

OPINION

A new, worse approach to pipeline regulation for FERC

A reinterpretation of ‘public convenience and necessity’ regulation for interstate gas pipelines will make the energy regulator a more subjective, less effective institution.

By Travis Kavulla • Aug. 31, 2017

Editor's note: the following is a viewpoint from Travis Kavulla, is the vice chairman of the Montana Public Service Commission and the former president of the National Association of Regulatory Utility Commissioners.

“When an agency claims to discover in a long-extant statute an unheralded power to regulate a significant portion of the American economy, we typically greet its announcement with a measure of skepticism,” Justice Antonin Scalia wrote in a memorable 2014 opinion.

The late justice summed up a subtle trend. After many years of deference, the judiciary has recently sounded cautious notes over government agencies’ self-endowment of ever grander regulatory authority.

So it is a little strange to see those roles reversed. Last Tuesday, the District of Columbia Circuit Court of Appeals told the Federal Energy Regulatory Commission that the agency had a job that FERC itself has long disclaimed: the power to regulate carbon emissions.

The court's ruling vacates FERC's authorization of the Southeast Market Pipelines Project on the basis that the pipeline would carry natural gas to be burned in Florida for electricity. The "downstream" greenhouse-gas consequences, the court ruled, should have been evaluated in the project's environmental impact statement (EIS). A complete EIS is a linchpin of FERC's review of these projects, so for the moment the project is operating without a license, even though it is already operational.

The ruling could cause problems for more than a dozen pipelines, since FERC has eschewed detailed downstream carbon-emissions analysis as a matter of routine. Better to leave that problem, so the thinking went, to air regulators like the Environmental Protection Agency (EPA) and local departments of environmental quality. Those regulators have a clearer authority to regulate emissions at the power plants that actually burn the gas, not merely the pipelines that brought it.

Yet the "public convenience and necessity" standard FERC follows to make pipeline decisions is so vague and capacious that it can harbor a discussion of virtually anything. The court acknowledged that, and has now fit the round peg of carbon emissions into the square hole of an antique, imprecise statutory

formulation. It is a new era, but predicated on an old, poorly understood regulatory concept.

Utility regulators are not Captain Planet

Until recently, both Democrats and Republicans have agreed that FERC was not the appropriate venue for the carbon-policy debate. Last year, I interviewed former FERC Chairman Norman Bay, a Democrat, two weeks after he and his colleagues approved the pipeline in question. When I asked what, in his official capacity, he was doing to fight climate change, he responded, “I think FERC has very prudently viewed itself as being an economic regulator, not an environmental one.” He added he wasn’t comfortable with the agency being a “driver for environmental policy.”

Many bureaucrats, if pressed to assume the role of Captain Planet, would be fine with receiving the laurels right then and there. Fish must swim, birds must fly, and regulators—well, like other of God’s creatures, they too have a natural bias toward the fulfillment of their *modus operandi*. But Bay’s skepticism about mixing environmental and economic regulation into a novel *mélange* was well placed. They are two very different things.

Environmental regulation, like other health and safety regulation, has as its premise the constraint of an industry’s production when external social costs associated with that production are not accounted for in the producer’s ledger. Utility regulation, meanwhile, tends to focus on the network economies of a monopoly provider whose captive customer base and cost-of-

service regulation dull the incentive to behave in a manner that cuts costs while increasing production.

Put another way, environmental regulation works to slow down business-like ambition, and utility regulation aims to speed it up. Asking one regulator to do both those things is to introduce a dual mandate into what is already a complicated job. A utility regulator tends to base decisions on monopoly pricing on known cost inputs. But if he is the one to determine the proper cost of an externality—whether it be carbon emissions, local economic development impacts, how the sun looks as it sets over a certain piece of infrastructure, and so forth—the job of economic regulation becomes a bog of subjectivity.

The carbon-emissions guessing game

Putting aside the niceties of institutional structure, there's another problem with studies of the carbon-emissions effects of infrastructure: They are essentially useless. The most rigorous environmental review ever conducted on this topic was the U.S. State Department's work on the Keystone XL pipeline. The department's analysts eventually decided to throw up their hands on questions of whether the pipeline would induce more oil production or merely replace other sources, and whether this oil would be produced anyways and shipped by rail to the market. As James Coleman notes in a comprehensive article on the subject, the question seemed to turn not on hard metrics but whether Keystone XL would be "perceived as enabling" oil extraction. Coleman concludes, "Seven years of review and the State Department's best economic modelling produced a result

that even the Department decided was so useless that it should be subordinated to contrary popular perception.”

