U.S. Department
of Transportation
**Pipeline and Hazardous Materials
Safety Administration**

Administrator

1200 New Jersey Avenue, SE.
Washington, DC 20590

The Honorable Robert C. Byrd
Chairman
Committee on Appropriations
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

In House Report 110-238 page 119 of the Departments of Transportation, and Housing and Urban Development, and Related Agencies Fiscal Year 2008 Appropriations Bill, the House Appropriations Committee directed the Pipeline and Hazardous Materials Safety Administration (PHMSA) to submit a report summarizing the agency's statutory authority to revise its current user fee structure; its assessment of the current fee structure; and any recommendations for changes to the fee structure that should be considered as a result of the passage of the Pipeline Inspection, Protection, Enforcement, and Safety (PIPES) Act of 2006 (Pub. L. 109-468). The PIPES Act did not amend the agency's authority over pipeline safety user fees or otherwise direct any changes in the allocation of costs among pipeline operators. However, as explained further below, the Act increased authorized spending and shifted program emphasis in ways that call into question the continued fairness of the agency's longstanding allocation methodology.

We appreciate the Committee's interest and are pleased to report on each of these subjects, as follows:

PHMSA's Authority to Revise the Fee Structure

In accordance with our annual appropriations, all direct costs of the Federal pipeline safety program are funded through user fees. The vast share of the program budget (77 percent in FY 2008), including all costs for oversight of natural gas pipelines, is funded through the Pipeline Safety Trust Fund, consisting of user fees assessed against pipeline operators under 49 U.S.C. § 60301. (The remaining share of the pipeline safety program budget is funded through the Oil Spill Liability Trust Fund.) Section 60301 authorizes the Secretary of Transportation to assess fees based on "usage (in reasonable relationship to volume-miles, miles, revenues, or a combination of volume-miles, miles, and revenues) of the pipelines" and directs the Secretary to "consider the allocation of resources of the Department." Further, § 60301 limits the categories of pipeline operators that must pay Federal user fees. By requiring that fees be "imposed on each person operating a gas pipeline transmission facility, a liquefied natural gas (LNG) pipeline facility, or a hazardous liquid pipeline facility," current law precludes direct assessment of fees on companies that operate only natural gas distribution pipelines or regulated gathering lines. Natural gas distribution pipelines -- those that directly serve residential, commercial, and other end users -- make up the largest share of the national pipeline network:

roughly 1.9 million of the 2.2 million miles of natural gas pipelines. Regulated gathering lines comprise a relatively small segment of the pipeline network – roughly 23,000 miles of regulated natural gas gathering lines and 3,400 miles of liquid gathering lines.

PHMSA assesses annual user fees under § 60301 on a per-mile basis against operators of natural gas transmission and hazardous liquid pipelines. Rates are calculated each year based on appropriations, areas of program emphasis, and resource allocation, with the ratio of costs apportioned to gas and liquid typically ranging between 40 and 60 percent. Although the rates change annually, the agency has followed the same methodology since 1986, when PHMSA's predecessor agency, the Research and Special Programs Administration (RSPA), established the basic formula and procedure in accordance with Congress' direction. See 51 FR 248 (1986).

As RSPA noted at the time, the governing statutory standard gives the agency limited discretion in allocating program costs. RSPA settled on transmission pipeline mileage and LNG facility volume as the bases for fee assessments, and, subject to a minimum mileage threshold, applied these formula to all operators of transmission pipelines and LNG facilities. RSPA acknowledged that some combination of volume and miles would more precisely track use and program spending, but favored a mileage-based allocation for reasons of administrative efficiency and in view of the consensus reached by the pipeline trade associations. In separate cases, the United States Supreme Court and the United States District Court for the District of Columbia upheld RSPA's decision. *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 22 (1989) (because it places multiple restrictions on the Secretary's exercise of discretion, § 60301 is not an unconstitutional delegation of Congress' taxing power); *Five Flags Pipeline Co. v. DOT*, Civ. A. No. 89-0119 (April 1, 1992) (holding, *inter alia*, that § 60301does not preclude assessment of fees on intrastate operations and that RSPA acted within its discretion in selecting mileage over more precise but complex measure).

