UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Transcontinental Gas Pipe Line Company, LLC) Docket No. CP15-138-000

REQUEST FOR REHEARING OF
THE NORTH CAROLINA UTILITIES COMMISSION AND
THE NEW YORK STATE PUBLIC SERVICE COMMISSION

The North Carolina Utilities Commission ("NCUC") and the New York State Public Service Commission ("NYPSC") (collectively, "State Commissions"), intervenors herein[1] pursuant to Section 19(a) of the Natural Gas Act ("NGA")[2] and Rules 207 and 713 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission" or "FERC"),[3] request rehearing of two issues ruled on in the Order Issuing Certificate[4] issued on February 3, 2017 in the above-referenced proceeding. The first issue is whether it was error to approve the use of the specified pre-tax return of 15.34% underlying the design of Transcontinental Gas Pipe Line Company, LLC's ("Transco's") approved settlement rates in Docket No. RP01-245-000 *et al.*—a case filed on March 1, 2001 to calculate the recourse rates in Docket No. CP15-

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[1] Together with the NCUC, the NYPSC submitted a timely Notice of Intervention, Protest, and Requests for Partial Consolidation and Evidentiary Hearing in Docket Nos. CP15-117, CP15-118, and CP15-138 (not consolidated) on April 22, 2015. The views expressed herein are not intended to represent those of any individual member of the NYPSC. Pursuant to Section 12 of the New York Public Service Law, the Chair of the NYPSC is authorized to direct this filing on behalf of the NYPSC.

[2] 15 U.S.C. § 717r(a) (2012).

[3] 18 C.F.R. §§ 385.207 and 385.713 (2016).

[4] *Transcontinental Gas Pipe Line Co., LLC*, 158 FERC ¶ 61,125 (2017) ("February 3 Order").

138.[5] The second issue is whether Transco met its burden of proof to demonstrate that it is consistent with the public interest to receive a certificate for a twenty-year lease of capacity when the only evidence supporting that request was an analysis of one year of cost and revenue data.[6] For the reasons detailed herein the Commission should grant rehearing on each of these issues.

I. BACKGROUND

Atlantic Sunrise Project, Docket No. CP15-138

On March 31, 2015, Transco submitted an application under section 7(c) of the Natural Gas Act[7] seeking a certificate of public convenience and necessity authorizing Transco to construct and operate its proposed Atlantic Sunrise Project. The purpose of the project is to increase firm incremental transportation service on Transco by 1,700,002 dakatherms ("Dth") per day. The total estimated cost of the project is $2.588 billion.[8] Transco's share of the estimated total project cost is $1.839 billion (the reduction is the result of the shared cost responsibility for the Central Penn Lines).[9] The projected daily reservation recourse rate for the project is $0.77473.[10] The pre-tax return of 15.34% from the settlement in Docket No. RP01-245 was used in calculating the projected recourse rates. Transco has executed binding precedent agreements with nine shippers for 100

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5 *Id.* at PP 38-41.

6 *Id.* at PP 60-61.

7 15 U.S.C. § 717f(c) (2012).

8 February 3 Order at P 12.

9 *Id.* PP 12, 50.

10 Transcontinental Gas Pipe Line Company, LLC, Docket No. CP15-138 Application at 4 (March 31 2015) ("Docket No. CP15-138 Application"), Exhibit P.

percent of the incremental firm transportation service provided by the project under negotiated rates.[11]

The two Central Penn Lines will be jointly owned by Transco and Meade Pipeline Company, LLC ("Meade") as tenants in common, with each party holding an undivided joint ownership interest in the facilities. Transco will hold a 41.18% undivided joint ownership interest in the Central Penn Line North and a 70.59% undivided joint ownership interest in the Central Penn Line South, and will provide all construction, operation, and maintenance services for the two Central Penn Lines. Meade will hold a 58.82% undivided joint ownership interest in the Central Penn Line North and a 29.41% undivided joint ownership interest in the Central Penn Line South.[12] Meade will hold its ownership interest as a "passive owner" of the two Central Penn Lines. The Lease Agreement provides for a primary term of 20 years. Transco will pay Meade a fixed monthly lease charge of $7,964,908 during the 20 year primary term.[13]

On April 22, 2015, the State Commissions filed a Notice of Intervention, Protest, and Requests for Partial Consolidation and Evidentiary Hearing. The State Commissions protested the 15.34% pre-tax return used by Transco in calculating its proposed incremental recourse rates for its Dalton Expansion Project in Docket No. CP15-117-000, its Virginia Southside Expansion Project II in Docket No. CP15-118-000, and its Atlantic Sunrise Project in Docket No. CP15-138-000.[14] The State Commissions explained that

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[11] February 3 Order at P 11.

[12] Docket No. CP15-138 Application at 7.

[13] *Id.* at 9.

[14] Notice of Intervention, Protest and Requests for Partial Consolidation and Evidentiary Hearing of the North Carolina Utilities Commission and the New York State Public

the service would be provided under negotiated rates but noted the importance of developing properly designed recourse rates because they provide a check on the pipeline's market power during the establishment of negotiated rates.[15] Although the State Commissions acknowledged the Commission's general policy of using the pipeline's last stated rate of return to calculate the recourse rates, the State Commissions argued that application of that policy in the case at hand would result in excessive recourse rates.[16] The State Commissions requested that the three certificate applications be partially consolidated to consider the appropriate pre-tax return in a full evidentiary hearing.

