UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

PennEast Pipeline Company, LLC	Docket No. CP15-558-___

REQUEST FOR REHEARING OF THE NEW JERSEY DIVISION OF RATE COUNSEL

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713, and Section 19 of the Natural Gas Act ("NGA"), 15 U.S.C. § 717r, the New Jersey Division of Rate Counsel ("NJ Rate Counsel"), an intervenor in this proceeding, hereby seeks rehearing of the Commission's January 19, 2018, *Order Issuing Certificates* in the above-captioned proceeding and rescission of that certificate.[1] The January 19 Order authorizes PennEast Pipeline Company, LLC ("PennEast") to construct and operate a new, 116-mile natural gas pipeline from Luzerne County, Pennsylvania, to Mercer County, New Jersey, along with three laterals extending off the mainline, a compressor station, and appurtenant above-ground facilities (together, "the Project").

Rehearing is appropriate because the Commission's authorization of the Project is not supported by the record. As NJ Rate Counsel has explained in its filings in this proceeding,[2] the record before the Commission fails to substantiate an essential fact: that the Project is actually needed. Even if the Commission did not err in finding a need for the Project, the Commission should still grant rehearing. PennEast's requested equity

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[1] *PennEast Pipeline Co., LLC*, 162 FERC ¶ 61,053 (2018) ("January 19 Order").

[2] Comments of the New Jersey Rate Counsel (Sept. 12, 2016), eLibrary No. 20160912-6003 ("NJ Rate Counsel Initial Comments"); Motion for Leave to Answer and Answer of New Jersey Rate Counsel (Nov. 14, 2016), eLibrary No. 20161114-5358 ("NJ Rate Counsel Reply Comments").

return and cost of debt for the Project are excessive and should not have been approved, providing additional independent grounds on which the Commission should grant rehearing.

For the reasons stated herein, the Commission should grant NJ Rate Counsel's request for rehearing, rescind the certificate, address deficiencies in the Final Environmental Impact Statement, and comply with the Commission's obligations pursuant to the National Environmental Policy Act ("NEPA"), 42 U.S.C. § 4321 *et seq.*, and the NGA, 15 U.S.C. § 717 *et seq*.

I. SPECIFICATION OF ERRORS

The January 19 Order errs in the following respects:

1. The Commission's grant of a certificate to PennEast to construct and operate the Project was contrary to substantial evidence, and therefore arbitrary and capricious. Record evidence demonstrates that PennEast's precedent agreements do not reflect genuine market demand. The evidence also demonstrates that the Project is not "required by the present or future public convenience and necessity." Administrative Procedure Act ("APA") § 706(2)(A), (E), 5 U.S.C. § 706(2)(A), (E); 40 C.F.R. § 1502.14(d); NGA § 7(e), 15 U.S.C. § 717f(e).

2. The Commission acted arbitrarily and capriciously when it failed to cite to or rely upon evidence of the Project's cost of capital, choosing instead to approve an excessive equity return on the ground that the Commission has "consistently approved equity returns of 14 percent."[3] APA § 706(2)(A), 5 U.S.C. § 706(2)(A).

3. The Commission acted arbitrarily and capriciously when it failed to cite to or rely upon evidence of the cost of Project-specific debt, and instead approved a debt cost because the "proposed 6 percent cost of debt is consistent with the cost of debt the Commission has approved for recent greenfield pipeline projects."[4] APA § 706(2)(A), 5 U.S.C. § 706(2)(A).

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[3] January 19 Order, P 61.

[4] January 19 Order, P 65.

II. STATEMENT OF ISSUES

1. Has the Commission acted arbitrarily and capriciously and without substantial evidence by issuing a certificate to construct and operate a pipeline when the Project has not been shown to be "required by the present or future public convenience and necessity?" APA § 706(2)(A), (E), 5 U.S.C. § 706(2)(A), (E); NGA § 7(e), 15 U.S.C. § 717f(e).

2. Has the Commission acted arbitrarily and capriciously in failing to cite to or rely upon evidence of the Project-specific cost of capital, and choosing instead to approve an equity return on the ground that the Commission has "consistently approved equity returns of 14 percent"?[5] APA § 706(2)(A), 5 U.S.C. § 706(2)(A).

3. Has the Commission acted arbitrarily and capriciously in failing to cite to or rely upon Project-specific evidence of the cost of debt, choosing instead to approve a debt cost because the "proposed 6 percent cost of debt is consistent with the cost of debt the Commission has approved for recent greenfield pipeline projects"?[6] APA § 706(2)(A), 5 U.S.C. § 706(2)(A).