RSPA reaffirmed its user fee methodology in 1998, in a report to Congress under Section 17 of the Accountable Pipeline Safety and Partnership Act of 1996. After examining various alternatives and stakeholder comments, the report recommended no change in the mileage-based assessment methodology adopted in 1986. Over objections from low-volume operators, RSPA concluded that mileage provided the best single indicator of inspection time and effort, and the least administratively burdensome assessment measure. Although RSPA acknowledged limitations in the current measure, it concluded that the administrative costs of refining the methodology were not justified.

At the time of the first RSPA proceeding, the program budget for the Office of Pipeline Safety was $7.73 million, roughly 8.3 percent of the amount proposed in the President's FY 2009 budget. The corresponding user fees have grown in similar proportion. The final fee assessment for 1986 was $23.99 per mile for gas transmission pipelines and $6.41 for hazardous liquid pipelines. We expect the FY 2008 user fee for natural gas transmission operators will exceed $161 per mile.

PHMSA's Assessment of the Current Fee Structure

The current user fee structure was largely a product of compromise, beginning with the legislative decision to limit the reach of § 60301 and including the agency's selection of mileage as the sole basis for apportioning costs among pipeline operators. As the size, costs, and focus of our program expand, it is appropriate to consider whether the current user fee structure remains the best option for future funding of the pipeline safety program.

As the Committee recognizes, passage of the PIPES Act focused new attention on the fairness of the current fee structure. The Act authorizes significant increases in funding for inspection and enforcement activities at the Federal and State levels and directs PHMSA to extend its integrity management program to gas distribution systems. Section 2(c) of the Act, amending 49 U.S.C. § 60107(a), increased the cap on Federal funding of state pipeline safety programs from 50 to 80 percent of costs, and section 2(b) authorized a new grant program targeting prevention of excavation-related damage. Because state programs oversee the vast share of the gas distribution network, and because excavation-related damage is an especially serious problem for these operations, the gas distribution industry will benefit significantly from the new spending.

Although the PIPES Act itself was widely supported by the pipeline industry, no consensus has emerged concerning the need to revise the current mileage-based user fee formula and, in particular, the merits of limiting charges for expenses of natural gas safety oversight to transmission and LNG facility operators. The Act granted the Secretary new authority to recover fees from applicants for LNG permits, but it did not expand the category of operators subject to the user fee assessment under 49 U.S.C. § 60301.

PHMSA carefully considered its user fee options as it prepared its FY 2009 budget, the first budget developed following the PIPES Act reauthorization. We reviewed our existing authority and welcomed the views of affected stakeholders. Without purporting to set forth all arguments and data offered in support of the respective positions, we offer a brief synopsis of views expressed by the interested industry associations:

- The Interstate Natural Gas Association of America (INGAA), which represents companies that operate only interstate natural gas transmission pipelines, maintains that market conditions and economic regulatory standards preclude natural gas transmission operators from recovering user fee increases from downstream distribution operators. The Federal Energy Regulatory Commission (FERC) continues to regulate interstate natural gas pipelines on a cost-of-service basis. However, rates set by the FERC are essentially rate caps. FERC permits and encourages rate discounting as a means of providing consumers with the benefits of competitive natural gas commodity and transportation markets. Because rate discounting is dictated by market conditions, and not by the regulator, FERC cannot guarantee that a pipeline will be able to recover increased costs, such as additional PHMSA user fees associated with natural gas distribution-related activities. INGAA points out that the agency's safety programs increasingly address natural gas distribution pipelines and maintains that PHMSA could and should differentiate between program costs related to oversight of transmission pipelines and the increasing proportion related to distribution system oversight.

- The trade associations representing gas distribution operators have a different perspective. Both the American Gas Association (AGA) and the American Public Gas Association (APGA) advocate continued use of the current user fee structure. As detailed in the organization's published report, AGA contends that the existing fee structure spreads the costs of pipeline safety programs among all users of natural gas, because virtually all natural gas consumed in the United States (20 to 22 Tcf annually) moves through transmission pipelines under rates that presumptively cover operating costs, including user fees. In contrast, AGA maintains, only 50 percent of natural gas consumed in the U.S. is transported by natural gas distribution operators. AGA contends that placing some Federal user fees at the beginning of the transportation system and others at the distribution end would result in overlapping and disproportionate user fee assessments and likely result in residential and smaller business customers paying a disproportionate share of the fees. APGA, which represents public sector gas distribution operators, contends that its members would face special hardships if required to pay user fees directly to the Federal government. APGA points out that its members already pay user fees indirectly through rates charged by transmission companies and directly to many state pipeline safety agencies. Additional user fees would further reduce city public works budgets.