On May 12, 2015, Transco filed an answer to the State Commissions Protest.[17] Transco maintained that the design of the recourse rates ensures that the projects will not be subsidized by Transco's existing customers.[18] Transco also argued that it is inappropriate to imply fault on Transco's part for "simply following" the Commission's policy on the utilization of Transco's latest Commission-approved rate of return.[19]

Service Commission, Docket Nos. CP15-117, CP15-118, and CP15-138 at 10-13 (April 22, 2015) ("State Commissions Protest").

15 *Id.* at 8-9.

16 *Id.* at 10.

17 Answer of Transcontinental Gas Pipe Line Company, LLC to Protest, Request for Partial Consolidation and Evidentiary Hearing, Docket Nos. CP15-117, CP15-118, and CP15-138 (May 12, 2015) ("Transco Answer").

18 *Id.* at 3.

19 *Id.* at 4.

On May 27, 2015, the State Commissions filed an answer to Transco's Answer.[20] The State Commissions explained that Transco's Answer fails to address the need for recourse rates to actually reflect the costs of the projects in order to check the pipeline's market power when entering into negotiated rates.[21] The State Commissions emphasized that unless the recourse rates are based on a reasonable estimate of the actual costs to construct the projects, they will not provide the necessary check on the pipeline's market power during the time frame that actually matters—the period during which the parties agreed to the negotiated rates.[22] The State Commissions also noted that Transco did not state, and thus seemingly could not demonstrate, that its proposed 15.34% pre-tax return reflects current market conditions.[23]

The Commission issued its order in Docket No. CP15-118 authorizing Transco to construct and operate the Virginia Southside Expansion Project II on July 7, 2016. On August 3, 2016, the Commission issued its order authorizing Transco to construct and operate the Dalton Expansion Project in Docket No. CP15-117. In both orders, the Commission made virtually identical findings regarding Transco's use of a 15-year old 15.34% pre-tax return to calculate recourse rates for both projects.[24] Specifically, the Commission found that it is appropriate to apply its general policy on rate of return in section 7 certificate proceedings to calculate Transco's initial recourse rate in this

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[20] Motion for Leave to Answer and Answer of the North Carolina Utilities Commission and the New York State Public Service Commission, Docket Nos. CP15-117, CP15-118, and CP15-138 (May 27, 2015) ("State Commissions Answer").

[21] *Id.* at 3.

[22] *Id.*

[23] *Id.* at 5.

[24] *Compare* August 3 Order at PP 23-29 *with* July 7 Order at PP 20-26.

proceeding.[25] As explained above, that policy requires that a pipeline's recourse rates be designed using the most recent stated rate of return in a general rate case for that pipeline approved by the Commission under section 4 of the NGA.[26] Because most general rate cases at FERC are settled on a "black-box" basis,[27] Transco's recourse rates for this project and the other projects used the specified pre-tax return of 15.34% underlying the design of its approved settlement rates in Docket No. RP01-245-000 *et al.*—a case filed on March 1, 2001.[28] The Commission agreed with the State Commissions that "the predicate for permitting a pipeline to charge a negotiated rate is that capacity is available at the recourse rate."[29] However, the Commission found that it was appropriate to apply its general policy to calculate Transco's initial recourse rate in this proceeding and denied the State Commissions' request for partial consolidation of Transco's certificate proceedings and full evidentiary hearing on the issue of rate of return.[30] On August 8, 2016, the State Commissions timely sought rehearing of the use of the specified pre-tax return of 15.34% underlying the design of its approved settlement rates in Docket No. RP01-245-000 *et al.*—a case filed on March 1, 2001 to calculate the recourse rates in Docket Nos. CP15-117 and CP15-118.

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[25] July 7 Order at P 26; August 3 Order at P 29.

[26] July 7 Order at P 23 (citations omitted); August 3 Order at P 26 (citations omitted).

[27] A "black-box" settlement resolves the total cost of service for a pipeline without assigning specific amounts to any particular item such as rate of return.

[28] July 7 Order at P 23 (citing *Transcontinental Gas Pipe Line Corp.*, 100 FERC ¶ 61,085 (2002)); August 3 Order at P 26 (same).

[29] July 7 Order at P 23 (citing *Columbia Gas Transmission Corp.*, 97 FERC ¶ 61,221, at 62,004 (2001)); August 3 Order at P 26 (same).

[30] July 7 Order at P 26; August 3 Order at P 13.

In the February 3 Order, FERC made virtually identical rulings to those in Docket Nos. CP15-117 and CP15-118, thereby approving the use of the outdated specified pre-tax return of 15.34% underlying the design of its approved settlement rates in Docket No. RP01-245-000 *et al.* to calculate the recourse rates in Docket No. CP15-138.

