UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

INITIAL COMMENTS OF THE
AMERICAN GAS ASSOCIATION

Pursuant to the "Notice of Inquiry" issued by the Federal Energy Regulatory Commission ("Commission") on March 21, 2019, in Docket No. PL19-4-000, *Inquiry Regarding the Commission's Policy for Determining Return on Equity*,[1] the American Gas Association ("AGA") respectfully submits these comments.

I. INTRODUCTION

AGA's member companies have a strong interest in ensuring that the interstate natural gas pipeline system is capable of transporting a secure and reliable supply of natural gas to customers, including natural gas local distribution companies, and that rates for interstate pipeline services are just and reasonable under the Natural Gas Act ("NGA"). AGA does not recommend or advocate for a specific policy or change in policy at this time for the natural gas industry.

As a preliminary matter, issues stemming from the court's remand decision in *Emera Maine v. FERC*,[2] regarding electric transmission rate issues, is currently under review by the Commission.[3] Therefore, while the Commission has proposed a method to use in response to the *Emera Maine*

[1] *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, 166 FERC ¶ 61,207, 84 Fed. Reg. 11769 (March 28, 2019) ("Notice").
[2] *Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017) (*Emera Maine*).
[3] *See Martha Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) ("Coakley Briefing Order"); *see also Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) ("MISO Briefing Order"). Furthermore, while certain proposals have been made by the Commission in the pending electric proceedings, specific proposals for the natural gas industry have not been offered by the Commission in natural gas related orders, therefore, at this time is premature and speculative to file specific comments on such matters.

remand, the proposed framework is still under review. Even assuming, *arguendo*, that the return on equity ("ROE") framework were settled for the electric industry, it should not be a forgone conclusion that the same policy should be applied to the natural gas industry. There are substantial differences between the various industries that the Commission regulates, which have been reflected in the Commission's determinations on ROEs, and the Commission's ROE methodology has in the past diverged in recognition of those differences.[4] Such distinctions warrant a thorough examination and review before applying a single ROE policy to the electric, natural gas, and oil industries. Additionally, while the Notice seeks comments on issues related to natural gas and oil pipeline ROEs, matters related to pipeline ROEs are likely to raise issues that differ from those addressed by the court in *Emera Maine*. Therefore, the Commission should not presuppose issues exist in the natural gas industry before fully examining the matter.[5] AGA recommends that the Commission use this proceeding as a first step in objectively gathering information, but that any possible change in policy for the natural gas industry must be fully vetted through additional notice and comment procedures.[6]

Notwithstanding the forgoing, if the Commission determines that a new ROE policy is warranted for the natural gas industry, AGA's comments herein discuss broad goals that should be met by any policy or standard chosen by the Commission for determining the appropriate ROE element for a pipeline's rates. As noted above, AGA is not recommending or advocating for a specific

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[4] *See, e.g.*, *Southern California Edison Company*, 92 FERC ¶ 61,070 (2000) ("As noted above, the Presiding Judge applied the two-step DCF model currently used by the Commission in natural gas pipeline cases, reasoning, among other things, that the precedents applicable under Natural Gas Act are equally applicable to a case decided under the Federal Power Act. Rather than adopting this approach, however, we believe that significant differences exist in the electric utility industry and the natural gas pipeline industry which warrant the continued use of different growth rates in the DCF models for each.") (footnote omitted).

[5] *See, e.g.*, *Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 844 (D.C. Cir. 2006) ("Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decision making.").

[6] AGA reserves the right to comment in any further proceeding concerning the Commission's policy on pipeline ROEs and other rate matters of interest to local natural gas distribution companies.

policy or change in policy at this time.[7] As discussed in more detail below, the Commission should ensure that whichever mechanism is used, interstate pipeline ROEs should be established at a level that allows for adequate infrastructure investment and development. However, the method used to ascertain the appropriate pipeline ROE should also protect consumer interests by ultimately establishing "just and reasonable" rates. In other words, there must be a balancing of investor and consumer interests. Furthermore, AGA encourages the Commission to utilize a policy regarding the mechanism to establish the ROE component of a natural gas pipeline's rates that is sustainable and produces rates for pipeline service that are "just and reasonable" based on a robust methodology. Any potentially revised policy must be well reasoned and factually-supported in order to withstand judicial review and provide certainty to the natural gas industry.

