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**

COMMENTS OF BOARDWALK PIPELINE PARTNERS, LP

Boardwalk Pipeline Partners, LP ("Boardwalk") submits the following comments in response to the Federal Energy Regulatory Commission's ("Commission") Notice of Inquiry Regarding the Commission's Policy for Determining Return on Equity issued on March 21, 2019 ("NOI").[1] The Commission is seeking "information and stakeholder views to help explore whether, and if so how, it should modify its policies concerning the determination of the return on equity ("ROE") to be used in designing jurisdictional rates charged by public utilities," and whether any such policy changes should also be applied to interstate natural gas and oil pipelines.[2]

Boardwalk is a limited partnership whose interstate natural gas subsidiary companies include Texas Gas Transmission, LLC; Gulf South Pipeline Company, LP; Gulf Crossing Pipeline Company LLC; and Boardwalk Storage Company, LLC. Boardwalk's interstate natural gas pipeline subsidiaries would be directly affected by any potential change in the Commission's ROE policies. Boardwalk, through its subsidiaries, operates approximately 14,365 miles of pipeline and underground storage caverns with an aggregate working gas capacity of approximately 205 billion cubic feet. Boardwalk is wholly owned by a public

[1] *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, Notice of Inquiry, 166 FERC ¶ 61,207 (2019).
[2] *Id.*

company, Loews Corporation, which is one of the largest diversified companies in the United States. Loews' subsidiaries operate businesses not only in the energy sector, but also in the insurance, hospitality, and packaging industries.

Boardwalk supports the comments submitted in this NOI proceeding by the Interstate Natural Gas Association of America ("INGAA")[3] and urges the Commission to avoid applying a one-size-fits-all approach to the application of its ROE policy across both interstate natural gas pipelines ("interstate pipelines") and electric transmission providers. The Supreme Court, in *Federal Power Commission v Hope Natural Gas Co.*,[4] has explained that the ROE earned by the owner of a regulated entity must "be commensurate with returns on investments in other enterprises *having corresponding risks*."[5] Interstate pipelines and electric transmission providers do *not* have corresponding risks due to significant differences in the regulatory structures of the two industries and the different levels of competition faced by each industry. The Supreme Court's mandate in *Hope* prohibits the Commission from applying an ROE policy developed for electric transmission providers that does not account for the unique business risks faced by interstate pipelines, and the Commission should avoid adopting any such policy in this proceeding.

The Commission's examination of ROE provides a timely opportunity to address the impact of the Commission's pro-competition policies on interstate pipelines. The Commission has largely succeeded in fostering a highly competitive interstate pipeline market that has created substantial benefits to gas consumers across the United States by providing open access to low-cost gas supplies. These same competitive policies have

[3] Initial Comments of the Interstate Natural Gas Association of America, Docket No. PL-19-4-000 (June 26, 2019) ("INGAA Comments").
[4] *Federal Power Commission v Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope").*
[5] *Id.* at 603 (emphasis added).

substantially increased the business risk of the interstate pipelines that participate in the market.[6] The business risks faced by interstate pipelines in the competitive market are asymmetrical: interstate pipelines may be required to meet competition by reducing rates below their maximum recourse rates in order to retain market share when the market is unfavorable, but they are prohibited from charging rates above their maximum recourse rates during favorable market conditions. The Commission's ROE policy should recognize the unique business risks faced by interstate pipelines operating in an intensely competitive market and take steps to balance the asymmetric nature of this risk as discussed more fully here and in the INGAA Comments.

The Commission's ROE policy should also fully consider the unique and changing market and operational conditions that apply to individual pipelines when the Commission establishes the ROE for a specific pipeline. For example, the at-risk condition that the Commission places on interstate pipelines for expansion projects creates substantial risk regarding the recovery of significant capital expended to construct the projects.[7] When a pipeline is subject to the at-risk condition, the Commission should either (i) authorize a higher ROE to be used in the rates for the at-risk facilities, or (ii) remove the maximum applicable rate cap that applies to service on the at-risk facilities. While this change would not necessarily ensure future cost recovery, it would provide a symmetrical regulatory approach that recognizes the long-term risks of building facilities that the Commission has

[6] See INGAA Comments.

[7] *Certification of New Interstate Natural Gas Facilities*, Notice of Inquiry, 163 FERC ¶ 61,042 at P 17 (2018) (citing *Certification of New Interstate Natural Gas Pipeline Facilities Statement of Policy,* 88 FERC ¶ 61,227 (1999) ("Policy Statement") (explaining that interstate pipelines "can recover the costs of the new facilities only from shippers who use them, and are fully at risk for the cost of the new facilities and will bear the financial burden of any unsubscribed capacity.").

found are in the public convenience and necessity but which are nevertheless subject to competition that makes long-term cost recovery uncertain.

The Commission should also reconsider revising its pricing policy related to expansion facilities[8] to ensure that all shippers utilizing at-risk expansion facilities are subject to rates that help recover the costs of the expansion facilities so that there is a level playing field among existing and expansion shippers. The Commission should also expand the scope of its review of pipeline rates before initiating a rate investigation pursuant to Section 5 of the Natural Gas Act[9] to ensure that it accounts for significant past periods of under-recovery and projected future periods of under-recovery. The Commission's ROE policies should further reflect that pipelines' realized ROEs are often substantially below the pipeline's authorized ROEs and avoid treating interstate pipelines as monopolies that can command rates that provide full recovery of their revenue requirements. The Commission's ROE policies must also recognize the financial constraints faced by interstate pipelines in attracting the capital necessary to maintain and expand their systems and ensure that pipelines are able to maintain their investment grade credit status.

COMMENTS

A. Interstate Pipelines Are Subject to Substantial Competition That Creates Unique Business Risks.

The Commission's ROE policy must be consistent with the Supreme Court's holding in *Federal Power Commission v Hope Natural Gas Co.*[10] that provides that ROE earned by

[8] *See, e.g., Gulf South Pipeline Co. LP,* 163 FERC ¶ 61,124 at, PP 22, 26 (2018) (denying pipeline's proposal to charge the incremental rate to shippers utilizing an expansion project on an interruptible basis and allow existing shippers to use the expansion facilities on a secondary basis without paying the incremental rate).
[9] 15 U.S.C. 717d.
[10] *Federal Power Commission v Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope").*

the owner of a regulated entity must "be commensurate with returns on investments in other enterprises *having corresponding risks*" and "be sufficient to assure confidence in the financial integrity of the enterprise, so as to *maintain its credit and to attract capital*."[11] *Hope* requires the Commission to examine the unique business risks facing interstate pipelines. These business risks are inextricably linked to the highly-competitive market for interstate pipeline capacity that the Commission has helped foster over the past thirty-five years. The Commission's pro-competition policies have created substantial benefits to gas consumers by allowing them to access diverse sources of gas supplies and to move those supplies to both new and existing markets. The pro-competition policies have also created unique business risks for interstate natural gas pipelines which the Commission must recognize when developing an appropriate policy for interstate pipeline ROEs that is consistent with *Hope's* directive that the Commission set a pipeline's ROE at a level commensurate to the returns earned by businesses with corresponding risks.

1. The Commission's Restructuring of the Natural Gas Industry has Created a Highly Competitive Environment for Interstate Pipelines.

The business risk currently faced by interstate pipelines was created in part by the Commission's restructuring of the natural gas industry. When the Natural Gas Act ("NGA") was enacted, interstate pipelines were merchants and provided a bundled transportation and commodity service to their customers. Often, there was only a single pipeline connecting a particular supply area to a market. Interstate pipelines now provide an unbundled transportation or storage service and customers contract for their own natural gas supplies either at a receipt point or through a bundled transportation and supply service provided by a producer or marketer. Many markets are now served by multiple pipelines and supply

[11] *Id.* at 603 (emphasis added).

sources, providing consumers with choices that simply did not exist when the NGA was enacted.

The change in the regulatory landscape began in the early 1980s, when the Commission issued Order No. 380 and eliminated the minimum bill provisions in interstate pipeline supply contracts.[12] The Commission found that minimum bill provisions prevented clear price signals between the wellhead and burner tip.[13] The Commission expressly noted that its intent was to restructure the natural gas industry and increase competition.[14] The elimination of minimum bill provisions effectively put interstate pipelines at risk for the long-term contracts they had executed to support their supply obligations. [15]

The Commission's next step in restructuring the natural gas industry came in 1985 when it issued Order No. 436[16] to respond to changed market conditions following the adoption of the Natural Gas Policy Act. Order No. 436 gave interstate pipelines the ability to offer open access transportation services independent of their natural gas commodity sales services. In Order No. 436, the Commission adopted regulations permitting pipelines to engage in selective discounting based on the varying demand elasticities of their customers.[17] The Commission found that selective discounting would help protect captive customers from

[12] *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Bill Provisions*, Order No. 380, 49 Fed. Reg. 22,778-01, [Regs. Preambles 1982-1985] FERC Stats. Regs. ¶ 30,571 (1984). *See also Transwestern Pipeline Co. v. FERC*, 820 F.2d 733, 746 (5th Cir. 1987) (upholding Commission orders eliminating minimum bills

[13] *Id.* at 22,781.