The State Commissions Protest also took issue with the lack of sufficient analysis to demonstrate that the proposed lease arrangements benefit ratepayers and to support a finding that issuing a certificate for the leased facility would be consistent with the public interest.[31] In particular, while the Central Penn Lines Lease has a 20-year primary term, the only support for issuing a certificate for that long-term asset was an analysis of a single year of estimated data.[32]

In its answer, Transco argued that its lease payments are less than, or equal to, the lessor's firm transportation rates for comparable service on the same facilities and explained that its analysis used the first year of the lease "in order to be consistent with Section 157.14(a)(18) of the Commission's regulations."[33] Transco also asserted that "any reasonable analysis of the annual lease payments over the primary terms of the leases compared to the estimated cost of service over that same period assuming Transco constructed and owned all of the corresponding Project facilities also would demonstrate that the proposed leases comply with the Commission's requirements"[34] but provided no analysis to support its claim.

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[31] State Commissions Protest at 13-17.

[32] *See* Docket No. CP15-138 Application, Exhibit N.

[33] Transco Answer at 6.

[34] *Id.* at n.10.

In their answer, the State Commissions identified three major flaws in the Transco Answer on the lease issues. First, they explained that, contrary to Transco's assertion that intervenors should have provided an analysis,[35] the burden of proof is on Transco, not intervenors, to support its lease proposal with complete data.[36] Two, despite not having the burden of proof, the State Commissions did provide an alternative analysis,[37] which cast substantial doubt as to whether Transco's complete reliance on a first year analysis results in a record that adequately addresses all factors bearing on the public interest. Three, Transco's reliance on 18 C.F.R. § 157.14(a)(18) is misplaced because that regulation sets out the requirements for initial rates. Therefore, compliance with that regulation does not resolve the issue of whether Transco has met its burden to demonstrate that the long-term lease of capacity from Dogwood meets the Commission's benefits test.[38]

In the February 3 Order, the Commission issued a certificate that authorized Transco to construct and operate the Atlantic Sunrise Project. In that order, the Commission waived its rules and accepted both Transco's and the State Commissions' answers.[39] As relevant here, the Commission granted a certificate for the 20-year leased

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[35] Transco Answer at 7.

[36] State Commissions Answer at 7-8.

[37] The State Commissions explained that over the term of the lease, the impact of depreciation on the fixed costs recovered via the leases calls into question the validity of Transco's single-year analysis of a lease with a 20 year initial term. FERC agreed that "the cost of service should decrease over time." August 3 Order at P 60.

[38] State Commissions Answer at 8.

[39] February 3 Order at P 18.

capacity, despite the fact that the only economic analysis provided Transco was a first-year cost of service analysis.[40]

II. REQUEST FOR REHEARING

A. Specification of Errors

Pursuant to 18 C.F.R. § 385.713(c)(1) (2016), the State Commissions respectfully submit that the February 3 Order contains the following errors:

1) It was error, and not the product of reasoned decision-making, for the Commission to establish recourse rates that do not take into account the significant changes in the financial markets which have occurred since Transco's rate case containing a stated return, Docket No. RP01-245. These findings are inconsistent with: (1) the Commission's obligations under the NGA; (2) FERC's acknowledgment that the predicate for allowing a pipeline to charge a negotiated rate is that capacity is available at the recourse rate; and (3) Commission precedent recognizing the importance of using current market conditions to develop capital costs. The Commission's proposed remedy—to address rate of return in a future Section 4 case—ignores the excessive pre-tax return granted to Transco in the instant proceeding and the time period during which the parties agreed to negotiated rates.

2) It was error, and not the product of reasoned decision-making, for the Commission to approve a lease with a 20-year initial term when the only analysis supporting the lease was for a single year.[41] That finding: (1) lacks substantial evidence as required by the NGA; (2) is inconsistent with the standard used by the Commission to approve leases *i.e.*, "the lease payments are less than, or equal to, the lessor's firm transportation rates for comparable service **over the terms of the lease on a net present value basis**,[42] and (3) improperly relies on a regulation for the calculation of initial recourse rates, 18 C.F.R. § 157.14(a)(18), to find that Transco need only provide one year of analysis to support the issuance of a certificate for capacity under a 20 year lease.[43]

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[40] *Id.* at P 59.

[41] *Id.* at PP 57-61.

[42] *Id.* at P 56.

[43] *Id.* at P 60.

B. Statement of Issues

Pursuant to 18 C.F.R. § 385.713(c)(2) (2016), the State Commissions respectfully provide the following Statement of Issues:

1) Whether it was error, and not the product of reasoned decision-making, for the Commission to establish recourse rates that do not take into account the significant changes in the financial markets which have occurred since Transco's rate case containing a stated return, Docket No. RP01-245? *See Motor Vehicle Mfrs. Ass'n of the United States, Inc., v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)); *Bluefield Water Works v. Pub. Serv. Comm'n*, 262 U.S. 679, 693 (1923); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

2) Whether it was error, and not the product of reasoned decision-making, for the Commission to approve a lease with a 20-year initial term when the only analysis supporting the lease was for a single year. Natural Gas Act, 15 U.S.C. § 717f(c) (2012) (requiring the Commission to ensure a proposed project is consistent with the public interest); *Atlantic Refining Co. v. Public Serv. Comm'n. of New York*, 360 U.S. 378, 391 (1959) (requiring the Commission to evaluation "all factors bearing on the public interest"); *California Gas Producers Ass'n v. FPC*, 421 F.2d 422, 428-29 (9th Cir. 1970) (explaining the Commission's primary obligation under the Natural Gas Act is to ensure that consumers do not pay excessive rates); *Midcontinent Express Pipeline LLC*, 124 FERC ¶ 61,089, at P 31 (2008) (providing the Commission's practice in approving a lease); *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (requiring the Commission to "examine the relevant data and articulate a satisfactory explanation for its actions, including a 'rational connection between the facts found and the choice made.'") (citation omitted); *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 528 (D.C. Cir. 2010) (requiring the Commission's factual findings to be supported by substantial evidence); *South Carolina Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 54 (D.C. Cir. 2014) (requiring the Commission's factual findings to be supported by substantial evidence).

