



# Legal Aspects of Natural Gas Regulation

Energy Regulatory Partnership Program  
Lansing, Michigan  
November 30 to December 6, 2008

*Presented by Robert W. Kehres*

## Legal underpinnings for utility regulation.

- Traced to British Common Law under the reign of King James as espoused by Lord Chief Justice Matthew Hale, [c. 1670. ]
- In Munn v Illinois, 94 US 113 (1876), a case dealing with grain elevators, the US Supreme Court stated:
- “When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to the control.”

# America's Model: Natural Gas Federal/State Regulation

- Supremacy Clause



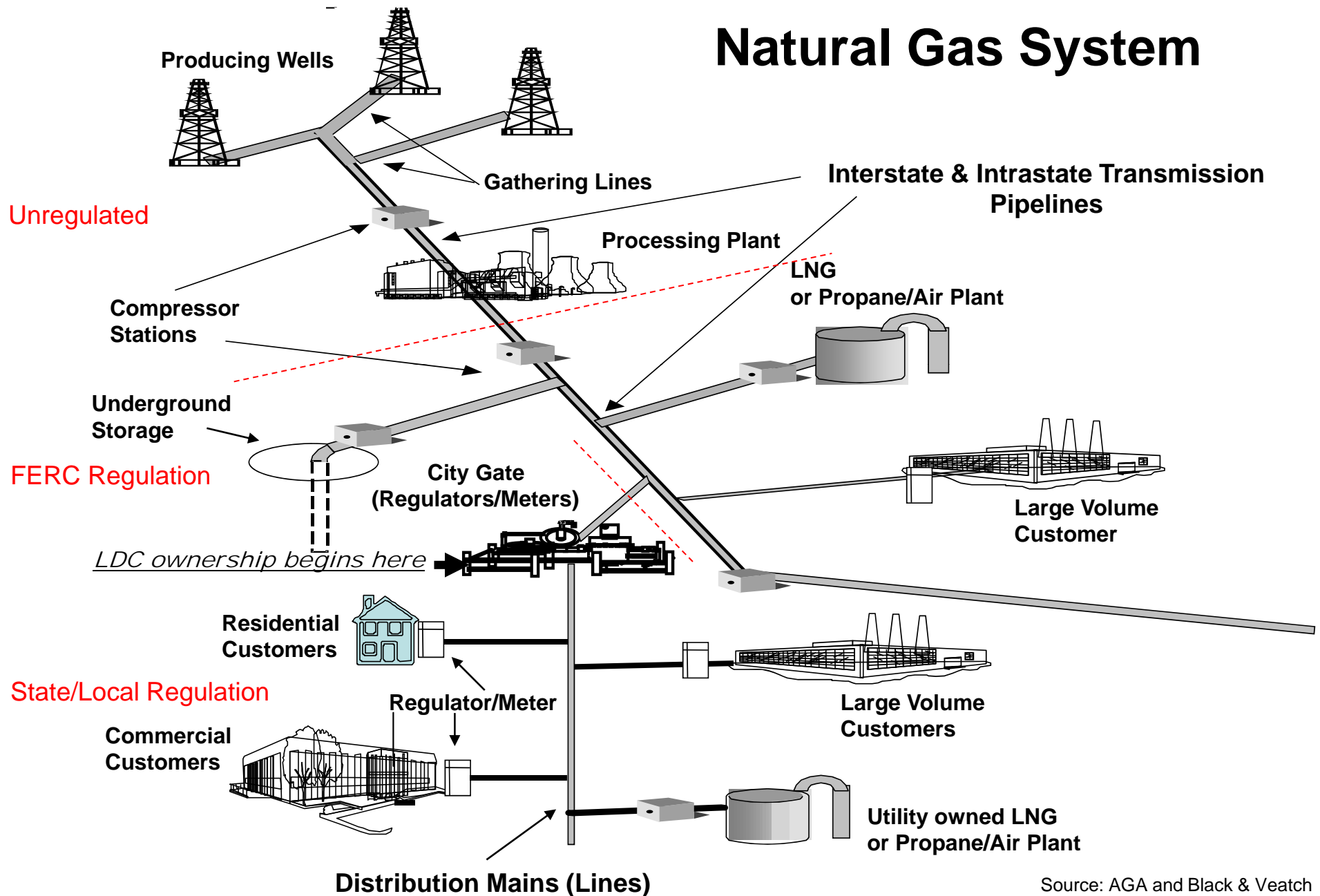
- Commerce Clause

- Gives U.S. Congress ability to preempt state authority
- Standards for preemption
- Examples of preemption
- Examples of the absence of preemption

# Regulatory Boundaries

- Federal Regulation - Interstate transportation and storage rates, facilities expansion for pipelines
- State or Local Regulation - delivery of gas to end- use customers, sales of gas commodity (unless market is open to competition), rates, financing, CPCN, etc.

