Reservation Rate Crediting for Interstate Natural Gas Pipelines
By: Arthur Miksis

INTRODUCTION

Spread across the United States is an elaborate system of natural gas pipelines. These pipelines fall into two main classifications: intrastate and interstate pipelines. The former transport natural gas and operate entirely within the borders of one State; while the latter transport natural gas and operate across the borders of two or more States. This distinction determines which regulatory authority has jurisdiction over a particular pipeline. Intrastate pipelines are regulated by the government of the State within which they operate. Interstate pipelines are regulated by the Federal Energy Regulatory Commission ("FERC" or "Commission") according to the Natural Gas Act of 1938 ("NGA") which gives FERC broad authority to regulate the interstate sale and transportation of natural gas. For the remainder of this article, the term "pipeline" will refer to interstate pipelines operating under FERC jurisdiction.

A pipeline needs customers ("shippers") the same as any other business does. When a shipper wants the pipeline to transport the shipper’s natural gas, the shipper and the pipeline enter into a firm transportation service agreement to schedule and transport a quantified amount of gas, for an agreed upon rate, from a specified receipt point to a specified delivery point on the pipeline system. To reserve capacity on the pipeline, a shipper must pay a reservation charge; however, complications arise when a reservation charge has been paid for and a subsequent service disruption occurs. Certain types of disruptions result in reservation charge credits due back to the shipper for the amount of service which the shipper nominated to be scheduled by the pipeline but that the pipeline was unable to schedule or deliver.2 Other service disruptions warrant the crediting of only a percentage of the reservation charge

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A pipeline outage is a service disruption resulting in the issuance of reservation charge credits to a shipper. During an outage, the pipeline itself is incapable of transporting the gas, even if the supply is ready and plentiful. The outage renders the pertinent section of the pipeline inoperable. An outage can be due to an act of nature, such as an earthquake; an act of decay, such as the deterioration of key pipeline components; or an act of man, such as the scheduling of maintenance that shuts down the pipeline temporarily.

These disruptions of service affect the firm contract between the shipper and the pipeline. Bearer of the financial burden for non-compliance with the contract provisions depends upon the nature of the outage. Assigning liability for an outage of service depends upon whether the outage is classified as either force majeure or non-force majeure; i.e., unforeseeable acts of God or foreseeable acts of man, respectively. This distinction carries with it financial consequences.

In general, the Commission requires all interstate pipelines to provide reservation charge credits to their firm shippers during both force majeure and non-force majeure outages. The Commission requires pipelines to provide full reservation charge credits for outages of primary firm service caused by non-force majeure events and partial reservation charge credits during force majeure outages, to allow risk sharing for events for which neither party is responsible. Partial credits may be provided pursuant to: (1) the No-Profit method under which the pipeline gives credits equal to its return on equity and income taxes starting on Day 1 [of the outage], or (2) the Safe Harbor method under which the pipeline provides full credits after a short grace period when no credit is due (i.e., 10 days or less).3

The Commission has defined force majeure outages as events that are both unexpected and uncontrollable. The Commission has held that routine, scheduled maintenance is not a force majeure event, even on “pipelines with little excess capacity”4 where such maintenance may require interruptions of primary firm service. Commission policy recognizes that even if such outages are considered to be uncontrollable, they are expected. The U.S. Court of Appeals for the District of Columbia Circuit affirmed this policy in North Baja Pipeline, LLC v. FERC,5 stating:

Although some scheduled maintenance interruptions may be uncontrollable, they certainly are not unexpected. There is nothing unreasonable about FERC’s policy that pipelines rates should incorporate the costs associated with a pipeline operating its system so that it can meet its contractual obligations.

