UNITED STATES OF AMERICA 112 FERC ¶ 61, 309
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Jurisdictional Public Utilities and Licensees Docket No. AI05-1-001
Natural Gas Companies
Oil Pipeline Companies

ORDER DENYING REHEARING AND PROVIDING CLARIFICATION

(Issued September 19, 2005)

I. Introduction

1. On August 1, 2005, the Interstate Natural Gas Association of America (INGAA) filed a request for rehearing of the Commission's order of June 30, 2005 in this proceeding.[1] Also on August 1, 2005, a group of shippers (Shippers)[2] on pipelines owned by Florida Gas Transmission Company and Southern Natural Gas Company filed a request for clarification or in the alternative for rehearing of the June 30 Order, and El Paso Natural Gas Company (El Paso) filed a request for clarification of that order. For the reasons appearing below, the requests for rehearing are denied and the order is clarified in the manner indicated in the discussion that follows.

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[1] *Jurisdictional Public Utilities and Licensees, Natural Gas Companies, Oil Pipeline Companies*, 111 FERC ¶ 61,501 (2005), (June 30 Order).

[2] The Shippers include Peoples Gas System, Tampa Electric Company, Municipal Gas Authority of Georgia, Alabama Municipal Distributors Group, The Southeast Alabama Gas District, Austell Gas System, Florida Municipal Natural Gas Association, Associated Gas Distributors of Florida, Inc., JEA, Orlando Utilities Commission, Lakeland Electric, City of Tallahassee, Florida, City of Gainesville, City of Tallahassee, Florida, and the Cities of Cordele, Dublin, Cartersville, Cuthbert, Hawkinsville, LaGrange, and Tallapoosa, Georgia.

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II. Background

2. As a result of regulations issued by the Office of Pipeline Safety (OPS) of the U.S. Department of Transportation, natural gas and oil pipeline companies are required to develop, implement, and follow an integrity management program for segments of pipeline in high consequence areas (IM Regulations).[3] On November 5, 2004, the Commission published a notice of a proposed accounting release, which would require that an entity recognize costs incurred in performing pipeline assessments that are part of a pipeline integrity management program as maintenance expenses.

3. On June 30, 2005, the Commission issued an order expanding on the accounting guidance in the proposed accounting release and addressed the proper accounting for costs that pipeline operators will incur in implementing all aspects of a pipeline integrity management program. The June 30 Order concluded that certain costs incurred related to a pipeline integrity management program should be capitalized, while others should be expensed.

4. INGAA's request for rehearing of the June 30 Order argued that the Commission erred by: 1) disconnecting the baseline assessment and related costs imposed by the IM Regulation from the safety, efficiency, and other public benefits that they produce; 2) concluding to expense the costs of establishing the HCA baselines upon those parts of the IM Regulations that provide for a process of continual evaluation and assessment; and 3) failing to consider that the IM Regulations are distinct from the on-going regulatory scheme for ordinary maintenance. INGAA also requested that the Commission permit interstate natural gas pipelines to capitalize the costs incurred from 2006 through 2012 in preparing for and performing baseline assessments and the associated tasks of updating their Integrity Plans and integrating data from the assessments into those Integrity Plans (baseline assessments and related costs).[4] Finally, INGAA requests that the Commission

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[3] *See* 49 CFR § 192, Pipeline Safety: Pipeline Integrity Management in High Consequence Areas (Gas Pipelines), Final Rule effective January 14, 2004; and 49 CFR § 195, Pipeline Safety: Pipeline Integrity management in High Consequence Areas (Hazardous Liquid Operators with 500 or more miles of Pipeline), Final Rule effective February 15, 2002.

[4] INGAA notes these costs would include the costs under the "Integrity Plans", "Baseline Testing", and "Data Integration" in Exhibit 8 of the OPS' Final Regulatory Evaluation, but does not include the "Annual Reports" or "Subsequent Testing" costs. *See* Final Regulatory Evaluation, Pipeline Integrity Management in High Consequence Areas (Gas Transmission Pipelines), U.S. Department of Transportation, Research and Special Programs Administration, Docket RSPA-00-7666-356.

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consider, as a basis for capitalizing baseline assessments and related costs, Emerging Issues Task Force Issue (EITF) No. 89-13, *Accounting for the Cost of Asbestos Removal*, (EITF No. 89-13) and Professor Bala Dharan's (Dharan)[5] discussion of the issue.

5. El Paso requests that the Commission clarify the June 30 Order so that it is clear that the implementation date set by the Commission requires only that a pipeline implement the requirements of the Order on January 1, 2006, or before if special circumstances require an earlier implementation.

6. The Shippers request that the Commission clarify that it did not intend to allow pipelines that have been accounting for pipeline IM costs as expenses to switch their accounting to capitalize such costs prior to January 1, 2006, in instances where the Commission decided in the June 30 Order that such costs should be expensed. The Shippers state that such a result would be prejudicial to ratepayers.

