notify other AGA members of safety issues that require immediate attention. **(5/30/12)**
- Develop a more comprehensive technical paper that presents benefits and disadvantages of the installation of ASV/RCV block valves on new, fully replaced and existing transmission pipelines. **(9/30/12)**
- Create technical guidance for oversight of new construction tasks to ensure quality. **(12/31/12)** (Track progress of industry's implementation of guidelines and summarize results annually)
- Utilize DIMP to evaluate the risks associated with trenchless pipeline techniques and implement, where necessary, initiatives to prevent and mitigate those risks. **(12/31/12)**
- Based on the results of the safety management study, identify and begin to implement initiatives that will enhance the appropriate sharing of safety information. **(12/31/12)**
- Include meter protection in 2013 AGA Distribution Best Practices Program with results. **(9/30/13)**

ACTIONS – TARGET DATES NOT APPLICABLE

- Work with PHMSA and distribution operators on ways to address risk to meters from vehicular damage, natural and other outside forces.
- Engage PHMSA and NAPSR in discussions on whether TIMP should be expanded beyond HCAs and the benefits and challenges of applying integrity management principles to additional areas.
- Highlight in DOT workshops, NAPSR meetings and discussions with Government Accountability Office that: 1) Many AGA members are required to manage DIMP and TIMP programs that overlap. The effectiveness, inefficiencies and duplication of multiple integrity management programs must be explored. 2) Low-stress pipelines operating below 30% SMYS should be treated differently.
- Work with industry and regulators to evaluate how the grandfather clause can be modified to reduce and/or effectively eliminate its use for transmission pipelines.
- Work with other stakeholders to develop potential technological solutions that allow for tracking and traceability of new pipeline components (pipe, valves, fittings and other appurtenances attached to the pipe).
- Develop guidelines that provide for an improved level of engagement between operators and excavators.
- Work with other stakeholders to improve pipeline safety data collection and analysis, convert data into meaningful information, determine opportunities to improve safety based on data analysis, identify gaps in the data collected by PHMSA and others, and communicate consistent messages based on the data.
- Develop publications dedicated to improving safety and operations
- Pilot application of PIPA guidelines with select member utilities.

U.S. Department of Transportation Call to Action
To Improve the Safety of the Nation's Energy Pipeline System

Executive Summary

Today, more than 2.5 million miles of pipelines are responsible for delivering oil and gas to communities and businesses across the United States. That's enough pipeline to circle the earth approximately 100 times.

Currently, these liquid and gas pipelines are operated by approximately 3,000 companies and fall under the safety regulations of the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration (PHMSA). PHMSA has engineers and inspectors around the country who oversee the safety of these lines and ensure that companies comply with critical safety rules that protect people and the environment from potential dangers. While PHMSA directly regulates most of the hazardous liquid pipelines in the nation, states take over when it comes to intrastate natural gas pipelines. Every state, except Hawaii and Alaska, is responsible for the inspection and enforcement of state pipeline safety laws for the natural gas pipeline systems within their respective states. Some states – about 20 percent - also regulate the hazardous liquid lines within state borders.

In the wake of several recent serious pipeline incidents, U.S. DOT/PHMSA is taking a hard look at the safety of the nation's pipeline system. Over the last three years, annual fatalities have risen from nine in 2008, to 13 in 2009 to 22 in 2010. Like other aspects of America's transportation infrastructure, the pipeline system is aging and needs a comprehensive evaluation of its fitness for service. Investments that are made now will ensure the safety of the American people and the integrity of the pipeline infrastructure for future generations.

For these reasons, Secretary LaHood has issued "A Call To Action" for all pipeline stakeholders, including the pipeline industry, the utility regulators, and our state and federal partners. Secretary LaHood brought together PHMSA Administrator Quarterman and the senior DOT leadership to design a strategy to achieve that goal. The action plan below is the result of those deliberations.

Background

Much of the nation's pipeline infrastructure was installed many decades ago, and some century-old infrastructure continues to transport energy supplies to residential and commercial customers, particularly in the urban areas across our nation. Older pipeline facilities that are constructed of obsolete materials (e.g., cast iron, copper, bare steel, and certain kinds of welded pipe) may have degraded over time, and some have been exposed to additional threats, such as excavation damage.