[14] *Id.* at 22,784.

[15] Order No. 380 coupled, with the deregulation of certain categories of natural gas on January 1, 1985, helped fuel the take-or-pay litigation between pipelines and producers over the validity of long-term natural gas supply contracts. The effects of this order took a severe financial toll on United Gas Pipe Line, which is now Gulf South.

[16] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, 50 Fed. Reg. 42,408-01, [Regs. Preambles 1982-1985] FERC Stats. & Regs. ¶ 30,665 at 31,516-17 (1985) ("Order No. 436").

[17] Order No. 436 at 42,451-52.

rate increases that would otherwise occur if pipelines lost volumes because they could not respond to competition.[18]

Order No. 636,[19] issued in 1992, fundamentally changed the regulatory scheme and competitive environment under which interstate pipelines operated. The Commission's objective in Order No. 636 was "to ensure that all shippers have meaningful access to the pipeline transportation grid so that willing buyers and sellers *can meet in a competitive, national market to transact the most efficient deals possible*."[20] Order No. 636 restructured the natural gas industry so that interstate pipelines became transportation and/or storage-only service providers and were no longer allowed to offer a bundled transportation and commodity sales service.

Order No. 636 provided shippers more flexibility, including creating a new secondary market for transportation capacity by allowing firm transportation shippers to release their excess firm transportation capacity to replacement shippers, providing shippers new flexibility to access additional receipt and delivery points under their contracts, and granting shippers the ability to segment their capacity. Interstate pipelines were also required to take steps to encourage the creation of liquid market centers across the grid and to make it easier

[18] *Id.*

[19] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, 59 FERC ¶ 61,030, [Reg. Preambles Jan. 1991-June 1996] FERC Stats & Regs, ¶ 30,939(1992), *order on reh'g*, Order No. 636-A, 60 FERC ¶ 61,102, [Reg Preambles Jan. 1991-June 1996] FERC Stats & Regs, ¶ 30,950 (1992); *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992*); reh'g denied*, 62 FERC ¶ 61,007 (1993); *aff'd in part and remanded in part*, *United Distrib. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996); *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

[20] Order No. 636 at 7 (emphasis added).

for customers to transact across multiple pipelines.[21] The implementation of Order No. 636 substantially increased competition across the entire interstate pipeline system.

Order No. 637,[22] issued in 2000, provided even more flexibility to shippers and further increased competition across the pipeline system.[23] The Commission's policies have encouraged competition not only among pipelines, but have also enabled shippers to compete directly with interstate pipelines in the same capacity market through the use of capacity release. For example, and as discussed further below, shippers holding pipeline capacity can segment that capacity into multiple paths and then release any portion of unneeded capacity. This provides potential customers with the choice to buy a pipeline's capacity directly from the pipeline or from a releasing shipper. Capacity can be released by shippers for above the maximum tariff rate for periods of up to one year, allowing shippers to capture greater revenue when market conditions permit. By contrast, interstate pipelines are bound to offer all capacity subject to the maximum recourse rate, limiting the pipelines' opportunities to increase revenues when market conditions support higher transport rates.

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[21] Order No. 636 promulgated a new regulation, 18 C.F.R. § 284.7(b)(3), prohibiting pipelines to include provisions in their tariffs that inhibit the development of market centers. In Order No. 636-C, the Commission noted that Order No. 636 had led to a substantial increase in the number or market centers in furtherance of the Commission's goal of "of opening up the pipeline grid to form a national gas market for gas sellers and gas purchasers to meet in the most efficient manner," and that "[t]hese market centers provide a variety of services that increase the flexibility of the system and facilitate connections between gas sellers and buyers," including "wheeling, parking, loaning, and storage. Order No. 636-C at 61,767.

[22] *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, 90 FERC ¶ 61,109, FERC Stats. & Regs. ¶ 31,091, *clarified,* Order No. 637-A, 65 Fed. Reg. 10,156, FERC Stats. & Regs. ¶ 31,099, *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom. Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, 101 FERC ¶ 61,127 (2002), *order on reh'g*, 106 FERC ¶ 61,088 (2004), *aff'd sub nom. American Gas Ass'n v. FERC, 428 F.3d 255* (D.C. Cir. 2005).

[23] For example, the Commission required pipelines to allow replacement and releasing shippers in capacity release transactions to each choose their own primary points in segmented releases to create competition between released capacity and the pipeline's sale of its own capacity. *See* Order No. 637-A at 10,194-95. The Commission further implemented policies revising the right of first refusal process, developing scheduling equality for released capacity, codifying segmentation rights and flexible point rights, changing requirements related to imbalance services and operational flow orders, and modifying requirements regarding retention of penalty revenues.

The numerous regulatory changes that were implemented in Order Nos. 636 and 637 have resulted in a transparent and highly competitive interstate natural gas market. The heightened competition has resulted in an increased level of discounted transportation agreements and negotiated rate transportation agreements below pipelines' maximum rates. The Commission's policies have achieved most, if not all, of the goals that supported the adoption of Orders Nos. 636 and 637. While this competition has been beneficial to the market as a whole, it has necessarily increased the business risks of the interstate pipelines.

2. The Commission's Certificate Policies Have Promoted Pipeline-on-Pipeline Competition.

The Commission has taken a "pro-competition" approach to the certification of new interstate pipeline facilities,[24] which elevates the business risk of interstate pipelines. The Commission has explained that this approach is based on the rationale "that potential adverse impacts on existing competitors through the potential future loss of load are likely to be outweighed by the economic and reliability benefits to natural gas consumers that come from increased access to new supply sources of competitively-priced natural gas."[25] The Commission has concluded that new pipelines "benefit consumers through increased competition," even if competition results in negative impacts on incumbent pipelines.[26]

Between 2000 and 2017, the Commission authorized approximately 18,000 miles of interstate natural gas transmission pipeline totaling more than 159 billion cubic feet per day of new interstate pipeline capacity,[27] and has also approved substantial additions since that time. These projects can roughly be divided into two broad categories: expansions of

[24] *Certification of New Interstate Natural Gas Facilities*, Notice of Inquiry, 163 FERC ¶ 61,042 at P 29 (2018).
[25] *Id.* at P 29.
[26] *Id.*
[27] Testimony of Terry L. Turpin, Director, Office of Energy Projects, Federal Energy Regulatory Commission, Hearing Before the U.S. Senate Energy and Natural Resources Committee, p. 4 (Dec. 12, 2017).

existing pipelines (including pipeline flow reversals) and the construction of new pipelines (either as an extension of an existing pipeline system or by a new interstate pipeline company). A significant portion of the new capacity has been developed to move newly-developed natural gas supplies from production areas to liquid markets, such as major pipeline interconnects, or directly to end-users. Other pipelines have been constructed to connect end-users to existing systems. The continued buildout of the interstate pipeline grid has provided consumers with many benefits, including a liquid and robust commodity market, increased access to diverse supplies, lower-priced natural gas, and increased connectivity of the grid. This buildout has also resulted in increased competition between pipelines to gain access to new supply and markets.

There has always been competition among interstate pipelines in the markets in which Boardwalk's interstate pipelines operate. This competition was historically focused on supply areas, with multiple interstate pipelines competing to take supply from a specific production area. Over the past thirteen years, the increase in shale gas production, including the growth of the Marcellus and Utica production, has disrupted the traditional supply and demand dynamics across the interstate system. Boardwalk has responded to the growth in shale gas supplies by both expanding its pipeline systems through the construction of new facilities and changing the direction of flow on existing facilities to move the new supplies to market. The availability of competitive transportation options has allowed pipeline customers to replace traditional distant supply sources with new supply sources that are closer to their markets.

