UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's Policy for Determining Return on Equity	**)))**	**Docket No. PL19-4-000**

INITIAL COMMENTS OF AIRLINES FOR AMERICA

Pursuant to the Notice of Inquiry ("NOI") issued in this docket on March 21, 2019, Airlines for America ("A4A") submits these comments to urge the Commission to refrain from establishing any one-size-fits all policy for determining return on equity ("ROE") in this proceeding. As A4A's primary interest is in oil pipelines, these comments will not address the full panoply of issues the Commission has raised in the NOI. Rather, A4A explains that there is no need for the Commission to establish universal principles governing ROE in all cases, and particularly why there is no need to change the well-established methodology used in oil pipeline proceedings at all. In short, the Commission is under no duty to change its ROE methodologies; it has provided no evidence that methodological changes are necessary in particular industries or across the industries regulated by FERC; and in any event, proposed methodological changes would be best examined in the context of individual rate proceedings in which the relevant factual basis regarding a regulated entity's risk profile can be fully developed.

I. *EMERA MAINE* DOES NOT REQUIRE CHANGES TO THE COMMISSION'S TRADITIONAL ROE ANALYSIS

The Commission has cited the *Emera Maine* decision, and the proceedings leading up to it, as an impetus for this inquiry.[1] While the Commission is certainly entitled to reconsider its ROE methodologies, *Emera Maine* does not require it to do so. Notably, the court made no finding as to the proper methodology for the Commission to use in determining the allowed rate

[1] *See* NOI at 1 (citing *Emera Maine v. Federal Energy Regulatory Commission*, 854 F.3d 9, 23 (D.C. Cir. 2017)).

of return for electric utilities in that case.[2] It remanded the Commission's decision because the Commission had not made the required showing that the utility's existing rate was unlawful before proceeding to a determination of whether the utility's allowed return was just and reasonable.[3] The court further determined that the Commission had failed to justify its selection of a particular ROE once it had embarked on this inquiry.[4] Neither of these findings require the Commission to reevaluate or reinvent the ROE methodologies it has traditionally applied to electric cases, and they plainly have nothing to say about the proper methodology to be applied in oil pipeline cases.

This is not to say that the Commission cannot consider changes to its methodology. Notably, *Emera Maine* did not contest the Commission's authority to import the two-step DCF analysis traditionally used in oil pipeline proceedings into the electric utility context. But because it is under no duty to change its methodology, it must provide a reasoned explanation for any departure from its prior practice.[5] *Emera Maine* found that the Commission had not provided such an explanation. As discussed further below, neither the Commission nor any other party has put forth a justification for making a blanket change to the ROE methodology for oil pipelines to date.

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[2] *Emera Maine v. Federal Energy Regulatory Commission*, 854 F.3d at 30 ("It is not our job to tell FERC what the 'correct' ROE is for Transmission Owners . . .").
[3] *Id.* at 26.
[4] *Id.* at 28.
[5] *See Southwest Airlines v. FERC*, Case No. 18-1134, Slip op. at 8 ("One of the most fundamental principles of administrative law is that agencies must give reasons for their actions.") (June 14, 2019); *id.*, slip op. at 9 (explaining that when changing course, an agency "must at least acknowledge its seemingly inconsistent precedents and either offer a reason to distinguish them or explain its apparent rejection of their approach" (internal quotations omitted)).

II. CHANGES TO ROE METHODOLOGIES SHOULD BE MADE ONLY IN THE CONTEXT OF INDIVIDUAL PROCEEDINGS

Even if the Commission believes changes to its ROE methodology are warranted, these changes would be best made in individual rate proceedings, not through a blanket rulemaking. The proper ROE to allow a regulated entity depends on numerous factors, including the risk profile of the entity itself and the industry in which it operates. For instance, adjustments above or below the DCF midpoint might be appropriate in certain cases, and other methodologies could play a role in guiding this analysis. But it is difficult to tell, outside the context of a specific rate case, what adjustments may be appropriate.

