

NOTE

FERC'S RIGHT TO CHANGE POLICY ON REMAND

I. INTRODUCTION

When an administrative agency applies a policy for many years, companies come to rely on that policy and make these decisions accordingly. A sudden change in policy may adversely affect business decisions. There is a need for agencies, as well as courts, to have uniformity in their decisions. Agencies, like courts, have a duty to follow precedent, thus allowing businesses to rely on past practices and policies in making business decisions. However, if an agency follows certain procedures, it is free to depart from precedent. This Note examines what occurred when the Federal Energy Regulatory Commission (FERC or Commission) abruptly changed its policy of when to use rolled-in versus incremental rates.

Southeastern Michigan Gas Company, v. FERC,¹ was an appellate decision resulting from an ongoing rate controversy at the FERC.² For over thirty years, the FERC used an analysis known as the *Battle Creek* test,³ then suddenly abandoned it in favor of another test.⁴ In remanding the case, the United States Court of Appeals, District of Columbia Circuit, ordered the FERC to clarify why it abandoned the *Battle Creek* precedent in favor of a new test. Consequently, on remand the FERC backtracked and readopted the *Battle Creek* test.⁵ *Southeastern Michigan* addressed the issue of the FERC's authority to change the substance of a decision when remanded for clarification.⁶

Southeastern Michigan clarified two issues regarding the FERC's power to change policy. First, the FERC may change a long-standing policy as long as it provides well reasoned explanation. Second, once a court remands a case to the FERC, the Commission may change any part of its previous decision, even if a complete reversal of policy occurs.

This Note will examine the possible impact of *Southeastern Michigan* on future business decisions.⁷ Section II will focus on the prevailing law at the time of this decision. While analyzing the *Battle Creek* test and the FERC's apparent preference for rolled-in rates,⁸ this Note will contrast the *Battle Creek* test with

1. *Southeastern Mich. Gas Co., v. FERC*, 133 F.3d 34 (D.C. Cir. 1998).

2. The rate dispute started when Great Lakes filed to have the rate figured by using rolled-in rates rather than incremental rates. See *infra* Section III.

3. *Battle Creek Gas Co., v. FPC*, 281 F.2d 42 (D.C. Cir. 1960).

4. *TransCanada Pipelines Ltd., v. FERC*, 24 F.3d 305 (D.C. Cir. 1994).

5. *Southeastern Mich.*, 133 F.3d at 37.

6. *Id.*

7. This Note focuses on the FERC's ability to change an established policy. Other issues involved in the case are beyond the scope of this Note.

8. With rolled-in pricing, the cost of the expansion adds to the total rate base of the pipeline. The result

the commensurate benefits analysis.⁹ Section III provides a factual and procedural history of the controversy leading up to *Southeastern Michigan*. Section IV analyzes the opinion of the court in *Southeastern Michigan*, while focusing on the FERC's ability and authority to construct or alter its policies.

II. BACKGROUND

A. FERC Guidelines For Rolled-in v. Incremental Pricing

1. The Battle Creek Test

In *Battle Creek Gas Company v. FPC*,¹⁰ the United States Court of Appeals, District of Columbia Circuit, set forth a test for the Federal Power Commission (FPC)¹¹ to determine whether the cost of building or expanding pipeline facilities¹² could be recovered by using rolled-in,¹³ rather than incremental pricing.¹⁴

The underlying dispute in *Battle Creek* resulted from the Trunkline Gas Company's (Trunkline) request for a Certificate of Public Convenience and Necessity¹⁵ to expand its pipeline capacity. Trunkline transports natural gas from

of using this type of pricing is that all customers pay for the expansion regardless of whether they directly benefit from it. *TransCanada Pipelines Ltd. v. FERC*, 24 F.3d 305, 307 (D.C. Cir. 1994).

9. With the commensurate benefits test, the FERC determines whether the benefits of rolled-in rates would be commensurate with the operational benefits of the new facility on the existing customers. 57 F.E.R.C. ¶ 61,140 at 61,521.

10. *Battle Creek*, 281 F.2d at 42.

11. The regulatory functions of the Federal Power Commission (FPC) were transferred to the Federal Energy Regulatory Commission (FERC) as a result of the Department of Energy Organization Act of 1977, Pub. L. No. 95-91, § 402(a), 91 Stat. 565, 583-84; codified at 42 U.S.C. §§ 7101-7382f (1994)). Decisions involving the FPC also serve as precedent for the FERC. For a discussion on the history of the FPC and the FERC, see Elizabeth Moler, David Ward, Robert C. Platt, Sherman Poland, David Benkin, 1995 *A Salute: 75 Years for the FPC and FERC*, 16 ENERGY L.J. 293 (1995).

