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 PUBLIC INTEREST ORGANIZATIONS

The undersigned commend the Federal Energy Regulatory Commission (FERC or Commission) for opening a Notice of Inquiry (NOI) proceeding on whether and how to revise its rate of return on equity (ROE) policy regarding rates charged by FERC-jurisdictional entities, including interstate gas pipelines.[1] The NOI spans several questions, mostly on the technical aspects of ROE methodology, and also invites comments on "any related matters or alternative proposals that commenters may wish to discuss."[2]

As discussed further below, FERC's practice of routinely granting an excessive 14 percent ROE for new gas pipelines is a key driver among a combination of related Commission policies that are incentivizing the overbuild of gas infrastructure. Of particular concern is the context in which the pipeline developer and its shipper customer are affiliates that both have a financial stake in the pipeline, and the affiliated customer is also a monopoly utility entity that will pass high pipeline costs onto its captive ratepayers. These comments focus on the implications of FERC's 14 percent ROE policy in this particular context, consistent with comments filed[3] in a related Notice of Inquiry

[1] *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, Notice of Inquiry, 166 FERC ¶ 61,207 (2019), Docket No. PL19-4-000.

[2] *Id.* at P 39.

[3] *See, e.g.,* "Comments of Public Interest Organizations" (July 25, 2018), FERC Docket No. PL18-1-000; and "Supplemental Comments of Natural Resources Defense Council, et al." (October 26, 2018), FERC Docket No. PL18-1-000.

proceeding involving FERC's revisiting of its gas pipeline certification policy.[4] Incentivizing the overbuilding of gas pipelines poses significant economic and environmental risks. Thus, we urge the Commission to reform its regulatory approach to new pipelines, including its policy of continually approving a 14 percent ROE as part of the overall rate for new gas pipelines, consistent with FERC's duty under the Natural Gas Act to protect the public interest.[5]

I. 14 percent ROE is excessive in relation to other capital-intensive regulated projects

The Commission's allowance of a 14 percent ROE for gas pipeline investments is a much higher profit margin than regulated utilities receive for other capital-intensive investments such as electric transmission—up to 40 percent higher, according to one report.[6] State public service commissions on average have granted utilities a 9.92 percent ROE in recent years.[7] A review by the Edison Electric Institute shows that the average ROE granted to utilities in 56 new rate cases filed in 2017 was approximately 9.7 percent.[8] Financial markets have changed since FERC began granting the 14 percent ROE to new pipelines over two decades ago,[9] including declining corporate bond rates

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[4] *Certification of New Interstate Natural Gas Pipeline Facilities*, Notice of Inquiry, 163 FERC ¶ 61,042 (2018), Docket No. PL18-1-000.

[5] 15 U.S.C. § 717f (2012).

[6] *Art of the Self-Deal: How Regulatory Failure Lets Gas Pipeline Companies Fabricate Need and Fleece Ratepayers* at 6, OIL CHANGE INTERNATIONAL (Sept. 2017) ("Art of the Self Deal").

[7] Cathy Kunkel & Tom Sanzillo, *Risks Associated with Natural Gas Pipeline Expansion in Appalachia: Proposed Atlantic Coast and Mountain Valley Pipelines Need Greater Scrutiny* at 8, INST. FOR ENERGY ECON. & FIN. ANALYSIS (Apr. 2016), http://ieefa.org/wp-content/uploads/2016/04/Risks-Associated-With-Natural-Gas-Pipeline-Expansion-in-Appalachia-_April-2016.pdf ("IEEFA Report").

[8] *2017 Financial Review* at 23, 27, EDISON ELECTRIC INSTITUTE (2018) (showing utility ROEs at a 30-year low), https://www.eei.org/resourcesandmedia/industrydataanalysis/industryfinancialanalysis/finreview/Documents/FinancialReview_2017.pdf.

[9] Dr. Steve Isser, *Natural Gas Pipeline Certification and Ratemaking* at 23 (Oct. 19, 2016), https://rethinkenergynj.org/wp-content/uploads/2016/10/ISSER_REPORT_CV.pdf ("Isser Report").

and lower interest rates.[10] "The decline in corporate bond rates suggests that 14% is too high a return even for highly leveraged greenfield projects, much less conservatively financed projects backed by regulated affiliated customers with captive ratepayers."[11]

II. Profit-driven pipeline affiliate deals place captive ratepayers at risk

The 14 percent ROE is fueling pipeline projects where utility holding companies serve as both the pipeline developer and pipeline customer, in questionable self-dealing affiliate arrangements. FERC routinely approves projects solely based on the existence of precedent agreements—contracts between pipeline developers and prospective shipper customers—a problematic practice in itself given that many other relevant factors should also be considered in judging whether a pipeline is actually needed.[12] When the pipeline developer is essentially contracting with itself, the actual market need for the pipeline is questionable at best. And when the affiliate customer is a monopoly utility, captive ratepayers may end up paying for the high costs of these capital-intensive and long-lived pipeline assets via their utility bills for decades to come.

