Pipeline Payday: How Builders Win Big, Whether More Gas Is Needed or Not

Close corporate relationships between pipeline builders and gas buyers are allowing companies to reap higher profits while locking in emissions for years to come.

By Phil McKenna

AUG 3, 2017

The real fight over America's energy future isn't in coal, despite the Trump administration's public focus on a mining revival. Rather, dozens of pipeline projects, making up one of the largest expansions of natural gas infrastructure in U.S. history, are where the fossil fuel action is.

At a cost of billions of dollars, these pipelines will tap the rich reservoir of fracked natural gas flowing out of the Marcellus-Utica shale basin that lies under much of Pennsylvania, Ohio and West Virginia.

The Trump administration and its allies, **energy-dominance** manifestoes in hand, are eager to see these projects approved as soon as the president's nominees to the Federal Energy Regulatory Commission (FERC) are confirmed by the Senate.

But are all these new gas pipelines really needed?

Critics say that the financial interests of gas and electric companies—not market demand—are driving most of the new pipelines proposed for the region. Those profits are approved by FERC, an agency that is charged with ensuring public interests, but that nurtures "an exceptionally cozy relationship" with industry, as described in a comprehensive investigation published last month by the **Center for Public Integrity and StateImpact Pennsylvania, with National Public Radio.**

"At every turn, the agency's process favors pipeline companies," the review found after the groups interviewed more than 100 people, reviewed FERC records, and analyzed nearly 500 pipeline cases.

It also noted another cozy relationship: the tight corporate links between the companies building the pipelines and those buying the natural gas, either to deliver it to homes and businesses or to use it to make electricity.

These close relationships, explored in greater depth here by InsideClimate News, not only set up surefire profits at the expense of consumers, critics say; they also lock in long-term incentives—in the form of physical infrastructure and financial rewards—to keep burning the fossil fuels that are warming the planet.

"It's bad for ratepayers, it's bad for the climate, it's bad for the environment, but it's really good for companies that are going to make profits," said Amy Mall, a senior policy analyst for the Natural Resources Defense Council.

More Gas, No Additional Demand

One example of this is in Missouri, where Spire STL Pipeline LLC, an interstate pipeline company, and Laclede Gas Company, a local gas utility, have proposed to build a $220 million pipeline that would deliver Marcellus shale gas to St. Louis.

Laclede and Spire are owned by the same parent company. Project opponents say this incestuous business arrangement between the customer, Laclede, and its supplier, Spire, puts the interest of shareholders above those of ratepayers.

If the project is approved, shareholders of Spire, Inc., the parent company, **will make a 14 percent** annual return on the equity they invest in the project. Laclede's captive ratepayers would probably have to pay higher gas rates to finance the new pipeline.

State regulators, a competing pipeline company, other utility companies from the region and an environmental organization are challenging the project.

"It is not clear that there is need," the Missouri Public Service

Commission wrote in a **conditional protest** in February to federal regulators overseeing the project.

Natural gas demand in Missouri has been flat since 1997, and no increase is anticipated until 2024, **according to the U.S. Energy Information Administration.**

Laclede has 18 percent more capacity than it needs during periods of peak demand, according to an analysis of Laclede's annual reports from 2006 to 2014.

Unused capacity from four existing pipelines supplying the St. Louis area could provide an additional 35 percent capacity above what Laclede needs on peak days, according to the analysis, by Enable Mississippi River Transmission, one of the pipeline companies that currently supplies Laclede's gas.

The new pipeline "has been shielded from a truly competitive market," it is subsidized by ratepayers, and, without such subsidy, it "**makes no economic sense**," Enable wrote in public comments filed to FERC.