Because of the potential impacts on State-regulated operations and rates, the National Association of Pipeline Safety Representatives (NAPSR), National Association of Regulatory Utility Commissioners (NARUC), and individual State regulators also should be consulted on any proposal to charge Federal user fees directly to distribution operators. We understand that many States assess their own user fees for safety program costs, and some may be concerned that the direct imposition of Federal fees could put funding streams at risk, impose undue costs on small operators or utility ratepayers, and/or impose unreasonable administrative burden.

Although we have explored various alternatives to the current, mileage-based fee structure, to date, PHMSA has not identified an approach that would address concerns about the current allocation of gas program costs without creating other perceived inequities or unintended consequences. In particular, we are not persuaded that overall fairness would be enhanced by allocating oversight costs associated with distribution and gathering line operations among only those distribution and gathering line operators that are reached under § 60301. As a matter of legal authority, PHMSA arguably could assess user fees based on distribution or regulated gathering line operations carried out by companies that also operate transmission pipelines. (Section 60301 plainly authorizes the agency to assess fees only against transmission *operators*; yet nothing in the provision limits the basis for assessing fees to transmission *operations*.) We are confident that we could reasonably estimate the proportion of program costs associated with distribution and gathering line operations, as distinct from transmission and LNG operations. But spreading those costs over fewer than all distribution and gathering line operators would create its own inequities. We understand that this approach would reach roughly half of the distribution operators in the United States, with no objectively reasonable pattern as to size or program use. Further, in any effort to reach distribution operators, we would be inclined to consider the extent to which the affected states receive grants-in-aid under our program. RSPA was justified in declining to account for these costs when it developed the current fee, but the

issue becomes more relevant to the extent that distribution program costs are directly charged to distribution operators.

Likewise, we do not believe that the concerns about our existing fee structure could be addressed by revising the basis on which costs are allocated among pipeline operators, for instance, by substituting volume-miles or any other measure contemplated by § 60301 for the current mileage basis. Although a more precise allocation could be possible, we are not aware of any serious support for reopening the fee methodology on this ground, and we have received no formal or informal proposal for such action. In the current environment, we doubt that a marginal improvement in precision would justify the additional administrative costs and information collection burdens of applying a more complex allocation basis.

Recognizing that all gas pipeline operators are subject to State or Federal economic regulation, we also considered whether cost allocation concerns could be addressed through economic regulatory relief. We assume most stakeholders would consider a fee structure fair if the costs of pipeline safety oversight could be passed through, in reasonable relationship to consumption, to the end users of energy products that are delivered by pipeline. In the case of intrastate operators, the ability to recover Federal fees or direct safety costs is subject to the standards and circumstances in each jurisdiction. We cannot assume that distribution operators would be able to pass along new Federal user fees in the rates charged by residential and commercial customers. By the same token, we do not assume that the current methodology produces pro rata cost distribution to downstream customers. In this connection, we considered whether a special user fee "tracker" would assist operators in recovering cost increases from their ratepayers (including distribution companies and electric generation facilities) without altering the current fee structure. This is an issue within FERC's expertise and exclusive jurisdiction over interstate gas transmission rates. Should the matter be raised in that forum, PHMSA would be pleased to participate and provide any information that may be useful to the parties and Commission. At this point, however, the operators that pay our user fees have no apparent interest in a user fee tracker. Under the market conditions described by INGAA, a user fee tracker would simply adjust the cost-of-service rate; it would not assure an operator's ability to collect the adjusted rate. Likewise, informal discussions with FERC representatives cast doubt on the feasibility of a user fee tracker. In the absence of a new or renewed consensus among the affected industry segments, PHMSA has no basis for advancing tracking or any other economic regulatory measures with respect to user fees.

