UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

INITIAL COMMENTS OF THE AMERICAN PUBLIC GAS ASSOCIATION

Pursuant to the Notice of Proposed Policy Statement ("Notice") issued by the Federal Energy Regulatory Commission ("Commission") on November 20, 2014, the American Public Gas Association ("APGA") files these initial comments.

APGA is the national, non-profit association of publicly-owned natural gas distribution systems, with over 700 members in 36 states. Overall, there are some 950 publicly-owned systems in the United States. Publicly-owned gas systems are not-for-profit retail distribution entities that are owned by, and accountable to, 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. APGA members purchase interstate natural gas transportation services, usually as captive customers of a single interstate pipeline, at rates and under terms and conditions that are regulated by the Commission under the Natural Gas Act ("NGA").

I. COMMUNICATIONS

Any communications regarding this pleading or this proceeding should be addressed to:

David Schryver
Executive Vice President
American Public Gas Association
Suite C-4
201 Massachusetts Avenue, N.E.
Washington, D.C. 20002
dschryver@apga.org

William T. Miller
McCarter & English, LLP
Twelfth Floor
1015 Fifteenth Street, N.W.
Washington, D.C. 20005
Telephone: (202) 753-3420
wmiller@mccarter.com

II. EXECUTIVE SUMMARY

The Commission is proposing a Policy Statement to provide greater certainty to interstate pipelines as to the recovery of the costs of modernizing their facilities and infrastructure to enhance the efficient and safe operation of their systems. The Commission proposes that pipelines seeking such a tracker mechanism satisfy five standards: (1) Review of existing rates; (2) Eligible costs; (3) Avoidance of cost shifting; (4) Periodic review of the surcharge; and (5) Shipper support. APGA opposes the proposed Policy Statement as wholly unwarranted as it is without factual or legal underpinnings sufficient to justify a radical departure from established Commission policy eschewing cost trackers as fundamentally inconsistent with the ratemaking scheme established by Congress under NGA Section 4. The five standards proposed by the Commission do not legitimize an otherwise unjustified and hence unlawful departure from the Natural Gas Act.

NGA Section 4 provides for full cost recovery by pipelines upon a showing, subject to full review by the Commission staff and the pipelines' customers, that the unit cost of doing business justifies the requested rate increase. This in-depth review recognizes that rising costs in one area may be more than offset by decreasing costs in other areas and/or by throughput increases, etc. The Commission has consistently rejected modernization trackers such as it is now proposing to allow because they sidestep the key customer protections of NGA Section 4 and the Commission's regulations thereunder (*see* Part III.A., below). And the history of NGA Section 4/Section 5 regulation demonstrates that trackers are not warranted or lawful under the NGA's "just and reasonable" standard (*see* Part III.B., below).

The Notice speculates about modernization costs to be incurred by pipelines in response to various pipeline safety and environmental statutes and regulations, but provides not a scintilla of evidence that pipelines will be unable to recover such costs in a timely fashion under NGA Section 4, assuming, of course, that they can demonstrate that their unit cost of transporting gas has increased – a showing that is avoided under tracker mechanisms (*see* Parts III.C. and III.E., below). If the Commission wants to offer a tracker mechanism that works, it should borrow from its Federal Power Act ("FPA") playbook, which provides for transmission formula rates that track costs up *and* down (*see* Part III.D., below).

A discussion of the facts underlying the Commission's approval of a modernization tracker in *Columbia Gas Transmission, LLC*, 142 FERC ¶ 61,062 (2013) ("*Columbia*") underscores the vast differences between the circumstances in the *Columbia* case and the circumstances prompting the proposed Policy Statement (*see* Part III.F., below). In point of fact, it appears that the genesis of the proposed Policy Statement is unrelated to any perceived shortcomings in NGA Section 4 but rather is associated with the so-called "Capstone Methane Stakeholder Roundtable" meetings in 2014, one outcome of which was the DOE Secretary's recommendation that "the Federal Energy Regulatory Commission … explore efforts to provide greater certainty for cost recovery for new investment in modernization of natural gas transmission infrastructure, …." With due respect, such recommendations, while undoubtedly well intentioned, do not provide a basis for short-circuiting NGA Section 4.

In the absence of any, much less compelling, evidence that pipelines are or will be unable to recover in a timely fashion any validated cost increases associated with obeying the law as it relates to pipeline safety and environmental concerns, the proposed Policy Statement should be abandoned. The five standards that are proposed as safeguards are inadequate to the task as they simply do not provide the consumer protections afforded under NGA Section 4. If, however, the Commission determines to proceed with the proposed Policy Statement, the five standards need to be considerably strengthened (as discussed in Part III.G., below) if they are intended to prevent customers from being exploited by natural gas companies.

