Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

October 29, 2015

Attention: Ms. Kimberly D. Bose, Secretary

Reference: PennEast Pipeline Company, LLC
Docket No. CP15-558

Dear Secretary Bose:

Thank you for the opportunity to comment on the PennEast application CP15-558. This project presents important and troubling issues for the Commission to consider. A full evidentiary proceeding is required to ascertain the facts about market-based need. The Commission cannot rely on precedent contracts with regulated affiliates who own 60 percent of the equity in PennEast as evidence of accurate price formation.

Without evidence of market-based need, this project amounts to significant overbuilding in a region that already has multiple competitive legacy pipelines and significant new capacity under construction.

In addition, this project poses substantial adverse effects on the economic interests of landowners and there is a high likelihood that a large proportion of landowners in New Jersey will not reach voluntary agreements on easements, forcing widespread use of eminent domain proceedings by PennEast.

The FERC policy statement states, "The strength of the benefit showing will need to be proportional to the applicant's proposed exercise of eminent domain procedures." PennEast will fail that test as PennEast will achieve minimal public benefit. PennEast's claims of public benefit are refuted in our comments, and there is evidence to suggest that the primary motivation for this project may be to earn excess profits by shifting market risk onto ratepayers.

Sincerely,

Michele Byers, Executive Director
New Jersey Conservation Foundation
170 Longview Road
Far Hills, NJ 07931

EXECUTIVE SUMMARY

<u>This project does not demonstrate market-based need.</u>

We request that FERC convene a full evidentiary hearing to determine the PennEast project's market-based need and evidence of public benefit. Issues of particular concern for this project include:

- A prior pattern of self-dealing is discernible for at least one LDC and its affiliate. Because of the potential for self-dealing by regulated utilities whose affiliates own 60% of PennEast, FERC should abandon the assumption that these precedent agreements are prima-facie evidence of market-based need.
- PennEast does not propose to support itself without substantial, multiple cross-subsidies from the existing, captive utility customers of its Affilliated-Anchor-Shipper owners.
- The PennEast project is based on unrealistic financing assumptions.

FERC should not conclude that the project is financially viable without subsidies, the first indicator of public benefit, until it has carefully reviewed relevant data – something that can only be done, given the facts in this case, after a full evidentiary hearing. Without evidence of public benefit, the threshold test of public convenience and necessity is not met.

<u>This project presents substantial adverse impacts.</u>

The Commission has a duty to protect the interests of "captive customers" on existing pipelines, particularly ratepayers. Because PennEast is not based on growth in demand, longer-term shipping contracts on legacy pipelines are at risk. As the volume of unsubscribed capacity increases on legacy pipelines, operators are entitled to seek new tariffs from FERC to recover costs, which can substantially increase the tariffs for captive customers, including ratepayers.

In addition, there is substantial evidence of adverse impacts on the economic interests of landowners due to the high likelihood of widespread use of eminent domain proceedings. With high adverse impacts, the Commission must require <u>exceptionally strong evidence</u> of public benefit.

<u>The case for public benefit is exceptionally weak.</u>

- FERC should require PennEast to submit credible new information to justify its claims of market demand and reliability. FERC must reject PennEast's current analysis of market demand and reliability.

<u>FERC must reject the application</u> based on minimal public benefits and substantial adverse impacts due to likely excessive use of eminent domain and impacts on captive customers.

Comments on CP15-558
New Jersey Conservation Foundation

INTRODUCTION

The Commission's review of the purported "market need" for the project should not rely on the precedent agreements submitted by the applicant because they were not reached in arm's-length transactions under competitive market conditions. Three of New Jersey's four captive natural gas utilities –New Jersey Natural Gas (NJNG), South Jersey Gas (SJG) and Elizabethtown -- own 60% of the total equity in PennEast while contracting for 38.9% of the capacity. Their precedent agreements with an affiliated pipeline developer for firm supply (at the expense of ratepayers) serves as the economic foundation for the proposed project and yet this agreement appears to be tainted by self-interest. Moreover, their ability to extract, not 38.9%, but 60% of the total equity in PennEast suggests excessive market power precluding reliance on the precedent agreements to demonstrate market need. When including PSEG, all four of New Jersey's Parent Utility Holding Companies (PUHCs) together represent 70% ownership in PennEast.