The pipeline-on-pipeline competition fostered by the Commission has increased the business risk of many incumbent pipelines. For example, when Order No. 636 was

implemented, the prevalent direction of flow for interstate gas was from the Gulf Coast production areas east to Florida or north on the long-haul pipelines serving the Midwest and Northeast. In response to the increase in shale gas production, particularly in the Marcellus and Utica, certain pipelines, including Boardwalk's Texas Gas, have modified their facilities to operate on a bi-directional basis to gain access to new markets. The long-haul pipelines that historically sourced gas along the Gulf Coast for markets in the Northeast are now actually flowing in the opposite direction and are not only serving their traditional Northeast and Midwest markets but also are flowing gas south for delivery into the Gulf Coast region and competing for markets historically served by other pipelines (both interstate and intrastate), including Gulf South. The development of LNG export terminals along the Gulf Coast, which liquefy massive quantities of natural gas, has increased the incentive to build additional pipeline capacity to serve this new southern demand. While this has created new opportunities for pipelines along the Gulf Coast, it also has placed additional competitive pressures on the existing infrastructure that has historically served the Gulf Coast markets.[28]

The Commission's policies do not protect incumbent interstate pipelines from pipeline-on-pipeline competition. For example, in a recent certificate proceeding, the Commission allowed a new interstate pipeline to be constructed to serve a market currently being served by another interstate pipeline, effectively bypassing the incumbent interstate pipeline.[29] The Commission recently explained that it:

> has emphasized its disinclination to second-guess reasonable business decisions by pipelines' customers evidenced by precedent agreements, as well as binding contracts. Similarly, the Commission, in the bypass cases,

[28]Similar levels of pipeline-on-pipelines competition has occurred in the Northeast and Midwest, as new shorter-haul pipeline facilities have been constructed to transport Marcellus and Utica production from the production areas to nearby market centers.

[29] *Spire STL Pipeline LLC*, 164 FERC ¶ 61,085 (2018).

> supported competition between interstate natural gas companies and LDCs vying for industrial customers. In those cases, we allowed end-users to receive transportation service directly from interstate pipelines by bypassing the LDCs that had in the past provided local distribution service, holding that we will not shield LDCs from the effects of competitive forces in the natural gas market. The Commission expanded this principle to interstate pipelines finding that *"[t]here is no reason why pipelines should be afforded any greater protection from bypass than LDCs."* Thus, the Commission's precedent and policy is clear; in the absence of evidence of anticompetitive behavior, *it is not the role of the Commission to protect pipelines from new entrants when they offer a new opportunity for a shipper*.[30]

The Commission's pro-competition policies place the risk of increased pipeline-on-pipeline competition squarely on interstate pipelines, whether incumbent or new. Because incumbent pipelines are not shielded from competition with new entrants, the value of an incumbent pipeline's capacity may decrease if a new entrant can offer existing shippers more favorable terms, particularly when the new pipeline facilities are built to compete with the existing pipeline capacity rather than being developed solely to serve incremental load.

Even relatively new pipeline expansions are not immune from competition when other pipelines undertake subsequent (or even simultaneous) expansions into the markets served by the earlier expansions. The Commission has held that applicants for certificates to expand natural gas pipeline facilities "can recover the costs of the new facilities only from shippers who use them, and are *fully at risk for the cost of the new facilities and will bear the financial burden of any unsubscribed capacity*."[31] The newer expansion has the ability to attract shippers away from the earlier expansion project when the initial service agreements from the first expansion project expire. This has the potential to upset the future revenue

[30] *Spire* at P 122 (footnotes omitted) (emphasis added).

[31] *Certification of New Interstate Natural Gas Facilities*, Notice of Inquiry, 163 FERC ¶ 61,042 at P 17 (2018) (citing the Policy Statement) ("[a]pplicants can recover the costs of the new facilities only from shippers who use them, and are fully at risk for the cost of the new facilities and will bear the financial burden of any unsubscribed capacity.").

expectations of the pipeline that built the first expansion project and increases the cost-recovery risk related to the expansion project.

Interstate pipelines face additional risk that an expansion shipper on an at-risk facility will declare bankruptcy and reject its precedent agreement and/or firm transportation contract. Texas Gas has had two shippers on its recently approved Northern Supply Access Project declare bankruptcy and reject their contracts in that proceeding. The pipeline will be forced to re-market this turned-back capacity, but, in doing so, the pipeline will not be able to charge the new shipper the rates that supported the project if they were above the maximum applicable rate. This means that, even in the rare instances in which a pipeline is able negotiate a service agreement for a pipeline expansion that is above the maximum applicable rate, the pipeline will not be able to charge that higher rate when remarketing the expansion capacity. If market conditions have changed in the interim, the pipeline may be required to remarket the capacity at rates significantly below the maximum applicable rate. This further increases the pipeline's cost-recovery risk related to expansion capacity.

The pipeline-on-pipeline competition encouraged by Commission policy provides substantial benefits to gas consumers and pipeline shippers, but increases the business risk of interstate pipelines who are required to assume the risk for expansion costs but may be forced to discount and/or face de-contracting of the expansion capacity as a result of competition. The Commission should recognize this elevated risk when setting ROE policy for interstate pipelines.

3. Interstate Pipelines Face Competition from Intrastate and Hinshaw Pipelines.

Many interstate pipelines face additional business risk as a result of competition from intrastate pipelines and Hinshaw pipelines. In Texas and Louisiana, a number of intrastate pipelines actively compete with interstate pipelines, including Gulf South, to attract new gas supplies and/or serve end-users. The intrastate pipelines in both of these states are subject to a different regulatory scheme than interstate pipelines. The regulatory differences, including the ability of intrastate pipelines to offer bundled transportation and commodity sales services and a lighter-handed regulatory approach (especially when it comes to building new facilities), provide intrastate pipelines with a competitive advantage over Commission-regulated interstate pipelines. Pursuant to Section 311 of the NGPA and the Commission's Order No. 63, intrastate and Hinshaw pipelines also can compete with interstate pipelines for interstate transportation markets.[32] Competition from intrastate and Hinshaw pipelines increases the business risk of interstate pipelines by threatening their retention of existing customers and ability to serve new markets. Since these competitors tend to be more regional, their impact on competition needs to be taken into account in determining the ROE of interstate pipelines that directly compete in these markets, such as Gulf South.

4. Interstate Pipelines Face Competition From Their Own Customers Via the Capacity Release Market.

The Commission's capacity release policies add to the business risk of interstate pipelines. One of the hallmarks of Order No. 636 was the creation of the capacity release program in which firm transportation customers can release some or all of their firm capacity to a third party. Capacity release allows the releasing shipper to compete directly against the

[32] *See generally Revisions to Procedural Regulations Governing Transportation by Intrastate Pipelines*, Order No. 781, 144 FERC¶ 61,034 at P 2 (2013).

transportation services offered by a pipeline,[33] and puts at risk what would otherwise be incremental transportation revenues, primarily interruptible revenues, for a pipeline. Capacity release transactions can also be used as the basis for marketing services offered by third parties that a pipeline cannot compete with when selling its own capacity. Marketers and asset managers can bundle released capacity with commodity sales and offer an attractive all-inclusive package of services that pipelines cannot offer. The Commission's capacity release regulations give capacity holders the ability to release capacity on a short-term basis at rates above the pipeline's maximum applicable rate.[34] This allows releasing shippers to take advantage of short-term pricing opportunities (such as a blow-out in price differential between two pipeline locations) in a way that is not available to interstate pipelines whose rates, including interruptible rates, are capped by the maximum rate. This has put pipelines at a distinct disadvantage in the short-term market.

The competition created by the capacity release market is a prime example of an asymmetric risk placed on interstate pipelines by the Commission's pro-competitive policies. Shippers releasing short-term capacity are not subject to a price cap. Releasing shippers can reduce prices of released capacity when market conditions are unfavorable and increase prices as high as the market will bear when market conditions are favorable.[35] The rates charged by interstate pipelines in the same short-term market are capped by maximum rates, which creates an asymmetric risk for interstate pipelines. Interstate pipelines are required to

[33] *See Promotion of a More Efficient Capacity Release Market*, Order No. 712, 123 FERC ¶ 61,286 at P 41 (2008) (explaining that Order No. 637 made "capacity release more competitive with pipeline services.")

[34] Order No. 712 at PP 30-71 (removing price cap on short-term capacity releases).

[35] Releasing shippers have additional advantage when competing against the interruptible transportation services offered by the pipeline that may prevent pipelines from effectively competing even at a lower rate. Shippers can release their capacity on a firm basis, which has a higher scheduling priority than pipelines' interruptible services, and the market does not always view pipelines' interruptible services as comparable. The short-term nature of many capacity release transactions also inhibits pipelines' ability to compete given the need for shippers seeking capacity directly from the pipeline to utilize pipelines' request for service procedures.

discount rates below maximum rates in order to retain market share during unfavorable market conditions, but they do not have the same ability as releasing shippers to charge rates above maximum rates during favorable market conditions. While interstate pipelines now operate in a market that has all of the attributes of a competitive non-regulated market, their rates remain regulated as though they are a monopoly. The Commission's capacity release policies, which subject interstate pipelines to the downside of competition but do not allow pipelines to capture the upside of competition, need to be factored into a pipeline's ROE and recognized as a policy risk that electric transmission companies do not face.

