

Blue Ridge Environmental Defense League

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June 26, 2019

Federal Energy Regulatory Commission
Secretary of the Commission
888 First Street NE
Washington, DC 20426

Filed electronically via www.ferc.gov

RE: Docket No. PL19-4-000

On behalf of the Blue Ridge Environmental Defense League, I write to provide comments as requested by the Federal Energy Regulatory Commission in this docket. BREDL is a non-profit environmental education organization with members and projects in six southeastern states. For thirty-five years we have focused on energy issues as they are related to public health, environmental protection and community welfare.

Background

“Return on equity” (ROE) is the net income returned by a firm to its owners or stockholders during a specified accounting period. ROE is a measure of the profitability of the firm. ROE is a ratio calculated by dividing the net profit by the weighted average of equity.

Following the decision of the U.S. Court of Appeals for the District of Columbia Circuit in *Emera Maine v. Federal Energy Regulatory Commission*, the Commission seeks information and stakeholder views to help the Commission 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. The Commission also seeks comment on whether any changes to its policies concerning public utility ROEs should be applied to interstate natural gas and oil pipelines. *See* Federal Register, Vol. 84, No. 60, March 28, 2019, pp.11769-11777.

Comments

Topic (A) Role and Objectives of the Commission’s Base ROE Policy

¶31. *The Commission seeks comment on the role of base ROE in investment decision-making and what objectives should guide the Commission’s approach to base ROE policy apart from the basic Hope/Bluefield standard.*

Sound policy generally should avoid causing harm. Mounting evidence suggests return on equity (ROE) rates in the pipeline industry are problematically high, distorting the energy market. That is, artificially high incentives in pipeline development caused excess pipelines to be built that would not have been under true free-market conditions. FERC must make evaluating the possibility that current pipeline ROE rates are too high a critical objective of its ratemaking review, or else risk exacerbating a problem by affecting changes that might produce even higher rates. Moreover, the very need for additional pipelines is increasingly in question, and before proceeding to evaluating how best to finance additional pipelines, FERC must first address that question.

The FERC has consistently set a 14% ROE for pipeline projects financed by up to 75% debt and no more than 50% equity since the 1997 *Alliance Pipeline* decision. This rate is significantly higher than the roughly 8-10% prevailing ROE, including those rates FERC typically sets for utilities in the power plant and electric transmission sectors. See NJ Rate Counsel comments on PennEast Pipeline, Sept. 2016. This distorted incentive would predict an excessive number of pipeline projects will be pursued than are actually justified. Indeed, pipelines proposals have spiked in recent years, despite lacking evidence for their demand. Precedent agreements between pipeline owners and shippers reserving capacity on the proposed pipelines constitute a questionable showing of market demand when the shippers are utilities affiliated with the pipeline owner and thus stand to benefit from the pipeline. Sure enough, many of these pipelines have not increased total energy supply or supplied cheaper energy, as promised, but instead diverted gas from that previously supplied by existing pipelines and raised consumers' rates.

On top of this evidence that there already exists a glut of natural gas pipelines; trends in energy demand and renewable energies all but guarantee pipelines' economic value will decline moving forward. Advances in efficiency have been lowering per capita energy consumption for decades, and in 2017 the Sustainable Energy in America Factbook stated, "The US has truly 'decoupled' economic growth from energy demand: since 2007, US GDP is up 12% while overall energy consumption has fallen by 3.6%." (SEA 2017 Factbook, 3). The BNEF's 2017 New Energy Outlook (NEO) projected electricity demand growing at just 0.25% through 2040 (ibid). Moreover, renewable energy sources are increasingly cost-competitive with fossil fuels. Increasing reliance on renewables (which generally have no zero fuel costs at time of dispatch and so are dispatched before gas-fired plants) has lowered the statewide capacity factor of natural gas pipelines in California to barely 20% in 2017, and capacity is falling national, too (Jonathan Nelson, "Calif. capacity factors may indicate retirement risk," *Platts Gas Daily*, Volume 33, Issue 228). The NEO estimates unsubsidized utility-scale wind and solar energy systems will be cost-competitive with new natural gas nationwide by 2023 (Lorne-Stockman 38).