III. Traditional utilities are lured by lucrative pipeline profits

Gas pipeline projects are very attractive to utility holding company systems with utilities operating under the traditional monopoly utility business model where a utility's realized revenue is dependent on the level of electricity sales. The utility has a strong incentive to preserve or increase sales volumes to increase profits. In recent years, flattening and declining electricity demand—due to structural changes in the economy,

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[10] David Trainer, *The Fed is Irrelevant: Low Interest Rates are the New Normal*, FORBES (Feb. 1, 2019), https://www.forbes.com/sites/greatspeculations/2019/02/01/the-fed-is-irrelevant-low-interest-rates-are-the-new-normal/#1775410276ae.

[11] Isser Report at 23.

[12] *See, e.g.,* "Comments of Public Interest Organizations" (July 25, 2018), FERC Docket No. PL18-1-000; and "Supplemental Comments of Natural Resources Defense Council, et al." (October 26, 2018), FERC Docket No. PL18-1-000.

improved efficiency, and new customer-side distributed energy technologies[13]—has put pressure on utilities to seek new sources of investment to grow their rate base and revenue requirements to provide greater shareholder wealth.[14] The high cost of new gas pipeline construction, which includes the unduly high 14 percent ROE, fits this bill, along with associated new gas generation. This utility investment strategy has also emerged in an environment where various pipelines appear to have earned higher rates than authorized. A Natural Gas Supply Association survey examined the ROE from 2009-2013 of 32 major pipelines, finding that most earned an ROE exceeding 12 percent, and two companies earned ROEs exceeding 24 percent.[15]

IV. A 14 percent ROE overstates utility pipeline investor risk

In authorizing a 14 percent ROE for utility holding company pipeline developers, FERC emphasizes that the companies are "new entrants" in the pipeline business that face greater market risks than do established pipeline companies. "Because new entrants building greenfield natural gas pipelines do not have an existing revenue base, they face greater risks constructing a new pipeline system and servicing new routes than established pipeline companies do when adding incremental capacity to their systems," according to FERC.[16] However, the Commission over-estimates the purported risk

[13] Robert Rapier, *New Sources of Revenue: What Will Generate Growth for Utilities?*, GENERAL ELECTRIC (Jan. 31, 2017), https://www.ge.com/power/transform/article.transform.articles.2017.jan.new-sources-of-revenue-what-wi#; *see also* David Roberts, *After rising for 100 years, electricity demand is flat. Utilities are freaking out*, VOX (Feb. 27, 2018), https://www.vox.com/energy-and-environment/2018/2/27/17052488/electricity-demand-utilities).

[14] Robert Rapier, *New Sources of Revenue: What Will Generate Growth for Utilities?*, https://www.ge.com/power/transform/article.transform.articles.2017.jan.new-sources-of-revenue-what-wi#.

[15] IEEFA Report at 9.

[16] *See*, *e.g.*, *Atlantic Coast Pipeline*, 161 FERC ¶ 61,042 at P 102 (2017), *order on reh'g*, 164 FERC ¶ 61,100 (2018); *see also Mountain Valley Pipeline*, 161 FERC ¶ 61,043 (2017) at P 82, *order on reh'g*, 163 FERC ¶ 61,197 (2018) (2018).

associated with these "new entrants." Many of these developers are among the world's largest utility holding companies with billions of dollars in assets and revenues, and with more resources than established pipeline owners.

Several utility holding company systems that also operate as pipeline developers serve as examples.[17] Duke Energy is one of the largest utilities in the U.S. It has over $133 billion in total assets, operates local distribution companies and has 32,900 miles of gas transmission and distribution pipelines. NextEra, also a large company, has ownership interests and development experience in numerous interstate gas pipelines, including Sabal Trail, Mountain Valley Pipeline, and Florida Southeast. Dominion Energy operates one of the country's largest gas storage systems, serving customers in 14 states, and has 15,000 miles of gas pipeline. Other Dominion subsidiaries include gas transmission and gas distribution companies in several states. Southern Company has local gas distribution companies and gas transmission pipelines in several states, and serves about nine million customers. These are well-capitalized, highly experienced energy companies that often have significant experience with various types of gas enterprises. Each of the utility holding companies has more assets and profits than does Williams Companies, the owner and operator of the Transcontinental Pipeline Company (Transco), one of the largest and oldest gas transmission pipeline networks in the nation.[18] These companies are by no means neophytes in the energy business and indicating that they "do not have an existing revenue base" for their pipeline projects

[17] The World's Top 10 Utility Companies, Investopedia, https://www.investopedia.com/articles/investing/022516/worlds-top-10-utility-companies.asp.