On December 4, 2009, PHMSA issued the Distribution Integrity Management Final Rule, which extends the pipeline integrity management principles that were established for hazardous liquid and natural gas transmission pipelines, to the local natural gas distribution pipeline systems. This regulation, which becomes effective in August of 2011, requires operators of local gas distribution pipelines to evaluate the risks on their pipeline systems to determine their fitness for service and take action to address those risks. For older gas distribution systems, the appropriate mitigation measures could involve major pipe rehabilitation, repair, and replacement programs. At a minimum, these measures are needed to requalify those systems as being fit for service. While these measures may be costly, they are necessary to address the threat to human life, property, and the environment.

In addition to the many pipelines constructed with obsolete materials, there are also early vintage steel pipelines in high consequence areas that may pose risks because of inferior materials, poor construction practices, and lack of maintenance or inadequate risk assessments performed by operators. The lack of basic information or incomplete records about these systems is also a contributing factor. The U.S. DOT is seeking to make sure these risks are identified, the pipelines are assessed accurately, and preventative steps are taken where they are needed.

Action Plan

The U.S. DOT and PHMSA have developed this action plan to accelerate rehabilitation, repair, and replacement programs for high-risk pipeline infrastructure and to requalify that infrastructure as fit for service. The Department will engage pipeline safety stakeholders in the process to systematically address parts of the pipeline infrastructure that need attention, and ensure that Americans remain confident in the safety of their families, their homes, and their communities. The strategy involves:

- **A CALL TO ACTION** – Secretary LaHood is issuing a "Call to Action" to engage state partners, technical experts, and pipeline operators in identifying pipeline risks and repairing, rehabilitating, and replacing the highest risk infrastructure. Secretary LaHood is also asking Congress to expand PHMSA's ability to oversee pipeline safety.

    - Secretary LaHood and PHMSA Administrator Quarterman have met with the Federal Energy Regulatory Commission (FERC), the National Association of Regulatory and Utility Commissioners (NARUC), state public utility commissions, and industry leaders to ask all parties to step up efforts to identify high-risk pipelines and ensure that they are repaired or replaced.

    - Secretary LaHood is asking Congress to increase the maximum civil penalties for pipeline violations from $100,000 per day to $250,000 per day, and from $1 million for a series of violations to $2.5 million for a series of violations. He is also asking Congress to help close regulatory loopholes, strengthen risk management requirements, add more inspectors, and improve data reporting to help identify potential pipeline safety risks early. The Senate has passed its version of the pipeline safety reauthorization legislation. The House of Representatives is currently considering two versions of a similar bill that could be passed by end of the year.

    - The U.S. DOT and PHMSA convened a Pipeline Safety Forum in April 2011 that engaged a working session around the actions that DOT/PHMSA, the state regulatory agencies, and the pipeline industry can take to drive more aggressive actions to raise the bar on pipeline safety. The U.S. DOT and PHMSA is preparing a report based on ideas, opportunities and challenges presented at the Forum and action that will be taken.

- **AGGRESSIVE EFFORTS** – The U.S. DOT and PHMSA are calling on pipeline operators and owners to review their pipelines and quickly repair and replace sections in poor condition.
  - PHMSA has asked technical associations and pipeline safety groups to provide best practices and technologies for repair, rehabilitation and replacement programs, and has asked industry groups for commitments to accelerate needed repairs.
  - PHMSA will review all data received from pipeline operators to identify areas with critical needs.
  - PHMSA's Distribution Integrity Management rule became effective in August, requiring all operators of local gas distribution pipeline systems to evaluate the risks on their pipeline systems and take action to address those risks.
- **TRANSPARENCY** - U.S. DOT and PHMSA will execute this plan in a transparent manner with opportunity for public engagement, including a dedicated website for this initiative, and regular reporting to the public.
  - PHMSA has launched a public website (http://opsweb.phmsa.dot.gov/pipelineforum), which describes the ongoing pipeline rehabilitation, replacement and repair initiatives.
  - All materials from the Pipeline Safety Forum will be publicly posted to the web, followed by a Draft Report for Notice and Comment. Once public input has been collected, PHMSA will publish a final Pipeline Safety Report to the Nation.
  - PHMSA will be holding a national forum on emergency preparedness and response to pipeline emergencies. The forum will take place December 9, 2011, and will include the major stakeholders from the emergency response community, industry and government to discuss how best to improve pipeline emergency preparedness and response capabilities.
  - A report from the forum will be prepared and published.