5. Interstate Pipelines Face Risk as a Result of Gas-on-Gas Competition.

The increasingly competitive market for gas supplies also affects interstate pipelines' business risk. The proliferation of new gas supplies in new locations increases the risk that a pipeline originally designed to transport gas from a particular supply area will see some or all of its capacity devalued. This could occur when an interstate pipeline's customer can source gas supplies closer to the consuming markets than its historic supply area. For example, there is now less demand to move gas to northern markets from Gulf Coast supply areas due to the increase in gas supplies available in the Marcellus and Utica production areas. An interstate pipeline's maximum applicable tariff rate is no longer the principal driver in establishing the price for transportation capacity. The value of transportation capacity is set now by the difference in price between where the gas is being received (at or near production area) and where it is being delivered (*i.e.*, basis differentials). If the basis differentials between two pipeline locations do not provide shippers with a sufficient margin of profit, they will not contract for or transport gas between those points.

This type of gas-on-gas competition also places risk on relatively newly-constructed pipelines. Pipelines built or expanded to facilitate access to new supply basins and competitively priced gas supply for the benefit of consumers are often underpinned by contracts with producers that seek new takeaway capacity as the result of strong basis differentials in the current market. These expansion projects may face a substantial risk of cost recovery as the initial contract terms expire if basis differentials no longer support paying the pipeline tariff or initial contract rate. While the competitive national market for natural gas fostered by Commission policies creates significant consumer benefits, it also creates business risk for interstate pipelines that should be reflected in the Commission's ROE policy.

6. Interstate Pipelines Face Risk as a Result of Environmental Policies and Competition with Renewable Resources.

The continuing expansion of renewable resources and environmental regulation has increased the business risk of interstate pipelines. The market has experienced an increased demand for renewables, particularly for electric generation, which is the result of both increased consumer demand and federal and state policies promoting renewables.[36] Natural gas, as fuel for electric generation, facilitates the integration of renewables into the nation's electric generation portfolio by helping to ensure electric reliability, and interstate pipelines are essential conduits for transporting gas to the nation's growing fleet of gas-fired generators.[37] As use of renewables increases, there is potential over the longer term for natural gas to be displaced or face decreased usage as a fuel for electric generation. State and

[36] See U.S. Energy Information Administration, *Updated renewable portfolio standards will lead to more renewable electricity generation* (Feb. 27, 2019), available at https://www.eia.gov/todayinenergy/detail.php?id=38492.

[37] See Black & Veatch, The Role of Natural Gas in the Transition to a Lower-Carbon Economy at 3, prepared for the INGAA Foundation (May 2019), available at https://www.ingaa.org/File.aspx?id=36501.

local policies, including policies that inhibit the buildout of necessary natural gas infrastructure, have the potential to reduce demand growth for natural gas.[38] This market and regulatory uncertainty resulting from these policies places downward pressure on the long-term transportation rates a customer is willing to pay and the length of contract they are willing to enter into. Given the long-lived nature of pipeline assets, any shift of demand away from natural gas to renewable or other energy sources will put additional pressure on interstate pipelines' earnings and cost-recovery and amplifies their business risks.

7. Pipelines Face Business Risk Due to Trends in Pipeline Contracting.

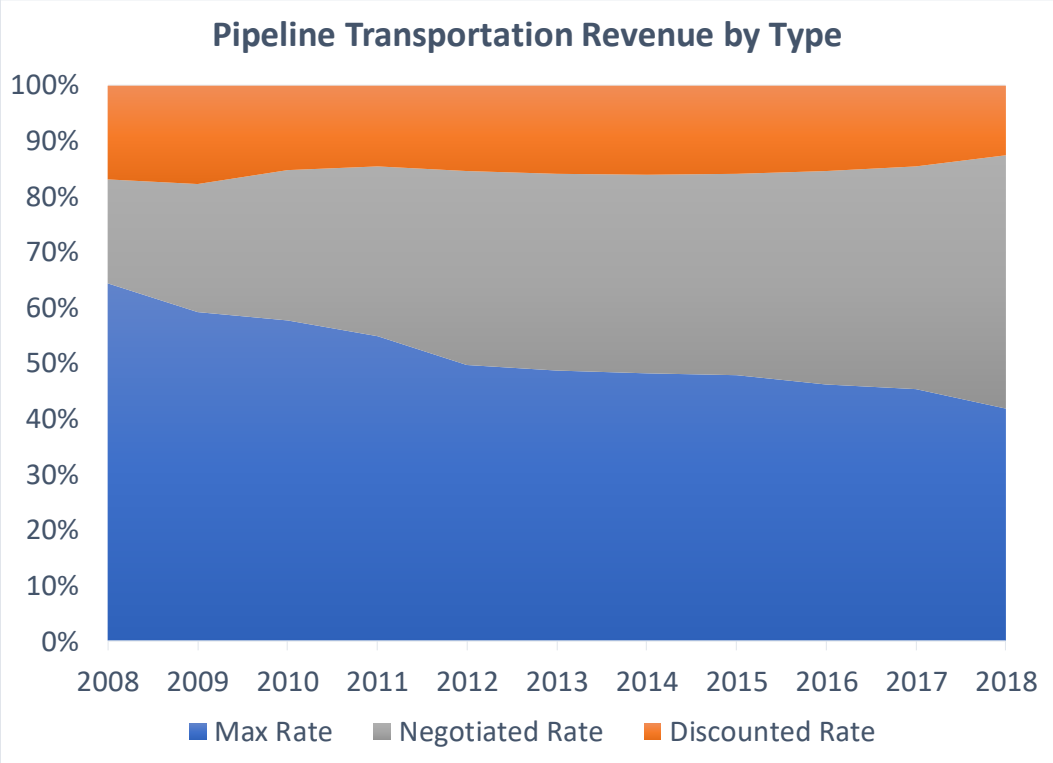
Interstate natural gas pipelines face asymmetric risk that must be considered in establishing a just and reasonable ROE. Interstate pipelines are required to offer service capped at the cost-of-service maximum applicable tariff rates that are established during a FERC rate or certificate proceeding. Interstate pipelines cannot require shippers to pay above the FERC-approved cost-based maximum applicable rate. In order to compete, pipelines are often required to offer their capacity under negotiated and discounted rates below the pipelines' maximum applicable rates. Market forces and competition often prevent interstate pipelines from actually earning a reasonable return, which creates substantial business risk for interstate pipelines.

Many interstate pipelines currently utilize negotiated and discounted rates for the majority of their transactions, and this trend is increasing. In 2008, maximum recourse rate contracts accounted for 64.4% of interstate pipelines' transportation revenue. Ten years

[38] *See, e.g.*, Crain's New York Business, *With gas pipeline nixed, National Grid stops processing hook-up requests*, available at https://www.crainsnewyork.com/energy-utilities/gas-pipeline-nixed-national-grid-stops-processing-hook-requests; Politico, *Con Edison warns of NYC gas moratorium if controversial pipeline is rejected* (Apr. 12, 2019) available at https://www.politico.com/states/new-york/albany/story/2019/04/12/con-edison-warns-of-nyc-gas-moratorium-if-controversial-pipeline-is-rejected-966290; Crain's New York Business, *Con Edison deal could end natural-gas crisis—in 2023* (Apr. 24, 2019) , available at https://www.crainsnewyork.com/energy-utilities/con-edison-deal-could-end-natural-gas-crisis-2023.

later, in 2018, the percentage of maximum recourse rate contracts has decreased to only 41.7% of revenues. For these same years, negotiated rate contracts grew to account for 45.7% of revenues, so that nearly half of all interstate pipeline transportation revenues are derived from negotiated rate customers. Discounted rates declined slightly from 16.9% in 2008 to 12.6% in 2018. In total, 58.3% of interstate pipelines' transportation revenues in 2018 were derived from negotiated rate and discounted rate customers.[39]