PHMSA Recommendations

For the reasons I have explained, PHMSA is not inclined to reconsider its current fee allocation method at this time and is not prepared to offer an alternative legislative proposal.

We would encourage industry stakeholders to continue exploring funding and allocation options to overcome concerns about the current methodology. In this connection, we welcome and support industry efforts to collaborate on safety-related projects that can be financed directly by pipeline operators. The "checkoff" program model that has been used successfully in other industries (beginning with agricultural commodities, but also including the propane industry) might offer a fair and appropriate framework for this purpose. Depending on its design, a

checkoff program may offer a suitable vehicle for investment in activities, such as research, technology development, and public awareness campaigns, for which there is widespread industry support.

If and when the current funding authority is reopened, PHMSA will be interested in the relationship between user fees and risk. In accordance with risk-based oversight, we would favor a funding mechanism that ties some cost allocation to relative safety risks, based on the nature of the operation and the relative condition and performance of the operator and facility. Properly executed, such an approach would reward operators with strong safety records and favorable risk profiles. Likewise, it is worth considering whether agency costs associated with complex incident investigations and extraordinary enforcement and oversight matters should be charged directly to the operator. Under the current fee structure, PHMSA's involvement with a single operator can distort allocation of program costs among industry segments. Like the proposal to assess fees on all gas distribution operators, this approach would require Congressional action to augment the Secretary's existing statutory authority under § 60301.

PHMSA takes its stewardship of the Pipeline Safety Fund seriously, recognizing our responsibility under § 60301 and the importance of cost-beneficial oversight to the safe and clean delivery of energy resources and products. Yet we also recognize, as has Congress, that the continued effectiveness of the pipeline safety program and implementation of the PIPES Act mandates require increasing investment in basic program activities, including support for state programs.

We are happy to work with Congress and stakeholders to further explore funding options. In the absence of industry consensus, however, we believe it is important to broaden the discussion beyond this Department. The allocation of PHMSA oversight costs could have consequences for State regulators and individual ratepayers. In an environment of increased competition among energy sources, decisions about funding of safety oversight also could have broader implications for Federal energy and environmental policy.

An identical letter has been sent to the Ranking Member of the Senate Committee on Appropriations and the Chairman and Ranking Member of the House Committee on Appropriations.

Sincerely,

Carl T. Johnson

U.S. Department
of Transportation
Pipeline and Hazardous Materials Safety Administration

Administrator

1200 New Jersey Avenue, SE.
Washington, DC 20590

The Honorable Thad Cochran
Ranking Member
Committee on Appropriations
United States Senate
Washington, DC 20510

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As RSPA noted at the time, the governing statutory standard gives the agency limited discretion in allocating program costs. RSPA settled on transmission pipeline mileage and LNG facility volume as the bases for fee assessments, and, subject to a minimum mileage threshold, applied these formula to all operators of transmission pipelines and LNG facilities. RSPA acknowledged that some combination of volume and miles would more precisely track use and program spending, but favored a mileage-based allocation for reasons of administrative efficiency and in view of the consensus reached by the pipeline trade associations. In separate cases, the United States Supreme Court and the United States District Court for the District of Columbia upheld RSPA's decision. *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 22 (1989) (because it places multiple restrictions on the Secretary's exercise of discretion, § 60301 is not an unconstitutional delegation of Congress' taxing power); *Five Flags Pipeline Co. v. DOT*, Civ. A. No. 89-0119 (April 1, 1992) (holding, *inter alia*, that § 60301does not preclude assessment of fees on intrastate operations and that RSPA acted within its discretion in selecting mileage over more precise but complex measure).

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issue becomes more relevant to the extent that distribution program costs are directly charged to distribution operators.

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PHMSA Recommendations

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If and when the current funding authority is reopened, PHMSA will be interested in the relationship between user fees and risk. In accordance with risk-based oversight, we would favor a funding mechanism that ties some cost allocation to relative safety risks, based on the nature of the operation and the relative condition and performance of the operator and facility. Properly executed, such an approach would reward operators with strong safety records and favorable risk profiles. Likewise, it is worth considering whether agency costs associated with complex incident investigations and extraordinary enforcement and oversight matters should be charged directly to the operator. Under the current fee structure, PHMSA's involvement with a single operator can distort allocation of program costs among industry segments. Like the proposal to assess fees on all gas distribution operators, this approach would require Congressional action to augment the Secretary's existing statutory authority under § 60301.