A general proceeding such as the instant inquiry cannot capture the variety of concerns that can influence the selection of a proper ROE for a particular entity. The difficulty of such an effort can be seen in the contours of the NOI itself. The Commission has called for comments on eight general topics, including broad topics such as the role of ROE in investment decision-making and specific, technical topics such as model mechanics and implementation. Within each of these general topics, the Commission has called for comment on numerous subtopics. To respond effectively to each of these topics and subtopics would be a Herculean task; indeed, multiple book-length treatises have been written about these topics. Furthermore, without the facts of a specific proceeding to guide the discussion, it is nearly impossible to develop comments that would meaningfully guide the Commission's decision-making in future cases. For instance, regarding the "First Prong of ROE Determination," the Commission asks whether "the approach outlined in the *Coakley* and MISO briefing orders [is] appropriate in single utility rate cases given that the proxy company ROEs tend to cluster near the center of the zone of reasonableness, making the middle quartile relatively narrow."[6] The answer, of course, is "it

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[6] NOI at 28 (topic G4)

depends"—but one would first have to determine whether the appropriate proxy companies have been selected; assess whether, once selected, their ROEs do in fact cluster near the center of the zone of reasonableness; then determine if there are any factors unique to the utility being evaluated that make this approach more or less reasonable. Deciding this issue in a general proceeding such as this inquiry is, to say the least, inadvisable.

Moreover, if the Commission declines to adopt universal guidelines in this proceeding, it will not limit its ability to pursue changed methodologies in the future. Any party to a particular proceeding is free to present an alternative ROE methodology and explain why it should be applied in the context of that particular case. Indeed, that is how the Commission decided to evaluate use of a composite method in *Coakley*.[7] By contrast, in Docket No. OR16-6 regarding SFPP, L.P.'s East Line oil pipeline, all parties endorsed the use of the DCF method for the calculation of SFPP's ROE.[8] The parties to a particular proceeding are in the best position to identify whether existing methodologies are most appropriate in that case, and decisions regarding whether to accept proposals to modify these methodologies will be best made when these parties are allowed to fully develop a record regarding the merits of a particular proposed change.

A4A understands the Commission's desire for consistency in its application of ROE principles. But this consistency can be established through reasoned decision-making in individual cases. As the facts are developed in each of these cases, the Commission will develop precedent on when it is appropriate to supplement its traditional ROE methodologies with other

[7] *See Coakley v. Bangor Hydro-Electric Co.*, 165 FERC ¶ 61,030 at PP 37-38 (2018) (quoting testimony arguing that "the use of multiple reasonable methodologies is appropriate" and that "[t]he Commission should not limit itself to using only the DCF model").
[8] *See* Docket No. OR16-6, Answer of Complainants to Motion of SFPP, L.P. to Reopen the Record at 3-4 (Dec. 27, 2018).

analyses and when it is not. Attempting to resolve these fact-specific issues through a general amorphous NOI such as this one, by contrast, will only lead to more confusion as the Commission attempts to shoe-horn individual cases into ill-fitting abstract guidelines.

III. OIL PIPELINES SHOULD BE EXCLUDED FROM THIS PROCEEDING

A. Oil Pipelines Are Uniquely Situated

Even if the Commission decides to proceed with evaluating methodological changes to determining the ROE for electric utilities or natural gas pipelines in this proceeding, it should refrain from extending those changes to oil pipelines. Oil pipelines are uniquely situated, governed by a distinct regulatory regime, and the Commission's reasoning for proposing the composite method for calculating ROE for electric utilities does not apply to oil pipelines.