III. BACKGROUND

On September 24, 2015, PennEast filed an application pursuant to NGA Section 7(c) and Parts 157 and 284 of the Commission's regulations seeking Commission authorization to construct and operate the Project.[7] The Project has an estimated cost of $1.13 billion, and will provide up to 1,107,000 dekatherms per day (Dth/d) of firm transportation service from northern Pennsylvania to markets in eastern and southeastern Pennsylvania, New Jersey, and surrounding states.[8] In response to the Commission's

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[5] January 19 Order, P 61.

[6] January 19 Order, P 65.

[7] Application of PennEast for Certificates of Public Convenience and Necessity and Related Authorizations (Sept. 24, 2015), eLibrary No. 20150925-5028 ("Application").

[8] The Project consists of 115.1 miles of new 36-inch-diameter pipeline extending from Luzerne County, Pennsylvania to Mercer County, New Jersey; the 2.1-mile Hellertown Lateral consisting of 24-inch-diameter pipe in Northampton County, Pennsylvania; the 0.1-mile Gilbert Lateral consisting of 12-inch-diameter pipe in Hunterdon County, New Jersey; the 1.5-mile Lambertville Lateral consisting of 36-inch-diameter pipe in Hunterdon County, New Jersey; a compression station, and various above-ground facilities.

Notice of the PennEast filing,[9] NJ Rate Counsel moved timely to intervene with full rights as a party to this proceeding.[10]

On January 13, 2015, FERC issued a Notice stating its intent to prepare an Environmental Impact Statement for the Project, seeking comments on environmental issues, and providing other information.[11] On July 22, 2016, Commission staff issued a Draft Environmental Impact Statement for the Project.[12] NJ Rate Counsel thereafter timely filed comments highlighting significant deficiencies in the Draft EIS, including its analysis of the need for the Project, and challenging PennEast's requested equity return, cost of debt, and capital structure.[13] In response to a further submission by PennEast, NJ Rate Counsel filed additional, reply comments on November 14, 2016.[14]

On April 7, 2017, Commission staff issued the Final Environmental Impact Statement for the Project,[15] which did not address the substance of any of the concerns raised by NJ Rate Counsel. Nine months later, the Commission issued the January 19 Order authorizing PennEast to construct and operate the Project.

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[9] PennEast Pipeline Co., LLC, Notice of Application (Oct. 8, 2015), eLibrary No. 20151008-3002.

[10] (doc-less) Motion to Intervene of the New Jersey Division of Rate Counsel (Oct. 28, 2015), eLibrary No. 20151028-5299.

[11] Notice of Intent to Prepare an Environmental Impact Statement for the Planned PennEast Pipeline Project, Request for Comments on Environmental Issues, and Notice of Public Scoping Meetings, *PennEast Pipeline Co., LLC*, Docket No. PF15-1-000 (Jan. 13, 2015), eLibrary No. 20150113-3000.

[12] Draft Environmental Impact Statement for the PennEast Pipeline Project (July 22, 2016), eLibrary No. 20160722-4001 ("Draft EIS").

[13] *See* NJ Rate Counsel Initial Comments.

[14] *See* NJ Rate Counsel Reply Comments.

[15] Final Environmental Impact Statement for the PennEast Pipeline Project (Apr. 7, 2017), eLibrary No. 20170407-4001 ("Final EIS").

IV. ARGUMENT

A. The Commission's Determination Of Project Need is Not Supported by Substantial Evidence and violates NEPA.

NEPA obligates the Commission, as part of its evaluation of PennEast's Application, to consider alternatives to the proposal—including a "no action" alternative. The obligation to assess alternatives requires, in turn, that the Commission examine rigorously the need for the Project.[16] The Commission's January 19 Order failed to meet this obligation. Instead of conducting the requisite, thorough need assessment, the Commission's conclusion that the Project is needed is based entirely on findings in the Final EIS. But the Final EIS is itself deficient because it failed to give fair consideration to the no action alternative. FERC's reliance on an inadequate and incomplete Final EIS as support for the "need finding" renders the determination in the January 19 Order to issue PennEast a certificate arbitrary and capricious, not based on substantial evidence, and a failure to engage in reasoned decision-making.