III. COMMENTS

In the Notice (at P 1), the Commission states that the proposed Policy Statement "explains the standards the Commission would require interstate natural gas pipelines to satisfy in order to establish simplified mechanisms, such as trackers or surcharges, to recover 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." The Commission then recites various statutes and regulatory initiatives (Notice, PP 2-7), on the basis of which it concludes that "[o]ne likely result" is "that interstate natural gas pipelines will soon face new safety standards requiring significant capital cost expenditures to enhance the safety and reliability of their systems." (Notice, P 8.) Thus, the Commission explains, it is proposing the Policy Statement "to ensure that existing Commission ratemaking policies do not unnecessarily inhibit interstate natural gas pipelines' ability to expedite needed or required upgrades or improvements." (Notice, P 9.)

The proposed Policy Statement is a bad idea, founded on false premises, as explained in more detail below.

A. The Tracker Concept Has Long Been Rejected as Incompatible with NGA Section 4.

First, it is important to explore the validity of the Commission's concern (noted above) "that existing Commission ratemaking policies … not unnecessarily inhibit intersate natural gas pipelines' ability to expedite needed or required upgrades or improvements." Under NGA Section 4, a pipeline may file for a rate increase anytime, and that rate increase goes into effect almost immediately (after a suspension period ranging from nominal to a *maximum* of 5 months), subject to refund to the extent the filed rates are found to be unjust and unreasonable. Section 4 rate case filings are required by Commission regulations to contain detailed cost-of-service support for a test period consisting of a base period (i.e., 12 consecutive months of the most recently available actual experience) and an adjustment period (i.e., a period of up to 9 months immediately following the base period). 18 C.F.R. § 154.303.

The various FERC filing requirements under NGA Section 4 are intended to protect both the pipeline, by permitting it to use both actual and forecasted data, and customers, by ensuring that pipelines file sufficient data to show that unit costs are indeed increasing (i.e., that a rate increase is justified) and if so, by how much. These protections are enhanced by reliance on liberal discovery policies and, in the absence of settlement, cross-examination in evidentiary hearings so that the Commission staff and affected customers are able to secure the data behind the data and thereby determine the legitimacy of the proposed rate increase. These are critical protections in ensuring that the NGA Section 4 mandate that pipelines charge only "just and reasonable" rates is fulfilled.

Needless to say, it would be inconceivable for a pipeline to seek a rate increase by simply showing, for example, that its capital expenditures related to pipeline safety are increasing since increasing capital (or any other) costs of a particular type do not demonstrate that the unit cost of providing transportation service is increasing. Other costs, such as, for example, the cost of capital in the marketplace or depreciation rates, may be declining, rate base may be declining on a net basis due to the increased depreciation reserve, or reservation units may be increasing, with the result that, viewed collectively, unit costs may not be increasing and may in fact be decreasing. In short, NGA Section 4 and the regulations thereunder are designed to guarantee that both the Commission and the affected customers have access to sufficient data to assess whether a proposed rate increase is justifiable under the statutory "just and reasonable" test. Trackers, by contrast, provide automatic rate increases without any of the protections afforded by NGA Section 4.

The Commission has time and again rejected trackers that would allow pipelines automatically to pass on costs associated with, for example, safety and environmental regulations, recognizing that trackers are inimical to true cost-of-service ratemaking under NGA Section 4. Thus, for example, in *CenterPoint Energy – Mississippi River Transmission, LLC*, 140 FERC ¶ 61,253 at P 64 (2012), the Commission held as follows (footnotes omitted):

> MRT's proposal to include environmental and pipeline safety costs is inconsistent with current Commission policy as described in *Florida Gas* and *Granite State*. In those cases the Commission stated that the cost-of-service tracking provisions related to such regulatory requirements are contrary to the requirement, in section 284.10(c)(2), to design rates based on estimated units of service. As discussed in Order No. 436, this requirement means that the pipeline is at risk for under-recovery of its costs between rate cases, but may retain any over-recovery. This gives the pipeline an incentive both to be efficient and to provide effective service. The Commission found that cost trackers undercut these incentives by guaranteeing the pipeline a set revenue recovery. The Commission also stated that jurisdictional pipelines commonly incur capital costs in response to regulatory requirements intended to benefit the public interest. Pipelines are entitled to seek recovery of such costs, along with a just and reasonable return, at any time through a general NGA section 4 rate proceeding.

