

Morgan Lewis

Navigating FERC Rate Complaints

The Natural Gas Industry Experience and Possible Signs
and Portents for Electric Transmission Providers



Why Here, Why Now?

- FERC has initiated and resolved two cycles of Section 5 rate complaints against interstate natural gas transmission providers.
- Chairman Wellinghoff has indicated that this process will continue and may be exported to the electric transmission industry:
 - FERC will look at the level of transmission providers' earnings and ask if they are overcharging
 - If earnings are in excess of a reasonable rate of return, without mitigating factors or one-time events, FERC may initiate a rate investigation

Lessons from the Natural Gas Industry

Where Does FERC Begin?

- In both November 2009 and November 2010, FERC initiated five rate investigations of interstate natural gas pipelines based upon a detailed review of their annual financial reporting requirements contained in FERC Form No. 2 (Form 2).
- Form 2 was revised in March 2008 to enhance transparency of financial reporting and to better reflect current markets and cost information. These changes included new reporting requirements to provide detailed information regarding:
 - Acquisition and disposition of fuel use and lost and unaccounted-for gas
 - Affiliate transactions
 - Non-traditional rate treatment afforded new or incremental projects
 - Reporting of revenues and volumes applicable to discounted and negotiated rate services

What Does Form 2 Not Tell the Commission?

- Form 2 does not calculate rates.
- Form 2 is purely historical.
- Form 2 provides no information on cost allocation or rate design among services.
- Form 2 provides marginal relevant information on the allocation of administrative and general costs among the constituent members of a natural gas pipeline holding company.

Who Is the Complainant?

- Section 5 of the Natural Gas Act provides:

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order
- A complainant need not be among the entities listed in Section 5 nor does it justify dismissal of a complaint on a basis of lack of standing if the complainant is not one of the parties specified in Section 5.
 - According to the Commission's procedural rules, any person may file a complaint seeking Commission action against any other.
 - A complaint filed with the Commission by a party other than those listed in Section 5 can be a request to the Commission asking that a Section 5 investigation be initiated by the Commission against the respondent.

Who Is the Complainant? (Cont'd)

- A complaint can be initiated by FERC on its own motion; or by FERC in response to a complaint from a state; state commission; municipality or gas distribution company; or by FERC in response to a motion or complaint by any other third party.
 - According to a recent court ruling, once the Commission has determined that a rate is unjust and unreasonable by initiating a rate investigation upon its own accord or in response to a complaint, it is the responsibility of the Commission to find a just and reasonable rate
- Once a complaint is set for hearing, and once intervenors obtain party status, they maintain their basic procedural rights.

How Have Natural Gas Pipelines Responded to FERC Initiated Complaints?

- Review of Basic Defense Strategies:
 - That Was Then, This Is Now.
 - PHMSA
 - Acquisition Premiums
 - The Springing Section 4 Rate Increase Proceeding
 - Service Changes

That Was Then, This Is Now

- Past period overrecoveries may have existed. Anticipated changes suggest a gloomy tomorrow in terms of :
 - Decontracting
 - Discounting
 - Competition
 - Declining Reserves

PHMSA

- Past period earnings did not reflect anticipated future spending to reflect pipeline safety mandates.

Acquisition Premiums

- Current rates may be defended through the use of an acquisition premium, the premium paid for a transmission asset above net book value
- Acquisition adjustments are permitted where the applicant can demonstrate:
 - It is either converting utility assets to a new public use or placing utility assets in FERC jurisdiction for the first time; and
 - The write-up provides substantial quantifiable benefits to ratepayers.
- The benefits requirement of the second prong remains a strict standard of proof and demands that the benefits alleged be tangible, quantifiable in monetary terms, and directly attributable to the expansion.
- FERC has previously stated that the burden of this benefits requirement may be practically impossible to meet.
- Acquisition premiums will be disallowed from rates without a showing of ratepayer benefit.

The Springing Section 4 Rate Increase Proceeding

- Overview of the Basic Strategy.
- The Last Clean Rate Doctrine and Section 5 refund floors.
- The Commission's unwillingness to revive interim rate reductions.
- Inapplicability to the Electric Transmission Industry.

Service Modifications

- Over time, pipelines and their customers can reach accommodations to ensure flexible service.
- Pipelines may argue that service flexibility should be reviewed if rates are to be reduced.