1. **The precedent agreements with regulated affiliates who own 60 percent of the equity in PennEast may not represent accurate price formation, and, absent a full evidentiary proceeding to determine "need," should not be viewed as evidence of public need.**

A central issue for the Commissioners to consider in this proceeding is whether the fact that companies are willing to invest in a project qualifies as a reasonable indicator of market-based need for a project. The natural gas markets and pipeline economics differ far more than in the past, and warrant a fresh look by FERC. The facts of this case illuminate a new method for operators to game the system, and **may not,** in the absence of an evidentiary proceeding, indicate market-based need. Without evidence of public benefit, the proposed project fails to meet the threshold test of public convenience and necessity.

This project raises important policy issues potentially not evident to Commissioners in earlier applications. This project requires a much closer look at the nature of the need alleged by the applicants as demonstrated by the precedent contracts. In doing so, Commissioners fulfill their goal of protecting captive customers, particularly ratepayers on other pipelines, as well as adducing evidence that will enable a determination as to whether ratepayers of the anchor shippers could be asked to pay higher tariff rates to the sole benefit of applicants/developers who are affiliates of and related entities to the anchor shippers.

This relationship between regulated local distribution companies (LDCs) and unregulated affiliates has the potential and likelihood to expose both (1) New Jersey's natural gas users to affiliate cross-subsidization as well as (2) ratepayers of pipelines whose capacity will be turned back by anchor shipper-affiliates of the applicants as a result of the excess capacity that the applicants propose to build. The interest of incumbent pipelines and their customers must be taken into account in deciding whether to certify a proposed project. The self-service affiliate relationships at the heart of the PennEast project imply that any such impacts are not the product of fair competition.

Accurate price signals require that the benefit to consumers, evidenced by the price they are willing to pay for this service in lieu of other services, is greater than the cost of the project plus profit. The opportunity for pipeline operators to earn a profit is not in dispute. In this case, however, investors did not rely on accurate price signals as indicia of customer interest in new capacity.

- The shipping rates offered cannot be determined to be accurate price signals of interest, unless it is first determined, by an evidentiary hearing, that the anchor shipper-LDCs/affiliated with the applicant are not proposing to turn back to legacy pipelines and/or do not have lower cost, existing options on those legacy pipelines. Absent a full evidentiary hearing, neither the Commission, nor anyone else can determine whether these three LDCs, accounting for almost 40% of the total capacity, would or would **not** have signed precedent contracts in arm's-length transactions under competitive market conditions.

- The "cost of service" contracts prove lucrative for energy companies as they provide a steady, almost risk free revenue and profit stream for the duration of the precedent agreements. This results in a strong financial incentive to build pipelines to capture these profits that essentially amount to obligations imposed on the ratepayers of their retail utility affiliates. One goal of FERC policy is to minimize unnecessary overbuilding, and it relies on precedent agreements as a key governor of that risk. Typically, it is difficult to attract sufficient customers who are willing to take **genuine market risk** on long-term firm contracts particularly in markets where multiple pipelines must compete for customers. Due to the large portion of the cost and risk passed on to ratepayers, the willingness of LDCs to sign firm contracts is key to building PennEast and many other pipelines.

  These contracts – especially non-arms-length contracts – are not a market-based price signal upon which the Commission can typically and rightly rely, but rather require a full vetting of the facts regarding need in order to make a complete regulatory decision. Such analysis will enable the Commission to avoid uncompetitive overbuilding of pipeline infrastructure.

There is clear evidence of benefits for the PUHCs that own the non-regulated affiliates invested in the project, which are not detailed here, but can be provided to FERC.

What is FERC's role in protecting the ratepayers of New Jersey? First, FERC has an overriding obligation to protect the "public interest." If New Jersey state regulators choose to ignore or feel unable to review the Precedent agreements in a timely and appropriate manner, FERC must adduce the facts in order to decide whether to approve a pipeline that absent such evidentiary finding only superficially meets FERC's "market-based need" test. The market-need litmus test is not sacrosanct, and does not always accomplish FERC's policy goals. It is appropriate to look more closely, to determine if there is genuine and legitimate market need that would otherwise be indicated by healthy arms-length negotiations and competition.

2. A prior pattern of self-dealing is discernible for at least one LDC and its affiliate. This activity casts further doubt on any assumption that firm contracts represent market-based need.