B. The Lessons of NGA Section 4/Section 5 Regulation Argue Against Trackers.

As the Commission well knows, the history of NGA Section 4/Section 5 regulation is that pipelines take full advantage of the opportunity to over-recover their cost of service and retain that over-recovery for the benefit of their shareholders. The Natural Gas Supply Association ("NGSA") annually tracks the returns of interstate pipelines, based on the pipelines' own Form 2 data, and each year the NGSA report shows huge over-recoveries by pipelines. For example, the most recent (2014) NGSA report, based on the pipeline Form 2s for the years 2008 through 2012, shows that of the 32 pipelines examined, they collectively earned approximately *$2.7 billion* in excess of what they would have collected over the five-year period using an average (and generous, under current market conditions) 12% allowed return on equity ("ROE"). The cost over-recovery for the 15 pipelines with ROEs' above 12% over the same period was nearly *$4.8 billion*. Five of the pipelines showed average ROEs over the five-year period in excess of 20%, and ten of them showed average ROEs over 14%. What this illustrates is that rather than being concerned with facilitating the ability of pipelines to track additional costs without full rate scrutiny, the Commission should, in furtherance of its NGA responsibilities, be considering a policy statement that remedies this chronic problem of pipeline over-recovery, which only occurs to the extent the Commission permits pipelines to levy rates in excess of the NGA Section "just and reasonable" standard.

Significantly, the Commission is not unaware of this over-recovery issue. In 2009, the Commission issued orders under NGA Section 5 initiating complaints against Natural Gas Pipeline Company of America ("Natural"), Northern Natural Gas Company ("Northern"), and Great Lakes Gas Transmission Limited Partnership ("Great Lakes").[1] In each of those orders,

[1] *Natural Gas Pipeline Co. of America*, 129 FERC ¶ 61,158 (2009); *Northern Natural Gas Co.*, 129 FERC ¶ 61,159 (2009); *Great Lakes Gas Transmission Limited Partnership,* 129 FERC ¶ 61,160 (2009).

the Commission observed that, on the basis of FERC staff review of the pipeline's Form 2, the pipeline in question "may be substantially over-recovering its cost of service,"[2] and went on to point out that the apparent actual ROE of each of the three pipelines was 24.5%, 24.36%, and 20.83%, respectively.[3] At the time these complaints were issued, then FERC Chairman Wellinghoff issued a statement noting that "Our mission statement is straightforward: to assist consumers in obtaining reliable, efficient and sustainable energy services at a reasonable cost."[4] The Commission continued this practice of scrutinizing pipeline Form 2s and initiating complaints against the most egregious over-achievers in 2010, 2011, and 2012, but has since ceased that practice despite the issuance of NGSA reports showing numerous pipelines earning excessive ROEs.

The Commission's experience with these NGA Section 5 cases also taught it what APGA has long known, which is that wresting excess profits from over-recovering pipelines is a difficult task given the absence of any FERC refund authority under NGA Section 5. Then-Chairman Wellinghoff made this point in his dissent in the *Northern Natural* Section 5 proceeding, as follows (133 FERC ¶ 61,111 (2010) (Wellinghoff dissent)):

> As a general matter, the lack of refund authority under section 5 of the NGA allows the regulated community to defeat the purpose of section 5 at least in some circumstances. This is not the case under the Federal Power Act (FPA). The Commission must establish a refund effective date for a section 206 proceeding and has the authority to order refunds for the period ending 15 months after the refund effective date. Thus, the incentive for game-playing is removed and the Commission can determine on the merits that a public utility's rates are just and reasonable. For this reason, I support legislative changes providing for NGA refund authority paralleling that provided to the Commission in the FPA.

[2] *Natural*, *supra*, at P 1; *Northern, supra*, at P 1; *Great Lakes, supra*, at P 1.

[3] *Natural*, *supra*, at P 5; *Northern, supra*, at P 5; *Great Lakes, supra*, at P 5.

[4] "Statement of Chairman Jon Wellinghoff on Natural Gas Pipeline Rate Investigations," issued Nov. 19, 2009 (Issuance # 20091119-3056).

Another point that was driven home in the Section 5 proceedings was how infrequently pipelines make NGA Section 4 filings, especially in the absence of come-back provisions in prior rate-case settlement agreements.[5] For example, in the 2009 *Natural* order, the Commission observed that Natural had last made a Section 4 filing 13 years ago;[6] and in the 2009 *Great Lakes* order, it observed that Great Lakes had made its last Section 4 filing over 18 years ago.[7] The Commission was pointing out what is common knowledge in the industry in terms of the pipelines' ability to profit at the customers' expense under the current structure of the NGA, by not darkening the Commission's doorstep and simply passing on excess profits to their shareholders, without fear of enforcement of the NGA "just and reasonable" standard. It was quite telling, and equally unsurprising, that when the Commission adopted incentive rate regulations that provided for pipelines to avoid Commission scrutiny by agreeing to share excess profits with their customers,[8] not a single pipeline stepped up to the plate.[9] Why share excess profits when you can keep them all?