Revised 11/1/11

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THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

March 28, 2011

Recent pipeline failures around the country have elevated concerns about pipeline safety. Neighborhoods in Allentown, Pennsylvania, and San Bruno, California, were rocked by fatal explosions caused by natural gas pipeline failures. These tragic events took lives, shook communities, and raised serious questions about the safety of some of our aging pipeline infrastructure.

These and other recent pipeline incidents, such as the one last summer in Marshall, Michigan, causing a large oil spill into sensitive waters, underscore the need to develop a comprehensive solution that will prevent accidents like these from recurring. The U.S. Department of Transportation (DOT) will host a Pipeline Safety Forum on these issues on April 18 in Washington, DC, and I invite you or your representative(s) to participate. This forum will bring together key stakeholders, including pipeline companies, State and Federal agencies, technical experts, public safety advocates, and the public, to tackle these issues head-on and discuss workable solutions. You or your representative(s) may RSVP for the Pipeline Safety Forum at pipelineforum@dot.gov.

We appreciate your State's partnership on pipeline safety inspection and enforcement. In 2009, the Pipeline and Hazardous Materials Safety Administration provided the majority of the funding for your pipeline safety program, trained your State's inspectors alongside our own, and worked with them to enforce your State pipeline safety laws.

Now, we want to partner with you again to ensure that all pipeline companies in your State, both public and private, are correctly analyzing the risks to their pipeline systems and using the appropriate assessment technologies. Your pipeline safety staff can help make this happen. We ask you to urge your staff to encourage companies and the State utility commission to accelerate pipeline repair, rehabilitation, and replacement programs for systems whose integrity cannot be positively confirmed. This is one of the best ways to help protect your citizens from accidents like those in Allentown, Marshall, and San Bruno.

In addition, there are several other actions you could take to prevent other types of pipeline accidents in your State. These include the following:

Issue a Proclamation on Safe Digging Month. You can help raise awareness about the importance of calling before you dig by issuing a State proclamation and holding a public awareness event. As you may know, April is National Safe Digging Month, and DOT will be highlighting our *811 Safe Digging Initiative.* Since establishing the 811 number in 2007 and raising awareness among excavators and do-it-yourselfers alike of the importance of calling 811 before digging, the number of gas distribution leaks caused by excavation damage has dropped by more than 45 percent. Even with this progress, excavation damage remains the number one cause of pipeline failures causing serious injuries and deaths. Your State proclamation will help raise awareness about this critical safety issue.

Enforce One-Call Laws. One of the critical components of a strong damage prevention program is fair and effective enforcement of the one-call laws. Governors play a vital role in supporting improved pipeline safety and a sound infrastructure, and we encourage your support for improvements in one-call laws and programs. Effective damage prevention laws are characterized by few or no exemptions from participation in the safe digging process, balanced enforcement that holds all parties accountable, and clearly defined responsibilities.

Encourage Better Land Use and Development. Another important damage prevention initiative is aimed at helping your cities and towns make better decisions about land use and development around existing pipelines. We have published a report on suggested practices and model legislation to help town planners and local officials coordinate with pipeline companies to ensure the safety of people and the environment. This report, called the Pipeline Informed Planning Alliance Report, can be found on our Web site at http://www.phmsa.dot.gov. Please help us by referring land use planners in your State to this report so they can make informed decisions about the best use of land near pipelines transporting natural gas or hazardous liquids.

I look forward to working with you on this critical safety issue. If the Office of the Secretary or DOT's Pipeline and Hazardous Material Safety Administration can be of any assistance to you, please contact Administrator Cynthia L. Quarterman at 202-366-4831.