C. Argument

1. The Commission's Decision to Establish Recourse Rates that Do Not Take into Account the Significant Changes in the Financial Markets Which Have Occurred since Transco's Rate Case Containing a Stated Return is Not Product of Reasoned Decision-Making.

The Commission's primary obligation under the NGA is to ensure that consumers do not pay excessive rates.[44] In the context of a certificate application under section 7 of the NGA, the Commission is obligated to make certain that the proposed project is consistent with the public interest.[45] In this proceeding, Transco proposed to provide service over the new Atlantic Sunrise facilities under negotiated rates. FERC only allows negotiated rates if the pipeline's market power is checked by the availability of service at recourse rates.[46] Specifically, the Commission must ensure that the proposed recourse rates for the project are designed properly so that they provide the needed check on the pipeline's market power during the establishment of negotiated rates.

The total cost of service for the Atlantic Sunrise project used to develop the incremental recourse rate is $480,719.972.[47] The pre-tax return of 15.34% percent comprises $278,657,000 of this total.[48] Applying FERC's general policy, Transco

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44 *See, e.g.*, *California Gas Producers Ass'n v. FPC*, 421 F.2d 422, 428 (9th Cir. 1970).

45 15 U.S.C. § 717f(c) (2012).

46 *Natural Gas Pipelines Negotiated Rate Policies and Practices; Modification of Negotiated Rate Policy*, 104 FERC ¶ 61,134 at P 4 (2003), *order on reh'g and clarification*, 114 FERC ¶ 61,042 (2006), *dismissing reh'g and denying clarification*, 114 FERC ¶ 61,304 (2006) ("Negotiated Rate Policy Statement").

47 Docket No. CP15-138 Application, Exhibit P line 12.

48 *Id.* (compare line 8 with line 12).

incorporated a pre-tax return from a 15-year old rate case.[49] The State Commissions protested Transco's applications on the basis that using this excessive pre-tax return from fifteen years ago does not reflect current market conditions and, consequently, results in excessive recourse rates which do not provide the necessary check on the market power of the pipeline in negotiating rates for service on the new Atlantic Sunrise Project. The Commission therefore committed legal error by establishing recourse rates in Docket No. CP15-138 that does not take into account the significant changes in the financial markets which have occurred since Transco's rate case containing a stated return, Docket No. RP01-245. In order to rectify these errors, the Commission should grant rehearing and consider the appropriate pre-tax return in a full evidentiary hearing.

A Commission order will be reversed on review if it is arbitrary or capricious, reflects an abuse of discretion, is not otherwise in accordance with law, or is not supported by substantial evidence.[50] In order to survive review under the "arbitrary and capricious" standard, the Commission must "examine the relevant data and articulate a satisfactory explanation for its actions, including a 'rational connection between the facts found and the choice made.'"[51] As explained below, the Commission's findings in paragraph 41 of the February 3 Order that it is appropriate to use Transco's pre-tax return of 15.34% from Docket No. RP01-245 to develop the recourse rates in this proceeding is unsupported and fails to satisfy the arbitrary and capricious standard.

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[49] Transco's last section 4 rate case specifying a rate of return was Docket No. RP01-245-000 *et al.* February 3 Order at P 34, n.52 (citing *Transcontinental Gas Pipe Line Corp*., 100 FERC ¶ 61,085 at P 2 (2002)).

[50] *South Carolina Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 54 (D.C. Cir. 2014); *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 528 (D.C. Cir. 2010).

[51] *See Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 43 (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. at 168).

a. FERC's Acknowledgment that the Predicate for Allowing a Pipeline to Charge a Negotiated Rate is that Capacity is Available at the Recourse Rate is Internally Inconsistent with its Finding Allowing Transco to Develop a Recourse Rate Using an Excessive Pre-tax Return.

As the State Commissions explained in their Protest, the Commission permits pipelines to negotiate individualized rates[52] which, unlike discounted rates,[53] are not constrained by the maximum and minimum rates in the pipeline's tariff.[54] However, pipelines must permit shippers the option of paying the traditional cost of service recourse rates in their tariffs, instead of requiring them to negotiate rates for any particular service. The Commission relies on the availability of recourse rates to prevent pipelines from exercising market power by assuring that the customer can revert to the just and reasonable tariff rate if the pipeline unilaterally demands excessive prices or withholds service.[55] Therefore, even if all service is being provided under negotiated rates, recourse rates need to be designed properly so that they provide the necessary check on the pipeline's market power during the establishment of negotiated rates.[56]

In the February 3 Order, the Commission agreed with the State Commissions that "the predicate for permitting a pipeline to charge a negotiated rate is that capacity is available at the recourse rate," and noted that it therefore "requires that shippers have the

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[52] *Alternatives to Traditional Cost of Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076, *reh'g denied*, 75 FERC ¶ 61,024 (1996), *petitions for review denied sub nom. Burlington Resources Oil & Gas Co. v. FERC*, 172 F.3d 918 (D.C. Cir. 1998); *see generally* Negotiated Rate Policy Statement.