APGA makes the above points not because the pipelines are doing anything immoral or unlawful; rather, they are simply taking full advantage of what the NGA permits. But the Commission, in proposing a tracker mechanism, should do so with full recognition of this history

---

[5] Many rate case settlements require that the affected pipeline file a Section 4 rate case within X (typically 4 or 5) years. More often than not, the affected pipeline, while not required to do so, chooses to wait until the end of the come-back period to make its filing, further illustrating that pipeline revenue streams are more than ample to cover all costs and provide a healthy return between rate cases (*e.g.*, Florida Gas Transmission Company's come-back Section 4 filings in RP04-12, RP10-21, and RP15-101 were made on the last day of the come-back periods).

[6] *Natural*, *supra*, 129 FERC ¶ 61,158 at P 7.

[7] *Great Lakes, supra*, 129 FERC ¶ 61,160 at P 6.

[8] *Policy Statement on Incentive Regulation*, 61 FERC ¶ 61,168 (1992); *Statement of Policy*, 74 FERC ¶ 61,076 (1996) (amending the *1992 Policy Statement*, at pp. 61,237-38, to try to further entice pipelines to file for incentive rates).

[9] *1996 Policy Statement, supra*, 74 FERC at p. 61,237: "Since the issuance of the [1992] Policy Statement, the Commission has not received any requests for approval of incentive rate proposals." APGA is unaware of any incentive rate filings following the *1996 Policy Statement*, in which the Commission tried to make the incentive rate program more attractive to pipelines.

and that any such mechanism will be used by the pipelines to further insulate themselves from meaningful FERC rate scrutiny by automatically increasing rates when a full NGA Section 4 rate review might show a rate decrease was in order. Interstate pipelines have made a handsome living staying away from the Commission, and trackers will only facilitate that *modus operandi*. Further, as pointed out in Part III.H., below, since a tracker reduces a pipeline's risk, any policy statement on the subject should require that a tracker mechanism be accompanied by a reduction in the allowed return on equity of the pipeline seeking such a tracker mechanism.

C. The Notice Substitutes Speculation for Substantial Evidence and Logic.

The Notice cites not an iota of empirical evidence to support its implicit finding that current Commission ratemaking policies would not "allow interstate natural gas pipelines to recover certain capital expenditures made to modernize pipeline system infrastructure in a manner that enhances system reliability, safety, and regulatory compliance." (Notice, P 9.) Rather, the Notice is premised almost completely on statutes that have been in effect for several years (and cited by other unsuccessful tracker applicants) and what agencies such as PHMSA and EPA are "considering" (Notice, PP 4, 5, 6), also cited by heretofore unsuccessful tracker applicants. More importantly, even if one agrees hypothetically with the Commission that "[o]ne 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 cost expenditures to enhance the safety and reliability of their systems" (Notice, P 8), there is not a shred of evidence that these costs cannot be completely and timely recovered by the affected pipelines via NGA Section 4 rate filings – rate filings that would ensure that the recovery was merited because the affected pipelines' *unit* cost of doing business (versus simply one component of the cost of doing business) had in fact increased.[10]

D. If the Commission Wants a Tracker Mechanism That Works, i.e., Ensures Just and Reasonable Rates, It Must Be a Two-Way Tracker, as Sanctioned under the FPA.

If what the Commission seeks is guaranteed cost recovery for pipelines without the burden of full NGA Section 4 filings, then it should follow its own lead in regulating public utilities under the Federal Power Act. The vast majority of public utilities have their transmission rates revised annually under formula rate mechanisms intended to protect utilities *and* consumers as overall costs go up and down. The advantages of 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 utilities are assured timely recovery of capital (and other) 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 is obviated.

Of course, APGA expects pipelines would be cold to this suggestion (just as they were to incentive rates) since the revenue over-recoveries that pipelines are so accustomed to enjoying under the NGA would be precluded. If the Commission's concern is full and timely cost recovery by pipelines without allowing windfalls, then it should present formula rates as the vehicle to achieve those ends and at the same time protect consumers from paying unjust and

[10] The *Columbia* case cited in the Notice (at PP 12 *et seq.*) is *sui generis* (as discussed below) and does not support the Commission's apparent thesis regarding the need for trackers. In point of fact, it appears that the real genesis for the subject Notice has nothing to do with any demonstrated inadequacies of NGA Section 4 but rather relates to the so-called "Capstone Methane Stakeholder Roundtable" meetings in 2014, one outcome of which was the DOE Secretary's recommendation that "the Federal Energy Regulatory Commission … explore efforts to provide greater certainty for cost recovery for new investment in modernization of natural gas transmission infrastructure, …." (available at http://energy.gov/articles/factsheet-initiative-help-modernize-natural-gas-transmission-and-distribution). Clearly, such recommendations do not excuse ignoring the law, under which interstate pipelines are responsible for seeking and justifying rate increases under the parameters of NGA Section 4.

unreasonable rates. Tracker mechanisms, no matter the "safeguards" (on which, more later), will not afford customers the protections to which they are entitled under the Natural Gas Act.