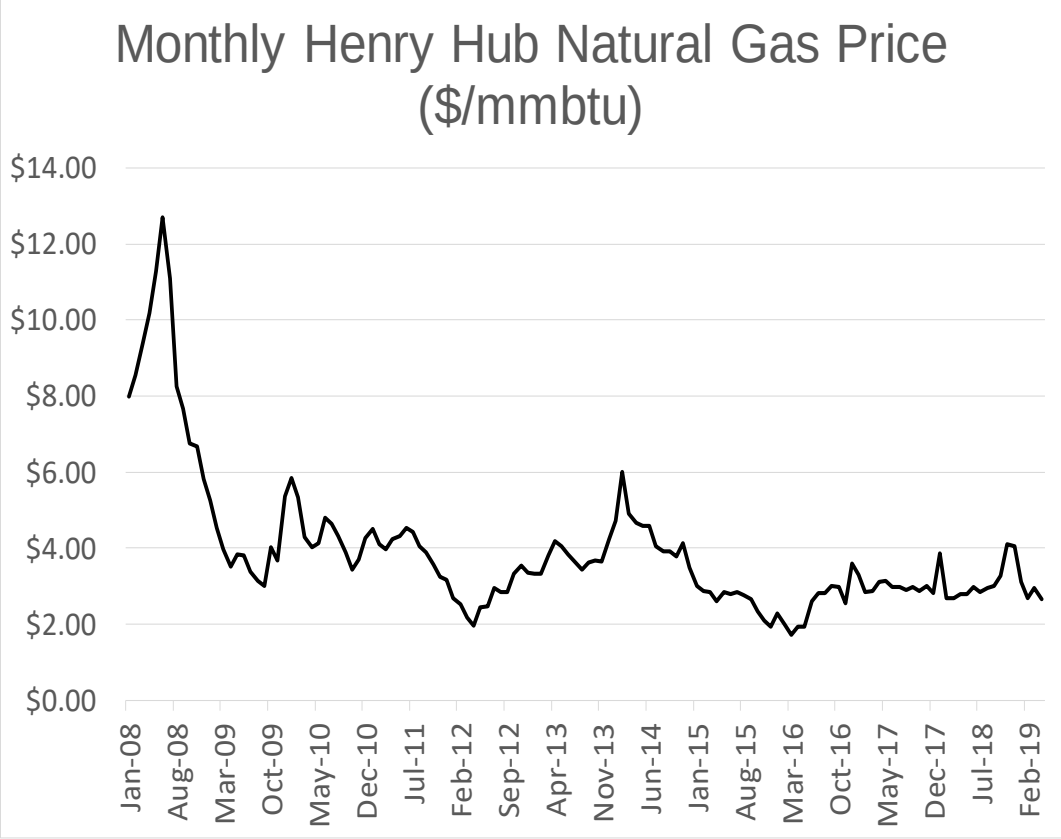
The chart below, utilizing data representing the 55 largest interstate natural gas pipeline companies, depicts the increasing reliance of the pipeline industry from 2008 to 2018 upon negotiated and discounted rate contracts.



[39] The pipeline transportation revenue considered here is derived from FERC Form 2 data 2008 to 2018, pages 300-301 at Line 10, Col. (h), and page 313, Line 2, Cols. (b) and (d). Revenue at maximum rate is calculated by taking total transportation revenue and subtracting negotiated and discounted rate revenue.

New natural gas pipelines are often built to meet the demands of supply-push customers like exploration and production companies that bid for new pipeline capacity based on expected basis differentials, or net-backs, from shale gas basins to liquid trading hubs. Basin differential pricing frequently compels pipelines to agree to fixed negotiated rates that allow producers to hedge and monetize their natural gas production. Since the start of the shale boom, producers have been the anchor shippers on many new natural gas pipelines serving growing shale gas production areas, benefitting consumers by providing them with new, abundant sources of inexpensive supply.

The price of natural gas since 2008 has remained relatively flat due to massive production increases from the shale plays with limited demand increases in the U.S. The U.S. Energy Information Administration reports that natural gas prices at the Henry Hub have remained in a fairly low range for the period 2008 to 2018 as shown below:



In this low-price environment, natural gas shippers have tremendous incentive to reduce risk and lock down their transportation costs for the duration of their contracts by insisting on a fixed negotiated rate over the life of the contract (often at less than the otherwise applicable maximum applicable rate) that will not change even if the pipeline's maximum rates are adjusted in a rate proceeding.

The risk to interstate pipelines from pricing capacity to meet competition using long-term fixed negotiated rates is reflected in the changes that have taken place since the first pipelines designed to transport gas from shale production areas were built across the Gulf Coast region beginning in the year 2007. New interstate natural gas pipeline capacity was built to connect these shale gas production areas, including the Haynesville, Woodford, Bossier Sands, and Barnett, with destination markets and with other pipeline interconnects as a source of supply for further transportation to downstream markets. These projects were supported by negotiated rate contracts that were typically below the initially-established cost-of-service maximum applicable rates. The Commission's certificate policy placed the cost burden on the pipelines for any unsubscribed capacity at the time the pipeline went into service to ensure that these costs could not later be shifted to existing shippers.[40] The depreciable life for the new pipeline assets was approved by the Commission and established a much longer lifespan than the initial contract terms.[41] The discrepancy between the

[40] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 (1999), *clarified*, 90 FERC ¶ 61,128, *further clarified*, 92 FERC ¶ 61,094 (2000) (Certificate Policy Statement).

[41] For example, the application for Southeast Supply Header (SESH) stated that SESH had entered into four precedent agreements/service agreements with two shippers (two contracts per shipper) for 700 Dth/day of its 1 Bcf/day capacity for durations of between 5 and 14 years. This works out to a weighted average contract life of 11.5 years. (See, Application For Authorization To Construct And Operate Pipeline Facilities Under The Natural Gas Act And Request For Preliminary Determination, Docket No. CP07-44-000, filed December 18, 2006, p. 9. In that application at Exhibit O, the project applicant requested a deprecation rate of 1.67% per year, reflecting a 60-year life. The Commission approved this depreciation rate in its "Preliminary

depreciation schedule and contract length creates substantial long-term risk for the project sponsors regarding the recovery of their investments in the projects.

The long-term risk to project sponsors is shown by comparing the initial contract lengths and depreciation schedules of several new interstate pipeline systems (not expansions or extensions of existing pipeline systems) that were built to transport gas from the Gulf Coast shale basins: Gulf Crossing; Southeast Supply Header, LLC; Fayetteville Express Pipeline LLC; Midcontinent Express Pipeline LLC; and ETC Tiger Pipeline, LLC. The original weighted contract lives for these pipeline projects ranged from 8.8 to 18.4 years, with an average of 11.5 years.[42] The current remaining average weighted contract life for these pipelines is now only 2.5 years, which illustrates the significant de-contracting risk faced by these pipelines. The Commission approved the initial depreciation rates for these five pipelines in a range from 1.67% (60 years) to 3% (33 years) based on the assumed useful or economic life of the assets. Assuming that, on average, these pipelines have been in service for approximately 10 years, the remaining life for these pipelines is 23 to 50 years from a depreciation recovery perspective. The difference between the depreciation schedules and contract terms creates a significant long-term risk given the low level of contractual commitment these pipelines are currently experiencing.

Interstate natural gas pipeline companies must attempt to recover the fixed investment costs of their pipeline systems over the long-term depreciable life of the asset, but competitive market forces may limit this cost recovery. For example, Bison Pipeline LLC ("Bison") was placed into service in 2011 under 10-year transportation agreements. The

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Determination on Non-Environmental Issues," issued on May 17, 2007 in Docket No. CP07-44-000, 119 FERC ¶ 61,153.

[42] For presentation purposes, the contract and depreciation life data have been combined for these five pipeline companies.

pipeline carries a 35-year depreciable life. As of last year, Bison had essentially no throughput and it is unlikely that long-term contracts will renew, leaving 25 years of remaining depreciable life at risk. Likewise, when Questar Southern Trails Pipeline Company's firm contract commitments expired, without renewals, the pipeline was forced to sell part of the asset for a fraction of its book value and abandoned the remainder of the asset outright. Significant reductions in the length of contractual commitments that shippers will agree to has substantially increased the business risk of pipelines.

