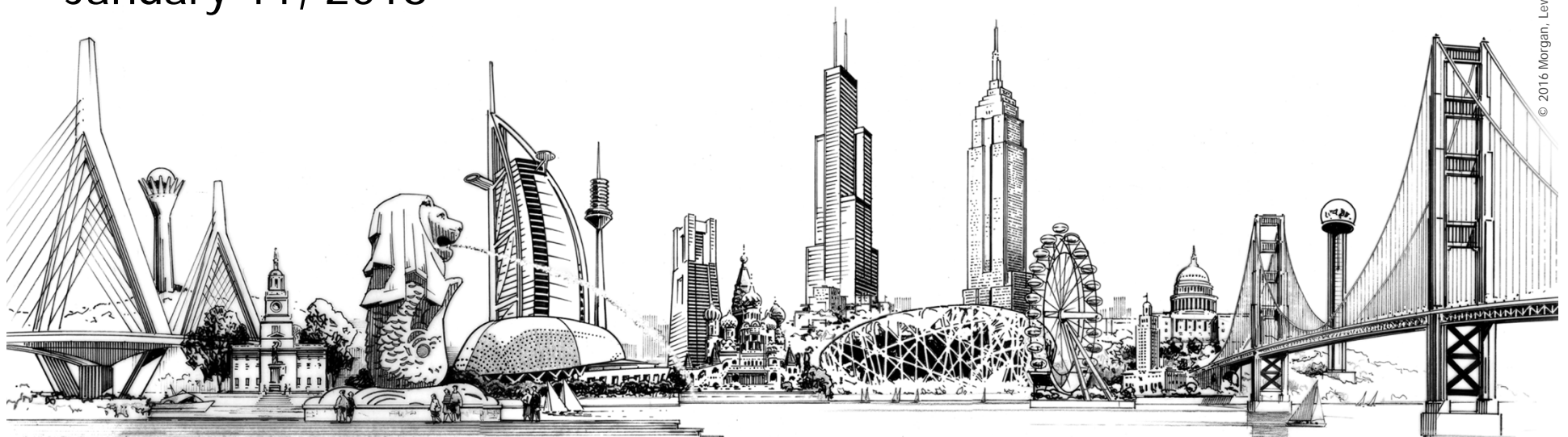


Morgan Lewis

OIL AND GAS: *REGULATORY ROUNDUP*

Levi McAllister and Pamela Wu
January 11, 2018



FERC Commission

- Commission restored to a full complement of five commissioners.
 - Chairman Kevin McIntyre
 - Sworn in on December 7, 2017
 - Will serve rest of term that expires on June 30, 2018 and another term that ends in 2023
 - Formerly in private practice and co-leader of the global Energy Practice
 - Commissioner Richard Glick
 - Sworn in on November 29, 2017
 - Term expires on June 30, 2022
 - Formerly the general counsel for the Democrats on the Senate Energy and Natural Resources Committee, serving as a senior policy advisor

Current Priorities of FERC

DOE Grid Resilience Proposal

- Secretary Perry granted FERC's request for a 30-day extension of time, but urged FERC to act before the deadline to ensure the resilience and security of the electric grid.
 - Additional time for newly sworn-in Chairman and Commissioner to consider the record, which includes more than 1,500 comments.
- FERC issued an order on January 8, 2018 that:
 - Terminated the rulemaking proceeding (RM18-1) that was initiated to address the Proposed Rule on Grid Reliability and Resilience Pricing;
 - Initiated a new proceeding (AD18-7) to evaluate the resilience of the bulk power system in RTOs and ISOs; and
 - Directed each RTO and ISO to submit information to FERC on certain resilience issues and concerns to enable FERC to examine the resilience of the bulk power system.

Current Priorities of FERC

Enforcement

- *De novo* reviews
 - FERC's position: federal court judge should rely on the investigative and administrative record submitted by FERC
 - Federal courts have held that de novo review requires "factual development through discovery" and not solely a review of the record underlying the FERC investigation or administrative process.
- Show Cause Orders
 - FERC will need to consider whether it will continue with its order to show cause process at the end of investigations.
- Procedural distinctions between power and natural gas enforcement cases.

No-Bump Rule

- In an October 2017 decision, FERC reiterated its policy applying a no-bump rule remains valid and enforceable.
 - Natural gas pipeline sought a waiver of the no-bump rule in order to permit certain Rate Schedule FHS shippers to bump previously scheduled interruptible service in the Intraday 3 nomination cycle.
 - In 1999, FERC accepted the no-bump rule, which provides that firm nominations submitted during the last intraday nomination cycle cannot bump previously scheduled interruptible service.
- Maintaining the no-bump rule ensures that there is no any stranded gas at the end of a business day.
- FERC views the permissible bumping of nominations in the first two nomination cycles combined with the no-bump rule to be a reasonable balancing of competing interests.