[53] *See* 18 C.F.R. § 284.10(c)(5).

[54] *See Northern Natural Gas Co.*, 105 FERC ¶ 61,299 at PP 12-17 (2003) (clarifying the distinction between discounted and negotiated rates).

[55] Negotiated Rate Policy Statement at P 4.

[56] State Commissions Protest at 9-10 (citing Negotiated Rate Policy Statement at P 4).

option of choosing to pay a cost-based recourse rate for expansion capacity that becomes available."[57] Despite acknowledging the need for proper recourse rates, the Commission then inconsistently found that Transco is allowed to calculate its initial recourse rates using a 15.34% pre-tax return from Docket No. RP01-245-000.[58] Given the Commission's previously stated concerns regarding "maintaining the integrity of recourse service,"[59] it was not reasoned decision-making to allow Transco to calculate its recourse rate using an excessive pre-tax return that does not take into account current market conditions.

In support of its decisions to allow Transco to use a 15.34% pre-tax return, the Commission cites to a series of cases dating back to 1994.[60] The Commission explains that its "consistent policy in section 7 certificate proceeds is to require that a pipeline's cost-based recourse rates for incrementally-priced expansion capacity be designed using the rate of return from its most recent general rate case approved by the Commission under section 4 of the NGA in which a specified rate of return was used to calculate the rates."[61] Although the State Commissions acknowledge that this is FERC's "consistent policy," FERC has an obligation to justify its policy each time it is applied.[62] The State

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[57] February 3 Order at P 38 (citing *Columbia Gas Transmission Corp.*, 97 FERC ¶ 61,221, at p. 62,004 (2001)).

[58] February 3 Order at P 41.

[59] 74 FERC ¶ 61,076 at p. 61,240.

[60] February 3 Order at P, n.60.

[61] February 3 Order at P 38.

[62] *Pac. Gas & Elec. Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974) ("When the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued"). The source of the Commission's policy at issue here is not a policy statement, but rather a series of adjudications. Although the State Commissions acknowledge that FERC has the

Commissions presented substantial evidence which demonstrated that applying this policy to Transco's three certificate applications would result in substantially overstated recourse rates. This substantial evidence raised a material issue of fact regarding Transco's applications and therefore warranted a hearing on this issue.[63] However, instead of analyzing the impact of applying the policy, FERC erred by simply—and uncritically—applying its policy without any analysis.

The significance of this error is demonstrated by reviewing the total costs of the three Transco projects filed at the Commission protested by the State Commissions: (1) the Virginia Southside Expansion II Project in Docket No. CP15-118 is estimated to cost $190 million;[64] (2) the Dalton Expansion Project in Docket No. CP15-117 is estimated to cost $471.9 million;[65] and (3) the Atlantic Sunrise Project in Docket No. CP15-138 is estimated to cost $2.588 billion (Transco's share is approximately $1.839 billion).[66] Furthermore, the excessive pre-tax return also makes up a significant portion of these project costs. Over half of the cost of service underlying the proposed recourse rates in

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ability to develop binding precedent via adjudications, it still has the obligation to analyze "whether the adjudicated facts conform to the rule and whether the rule should be waived or applied in [the] particular instance." *Id.* In this instance, FERC should have waived its general rule given the facts presented by Transco's applications.

63 *See Cajun Elec. Power Coop., Inc. v. FERC*, 28 F.3d 173, 177 (D.C. Cir. 1994); *Moreau v. FERC*, 982 F.2d 556, 568 (D.C. Cir. 1993); *Vt. Dept. of Pub. Serv. v. FERC*, 817 F.2d 127, 140 (D.C. Cir. 1987).

64 Docket No. CP15-118 Application, Exhibit P, Column (C).

65 Docket No. CP15-117 Application at 4.

66 Transcontinental Gas Pipe Line Company, LLC, Docket No. CP15-138 Application at 6 (March 31, 2015).

two of the certificate applications is "Pre-tax return at 15.34%."[67] In the Docket No. CP15-117 Application, "Pre-tax return at 15.34%" is approximately 48% of the overall cost of service.[68] Allowing Transco to base its recourse rates on a pre-tax return of 15.34% on this level of investment certainly does not maintain the integrity of recourse rates, and accordingly, are arbitrary and capricious findings. Rehearing is therefore appropriate.

b. The Commission's Rationale that it Would Be Too Difficult and Time Consuming to Ensure Appropriate Recourse Rates in Section 7 Proceedings is an Abdication of the Commission's Obligations under the NGA.