Complaints Roll In

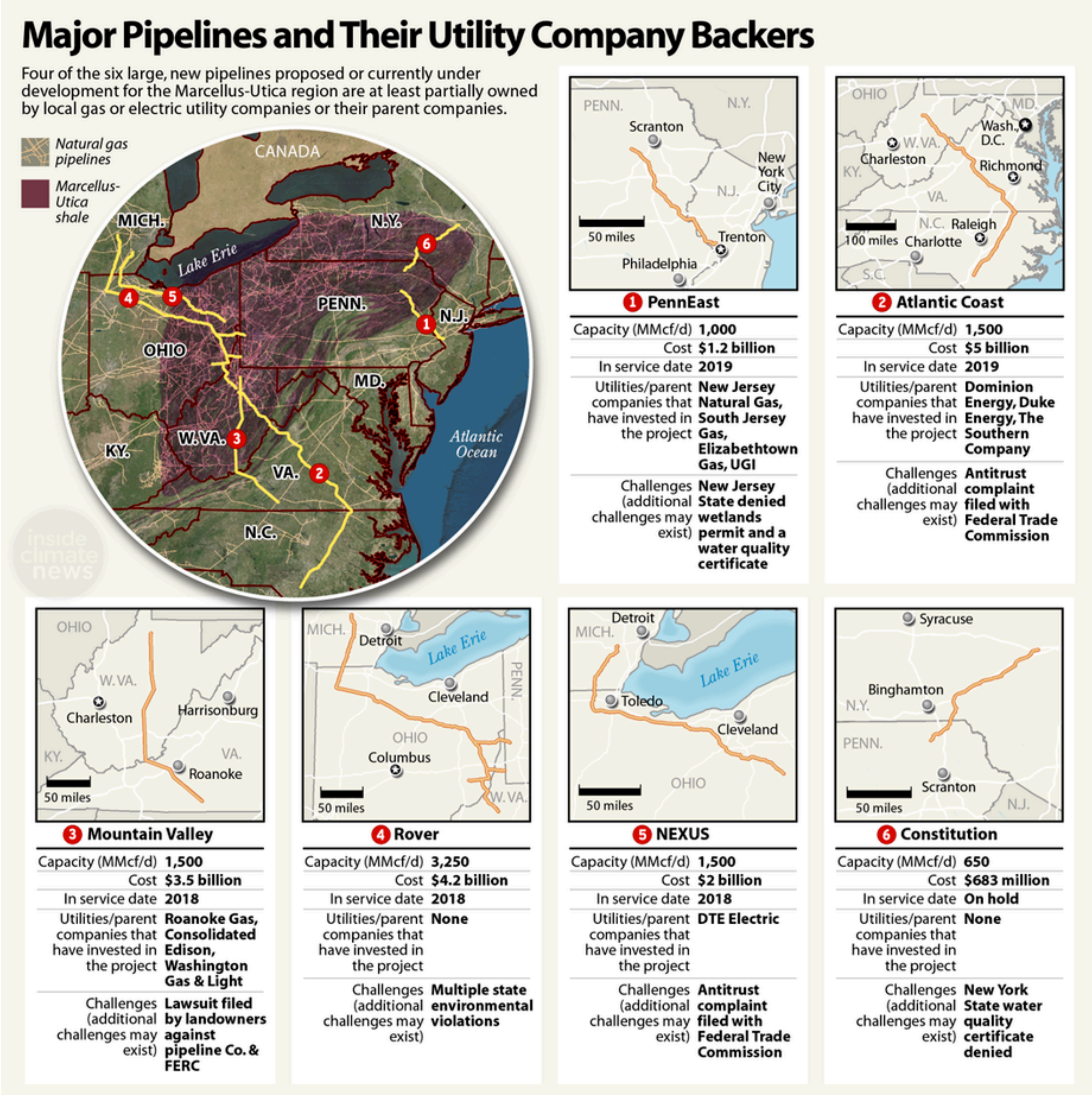
It's hardly a unique situation, InsideClimate's review of several projects shows.

Four of the six large, new pipelines proposed or currently under development for the Marcellus-Utica region are "affiliate pipelines," where a parent company owns the gas or electric utility that will purchase the gas and also owns, or enters into a joint venture with, the pipeline company that will build the pipeline.

Complaints filed with the Federal Trade Commission allege two of these pipelines, Atlantic Coast and NEXUS, violate antitrust laws.

State regulators typically allow a roughly 8 percent annual return on equity for new pipeline projects for local gas and electric utilities. Affiliate agreements, however, allow the parent company of a state-regulated utility to seek federal certificates for interstate pipelines. These permits typically allow a 14 percent annual return on equity, a rate that is "tantamount to winning the lottery," according to one state agency.

Existing pipelines run at only slightly more than half capacity. Average capacity utilization for the interstate pipeline system between 1998 and 2013 was only 54 percent, a figure that for major pipelines is expected to increase only slightly to 57 percent by 2030, according to the U.S. Department of Energy. "Given the cost of building new pipelines, finding alternative routes utilizing available capacity on existing pipelines is often less costly than expanding pipeline capacity," **the department concluded in a 2015 report**.