The Final EIS rejects the potential no action alternative on grounds that, while doing so would avoid the Project's short- and long-term environmental impacts, "the objectives of the Project would not be met." Final EIS at 3-3. More to the point, the Final EIS states that "[t]he Project was developed in response to market demands and interest from shippers that require transportation capacity to accommodate increased demand and greater reliability of natural gas in the region," citing a table listing the Project's capacity contracted under precedent agreements. *Id.* The Final EIS did not question whether these shippers' respective contract demands were new, and which

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[16] *See* 40 C.F.R. § 1502.14(a) (requiring an agency preparing an environmental impact statement to "[r]igorously explore and objectively evaluate all reasonable alternatives"; *see also* 40 C.F.R. § 1502.14(d) (requiring the Commission to evaluate "the alternative of no action").

would *require* a new pipeline, or simply transferred demands. If, as NJ Rate Counsel contends, and which contention is supported by PennEast's affiliates' own state regulatory filings, the contract demands will be transferred from existing pipelines to PennEast, in the absence of load growth—and the record lacks evidence of regional load growth—the construction of PennEast will create excess capacity on the region's natural gas transportation network.

NEPA requires that federal agencies undertake a thorough review of proposed actions:[17]

> [a] conclusory statement "unsupported by empirical or experimental data, scientific authorities, or explanatory information of any kind" not only fails to crystallize issues, *Natural Resources Defense Council v. Grant*, 355 F.Supp. 280, 287 (E.D.N.C.1973), but "affords no basis for a comparison of the problems involved with the proposed project and the difficulties involved in the alternatives." *Monroe County Conservation Council v. Volpe*, 472 F.2d 693, 697 (2d Cir. 1972).

But in evaluating the need for the Project, the Commission has done little more than a conclusory analysis. The Final EIS and, in turn, the January 19 Order that relies upon it, accept at face value PennEast's assertion of need for the Project. The Commission fails to examine with any rigor whether PennEast has in fact demonstrated that need. Specifically, the Final EIS finds that:

> [i]f PennEast's proposed facilities are not constructed, the Project shippers may need to obtain an equivalent supply of natural gas from new or existing pipeline systems. In response, PennEast or another natural gas transmission company would likely develop a new project or projects to provide the volume of natural gas contracted through the Project's binding precedent agreements with the Project

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[17] *Silva v. Lynn*, 482 F.2d 1282, 1285 (1st Cir. 1973).

> shippers. Alternatively, customers of the Project shippers could seek to use alternative fuel or renewable energy sources, which could require new facilities. In either case, construction of new pipelines or other energy infrastructure would result in environmental impacts that could be equal to or greater than those of the Project.

Final EIS at 3-3. For these reasons, the Final EIS finds that the "No Action Alternative" would be neither "preferable to or provide a significant environmental advantage over the Project." *Id.*

In reaching these conclusions, the Commission has not engaged in any independent analysis of either demand for gas at the PennEast delivery points or demand for outlet of gas at the PennEast receipt points. The Commission relied instead on the existence of "binding" precedent agreements—the majority of which are between PennEast and its affiliates. Dismissing the no action alternative simply because the developer of the proposed pipeline says their project is needed—using contracts with itself as evidence of that need—is plainly insufficient under NEPA.

While the majority of firm shipping volumes are under precedent agreements with PennEast's affiliates, the January 19 Order fails to address the concern that intercompany precedent agreements, by themselves, do not provide an appropriate basis for a need finding. The January 19 Order states that:

> the fact that 6 of the 12 shippers on the PennEast Project are affiliated with the project's sponsors does not require the Commission to look behind the precedent agreements to evaluate project need. . . . The mere fact that six of the shippers are affiliates of PennEast does not call into question their need for the new capacity or otherwise diminish the showing of market support.

January 19 Order, P33. But the Commission's contention cannot be squared with its 1999 Policy Statement on certification of new interstate natural gas pipeline facilities.[18] The Commission there opined on the drawbacks of its pre-1999 policy, observing that:[19]

> The amount of capacity under contract also is not a sufficient indicator by itself of the need for a project, because the industry has been moving to a practice of relying on short-term contracts, and pipeline capacity is often managed by an entity that is not the actual purchaser of the gas. *Using contracts as the primary indicator of market support for the proposed pipeline project also raises additional issues when the contracts are held by pipeline affiliates.* Thus, the test relying on the percent of capacity contracted does not reflect the reality of the natural gas industry's structure and presents difficult issues.

