

FERC Initiates New Review on Contracts Between Oil Pipelines and Their Affiliates

December 21, 2022

On December 15, 2022, the Federal Energy Regulatory Commission (FERC) voted to issue a **Proposed Policy Statement on Oil Pipeline Affiliate Committed Service** (the “Proposed Policy Statement”) in a new docketed proceeding in PL23-1-000. The Proposed Policy Statement addresses whether contractual commitments for oil or liquids pipeline transportation comply with the Interstate Commerce Act (ICA) when, following a public open season, the only shipper to agree to the noticed service is an affiliate of the regulated pipeline (“Affiliate Contracts”). If adopted, it would create a rebuttable presumption that Affiliate Contracts are unduly discriminatory and not just and reasonable in certain circumstances and require a pipeline to produce additional evidentiary support for Affiliate Contract rates and terms. This follows a trend of increased scrutiny by FERC on affiliated contracts across all industries it regulates. Initial comments on the Proposed Policy Statement will be due on or before February 13, 2023, with reply comments due on March 30, 2023.

The Proposed Policy Statement marks the second FERC-proposed policy statement to review its treatment of Affiliate Contracts with ICA-regulated pipelines. In October 2020, FERC initiated a similar inquiry in Docket No. PL21-1-000 (“2020 Proposal”). It withdrew the 2020 Proposal two months later, but following the filing of initial comments, on grounds that additional guidance was not necessary for oil pipelines to demonstrate that Affiliate Contracts are just, reasonable and not unduly discriminatory under the ICA. The 2020 Proposal would have considered Affiliate Contracts more broadly whereas the Proposed Policy Statement is specifically limited to those situations where the Affiliate Contract is the only committed shipper contract executed following a public open season (“Affiliate-Only Committed Service”).

In some respects, the Proposed Policy Statement is more narrowly tailored than the 2020 Proposal because it is specifically limited to Affiliate-Only Committed Service. However, it expands upon the 2020 Proposal in two key responses. It expands upon the use of “safe harbor” for Affiliate-Only Committed Service whereby the use of a cost-of-service rate is presumed to be just and reasonable and not unduly discriminatory. It also seeks comments on whether non-rate terms in an Affiliate Contract may be unduly preferential.

Contact Information

For questions concerning the case and to understand the implications of the decision on diverse sets of interests, please reach out to:

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Safe Harbor Provision Request for Comments

The Proposed Policy Statement seeks comments on two ways a pipeline could satisfy the cost-of-service safe harbors:

- (i) provide cost-of-service support for the initial rate; (ii) provide in the contract that adjustments to the rate over the term of the contract by the pipeline would be pursuant to the Commission's cost-of-service and indexing regulations; (iii) provide in the contract that the committed shipper has the right to directly challenge the committed rate on a cost-of-service basis during the term; and (iv) provide that whenever the rate is established or changed during the contract term on a cost-of-service basis, the cost of service will be set at a 100 percent load factor (or some other reasonable limit).
- (i) provide cost-of-service estimates to support the contract rate for the entire contract term; (ii) provide in the contract that the committed shipper may have a one-time right to challenge such cost-of-service showing made in the pipeline's initial filing for the service; and (iii) apply a 100 percent load factor (or some other reasonable limit).

FERC also asks commenters to suggest alternative methods to demonstrate that an Affiliate-Only Committed Service rate is not the product of undue discrimination designed to exclude non-affiliate shippers. It asks that suggestions (1) provide a detailed description of the proposed method for justifying an Affiliate-Only Committed Service rate; (2) describe the information a pipeline would need to provide in order to support the proposed rate under the proposed method; (3) explain how such a showing would support a finding that the rate is just and reasonable and does not reflect undue discrimination towards potential non-affiliated shippers; and (4) address whether such method is consistent with the Commission's regulations or, if not, changes that would be necessary to permit such method.

Non-Rate Terms Request for Comments

Additional comments are sought on Affiliate Contract non-rate terms such as minimum volume commitments, minimum term-length requirements, deficiency provisions or duty-to-support clauses. In this vein, FERC proposes to apply a rebuttable presumption that Affiliate-Only Committed Service contracts are unduly discriminatory and not just and reasonable where the affiliate, any time before or shortly after the committed service begins, remarkets the contracted capacity to one or more non-affiliated third parties. FERC states that the non-affiliated third party's decision in this instance indicates that the terms offered in the open season were less favorable and inconsistent with market demand, raising concern that the open season was structured in such a way as to create an undue preference for the affiliate. FERC suggests further that remarketing by the affiliate would constitute an evasion of the ICA's strictures on the pipeline. FERC also broadly solicits comments on any of its policies, or the practices or tariffs of regulated pipelines, to the extent they create disadvantages or impediments that create incentives for shippers to transact with the pipeline's shipper affiliate as opposed to the FERC-regulated pipeline. It asks for comments on potential actions FERC could take in response, consistent with its ICA obligations.

Analysis

The Proposed Policy Statement is expected to garner intense interest from the regulated common carrier pipeline community, as well as the shippers who use their services. Major pipeline systems, their trade association and consortiums of shipper interests filed lengthy initial comments on the 2020 Proposal that were never addressed in reply comments or by FERC. And, the interest in this topic has not waned. While the use of FERC's petition for declaratory order process to obtain rate certainty for committed shipper contracts has waned in recent years, capacity constraints and market demand for oil and liquid products continue on several regulated pipeline systems. Some of the issues raised in the prior proceeding will need to be addressed here, such as whether FERC is overstepping its ICA jurisdiction by launching an investigation into non-jurisdictional transactions, such as buy/sell arrangements, and whether it is elevating the importance of cost-of-service rates in an industry where multiple rate designs are permitted to set just and reasonable rates. Moreover, commenters may ask whether a policy statement on Affiliate Contracts is necessary considering guidance provided by FERC on shipper affiliate relationships with ICA-regulated pipelines in an order issued concurrently with the Proposed Policy Statement.

Commissioner Danly filed a dissent to the Proposed Policy Statement. In part, he argues that the Proposed Policy Statement was not prompted by the filing of a complaint, nor a public investigation into affiliate practices on common carrier pipelines, nor does it explain any changed circumstances from the sentiment expressed by FERC when it withdrew the Withdrawn Proposal. He adds that it does not cite to address any of the arguments raised in the initial comments filed in response to the Withdrawn Proposal, either critical or supportive. Commissioner Christie issued a concurrence on grounds that affiliate contracts should be subject to a higher level of scrutiny, but suggesting that the Proposed Policy Statement may go too far. Both commissioners' viewpoints are likely to be echoed in the subsequent comments on the proposal.

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