III. Discussion

A. Request for Rehearing

7. INGAA requests rehearing of the June 30 Order insofar as it bars interstate pipelines from capitalizing those IM Regulation costs of conducting actual baseline assessments and the costs of integrating the data collected with the historical design, construction, maintenance, and operating data for high consequence area segments. Specifically, INGAA claims that the Commission took a narrow view of the relationship between the baseline assessment and related costs in complying with the IM Regulations and the significant, long-term safety and efficiency benefits that will be produced by the accelerated regime of safety testing. INGAA contends these long-term safety and efficiency benefits merit capitalization of the costs and can be seen as a process of accelerating future expenditures that can produce long-term savings equivalent to prepaid expenses. Further, INGAA claims that it is proper to capitalize such costs imposed by new regulations based on considerations of public benefit through improved safety and efficiency.

8. The June 30 Order considered the specific activities conducted to comply with the regulations and made a determination whether the cost of the activity should be expensed or capitalized based on the Commission's accounting rules in the Uniform Systems of

[5] In an affidavit, written by Dharan, filed with INGAA's request for rehearing, Dharan describes the specific categories of IM costs for which he recommends capitalization of these costs and includes support from the existing accounting practice under the generally accepted accounting principles (GAAP).

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Accounts (USofA). After such consideration, the Commission determined that certain activities meet the criteria for capitalization under the USofA while others do not.[6] We are not persuaded by INGAA's arguments that the outcome reached in the June 30 Order is incorrect.

9. INGAA essentially argues that capitalization of the baseline assessments and related costs should be permitted if a conceptual basis exists to link the costs to a future benefit. However, it is generally recognized that in many instances a conceptual basis that links a cost to a future benefit may not be sufficient to permit capitalization as an asset. For example, advertising and research and development costs are expensed when incurred even when management's intent in incurring these costs is to enhance future economic benefits available to the entity. In those instances the realization of the potential future economic benefits is too uncertain or speculative to support recognition of the costs as an asset.[7] As in those instances, the fact that the IM regulations *could* result in increases in pipeline operating pressure involves circumstances where realization of the potential economic benefits is too speculative to support capitalization of the costs.

10. It would also be incorrect to classify these costs as prepaid expenses. A prepaid expense is an asset to a business because it is the unamortized cost for the right to receive a future service or a resource.[8] As such, we do not see how the baseline assessments or the related activities provide a pipeline company with the right to receive a future service or resource. We also reject the claim made by INGAA that the integrity management costs should be capitalized because they are the costs of compliance with new regulations and failure to comply could result in the loss of the use of the asset. This claim is not supported by any authoritative accounting literature. Additionally, in following INGAA's logic, any cost to maintain an asset required by a regulator, like the cost of "ordinary maintenance" required by the OPS,[9] could be capitalized because failure to follow the regulatory requirements could result in the loss of use of the asset. Accordingly, the baseline assessments and related costs are being incurred to insure that assets are being operated within established safety parameters and should be a cost of current operations.

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[6] *See* June 30 Order, P 24-28.

[7] Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6 (FASB Statement No. 6), Elements of Financial Statements, paragraphs 174-176 (December 1985).

[8] FASB Statement No. 6, P 175, 176, and 181.

[9] *See INGAA*'s request for rehearing at 14.

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11. INGAA also states the Commission incorrectly relied upon portions of the IM Regulations which provide for ongoing activities in determining to expense the baseline assessments and related costs. We disagree. In the June 30 Order the Commission concluded that the baseline assessment and related costs should be expensed based upon its established accounting rules in the USofA.[10] These accounting rules state that testing the condition of existing plant is a maintenance item and is to be charged to expense and the cost of preparing instructions for maintenance activities should also be charged to maintenance expense. Therefore, the Commission concluded that the proper accounting treatment would be to expense the baseline assessments and related costs.

12. Additionally, INGAA argues that the Commission failed to consider that IM Regulations are distinct from the ongoing regulatory scheme for ordinary maintenance. The Commission understands that the IM Regulations have changed what was once considered to be normal operation and maintenance of pipeline assets. The changes brought about by the IM Regulations were needed to address the fact that a higher level of assurance was needed to protect high consequence areas. Accordingly, the IM Regulations require pipeline operators to undertake additional safety measures beyond those previously required and have effectively broadened what is considered routine maintenance. However, an increase in the required level of maintenance does not change the fact that the work remains a maintenance activity.

13. These additional safety measures are not one-time events, but are scheduled on a routine and re-occurring basis into the foreseeable future to provide assurance as to the operational safety of pipeline segments. The pipeline assessments and related activities conducted during the baseline period are the first instance of many other similar assessments and activities to be conducted into the foreseeable future. The activities incurred during the baseline period, are not materially different, if different at all, from the same category of costs that INGAA does not object to expensing after the baseline period. Accordingly, we find no reason why the same accounting standard should not be applied to each cost category whether the cost is being incurred for the first time or a subsequent time.

14. Upon reviewing EITF No. 89-13, we do not agree that EITF No. 89-13 alone provides a framework that can be used in determining the proper accounting for IM Regulation costs. INGAA, in reaching their conclusion, focus on the similarities between IM Regulations and the laws requiring the removal of asbestos but fail to fully acknowledge the rationale underlying the EITF's decision, which can only be found by examining EITF 90-8, *Accounting for Environmental Contamination Treatment Costs*.