NJCF is investigating the relationship between LDCs and their non-regulated affiliates prior to PennEast in order to better understand the purpose of the new PennEast shipping contracts. An analysis of firm contracts during the winter 2014/2015 by Skipping Stone[1] shows that New Jersey Natural Gas (NJNG) may have purchased firm contracts in excess of what was needed to serve its native load even during peak winter months. As an example, rather than using all of its contracted capacity, during the winter of 2014/15 NJNG released 470,738 Dth/d of non-lateral capacity on Texas Eastern (TETCO). Of that released capacity, **87.8%** went to its affiliate NJR Energy Services.

In New Jersey, as in New England, the Board of Public Utilities provides an incentive for LDCs to release any unneeded capacity (which has economic value), by allowing 85% of pre-tax margins to be credited to the BGSSC (ratepayers) and allowing LDCs to retain 15% of the profit from such sales. If not properly monitored, this rule creates an incentive for an LDC to subscribe to higher capacity than is needed to serve customers, and profit from its resale. In 2015, expert analysis revealed a similar pattern by LDCs in New England.

> An outcome of the 80-90% “sharing” is that the LDC gets to keep—as pure profit—the remaining 10% to 20%. Some have noted that this current system leads to perverse incentives. For example, an LDC could conceivably add unneeded capacity to their inventory, having ratepayers pay 100% of the cost, and then use that new capacity to make sales from which they get to keep 10% - 20% of the margin. In essence, 100% of the cost goes to the ratepayer and then 10%-20% of the “cost-free” and “risk-free” margin goes to the LDC and its shareholders.[2]

NJCF has commissioned further analysis by Skipping Stone to determine the extent of these purchases, the pattern of releases, and prices. FERC must fully analyze whether the LDCs are able to meet current and future native load with existing sources, and whether additional contracts for capacity via PennEast are needed for the purpose of meeting market-based need, and are in the public interest.

REQUESTS OF FERC:

- Convene a full evidentiary hearing to determine the existence of need.
    - A prior pattern of self-dealing is discernible for at least one LDC and its affiliate. With the potential for self-dealing by regulated utilities whose affiliates own 60% of PennEast, FERC should abandon the assumption that these precedent agreements are prima-facie evidence of market-based need.
    - FERC should not conclude that the project is financially viable ***without subsidies***, the

[1] Skipping Stone has provided Commissioners with numerous analyses of pipeline issues to help clarify whether the markets for natural gas are working efficiently.
[2] Lander, Greg. (2015). Solving New England's Gas Deliverability Problem Using LNG Storage and Market Incentives. Skipping Stone. P.D-2

first indicator of public benefit, until it has carefully reviewed relevant data – something that can only be done, given the facts in this case, after a full evidentiary hearing.

- After a full evidentiary hearing, should FERC find that the PennEast project is based on distorted price signals and does not reflect market-based need, ***it must reject the application***.

3. PennEast project is based on market manipulation

Under the Energy Policy Act of 2005, Congress provided FERC with authority to prevent the gaming of energy markets. According to FERC's 1999 policy statement, the Commission's threshold criteria for certifying a project is whether it will financially support itself without subsidies from existing customers. The clear answer to this threshold question is that PennEast does not propose to support itself without substantial, multiple cross-subsidies from the existing, captive utility customers of its Affilliated-Anchor-Shipper owners. Nor can PennEast credibly claim that it does not adversely impact other existing pipelines and their captive customers or affected landowners and communities.

As FERC Commissioner Tony Clark has said, there are:

> some people who will argue that the only thing that FERC should do is a very strict, rules-based enforcement, where you define everything with great specificity in a tariff and say, this is what you can't do, and then they would argue that FERC should only be able to enforce that. I would argue it can't work like that. There are certain things that are just very definitively described in a tariff that you can't do. You can't define every possible way that someone could manipulate an energy market. If FERC were to adopt a strict reading under which only rules-based enforcement is to be allowed, effectively it would be the commission adopting what I'd call a one free bite at the apple theory of market manipulation, which is – as long as you can come up with a novel way of manipulating the market, you get one free bite at it until the commission finds it and then it would be very specifically defined in a rule and then you couldn't do that from there on out. I can't imagine that's what Congress was envisioning when they gave the commission the authority that it did under the Energy Policy Act of 2005.[3]

4. PennEast is not financially viable

An evidentiary hearing can adduce whether, as it appears here, that financial viability can be assumed because PennEast was not able to extract 20-year commitments, the common standard for a project of this scale and cost. With 15-year contracts in hand, PennEast is able to borrow at interest rates that one assumes (absent evidence adduced at hearing) will be covered by its rates over the initial 15-year period. Those rates may not, however, generate sufficient cash-flow to amortize the debt. Absent an evidentiary hearing, it will be unknown as to whether there will be a balloon payment due in 15 years that must be refinanced, possibly in the absence of contracts.