In support of their assertions that the 15.34% pre-tax return is not reflective of current economic conditions, the State Commissions Protest included a Discounted Cash Flow ("DCF") analysis for natural gas pipelines supported by Kristine Prylo, Associate Utility Financial Analyst, of the NYPSC.[69] That preliminary analysis incorporated current market conditions and reflected a median Return on Equity ("ROE") of 10.95%.[70] The State Commissions also pointed to recent Commission pronouncements on pipeline ROEs of 10.28%, 10.55%, and 11.55%.[71] Although the State Commissions recognized that these ROEs are not directly comparable to the pre-tax return of 15.34% used by Transco,[72] the State Commissions argued that they provide valuable perspective

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67 Docket No. CP15-118 Application, Exhibit P at page 4 (compare line 8 with line 12); Docket No. CP15-138 Application, Exhibit P (compare line 8 with line 12).

68 Docket No. CP15-117 Application, Exhibit P (compare line 8 with line 12).

69 *See* the analysis attached to the State Commissions Protest.

70 State Commissions Protest at 12, 23.

71 *Id.* at 12.

on the reasonableness of Transco's proposed 15.34% pre-tax return. The State Commissions also requested that the Commission set for hearing the issue of an appropriate pre-tax return.[73]

The February 3 Order, like the July 7 Order and August 3 Order, found that "conducting DCF analyses in individual certificate proceedings would [not] be the most effective or efficient way for determining the appropriate ROEs for proposed pipeline expansions."[74] The Commission explained that it would difficult to complete a section 4-type analysis of return in section 7 cases in a timely manner and that doing so would unnecessarily delay proposed projects with time sensitive in-service schedules.[75] This finding ignores the fact that, in the past, the Commission has looked to DCF analyses to inform its rate of return findings in certificate proceedings.[76] Furthermore, the crux of this argument—that it would be too difficult or time consuming to ensure appropriate recourse rates in section 7 proceedings—is an abdication of the Commission's obligation under the NGA to protect consumers from excessive rates.[77]

FERC satisfies its consumer protection obligation by maintaining the integrity of recourse rates in certificate proceedings. If the recourse rates are not properly designed, they fail to provide the necessary check on the pipeline's market power at the time it

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[72] The State Commissions explained that the lack of specified ROE, debt costs, and capital structure in all of Transco's applications precludes any apples-to-apples comparison. *Id.* at 13.

[73] *Id.*

[74] February 3 Order at P 39, July 7 Order at P 24; August 3 Order at P 27.

[75] February 3 Order at P 39, July 7 Order at P 24; August 3 Order at P 27.

[76] *See, e.g.*, *WestGas InterState Inc.*, 59 FERC ¶ 61,029 at p. 61,065 (1992) (considering, among other factors, the results of a DCF analysis to find that the pipeline's requested 15% ROE should be reduced to 12.50%).

[77] *See, e.g.*, *California Gas Producers Ass'n v. FPC*, 421 F.2d 422, 428 (9th Cir. 1970).

matters most, when the pipeline is entering into negotiated rate agreements. The State Commissions explicitly raised this issue, but the February 3 Order does not address it.[78] That was clear error.

Merely accepting a fifteen year-old pre-tax return, when current economic conditions clearly demonstrate the excessive nature of that major portion of the cost of service underlying Transco's proposed recourse rates, runs counter to precedent. FERC's ratemaking function involves "pragmatic adjustments," the end result being the most important.[79] The end result here—allowing Transco to base its recourse rates on a 15.34% pre-tax return on billions of dollars of investment[80]—is the epitome of arbitrary and capricious decision-making. Given that ratepayer protection is the Commission's primary obligation under the Natural Gas Act,[81] rehearing is warranted in this case to correct the error of allowing Transco to develop excessive recourse rates.

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[78] The State Commissions raised this issue in their May 27 Answer at page 3. Although the Commission states that it accepted this answer because it provided information that assisted its decision-making (*see* February 3 Order at P 18), it failed to meaningfully respond to the State Commissions' arguments. An agency's "failure to respond meaningfully" to objections raised by a party renders its decision arbitrary and capricious. *Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001); *Pub. Serv. Comm'n v. FERC*, 397 F.3d 1004, 1008 (D.C. Cir. 2005).

[79] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

[80] As explained *supra*, while Docket No. CP15-118 "only" involves $190 million of new investment, the State Commissions also protested Transco's Dalton Expansion Project in Docket No. CP15-117 (estimated to cost $471.9 million) and the Atlantic Sunrise Project in Docket No. CP15-138 (estimated to cost $2.588 billion), for a total in excess of $3 billion.

[81] *Atlantic Refining Co. v. P.S.C. of New York*, 360 U.S. 378, 388 (1959).

c. Using Transco's Pre-Tax Return of 15.34% to Develop the Recourse Rate is Contrary to Commission Precedent Recognizing the Critical Importance of Relying on Current Market Conditions to Develop Capital Costs.

Transco's proposed incremental project recourse rate in this certificate proceeding is based on the specified pre-tax return of 15.34% underlying the design of its approved settlement rates in Docket No. RP01-245-000. Transco's more recently approved general rate case settlements in Docket Nos. RP12-993-000, *et al*. and RP06-569-004, *et al.* were both "black box" settlements that did not specify the rate of return or most other cost of service components used to calculate the settlement rates. In accordance with the Commission's policy of using the rate of return from the most recent section 4 proceeding in which a specified rate of return was used to calculate the rates, Transco applied the 15-year old 15.34% pre-tax return in this proceeding.

