COST OF SERVICE, COST ALLOCATION & RATE DESIGN FOR FERC REGULATED NATURAL GAS INTERSTATE PIPELINE COMPANIES

January 23-24, 2020
Houston Marriott West Loop by The Galleria
Houston, TX

"Ken is a good speaker and very knowledgeable and interesting."
Regulatory Analyst, MB Hydro/Centra

TAG US #EUCI #EUCIEvents
FOLLOW US @EUCIEvents

EUCI is authorized by IACET to offer 1.5 CEUs for the course
OVERVIEW

Laws govern all regulations regarding the establishment of rates that natural gas pipelines may charge and set forth in their tariffs. Regulations and FERC policies continue to change in response to revisions in the laws, economic and financial conditions, gas supply modifications, and market demands. These courses provide attendees a detailed view of the natural gas industry, the development of rates, and the computation of the cost of service, while providing real world experience applying the pertinent regulations and principles.

Please note, exercises using Microsoft Office and PDF files will be used in class. Therefore, it is requested you bring a laptop computer with Microsoft Office and Adobe Reader software to the class.

LEARNING OUTCOMES

- Discuss the history of the natural gas industry, laws and regulations pertaining to rate regulation, and related processes
- Develop expertise pertaining to the regulatory principles and processes followed by natural gas pipeline companies to propose and support just and reasonable rates, terms, and conditions
- Review the economic principles affording an opportunity to earn fair profits on FERC regulated natural gas pipelines
- Discuss the concepts of functionalized costs, the difference between fixed and variable costs, the allocation and classification of costs to different functions, and different classes of service
- Evaluate and apply principles used to develop and calculate an overall cost of service, which includes: rate base, capital structure and cost of capital, income tax allowance (Post 2017 Tax Cut and Jobs Act Impacts), operating expenses (depreciation, administrative and general, operating and maintenance, taxes other than income), and regulatory adjustments (FERC’s 2018 MLP Decisions)
- Evaluate and apply principles used to allocate costs to different services or different classes of service and develop a proper rate design and calculate rates
- Discuss the principles utilized to achieve regulatory goals, including techniques used to achieve favorable judgments for FERC related litigation and “Black-Box” settlements
- Analyze FERC regulatory trends and the implications of those developments on stakeholders involved in FERC’s natural gas pipeline regulation

“Very knowledgeable, hands-on experience.”
Principal Manager, DTE

“This course provides a very good basic understanding and foundation on cost of service and rate design. The presenter is very experienced and knowledgeable on the subject.”
Utility Analyst, Alaska AG Office
AGENDA

COST OF SERVICE FOR NATURAL GAS INTERSTATE PIPELINE COMPANIES

THURSDAY, JANUARY 23, 2020

8:00 – 8:30 am  Registration and Continental Breakfast

8:30 am – 5:00 pm  Course Timing

12:00 – 1:00 pm  Group Luncheon

Course Overview and Introduction
- Course objectives
- The regulated natural gas industry
  - Natural Gas Act
  - Natural gas industry structure
  - FERC—purpose, organization, website, and funding mechanism
  - Federal regulations, historical decisions, and market responses
  - Code of Federal Regulations—pertinent sections
  - FERC Uniform System of Accounts

FERC Standards for Rate Review
- Just and Reasonable standard
- Public Interest standard

Types of Rate and Regulatory Filings and Timelines
- Section 7 Initial Rates—Incremental Facility Rate Development
- NGA Section 4 general rate case filings
- NGA Section 5 rate filings
- Other proceedings/filings (fuel trackers, modernization trackers, Negotiated Rate Contracts, FERC Form 2, etc.)

Cost of Service Computation Steps
- Purpose of computing cost of service
- Source data and documents (FERC Form 2 review)
- Concepts of base, test, and adjustment periods
- Concepts of regulatory adjustments
- Rate base formula, concepts, and requirements
  - Gross plant investment
  - Accumulated depreciation and amortization
  - Reserve for negative salvage (cost of removal, interim retirements, etc.)
- Asset retirement obligations
- Working capital components
- Regulatory assets/liabilities
- Accumulated deferred income taxes (impacts of the Tax Cuts and Jobs Act and FERC’s 2018 MLP Decisions)
- Cost of service formula
- Operation and maintenance
  - Labor costs
  - Gas costs – fuel for compressors
  - Material and other costs
  - Fixed and variable costs
- Administrative and general (directly assigned and/or allocated) (Massachusetts Formula & Kansas-Nebraska [KN] Formula)
THURSDAY, JANUARY 23, 2020 (CONTINUED)