E. The Commission's Notice Fails To Ask and Answer the Key Questions.

There is the implication in the Notice that a tracker is necessary so that pipelines will timely keep their facilities in good operating condition. For example, the Commission expresses concern about "replacing old and inefficient compressors and leak-prone pipes …." (Notice, P 1.) The Commission never asks itself, much less addresses, several key questions, the first of which, of course, is why these costs, *to the extent they are causing unit costs to increase*, should not be recovered in an NGA Section 4 proceeding, which provides consumer protections completely absent from tracker filings. The second key question is, given the ample operation and maintenance dollars in the pipelines' costs of service, which are automatically collected through rates, to what extent are these dollars not being spent for their intended purpose, thereby causing the degradation of existing pipeline facilities. Has the Commission made any effort to determine whether the much ballyhooed "incentive" for pipelines to make and keep over-recoveries[11] is responsible for pipelines opting, between rate cases, to minimize expenditures to maintain their pipeline facilities in good operating condition?

These are the questions that should concern a Commission whose "mission … is to assist consumers in obtaining reliable, efficient and sustainable energy services at a reasonable cost"[12] and whose task is "to protect consumers against exploitation at the hands of natural gas companies."[13]

---

[11] *E.g.*, Notice, PP 10, 27; *Columbia* at PP 20, 22.

[12] "Statement of Chairman Jon Wellinghoff on Natural Gas Pipeline Rate Investigations," issued Nov. 19, 2009 (Issuance # 20091119-3056).

[13] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944) (the "primary aim of this [NGA] legislation was to protect consumers against exploitation at the hands of natural gas companies.").

In addition to the implication in the Notice that pipelines will not maintain their facilities consistent with good utility practice absent a tracker mechanism, there is also the implication in the Notice that pipelines will not, absent a tracker mechanism, follow legislative and regulatory mandates regarding safe pipeline operation (Notice, PP 2-9). APGA assumes that pipelines will be as offended by that suggestion as it is. First, as FERC-certificated interstate transporters of natural gas, pipelines have a public service obligation to provide safe and reliable service to their customers, consistent with good utility practice, which perforce means adhering to all safety laws and regulations. To the extent pipelines incur costs in obeying the law, safety-related or otherwise, they are entitled to cost recovery, to the extent they can justify it, under NGA Section 4 (i.e., no one-way tracking of costs), as noted by the Commission in the *CenterPoint* case ("Pipelines are entitled to seek recovery of such costs, along with a just and reasonable return, at any time through a general NGA section 4 rate proceeding"; 140 FERC ¶ 61,253 at P 64). The notion that absent a tracker mechanism, pipelines will shirk their public service obligations, not to mention their legal obligations under the prevailing law, is unsubstantiated. While, as noted, pipelines are certainly successful profit-maximization creatures, they are not to our knowledge scofflaws. The working assumption must be that pipelines will obey the law, and to the extent that obeying the law causes their *unit* cost of doing business to increase, they will take full advantage of their rate-increase rights under NGA Section 4.

F. The *Columbia* Case Provides No Support for the Proposed Tracker Mechanism

In the Notice, the Commission discusses its approval of a tracker mechanism in a settlement in *Columbia Gas Transmission, LLC*, 142 FERC ¶ 61,062 (2013) ("*Columbia*"), Notice, PP 12-17, and then states that it intends to base its policy on tracking "on the guiding principles established in *Columbia Gas*." (Notice, P 20.) As the discussion below makes clear, the *Columbia* case is *sui generis* and provides no basis for adopting an industry-wide tracker mechanism policy along the lines suggested by the Notice.