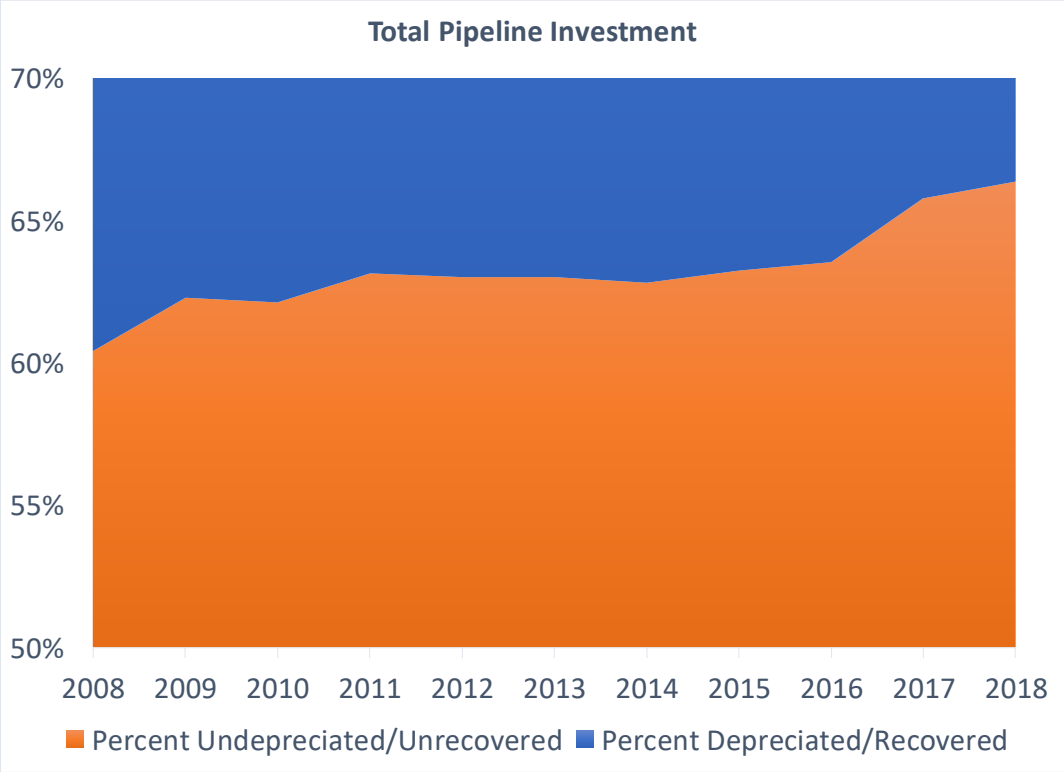
A decline in remaining contract life for a pipeline is the "canary in the coal mine," that indicates significant risk of project cost recovery. For example, the current market for transportation capacity in the offshore Gulf Coast transportation market is characterized by declining contractual commitments, unsubscribed capacity, limited prospects for future demand or growth, and declining throughput.[43] When producers and marketers recognize that a pipeline is underutilized and capacity is available every day of the year, they have little or no incentive to execute long-term firm service agreements at or near the pipelines' maximum applicable rate. Declining throughput on a pipeline informs the market that there may be an over-supply of pipeline capacity, numerous good alternatives exist, and/or significant demand displacement has occurred. Shippers will rely on daily interruptible services, often at significant discounts or discounted capacity release, instead of contracting for long-term firm service with a monthly demand charge. This is an economically logical choice under these market conditions. When a pipeline has significant unsubscribed capacity, the reliability of firm and interruptible transportation services become practically

[43] For example, both Sea Robin Pipeline Company, LLC, and High Island Offshore System LLC operate below their capacity and offer significant rate discounts due to declining demand for transportation service on their pipeline systems.

indistinguishable as interruptible transportation is almost always guaranteed to be scheduled. This scenario compounds the business risk of an underutilized pipeline because the absence of long-term, firm service agreements makes the recovery of investment increasingly problematic, and full recovery of their cost of service is virtually impossible.

The asymmetric risk faced by interstate pipelines is also demonstrated by the insufficient level of cost recovery exhibited by many pipelines. For example, in order to keep rates lower and allow the pipeline to remain competitive, pipelines often agree to reduced depreciation rates in comprehensive rate case settlements when a majority of their transportation contracts are under negotiated or discounted rates. Pipelines do this because basis differentials set the value of transportation capacity in many transportation markets, which means that a pipeline will not be able to contract for capacity at rate levels supported by higher depreciation rates except for limited instances where those rate levels are currently supported by basis differentials. By reducing depreciation rates, the pipeline seeks to defer full recovery of asset costs as well as other cost items in a pipeline's cost of service into the future when a stronger market may support higher rates. For pipelines that have deferred cost recovery to remain competitive in the near-term, it is uncertain whether markets in the future will actually support rates that are sufficiently high to provide full cost recovery.

The overall business risk to interstate pipelines is demonstrated by the chart below, which shows that the level of undepreciated/unrecovered pipeline investment has increased from 60% in 2008 to 66% in 2018 for the 55 pipelines in the study group.[44]



This chart reflects the significant new additions to the interstate pipeline network over the past decade, but also demonstrates that the interstate pipeline industry is significantly less depreciated today than it was 10 years ago. Interstate pipelines face risk due to the high percentage of under recovered investment and uncertainty regarding recovery of that investment in a highly competitive market. This risk is compounded due to the trend towards increasingly shorter contract durations. The Commission must recognize this risk when determining the appropriate ROE policy for interstate pipelines.

[44] The percentage of depreciated plant is derived from FERC Form 2 data from 2008 to 2018, page 110 at Lines 4 and 5.

8. Interstate Pipelines Face Risk Related to Delayed Completion of Expansion Projects.

Natural gas pipelines are facing an increased risk of construction delay and cost overruns due to increased litigation and state challenges to projects approved by the Commission.[45] Delays resulting from litigation have the potential to upset the economics of a project by increasing construction costs beyond reasonably foreseeable levels and potentially requiring payments to shippers for in-service delays. Denials of certain permits by states or other federal agencies have the potential to block a project altogether, despite a determination by the Commission that the project is required by the public interest.[46] Blocked projects and litigation have the potential to strand substantial capital investments, since the pipeline has typically already ordered or secured long-lead time items before the litigation began. The increase in opposition to natural gas pipeline expansions and the potential delays or inability to complete expansion projects due to this opposition have increased interstate pipelines' business risk. This risk has been recognized by the investment community and in some cases makes securing capital for expansion projects more difficult. The Commission must also consider this risk when determining the appropriate ROE when approving the certificates for interstate pipelines.

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[45] Among pipeline project that are facing or have faced substantial delays are the Atlantic Coast Pipeline, see Dominion Energy, *Dominion Energy Releases Statement Regarding Atlantic Coast Pipeline*, News Release (Feb. 26, 2019), available at https://news.dominionenergy.com/2019-02-26-Dominion-Energy-Releases-Statement-Regarding-Atlantic-Coast-Pipeline; the Mountain Valley Pipeline, *see* Reuters, *EQM says 'unlikely' to complete Mountain Valley natgas pipe in 2019* (Apr. 30, 2019), available at https://www.reuters.com/article/us-equitrans-mid-mountain-valley-natgas/eqm-says-unlikely-to-complete-mountain-valley-natgas-pipe-in-2019-idUSKCN1S61IY; and Millennium Pipeline's Valley Lateral Project, *see* Reuters, *U.S. approves startup of N.Y. Millennium Valley lateral natural gas pipe* (July 9, 2018) , available at https://www.reuters.com/article/us-usa-new-york-millennium-natgas/u-s-approves-startup-of-n-y-millennium-valley-lateral-natural-gas-pipe-idUSKBN1JZ29J.

[46] See, e.g., Constitution Pipeline, News Release, *Constitution Pipeline Challenges Decision by New York State to Block Federally Approved Pipeline* (May 16, 2016) available at https://investor.williams.com/press-release/williams/constitution-pipeline-challenges-decision-new-york-state-block-federally-appr.

9. Interstate Pipelines Face Business Risk Resulting from Regulatory Uncertainty.

Interstate pipelines face additional risk due to investor perception of increased regulatory uncertainty. The perceived stability of the regulatory environment directly affects an investor's decision regarding the return required to invest in a company in that sector. Interstate pipelines have experienced an increased level of regulatory instability over the past 18 months. For example, in 2018 the Commission issued a new policy statement that eliminated the income tax allowance for interstate pipelines owned by MLPs. The impacts of the newly-announced policy statement led to a loss of billions of dollars in the market capitalization of companies owning interstate pipelines, which highlights the risks created by regulatory instability.[47]

The Commission also initiated a process that required all interstate pipelines to file a new Form No. 501-G, established a process for customers to question a pipeline's previously Commission-approved rates, and has set the rates of 8 pipelines for investigation pursuant to Section 5 of the NGA.[48] The increased use of Section 5 investigations creates regulatory uncertainty and revenue instability. The Commission generally initiates Section 5 proceedings based only on a snapshot of a pipeline's current returns that does not consider what has happened before the snapshot was taken or what may happen in the future. This approach to Section 5 places an asymmetrical business risk on interstate pipelines because it

[47] *See, e.g.*, Comments of Boardwalk Pipeline Partners, LP, Docket No. RM18-118-000 (Apr. 25, 2018) (demonstrating $12 billion loss in market capitalization across nine companies following the Commission's actions); Request for Clarification or Rehearing and Request for Expedited Action of Dominion Energy, Inc. at 3, Docket No. PL17-1-000 (Mar. 30, 2018) (estimating that in the ten trading days following the Commission's announcement, MLPs lost nearly $30 billion in market value.)