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5 North Baja Pipeline, LLC v. FERC, 483 F.3d 819, 823 (D.C. Cir. 2007), aff’g, North Baja Pipeline, LLC, 109 FERC ¶ 61,159 (2004), order on reh’g, North Baja Pipeline, LLC, 111 FERC ¶ 61,101 (2005) (North Baja).
ANALYSIS

The Commission went to great lengths outlining the demarcation points between force majeure and non-force majeure outages. The Commission held that an outage due to periodic maintenance required by government regulations for the safe operation of the pipeline “is a necessary non-force majeure event within the control of the pipeline.” In subsequent orders, the Commission has explained that testing and maintenance required by government regulation are a part of the service provider’s duties under a certificate of public convenience and necessity and thus are not appropriately considered a force majeure event or otherwise exempted from the requirement for full reservation charge crediting.

It is important to note the “control” factor highlighted by the Commission as a clear indication of a non-force majeure event. An outage the pipeline has control over scheduling is not seen as an unexpected event thrust upon an unsuspecting pipeline. These types of outages typically involve routine maintenance functions and compliance testing to meet government regulations. Upkeep of this nature applies to all pipelines uniformly and maintenance of the pipeline is a foreseeable capital, labor, and time expenditure. When the outage can be anticipated, planned for, and incorporated into the reservation charge, the Commission believes the pipeline should bear the financial burden of that outage as a cost of doing business; and therefore, the shipper is entitled to a full reservation charge credit for the amount of gas not transported throughout the duration of the outage.

PHMSA, SECTION 60139(c)

Juxtaposing the Commission’s long held belief, that compliance with government regulation is a predictable and foreseeable component of doing business as a pipeline, is the Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011 (2011 Act). The 2011 Act delegates rule making authority to the Pipeline and Hazardous Materials Safety Administration (PHMSA) of the Department of Transportation (DOT). Specifically, the 2011 Act added section 60139(c), Maximum Allowable Operating Pressure (MAOP), to Chapter 601 of Title 49 of the U.S. Code.

Section 60139(c) provides that, if a pipeline is unable to confirm MAOP for a pipeline segment by July 3, 2013, PHMSA must require the pipeline to reconfirm the MAOP of the segment as expeditiously as economically feasible, and PHMSA may require the

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pipeline to take interim actions to maintain safety until MAOP can be confirmed. Unlike the other sections of the 2011 Act […] all of which require PHMSA to conduct rulemaking proceedings before modifying current requirements, section 60139(c) does not require PHMSA to conduct any rulemaking proceeding before it orders particular pipelines to reconfirm MAOP and take interim actions to maintain safety until MAOP is confirmed. Rather, PHMSA may simply issue an order to a particular pipeline tailored to address the specific circumstances of its system. Therefore, unlike the non-MAOP provisions of the 2011 Act […], PHMSA actions pursuant to section 60139(c) are relatively imminent and could take effect at any time without advance notice of the type that would ordinarily be provided in a rulemaking proceeding.8

The Commission distinguishes between outages due to section 60139(c) compliance and other regulatory provisions. Actions PHMSA takes pursuant to section 60139(c) of the 2011 Act would be one-time non-recurring events.9 Costs of outages for such one-time testing or reduced operating pressure would generally not be recurring costs eligible for inclusion in a pipeline’s rates in a general section 4 rate case.10 Therefore, reservation charge credits resulting from outages due to section 60139(c) compliance should be handled as force majeure outages because there is no advanced notice provided, regulatory action is imminent, and the action is a one-time occurrence. In an effort to evenly divide the risk between the parties, only partial reservation charge credits are provided to the shipper.

This decision starkly contrasts against previously held Commission orders and opinions regarding outages due to regulatory compliance. As such, “[t]he Commission [limits] any authorization for partial crediting for outages resulting from section 60139(c) to a transitional period of two years.”11 The two year period commences on January 1, 2013.

All potentially affected pipelines should take due notice thereof and govern accordingly.

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8 Gulf South Pipeline Company, LP, 141 FERC ¶ 61,224, at P 14 (2012).
9 Id., at P 15.
11 Gulf South Pipeline Company, LP, 141 FERC ¶ 61,224, at P 16 (2012).