Among the key factors cited by the Commission in approving Columbia's capital cost recovery mechanism ("CCRM") were (i) the "substantial costs of addressing urgent public safety and reliability concerns" precipitated by unique facts regarding the state of Columbia's system, namely, the facts that "half of its pipeline infrastructure regulated by DOT is over fifty years old, approximately 55 percent of its compressors were installed before 1970 and there is limited horsepower back-up at many critical locations" and that "the system contains approximately 1272 miles of potentially dangerous bare steel pipeline, many of its control systems run on an obsolete platform and because the older part of the system was not designed to accommodate in-line inspection" (*Columbia* at P 22); (ii) the development of the CCRM "began with Columbia and its shippers engaging in a collaborative effort to review Columbia's current base rates, leading to Columbia's agreement to reduce its base rates by $35 million retroactive to January 1, 2012, by another $25 million effective January 1, 2014, and to provide refunds to firm shippers of $50 million," thereby providing "the shippers rate relief which could otherwise only be obtained pursuant to NGA section 5 and could not take effect in the retroactive manner provided by the Settlement" (*id.* at P 23); (iii) the Settlement identified "by pipeline segment and compressor stations, the specific Eligible Facilities for which costs may be recovered through the CCRM" (*id.* at P 24); (iv) Columbia's agreement to (a) establish a billing determinant floor for calculating the CCRM and (b) impute the revenues it would achieve by charging the maximum rate for service at the level of the billing determinant floor before it trues up any cost under-recoveries, with any true-up limited to the $300 million annual cap and other related cost caps – with FERC concluding that "[t]hese provisions, along with the required base rate reductions and the provisions for Columbia to continue substantial capital maintenance investments that will not be recovered in the CCRM surcharge, subject Columbia to a continuing risk of cost under-recovery" (*id.* at P 25); (v) the CCRM would not be a permanent part of Columbia's rates (*id.* at P 26); (vi) the settlement was either supported or not opposed "by all of Columbia's customers" (*id.* at P 27); and (vii) the settlement also included "numerous other significant benefits for Columbia's shippers which would not be available absent the Settlement," including, in addition to "the significant retroactive rate reduction and refund payments already discussed," "(1) the revenue sharing mechanism under which Columbia will refund to its customers 75 percent of any base rate revenues it collects over $750 million in any year after January 1, 2012, (2) a rate moratorium that will provide rate certainty until 2018, (3) a requirement for the pipeline to file an NGA section 4 general rate case by February 2019, (4) the removal of Columbia's existing daily scheduling penalty, thus providing shippers greater flexibility to modify their daily takes to respond to unexpected changes in their need for gas without incurring additional costs, and (5) Columbia's agreement not to propose market-based rates for new storage projects during the term of the Settlement or to propose any additional cost tracking mechanisms." (*Id.* at P 30.)

In brief, in a situation where a pipeline has, for reasons not relevant to this discussion, permitted itself to get in such dire straights as Columbia and because of that is willing to make important and substantial concessions to its customers that would not otherwise be obtainable under the NGA, and where the customers unanimously agree that extraordinary relief is warranted, then the sort of negotiated relief approved by the Commission in *Columbia* is understandable and supportable. But the *Columbia* situation is anomalous and does not serve as a blueprint or template for the sort of tracker mechanism being proposed in the Notice.

G. The "Five Standards" in the Notice Do Not Justify a Tracker Mechanism

Parts III.A-F, above, demonstrate that the Commission has failed to justify abandoning its preclusion of tracker mechanisms under NGA Section 4, which should be the end of the matter. The Commission has suggested as part of its proposed Policy Statement five standards, which it offers as safeguards against pipeline abuse of the tracker mechanism. The discussion below regarding these standards and how to improve them should *not* be construed as support for the tracker mechanism concept, which is unsubstantiated – only as means for minimizing harm should the Commission proceed with the Policy Statement.

1. Review of Existing Rates

The first standard would require that the pipeline proposing a tracker mechanism "establish that the base rates to which any surcharge would be added are just and reasonable and reflect the pipeline's current costs and revenues as of the date of the initial approval of the tracker mechanism." (Notice, P 22.) There are several obvious problems with this requirement. The first has already been discussed, which is that setting just and reasonable rates as of a given point in time does not mean that any new cost incurred thereafter results in under-recovery by the pipeline since just as some costs go up, others go down, and it is only when you view the totality of the inputs that you can determine whether the unit cost of doing business is rising, declining, or remaining stable; as the Commission has so often found, trackers distort ratemaking fundamentals.

The Commission points to the negotiated rate settlement in the *Columbia* case in which Columbia "agreed to reduce its base rates and establish a revenue sharing mechanism for base rate revenues above a certain level," (*id.*) but then quickly notes that "the Commission will consider methods other than a pre-negotiated base rate settlement by which the pipeline could establish that its current base rates are just and reasonable," and then suggests either a new NGA general section 4 rate filing or a cost and revenue study per section 154.313 of the Commission's regulations to show that existing rates are just and reasonable. (*Id.*) That, of course, completely misses the point of what happened in *Columbia*, which is that in the context of negotiating the total package, including substantial rate reductions and refunds, a just and reasonable rate level was agreed upon. The Commission's suggested in lieu approach has none of the advantages of what Columbia and its customers negotiated in the *Columbia* case, and all of the failings associated with a tracker mechanism noted in the *CenterPoint* case.