[48] *See Stagecoach Pipeline & Storage Company LLC* 166 FERC ¶ 61,199 (2019); *Southwest Gas Storage Co.*, 166 FERC ¶ 61,117 (2019); *Panhandle Eastern Pipe Line Co., LP*, 166 FERC ¶ 61,032 (2019); *Northern Natural Gas Co.*, 166 FERC ¶ 61,033 (2019); *Bear Creek Storage Company, L.L.C.*, 166 FERC ¶ 61,034 (2019); *East Tennessee Natural Gas, LLC*, 165 FERC ¶ 61,198 (2018); *Midwestern Gas Transmission Co.*, 162 FERC ¶ 61,219 (2018); *Dominion Energy Overthrust Pipeline, LLC*, 162 FERC ¶ 61,218 (2018);

places pipelines at risk for low returns during unfavorable market conditions without allowing the pipeline an opportunity to offset that risk by capturing higher returns during favorable market conditions. Pipelines can and have experienced years of under-recovery only to be placed under Section 5 review when market conditions briefly improve. The Commission does not appear to take into account years of significant cost under-recovery before initiating a Section 5 proceeding. Given the current contracting trends and the increased level of discounting/below maximum applicable rate negotiated rates, the Commission should consider more than a twelve-month snapshot of financial results before deciding to exercise its authority under Section 5 of the NGA.[49]

The Commission also recently issued a Notice of Inquiry to review the Commission's Certificate Policy Statement governing the construction of new facilities, and that proceeding remains pending. During a recent investor conference, investors questioned Boardwalk's CEO regarding whether the Commission is looking to fundamentally change how interstate pipelines are regulated. The current lack of regulatory certainty is disquieting to investors and directly affects how they evaluate the risks of potential investments in the sector.

10. Interstate Pipelines Face Business Risk Related to the Commission's Pipeline Abandonment Policies.

Interstate pipelines face a unique risk as a result of the Commission's policies that can prohibit pipelines from abandoning service on underperforming pipeline facilities. Section 7(b) of the NGA prohibits a pipeline from abandoning facilities or service without

[49] In *Northern Natural Gas Co.*, 131 FERC ¶ 61,178 at PP 15-16 (2010), the Commission terminated a NGA section 5 proceeding after determining that the pipeline had experienced a revenue decrease such that the Commission's rate analysis used to initiate the Section 5 no longer supported the pipeline's current financial position. The Commission should conduct a similar review of a pipeline's anticipated economic circumstances prior to implementing a Section 5 investigation.

Commission authorization.[50] The Commission has denied requests by pipelines to abandon uneconomic pipeline facilities if the shippers utilizing the facilities object to the proposed abandonment, even if those shippers utilize only a small proportion of the capacity on the facilities.[51] The Commission has denied abandonment even if continued service would make it difficult for the pipeline to earn a reasonable return based on the rationale that the pipeline has the opportunity to file a rate case and allocate costs to the underutilized facilities. In *Gulf South*, the Commission rejected an abandonment application despite the pipeline's argument that the rate case option would not solve the economic issues related to the underutilized facilities. The Commission stated that "while a company has a right for an opportunity to earn a reasonable rate of return, the Commission does not guarantee that a regulated entity will earn its allowed return."[52] The Commission ultimately determined that abandonment would only be proper if the pipeline first filed to establish new rates, then determined whether "customers leave the system for less costly alternatives," and, if so, then filed "a renewed application for abandonment."[53]

The Commission's prescription may require the pipeline to continue to maintain and operate underutilized facilities for an extended period with no assurance of cost recovery. The lengthy and uncertain process that the Commission requires prior to authorizing the

[50] 15 U.S.C. § 717f(b).

[51] *See, e.g., Gulf South Pipeline Company, LP*, 145 FERC ¶ 61,236 (2013) (denying abandonment of uneconomic facilities following opposition by firm shippers). The Commission has denied abandonment applications even when the abandonment is opposed only by interruptible shippers. *See Northern Natural Gas Co*., 135 FERC ¶ 61,048, at P 4, 35 (2011) (*MOPS*) (denying abandonment despite the absence of firm contracts on the pipeline).

[52] *Gulf South* at P 126 & n.115 (explaining that the Commission's "emphasis in abandonment cases is on continuity and stability of existing services, not on establishing rates to provide a company with an opportunity to earn a reasonable return on equity," and that, "while a company has a right for an opportunity to earn a reasonable rate of return, the Commission does not guarantee that a regulated entity will earn its allowed return.").

[53] *Gulf South Pipeline Company, LP*, 154 FERC ¶ 61,219 at P 34 (2016).

abandonment of underutilized facilities increases interstate pipelines' risk of cost recovery. Pipelines face a competitive market, but the Commission nevertheless denies them the ability to meet that competition by taking timely steps to right-size their assets, which is a key tool utilized by other businesses that must respond to market forces. If the Commission is going to elevate a pipeline's obligation over its ability to right size its assets, then the Commission must increase the ROE to reflect these increased business risks to satisfy its obligations under *Hope*.

B. The Commission Should Adopt a More Flexible Approach to Its Policies to Better Reflect the Competitive Interstate Pipeline Market.

Boardwalk supports the reforms to the Commission's ROE policy included in the INGAA Comments.[54] The Commission should also consider adopting the following policies to address the business risk faced by interstate pipelines and to help ensure that pipelines have an opportunity to recover their costs and earn a reasonable return on their investments.

Under traditional ratemaking, ROE is an important component of calculating the revenue requirement that is recovered through pipeline rates. The ROE is calculated based on one or more formulas that are theoretically designed to reflect the return an investor would expect to earn from investing in the stock of the pipeline under consideration.[55] Since the ROE is determined either when a pipeline is first placed into service or during a subsequent Section 4 or 5 rate case, the ROE reflects only the conditions at the time it was established. The rates (and underlying ROEs) for Boardwalk's interstate pipelines tend to stay in place for long-periods of time because the competitive markets in which they operate prevents the pipelines from charging rates that are anything close to the current maximum

[54] *See* INGAA Comments.
[55] *See generally Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at P 48 (2008) ("Proxy Group Policy Statement").

applicable rates. For example, Gulf South and Gulf Crossing Form 501-Gs both reflected an ROE below 7%. Under these competitive circumstances, the market, not the Commission, sets the rates that a pipeline is able to charge. The filing of a new rate case may result in an increase in the maximum applicable rates that the pipeline may theoretically charge, but a rate case will not increase the rates the pipeline can actually charge and will not necessarily cure the pipeline's under-recovery.

The Commission should avoid adopting a mechanical approach to determining ROEs for interstate natural gas pipelines that does not address the competitive interstate pipeline market. The Commission's ROE policy should address the business risk that many pipelines face as a result of the "at-risk" condition that the Commission places on many pipeline expansion projects, which puts the pipeline at risk for any under-recoveries of its costs to build the new infrastructure. Despite placing the pipeline at risk, the Commission utilizes the same ROE model as would be used for facilities without any at-risk condition. For some expansion projects, the at-risk condition may apply for the entire life of the asset. This places the pipeline at significant risk of under-recovery, particularly in cases in which the contracts supporting an expansion project provide for fixed negotiated rates that are lower than the calculated cost-based maximum applicable rate and likely last for a term of only ten to twenty years in a best-case scenario. Even under the best-case scenario, the pipeline is left with millions of dollars of investment at risk without any potential for recovery and has no ability to make up for past under-recoveries by charging rates above the maximum applicable rates in the future. The traditional ratemaking model and derivation of ROE does not work for at-risk facilities.

The Commission should address the heightened business risk associated with at-risk facilities. The Commission should either (i) utilize a higher ROE in the development of a maximum applicable rate for at-risk pipelines that recognizes the present and future cost-recovery risk related to the project or, (ii) remove the maximum applicable rate cap for at-risk pipelines. Both of these alternatives would provide a pipeline a more reasonable opportunity to recover its cost-of-service. The higher ROE would allow the pipeline the opportunity to charge higher rates in the future after the initial negotiated rate agreements supporting the project have rolled off. The removal of the rate cap on these facilities would be entirely consistent with the at-risk condition and would recognize that there are no captive customers that need to be protected. Both of these approaches help reduce the asymmetric risk created by the Commission's existing rate treatment for at-risk facilities.