Cost of Service Computation Steps (continued)
- Taxes other than income
- Recovery of investment vs. return on investment
- Depreciation expense
- Derivation of depreciation and amortization rates
- Depreciation studies
  - Objectives and methods
  - Interim retirement costs
  - Negative salvage – final system abandonment costs
- Calculation of return on rate base
- Capital structure, cost of capital, and weighted average cost of capital
- Actual or imputed capital structure
- Calculation of the cost of debt and overall rate of return
- Estimating the cost of debt and overall rate of return
- Estimating the cost of common equity and available methods (impacts of current FERC policy review)
- FERC's DCF methodology under review (Remand of Opinion No. 531)
  - Proxy group selection – risk comparisons – placement within range
  - The DCF formula (one-step to two-step)
  - Risk Premium Analysis
  - Capital-Asset Pricing Model
  - Expected Earnings Analysis
- Calculating the pre-tax rate of return
- The income tax allowance (impacts from the Tax Cuts and Jobs ACT and FERC 2018 MLP Orders)
  - Flow through vs. normalized
  - The effective income tax rate (35% vs. 21%) (corporation vs. MLP vs. disregarded entity)
  - The income tax gross-up and before-tax factors
  - Deferred and current income taxes
  - The composite state income tax rate
  - Income tax adjustments
    - Equity AFUDC as it affects rate base and the tax allowance
    - South Georgia and reverse South Georgia adjustments
    - Other adjustments
  - Other revenue credits

Models and Presentation Requirements for Cost of Service Statements and Schedules
- Overview of required statements and schedules for cost of service filings
- Model design considerations
- Requirements for incremental facilities
- Cost recovery models
  - Traditional—declining rate base model
  - Levelized cost of service model
  - Usage considerations

Calculating Cost of Service Exercises and Excel Based Modeling Exercise

Current Cost Recovery Issues
- Cost recovery for safety, integrity, and other mandated compliance matters
- Appropriate depreciation and amortization rates
- Tax cuts and Job Acts impacts
- FERC’s 2018 MLP Orders
- FERC’s return on equity review (Remand Order 10/18/18)
AGENDA

RATE DESIGN FOR NATURAL GAS INTERSTATE PIPELINE COMPANIES

FRIDAY, JANUARY 24, 2020

8:00 – 8:30 am  Continental Breakfast
8:30 am – 5:00 pm  Course Timing
12:00 – 1:00 pm  Group Luncheon

Course Overview and Introduction
• Course objectives
• Reference materials – course evaluations, CPE/CLE credit
• Rate design course overview of key outcomes
  o Rate design—terminology and history
  o Determining cost inputs for the rate design process
  o Developing/reviewing rate design billing and determinants
  o Proper rate design development for configured natural gas pipeline systems
  o Rate design case study (Excel-based cost allocation and rate design)

Rate Design Principles and Objectives
• Changing market realities, gas flows, and government policies
• FERC’s rate objectives
• Rate refund floor concept – last found just & reasonable rate
• State maximum rates vs. discount rates vs. negotiated rates
• Achieving market-oriented pricing in a regulated environment

Developing Rate Design Billing Determinants - from the G to J Schedules
• Detailed revenue and billing determinant data for base and test periods
• Determination of billing determinant contract and quantity adjustments
• Adjustment methods to recognize discounting impacts
• Policies concerning treatment of negotiated rate contracts
• Calculating imputed demand units

Rate Design Cost Factors
• Cost functionalization, cost classification, and cost allocation
• Functionalization storage, transmission, and incremental costs
  o Direct and indirect costs
  o KN methodology
• Classifying costs between fixed or variable
• Cost allocation to services and zones
• Allocating costs to peak and non-peak services
• Developing the statement and schedules required
AGENDA

FRIDAY, JANUARY 24, 2020 (CONTINUED)

Rate Calculations
• Reservation/demand rates
• Volumetric/usage rates
• Daily vs. monthly rates
• Load factor adjusted, “effective” rates
• 100% load factor rates for IT service
• Proving the proposed rates generate the revenue requirement

Rate Design Alternatives
• Postage stamp rates vs. zoned rates
• Distance-based costs vs. system access costs
• Distance-based rate designs
  o Mileage-based rates
  o Zone rates
  o Zone matrix rates
  o Zone gate rates
• Storage rate design

Pipeline Rate Design Case Study and Participant Questions Other Rate Design Issues
• Term differentiated, seasonal, and short-term rates
• Park and loan and other service rates
• Fuel factor rate designs
• Surcharges
• Negotiated rates, market-based rates, and non-conforming contracts
• Roll-in rate studies

Additional Rate Design and Tariff Considerations
• The impact of rate design changes on customers
• Implementation process for rate design changes
• Tariff provisions and commission policies

Ratemaking Process
• Timelines and strategy development
• Expert witnesses
• Due diligence process
• Settlement process - alternatives to achieve agreement among the parties
• Litigation and hearing

Questions & Answers Session
INSTRUCTOR

Kenneth A. Sosnick  
Managing Director, FTI Consulting

Prior to joining FTI Consulting, Mr. Sosnick spent over five years as a consultant, extensively engaged in the natural gas, crude/product, and electricity markets. His work included analysis of natural gas pipeline and crude/product pipeline cost of service rates, levelized rates, market-based rates, discounted and negotiated rates, incremental vs. rolled-in project costs, initial certificate rates, allocation of corporate overhead costs, and master-limited partnership income taxes. He also specializes in throughput/system rate design quantities, fuel recover mechanisms, NGA Section 5 rate complaints, return on equity calculations under the discounted cash flow/risk premium/capital asset pricing model/expected earnings methods, depreciation rate and negative salvage rate calculations, asset retirement obligations, FERC Form 1 and 2 filing requirements, as well as being proficient in the application of FERC’s uniform system of accounts.