The Commission suggests that one method of testing base rates for justness and reasonableness is via a cost-and-revenue study in the form specified in section 154.313 of the Commission's regulations (Notice, P 22). Another of the many lessons learned in the NGA Section 5 proceedings initiated by the Commission during the 2009-12 time frame is the ability of pipelines to manipulate such cost-and-revenue studies to produce whatever outcomes they desire by, for example, using inflated rates of returns and depreciation rates, by projecting capital and other expenditures that are without basis, by projecting lower throughput than is realistic, *etc.*, all of which happens in a context that is without the protections afforded customers under NGA Section 4.

2. Eligible Facilities

Under this guideline, the Commission would require that the tracking mechanism "be used by pipelines to recover only capital costs incurred to modify their existing systems to address the safety and other concerns noted above." (Notice, P 23.) The Commission then specifies that the capital costs would "be limited to one-time capital costs to modify the pipeline's existing system to comply with safety and environmental regulations, such as those being considered by PHMSA and by the EPA, as well as other capital costs shown to be necessary for the safe or efficient operation of the pipeline." (*id.*) It is difficult to imagine what capital costs could not be shown "to be necessary for the safe and efficient operation of the pipeline."

The Commission notes that it "will continue to be the Commission's policy that …ordinary capital maintenance costs should not be included in a tracker mechanism." (Notice, P 24.) It then explains that "in order for a pipeline to recover costs through a proposed modernization surcharge mechanism, it would need to demonstrate that the costs to be included are not normal capital maintenance expenditures but are costs necessary to address system safety, efficiency, or other similar concerns, …." (*Id.*) Since in our view the assumption should be that "ordinary capital maintenance costs" should be incurred on a routine basis to maintain a safe and efficient pipeline, we have no idea how the Commission would administer the "not normal" test that it posits. At a minimum, any pipeline seeking a tracker mechanism would need to explain in detail both why the planned "modernization" was needed (*i.e.*, both why it had not been addressed in the past in the normal course of operating consistently with good utility practice and why it would not be addressed in the future as a matter of prudent capital investment related to system maintenance). In other words, there must be a very high bar for facilities to qualify as "eligible facilities." Trackers must not be a mechanism for pipelines to gold-plate their systems at customer expense.

The Commission also states that a pipeline seeking a tracker mechanism "should specifically identify in its proposal the projects eligible for recovery, 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." (Notice, P 25.) This requirement must, of course, be part and parcel of the obligation to prove that such projects are not more properly treated as ordinary maintenance capital costs of a prudent pipeline.

The Commission speaks of providing the pipeline "with an inducement to make the necessary modifications on an expedited basis without inhibiting the pipeline's incentive to provide the maximum level of service." (*Id.*) The Commission explains neither why making the modifications "on an expedited basis" is necessary or in the public interest nor the basis for any concern about "inhibiting the pipeline's incentive to provide the maximum level of service." The point should be, and should always have been, to make capital investments timely, versus on "an expedited basis," whatever that means, in order to ensure safe and reliable service. As far as "inhibiting the pipeline's incentive to provide the maximum level of service," the Commission does not explain why, under normal NGA Section 4 ratemaking principles, there is any negative inducement to provide the maximum level of service.

The Commission then asks whether additional costs should be considered eligible for tracking. The short answer is no, for all the reasons given above; the longer answer is that if the Commission determines to issue a policy statement on trackers, it should keep the policy statement as narrow and as tight as possible, and revisit the entire tracking mechanism concept within 3 to 5 years to determine whether it is working as intended as well as whether amended guidelines are warranted.

3. Avoid Cost Shifts

The Commission proposes to require a tracking pipeline "to design the surcharge in a manner that will protect the pipeline's shippers from significant cost shifts." (Notice, P 29.) The Commission cites to the *Columbia* settlement under which the pipeline was required to design the surcharge based on the greater of actual annual billing determinants or the agreed-upon floor, and to impute the revenue it would achieve by charging the maximum rate for service at the level of the billing determinant floor before trueing up any cost under-recoveries (*id.*).

APGA views this as a minimum requirement which, along with a refund obligation associated with any NGA Section 5 proceeding showing the pipeline's rates to be unjust and unreasonable (see discussion below), would afford important protections to captive shippers.