II. COMMUNICATIONS

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III. IDENTITY AND INTERESTS

The American Gas Association, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 74 million residential, commercial and industrial natural gas customers in the United States, of which 95 percent

[7] AGA reserves the right to file reply comments in this proceeding if warranted. The Commission has specifically provided for interested parties to submit reply comments in this proceeding; therefore, AGA may file further comments to ensure that the record adequately addresses the issues. *See* Notice at P 39.

— more than 71 million customers — receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies and industry associates. Today, natural gas meets more than one-fourth of the United States' energy needs.[8]

AGA member companies take service from virtually every interstate natural gas pipeline company regulated by the Commission under the NGA. As such, AGA members are directly affected by the rates charged by interstate pipelines for such services and by Commission policies regarding how such rates are developed. AGA's members, therefore, as customers of jurisdictional natural gas pipelines, have a direct and substantial interest in the issues raised in this proceeding.

IV. BACKGROUND

Since the 1980s, the Commission has used the Discounted Cash Flow ("DCF") model to develop a range of returns earned on investments in companies with corresponding risks for purposes of determining a just and reasonable ROE for regulated entities,[9] with relatively modest refinements over time.[10] Although the Commission has historically used the DCF model to determine ROEs for public utilities and natural gas and oil pipelines, the Commission is re-evaluating its ROE policies following the recent U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") decision in *Emera Maine*. In that decision, the D.C. Circuit held that the Commission failed to establish a "rational connection" between the record evidence and its decision under section 206 of

[8] For more information, please visit www.aga.org.
[9] Notice at P 4 (explaining that under the DCF formula, k = D/P + g, where "k" is the cost of equity, "D/P" is the current dividend yield (dividends divided by stock price), and "g" is the expected growth rate in dividends.).
[10] *See, e.g.*, "Policy Statement," *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 (2008) ("*Proxy Group Policy Statement*").

the Federal Power Act ("FPA")[11] to set the ROE of the New England Transmission Owners at the midpoint of the upper half of the zone of reasonableness produced by the two-step DCF analysis.[12]

On remand, the Commission has considered certain financial models, in addition to the DCF methodology, when determining the just and reasonable ROE for public utilities.[13] Specifically, the Commission proposed to rely on the DCF model, the Capital Asset Pricing Model ("CAPM"), and Expected Earnings model to establish a composite zone of reasonableness when evaluating whether an existing base ROE remains just and reasonable.[14] The zone of reasonableness produced by each model would be given equal weight and averaged to determine the composite zone of reasonableness. For establishing a new just and reasonable base ROE when the existing base ROE has been shown to be unjust and unreasonable, the Commission proposed relying on the DCF model, CAPM model, Expected Earnings model, and Risk Premium model to create four separate base ROE estimates that would be averaged to produce a just and reasonable base ROE.[15]

The Commission is broadening its inquiry beyond the particular interests of the parties to the *Emera Maine* proceeding and is seeking comment in this docket on potential modifications to its approach for determining a just and reasonable ROE. While *Emera Maine* specifically addressed the establishment of rates pursuant to the FPA, the Notice highlights the significant and widespread effect of the Commission's ROE policies upon public utilities and the other industries FERC regulates.[16] Therefore, in addition to seeking potential modifications to its approach for determining a just and

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[11] 16 U.S.C. § 824e.
[12] Notice at P 2.
[13] *Id*. at P 13.
[14] *Id.* at P 25.
[15] *Id.* at P 26.
[16] *Id.* at P 3.

reasonable ROE for public utilities, the Commission is also considering whether any changes to its policies concerning public utility ROEs should be applied to interstate natural gas and oil pipelines.[17]

V. COMMENTS

A. ROEs Should Be Established to Allow for Adequate Infrastructure Investment

The Supreme Court has held that the rate of return should be commensurate with the return on investment in other enterprises having corresponding risks and should be sufficient to assure confidence in the financial integrity of the enterprise, so as to attract capital.[18] ROEs must be sufficient to ensure adequate infrastructure investment, both as to maintenance and pipeline safety, and to create needed additional pipeline capacity.[19] Projections by the United States Department of Energy's Energy Information Administration,[20] and industry studies,[21] *inter alia*, project continued increases in domestic consumption of natural gas as well as exports, which in turn will necessitate substantial new pipeline investments over the next decades. This trend is likely to continue even as the United States takes steps towards a less carbon-intensive economy.[22]

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[17] *Id*. at P 1. As noted above, the Commission should not presuppose that changes to its electric rate policy should apply to or are appropriate for natural gas pipelines without a thorough examination.