The Commission should also take steps to address its policies regarding the pricing of expansion facilities. The Commission's recent certificate orders have distinguished two categories of incrementally-priced facilities: (i) "incremental-plus" pricing, under which all shippers pay an additional charge to access expansion facilities, and (ii) "incremental" pricing, under which only the expansion shippers are subject to an additional charges that reflects the costs of the expansion facilities to access the new facilities, while all other shippers gain access to the expansion facilities at no extra charge.[56] This distinction creates an un-level playing field between existing and expansion shippers because existing shippers are permitted to access the expansion facilities on a secondary firm or interruptible basis by paying their (lower) existing rate while expansions shippers pay the higher incremental

[56] *See, e.g., Gulf South Pipeline Co. LP*, 163 FERC ¶ 61,124 at PP 21-22 & n.16 (2018) (making distinction between "incremental" and "incremental plus" pricing for an expansion facility).

rate.[57] This distinction also inhibits the pipeline's ability to recover its investment in the expansion project because existing shippers are able to use the expansion facilities without paying a rate that contributes to the recovery of expansion costs. The Commission should amend its pricing of expansion facilities to ensure that all shippers using expansion facilities pay a rate that helps recover the expansion costs.

The Commission should focus on a pipeline's realized ROE rather than the authorized ROE. The Commission's ROE policies generally presume that a pipeline is able to charge its maximum applicable rate and earn its authorized ROE. The authorized ROE is merely the theoretical maximum amount a pipeline might earn if it is able to sell the capacity that its rates were designed on, at its maximum applicable rates. The Commission's focus on the authorized ROE during the ratemaking process does not account for the reality that many pipelines are earning far below their authorized ROEs. If an interstate pipeline under-recovers its authorized ROE due to competitive market forces, the pipeline is forced to shoulder that under-recovery. If a pipeline exceeds the authorized ROE, even on a short-term basis, it risks having its rates reduced pursuant to NGA Section 5 even if the pipeline has experienced years of significant under-recovery. The Commission's focus on the authorized ROE has the tendency to cause pipelines in competitive markets to have realized ROEs that are significantly below their authorized ROEs. The Commission should place an increased focus on realized ROEs during the ratemaking process. This focus would allow the Commission to set rates with a better understanding of the pipeline's ability to actually recover its costs and earn a reasonable return. Utilizing this approach under both Sections 4

[57] *See Gulf South* at PP 22, 26 (rejecting proposed rate treatment for expansion facilities built to serve a new market and holding that secondary firm and interruptible shippers must be allowed to access the expansion facilities (and the new market) without paying a rate that includes the cost of the expansion facilities).

and 5 of the NGA should result in a more individualized ROE that reflects the true nature of the risks faced by a pipeline as contemplated by *Hope*, instead of a ROE that is the result of a mechanical application of a formula.

C. The Commission Should Expand the Scope of Its Review Before Initiating a Section 5 Investigation.

The Commission typically initiates Section 5 investigations based on a snapshot of a pipeline's current realized ROE. This snapshot generally does not consider the actual ROE that was realized or will be realized by the pipeline during the periods before and after the snapshot was taken. Pipelines that have experienced years of under-recovery are at risk of facing a Section 5 review as soon as market conditions improve. The Commission does not appear to take into account the years of significant cost under-recovery before initiating a Section 5 proceeding. The Commission's policy creates asymmetric risk for interstate pipelines by allowing them to undergo years of under-recovery in the face of bad market conditions but capping offsetting over-recovery by initiating Section 5 investigations once market conditions improve.

The Commission should delay implementing a Section 5 proceeding in circumstances in which current over-recoveries are balancing out past under-recoveries. Over the past couple of years the natural gas commodity market has been backwardated (*i.e.*, the current spot price of gas has been higher than the future price of gas trading in the futures market). The backwardated market conditions have diminished the value of storage and park-and-loan ("PAL") services because it has been more valuable for customers to deliver gas now than to store it and deliver it in the future. This has driven down the rates that customers are willing to pay for storage and PAL services, and many pipelines have been under-recovering their revenue requirements associated with these services. The natural gas commodity market has

recently become a contango market (*i.e.*, the futures prices for gas are trading higher than the spot prices), which tends to increase the value of storage and PAL capacity and allow pipelines to charge higher rates. If the Commission only looks at a snapshot of a pipeline's cost recovery during the current contango market, the financial result may appear to show that a pipeline is adequately or even over-recovering its costs during this time. The Commission should ensure that it understands the dynamic nature of this market and the need to balance over- and under-recoveries before initiating Section 5 investigations.

The Commission similarly does not appear to account for anticipated future under-recoveries before initiating a Section 5 investigation. For example, in *Northern Natural Gas Company,*[58] the Commission initiated a Section 5 rate proceeding against the pipeline after finding that the snapshot cost and revenue data reported in the pipeline's Year 2008 Form 2 indicated that the pipeline might be substantially over-recovering its cost of service at an ROE of approximately 24.36%. Six months into that proceeding certain of Northern's customers filed to terminate the Section 5 proceeding because the pipeline indicated that, if the Section 5 proceeding continued, it would be forced to file a Section 4 rate proceeding to increase its rates. Information gained through discovery (which covered a broader period of time than the Form 2 relied upon by the Commission in establishing its Section 5 proceeding) demonstrated that the pipeline's Field Area revenues had dropped by over 70 percent during the second half of 2009, the pipeline's operations had negatively changed, and the Commission's 2008 analysis did not reflect the pipeline's current position. Northern's response to the Section 5 action was not a reduction in its maximum applicable rates, but a Section 4 filing which would ultimately increase the customers rates by more than 30

[58] *Northern Natural Gas Company,* 131 FERC ¶ 61,178 (2010) ("*Northern"*).

percent. The Commission ultimately terminated the Section 5 proceeding, but not before significant litigation costs were incurred by the parties to that proceeding. The Commission could avoid the unnecessary initiation of Section 5 proceedings in the future by taking steps to project future recovery scenarios rather than relying solely upon a snapshot of a pipeline's current financial circumstances.

D. The Commission's ROE Policies Should Support a Pipeline's Ability to Attract Capital, Acknowledging that ROE is Only One of Several Financial Metrics Used to Assess Financial Health.

While ROE is important in establishing the Commission authorized revenue requirement for interstate pipelines, ROE is not the primary metric utilized by interstate pipelines to manage their day-to-day operations and to ensure financial health. Interstate pipelines rely on Earnings Before Interest, Tax, Depreciation, and Amortization ("EBITDA"), cash flow (including Distributable Cash Flow), leverage statistics, and other metrics to manage their business. These are the same metrics utilized by the unregulated business with which interstate pipelines compete for capital in the broader marketplace. When ratings agencies are evaluating the creditworthiness of a pipeline, these are the metrics they utilize, not a pipeline's regulated ROE. As INGAA's Comments explain, these metrics limit the amount of debt financing that a pipeline may undertake for the pipeline to maintain its creditworthiness, and result in pipelines relying more heavily on equity financing than they have in the past.[59]

Boardwalk supports INGAA's Comments stating that the Commission's ROE policies should recognize the financial constraints faced by interstate pipelines in attracting

[59] *See* INGAA Comments.

the capital necessary to maintain and expand their systems.[60] *Hope* requires that the Commission set ROE at a level "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[61] The Commission's policies should facilitate pipelines' ability to achieve and maintain an investment grade credit rating, which will typically require the pipelines to adopt a capital structure that is "thicker" in equity than in debt. The Commission's policies should not place unnecessary obstacles in the pipeline's management of its credit rating, and should encourage pipelines to use internally-generated capital when that is the most efficient source of funding.

This is particularly important for an entity like Boardwalk, whose parent Loews is a diversified conglomerate operating a number of different regulated and unregulated businesses in the insurance, energy, hospitality, and packaging industries. Boardwalk must compete with these companies for capital funding from Loews. Each business's capital needs, including Boardwalk's, are evaluated based on the metrics described above in addition to the metrics that currently determine the ROE. The Commission's policies should recognize the importance of these metrics, and support the pipelines' ability to attract capital that is funded both externally and internally.

[60] *See* INGAA Comments.
[61] *Hope*, 320 U.S. at 603.

CONCLUSION

The Commission should avoid adopting a one-size-fits-all approach to ROE policy that does not account for the specific risks faced by interstate pipelines. The Commission should further adopt the policies proposed in the instant Boardwalk comments in addition to the INGAA Comments.

Respectfully submitted,

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Document Content(s)