

March 10, 2014

FERC Reaffirms Reliance on “Committed Shipper” Rate Agreements for Oil Pipelines

The Commission emphasizes that a committed shipper negotiated rate’s deviation from cost-of-service does not overturn the presumption that the rate is just and reasonable.

In addressing interstate pipeline requests to build new infrastructure for facilities subject to the Interstate Commerce Act, the Federal Energy Regulatory Commission (FERC or the Commission) has permitted pipelines to negotiate long-term agreements with anchor or “committed” shippers following publicized open seasons. FERC has approved committed shipper negotiated rates that deviate from strict cost-of-service ratemaking principles and has permitted parties additional flexibility on some terms and conditions of service. On September 13, 2013, a FERC administrative law judge (ALJ) issued an initial decision in *Seaway Crude Pipeline Co.*¹ The Initial Decision found that committed shipper rates must be cost-based. Committed shippers and the pipeline challenged that finding. On February 28, a unanimous Commission reversed the Initial Decision.²

The Commission’s Order

Rejecting the ALJ’s decision in its entirety, FERC emphasized that the requirement to provide cost-of-service data does not also require committed rates to be cost-based. The Commission highlighted its “well-established policy of honoring negotiated contract rates,”³ which the ALJ failed to respect. Although the Commission acknowledged, as did the ALJ, its authority to modify committed rates that it finds unjust and unreasonable,⁴ it expressly declined to exercise that authority. The Commission also pointed out that pipelines must support protested uncommitted rates with cost data, but not committed rates.⁵

The Rationale

The Commission underlined that it accepts a number of ratemaking methods in addition to cost-of-service ratemaking and acknowledged that negotiated rates are not necessarily unjust or unreasonable. More specifically, in the present context, the Commission said that negotiated rates between “sophisticated businesses” might involve a number of rationales in the valuation of the services.⁶ Just and reasonable rates need not be cost-of-service, but they must “fall within the oft-cited zone of reasonableness, where rates are neither less than compensatory nor excessive.”⁷

At the same time, FERC set guidelines for when it might find a negotiated rate to be unjust and unreasonable.

1. Docket No. IS12-226-000, 144 FERC ¶ 63,026 (2013) [hereinafter Initial Decision].

2. *Seaway Crude Pipeline Co. LLC*, Docket No. IS12-226-000, 146 FERC ¶ 61,151 (2014), available at <http://www.ferc.gov/CalendarFiles/20140228184140-IS12-226-000.pdf>.

3. *Id.* at P 17.

4. The ALJ justified the rate modification under a Transportation Service Agreement term, while the Commission cited its authority to modify rates under the Interstate Commerce Act. *See id.* at PP 18–19.

5. *See id.* at P 20.

6. *See id.* at P 25.

7. *See id.* at P 27 (internal citation and quotations omitted).

Specifically, “contract negotiations must be held in good faith and not involve fraud or improper conduct.”⁸ To protect against abuses of market power, shippers that refuse to or cannot pay a negotiated rate must receive “an alternative cost-based” uncommitted rate.⁹ Further, the Commission will not require pipelines to show that they lack market power in order to justify their negotiated rates unless “a pipeline’s non-cost based rates will be payable by all shippers.”¹⁰ The Commission suggested that it would consider modifying a contract “where the negotiated rate places an excess burden on [third parties],” but it found that this was not the case here.¹¹ Finally, the Commission emphasized that it would honor negotiated rates when “the process was open, transparent, and free of the traditional contract nullifiers.”¹² In FERC’s view, as long as negotiations are fair, deviations from cost-of-service do not by themselves make negotiated rates unjust and unreasonable.

The Outcome

The Commission reversed and remanded the ALJ’s decision for a “revised Initial Decision.” Citing a public interest in finality, the Commission declined to reopen the evidentiary record. However, the Commission allowed briefs that addressed exceptions in the proceeding.

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8. *Id.* at P 28.

9. *See id.* at PP 29–30.

10. *Id.* at P 32.

11. *Id.* at P 33.

12. *Id.* at P 37.