4. Periodic Review of Surcharge

Under this standard, the Commission "proposes to require pipelines seeking approval of a modernization surcharge to include some method to allow a periodic review of whether the surcharge and the pipeline's base rates remain just and reasonable." (Notice, P 30.) The Commission observes that in the *Columbia* case, the surcharge expired automatically after five years and required a Section 4 filing at the end of the surcharge period.

APGA believes that these minimum requirements must be supplemented with agreement by the requesting pipeline that if during the period that a surcharge mechanism is in effect, an NGA Section 5 complaint is initiated against the pipeline, the pipeline must agree that, to the extent its rates are determined to be unjust and unreasonable, it will make refunds retroactive to the date of the complaint. As noted earlier, NGA Section 5 (unlike its FPA counterpart, Section 206) has no such refund protection, such that pipelines may permanently retain over-recoveries, with any rate correction only effective from and after the date of a Commission order finding the rates to be unjust and unreasonable. The Commission should require that if a pipeline wants an exception to NGA Section 4 ratemaking principles, such that capital costs for modernization may be tracked, that pipeline must agree, as a pre-condition to such a tracker mechanism, that it will refund overcharges determined in an NGA Section 5 proceeding from and after the date of a complaint that is initiated while the tracker mechanism is in effect.

If a tracking mechanism is not a vehicle for circumventing NGA Section 4, then this condition should not be objectionable; however, to the extent that a tracking mechanism results in excess profits for a pipeline, it is only fair to require refunds of those excess profits from the date a complaint is filed. Presumably, the Commission is not viewing a tracking mechanism as a means to circumvent NGA Section 4, and therefore it should be amenable to a condition under which if the Commission or a pipeline's customers bear their NGA Section 5 burden of proving that, during the period in which a tracking mechanism was in place, a pipeline's rates are unjust and unreasonable, refunds of revenues resulting from those unjust and unreasonable rates are required.

5. Shipper Support

The Commission indicates it expects any pipeline seeking approval of a tracker mechanism "to work collaboratively with its shippers to seek support for the pipeline's proposal." (Notice, P 31.) The Commission then notes that it will not require 100% customer support, but it declines to indicate what degree of support is necessary (*id.*).

APGA believes that a critical element of the *Columbia* case was the customer support. Columbia went to its customers with hat in hand, explaining in great detail its problems and offering to make substantial, real-world concessions, such that both sides saw benefits from a negotiated outcome that veered from Commission policy. The result was unanimous customer support for the settlement. While we understand that requiring complete customer support may not be desirable, as it gives any single customer undue leverage, substantial customer support (which we define as at least 90%) must be a *quid pro quo*, because absence of customer support could indicate, among other things, that the pipeline has failed to demonstrate a need for such a mechanism and/or that the normal give-and-take of settlement discussions was absent. The

Commission has to understand that issuance of a Policy Statement along the lines it is suggesting will move the leverage needle to a very different place from where it was in the *Columbia* proceeding, thereby diminishing the likelihood of a balanced outcome.

H. Miscellaneous

The Commission asks several questions at the end of the Notice (PP 33-35). APGA will address these questions briefly, as well as a question not asked by the Commission.

Accelerated amortization: The Commission asks whether pipelines should be able to request either rate base treatment of tracked capital costs or accelerated amortization (Notice, P 33). APGA's view is that the 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. Absent a meeting of the minds among the customers, this issue could be briefed to the Commission, assuming all other pre-conditions for a tracker were met.

Reservation charge credits: The Commission asks whether it should modify its existing reservation crediting policy 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 (Notice, P 34). To the extent that a tracking mechanism results in increased interruptions of service, which presumably would be the case if the effect of the tracker is to incentivize pipeline modernization that would not otherwise occur, a fair trade-off would seem to be full reservation credits for firm customers experiencing greater service interruptions.

Return on equity: Unquestionably a pipeline tracker reduces a pipeline's risk of under-recovery (or, perhaps more accurately, increases the likelihood of over-recovery). Hence, why is it not appropriate to require any pipeline seeking a tracker to agree to a reduction in its ROE, in the neighborhood of 25 to 50 basis points? The DCF methodology relied upon by the Commission in its ROE analysis, which uses a proxy group of pipelines to set a zone of reasonableness, will not reflect the risk reduction attributes of a given pipeline's tracker, and thus this should be separately accounted for by the Commission.

IV. CONCLUSION

APGA respectfully requests that, for the reasons discussed above, the Commission withdraw its proposed Policy Statement.

Respectfully submitted,

AMERICAN PUBLIC GAS ASSOCIATION

By __/s/__William T. Miller_______________

William T. Miller
McCarter & English, LLP
Twelfth Floor
1015 Fifteenth Street, N.W.
Washington, D.C. 20005
(202) 753-3400

January 26, 2015

Its Attorney