[3] Clark, T. (2015, February 23). Public Power Weekly Exclusive: FERC's Clark discusses enforcement approaches in interview [Public Power Daily]. Retrieved from https://www.ferc.gov/media/statements-speeches/clark/2015/03-13-15.pdf

5. **PennEast places excessive risks on ratepayers**

There is real possibility of project delays, as well as state requirements calling for necessary, but more costly constructions practices that cast serious doubt on the financial viability of the applicants' proposed pipeline.

In the precedent contracts with public utilities, accounting for 38.9% of total capacity, utility ratepayers may be asked to assume considerable risk once the project moves forward and could pay substantially higher rates.

REQUESTS OF FERC:

- If FERC finds, after a full evidentiary hearing, that the PennEast project is based on unrealistic financing assumptions, ***it must reject the application***.

6. **The adverse effects of PennEast to landowners are substantial in light of the evidence that the project would require extensive use of eminent domain.**

In the case of PennEast, hundreds of individual landowners have concluded that their property rights have substantial value far greater than what PennEast has offered. This is evidenced by the fact that, to date, none have signed easement agreements. There is evidence that, should FERC issue a certificate, majority significant percentage of landowners in New Jersey would **not** reach voluntary agreements. By October 2015, New Jersey landowners have refused survey access to PennEast on 70% of the proposed route, showing both their strong opposition to this project and the high valuation they place on their property rights.

Landowners choose to live in this region of New Jersey precisely ***because of*** the scenic landscape, preserved open lands, extensive farmlands, healthy streams, as well as clean water and air. For many, there is a significant gap between the value of an easement to landowners, based on characteristics of the region, and the "market value" being discussed by PennEast.

Preserving land creates a perverse incentive to **attract the use of eminent domain**, by siting pipelines, since low market valuation associated with the lack of development saves money on acquisition costs. In fact, PennEast has created the "least cost" route by deliberately traversing over 4,000 acres of preserved land in New Jersey alone.

By forcing landowners to accept nominal amounts for assets that have significant value to landowners, the Commissioners would be destroying substantial economic value. Such an action would be irreconcilable with New Jersey policies that call for investing substantial taxpayer dollars in preservation, and enjoy strong bi-partisan support. States have the right to make local policy that should not be undermined by excessive federal use of eminent domain. Living in the most densely populated state in the country, New Jersey voters have spoken, and now landowners are speaking.

If approved, PennEast could be forced to conduct eminent domain proceedings on a very large scale, a practice clearly discouraged by the FERC policy statement, which states, "The strength of the benefit showing will need to be proportional to the applicant's proposed exercise of eminent domain procedures." Given the widespread opposition to the project, and likelihood of massive eminent domain actions against landowners over private property rights, PennEast should be compelled by FERC to submit evidence of **very substantial** public need from which a benefit assessment can be made.

7. PennEast will create substantial adverse effects to captive customers of legacy pipelines

According to FERC Policy, the Commission should also consider "how the proposal would affect the cost recovery of the existing pipeline, particularly the amount of unsubscribed capacity that would be created and who would bear that risk, before approving the project," especially accounting for the interests of "captive customers." In addition, the evidence of benefits "will need to be more specific and detailed than the generalized benefits that arise from the availability of competitive alternatives." [4]

There are two categories of captive customers affected by PennEast. First, the LDC ratepayers who will be asked to pay more for shipping capacity will experience financial harm as previously discussed. Second, legacy pipelines in the region currently serve a range of customers, including ratepayers. As the volume of unsubscribed capacity increases, so does the risk to longer-term shipping contracts on legacy pipelines. PennEast is not based on growth in demand (see section 8), making unsubscribed capacity unlikely to occur. Pipeline operators are entitled to seek new tariffs from FERC to recover costs, which can substantially increase the tariffs for captive customers, including ratepayers.