There are other, even more laughable examples. Cowlitz County and the State of Washington’s Department of Ecology studied the carbon-emissions effects of the Longview coal export terminal recently. That chapter of the EIS is a bizarre combination of flyspeck analyses and sweeping assumptions that ultimately leaves the reader without any view as to how much, or even whether, carbon emissions will increase because of the project. The EIS concludes that the coal export terminal could either lead to as much as 780 million tons in increased emissions, or it could *reduce* emissions by as much as 42 million tons.

The D.C. Circuit’s ruling waives off the indeterminacy of this field, explaining, “We understand emissions estimates would be largely influenced by assumptions rather than direct parameters about the project, but some educated assumptions are inevitable” in the process. This is small comfort except to the legion of modelling consultants who FERC will have to hire to arrive at whatever FERC’s pre-ordained conclusion is.

In all likelihood—and, caveating, I base the following judgment merely on *intuitive understanding of the electric sector*, without the use of a finely calibrated model into which I’ve plugged my many assumptions—the natural gas that the Southeast Market Pipelines Project carries will likely serve as a substitute for coal in the Florida market, leading to a net decrease in emissions. Indeed, when the Stanford economist Frank Wolak pieced together a model to study the carbon-emissions effect of

opening a *coal* export terminal on the West Coast of the United States, the model suggested that carbon emissions would be lower globally. (In the model, coal exports push up the fuel's price in the United States, hastening the switch to natural gas, while China simply uses American coal as a substitute for other, often dirtier coal, meaning the net effect on emissions is a negative number.)

The point is that my guesswork, or Cowlitz County's, or FERC's, or even Prof. Wolak's, should not really matter. Because, in the first place, it is hard to imagine a less efficient or precise regulation than an *ad hoc* analysis of the indirect, consequential emissions of any given piece of energy transportation infrastructure. As far as carbon policy goes, it's not just a second- or third-best option. It's probably somewhere around twelfth-best. Would it not be better, instead, to hew to environmental regulation that is single-mindedly focused on emissions when and where those fossil fuels are actually burned?

Without such a comprehensive policy, the type of pipeline regulation that the court and activists are cheering is just background noise, a clutter to a permitting process which should be more efficient. Sadly, this is the *raison d'être* of such groups as Beyond Extreme Energy, whose uncomplicated statement of purpose is "No new permits for fossil fuel infrastructure." They don't seek to make environmental regulation more efficient or meaningful. They and their kin only serve to introduce new chokepoints into ancillary regulatory processes. If EPA isn't doing what these activists view as that agency's job, they reason, then let's make sure FERC cannot do its own job. This is the worst

type of environmentalism: one that doesn't channel its energies toward real policy ideas, but is merely dedicated to the muck of the bureaucracy's mire.

Goodbye to the demure regulator

The tragedy in all this is that FERC's *economic* regulation of pipelines has been working pretty well. It's an exemplary history of a regulator identifying a problem and solving it through the introduction of objective tools, pitting self-interested counterparties against one another to make an erstwhile command-and-control industry incrementally more competitive.

The original premise of FERC's "public convenience and necessity" (PCN) regulation is that regulators can identify the "need" for essential services in a marketplace, and then proceed to objectively inquire as to whether incumbent facilities are meeting the need, as well as whether a new entrant would do harm to the economic viability of the network. (PCN is the same regulation that, for many states, initially barred Uber and other transportation network carriers from the market; the taxi franchises, it was reasoned, were already meeting the need.) The even-handed administration of PCN regulation, conducted without bias, is a tall order.

FERC laudably removed itself from the vagaries of this command-and-control model, when two decades ago it started a kind of open-season for long-term shipping rights of pipeline capacity, tradable by third parties. (The history is succinctly retold in Jeff Makhholm's *The Political Economy of Pipelines*.) This reform has prevented pipelines from self-dealing and foisting

costs on unwilling customers. Generally, it allows them only to be built when someone actually is willing to pony up his own money in advance, rather than having a regulator guess as to its economic necessity. FERC's pipeline regulation has largely accomplished its purpose of effectively regulating the problem of monopoly which is—or, perhaps better to say, *should be*—at the core of FERC's mission.

“Public convenience and necessity” is—or was, until the court's ruling—something of a relic. An expansive reinterpretation of PCN, which uncovers unheralded environmental goals within it, re-introduces the regulator as a prominent and subjective force. It's an attempt to fix one of the government programs that is actually working. That is a shame.

Travis Kavulla is the vice chairman of the Montana Public Service Commission and the former president of the National Association of Regulatory Utility Commissioners.

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