PHMSA takes its stewardship of the Pipeline Safety Fund seriously, recognizing our responsibility under § 60301 and the importance of cost-beneficial oversight to the safe and clean delivery of energy resources and products. Yet we also recognize, as has Congress, that the continued effectiveness of the pipeline safety program and implementation of the PIPES Act mandates require increasing investment in basic program activities, including support for state programs.

We are happy to work with Congress and stakeholders to further explore funding options. In the absence of industry consensus, however, we believe it is important to broaden the discussion beyond this Department. The allocation of PHMSA oversight costs could have consequences for State regulators and individual ratepayers. In an environment of increased competition among energy sources, decisions about funding of safety oversight also could have broader implications for Federal energy and environmental policy.

An identical letter has been sent to the Chairman of the Senate Committee on Appropriations and the Chairman and Ranking Member of the House Committee on Appropriations.

Sincerely,

Carl T. Johnson

U.S. Department
of Transportation
**Pipeline and Hazardous Materials
Safety Administration**

Administrator

1200 New Jersey Avenue, SE.
Washington, DC 20590

The Honorable David Obey
Chairman
Committee on Appropriations
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Obey:

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As RSPA noted at the time, the governing statutory standard gives the agency limited discretion in allocating program costs. RSPA settled on transmission pipeline mileage and LNG facility volume as the bases for fee assessments, and, subject to a minimum mileage threshold, applied these formula to all operators of transmission pipelines and LNG facilities. RSPA acknowledged that some combination of volume and miles would more precisely track use and program spending, but favored a mileage-based allocation for reasons of administrative efficiency and in view of the consensus reached by the pipeline trade associations. In separate cases, the United States Supreme Court and the United States District Court for the District of Columbia upheld RSPA's decision. *Skinner v. Mid-America Pipeline Co.*, 490 U.S. 22 (1989) (because it places multiple restrictions on the Secretary's exercise of discretion, § 60301 is not an unconstitutional delegation of Congress' taxing power); *Five Flags Pipeline Co. v. DOT*, Civ. A. No. 89-0119 (April 1, 1992) (holding, *inter alia*, that § 60301does not preclude assessment of fees on intrastate operations and that RSPA acted within its discretion in selecting mileage over more precise but complex measure).

RSPA reaffirmed its user fee methodology in 1998, in a report to Congress under Section 17 of the Accountable Pipeline Safety and Partnership Act of 1996. After examining various alternatives and stakeholder comments, the report recommended no change in the mileage-based assessment methodology adopted in 1986. Over objections from low-volume operators, RSPA concluded that mileage provided the best single indicator of inspection time and effort, and the least administratively burdensome assessment measure. Although RSPA acknowledged limitations in the current measure, it concluded that the administrative costs of refining the methodology were not justified.

At the time of the first RSPA proceeding, the program budget for the Office of Pipeline Safety was $7.73 million, roughly 8.3 percent of the amount proposed in the President's FY 2009 budget. The corresponding user fees have grown in similar proportion. The final fee assessment for 1986 was $23.99 per mile for gas transmission pipelines and $6.41 for hazardous liquid pipelines. We expect the FY 2008 user fee for natural gas transmission operators will exceed $161 per mile.

PHMSA's Assessment of the Current Fee Structure

The current user fee structure was largely a product of compromise, beginning with the legislative decision to limit the reach of § 60301 and including the agency's selection of mileage as the sole basis for apportioning costs among pipeline operators. As the size, costs, and focus of our program expand, it is appropriate to consider whether the current user fee structure remains the best option for future funding of the pipeline safety program.

As the Committee recognizes, passage of the PIPES Act focused new attention on the fairness of the current fee structure. The Act authorizes significant increases in funding for inspection and enforcement activities at the Federal and State levels and directs PHMSA to extend its integrity management program to gas distribution systems. Section 2(c) of the Act, amending 49 U.S.C. § 60107(a), increased the cap on Federal funding of state pipeline safety programs from 50 to 80 percent of costs, and section 2(b) authorized a new grant program targeting prevention of excavation-related damage. Because state programs oversee the vast share of the gas distribution network, and because excavation-related damage is an especially serious problem for these operations, the gas distribution industry will benefit significantly from the new spending.