# Natural Gas System



Source: AGA and Black & Veatch

# The FERC



# Federal Energy Regulatory Commission

- FERC determinations may preempt MPSC decisions in certain areas.
  - The FERC has jurisdiction over wholesale power markets and interstate power transactions.
  - Any time natural gas gets transported in interstate commerce, the authority of the FERC comes into play.
  - The MPSC's authority extends to retail markets in Michigan and intrastate transportation.
  - Michigan is a gas producing state.

# Key Federal Statutes

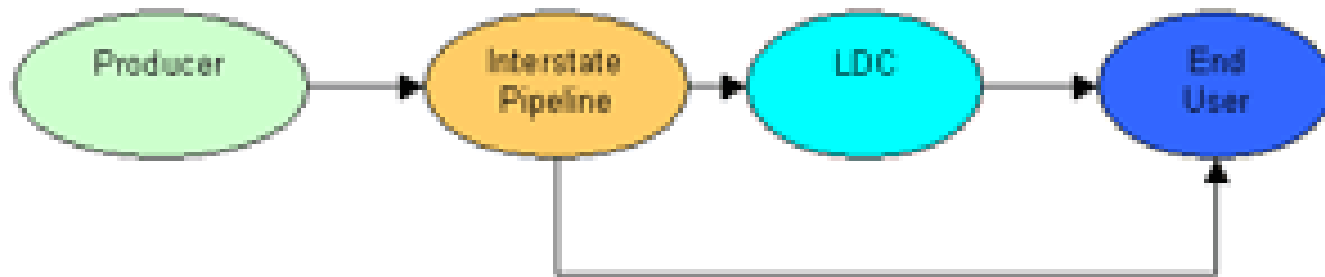
- Natural Gas Act of 1935
- Natural Gas Policy Act of 1978
- Natural Gas Wellhead Decontrol Act of 1989