Research by PHIL MCKENNA / InsideClimate News

PAUL HORN / InsideClimate News

In February, outgoing FERC chair and Obama appointee Norman Bay warned on his last week in office of the potential for affiliate pipeline agreements to result in an overbuild of pipelines. "It is inefficient to build pipelines that may not be needed over the long term and that become stranded assets," he said.

Proposed gas pipeline projects coming out of the Marcellus-Utica shale basin would lock in added carbon and methane emissions for decades to come by incentivizing additional gas use in the future once the pipelines are built and paid for.

Bay noted in his departing memo that FERC should "be open to analyzing the downstream impacts of the use of natural gas and to performing a life-cycle greenhouse gas emissions study." **A recent analysis by environmental organizations** did just that and concluded "the currently planned gas production expansion in Appalachia would make meeting U.S. climate goals impossible."

How the Cozy Relationship Pays Off

Historically, utilities had no corporate affiliation with the pipeline companies that provided their natural gas. That has changed in recent years as utilities seek to take advantage of higher returns from interstate pipeline projects and the limited scrutiny from federal officials who oversee those permit applications.

As regulated monopolies, utilities are allowed to be the sole provider of gas or electricity in a given region in exchange for the public service they provide. The utilities are allowed to make a profit, but they agree to certain limits on what they can charge customers who have nowhere else to go for their energy needs.

One way states limit local utilities' profits is through the rate of return they are allowed to receive on new infrastructure projects—typically an 8 percent return on equity.

Interstate natural gas transmission pipelines, however, are regulated by the federal government, which typically allows around a 14 percent return on equity.

To capture that higher rate of return, the parent company of a local utility may acquire a gas pipeline company, or form a joint venture with a pipeline company, and then pair their utility and pipeline company together to build a new pipeline. Shareholders of the parent company make a tidy profit while ratepayers are stuck paying a premium for expensive new infrastructure.

"Instead of an investment earning 8 percent, they are able to get a very large return through the same invested capital," said Greg Lander, president of **Skipping Stone**, an energy markets consulting firm.

PennEast: A Question of Need

PennEast

Capacity (MMcf/d)	**1,000**
Cost	**$1.2 billion**
In service date	**2019**
Utilities/parent companies that have invested in the project	**New Jersey Natural Gas, South Jersey Gas, Elizabethtown Gas, UGI**
Challenges (additional challenges may exist)	**New Jersey State denied wetlands permit and a water quality certificate**

"We are in perfectly fine shape right now with the capacity that we have," said Stefanie Brand, director for the **Division of Rate Counsel in New Jersey**, which officially represents the interests of consumers of regulated utilities.

Existing pipelines supplying local gas distribution utilities in eastern Pennsylvania and New Jersey currently have 50 percent more capacity than needed to meet their periods of greatest demand—even during the "polar vortex" extreme winter weather of 2014, according to **a study conducted by Lander** for The New Jersey Conservation Foundation.

If approved, pipeline builder Spectra and the utility holding companies that would own the pipeline would receive a 14 percent return on equity for the project.

New Jersey's Rate Counsel "is concerned that this opportunity may be a key motivating factor behind the project," counsel attorneys wrote in **comments filed to FERC** last September. "In this financial environment, the opportunity to receive a Commission-regulated return of 14 percent is tantamount to winning the lottery."

The American Gas Association, a trade group representing local natural gas utility companies, said gas companies only invest in pipeline projects if they need the added pipeline capacity.

"They are not going to sign on to capacity when they can't demonstrate that they actually need it," said Susan Bergles, assistant general counsel for the **American Gas Association**. "They are getting involved in a project because they need it."

The 14 percent return on equity that FERC allows is a relic from another time. FERC's current policies on the certification and pricing of new interstate gas pipelines were set in September 1999. At the time, the prime interest rate—the rate banks charge their most creditworthy customers—was 8.25 percent, compared to 4.25 percent today.

State public utility commissions from at least five states—North Carolina, New York, Missouri, Connecticut and Kentucky—have challenged the high rates of return allowed by FERC since its current pricing policy was enacted in 1999, yet the policy remains.

FERC spokeswoman Tamara Young-Allen declined to comment for this article because the issues of rate of return and determination of need have been raised in cases pending before the commission.

The 1999 pricing policy played a role in the rise of the affiliate pipelines of today. Another key element came in 2005, when the Public Utility Holding Company Act of 1935 was repealed. The act kept the parent, or "holding," companies of regulated utilities from engaging in non-regulated business. The longstanding law was replaced by less-stringent restrictions on regulated utilities, paving the way for the growing number of affiliate pipeline projects seen today.