Although the PIPES Act itself was widely supported by the pipeline industry, no consensus has emerged concerning the need to revise the current mileage-based user fee formula and, in particular, the merits of limiting charges for expenses of natural gas safety oversight to transmission and LNG facility operators. The Act granted the Secretary new authority to recover fees from applicants for LNG permits, but it did not expand the category of operators subject to the user fee assessment under 49 U.S.C. § 60301.

PHMSA carefully considered its user fee options as it prepared its FY 2009 budget, the first budget developed following the PIPES Act reauthorization. We reviewed our existing authority and welcomed the views of affected stakeholders. Without purporting to set forth all arguments and data offered in support of the respective positions, we offer a brief synopsis of views expressed by the interested industry associations:

- The Interstate Natural Gas Association of America (INGAA), which represents companies that operate only interstate natural gas transmission pipelines, maintains that market conditions and economic regulatory standards preclude natural gas transmission operators from recovering user fee increases from downstream distribution operators. The Federal Energy Regulatory Commission (FERC) continues to regulate interstate natural gas pipelines on a cost-of-service basis. However, rates set by the FERC are essentially rate caps. FERC permits and encourages rate discounting as a means of providing consumers with the benefits of competitive natural gas commodity and transportation markets. Because rate discounting is dictated by market conditions, and not by the regulator, FERC cannot guarantee that a pipeline will be able to recover increased costs, such as additional PHMSA user fees associated with natural gas distribution-related activities. INGAA points out that the agency's safety programs increasingly address natural gas distribution pipelines and maintains that PHMSA could and should differentiate between program costs related to oversight of transmission pipelines and the increasing proportion related to distribution system oversight.

- The trade associations representing gas distribution operators have a different perspective. Both the American Gas Association (AGA) and the American Public Gas Association (APGA) advocate continued use of the current user fee structure. As detailed in the organization's published report, AGA contends that the existing fee structure spreads the costs of pipeline safety programs among all users of natural gas, because virtually all natural gas consumed in the United States (20 to 22 Tcf annually) moves through transmission pipelines under rates that presumptively cover operating costs, including user fees. In contrast, AGA maintains, only 50 percent of natural gas consumed in the U.S. is transported by natural gas distribution operators. AGA contends that placing some Federal user fees at the beginning of the transportation system and others at the distribution end would result in overlapping and disproportionate user fee assessments and likely result in residential and smaller business customers paying a disproportionate share of the fees. APGA, which represents public sector gas distribution operators, contends that its members would face special hardships if required to pay user fees directly to the Federal government. APGA points out that its members already pay user fees indirectly through rates charged by transmission companies and directly to many state pipeline safety agencies. Additional user fees would further reduce city public works budgets.

Because of the potential impacts on State-regulated operations and rates, the National Association of Pipeline Safety Representatives (NAPSR), National Association of Regulatory Utility Commissioners (NARUC), and individual State regulators also should be consulted on any proposal to charge Federal user fees directly to distribution operators. We understand that many States assess their own user fees for safety program costs, and some may be concerned that the direct imposition of Federal fees could put funding streams at risk, impose undue costs on small operators or utility ratepayers, and/or impose unreasonable administrative burden.

Although we have explored various alternatives to the current, mileage-based fee structure, to date, PHMSA has not identified an approach that would address concerns about the current allocation of gas program costs without creating other perceived inequities or unintended consequences. In particular, we are not persuaded that overall fairness would be enhanced by allocating oversight costs associated with distribution and gathering line operations among only those distribution and gathering line operators that are reached under § 60301. As a matter of legal authority, PHMSA arguably could assess user fees based on distribution or regulated gathering line operations carried out by companies that also operate transmission pipelines. (Section 60301 plainly authorizes the agency to assess fees only against transmission *operators*; yet nothing in the provision limits the basis for assessing fees to transmission *operations*.) We are confident that we could reasonably estimate the proportion of program costs associated with distribution and gathering line operations, as distinct from transmission and LNG operations. But spreading those costs over fewer than all distribution and gathering line operators would create its own inequities. We understand that this approach would reach roughly half of the distribution operators in the United States, with no objectively reasonable pattern as to size or program use. Further, in any effort to reach distribution operators, we would be inclined to consider the extent to which the affected states receive grants-in-aid under our program. RSPA was justified in declining to account for these costs when it developed the current fee, but the

issue becomes more relevant to the extent that distribution program costs are directly charged to distribution operators.