[18] *See* Williams Companies financials at https://www.nasdaq.com/symbol/wmb/financials?query=income-statement.

does not reflect the complete context of these holding company systems and their vast resources.

In addition, when utility holding companies' own utility subsidiaries subscribe to a majority of the pipeline project's reserved capacity as shipper customers, which is often the case,[19] the risks are reduced further still, as the utilities will pass through the costs of the pipeline to their captive ratepayers. The Commission assigns these "new entrants" a much higher risk factor than truly exists. The 14 percent ROE the companies routinely receive is unwarranted.

V. Pipeline investments are at risk of becoming stranded assets

Despite the fact that many gas pipelines will become stranded assets well before the end of their useful life, FERC continues to approve virtually every proposed pipeline and allow investors to recover hefty profits. FERC has approved approximately 470 pipeline projects over the past two decades, rejecting only two.[20] The stranded asset risk is significant given the long-lived nature of gas pipelines, coupled with uncertainty regarding future energy demand and climate policy and increased use of cleaner energy resources. New pipeline development is being incentivized at a time when the risk of stranded assets, due to uncertainties around future technology and fuel prices, energy demand, and environmental policies, should urge regulatory caution.

Evidence increasingly shows that the mismatch between the 40-to-50-year lifespan[21] of pipeline projects with the declining prospect of their long-term usefulness

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[19] For instance, utility affiliates of two of the owners of the Sabal Trail pipeline reserved 93 percent of the pipeline's capacity. *Florida Southeast Connection*, 154 FERC ¶ 61,080 at P 81 (2016).

[20] *See* Approved Major Pipeline Projects (2009-present), FERC, https://www.ferc.gov/industries/gas/indus-act/pipelines/approved-projects.asp.

[21] *The Interstate Natural Gas Transmission System: Scale, Physical Complexity and Business Model* at 1, INGAA (2010), http://www.ingaa.org/file.aspx?id=10751.

cannot be ignored. Shipper customers, including the pipeline affiliates contracting with the pipeline developer, typically enter into 20-year gas transportation contracts that incorporate the main provisions of the precedent agreement including the length of the contract. There is no guarantee the transportation contracts will be renewed at the end of their term. Moreover, the pipeline assets that are the subject of the contract might become economically stranded prior to the contract's end, given current trends.

A Rocky Mountain Institute (RMI) analysis demonstrates that the "'rush to gas'" will burden both ratepayers and shareholders with billions of dollars in stranded gas assets.[22] RMI's study revealed that the growing use of clean energy resources threatens to erode gas-fired plant revenue within 10 years.[23] As the cost of new renewable resources continues to plummet, new and even existing gas plants may not be able to compete. According to RMI:

> the $112 billion of gas-fired power plants currently proposed or under construction, along with $32 billion of proposed gas pipelines to serve these power plants, are already at risk of becoming stranded assets. This has significant implications for investors in gas projects (both

[22] Mark Dyson, Alexander Engel, & Jamil Farbes, *The Economics of Clean Energy Portfolios: How Renewable and Distributed Energy Resources are Outcompeting and Can Strand Investment in Natural Gas-Fired Generation* at 5, RMI (May 2018), https://www.rmi.org/wp-content/uploads/2018/05/RMI_Executive_Summary_Economics_of_Clean_Energy_Portfolios.pdf ("RMI Report"); Jeff McMahon, *The 'Rush to Gas' Will Strand Billions As Renewables Get Cheaper, Study Says*, FORBES (May 21, 2018), https://www.forbes.com/sites/jeffmcmahon/2018/05/21/the-rush-to-gas-will-cost-billions-in-stranded-assets-as-renewables-get-cheaper-institute-says/#462687c33a0d; see also David Roberts, *Clean energy is catching up to natural gas*, VOX (July 13, 2018), https://www.vox.com/energy-and-environment/2018/7/13/17551878/natural-gas-markets-renewable-energy; Danny Kennedy, *The end of natural gas is near*, GREEN BIZ (Jan. 22, 2018), https://www.greenbiz.com/article/end-natural-gas-near (indicators include two of the world's leading gas plant turbine makers, GE and Siemens, beginning to exit the turbine-making business due to falling sales including the rise of competing large-scale energy storage).