Substantial evidence shows that the current marketplace for natural gas in New Jersey has served and can continue to serve public interest, convenience, and necessity. New Jersey is currently served by a competitive interstate pipeline system that has provided customers with substantial cost savings in comparison to pre-Marcellus prices. According to Energy Information Association (EIA) data, the residential price of natural gas in New Jersey reached $15.21 per thousand cubic feet in 2008; it was $9.69 in 2014, a savings of more than 37 percent. The state's electric power price was $10.78 in 2008; it was $4.83 in 2014, a savings of more than 55 percent. Pennsylvania has experienced similar savings.

REQUESTS OF FERC:

- If FERC finds that the PennEast project poses substantial adverse effects on the economic interests of landowners and ratepayers who are captive customers of existing pipelines, ***it must require exceptionally strong evidence of public benefit.***

8. PennEast will achieve minimal public benefit

Given the defects in the precedent agreements described above, and the likely widespread use of eminent domain, it will be particularly important for FERC to critically examine claims of public benefits

[4] Courts have found that FERC has a strong responsibility to protect consumers from excessive rates is a critical public interest based on Policy Statement 1999 as well as the legislative history of the Natural Gas Act.

that might offset the substantial adverse effects of this project. Some of these issues will be addressed more fully in an evidentiary hearing to examine market-based need.

This project fails to overcome significant adverse effects, as the case for public benefit is exceptionally weak. PennEast's claims of public benefit are refuted below.

1. **Demand.** According to a report from Labyrinth Consulting, PennEast is not justified by an increase in demand for natural gas in the state, as show in the EIA chart below.

   "Natural Gas consumption for New Jersey has been relatively flat for the past four years at an average rate of 1.8 Billion cubic feet of gas per day (Bcf/d), somewhat below the higher levels of the late 1990s."[5]

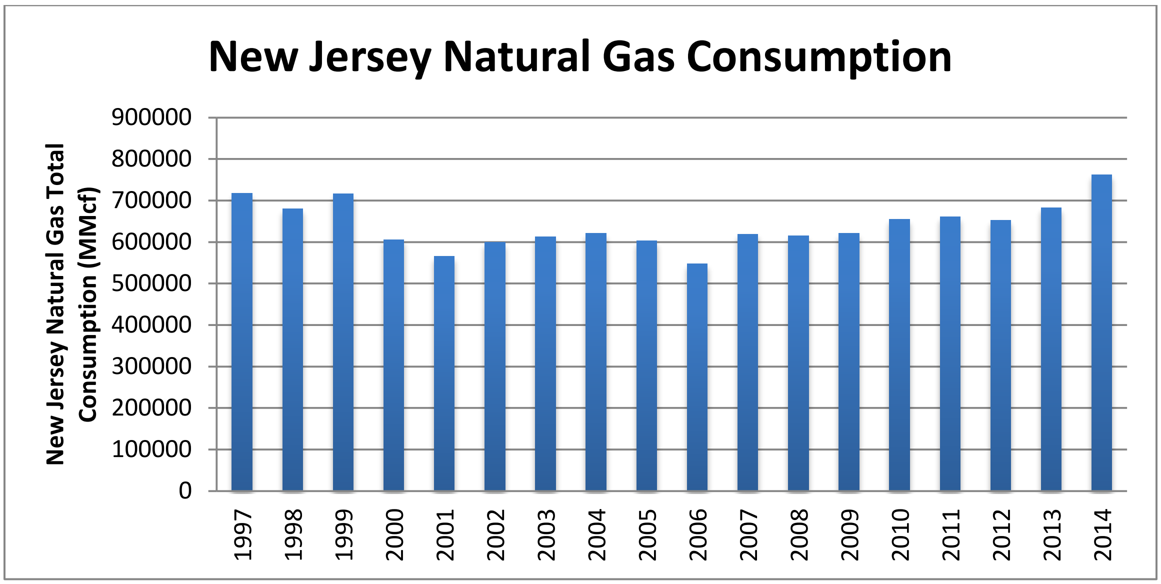

Figure 1. New Jersey annual natural gas consumption. Source: EIA.

This well-documented lack of future growth is acknowledged by PennEast in Resource Report 1. Both PSEG and South Jersey Gas describe their goal as "displacement" rather than serving growth.