[18] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944) ("[T]he return to the equity owner should be commensurate with the return on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."); *see also Bluefield Water Works & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679, 692-693 (1923) (*Bluefield*) ("The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.").

[19] *See Bluefield,* 262 U.S. at 692-693.

[20] *See* "Annual Energy Outlook 2019 with projections to 2050," U.S. Energy Information Administration (January 2019) at 69-86, available at www.eia.gov/outlooks/aeo/pdf/aeo2019.pdf.

[21] *See*, *e.g.*, "North American Midstream Infrastructure through 2035: Significant Development Continues," The INGAA Foundation (June 18, 2018) (finding that the United States and Canada will need annual average natural gas, oil and natural gas liquids midstream infrastructure investment of about $44 billion per year, from 2018 through 2035), available at www.ingaa.org/File.aspx?id=34703.

[22] *See* "The Role of Natural Gas in the Transition to a Lower-Carbon Economy," The INGAA Foundation (May 2019), available at www.ingaa.org/File.aspx?id=36337&v=11f69171.

Expanding the nation's natural gas pipeline network is necessary to achieve the country's economic, environmental, and national security goals. The United States has an abundant and growing supply of clean natural gas, more than enough to satisfy existing and new markets at very competitive prices.[23] Implementing an ROE mechanism that does not attract infrastructure investment and development will hinder access to the geographically diverse production areas and limit the ability of natural gas utilities to expand access to pipeline capacity.

The highest priority for a natural gas local distribution company is to deliver natural gas to its customers safely, reliably, responsibly, and at just and reasonable rates. While natural gas utilities are not responsible for the construction of interstate transmission pipeline projects, natural gas utilities often distribute the natural gas transported by the interstate pipelines to retail, commercial, industrial, and electric generation customers. The maintenance and expansion of pipeline capacity, and ability of natural gas utilities to provide service to customers, play a vital role in local economies by providing jobs and tax revenues, and attracting manufacturing and commercial investments. Furthermore, the robustness of the natural gas system in the United States has resulted in a reliable and resilient system that can continue to provide service when demand is high and during severe weather events.[24] If a change in policy is warranted, AGA encourages the Commission to implement a revised ROE policy that provides appropriate incentives for infrastructure development so that gas

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[23] *See, e.g.,* "Advancing the Landscape of Clean Energy Innovation" (February 2019) (finding that the technology-enabled unlocking of shale gas and tight oil resources in the U.S. has dramatically expanded available oil and natural gas resources, reduced the costs of producing them, and redefined the U.S. role in global oil and gas markets) available at http://www.b-t.energy/wp-content/uploads/2019/02/Report_-Advancing-the-Landscape-of-Clean-Energy-Innovation_2019.pdf

[24] *See, e.g.*, "Natural Gas Systems – Reliable & Resilient" (July 2017) and "Weather Resilience in the Natural Gas Industry: the 2017-2018 Test and Results" (August 2018) issued by the Natural Gas Council, available at www.naturalgascouncil.org.

utilities continue to have access to diverse markets with competitively priced natural gas and the reliability and resiliency of the natural gas system is maintained.

B. Any Modified ROE Policy Should Ensure that Rates Remain Just and Reasonable

As the Supreme Court noted in *Hope*, "[t]he rate-making process under the Act, *i.e.*, the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests."[25] The Supreme Court subsequently emphasized the importance of the consumer protection aspect of the NGA as emphasized in *CATCO:*[26]

> The purpose of the Natural Gas Act was to underwrite just and reasonable rates to the consumers of natural gas. … [I]t was "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate public service in the public interest." The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges.

Consequently, pursuant to court precedent and statutory requirements the Commission's ROE policy should also protect consumer interests.[27] As customers of jurisdictional pipelines, natural gas utilities are very cognizant of the impact that the Commission's ROE and rate policies have on shippers and ultimately retail consumers.[28] When establishing a new ROE policy, if warranted after

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[25] *Hope*, 320 U.S. at 603.

[26] *Atlantic Refining Co. v. Pub. Serv. Comm'n of N.Y.,* 360 U.S. 378 (1959) ("*CATCO*") (internal citations and footnotes omitted).

[27] *See Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) (one of the court's responsibilities is to "determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable").

