PUBLIC UTILITIES FORTNIGHTLY
ENERGY, MONEY, POWER
Published on *Fortnightly* (http://www.fortnightly.com)

A little more than two million miles of natural gas distribution pipelines crisscross the United States, connecting homes and businesses with one of our most important energy resources—natural gas. The nation's pipeline system is the safest, most reliable and cost-effective way to transport this essential fuel across the country. Yet, despite the gas industry's strong safety record, the 2010 San Bruno, Calif., and 2011 Allentown, Penn., incidents transformed public sentiment and placed both industry and regulators under intense scrutiny about the perceived safety of pipeline systems and the effectiveness of federal and state enforcement.

As these recent incidents demonstrate, a life lost because of a gas or hazardous materials pipeline accident is a tragedy that strikes pain and fear into the heart of the affected community. Any incident is always one too many.

Pipeline safety is at the heart of state utility commissioners' duty, as representatives of the state governments responsible for overseeing natural gas utilities and many of the safety programs at the distribution level, to ensure safe and reliable service to customers. Our state pipeline safety inspectors carry an even greater burden; they're literally the boots on the ground and are among the first responders to the scene after an incident occurs. They coordinate with emergency personnel and utility officials, and they lead investigations into what happened and why. They're always on call, working days, nights, and weekends to ensure utilities are doing all they can to keep the pipeline system safe, reliable, and secure.

The challenges inspectors and the regulatory community face are growing. As pipelines age, the need to replace utility infrastructure becomes more crucial. At a July 2011 National Association of Regulatory Utility Commissioners meeting, one expert estimated the cost of upgrading the nation's pipeline system—both transmission and distribution—to be roughly $215 billion over the next 10 to 20 years.[1] This number is sobering on its own. And when added to the roughly $2 trillion estimated for electric utility upgrades and the more than $1 trillion for the nation's water infrastructure, the price tag becomes even more daunting.[2]

Simply rolling this trillion-dollar cost into our consumers' rates is a non-starter. While the regulatory compact demands that utilities maintain and upgrade their systems proactively, it also requires that utilities be given a fair opportunity to earn a return on the capital invested in their systems. In practice, this means that utilities must affirmatively take action to upgrade the pipeline system, despite the fact that traditional ratemaking policies can leave utilities with the residual risk of not securing timely or complete cost recovery.

But as a practical matter, this can sometimes have counter-intuitive implications when it comes to advancing public safety; a utility that needs to systematically invest increasing amounts of capital to replace aged pipeline infrastructure might not necessarily recover the costs of incremental investments in a timely manner without filing successive rate cases. Pancaking rate cases annually to maintain timely cost recovery of investments is anathema to most utilities—and most sane regulators as well. And when a utility's budget becomes constrained by aggressive capital spending, something has to give—more rate cases or less spending, the latter of which can have real implications for the pace at which high risk infrastructure is replaced. So, the challenge for regulators must be to determine whether the safety concerns and conditions of a particular utility system warrant a different or modified approach in terms of the applied rate recovery methodology.

Paying for Safety

A number of states have determined that a different approach to ratemaking is appropriate. For instance, New Jersey, Pennsylvania, Georgia, Ohio, Rhode Island, and others have implemented alternative rate recovery methods, such as surcharges or rate riders that automatically fund pipeline improvement programs. Also, the Washington Utilities and Transportation Commission just developed a policy statement detailing how the state's natural gas companies can seek a special cost-recovery mechanism for accelerated high-risk pipeline replacement. These riders naturally shift the financial risk from utilities to consumers, but for some utility systems, the shift in risk is balanced by the concomitant increase in public safety stemming from more aggressive pipe replacement actions.

On the other hand, not all states have found it necessary to use surcharges or rate riders to address the growing capital needs associated with system replacement or expansion. In Vermont, for example, regulators approved an 80-mile expansion of one utility's system and financed it by withholding an anticipated rate decrease from existing customers. This highlights the fact that collaborative opportunities might exist under traditional ratemaking policies that can address the need for system upgrades. Cost structure, revenue forecasts, and balance sheets create the prism through which to gauge whether a particular utility possesses the necessary financial strength to address the need for system improvements through traditional ratemaking policies. Simply put, there's no standardized methodology for financing system improvements, because each state is different and the needs and financial circumstances of each utility system are unique. Given the steep challenges that we face today and over the decades to come, it remains incumbent on regulators and industry to work together to consider sensible programs aimed at replacing the most vulnerable pipelines as quickly as possible, along with the adoption of rate recovery mechanisms that reflect the financial realities of the particular utility in question.

Ensuring pipeline safety is about more than just replacement and cost recovery. It's also about effective communication, enforcement, risk sharing, and establishing a long-range strategic plan that ensures a safe and reliable gas pipeline system. It's about working together among industry and government stakeholders, at both the federal and state levels.

In this context, states have long enjoyed a strong partnership with the U.S. Pipeline and

Hazardous Materials Safety Administration. Under federal law, PHMSA is responsible for overseeing the safety regulation of all pipeline systems, both transmission and distribution. PHMSA delegates much of this responsibility to state inspectors, most of whom work within their respective state utility regulatory agencies. This dual system of regulation puts those with the direct local knowledge and access—the states—in charge of the inspection process. That has resulted in our member states implementing safety standards far stricter than what PHSMA requires under existing federal regulations. In fact, NARUC's sister organization, the National Association of Pipeline Safety Representatives, recently released an exhaustive compendium detailing more than 1,100 instances in which state laws or regulations exceed the federal requirements.[3]

Uphill Challenge

Although we have a strong and committed workforce, along with a crucial partnership with our federal counterparts, we know we're facing an uphill infrastructure challenge. The slope is steeper for some states than for others, but at the end of the day we must continue working together, and developing risk-based approaches to advancing pipeline safety and replacement programs. At the state level, we will continue to work with the industry to prioritize replacement of the most vulnerable portions of the system. But let us be clear: there are degrees of separation between the information utilities and regulators possess. The local distribution companies that own the systems will always have more information than their regulators do. By law, the utilities are charged with knowing the location, material, age, and condition of their systems. Developing essential data to evaluate the integrity of those systems is the foundation for any conversation or decision over what regulators need to fund in rates, as well as what rate recovery methodology best suits a particular case.

Natural gas is an essential fuel for our economic and societal well-being. With the shale gas boom and new regulations on coal-fired generation, we'll be relying even more heavily on natural gas in the near future and over the long term. It's incumbent upon all of us—state and federal regulators and industry—to work together to keep our pipeline systems operating as safely, reliably, and affordably as possible.

Endnotes:

1. The Cruthirds Report, July 24, 2011

2. Ibid.

3. Compendium of State Pipeline Safety Requirements & Initiatives Providing Increased Public Safety Levels Compared to Code of Federal Regulations, November 2011.

Source URL: http://www.fortnightly.com/fortnightly/2013/02/partnering-pipeline-safety