In sum, pipelines are presently returning above-market profits, their alleged Necessity is in question, and market trends all but assure their viability will only diminish with time. FERC must acknowledge these concerns. Reconsidering the very presumption that additional pipeline infrastructure is needed, especially given the growing viability of renewable energy, must be a central objective of FERC's review process. Outgoing FERC-Chairman Bay emphasized the danger of relying on Precedent Agreements and the importance of more strenuously assessing the actual need for pipelines in his farewell speech (Lorne-Stockman 16).

A4. Should the ROE reflect the cost of capital at the time of the investment or be subject to adjustment to reflect the contemporary ROE required by investors?

ROE must be subject to adjustment. Economic factors affecting how much annual revenue utilities need to generate and how much interest they need to offer their investors in order to secure financing change over time. Automatically, the optimal "just" rate that perfectly balances consumer- and investor-interests also changes. If the ideal rate can be expected to change over time, rates should be regularly reevaluated. Obviously, a 14% ROE, while normal in 1997, is above-market today. Rates must be adapted to changing circumstances.

B. ROEs for Different Commission-Regulated Industries

¶32. *The Commission seeks comment on whether to apply a single ROE policy across electric, interstate natural gas and oil pipeline industries.*

B1. In Opinion No. 531, the Commission found that the same DCF methodology should be used to determine an ROE for all its regulated industries, including public utilities, as well as gas and oil pipelines. If the Commission departs from our sole use of a two-step DCF methodology for public utilities, should the new method or methods also be used to determine natural gas and oil pipeline ROEs?

Perhaps but not necessarily, and probably not. While the pipeline and utility industries overlap, they are different industries, with differing investment risk, profitability and basic dynamics. As such, while it is reasonable to expect some regulatory policies appropriate for one industry would also benefit the other, it is unreasonable to make that possibility of compatibility the default presumption. In this NOI, FERC poses two questions: 1) should ratemaking policies for utilities be changed, and 2) should such changes be applied to pipelines as well. These questions are disjointed. Finding changes are justified for utilities does not constitute a presumption they are also justified for pipelines. Separate reviews are obviously needed. Simplicity is the enemy of fairness.

*B4. What, if any, differences between public utilities on the one hand and natural gas and oil pipelines on the other would justify using different methodologies to determine their ROEs?*⁵⁹

The average investment returns differ between pipeline and utility sectors. The 14% ROE commonly bestowed on pipelines is roughly 40% higher than the rates utilities in power plant and electric transmission sectors typically receive. Utility sector profits have fallen in recent years while pipelines remain reliably lucrative.

In practical terms, there is a clear on-the-ground need for upgraded transmission lines. Electric utilities commonly contend with regional bottlenecks that disrupt productivity. Natural gas demand is broadly distributed, not regionally concentrated, which reduces capacity constraints, and does not experience supply shortfalls.

Also, as noted in B2 and B3, applying the methodology proposed for utilities in Opinion 531 is problematic for several reasons. Because pipeline industry settlements are typically “black box” there is no available record of historical ROE settlements from which to develop the proposed Risk Premium study. Likewise, the Expected Earnings methodology may be inapplicable to pipelines due to insufficient number of companies to form a proxy group.

Conclusion

FERC’s mission is to assist consumers to obtain economical, safe, reliable, and secure energy services at a reasonable cost. But artificially high incentives in pipeline development are causing excessive pipeline construction and needless community devastation. Within the next four years, utility-scale wind and solar energy systems will be cost-competitive with new natural gas. For the reasons detailed in these comments, FERC should take its thumb off the scale and end artificially high returns on natural gas pipeline investment.

Respectfully submitted,

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