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FERC Rejects Requests for Clarification but Provides Additional Details Regarding Pipeline Modernization Surcharge Mechanisms

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On July 16, 2015, the Federal Energy Regulatory Commission (“FERC” or the “Commission”) issued an [order](#) (“July 16 Order”) denying the request by the Process Gas Consumers Group (“PGC”) and the American Forest and Paper Association (“AF&PA”) for clarification of FERC’s April 16, 2015 Policy Statement on [Cost Recovery Mechanisms for Modernization of Natural Gas Facilities](#) (the “Policy Statement”). In the Policy Statement, which will go into effect on October 1, 2015, FERC set forth the following five standards that pipelines will need to satisfy to establish a system modernization surcharge mechanism:

- Standard 1: Review of existing rates;
- Standard 2: Eligible costs must be limited;
- Standard 3: Avoidance of cost shifting;
- Standard 4: Periodic review of the surcharge; and
- Standard 5: Shipper support.

PGC and AF&PA specifically requested that FERC clarify the following six issues related to those five standards:

1. The type of information that pipelines must provide to justify existing rates under Standard 1;
2. Under existing capacity releases, the entity that will be responsible for paying the pipeline surcharge;
3. The formal procedures that pipelines must use to ensure that all stakeholders are invited to and included in meetings related to surcharge mechanisms proposed pursuant to the Policy Statement;
4. That in the collaborative process associated with establishing such surcharge mechanisms, pipeline companies must work with all shipper sectors;
5. That in the event a pipeline’s surcharge or tracker mechanism results in the pipeline’s over-collection, refunds will be required and calculated from the date a protest or complaint was filed; and
6. That pipelines must wait until October 1, 2015, to seek to implement a surcharge or tracker mechanism established under the Policy Statement.

While FERC denied clarification of each of the six requests, its discussion in its July 16 Order provides additional insight for shippers and pipeline companies alike in moving forward with cost-recovery mechanisms for pipeline modernization.

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Issue 1. Type of Information Pipelines Must Submit

In declining to specify the type of information that pipelines must provide to justify existing rates (e.g., actual cost and revenue information, based on 12 months of operations), FERC explained that if any interested parties are not satisfied with a pipeline's process for demonstrating that its existing rates are just and reasonable, such parties may file protests with the Commission. In the event such protests are based on substantial evidence on the record, FERC will establish procedures (potentially including hearing procedures before an Administrative Law Judge) to resolve any disputed issues of fact. The Commission further explained that if a pipeline files a settlement that some, but not all, shippers consent to, the Commission may approve the settlement as it applies to the consenting shippers and sever the contesting shippers to allow them to move forward with litigation of their issues. This process is generally in line with FERC's existing practice in rate case proceedings under Section 4 of the Natural Gas Act.

Issue 2. Responsible Party Under Existing Capacity Releases

The Commission pointed out that the party that will bear the responsibility for paying the pipeline's surcharge under a capacity release agreement will vary depending on the terms of the releasing shipper's service agreement with the pipeline and the terms of the capacity release agreement between the releasing and replacement shipper. In light of the commercial and contractual nature of this issue, the Commission declined to provide a general policy. Consequently, it is incumbent upon parties to a capacity release agreement to review the terms of their agreement carefully to determine which party, if either, is responsible for paying the surcharge.

Issues 3 & 4. Formal Procedures for Stakeholder Engagement and Responsibility to Work With All Shipper Sectors

As explained in the Policy Statement, the Commission does not intend to establish formal procedures for stakeholder engagement, recognizing that these processes will need to be flexible to accommodate each pipeline's circumstances. However, in the July 16 Order FERC noted that the process should be informal and allow for the parties to share information and negotiation in the absence of Commission involvement. Furthermore, the Commission pointed out that a pipeline will need to make a Section 4 filing to implement a surcharge mechanism under the Policy Statement. The Commission will file a public notice of this submission, consistent with its general procedures, and will provide interested parties with the opportunity to comment on and/or protest the pipeline's application. The Natural Gas Act provides that the pipeline will bear the burden of proof with respect to demonstrating that its proposal is just and reasonable and, as outlined above, the Commission may establish additional procedures to resolve any disputed issues of fact.

Issue 5. Retroactive Refunds in the Event of Pipeline Over-Collection

The Commission explained that if it cannot determine whether a proposed surcharge mechanism is just and reasonable within 30 days after the proposal is filed, the Commission will suspend the filing, subject to refund. Once a surcharge mechanism is FERC-approved, however, if the established surcharge is found to result in an over- or under-collection, the pipeline would adjust the amount of its surcharge for the next period to resolve the over- or

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under-collection rather than provide retroactive refunds. This process is generally consistent with the Commission's existing practice.

Issue 6. Pipelines May File Surcharge Proposals Prior to the New Policy's October 1, 2015 Effective Date

To date, a number of interstate natural gas pipelines have commenced discussions with shippers aimed at reaching a settlement agreement to establish a surcharge mechanism under the Policy Statement. In addition, some pipeline companies have filed applications with the Commission that include modernization surcharge mechanisms. The Commission explained in the July 16 Order that "there is nothing to prevent a pipeline from making a proposal consistent with the Commission's existing policy as set forth in *Columbia Gas Transmission, LLC*, prior to October 1, 2015." (citation omitted). In addition, the Commission explained that there is no need for pipelines to delay informal discussions with shippers, in particular given that the Commission has declined to establish formal procedures for such processes.

Conclusion

The July 16 Order clearly is intended to leave in place the broad parameters established in the Policy Statement around the pipelines' processes for establishing modernization surcharge mechanisms and the limitations on those mechanisms. However, the information that the Commission has provided in the July 16 Order explains in more detail the Commission's own procedures for considering pipelines' applications to establish such surcharge mechanisms and contesting shippers' rights. In this way, the Commission is attempting to take a balanced approach to the issue of cost-recovery mechanisms for surcharges that pipelines impose on their customers in an effort to modernize pipeline transportation infrastructure. Ultimately, based on FERC's case-by-case approach, it seems the process and outcome will be variable, though not necessarily distinct, for each pipeline.

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