> PSEG as the largest utility in New Jersey, and one of the largest buyers of Marcellus Shale supplies in the northeast, intends to utilize the supplies of gas from the proposed PennEast Project to **displace more expensive supplies** of gas from the Gulf of Mexico.[6]

[5] Labyrinth Consulting Services, LLC, "Professional Opinion on the Proposed PennEast Pipeline Project, Updated June 18, 2015"

[6] PennEast Resource Report 1 as of July 31st, 2015, Purpose and Need Justification Page 1-4: http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=13946534

> South Jersey's capacity portfolio is uniquely positioned to take advantage of the Project because the Company currently has interstate pipeline capacity with a receipt point very close to the terminus of the PennEast Project. These conditions will allow for the displacement of supplies that could be very expensive with much lower, secure supply prices.[7]

2. **Bottlenecks and New Supplies**. Both EIA and FERC document extensive new pipeline capacity coming in-service prior to PennEast, as well as announcements of significant flow reversal on legacy pipelines. According to FERC's 2015-16 Winter Energy Market Assessment:

   > Growing Northeast natural gas production and new pipeline takeaway capacity continue to reshape the nation's flow patterns and prices. Since the start of 2014, 9 Bcfd of capacity additions have come online to further link production with markets in the Mid-Atlantic, the Southeast, and the Midwest. As a result, the Northeast corner of the nation became a net exporter of natural gas for the first time this summer. Northeast production will also increasingly reach Midwest markets. Rockies Express has added 1.2 Bcfd of capacity through its East-to-West reversal project, while Texas Eastern has added 550 MMcfd through the OPEN project and 425 MMcfd through the Uniontown-to-Gas City expansion project. By the end of 2015, additional projects along Columbia Gas Transmission, Transco, and Tennessee will provide another 2 Bcfd of capacity to market from Northeast production areas. Furthermore, over 25 Bcfd of additional pipeline capacity by 2018 has been either approved by or filed with FERC.

   <u>Three projects alone will provide more than 3 bcf/day of additional capacity to the New Jersey system before PennEast would be completed</u>: Leidy Southeast Expansion (end of 2015), Atlantic Sunrise project (mid 2017), and reversal of flow on the Transco main line to the Northeast region by the end of 2015.

   One argument made for additional supplies is the possibility of reducing costs for consumers. Recent data clearly shows that New Jersey already has low gas prices. EIA data[8] shows that despite a harsh winter in the 2014/2015 season, residential rates in New Jersey fluctuated between 4th and 8th lowest in the nation. In April 2015, **New Jersey actually had the lowest residential gas prices** in the entire country.

3. **Reliability.** Commissioners are well aware of the extensive reforms instituted by both PJM and FERC to address gas - electric reliability in the region. There is currently sufficient pipeline capacity to meet the operating needs of LDCs and power generation in New Jersey. **Appendix A** summarizes recent research on the utilization of legacy pipelines during the Polar Vortex and other reforms that have recently been adopted to further address reliability concerns.

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[7] Ibid, Page 1-4.
[8] EIA.GOV. State Historical Residential Natural Gas Prices. Retrieved from: http://www.eia.gov/dnav/ng/xls/NG_PRI_SUM_A_EPG0_PRS_DMCF_M.xls

4. **Clean Air.** Inevitably, New Jersey cannot further reduce emissions to improve air quality without reducing the use of natural gas for power generation.[9] As stated by the New Jersey Department of Environmental Protection in a recent letter to the EPA, "New Jersey's fossil fuel baseline is made up of 92% NGCC units." This provides yet another reason why future demand for natural gas is likely to decline in New Jersey.

REQUESTS OF FERC:

- Require PennEast to submit credible new information to justify its claims of market demand and reliability. FERC must reject PennEast's current analysis of market demand and reliability.
- **FERC must reject the application** based on minimal public benefits and substantial adverse impacts due to likely excessive use of eminent domain.

APPENDIX A. Reliability and Polar Vortex Analysis
Filed separately on October 29, 2015

APPENDIX B. Analysis of Capacity Releases by LDCs during Winter Months
Forthcoming report by Skipping Stone

[9] Letter from Bob Martin, Commissioner, New Jersey Department of Environmental Protection to Gina McCarthy, Administrator, US EPA, dated September 2, 2015.