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[10] *See* June 30 Order at P 24, 25, and 27.

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EITF No. 90-8 provides a rationale for expensing or capitalizing environmental contamination treatment costs. It also contains implementation examples including one regarding asbestos removal. EITF No. 90-8 explains that the costs to remove asbestos may be capitalized because removing the asbestos improves the building's safety over its original condition since the environmental contamination (asbestos) existed when the building was constructed or acquired. Likewise, other environmental contamination treatment costs may be capitalized if the costs extend the life, increase the capacity, or improve the safety or efficiency of property owned as compared with the condition of that property when originally constructed or acquired. Thus, in analyzing the rationale for capitalizing asbestos removal costs and other environmental containment treatment costs we do not believe that baseline assessments and the related costs increase or extend the life, capacity, safety, or efficiency of a pipeline beyond its original construction or acquisition state.

15. Finally, INGAA states that the current projections of IM spending suggest that the Commission's estimates in the June 30 Order may substantially understate the total IM Regulation spending by industry and the portion that must be expensed. The Commission understands that the cost projections provided by the OPS were determined in 2001 dollars. Taking into consideration the time value of money, it is not surprising that for the years 2006 through 2008 the costs have increased. Further, we did not base our decision on the estimated costs of the IM Regulations; rather, we relied upon the accounting rules provided in the USofA, as discussed above.

B. Requests for Clarification

16. We grant El Paso's request for clarification, and clarify that a pipeline may adopt the accounting required in the June 30 Order at any time on or before January 1, 2006. This early adoption is only permitted in instances when adequate internal controls are in place to appropriately account for IM costs. Additionally, in this instance, a company must file a request for approval of its proposed accounting with the Chief Accountant within 30 days of the issuance of this order. The accounting changes made as a result of early adoption should also be fully disclosed in the notes to the company's financial statements. Further, we clarify that early adoption of the accounting is only for accounting purposes and does not constitute a determination by the Commission regarding the recovery of these amounts in rates.

17. We also grant the Shippers request for clarification, and clarify that it was not our intention to allow pipelines that expensed integrity management costs, prior to the June 30 Order, to change their accounting and capitalize these costs prior to January 1, 2006

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The Commission orders**:**

The June 30 Order is clarified as indicated in the text of this order and rehearing is denied.

By the Commission. Commission Brownell dissenting with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

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BROWNELL, Commissioner, dissenting:

I dissent for the reasons set forth in *Jurisdictional Public Utilities and Licensees, Natural Gas Companies, Oil Pipeline Companies,* 111 FERC ¶ 61,501 (2005).

On rehearing, the majority states that generally when a future benefit is too speculative it is inappropriate to capitalize a current cost. I do not disagree. The majority then notes that a good example of this principle is the benefits derived from advertising costs. The majority concludes by declaring that the economic benefits from the baseline assessment and related costs, such as the ability to increase pipeline operating pressure, are too speculative to support capitalization of the costs. I do not believe a general declaration provides a sufficient basis for finding that these costs should not be capitalized.

The conclusion reached by the majority directly conflicts with the findings of OPS. OPS noted that it did have some experience in granting requests to operate at higher pressures in order to make additional capacity available. Based on this experience, OPS determined that increased capacity (and efficiency) from higher operating pressures was a benefit that justified the new safety program. In particular, OPS pointed out that increases in operating pressures could make additional gas available in rapid order to alleviate an emergency, like that experienced in California in 2000.[11] In conclusion, OPS stated "when emergencies occur, as seen in California in 2000, any ability to increase the supply of gas to an affected area is a significant benefit."[12] Since the IM Regulations will reduce, but not eliminate, emergencies,[13] I believe the benefits are tangible, not conceptual.

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[11] OPS's Final Regulatory Evaluation at 30.

[12] *Id*. at 31.

[13] *Id*. at 18.

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Furthermore, advertising costs are not analogous to baseline assessment and related costs. Advertising costs are never treated as capital costs. In fact, advertising costs are generally not permitted in rates even as an expense item because the benefits run to the corporation, not the consumer.

The Commission's accounting rules generally require that assessment and related costs should be expensed. However, these accounting rules concern assessment and related costs incurred on a routine basis in the general conduct of pipeline operations. In contrast, as several commenters pointed out, the Commission has made a distinction if the assessment and related costs are part of a comprehensive program and permitted the capitalization.[14] The assessment and related costs incurred because of the IM Regulations are distinctly different. The IM Regulations represent a comprehensive pipeline safety and integrity program. OPS described its rulemaking as "a comprehensive response to the NTSB's recommendations and Congressional mandates, as well as pipeline safety and environmental issues raised over the years."[15] Therefore, the majority's reliance on the accounting rules for its decision is inapposite and the departure from past practice is unexplained.

For these reasons, I respectfully dissent.

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Nora Mead Brownell
Commissioner

[14] *See* INGAA comments at 10-11Enbridge comments at 4 and 7-8; and El Paso comments at 6-7.

[15] OPS's Final Regulatory Evaluation at 2.