Likewise, we do not believe that the concerns about our existing fee structure could be addressed by revising the basis on which costs are allocated among pipeline operators, for instance, by substituting volume-miles or any other measure contemplated by § 60301 for the current mileage basis. Although a more precise allocation could be possible, we are not aware of any serious support for reopening the fee methodology on this ground, and we have received no formal or informal proposal for such action. In the current environment, we doubt that a marginal improvement in precision would justify the additional administrative costs and information collection burdens of applying a more complex allocation basis.

Recognizing that all gas pipeline operators are subject to State or Federal economic regulation, we also considered whether cost allocation concerns could be addressed through economic regulatory relief. We assume most stakeholders would consider a fee structure fair if the costs of pipeline safety oversight could be passed through, in reasonable relationship to consumption, to the end users of energy products that are delivered by pipeline. In the case of intrastate operators, the ability to recover Federal fees or direct safety costs is subject to the standards and circumstances in each jurisdiction. We cannot assume that distribution operators would be able to pass along new Federal user fees in the rates charged by residential and commercial customers. By the same token, we do not assume that the current methodology produces pro rata cost distribution to downstream customers. In this connection, we considered whether a special user fee "tracker" would assist operators in recovering cost increases from their ratepayers (including distribution companies and electric generation facilities) without altering the current fee structure. This is an issue within FERC's expertise and exclusive jurisdiction over interstate gas transmission rates. Should the matter be raised in that forum, PHMSA would be pleased to participate and provide any information that may be useful to the parties and Commission. At this point, however, the operators that pay our user fees have no apparent interest in a user fee tracker. Under the market conditions described by INGAA, a user fee tracker would simply adjust the cost-of-service rate; it would not assure an operator's ability to collect the adjusted rate. Likewise, informal discussions with FERC representatives cast doubt on the feasibility of a user fee tracker. In the absence of a new or renewed consensus among the affected industry segments, PHMSA has no basis for advancing tracking or any other economic regulatory measures with respect to user fees.

PHMSA Recommendations

For the reasons I have explained, PHMSA is not inclined to reconsider its current fee allocation method at this time and is not prepared to offer an alternative legislative proposal.

We would encourage industry stakeholders to continue exploring funding and allocation options to overcome concerns about the current methodology. In this connection, we welcome and support industry efforts to collaborate on safety-related projects that can be financed directly by pipeline operators. The "checkoff" program model that has been used successfully in other industries (beginning with agricultural commodities, but also including the propane industry) might offer a fair and appropriate framework for this purpose. Depending on its design, a

checkoff program may offer a suitable vehicle for investment in activities, such as research, technology development, and public awareness campaigns, for which there is widespread industry support.

If and when the current funding authority is reopened, PHMSA will be interested in the relationship between user fees and risk. In accordance with risk-based oversight, we would favor a funding mechanism that ties some cost allocation to relative safety risks, based on the nature of the operation and the relative condition and performance of the operator and facility. Properly executed, such an approach would reward operators with strong safety records and favorable risk profiles. Likewise, it is worth considering whether agency costs associated with complex incident investigations and extraordinary enforcement and oversight matters should be charged directly to the operator. Under the current fee structure, PHMSA's involvement with a single operator can distort allocation of program costs among industry segments. Like the proposal to assess fees on all gas distribution operators, this approach would require Congressional action to augment the Secretary's existing statutory authority under § 60301.

PHMSA takes its stewardship of the Pipeline Safety Fund seriously, recognizing our responsibility under § 60301 and the importance of cost-beneficial oversight to the safe and clean delivery of energy resources and products. Yet we also recognize, as has Congress, that the continued effectiveness of the pipeline safety program and implementation of the PIPES Act mandates require increasing investment in basic program activities, including support for state programs.