Sincerely yours,

Ray LaHood

151 FERC ¶ 61,047
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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Docket No. PL15-1-000

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SUPPLEMENTARY INFORMATION:

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

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UNITED STATES OF AMERICA
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.[1] 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

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

costs and to ensure that existing Commission ratemaking policies do not unnecessarily inhibit interstate natural gas pipelines' ability to expedite needed or required upgrades 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.[2] That act includes requirements for

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[2] Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011, 49 U.S.C.S. 60101 (2012) (Pipeline Safety Act).

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 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.[3] 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.[4] The ANOPR requested public comment on a range of topics related to current industry practices, the effects of

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[3] Written Statement of Cynthia Quarterman, Administrator, PHSMA, 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.

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

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.

6. Also as part of the ANOPR process, PHSMA is considering expanding the definition of a High Consequence Area (HCA) so that more miles of pipeline may become subject to integrity management requirements.[5] 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."[6]

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

[5] 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.

[6] Quarterman Testimony at 10.

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.[7] To this end, PHMSA seeks information as to what anomalies have been detected using the various 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.[8] 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,

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[7] 78 FR 56,268 (Sept. 12, 2013).

[8] 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

including replacement of the compressor rod packing, replacement of the piston rod, and the refitting or realignment of the piston rod."[9] 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."[10] If the EPA's white papers result in the agency imposing mitigation requirements on natural gas pipelines, the cost of such controls could be significant.[11]

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.[12] 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

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[9] EPA Compressor White Paper at 29.

[10] *Id.* at 29-42.

[11] 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).

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

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.[13] 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 compressor stations. The EPA also proposed confidentiality determinations for new data elements contained in the proposed amendments.[14]

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

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[13] 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).

[14] *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).

compliance costs, as well as potentially having to replace or repair existing natural gas compressors or other facilities.[15]

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.[16] 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 costs consistent with reliable long-term service"[17] and (2) "provide the maximum amount of service to the public."[18]

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

[15] 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.

[16] 18 CFR 284.10(c)(2) (2014).

[17] *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).

[18] *Id.* at 31,537.

regulations should not be included in surcharges,[19] except in the context of an uncontested settlement.[20] 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) demonstrated were necessary to ensure the safety and reliability of its pipeline system.[21] 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

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[19] *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*).

[20] *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 PHSMA 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*).

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

monitor and maintain the system using efficient modern techniques.[22] 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.

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

[22] 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.

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.[23]

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[23] Other questions included whether the costs of modifications to compressors for the purpose of waste heat recovery should be eligible for recovery under a modernization

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D. Comments

22. The Commission received a variety of comments in response to the Proposed Policy Statement.[24] 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

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?

[24] 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.[25] Some advocate granting pipelines added flexibility to comply with the five standards necessary to establish such trackers.[26] 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.[27] 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

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[25] 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).

[26] *See, e.g.*, INGAA Comments at 2, Boardwalk Comments at 4, Kinder Morgan Comments at 5.

[27] *See, e.g.*, AGA Comments at 1 Laclede Comments at 1.

improvements for safety purposes and for compliance with environmental regulations.[28] 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.[29] 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.[30]

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.[31] Opponents' claims that additional

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[28] Xcel Energy Services (XES) Comments at 2; Wisconsin Electric and Wisconsin Gas Comments at 4.

[29] Calpine Corporation (Calpine) Comments at 1.

[30] Environmental Commenters Comments at 3-5.

[31] 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

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cost-recovery guarantees to incentivize compliance with mandatory environmental and 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.[32] 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.[33] 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 though NGA section

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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).

[32] *See*, *e.g.*, NGSA Comments at 3.

[33] NGSA Comments at 10-11, APGA Comments at 2-4, Indicated Shippers Comments at 5-18 .

4 rate cases.[34] Opponents also claim that the Proposed Policy Statement is premature, because PHMSA and the EPA have not yet issued new regulations.[35]

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 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

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[34] APGA Comments at 2-4, NGSA Comments at 7-8.

[35] NGSA Comments at 8-9.

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.[36] 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 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…."[37] 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

[36] DOE Comments at 1.

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

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.[38] 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.[39]

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

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[38] 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_2 emissions.

[39] DOE Comments at 5.

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;[40] (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.