Commissioner Glick, in his dissent, echoed similar concerns:[20]

> [C]ontracts among affiliates may be less probative of that need because they are not necessarily the result of an arms-length negotiation. By itself, the existence of precedent agreements that are in significant part between the pipeline developer and its affiliates is insufficient to carry the developer's burden to show that the pipeline is needed.
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> Under these circumstances, I believe that the Commission must consider additional evidence regarding the need for the pipeline. As the Commission explained in the Certificate Policy Statement, this additional evidence might include, among other things, projections of the demand for natural gas, analyses of the available pipeline capacity, and an assessment of the cost savings that the proposed pipeline would provide to consumers.

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[18] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 at 61,744 (Sept. 15, 1999), *clarified*, 90 FERC ¶ 61,128 (Feb. 9, 2000), *further clarified*, 92 FERC ¶ 61,094 (July 28, 2000) ("1999 Policy Statement").

[19] *Id.* (emphasis added).

[20] *PennEast Pipeline Co.*, 162 FERC ¶ 61,053 (2018) (Glick, Comm'r, dissenting) (footnotes omitted).

Thus, while the Commission views long-term firm capacity as important evidence of market demand,[21] it is not the only pertinent factor,[22] nor should it be dispositive—particularly where, as here, those firm capacity subscriptions are largely between the pipeline owner and its affiliates. NJ Rate Counsel has explained that at least two-thirds of the capacity under the precedent agreements is subscribed by affiliates of PennEast. While the January 19 Order expresses little concern about this point, NJ Rate Counsel asserts that, given the identity of the shippers, the Commission was obligated to undertake an independent analysis of the legitimacy of the claimed need for Project capacity.[23]

An independent analysis would not have been difficult to conduct. In further support of the contention that PennEast had failed to demonstrate that the Project was in fact needed, NJ Rate Counsel presented data showing that (1) the local distribution company/PennEast affiliates ("LDCs") currently have adequate pipeline capacity *without PennEast*; (2) the LDCs do not forecast load growth; and (3) some of the LDCs are turning back existing contracts for firm capacity.[24] NJ Rate Counsel expert affiant David Dismukes explained that demand for natural gas in the Mid-Atlantic region has been declining, not increasing.[25] Indeed, the demand projections of New Jersey and

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[21] 1999 Policy Statement at 61,744.

[22] *See id.* at 61,747 ("[T]he Commission will consider all relevant factors reflecting on the need for the project. *These might include, but would not be limited to, precedent agreements*, demand projections, potential cost savings to consumers, or a comparison of projected demand with the amount of capacity currently serving the market.") (emphasis added).

[23] NJ Rate Counsel Initial Comments at 2-5. According to Commissioner Glick's dissent, PennEast's affiliates hold an even larger share—more than *75 percent*—of the Project's subscribed capacity than NJ Rate Counsel initially believed.

[24] *Id.* at 5-8.

[25] *Id.*, Affidavit of David E. Dismukes ¶¶ 10, 12-13 ("Dismukes Aff.").

Pennsylvania LDCs indicate that there is no imminent need for significant amounts of additional capacity,[26] particularly in light of the glut of underutilized capacity on existing long-haul gas transmission systems serving the Mid-Atlantic.[27] While the January 19 Order states the assumption that decreased pipeline utilization rates reflect only gas flows and not available firm capacity,[28] the Commission ignores the evidence presented by NJ Rate Counsel that in recent years some LDCs have turned back substantial capacity.[29] Nor can the Project be justified on need for increased access to the Marcellus Shale—New Jersey LDCs report sufficient access to production from the Marcellus Shale without the Project.[30] The January 19 Order does not refute these data. NJ Rate Counsel fails to see how the Commission can reasonably have concluded that the Project is needed in the face of unchallenged market data showing exactly the opposite.

Rather than confront these data head-on, the January 19 Order brushes them aside with only cursory analysis. For example, the January 19 Order emphasizes that "there is not sufficient available capacity on existing pipeline systems to transport all of the

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[26] *Id.*, Dismukes Aff. ¶¶ 10-12.

[27] *Id.*, Dismukes Aff. ¶ 13.

[28] January 19 Order, P 32.

[29] NJ Rate Counsel Initial Comments at 7 & n.6 (citing PSE&G, Initial Filing Motion, Supporting Testimony, and Tariff Modifications at Item 18, § 3, *In the Matter of Pub. Serv. Elec. & Gas Co.'s 2016/2017 Annual BGSS Commodity Charge Filing for its Residential Gas Customers Under its Periodic Pricing Mechanism and for Changes in its Balancing Charge,* Docket No. GR16060486 (N.J. Bd. Pub. Utils. June 1, 2016)).