[23] RMI Report at 9; see also Alan Larsen, *GenOn Energy to Retire Three California Gas Plants*, POWER MAGAZINE (Mar. 15, 2018), http://www.powermag.com/genon-energy-to-retire-three-california-gas-plants/. ("In a move that demonstrates how difficult current market conditions are, even for some gas-fired facilities, GenOn Energy—a subsidiary of NRG Energy—said it will shutter three California gas-fired power plants for economic reasons."); Herman K. Trabish, *As gas plants struggle, California seeks new flexible capacity strategies*," UTILITY DIVE (June 27, 2017), https://www.utilitydive.com/news/as-gas-plants-struggle-california-seeks-new-flexible-capacity-strategies/445760/. Alwyn Scott, "General Electric to scrap California power plant 20 years early," REUTERS (June 21, 2019), https://finance.yahoo.com/news/general-electric-scrap-california-power-204042157.html.

> utilities and independent power producers) as well as regulators responsible for approving investment in vertically integrated territories.[24]

VI. Pipeline overbuild is occurring

As just one example of pipeline overbuilding, early reports regarding the Sabal Trail Pipeline (which was in part financed with affiliate agreements) pointed to unneeded capacity. "Data from [Sabal Trail's] first week of preliminary service ... indicates the project is taking capacity away from existing pipeline systems, rather than supplying additional volumes of gas to its destination market of Florida."[25] Flawed regulatory policies can cause flawed price signals and other serious harms, as FERC itself has recognized in discussing its pipeline review policy:

> Sending the wrong price signals to the market can lead to inefficient investment and contracting decisions which can cause pipelines to build capacity for which there is not a demonstrated market need. Such overbuilding, in turn, can exacerbate adverse environmental impacts, distort competition between pipelines for new customers, and financially penalize existing customers of expanding pipelines and customers of the pipelines affected by the expansion.[26]

Some industry members acknowledge the reality of pipeline overbuild. According to the CEO of Energy Transfer Partners, the company behind the Rover Pipeline, among others, "[t]he pipeline business will overbuild until the end of time. I mean that's what competitive people do. We've done it. Others have done it around us."[27] In the last 20 years, pipeline developers have built more than twice the pipeline capacity needed to

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[24] RMI Report at 9.

[25] *Art of the Self Deal* at 21 (citing Andrew Bradford, *Sabal Trail Adding Pipeline Capacity But Not Demand*, BTU Analytics (June 20, 2017), https://btuanalytics.com/sabal-trail-pipeline-capacity/). The 515-mile Sabal Trail Pipeline is intended to carry gas from Alabama, through Georgia and into Florida.

[26] *Certification of New Interstate Natural Gas Pipeline Facilities*, Order Clarifying Statement of Policy, 90 FERC ¶ 61,128 at P 4, Docket No. PL99-3-001 (2000).

[27] Kelcy L. Warren, Chairman & Chief Executive Officer, Energy Transfer Partners, second quarter 2015 earnings call to industry analysts, http://seekingalpha.com/article/3409276-energy-transfer-partners-lp-etp-kelcy-l-warren-on-q2-2015-results-earnings-call-transcript?page=10.

meet our maximum national use.[28] This does not factor in all of the pipelines built in the 20th century and those currently under development.

VII. Recommendations

The values established for the ROE greatly influence the development of interstate gas pipelines, and the Commission has continually approved an excessive 14 percent ROE for new pipelines for over 20 years. The policy incentivizes pipeline overbuild at a time when we can ill afford the harmful climate and other environmental impacts, or the unwarranted costs to captive ratepayers and other consumers. FERC therefore should reform its policy. The Commission should assign ROEs that more accurately reflect the true, lower risk to utility-affiliated pipeline developers with captive customers, acknowledging that these companies are not "new entrants" in the energy business that lack revenues. The ROE for new pipelines should be more in line with the authorized rates of return for other capital-intensive energy investments such as electric transmission. The Commission should also explain and justify how the ROE for pipeline projects is developed, using an evidentiary process to allow transparency.

VIII. Conclusion

We again commend the Commission on initiating this important process to revisit FERC's ROE policy. We appreciate the opportunity to offer these comments, and look forward to a robust process that gives careful, thorough consideration to the critical issues presented in this proceeding.

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[28] Susan Tierney, Ph.D., *Natural Gas Pipeline Certification: Policy Considerations for a Changing Industry* at 12, ANALYSIS GROUP (Nov. 6, 2017), http://www.analysisgroup.com/uploadedfiles/content/insights/publishing/ag_ferc_natural_gas_pipeline_certification.pdf.

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