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"

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

to recover their reasonable costs but that trackers guarantee cost recovery in violation of that principle.[41] 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.[42] 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 mechanisms being just and reasonable in certain circumstances and subject to appropriate controls.[43] As discussed above, the increased concerns with pipeline safety reflected in

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[41] *See, e.g.*, NGSA Comments at 10, Indicated Shippers' Comments at 3.

[42] *See, e.g.*, Indicated Shippers' Comments at 5– 11, and cases cited therein.

[43] Proposed Policy Statement, PP 18-20.

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 rates.[44] This will give pipelines an incentive to operate their systems as efficiently as

[44] 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

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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.[45] 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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proposed base rate cost- of-service tracker, which sought to recover all of the pipeline's cost of service, as contrary to our regulations.

[45] *See, e.g.*, Indicated Shippers' Comments at 5– 11.

distinguished it from our orders rejecting tracker proposals.[46] 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.[47] 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.[48] 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.[49] Further, Columbia Gas' tracker is temporary, and terminates by

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[46] *Columbia Gas*, 142 FERC ¶ 61,062 at PP 22-27.

[47] *Id.* P 22.

[48] 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.

[49] 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

(continued ...)

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

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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 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.

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 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."[50] Thus, while we are imposing specific conditions on the approval of any proposed modernization cost tracker, leaving the 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

[50] Proposed Policy Statement at P 9.

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. [51]

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

[51] 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.

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 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 NYPSC, 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.*[52]

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.

[52] 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).

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.

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 NGSA, IOGA, 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. NGSA argues 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 section7(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."[53] 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 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

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[53] PEG Comments at 7.

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. <u>Determination</u>

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.[54] The 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

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[54] 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 . . ." (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.

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.[55]

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,[56] consider including in a modernization cost tracker a mechanism for ensuring that a representative level of ordinary system maintenance 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

[55] *See, e.g.*, INGAA Comments at 13.

[56] INGAA reply comments at 18-19. Environmental Commenters at 12-13.

modernization cost tracker.[57] 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.[58] 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 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.

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[57] Section 7.3 of the Columbia Gas settlement.

[58] *See*, *e.g.*, INGAA Comments at 5-7, AGA Comments at 7.

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.[59]

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.[60] The Commission

[59] *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).

[60] *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 at 9,

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.[61]

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,[62] while others 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.[63] 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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[61] The *Columbia Gas* settlement includes such a provision at section 7.5 of that settlement.

[62] *See, e.g.*, DOE Comments at 3, Wisconsin Electric and Wisconsin Gas Comments at 8, Michigan PSC Comments at 15.

[63] *See, e.g.*, PGC Comments at 17-18, NGSA 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.[64] 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

[64] 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.

surcharge. INGAA requests that the Commission permit pipelines either to propose a list 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.[65] 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.

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[65] *See* section 7.2 of the Columbia Gas Settlement setting forth such a mechanism.

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 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. NGSA argues 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,[66] 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

[66] 18 CFR 284.10(c)(2) (2014).

disfavored trackers, namely that the cost shifting described would occur without 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.[67]

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.

[67] 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.

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 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.[68]

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[68] 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 truing up any under-recoveries due to discounting. *See Natural Gas Pipeline Co. of America*, 70 FERC ¶ 61,317 (1995).

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 pipeline will be permitted to do so.[69] 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

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

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 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

NYPSC 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. NGSA 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.[70] 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,[71] to recover the costs of any facilities installed pursuant to a 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

[70] *Columbia Gas*, 142 FERC ¶ 61,062 at P 9.

[71] *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.

installed pursuant to eligible modernization projects.[72] 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.[73] NGSA argues 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.[74] NGSA argues 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.[75]

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

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[72] Wisconsin Electric and Wisconsin Gas Comments at 14.

[73] IECA Comments at 21.

[74] NGSA Comments at 12-13, 24.

[75] NGSA Comments at 24.

costs through accelerated amortization methodologies, and argues that any costs not recovered through tracker rates should be rolled into rate base.[76]

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.[77] Calpine also does not object to allowing pipelines and their shippers to consider accelerated amortization methodologies as part of their modernization surcharge negotiations.[78] 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.[79] INGAA requests that the Commission provide each pipeline that

[76] 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.).