[30] *See id.* at 7 & n.7 (("The ability of the Company to buy more economical gas supplies in the Marcellus region has provided the ability to turn back [] capacity at the expiration of [its] pipeline contracts," with "both Trunkline and Panhandle."); *see also* Pre-filed Direct Testimony and Exhibits of Jayana S. Shah at 6:10-11, attached to N.J. Natural Gas Co., Petition, *In the Matter of the Petition of N.J. Natural Gas Co. for the Annual Review & Revision of Its Basic Gas Supply Serv. (BGSS) & Conservation Incentive Program (CIP) Rates for F/Y 2017,* Docket No. GR16060482 (N.J. Bd. Pub. Utils. June 1, 2016) ("The Company's transport and storage assets are positioned to flow supply from Marcellus Shale."). *See also, id.* at 6:17-19 (explaining that in a state proceeding evaluating New Jersey Natural Gas Company's ability to provide standard reported that "[t]he majority of the market area assets of the Company are positioned to take advantage of the natural gas produced in the Marcellus Shale.")).

volumes contemplated to be transported by the PennEast Project to the range of delivery points proposed by PennEast, and that expansion of existing pipeline systems was not a feasible alternative."[31] In other words, in the face of evidence of adequate existing capacity, limited load growth, and the turning back of substantial capacity, the January 19 Order assumes that LDCs will maintain all of their existing capacity contracts and will also need and maintain their contracts for substantial new capacity on PennEast. That assumption ignores reality. In the absence of substantial load growth, LDCs will turn back capacity on other pipelines, and do not need to have another pipeline constructed to provide more firm capacity.

The inevitable capacity turn-back will impact other pipelines, but the Commission erred in the January 19 Order in refusing to examine this impact. While the Commission observes that no customers on other pipelines filed adverse comments,[32] their presence or absence is irrelevant to the Commission's fulfillment of each of its obligations under Section 7 of the NGA. For example, the Commission has stated:[33]

> the Commission has an independent obligation under NGA section 7 to ensure that initial rates are in the public interest.[88]
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> [88] *See, e.g., Missouri Pub. Service Comm. v. FERC*, 337 F.3d 1066, 1076 (D.C. Cir. 2003) ("Section 7 imposes a duty on FERC to determine for itself whether the rates it approves are in the public interest.").

Nonetheless, there is no evidence that the Commission considered the inevitable consequences if the Project is completed. The January 19 Order erred because it assumes

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[31] January 19 Order, P 31.

[32] *Id.* P 37.

[33] *Mo. Interstate Gas, LLC*, 144 FERC ¶ 61,220, P 50 (2013).

that LDCs that already have sufficient capacity and forecasts of limited load growth will not turn back existing capacity in favor of PennEast capacity, or, in the alternative, does not consider the impact of such turn back on captive customers on existing pipelines.

In addition to the January 19 Order's cursory analysis of anticipated demand for Project capacity, the Commission accepts without scrutiny PennEast's claim that the Project will provide reliable, flexible, and diverse gas supply.[34] While the January 19 Order accuses commenters of "overlook[ing]" claims beyond load growth, it is in fact the Commission that overlooks the evidence. NJ Rate Counsel relied on state regulatory filings by PennEast's affiliates to demonstrate that those affiliates already have ample access to the Marcellus region.[35] And following PennEast's assertions that the Project provides reliable, flexible and diverse gas supplies,[36] NJ Rate Counsel presented data showing that completion of the Project and subscription to it by LDCs will actually decrease diversity of supply and flexibility of delivery pipelines. The reason is that completion of the Project will result in a decrease in the use of other pipelines that provide access to gas sources other than the Marcellus, while increasing reliance on Marcellus gas.[37] In other words, the record before the Commission—including evidence of stagnant load growth, the increasing turn back of capacity, and decreasing supply diversity—provides the Commission with ample reason to "second guess the business

[34] January 19 Order, P 30.

[35] NJ Rate Counsel Initial Comments at 7 & nn.7-8.

[36] PennEast Pipeline Co., Reply to New Jersey Division of Rate Counsel Comments, P 25 (Oct. 17, 2016), eLibrary No. 20161017-5038.

[37] NJ Rate Counsel Reply Comments at 5-6.

decisions of [PennEast's affiliated] shippers that they need the service to which they have subscribed."[38] However, the January 19 Order does not show such analysis.

For all of the foregoing reasons, PennEast has not demonstrated that there is a need for the Project. The Commission's reliance on PennEast's assertions, cursory analysis, and the deficient Final EIS are fatal to the January 19 Order. The Commission's decision to issue the certificate without demonstrated need for the Project is not based on substantial evidence and is arbitrary and capricious.