Electric transmission companies each have an approved ROE embedded in their rates whereas the vast majority of ICA-regulated pipelines use contract rates or indexed rates and have not undergone a cost-of-service review in decades, if ever. The Commission recently acknowledged this fact when deciding to defer the application of the Tax Cuts and Jobs Act of 2017 ("TCJA") to crude oil and petroleum products pipelines. As the Commission explained, "[u]nlike public utilities and natural gas pipelines, the majority of oil pipelines set their rates using indexing, not cost-of-service ratemaking using an oil pipeline's particular costs."[9] The Commission went on to explain that, "[u]nder indexing, oil pipelines may adjust their rates annually, so long as those rates remain at or below the applicable ceiling levels" and, therefore, it was appropriate to wait until the Commission's next indexing proceeding to apply the reductions in corporate income taxes that could have substantial effects on the overall level of the rates for

[9] *Inquiry Regarding the Effect of the Tax Cuts and Jobs Act on Commission-Jurisdictional Rates*, 162 FERC ¶ 61,223, at P 8 (2018).

crude oil and petroleum product pipelines.[10] Due to the lack of indexing for electric utilities, the Commission did not treat electric utilities the same way, requiring them to make compliance filings showing that they reduced the income tax portion of their rates so as to give transmission customers the immediate benefits of lower rates.

Moreover, the Commission has a long history of applying different ROE calculation methodologies for electric transmission companies under FPA regulation than for the natural gas and oil pipelines it regulates under the auspices of the Natural Gas Act and ICA, respectively. Indeed, it was only in Opinion No. 531, issued in 2014, that the Commission first suggested applying the two-step DCF method traditionally relied on for pipelines in the electric transmission context. In addition, the nature of potential proxy group companies differs in the two industries. Furthermore, crude oil and petroleum product pipeline companies are often owned by parent companies that own interests in a wide array of businesses, many of which are unregulated. These circumstances are relevant to the risk profiles of oil pipelines, and they distinguish oil pipelines from electric transmission companies, which are often dedicated to a single, pervasively regulated line of business. Finally, even where cost of service rates are in place, oil pipeline rates are developed on a Trended Original Cost basis, rather than an original cost basis. Thus, the Commission would need to evaluate whether the ROE methodologies proposed for electric utilities can be fairly applied to a rate base developed in this way.

B. The DCF Methodology Fairly Reflects the Risk Profile of Oil Pipelines

Finally, despite the concerns the Commission has voiced in electric proceedings, there has been no evidence put forth in oil pipeline proceedings to date that the DCF method does not fairly reflect the risk profile of oil pipelines. There have been numerous rate cases post-

[10] *Id.*

recession, and participants have had ample opportunity to raise these issues to the Commission. Yet the use of the DCF methodology had not been contested until after *Coakley* and *Emera Maine*, when SFPP moved to reopen the record to consider additional ROE evidence in Docket No. OR16-6.[11] If economic circumstances for oil pipelines since the Great Recession had changed in such a way that the DCF methodology no longer produced a reasonable ROE, one would expect that an oil pipeline would have raised this issue in at least one proceeding over the past 10 years. Yet none has, and oil pipelines have continued to attract investment and operate profitably. There is no reason, therefore, to revisit the oil pipeline DCF methodology in this proceeding.

IV. **CONCLUSION**

For the reasons set forth above, the Commission should not revisit its ROE methodology in this docket. Rather, it should defer evaluation of any proposed changes to ROE methodologies to individual dockets in which those proposals can be evaluated in the context of the risk profile and investment needs of specific regulated companies and industries. In particular, due to the distinct legal and factual circumstances of the oil pipeline industry, the Commission should refrain from making any changes to the ROE methodology for oil pipelines at this time.

[11] *See* Docket No. OR16-6, Answer of Complainants to Motion of SFPP, L.P. to Reopen the Record at 4 (Dec. 27, 2018) (relating how all participants in the docket accepted the DCF methodology and no expert witnesses argued that changed circumstances or anomalous market conditions required the use of alternative methodologies even though the Commission had raised those issues in *Coakley* prior or during the OR16-6 hearing). SFPP did not raise any objection to the DCF methodology on brief in this proceeding; it was only in December 2018, well after an Initial Decision had been issued, that SFPP moved to reopen the record to consider the use of an alternative ROE methodology nominally (but not actually) based on that used in *Coakley*.

Respectfully submitted,

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