[77] 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).

[78] Calpine Comments at 30.

[79] Columbia Gas Comments at 34. *See also* APGA comments at 22 (to the extent the Commission permits pipelines to implement the modernization cost tracker, 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).

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.[80]

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.[81] In light of these varying

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[80] INGAA Comments at 19-20.

[81] *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.[82] 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.[83] 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

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[82] *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*).

[83] 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.

(i.e., 10 days or less).[84] The Commission permits pipelines to reflect the recurring cost of providing reservation charge credits during non-*force majeure* events in their rates.[85]

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.[86] 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.[87]

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

[85] *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*).

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

[87] Proposed Policy Statement at P 34.

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, [88] and thus the Commission 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.[89] 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.[90] Columbia Gas urges the Commission to extend its

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[88] INGAA Comments at 15-18.

[89] INGAA Comments at 18.

[90] 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.).

policy of granting partial reservation charge credits to outages due to construction of eligible modernization projects.[91]

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 eligible facilities under the provisions of the modernization tracker.[92] 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.[93] Likewise, while PGC, APGA, IPAA, and NGSA 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

[91] 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.).

[92] 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.

[93] NCUC Comments at 34.

reservation charge credits to firm customers during any period that the pipeline must interrupt primary firm service to replace or install eligible facilities.[94]

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.[95]

106. The Commission has defined *force majeure* outages as events that are both "unexpected and uncontrollable." In *TransColorado*[96] and *Gulf South*,[97] 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

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[94] PGC Comments at 20, APGA Comments at 22, IPAA Comments at 3, 26-27, NGSA Comments at 13, 25.

[95] *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).

[96] *TransColorado,* 144 FERC ¶ 61,175 at PP 35-43.

[97] *Gulf South*, 144 FERC ¶ 61, 215 at PP 31-34.

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 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.[98] 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 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. .

[98] *Texas Eastern*, 149 FERC ¶ 61,143 at P 123.

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. <u>Other Issues</u>

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.[99] 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.[100] 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.[101]

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 tracker or surcharge could be a factor that is considered as to the appropriate level of a

[99] 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).

[100] EPMCG Comments at 43, APGA Comments at 22-23, and MDG Comments at P 2, NYPSC Comments at P 1-3.

[101] IPAA Comments at 3, 26, NGSA Comments at 13.

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.[102] 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

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[102] APGA Comments at 11-12.

undercutting the benefits of that policy of providing pipeline an incentive to minimize 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.[103]

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

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[103] Wisconsin Electric and Wisconsin Gas Comments at 15.

compliance with its tariff to implement a modernization cost tracker may be subject to scrutiny through a Commission audit.

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.[104] 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.[105] 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.[106]

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

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[104] Columbia Gas Comments at 37.

[105] Columbia Gas Comments at 21.

[106] Boardwalk Comments at 18-19.

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 Paperwork Reduction Act of 1995[107] and OMB's implementing regulations.[108] 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).[109] The following estimate of reporting burden is related only to this Policy Statement.

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[107] 44 U.S.C. 3507(d) (2012).

[108] 5 CFR 1320.

[109] 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

(continued ...)

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

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.

FERC-545A, as implemented in Policy Statement in PL15-1-000					
	Number of Respondents[110] **(1)**	**Number of Responses per Respondent (2)**	**Average Burden Hours Per Response (3)**	**Total Annual Burden Hours (1)x(2)x(3)**	**Total Annual Cost ($)**[111] **[rounded]**
provide information to shippers for any surcharge proposal, and prepare modernization cost tracker filing[112]	3	1	750	2,250	$147, 578

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[110] 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.

[111] 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 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).

[112] The pipeline's modernization cost tracker filing is expected to include information to:

(continued ...)

perform periodic review and provide information to show that both base rates and the surcharge amount remain just and reasonable	3	0.60[113]	350	630	$42,235

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

- 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 or provide alternative methods of providing service.

[113] 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).

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

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, 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, or the Public Reference Room at (202) 502-8371, TTY (202) 502-8659. E-mail the Public Reference Room at 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.
Tenneesse 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