B. The Commission's Approval of PennEast's Requested Equity Return and Cost of Debt is Not Supported by Substantial Evidence.

By permitting PennEast to establish initial rates utilizing a 14 percent equity return and a 6 percent assumed cost of debt, the Commission has failed in its duty under Section 7 of the NGA to protect consumers. While the Commission is correct in its assertion (January 19 Order P 63 & n.83) that Section 7 proceedings have a less rigorous standard than those under Sections 4 or 5, the Commission has (again) afforded itself far broader discretion than is permissible under *Atlantic Refining*.[39] As the D.C. Circuit has said in response to previous undue reliance on *Atlantic Refining*:[40]

> But both the Supreme Court and this circuit have made clear that the Commission has a duty to use its § 7 power to protect consumers. *See id.* ("[T]he inordinate delay... in the processing of § 5 proceedings requires a most careful scrutiny and responsible reaction to initial price proposals of producers under § 7."); *Consumer Fed'n of Am. v. Federal Power Comm'n*, 515 F.2d 347, 356 (D.C. Cir. 1975) (declaring that "preservation of the statutory scheme depends on diligent enforcement of the § 7 certification

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[38] January 19 Order, P 30.

[39] *Atlantic Refining Co. v. Pub. Serv. Comm'n of NY*, 360 U.S. 378 (1959).

[40] *Mo. Pub. Serv. Comm'n v. FERC*, 337 F.3d 1066, 1070-71 (D.C. Cir. 2003).

> requirement as a holding operation on initial rates"). Indeed, the Commission's "usual practice in Section 7 certificate proceedings" is to "apply [ ], to the extent practicable, the same ratemaking policies that it applies in Section 4 rate cases in determining just and reasonable rates on a cost of service basis." 2001 Remand Order, 97 F.E.R.C. at 61,785; *see Maritimes & Northeast Pipeline, L.L.C.*, 84 F.E.R.C. ¶ 61,130, at 61,683, 1998 WL 765443 (1998).

Rather than apply the same ratemaking policies used in Section 4 proceedings to the extent practicable in this proceeding, the Commission here abdicates its responsibility and justifies the 14 percent equity return and 6 percent cost of debt because that is what the Commission has approved in other cases.

1. The Commission's acceptance of a 14 percent equity return was unsupported by substantial evidence, disregards contrary record evidence, and amounts to unreasoned decision-making.

As the Commission is well aware, its practice for establishing an equity return in an NGA Section 4 case is to select a proxy group of comparable companies and use a two-stage discounted cash flow analysis to determine those companies' implied costs of equity. The resultant range of implied costs of equity establishes the range of reasonableness, and the Commission uses its judgment to set within that range the equity return of the company under examination.[41] The Commission's practice, however, is not to choose any number within that range of reasonableness. Rather, the Commission has stated that "absent highly unusual circumstances,"[42] the Commission assumes a pipeline

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[41] *See, e.g.*, *El Paso Nat. Gas Co.*, 154 FERC ¶ 61,120, P 215 (2016) ("*El Paso*") (providing a high level summary of the Commission's methodology for establishing a pipeline's cost of equity). Beginning at P 215 and continuing through P 340, the Commission provides an extensive explanation of its methodology and its analysis supporting a 10.55 percent return on equity for El Paso Natural Gas Co.

[42] *Id.* P 302 (citing *Transcontinental Gas Pipeline Corp.*, 90 FERC ¶ 61,279, at 61,936 (2000) ("*Transco*")).

is of average risk and sets the equity return at the median of the range. In *El Paso*, that range extended from 10.39 percent to 11.08 percent[43] and the Commission set the return at 10.55 percent. To deviate from the median, the Commission has stated that a pipeline must make a "very persuasive"[44] case. For example, in Opinion No. 524,[45] Portland Natural had a below investment grade credit rating *and* was unable "to reflect its unsubscribed capacity in its rate design."[46] The Commission viewed this combination of factors as, "for the first time since Opinion No. 414-A [15 years prior in 1998],"[47] justifying use of the upper end of, but not above, the zone of reasonableness.[48] The Commission should also note that its discounted cash flow ("DCF") analyses in *Portland Natural* (in 2013) and *El Paso* (in 2016) demonstrate both that the upper end of the zone of reasonableness is between 11 and 12 percent and that the upper end of the zone for pipelines has declined.[49]

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[43] *Id.* P 284.

[44] *Transco* at 61,936.