[28] Generally, one element of a retail customer's utility bill is the cost of interstate transportation; therefore, utilities and state regulators have an interest in ensuring that interstate rates are "just and reasonable." Indeed, for this reason, among others, state public utility commissions often intervene and take an active role in interstate pipeline rate and tariff proceedings, *inter alia,* that are pending before the Commission. The Commission's regulations contemplate state commission participation in proceedings because such entities are granted party status as a right when a notice of intervention is filed. 18 CFR § 385.214(a)(2).

a full examination, the Commission should remain cognizant of its requirement to protect customers, such as natural gas utilities, and strike the right balance between transportation customer interests and pipeline interests. The current policy has produced ROEs that have resulted in "just and reasonable" rates, while successfully providing a ratemaking standard under which dramatic increases in pipeline capacity have been achieved to meet growing demand during the past two decades.[29] In the event there is a change in policy, it is important that the Commission's ROE policy balance the need for adequate infrastructure investment and service at just and reasonable rates.

C. Any Potential Revised Policy Should Provide a Robust ROE Methodology and Certainty

AGA does not advocate for or against any specific ROE policy, policy change, or use of any specific financial model(s), and accordingly takes no position on such matters; however, AGA urges that in the event a revised policy is warranted the Commission should focus on providing a strong legal and factual basis for the resulting ROEs – the focus should not be on whether ROEs should be higher or lower. Rather, natural gas pipelines and their customers need to be able to rely upon a methodology that both meets the twin goals discussed above – adequate capital attraction and reasonable rates – while being defensible in the event of a probing judicial review, such as that undertaken by the D.C. Circuit in *Emera Maine*.

The Commission has previously adjusted its DCF methodology to account for changing industry circumstances, as illustrated by the revisions established in the *Proxy Group Policy Statement*, and any retained or revised policy will similarly need to address new challenges with the proxy group determinations stemming from changes in the number of comparable pipelines. Further, any revised

[29] *See, e.g.*, Federal Energy Regulatory Commission, "Approved Major Pipeline Projects" (March 2019) (listing mileage, by year, of approved major pipeline projects, listing approximately 21,000 miles of pipelines approved between 2000 and 2019), available at https://www.ferc.gov/industries/gas/indus-act/pipelines/approved-projects.asp.

DCF methodology or other ROE policy will need to address this issue in a reasoned and factually-supported manner.

The Commission should also consider the importance of certainty and reasonable predictability in assessing whether and how to revise the ROE methodology. If a new policy produces vastly divergent results from the existing policy, the Commission should carefully consider whether a departure is appropriate. From a customer and pipeline standpoint, stability and certainty are important considerations for gas supply planning, both before and after interstate facilities are constructed and in service. The Commission should ensure that any revised policy both represents a "point of balance" between consumer and pipeline interests, as well as meets the industry's need for a predictable and robust methodology that provides clear guidance and certainty in the determination of rates under the NGA.

AGA also recommends that the Commission consider in its deliberations on the appropriate ROE policy, whether and to what extent differences in the industries subject to its jurisdiction may warrant different treatment, in any respect, *i.e.,* differences between the natural gas pipeline and electric transmission industries. Notably, the Commission's *Proxy Group Policy Statement* was premised on the conclusion that trends in the natural gas and liquids pipeline industries, at the time – chiefly the rise of master limited partnerships and the decline in corporations for proxy group purposes – resulted in the need to change both the proxy group requirements, as well as several other alterations to the DCF methodology, as to natural gas and liquids pipeline proceedings.[30] Past experience, and the broad, underlying differences in the industries for which the *Hope* standard is to be applied, suggest that the Commission should not impose identical standards on electric transmission

[30] *See Proxy Group Policy Statement* at P 1, *compare*, Notice at P 34 (there is an "increased amount of merger and acquisition activity involving master limited partnerships (MLPs) and the multiple recent conversions of MLPs to C-corporations").

companies and natural gas pipelines, where industry differences may merit variations in approach and the facts support such a different treatment. As the Supreme Court stated in *Hope*, the Commission is, "not bound to the use of any single formula or combination of formulae in determining rates," and that its "rate-making function, moreover, involves the making of 'pragmatic adjustments."[31]

VI. CONCLUSION

Wherefore, the American Gas Association respectfully requests that the Commission consider these comments in this proceeding.

Respectfully submitted,

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June 26, 2019

[31] *Hope*, 320 U.S. at 602.