ICA: Becoming a Common Carrier

Common Carrier Status for Leased Facilities

- *Aircraft Service International Group, Inc. v. Central Florida Pipeline LLC and Kinder Morgan Liquid Terminals LLC*
 - Is a lessor who has given exclusive control over capacity at storage tanks a regulated party under the ICA?
 - Airline's complaint:
 - CFPL unlawfully provided for physical transportation of jet fuel in interstate commerce without filing a tariff with FERC, in violation of ICA Section 6(1)
 - KMLT unlawfully provided untariffed FERC jurisdictional break out tankage service at its liquids terminal in Florida in violation of ICA Section 6(1)
 - The rates charged by CFPL for the transportation of jet fuel are not just and reasonable.

ICA: Becoming a Common Carrier

- Phased litigation before a FERC ALJ.
 - Phase I: addresses whether the CFPL pipeline and KMLT terminal facilities are providing interstate oil pipeline transportation service that is subject to FERC's jurisdiction under the ICA.
 - Phase II: addresses all remaining issues set for hearing
- Phase I hearing was held in September and briefing was completed in November.
- FERC Staff's position:
 - The lessee of jurisdictional capacity becomes the common carrier of leased capacity. The airlines are regulated parties under the ICA because they have exclusive control over the leased capacity.
 - The lessor is not considered the common carrier subject to the ICA for the leased capacity. KMLT is not subject to ICA common carrier requirements insofar as the tanks remain leased to the airlines and no new shipper requests service.
 - The tanks are jurisdictional to the extent the airline's shipments are jurisdictional.
- Initial Decision is expected on or before January 23, 2018.

ICA: Discriminatory Practices Among Affiliates

- In *Magellan*, FERC found that commercial arrangements in which a marketing affiliate ships crude oil (or other products subject to ICA jurisdiction) on an affiliated pipeline at an economic loss amounts to an unlawful rebate.
 - Magellan sought approval to establish a marketing affiliate that would buy, sell, and ship crude oil on Magellan's pipeline system at the applicable tariff rate.
 - Magellan further requested that FERC approve specific a structure whereby it was permissible for the marketing affiliate to transport crude at an economic loss when the price differentials between the origin and destination points were lower than the published tariff rates paid by the affiliate.
 - Magellan explained that such an arrangement would provide an overall benefit to the integrated company so long as the price differential exceeds the variable costs of the movement.
 - FERC denied the request.
 - The proposed transactions were barred under Section 6(7) of the ICA, which prohibits a carrier from providing rebates of the filed rates.
 - Direct or indirect payments back to a shipper constitute prohibited rebates from the filed tariff rate, and even though the affiliated shipper would facially pay the pipeline's tariff rate, the integrated nature of the companies coupled with the intentional loss on the marketer's buy/sell arrangement would act as an indirect payment back to the affiliated marketer to support that loss.
- What is the rebate?

Oil Pipeline Ratemaking Methodologies

- Does Q3 2017 foreshadow a shift to greater reliance on MBR for crude oil and liquids rates?
 - West Texas LPG MBR application
 - WTXP sought MBR approval for NGL transport to Mont Belvieu.
 - WTXP states that it would have “greater flexibility in setting rates than that currently available to it” under FERC’s indexing and cost-of-service ratemaking regulations.
 - Oil Pipeline Rate Index Formula
 - DC Circuit found that FERC adequately and reasonably explained its decision to adopt the index formula that governs pipeline rates for the 2016-2021 period.
 - FERC used:
 - Page 700 cost-of-service data because (1) it better reflected changes to recoverable costs, (2) eliminated the need to use proxies to measure capital costs and income tax costs, and (3) would no longer commingle interstate and intrastate costs.
 - Middle 50% of pipeline cost-change data because the middle 80% was more likely to have outlying cost change and would have skewed the index upward
 - FERC is not required to apply the same methodology as in prior index reviews.
 - Don’t forget the NOI!

FERC Annual Enforcement Report

- Same priorities as previous years:
 - Fraud and market manipulation
 - Serious violations of the Reliability Standards
 - Anticompetitive conduct
 - Conduct that threatens the transparency of regulated markets
- In 2017:
 - DOI Staff opened 27 new investigations and closed 16 pending investigations with no action or through settlement.
 - Settlements involved more than \$51 million of civil penalties and disgorgement of over \$42 million in unjust profits.
 - DAS provided analytical support on approx. 50 investigations with DOI.
 - DAA Staff conducted 11 audits of oil pipelines, electric utilities, and natural gas companies, resulting in 301 recommendations for corrective action and directing refunds and recovery of \$13.3 million.