[45] *Portland Nat. Gas Transmission Sys. Op.*, Op. No. 524, 142 FERC ¶ 61,197 (2013), *reh'g denied*, Op. No. 524-A, 150 FERC ¶ 61,107 (2015) ("*Portland Natural*") (setting Portland Natural's return on equity at 11.59 percent, at the top of a range of reasonableness that extended from 8.69 percent to 11.59 percent).

[46] *Id.* P 382.

[47] *Id.*

[48] *Id.*

[49] NJ Rate Counsel recognizes that 2 data points would generally not represent a significant sample size. These decisions, however, are the only fully litigated proceedings (i.e., adversarial hearing, initial decision, and Commission order on initial decision) in which the return on equity of a natural gas pipeline company was at issue in the last 5 years. While based on 2004 test period data that is stale and irrelevant to current circumstances, in 2013, the Commission did issue Opinion No. 486-F in *Kern River Gas Transmission Co.*, 142 FERC ¶ 61,132, PP 220, 263 (2013), which affirmed the Commission's 2011 decision to set the pipeline's rate of return at 11.55%, the median of a range of reasonableness of 8.8% to 13.0%. Prior to these decisions, the Commission issued Opinion No. 510 in *Portland Natural Gas Transmission System*, 134 FERC ¶ 61,129 (2011). But the Commission in that case relied on financial data from November 2008 through April 2009, *id.* at P 242, in the middle of the Great Recession. In Opinion No. 510, the Commission found a median of 12.99% within a range of reasonableness from 12.18% to 14.89%. And, of course, in Portland Natural's immediately following rate proceeding, even though Portland Natural was found to be not creditworthy, the Commission *reduced* the company's return to 11.59% due to the changing economic conditions.

The *Portland Natural* and *El Paso* decisions reflect a detailed analysis of capital markets that can be applied to rate review of companies with a wide variety of economic circumstances. In addition, these cases reflect the substantial burden a company must meet to receive an elevated return. But notwithstanding this fundamental ratemaking practice used in Section 4 proceedings, PennEast did not offer, nor did the Commission require, a DCF analysis for the Project. Nor did the Commission present its own DCF analysis, or explain why a DCF analysis could not be provided. The record is devoid of evidence of what the range of reasonableness is or where within that range PennEast's equity return should be placed. If the Commission believes that the Project is particularly risky and justifies an equity return above the zone of reasonableness, then the Commission should quantify that additional risk and provide an analysis of why that is the case. In short, while the Commission should have set PennEast's equity return in accordance with Commission policies applicable to Section 4 proceedings, the January 19 Order makes no effort to do so. The absence of a DCF analysis demonstrating that the 14 percent equity return is just and reasonable renders the Commission's decision arbitrary and capricious.

The assertion (January 19 Order, P 59) that the Commission has a "policy" of awarding a 14 percent equity return cannot substitute for substantial evidence. The Order points to no rulemaking establishing, as a general rule, that new pipelines are awarded a 14 percent equity return—regardless of capital market conditions. Indeed, there would be no reasonable basis for the Commission to adopt such a rule. Capital markets change and thus the necessary equity return must change as well. Indeed, as the Commission's orders in *El Paso* and *Portland Natural* show, return on equity determinations are based on actual economic evidence—not presumptions. Moreover, returns since the time those decisions were issued have declined. A policy that awards a premium of 200 to 300 basis points over the top of a range of reasonableness revealed by economic analysis, and does so without explanation, is arbitrary and capricious.

The January 19 Order's invocation of a "policy" awarding new pipelines a 14 percent return also ignores evidence concerning how this "policy" came into existence. At note 17 of its Initial Comments, NJ Rate Counsel provided a list of cases, beginning with the 1997 *Alliance Pipeline L.P.*[50] decision, in which the Commission cites its prior orders supporting a 14 percent equity return. NJ Rate Counsel observed that several of these prior decisions stand out because the proposed pipeline was exceptionally risky because of its very highly leveraged (over 70 percent debt) capital structure.[51] Moreover, the Commission has provided no explanation as to why a 14 percent return found just and reasonable more than 20 years ago—before the dramatic changes in natural gas extraction that have so affected gas supply and gas transportation markets—remains just and reasonable today. Nor does the January 19 Order explain why, if a 14 percent return was necessary at the bottom of the economy and the height of the Great Recession, that same 14 percent return is still required now. A "one size fits all" policy with respect to new pipeline returns is arbitrary and capricious when the capital markets have varied so substantially in the two-plus decades since the *Alliance Pipeline L.P.* decision.