Although Transco followed the Commission's policy, application of that policy in this case results in an arbitrary and capricious finding as it is inconsistent with prior Commission precedent. Commission precedent recognizes the critical importance of basing an ROE on current market data, including market data during times of allegedly anomalous conditions.[82] As the Supreme Court has recognized, there is a sound basis for using current market data. Namely, a just and reasonable return will change as market conditions change.[83] Relying on a pre-tax return developed in the early years of this

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[82] *See, e.g.*, *Portland Natural Gas Transmission Sys.*, 142 FERC ¶ 61,198 at P 233 (2013) (finding that "on balance…the use of the most recent data in the record consistent with long standing policy outweighed any adjustment to reflect purportedly anomalous results"), *order on request for rehearing and refund report*, 150 FERC ¶ 61,106 (2015).

[83] *See Bluefield Water Works v. Pub. Serv. Comm'n*, 262 U.S. 679, 693 (1923) (holding that a return "may be reasonable at one time and become too high or too low by

century simply does not comport with this precedent requiring use of current market data. Accordingly, the Commission should grant rehearing on this issue and set for evidentiary hearing the issue of an appropriate return.

d. The Commission's Rationale that it is Adequate in a Section 7 Proceeding for FERC to "Hold the Line" until Rates Can be Adjudicated in a Future Section 4 Proceeding is an Inadequate Remedy to Address Transco's Use of an Excessive Pre-Tax Return to Develop Recourse Rates.

In order to justify its decision of allowing recourse rates to be developed using an excessive return, the Commission cites a 1959 decision explaining that it is an appropriate exercise of discretion in section 7 proceedings to approve initial rates that will "hold the line" until just and reasonable rates are adjudicated under section 4 or 5 of the Natural Gas Act.[84] This purported solution does nothing to ensure that the recourse rates in this proceeding are not excessive. To begin, negotiated rates did not exist in 1959 at the time of this decision. This change in circumstance renders this decision inapposite. The Commission also relies on the fact that Transco is required to file an NGA general section 4 rate case by August 31, 2018, pursuant to the comeback provision in Article 6 of the settlement in Docket No. RP12-993.[85] While it is true that parties may challenge the issue of return in that future proceeding, Transco's recourse rates will remain excessive until that future date. Thus, "holding the line" until the next section 4 or 5 proceeding is deficient because any section 4 filing will go into effect after the rate is

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changes affecting opportunities for investment, the money market and business conditions generally").

[84] February 3 Order at P 39 (citing *Atlantic Refining Co. v. Public Serv. Comm'n of New York*, 360 U.S. 378 (1959)).

[85] July 7 Order at P 25 (citing *Transcontinental Gas Pipe Line Co., LLC*, 144 FERC ¶ 63,029 (2013)); August 3 Order at P 28 (same).

filed. Furthermore, unless the initial recourse rates filed with a certificate application are based on a reasonable estimate of the pipeline's actual costs, they will not achieve their purpose—to provide a check on the pipeline's market power when the pipeline is entering into the negotiated rates as required by the Commission's Negotiated Rate Policy. Raising this issue in Transco's next rate case will not address the time frame that actually matters (*i.e.*, the period during which the parties agreed to the negotiated rates).[86] Nor will the negotiated rates be at issue in the next rate case – those negotiated rates are set for the term of the contract. Accordingly, the State Commissions request that the Commission grant rehearing of this issue and set for evidentiary hearing the issue of an appropriate return.

2. The Commission's Findings that Transco Met its Burden of Proof to Demonstrate that the Proposed Lease Meets this Standard Even Though it Only Provided an Analysis of One Year of Data is Not Reasoned Decision-Making and Fails to Satisfy the Arbitrary and Capricious Standard.

As noted above, the Commission's primary obligation under the NGA is to ensure that consumers do not pay excessive rates.[87] In the context of a certificate application under section 7 of the NGA, the Commission is obligated to make certain that the proposed project is consistent with the public interest.[88] A Commission order will be reversed on review if it is arbitrary or capricious, reflects an abuse of discretion, is not otherwise in accordance with law, or is not supported by substantial evidence.[89] In order

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86 Negotiated Rate Policy Statement at P4.

87 *See, e.g.*, *California Gas Producers Ass'n v. FPC*, 421 F.2d 422, 428-29 (9th Cir. 1970).

88 15 U.S.C. § 717f(c) (2012).

89 *South Carolina Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 54 (D.C. Cir. 2014); *Sacramento Mun. Util. Dist. v. FERC*, 616 F.3d 520, 528 (D.C. Cir. 2010).

to survive review under the "arbitrary and capricious" standard, the Commission must "examine the relevant data and articulate a satisfactory explanation for its actions, including a 'rational connection between the facts found and the choice made.'"[90]

In the February 3 Order, the Commission recognizes that its practice has been to approve a lease if it finds that: (1) there are benefits from using a lease arrangement; (2) the lease payments are less than, or equal to, the lessor's firm transportation rates for comparable service **over the terms of the lease on a net present value basis**; and (3) the lease arrangement does not adversely affect existing customers.[91] As explained below, the Commission's findings in paragraphs 60-61 of the February 3 Order—that Transco met its burden of proof to demonstrate that the proposed 20 year lease meets this standard even though it only provided an analysis of one year of data—are not the product of reasoned decision-making and fail to satisfy the arbitrary and capricious standard.