The Scorecard

- Overview of the outcomes of the FERC's initial Section 5 rate complaints.
 - Avoidance of hearing
 - Impact stemming from lack of refund liability
 - Fuel
 - Fuel trackers
 - Stay out and comeback

Lessons Learned and Unlearned

- On the NGA side, the absence of a refund effective date complicates the ability of FERC to review rates under Section 5 in a timely and appropriate manner.
- The conventional response to this fact has been to advocate legislative changes to Section 5, which does not appear to be imminent.
- FERC has, however, tools today to address some of the structural issues with Section 5 of the NGA in the form of interim rate relief.
- While FERC cannot mandate periodic rate increase filings under Section 4, FERC could mandate triennial cost and revenue studies.

FPA Section 206 Proceedings

- FPA Section 206 is FPA parallel to NGA Section 5
- Section 206 proceedings may be commenced by FERC on its own motion or by complaint.
 - Any “person” may file a complaint
- On FERC’s motion:
 - FERC has burden of proof
 - FERC must do two primary things:
 - Determine that the current rate charged is unjust and unreasonable.
 - Fix the just and reasonable rate to be thereafter observed.

Changing a Rate under 206

- Fixing the New Rate under Section 206:
 - Unlike NGA Section 5, new rate fixed under Section 206 can be a decrease or an increase.
 - To “fix” a rate, FERC must be specific; it can’t set forth only basic principles.
 - New rate can’t be retroactive.

206(b) Refunds

- Refunds may be ordered where customers paid rates in excess of the rates determined to be just and reasonable by FERC.
 - If rate fixed as just and reasonable is higher than current rate, FERC can't order customers to pay the difference.
- Refund is the difference between the rate that was charged and the rate determined by FERC to be just and reasonable.

206(b) Refund Effective Date

- For proceedings begun on its own motion, FERC may establish refund effective date at any time between the date of publication of notice of the proceedings and five months later.
- For proceedings begun by complaint, FERC may establish refund effective date at any time between date of filing of complaint and five months later.
- FERC policy: establish refund effective date to give maximum protection to customers.

206(b) Refund Effective Date

- EPAAct 2005 Changes to Refund Effective Date:
 - 206 Proceedings on FERC Motion
 - Can be as early as date of publication of notice of commencement of proceedings
 - 206 Proceedings on Complaint
 - Can be as early as date of filing of complaint

206(b) Refund Limits

- Refunds can be ordered for only a fifteen month period.
 - Generator Interconnection Case example:
 - Complaint filed September 16, 2003.
 - Refund Effective Date is April 15, 2004.
 - Just and reasonable rate fixed on January 19, 2007.
 - Customer gets refunds between April 15, 2004 and July 15, 2005 (fifteen months).
 - No refunds between July 15, 2005 and January 19, 2007.
- Exception: Dilatory tactics by the public utility caused delay in resolution of proceeding.

Transmission Rates

- A difference between Electric Transmission rates and Natural Gas Transportation rates: formula rates are common on public utility side
 - Structure of formulas for transmission rates are similar among public utilities.
 - Formulas are updated annually, based on the Form 1.
 - Typical “protocols” of formulas permit customers to challenge the annual updates informally and at FERC.
- Transmission Providers without formula rates that have not filed a rate case may be vulnerable.
 - “Stated” rates that have not been changed in 10+ years.
 - High ROEs relative to prevailing rates of return.

Market-Based Rates for Power

- With respect to wholesale power sales, many entities have market-based rates.
- FERC has series of “checks” in place to oversee market-based prices:
 - Electric Quarterly Reports
 - Notices of Change in Status
 - Order No. 697 Regional Market Power Update Process
- FERC uses these processes as a tool to determine whether to institute Section 206 proceeding to revoke market-based rates and require cost-based rates.

ISO/RTO Power Markets

- Many entities buy and sell power in ISO/RTO power markets at market-based rates
- FERC oversees prices in these power markets through various additional means
- Examples:
 - Independent market monitors
 - Automatic market mitigation measures and bid caps
- FERC has instituted Section 206 proceedings on ISO/RTO market rules and behavior of market participants
 - Examples of precipitating event: spike in market price, communication from independent market monitors

Cost-Based Power Sales

- Some sellers use cost-based power sales.
 - In some cases, cost-based power sales tariffs are used by sellers that have lost market-based rate authority.
 - Others have older vintage bilateral cost-based rates.
- Cost-based power sellers may use formula-based or stated rates.
- As with transmission, cost-based power sellers without formula rates that have not filed a rate case may be vulnerable to Section 206 proceedings.
 - “Stated” rates that have not been changed in 10+ years
 - High ROEs relative to prevailing rates of return
 - Older bilateral power sales agreements may have *Mobile-Sierra* clauses, making challenge more difficult.

NY CLE

- The NY alphanumeric code is: 05NRC2011

Conclusions