Atlantic Coast: Antitrust Concerns

In Virginia and North Carolina, a group of three utility holding companies formed Atlantic Coast Pipeline, LLC, a joint venture, to construct and operate the Atlantic Coast Pipeline.

Atlantic Coast

Capacity (MMcf/d)	**1,500**
Cost	**$5 billion**
In service date	**2019**
Utilities/parent companies that have invested in the project	**Dominion Energy, Duke Energy, The Southern Company**
Challenges (additional challenges may exist)	**Antitrust complaint filed with Federal Trade Commission**

The $5 billion Atlantic Coast Pipeline would run 600 miles from West Virginia to North Carolina and has been hotly contested by environmental advocates and landowners who oppose the project.

According to Michael Hirrel, a former antitrust attorney with the U.S. Department of Justice, the pipeline is an illegal monopoly. Hirrel, who owns a second home at a resort in the Blue Ridge Mountains where the pipeline would cross, filed **a complaint with the Federal Trade Commission** in 2016 alleging the pipeline violates U.S. antitrust laws.

Dominion Energy and Duke Energy, the lead investors in the project, declined to comment.

The utility companies have legal, regulated monopolies selling retail gas and electricity to their ratepayers, but they run into trouble when they branch out into other related businesses, Hirrel said. "An existing monopoly cannot extend its monopoly upstream or downstream into what are now competitive markets," Hirrel, said. "That goes back to the beginning of antitrust law."

NEXUS: Blocking More Cost-Effective Sources?

The Sierra Club filed a similar antitrust complaint with FERC, the Department of Justice and the Federal Trade Commission in November against the DTE Electric Company in Michigan. DTE and its affiliate, NEXUS Gas Transmission, LLC, seek to build the $2 billion NEXUS pipeline from Ohio to Michigan.

NEXUS

Capacity (MMcf/d)	**1,500**
Cost	**$2 billion**
In service date	**2018**
Utilities/parent companies that have invested in the project	**DTE Electric**
Challenges (additional challenges may exist)	**Antitrust complaint filed with Federal Trade Commission**

The complaint alleges the project would raise electricity rates above competitive levels and exclude more cost-effective energy sources, including renewables.

It's unclear what will happen in either antitrust case, but opponents of affiliate pipelines have had recent success elsewhere.

In 2016, environmental advocacy group Conservation Law Foundation won a lawsuit against the Massachusetts Department of Energy Resources that effectively halted Access Northeast, an affiliate pipeline project that the advocacy group said was not needed.

After New Jersey's Rate Counsel first voiced opposition to the PennEast pipeline last year, Public Service Enterprise Group (PSEG), one of the holding companies involved in the project, pulled out in June. The company said opposition to the project played no role in its decision.

"PSEG sold its share to concentrate on core business, not in reaction to actions taken by others," PSEG spokesman Paul Rosengren said.

The Rate Counsel is now urging FERC to conduct an independent analysis of whether there is a need for PennEast rather than relying on contracts between closely related companies as evidence of demand.

A model for such independent analysis is close at hand, NRDC's Mall said.

"Look at how FERC has set up approvals for electricity transmission—it's very different," she said. "When they look at electricity transmission, they have to do a regional analysis of what is needed, and they have regional organizations that look at this issue."

Is the Pipeline Boom a Bubble in the Making?

If questionable projects continue to be approved, the current pipeline boom could soon bust in the same way subprime mortgages imploded the housing market in the late 2000s, said Lander, the energy markets consultant.

"When transactions like that were motivated simply by money rather than providing a necessary service, it was indication of the coming bust," Lander said of the housing crash. "It is possible that the pipelines that are driven by affiliate subscriptions are an indication that the truly economic pipelines that really meet market need and market demand are getting fewer and fewer and people are being motivated more and more by just financial engineering."

Ranchers Fight Keystone XL Pipeline by Building Solar Panels in Its Path

BY PHIL MCKENNA

Rover Gas Pipeline Builder Faces Investigation by Federal Regulators

BY PHIL MCKENNA

Judge Orders Dakota Access Pipeline Review, Citing Environmental Justice

BY MARIANNE LAVELLE

BY PHIL MCKENNA

50% Rise in Renewable Energy Needed to Meet Ambitious State Standards

BY PHIL MCKENNA

Rover Gas Pipeline Builder Faces Investigation by Federal Regulators

BY PHIL MCKENNA

MORE BY PHIL MCKENNA