The other assertions in the January 19 Order—that start-up pipelines are more risky and a 14 percent equity return is responsive to the risks facing PennEast—are

[50] *Alliance Pipeline L.P.*, 80 FERC ¶ 61,149, at 61,592 (1997) (subsequent history omitted).

[51] NJ Rate Counsel Initial Comments at 12 & n.17.

equally unavailing. A DCF analysis could have identified the risks facing a startup pipeline venture and the equity return that might be demanded for such a venture. But the record lacks such analysis. Assuming the Commission's assertion that PennEast is more risky than an existing pipeline is correct, the January 19 Order fails to establish a baseline, much less quantify the additional compensation the capital markets might command to bear the risk of the new pipeline.

The Commission's assertion that new pipelines face greater risk is itself unsupported. In Section 4 cases, existing pipelines tout their own risks. For example, in the 2016 *El Paso* decision (10.55 percent equity return), the Commission addressed many risk issues—including risks of declining subscriptions. PennEast has gone the other way—highlighting the present absence of that risk by stating that it is 90 percent subscribed with long-term contracts. In the 2013 *Portland Natural* decision (11.59 percent equity return), the pipeline's credit rating was found to be not creditworthy. Not so with PennEast. Yet the January 19 Order does not explain or quantify why PennEast's risk justifies a 345 basis point premium over El Paso or a 241 basis point premium over Portland Natural.

The absence of any evidence or explanation supporting PennEast's requested 14 percent equity return in light of current economic circumstances renders the Commission's decision arbitrary and capricious.

2. The Commission's acceptance of a 6 percent cost of debt is not supported by substantial evidence.

PennEast has sought to reflect a 6 percent cost of debt in its initial rates, but failed to make any showing of what its actual debt cost will be. To support its award of a 6 percent cost of debt, the Commission states that the award is consistent with other greenfield pipeline projects and within a range of debt rates established for other projects. Because the January 19 Order does not include any analysis related to PennEast's requested debt cost, it is unclear what evidence the Commission relied upon in making this determination. The absence of a supporting rationale renders the Commission's decision arbitrary and capricious.

NJ Rate Counsel provided evidence that, even in the unlikely event that PennEast debt would have "junk bond" status, the highest Moody's utility yield during the 2016 year-to-date period was 5.49 percent in January 2016, but that yield had declined to 4.16 percent by July 2016.[52] As of October 2017, Moody's reported that its measure of the Baa utility yield was 4.26 percent. The Commission offers no explanation for why PennEast requires a 100-200 basis point premium over current junk bond yields.

At note 87 of the January 19 Order, the Commission cites four decisions that rely on debt costs ranging from 4.8 percent to 9.3 percent.[53] In each of these cases, however, it appears that the Commission simply accepted the pipeline's requests. The decisions provide no discussion as to why the respective costs of debt were appropriate. As relevant here, the January 19 Order includes no analysis comparing PennEast and the cited projects with respect to relative size or scope, financial backing, state of capital markets, or any other material factor that would support the award of a higher or lower debt cost than the assumed debt costs that the pipelines requested in the cited cases. Put simply, it cannot be assumed that all greenfield pipelines have equal risk and that lenders will demand the same interest rate.

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[52] NJ Rate Counsel Initial Comments at 15.

[53] January 19 Order, P 65 n.87.

Given that the only objective evidence in the record of actual debt costs was supplied by NJ Rate Counsel, and that evidence supports a debt rate substantially below 6 percent, the award of a 6 percent debt cost in the January 19 Order is unsupported by substantial evidence and therefore arbitrary and capricious.

V. CONCLUSION

NJ Rate Counsel respectfully requests that the Commission grant its request for rehearing, rescind the January 19 Order and deficient Final EIS, and perform its public convenience and necessity analysis in a manner that complies with the Commission's obligations under the NGA, NEPA, and the APA.

Respectfully submitted,

/s/ *Stephen C. Pearson*

Scott H. Strauss
Stephen C. Pearson

Attorneys for
New Jersey Division of Rate Counsel

Law Offices of:
SPIEGEL & MCDIARMID LLP
1875 Eye Street, NW
Suite 700
Washington, DC 20006
(202) 879-4000

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CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated on this 20th day of February, 2018.

/s/ *Stephen C. Pearson*
Stephen C. Pearson

Law Offices of:
SPIEGEL & MCDIARMID LLP
1875 Eye Street, NW
Suite 700
Washington, DC 20006
(202) 879-4000