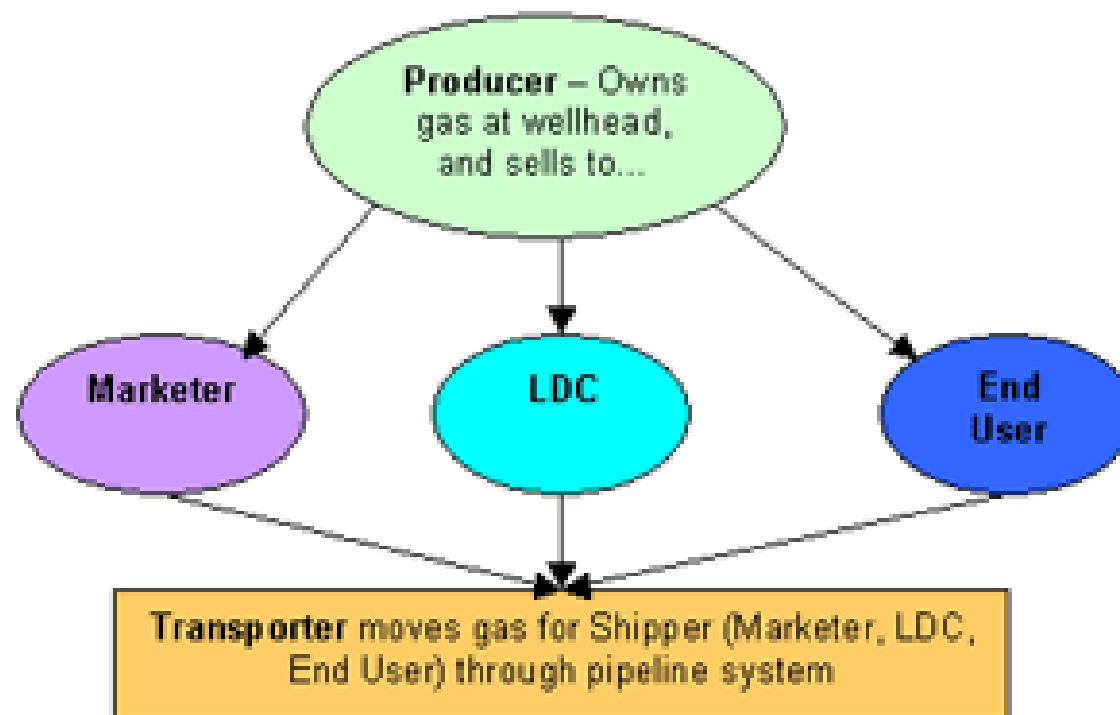
# Forms of Federal Regulation

- Pipeline Safety [U. S. D.O.T.]
- Gas Storage Fields
- Interstate Transportation Rates
- Open Access

# Old Economic Regulation Model



# New market-based model



# Michigan



# Major Substantive Laws giving the Commission its jurisdiction

- Railroad Act (1909)
- Transmission of Electricity Act (1909)
- Public Utilities Commission Act (1919)
- Carriers by Water Act [a/k/a Ferry Boats] (1921)
- Certificates of Convenience and Necessity Act (1929)
- Public Service Commission Act (1939)
- Protection of Underground Facilities (1974)
- Michigan Telecommunications Act (1991)
- Electric Transmission Line Certification Act (1995)
- Customer Choice and Reliability Act (2000)
- Video Franchising Act (2006)

# Major Procedural Laws governing the Commission

- Administrative Procedures Act (1969)
- Open Meetings Act (1976)
- Freedom of information Act (1976)
- Costs of Regulating Utilities Act (1972)

# The *Union Carbide* decision,

- “The Public Service Commission possesses no ‘common law’ powers.....As a creature of the Legislature, the commission possesses only that authority bestowed upon it by statute.”
- *Union Carbide v PSC*, 431 Mich 135 (1988)

# How the MPSC Regulates

- Informal Contacts
- Formal Investigations
- Show Cause Proceedings
- Uncontested Cases
- Contested Cases
- Adoption of Administrative Rules
- Adoption of Guidelines
- Declaratory Rulings



