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4 Things To Watch As FERC Sets Sights On Pipeline Policies

By **Keith Goldberg**

Law360 (May 14, 2018, 7:55 PM EDT) -- From revamping 20-year-old guidelines for approving natural gas pipelines to sparking a massive rewrite of oil and gas pipeline contracts, the Federal Energy Regulatory Commission is working on several policy changes that could reshape how the pipeline industry does business.

That all these moves are happening at the same time isn't unexpected, pipeline attorneys say. The massive buildout of pipeline infrastructure due to soaring U.S. oil and gas production and the Trump administration's embrace of pro-business policies, including corporate tax changes and streamlined project permitting, have created conditions ripe for policy changes at FERC.

"The assumption was it was going to be clearly moving in a direction more favorable to the pipeline industry," White & Case LLP partner Jane Rueger said. "What has come out so far has the potential to be more 'win some, lose some.' Some of it is still in flux."

Here are four policy issues percolating at FERC that the pipeline industry is watching closely.

Gas Pipeline Approval Policy

Last month, FERC formally kicked off a review of its 1999 gas pipeline approval policy statement by issuing a notice of inquiry seeking public feedback on potential changes. And commissioners have said they're eager to tackle issues including FERC's reliance on developers inking gas shipping contracts and what role climate change should play in evaluating a project's need.

"It looks to me like they're willing to look at things that would help the industry and things that industry would have to grapple with," Rueger said. "That has an effect on investment."

FERC's willingness to re-examine its consideration of so-called precedent shipping agreements and service contracts as evidence of a pipeline project's need is an eyebrow-raiser. Shipping agreements are generally 20 years long, and Morgan Lewis & Bockius LLP partner Kirstin Gibbs said it'd be pretty hard to find a stronger indication of a project's need than a willingness to make such a long-term commitment, even if the agreements are inked with affiliates of the pipeline developer.

"FERC will have to be very careful at how it looks at this," Gibbs said. "I'd hate to have them implementing something where they're picking the winners and losers and determining what the market demand is."

Meanwhile, attorneys say FERC's request for feedback to evaluate a project's environmental impacts, including climate change impacts, has been teed up not only by the D.C. Circuit's decision last year ordering FERC to consider the downstream greenhouse gas emissions impacts of pipelines it approves, but the sheer volume of rehearing requests and court challenges the commission is facing over its project approvals.

Democratic Commissioner Cheryl LaFleur, for one, said she wants input on how the commission evaluates upstream and downstream GHG impacts and if and how it can use the social cost of carbon in its climate change analysis.

"So far, FERC has been pretty steadfast in not approving the social cost of carbon method that many environmental constituents have proposed," Rueger said. "That's been upheld by the courts so far as long as FERC can explain the method it's used, but now that's up for analysis."

Oil Pipeline Marketing Affiliates

FERC sent shock waves through the oil pipeline sector in November when it ruled that a company's plan for its marketing arm to buy up pipeline space at full price while reselling it at a discount is illegal.

FERC may have said Magellan Midstream Partners LP's proposal would constitute an illegal "rebate" under the Interstate Commerce Act, which governs oil and liquid pipeline rates, as well as discriminate against marketing companies that aren't affiliated with the pipeline operator and have to pay the full price to buy, sell and ship along Magellan's pipeline. But with marketing affiliates commonplace in the oil pipeline sector, FERC's decision could force companies to re-examine, and potentially renegotiate their own deals, attorneys say.

It's little wonder that several oil pipeline companies have joined Magellan in urging FERC to reconsider its ruling, or at least clarify it.

"To me, that's the really big one," Gibbs said.

If FERC sticks with its decision, pipeline companies may have to alter how their marketing affiliates do business, whether it's demonstrating a legitimate business reason why they've inked agreements where the affiliates are taking a loss on sales, or simply walking away from deals.

Attorneys say it could also embolden parties — notably, unaffiliated marketing companies and pipeline shippers paying full price — to file complaints with FERC if they suspect pipeline operators have brokered similar deals with marketing affiliates.

Tax Policy Changes and Pipeline MLPs

Many pipeline companies are organized as master limited partnerships, which throw off cash to investors while avoiding corporate-level taxes. In March, FERC said it would no longer allow pipeline MLPs to recover income tax allowances in the cost-of-service rates they charge.

The revised policy statement was in response to the D.C. Circuit's 2016 ruling that scrapped SFPP LP's tax allowance that several airlines and oil companies had complained resulted in a double recovery for the liquids pipeline MLP's investors.

"For other pipelines organized as MLPs, they'll just wait until they have to comply with the policy statement and they'll then be aggrieved for purposes of judicial review if they wish to appeal," Latham & Watkins LLP partner Gene Elrod said. "The order is not a model of clarity."

That's especially true for gas pipelines, which rely more heavily on rates negotiated between pipeline operators and shippers. When FERC announced it would no longer allow MLPs to recover income tax allowances in cost-of-service rates, it also initiated a notice of proposed rulemaking that directs pipeline operators to disclose the effect of that policy change on its rates.

"There's still some uncertainty as how that's going to play out and which pipelines are going to be affected," Rueger said. "Other pipelines have settlement rates and haven't been into FERC for a rate case for a while."

The notice of proposed rulemaking also wants gas pipeline operators to disclose the rate effects of the Tax Cuts and Jobs Act of 2017 that slashed corporate tax rates from 35 percent to 21 percent. Both requests could be a precursor to FERC determining that rates charged by some gas pipelines are unjust and unreasonable.

For oil pipelines, FERC said it would address the tax changes when it does its next five-year review and setting of the oil pipeline index rate in 2020. The index rate allows pipeline companies to increase their rates subject to caps based on an adjusted index of industrywide cost changes instead of making formal rate increase applications with the commission.

"It remains to be seen whether there will be two indices, one for C-corp. pipelines and one for MLP pipelines," Elrod said. "The vast majority of pipelines change their rates according to the index. In that sense, oil pipelines got a bit of a break. On the gas pipeline side, they get hit with the tax changes earlier."

Standards of Conduct for Oil Pipelines

FERC is currently mulling a rulemaking petition lodged in February by airline industry group Airlines for America and the National Propane Gas Association asking the commission to craft so-called "standards of conduct" regulations for oil pipelines that would wall off their marketing operations from their transmission operations. Currently, FERC only has such regulations for gas pipelines and electric utilities.

"Essentially, what the standards of conduct do is preclude employees who have day-to-day responsibility for marketing functions from communicating with employees with day-to-day responsibility for transmission functions," Elrod said. "The concern is that sharing transmission-function information with marketing affiliates would give a leg up to the marketing affiliates over the rest of those who use the transmission system."

Gibbs said a straight line can be drawn between the rulemaking petition and the Magellan case decided by FERC last fall. Indeed, the petitioners heavily cite the Magellan case in urging FERC to establish standards of conduct for oil pipelines.

Oil pipeline companies, including the sector's main trade group, the Association of Oil Pipelines, have told FERC that there's no evidence of abusive industrywide practices that would make standards of conduct necessary and that adopting such a rule would force companies to restructure their operations, at high costs.

But Gibbs said the crux of the matter is that adopting standards of conduct regulations would create another compliance risk for oil pipeline operators.

"It just creates more risk that someone makes a mistake and can be fined for violating standards of conduct," Gibbs said.

--Editing by Katherine Rautenberg and Catherine Sum.