We are happy to work with Congress and stakeholders to further explore funding options. In the absence of industry consensus, however, we believe it is important to broaden the discussion beyond this Department. The allocation of PHMSA oversight costs could have consequences for State regulators and individual ratepayers. In an environment of increased competition among energy sources, decisions about funding of safety oversight also could have broader implications for Federal energy and environmental policy.

An identical letter has been sent to the Ranking Member of the House Committee on Appropriations and the Chairman and Ranking Member of the Senate Committee on Appropriations.

Sincerely,

Carl T. Johnson

U.S. Department
of Transportation
**Pipeline and Hazardous Materials
Safety Administration**

Administrator

1200 New Jersey Avenue, SE.
Washington, DC 20590

The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Lewis:

In House Report 110-238 page 119 of the Departments of Transportation, and Housing and Urban Development, and Related Agencies Fiscal Year 2008 Appropriations Bill, the House Appropriations Committee directed the Pipeline and Hazardous Materials Safety Administration (PHMSA) to submit a report summarizing the agency's statutory authority to revise its current user fee structure; its assessment of the current fee structure; and any recommendations for changes to the fee structure that should be considered as a result of the passage of the Pipeline Inspection, Protection, Enforcement, and Safety (PIPES) Act of 2006 (Pub. L. 109-468). The PIPES Act did not amend the agency's authority over pipeline safety user fees or otherwise direct any changes in the allocation of costs among pipeline operators. However, as explained further below, the Act increased authorized spending and shifted program emphasis in ways that call into question the continued fairness of the agency's longstanding allocation methodology.

We appreciate the Committee's interest and are pleased to report on each of these subjects, as follows:

PHMSA's Authority to Revise the Fee Structure

In accordance with our annual appropriations, all direct costs of the Federal pipeline safety program are funded through user fees. The vast share of the program budget (77 percent in FY 2008), including all costs for oversight of natural gas pipelines, is funded through the Pipeline Safety Trust Fund, consisting of user fees assessed against pipeline operators under 49 U.S.C. § 60301. (The remaining share of the pipeline safety program budget is funded through the Oil Spill Liability Trust Fund.) Section 60301 authorizes the Secretary of Transportation to assess fees based on "usage (in reasonable relationship to volume-miles, miles, revenues, or a combination of volume-miles, miles, and revenues) of the pipelines" and directs the Secretary to "consider the allocation of resources of the Department." Further, § 60301 limits the categories of pipeline operators that must pay Federal user fees. By requiring that fees be "imposed on each person operating a gas pipeline transmission facility, a liquefied natural gas (LNG) pipeline facility, or a hazardous liquid pipeline facility," current law precludes direct assessment of fees on companies that operate only natural gas distribution pipelines or regulated gathering lines. Natural gas distribution pipelines -- those that directly serve residential, commercial, and other end users -- make up the largest share of the national pipeline network:

roughly 1.9 million of the 2.2 million miles of natural gas pipelines. Regulated gathering lines comprise a relatively small segment of the pipeline network – roughly 23,000 miles of regulated natural gas gathering lines and 3,400 miles of liquid gathering lines.

PHMSA assesses annual user fees under § 60301 on a per-mile basis against operators of natural gas transmission and hazardous liquid pipelines. Rates are calculated each year based on appropriations, areas of program emphasis, and resource allocation, with the ratio of costs apportioned to gas and liquid typically ranging between 40 and 60 percent. Although the rates change annually, the agency has followed the same methodology since 1986, when PHMSA's predecessor agency, the Research and Special Programs Administration (RSPA), established the basic formula and procedure in accordance with Congress' direction. See 51 FR 248 (1986).

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PHMSA takes its stewardship of the Pipeline Safety Fund seriously, recognizing our responsibility under § 60301 and the importance of cost-beneficial oversight to the safe and clean delivery of energy resources and products. Yet we also recognize, as has Congress, that the continued effectiveness of the pipeline safety program and implementation of the PIPES Act mandates require increasing investment in basic program activities, including support for state programs.

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An identical letter has been sent to the Chairman of the House Committee on Appropriations and the Chairman and Ranking Member of the Senate Committee on Appropriations.

Sincerely,

Carl T. Johnson