# Utilities have rights and responsibilities

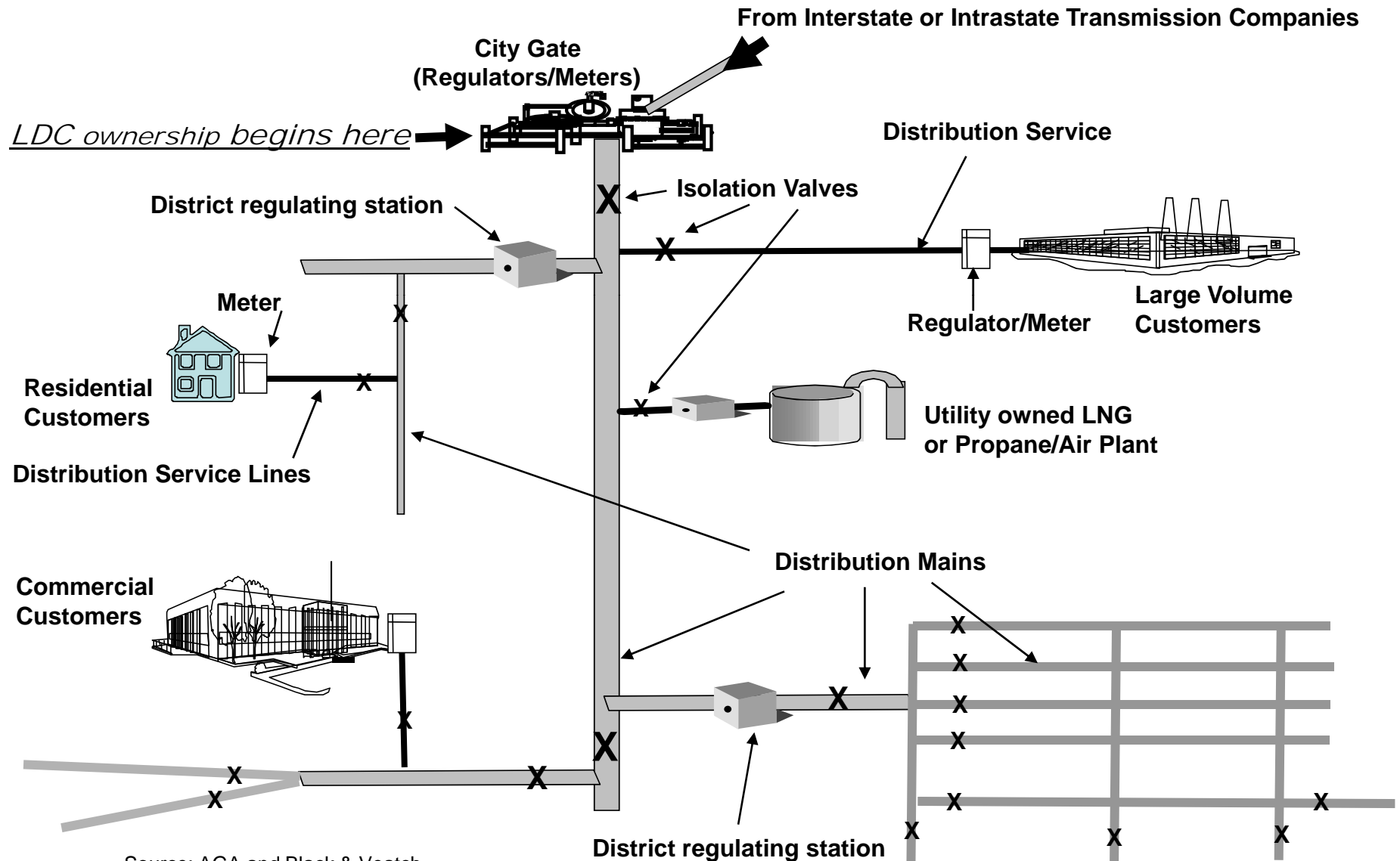
## Obligations

- Obligation to serve
  - Defined by statutory scheme, tariff or franchise
  - Obligation not unlimited - line extension policies
  - Right to reasonable return on the prudently incurred cost of used and useful assets
- Safe and reliable service
- Non-discriminatory rates
- Just and reasonable rates

## Rights

- Right to reasonable return
- Service subject to reasonable rates, rules and regulations
- Protection from competition
- Eminent domain

# LDC Distribution System



Source: AGA and Black & Veatch

# Forms of Regulation in Michigan

- Pipelines: Construction, Safety, and Rates
- Gas Wells: Proration and Operation
- Gas Storage Reservoirs
- Retail Intrastate Sales and Transportation Rates
- Alternative Gas Suppliers
- Distribution Service Territories
- Curtailment Issues

# Gas Ratemaking 101

- Rates based on approved costs and throughput for test year (Historic, Normalized and Annualized, Pro forma, Forecast).
- Rate determination
  - Revenue requirement =  $O + M + D + T + (GP - AD)R$   
where O is operating expense, M is maintenance expense, D is depreciation expense, T is taxes and  $(GP - AD)R^*$  is return on rate base
  - Rates = Revenue Requirement / Test year throughput (net of losses)

# Gas Ratemaking 101 *continued*

- Total revenue requirement divided among classes of service to develop rates
- Costs and throughput re-set during rate case
- Rates designed to provide reasonable opportunity to earn allowed return
- Opportunity to exceed allowed return if costs can be reduced below level assumed in revenue requirement, and/or throughput is higher than assumed without cost of additional throughput exceeding historic revenue requirement

# Gas Ratemaking 101 *continued*

- Regulatory risks impact opportunity to earn allowed return
- Earned return is critical to financial capability

# Distribution Rates

- Rates regulated by state commissions
  - Sometimes set initially by local authorities
  - Distribution costs spread over fixed and commodity charges (some jurisdictions moving to pure fixed/variable rates)
  - Purchased gas adjustment mechanisms to recover changes in supply costs
- Non-commodity rate schedules based on maximum demands
  - Firm
  - Interruptible/special contracts
  - Transportation
- Non-regulatory factors affecting earned returns
  - Weather
  - Competition
  - New construction/marketing
  - Conservation

Questions?



# The End