Mr. Sosnick has prepared expert testimony for proceedings at FERC, prepared expert reports assessing and quantifying damages in civil litigation, conducted strategic analysis for a large energy company considering alternatives for its existing pipeline and storage portfolio, written a whitepaper on the impacts of the Tax Cuts and Jobs Act on FERC regulated assets as well as a whitepaper on the impacts of FERC Orders in SFPP, LP Docket No. IS08-390 related to Master Limited Partnerships and other pass-through entities income tax allowance. In addition, he has conducted confidential buy-side valuations and assessments of regulated electric and natural gas utilities in the U.S.

Before working as a consultant, Mr. Sosnick spent 10 years at FERC and spent two years as an auditor in the Office of Enforcement and eight years as an expert witness and a lead technical staff negotiator on major electric utility, interstate natural gas pipeline, and crude/product pipeline proceedings in the Office of Administrative Litigation. Mr. Sosnick’s insights were incorporated into the revision of the FERC Form 2 in Docket No. RM07-9-000, which lead to the FERC-initiated Section 5 natural gas pipeline proceedings from 2009 to today.

Mr. Sosnick currently teaches an executive FERC Natural Gas 101 course for EUCI and previously taught Practical and Regulatory Training for the Natural Gas Interstate Pipeline Industry at the New Mexico State University Center for Public Utilities, specifically addressing FERC requirements for determining “just and reasonable” rates. Mr. Sosnick holds a B.S. in Accounting from the Indiana University of Pennsylvania. He is a member of the Energy Bar Association, FERC Liquids Committee, FERC Natural Gas Pipeline Committee, and FERC Practice Committee.
INSTRUCTIONAL METHODS

PowerPoint presentations, interactive group exercise, and group discussion will be used during this course.

Please note, exercises using Microsoft Office and PDF files will be used in class. Therefore, it is requested you bring a laptop computer with Microsoft Office and Adobe Reader software to the class.

REQUIREMENTS FOR SUCCESSFUL COMPLETION

Participants must sign in/out each day and be in attendance for a minimum of four hours to be eligible for any continuing education credit.

IACET CREDITS

EUCI has been accredited as an Authorized Provider by the International Association for Continuing Education and Training (IACET). In obtaining this accreditation, EUCI has demonstrated that it complies with the ANSI/IACET Standard which is recognized internationally as a standard of good practice. As a result of their Authorized Provider status, EUCI is authorized to offer IACET CEUs for its programs that qualify under the ANSI/IACET Standard.

EUCI is authorized by IACET to offer 1.5 CEUs for this course

EVENT LOCATION

A room block has been reserved at the Houston Marriott West Loop by The Galleria, 1750 W Loop S, Houston, TX 77027, for the nights of January 22-23, 2020. Room rates are US $159 plus applicable tax. Call 1-713-960-0111 for reservations and mention the EUCI event to get the group rate. The cutoff date to receive the group rate is December 22, 2019 but as there are a limited number of rooms available at this rate, the room block may close sooner. Please make your reservations early.

REGISTER 3, SEND THE 4TH FREE

Any organization wishing to send multiple attendees to this conference may send 1 FREE for every 3 delegates registered. Please note that all registrations must be made at the same time to qualify.
A room block has been reserved at the Houston Marriott West Loop by The Galleria, 1750 W Loop S, Houston, TX 77027, for the nights of January 22-23, 2020. Room rates are US $159 plus applicable tax. Call 1-713-960-0111 for reservations and mention the EUCI event to get the group rate. The cutoff date to receive the group rate is December 22, 2019 but as there are a limited number of rooms available at this rate, the room block may close sooner. Please make your reservations early.

COST OF SERVICE, COST ALLOCATION & RATE DESIGN FOR FERC REGULATED NATURAL GAS INTERSTATE PIPELINE COMPANIES COURSE
JANUARY 23-24, 2020: US $1495
EARLY BIRD on or before JANUARY 10, 2020: US $1295

Energize Weekly is EUCI’s free weekly newsletter, delivered to your inbox every Wednesday. We provide you with the latest industry news as well as in-depth analysis from our own team of experts. Subscribers also receive free downloadable presentations from our past events.

Sign me up for Energize Weekly