FERC Annual Enforcement Report

- Examples of Enforcement Actions Resolved by Settlement in FY2017:
 - Gaming of Market Rules – GDF SUEZ Energy Marketing NA, Inc. inflated the amount of lost opportunity credits it would receive by offering generation resources at below-cost offers when the units would otherwise be out of the money and when it knew they would have a low likelihood of being dispatched.
 - \$41 million civil penalty; \$40.8 million disgorgement
 - Cross Market Manipulation – City Power Marketing used PJM Up to Congestion transactions at certain pricing nodes as a pretext to reserve unprofitably large volumes of transmission to earn a larger share of Marginal Loss Surplus Allocation under PJM rules.
 - City Power: \$9 million civil penalty
 - Tsingas: \$1.42 million civil penalty; \$1.3 disgorgement; 3-year trading ban

FERC Annual Enforcement Report

- Self Reports
 - 80 new self-reports
 - Closed 121 self-reports (includes some carried over from previous fiscal years)
 - Ex. Shipper Must Have Title (SMHT) and Prohibition on Buy-Sell Transactions: a large public utility self-reported violations on behalf of certain recently-acquired retail natural gas marketing subsidiaries. Violations were discovered due to compliance training, which enabled employees to identify problematic transactions observed during the integration process. Closed with no action because violations (1) were inadvertent, (2) involved modest volumes of gas, and (3) did not result in harm to other market participants.
 - Ex. SMHT Violation: a natural gas pipeline incorrectly transported gas owned by third parties using a shipping contract controlled by a different entity. Closed with no action because violation lasted less than 24 hours, was not intentional, and was quickly identified through the pipeline's internal compliance processes.

CFTC Enforcement Report

- In 2017, CFTC Enforcement:
 - Brought 49 enforcement actions
 - Anti-manipulation
 - Spoofing
 - Unlawful use of customer funds
 - Retail fraud
 - Obtained orders that obtained \$413 million in restitution, disgorgement, and penalties
 - Implemented enhancements to increase the effectiveness and strength of the enforcement program.
 - Realigned the market surveillance unit under the Division of Enforcement
 - Issued cooperation advisories

CFTC Swap De Minimis Threshold

- CFTC delayed implementation of the reduction in the *de minimis* threshold by another year.
- *De Minimis* Exception: a person is not considered to be a swap dealer unless its swap dealing activity exceeds an aggregate gross notional amount threshold.
 - Current threshold = \$8 billion, subject to a phase in period
 - Post-phase in period threshold = \$3 billion
- Phase in period termination was extended from December 31, 2018 to December 31, 2019.
- CFTC plans to take further action on the *de minimis* threshold before the phase-in period terminates.

Virtual Currency Trading

- Virtual currencies are commodities under the CEA.
 - Bitcoin
 - Blockchain
- CFTC jurisdiction is implicated when:
 - Virtual currency is used in a derivatives contract
 - If there is fraud or manipulation involving a virtual currency traded in interstate commerce.
 - Pre-arranged or wash trading in an exchange-traded virtual currency swap or futures contract.
- CFTC maintains general anti-fraud and manipulation enforcement authority over virtual currency cash markets as a commodity in interstate commerce, but its regulatory oversight authority over commodity cash markets is limited.

2018: What to Expect

Review of Policy Governing Pipeline Approvals

- Policy Statement on Certification of New Interstate Natural Gas Pipeline Facilities was issued in 1999 and explains how FERC evaluates proposals for certificating new gas pipeline construction.
- Issues for identified for review:
 - How FERC conducts its environmental review
 - Factors FERC considers when determining the economic needs of gas pipeline proposals
 - Opportunities for potential improvements and greater efficiencies
- Chairman McIntyre does not believe the review will affect current pending pipeline applications.

2018: What to Expect

Natural Gas rate case litigation

- Seven pipelines due to file rate cases in 2018.
- Potential for FERC initiation of proceedings under Section 5.
- Questions regularly arise in rate case proceedings concerning rate base computations, operating and maintenance expenses, depreciation, revenue credits, and the expenses properly included in the appropriate Base Period (as adjusted) when considering the pipeline's revenue requirement.
 - It is also quite common to analyze questions surrounding capital structure when considering questions relating to just and reasonable rates of return.
- In 2018, novel issues are expected to also be raised.
 - Impact of Trump tax cuts
 - Evidentiary showing for a modernization tracker
 - Tax allowance treatment in light of *United Airlines*

2018: What to Expect

Additional Issues:

- Oil and liquids pipeline allocation
- Oil and liquids ratemaking issues
- Evolution of blockchain in the energy trading sector
 - Regulatory questions?

Questions?



Levi McAllister

- levi.mcallister@morganlewis.com
- +1.202.739.5837



Pamela Tsang Wu

- pamela.wu@morganlewis.com
- +1.202.739.5199

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