ALERT
MARCH 4, 2013

Energy, Environmental and Utilities Group
News Concerning
Recent Developments in Energy and Environmental Law

FERC Approval of Columbia Gas Transmission Settlement Puts Focus on Recovery of and Return on Pipeline Safety Expenditures

Ahren Scott Tryon • 202.912.4827 • *atryon@cozen.com*
Ira G. Megdal • 856.910.5007 • *imegdal@cozen.com*

On January 24, the Federal Energy Regulatory Commission (FERC) approved a significant settlement addressing the base rate treatment for planned actions to overhaul the aging Columbia Gas Transmission, LLC (Columbia) pipeline system. While by its own terms the settlement is not considered precedential, FERC's approval of the settlement is noteworthy for operators of older natural gas transmission and distribution pipelines and hazardous liquids pipelines systems. These pipeline systems may contain bare steel or cast iron, may have inadequate cathodic protection, may be subject to settling or other environmental conditions that have placed significant stress on pipe, may not be "piggable," or otherwise may be at risk of reduced operating pressure in the face of potentially heightened requirements for establishing maximum allowable operating pressure. As increased focus on pipeline integrity management drives capital expenditures and operating and maintenance priorities, these transmission and distribution pipeline operators (representing a majority of pipeline mileage in the United States) must engage in thoughtful planning for pipeline facility repairs, upgrades and replacements and identify cost recovery mechanisms that work best for their specific circumstances.

Columbia's settlement is substantial in its scope and terms largely due to Columbia's need to address the heightened risk of corrosion inherent on an interstate transmission system with more bare steel pipe than any other (1,272 miles of bare pipe). With more than half of its system installed before the federal pipeline safety standards were enacted in 1970, the system has many segments that cannot be internally inspected with commercially available pigs but that otherwise may be subject to significant integrity risk. Columbia's 10 to 15-year "Modernization Program" thus requires substantial cost recovery, which will be ensured for an initial five-year term at an annual capped level of $300 million through the approved "capital cost recovery mechanism (CCRM), which will recoup costs incurred from 2013 through 2017. Columbia's revenue incentive for implementing its Modernization Program comes in the form of the CCRM's included 14 percent rate of return on capital, consisting of a 12 percent pre-tax return and 2 percent for "Taxes Other Than Income."

Tempering the potential windfall of Columbia's Modernization Program cost recovery through the CCRM rate component, the settlement provides significant benefits to shippers, including the following: (1) an annual $35 million rate reduction effective back to January 1, 2012, and an additional base rate reduction of $25 million each year beginning January 1, 2014, with both reductions lasting until the effective date of Columbia's next general rate case or adjustment under the Natural Gas Act (NGA); (2) $50 million in refunds to firm shippers; (3) a rate moratorium through January 31, 2018, and an obligation to file a NGA general rate case no later than February 1, 2019; (3) a 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; and (4) application of the "just and reasonable" standard of review to any future changes to the approved settlement.

Notably, the Maryland Public Service Commission (Maryland PSC) was the only participant in the Columbia proceeding that opposed the settlement. The Maryland PSC generally asserted that the CCRM surcharge was an inappropriate method to recover core infrastructure expenditures because of its belief that it reduces the pipeline's incentive to reduce costs while maximizing revenues and shifts the burden of investment costs from Columbia to its customers. Asserting that approval of the CCRM could lead down a slippery slope to similar cost trackers as a substitute for rate cases, the Maryland PSC noted that it and FERC had repeatedly considered and rejected such mechanisms. However, FERC brushed off the Maryland PSC's concerns, finding that despite prior rejections of pipeline safety cost trackers it has "permitted such a regulatory surcharge for pipeline safety costs in uncontested settlements."

Looking at the participants' settlement proposal in total, FERC determined "that the very substantial benefits that will inure to Columbia's shippers through the Settlement outweigh the inclusion of an otherwise disfavored surcharge, particularly given the customer protections inherent in the CCRM." FERC's pragmatic approach in this proceeding may be at odds with what certain state public service commissions would prefer (clearly including the Maryland PSC). Yet, from a regulatory standpoint, it may be impractical or even inappropriate for FERC to strike down as unjust, unreasonable or discriminatory settlement with an "otherwise disfavored surcharge" that is supported or unopposed by all shippers.

While the specifics of the approved settlement may be unique to Columbia's system, the overarching issues of capital expenditures driven by pipeline safety requirements and cost recovery mechanisms for those expenditures will increasingly confront pipelines subject to federal or state pipeline safety and rate regulation. A high level of coordination between a pipeline company's capital planning and rate personnel and consultants is crucial to ensure efficient and maximal recovery for these expenditures.

To discuss any questions you may have regarding this Alert, or how it may apply to your particular circumstances, please contact a member of Cozen O'Connor's Energy, Environmental & Public Utilities Practice.

© 2013 Cozen O'Connor. All Rights Reserved. Comments in the Cozen O'Connor Alert are not intended to provide legal advice. The analysis, conclusions, and/or views expressed herein do not necessarily represent the position of the law firm of Cozen O'Connor or any of its employees, or the opinion of any current or former client of Cozen O'Connor. Readers should not act or rely on information in the Alert without seeking specific legal advice from Cozen O'Connor on matters which concern them.