UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

COMMENTS OF THE NEW YORK STATE PUBLIC SERVICE COMMISSION

The New York State Public Service Commission (NYPSC) submits these comments in response to the Federal Energy Regulatory Commission's (Commission or FERC) November 20, 2014 Proposed Policy Statement.[1] In the Proposed Policy Statement, the Commission proposes allowing interstate natural gas pipelines to recover certain capital expenditures made to modernize pipeline system infrastructure through a surcharge mechanism, provided that five standards are satisfied by the requesting pipeline. If a surcharge is allowed, NYPSC urges the Commission to consider a pipeline's incremental reduction in risk due to the proposed surcharge, and reduce the pipeline's return on equity (ROE) accordingly.

BACKGROUND

The Proposed Policy Statement notes that several recent legislative actions, including the Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011, have resulted in regulatory initiatives to address natural gas pipeline infrastructure safety and reliability that will likely lead to the imposition of new safety standards on pipelines. The Commission states that these safety standards will require significant capital cost expenditures and proposes a surcharge mechanism to recover costs incurred to modernize pipeline system infrastructure and ensure system

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

reliability, safety, and regulatory compliance, including compliance with federal and state environmental regulations. The Commission proposes making the surcharge conditional upon the satisfaction of the following five standards: (1) the pipeline's base rates must have been recently reviewed, (2) the costs are one-time capital costs incurred to modify the pipeline's existing system to comply with safety or environmental regulations issued by federal or state government agencies or other capital costs shown to be necessary for the safe or efficient operation of the pipeline, (3) the pipeline designs the proposed surcharge in a manner that protects the pipeline's captive customers from cost shifts if the pipeline loses shippers, (4) the pipeline includes a method to allow a periodic review of whether the surcharge and the pipeline's base rates remain just and reasonable, and (5) the pipeline seeks shipper support for any surcharge proposal. These standards are based on parameters that the Commission established in its approval of a contested settlement that included a tracker that recovers Columbia Gas Transmission LLC's (Columbia Gas) pipeline modernization costs.[2]

The Commission's regulations require that interstate natural gas pipelines design their rates to recover their costs based on projected units of service.[3] The Commission notes that "this requirement gives the pipeline an incentive [to] provide the maximum amount of service to the public" and places any risk of under-recovery of costs between rate cases upon the pipeline.[4] A tracking mechanism, by nature, is contrary to FERC regulations of designing rate base from projected units of service. By guaranteeing the pipeline a set revenue recovery, cost-tracking mechanisms for capital expenditures reduce the risk to the pipeline of under-recovery.[5]

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[2] *See id.* at P 13, *citing* Columbia Gas Transmission, LLC, 142 FERC ¶ 61,062 (2013)(Columbia Gas).

[3] 15 C.F.R. § 284.10(c)(2) (2014).

[4] Proposed Policy Statement at P 10, *citing* Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, FERC Stats. & Regs., Regulations Preambles 1982-1985 ¶ 30,665 at ¶¶ 31,534 and 31,537.

[5] *See id.*

COMMENTS

The Commission has supported the use of Straight Fixed-Variable (SFV) rate design since its adoption in Order 636.[6] As a result, much of a pipeline's risk of under-recovery due to underutilization is reduced.[7] By guaranteeing interstate pipelines a set revenue recovery, cost-trackers further reduce any risk of under-recovery inherent in rate design based on estimated units of service. Therefore, during pipeline rate cases the Commission should consider the incremental reduction of risk due to the tracker, and the pipeline's ROE should be reduced accordingly.

The effect of a cost-tracker mechanism on risk is similar to that of SFV rate design. In Order 636, the Commission noted that "[it had] stated in the past that pipelines [are exposed] to risk through the assignment of fixed costs to the usage charge. Under SFV, no fixed costs are assigned to the usage charge."[8] Therefore, under SFV rate design, the pipeline would bear none of the risk of underutilization of new facilities. Due to this reduction in risk, the Commission has appropriately lowered a pipeline's approved ROE commensurate with the reduction of risk.[9] A similar approach should be adopted when allowing surcharges for the modernization of pipeline infrastructure.

The Commission found the Columbia Gas settlement, on which the Proposed Policy Statement is based, to be just and reasonable primarily because the settlement, the product of a

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[6] Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations*, 59 FERC ¶ 61,030, FERC Stats. and Regs. ¶ 30,939 (1992) (Order 636).

[7] *Cf.* Transcontinental Gas Pipe Line Corp., 56 FERC ¶ 61,037 at p. 61,134 (1991)(Transco Order) (Rejecting Transco's SFV rate design because it would allow Transco recovery all of its fixed costs in its demand charge and not bear any risk of underutilization).

[8] Order 636 at p. 133.

[9] *See, e.g.*, Transco Order at p. 61,136 (Reducing the pipeline's most recently approved ROE by 25 basis points to reflect the change to fixed variable rate design).

review of Columbia's base rates, resulted in a base rate reduction and $50 million refund to firm shippers.[10] However, a base rate reduction or refund is not one of the Commission's proposed standards for approving modernization surcharges. In lieu of such a requirement, the Commission should review and reduce a pipeline's allowed ROE to reflect risk reduction and ensure that rates are just and reasonable.

In approving the Columbia Gas settlement, the Commission found that Columbia Gas would be subject to a continuing risk of cost under-recovery. This is in part because a billing determinant floor was established for calculating the capital cost recovery mechanism, and Columbia Gas would impute the revenue that it would achieve by charging the maximum rate for service at the level of the billing determinant floor before truing up any cost under-recoveries.[11] While requiring a billing determinant floor for the surcharge does allow some risk to remain with the pipeline, a tracker mechanism still reduces a pipeline's risk and transfers it to shippers. Noting this risk transfer, Chairman Wellinghoff's concurrence in *Columbia Gas* suggested that "it would be appropriate for a pipeline to credit shippers all revenues from services provided over the facilities at issue that were not included in the rate design billing determinants and to explore a reduction in the return on equity that applies to those facilities."[12]

In regard to the first and fourth standards, that the pipeline's base rates must have been recently reviewed and that periodic review should be conducted of the surcharge and the pipeline's base rates, the Commission should require concurrent base rate review with the establishment of the surcharge. A Natural Gas Act section 4 rate proceeding or a collaborative effort between the pipeline and its customers would be the proper forum for risk analysis and

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[10] *See* Columbia Gas at P 23.

[11] *Id.* at P 25.

[12] *Id.* (Wellinghoff, concurring).

corresponding ROE reduction.[13] The periodic review should ensure that the surcharge does not produce earnings above authorized rates of return.

CONCLUSION

NYPSC appreciates the opportunity to submit these comments in response to the Proposed Policy Statement and recommends that the Commission reduce a pipeline's approved ROE if the proposed cost recovery mechanism is allowed.

Respectfully submitted,

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[13] Order 636 at p. 135 ("pipeline risk is a matter for pipeline-specific analysis in light of all risks … This issue [SFV] is more appropriately addressed in rate proceedings where the Commission examines all other factors affecting risk and establishes the pipeline's allowed rate of return on equity").