Despite the fact that the lease has a primary term of 20 years, FERC's analysis was limited to estimates of the first year of cost of service versus the lease payments.[92] Even though the Commission only analyzed one year of data, it nonetheless found that "approval of this lease agreement will reduce Transco's costs associated with the project, by an estimated $66,430,118 **per year**."[93] The facts found simply do not flow from the

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[90] *See Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

[91] February 3 Order at P 56, emphasis supplied (citing *Midcontinent Express Pipeline LLC*, 124 FERC ¶ 61,089 (2008), *order on reh'g*, 127 FERC ¶ 61,164 (2009), *order on remand*, 134 FERC ¶ 61,155 (2011); *Colorado Interstate Gas Co.*, 122 FERC ¶ 61,256, at P 30 (2008); *Gulf South Pipeline Co., L.P.*, 119 FERC ¶ 61,281, at P 37 (2007)).

[92] *Id.*

[93] *Id.* at P 57 (emphasis supplied) (citing Exhibit N, Line 15).

evidence proffered. The record is devoid of any evidence of the costs of Transco constructing and owning the facilities beyond the first year.[94] The finding that there will be "per year" savings is undermined by the Commission's recognition that as the leased facilities are depreciated over time, the cost of service should decrease due to the decrease in rate base, and Transco's analysis did not take into account the impact of depreciation because it was limited to one year.[95] Accordingly, the Commission's finding that there will be savings any time after the first year is not supported by any, much less substantial, evidence.

The State Commission are not trying to delay or impede the development of needed pipeline infrastructure. Rather, the State Commissions are simply asking that the Commission require that Transco, as an applicant seeking a certificate of public convenience and necessity, comply with the clear requirements of the NGA and demonstrate that issuance of the requested certificate for the leased portions of capacity would be consistent with the public interest. Given the 20-year initial term of the lease, reasoned decision-making would seem to require analyzing more than simply the economics of the first year of the lease. The reasonableness of a life of the lease analysis is confirmed by the Commission's recognition that the second prong of its long-standing practice in analyzing leases is to perform the economic analysis "over the terms of the lease on a net present value basis."[96]

Rather than providing any analysis beyond the first year, Transco asserts its belief that "any reasonable analysis" of the annual lease payments over the primary term of the

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[94] *See* Transco Answer at 6-7.

[95] *See* February Order at 60.

[96] *Id.* at P 56.

leased capacity would demonstrate that the proposed lease complies with the Commission's requirements.[97] The State Commissions do not doubt Transco's belief. In fact, Transco's assertion of that belief demonstrates the reasonableness of requiring Transco to support its request for a certificate for the capacity it proposes to lease for 20 years with a life of the lease analysis. To put it another way, given that the NGA places the burden of proof on the applicant, simply requiring Transco to "show its work" and back up its claim with a life of the lease analysis should be an essential element of issuing a certificate for capacity obtained under a 20-year lease. It was not reasoned decision-making to issue the certificate for the leased capacity without requiring Transco to do so, and without that analysis, the Commission's findings lack the necessary substantial evidence.

Transco also asserted that, as a practical matter, there is no way to know what future Project rates will be over the lease term, assuming Transco constructed and owned all of the corresponding Project facilities.[98] That argument ignores the fact that every analysis of cost and benefits of long-term assets by necessity requires some projections. Despite the lack of precision, the second prong of the Commission's practice requires sufficient evidence to support a finding that lease payments are less than, or equal to, the lessor's firm transportation rates for comparable service over the terms of the lease on a net present value basis.[99] The lack of perfect cost and revenue projections should not be allowed to negate the requirements that an applicant must support its request for a

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[97] Transco Answer at n.10.

[98] *Id.*

[99] *See* February 3 Order at P 56.

certificate, and that the Commission's finding must be supported with, substantial evidence.

The Commission's reliance on 18 C.F.R. § 157.14(a)(19),[100] which only requires a one year of projected cost and revenue data to support initial rates, is also misplaced. Even Transco did not assert that that regulation is definitive as to the requirements of the public interest showing mandated by the NGA. Instead, Transco merely stated that its use of a first year of data is "consistent with" that regulation.[101] In any event, the issue is not whether the initial rates were precisely calculated. The issue is whether or not the Commission has evaluated "all factors bearing on the public interest."[102] The State Commissions submit that ignoring 95% of the life of lease in its economic analysis of that lease results in the Commission failing to have evaluated all factors bearing on the public interest determination regarding the lease. Accordingly, the Commission should grant rehearing and require Transco to provide a life of the lease analysis of the economics of the lease.

III. CONCLUSION

WHEREFORE, the North Carolina Utilities Commission and the New York State Public Service Commission respectfully request that the Commission grant rehearing of the afore-mentioned findings in its February 3 Order in Docket No. CP15-138.

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[100] *Id*. at P 60.

[101] Transco Answer at 6.

[102] *See* February 3 Order at P 39 n.64 (quoting *Atlantic Refining Co. v. Public Serv. Comm'n. of New York*, 360 U.S. 378, 391 (1959)).

Date: March 6, 2017

Respectfully Submitted,

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CERTIFICATE OF SERVICE

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010 (2016), I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, DC, this 6th day of March, 2017.

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