12. For a presentation of economic arguments in support of incremental pricing of pipeline expansions, see Daniel F. Spulber, *Pricing and the Incentive to Invest in Pipelines After Great Lakes*, 15 ENERGY L.J. 377 (1994). For a discussion of the fundamental faults of the FERC's use of incremental pricing, see Eugene E. Threadgill, *A Perspective on Pipeline Pricing Under the Natural Gas Act*, 16 ENERGY L.J. 441 (1995).

13. The advantage of rolled-in pricing is that:

It avoids the onerous administrative burden of having to assign a different portion of the cost to each of a large number of customers (footnote omitted). It results, if all other factors are equal, in all customers paying the same price for gas taken from the pipeline at the same point, and recognizes that all customers enjoy the benefits of having the whole gas gathering and pipeline system . . . [this] approach ensures that two otherwise similar customers will not pay radically different prices for commingled gas coming from the same pipe, merely because one happens to have been receiving the service longer than the other. . . .

[A disadvantage of rolled-in pricing is that it is] generally disadvantageous . . . to old customers of an expanding pipeline [since the] rolled-in rate requires old customers to pay a higher price and bear part of the cost of an expansion from which they receive little visible increase in service.

Battle Creek, 281 F.2d at 46.

14. Incremental pricing assigns the cost of an expansion facility to "particular customers and [the cost is] recaptured by increasing the rates charged to those customers." *TransCanada*, 24 F.3d at 307.

15. A pipeline company is required to apply to the FERC for a certificate of public convenience before it commences either building a new pipeline, or expanding an old one. 18 C.F.R. Part 157.5-21 (1998). Under the Natural Gas Act of 1938 (NGA), the FERC has the power to regulate interstate transportation of natural gas

the Gulf of Mexico through the Mississippi River Valley to Tuscola, Illinois¹⁶ where it joins the Panhandle-Eastern Pipeline (Panhandle).¹⁷ Trunkline sought FPC authorization to provide a partial looping¹⁸ of its main pipeline. This results in an increase in the capacity¹⁹ of the pipeline.²⁰ Trunkline also sought authorization to construct a new pipeline expansion from Tuscola to Consumers Power Company (CPC), located near White Pine, Michigan. Pre-expansion customers would indirectly benefit from the expansion in the main pipeline, but the added lateral from Tuscola to White Pine would only benefit CPC. In granting the certificate, the FPC ordered rolled-in pricing for the expansion of the main pipeline and incremental pricing for the new facility to service CPC.²¹

Battle Creek Gas Company (Battle Creek) was a local distribution company (LDC)²² that received gas from Panhandle,²³ and would ultimately suffer under rolled-in cost recovery. Battle Creek appealed the FPC decision to allow rolled-in rates to the United States Court of Appeals, District of Columbia Circuit. Battle Creek, claiming that the FPC's decision "put an unfair burden on [Battle Creek Gas] . . . and other [pre-expansion] customers who would thus be required to bear the cost of the expanded facilities but would receive no benefit from them."²⁴

In affirming the FPC's decision, the court set out a two-part test. Rolled-in rates should be ordered when: (1) the expanding pipeline can show the expansion integrates into the main system; and (2) there is some positive benefit to all existing customers.²⁵ The court found that the Trunkline expansion benefited all of its customers by providing an integrated system, which would "provide 'cheap expansibility' . . . permitting future expansions to be made by relatively inexpensive increases in pumping facilities and partial looping at a fraction of what the further expanding capacity would otherwise cost."²⁶ This two-part analysis remained the prevailing policy governing the use of rolled-in versus incremental rates until May, 1995.²⁷

in addition to regulating the sale of interstate gas. 15 U.S.C. §§ 717-717w (1994).

16. *Id.* at 43.

17. Trunkline is a wholly owned subsidiary of Panhandle-Eastern. *Id.*

18. The court defines the term looping as "construction of a second pipeline parallel to the original line, thus increasing the carrying capacity of that part of the line. Partial looping is a method of pipeline expansion in which the parallel pipe is installed along only part of the line." *Battle Creek*, 281 F.2d at 43 n. 7.

19. *See e.g.*, *Northern Natural Gas Co. v. O'Malley*, 174 F.Supp. 176 (D. Neb. 1959).

20. *Battle Creek*, 281 F.2d at 43.

21. *Id.* at 47.

22. A local distribution company (LDC) is a local company distributing gas to local residential, commercial, and industrial consumers. *MANUAL OF OIL AND GAS TERMS* 597 (9th ed. 1994).

23. *Battle Creek*, 281 F.2d at 45.

24. *Id.*

25. *Id.* at 43-47.

26. *Id.*

27. *Pricing Policy for New and Existing Facilities Constructed by Interstate Natural Gas Pipelines*, 71 F.E.R.C. ¶ 61,241 (1995).

2. FERC's Pricing Policy Statement, May, 1995

In May 1995, the FERC issued a new pricing policy (Pricing Policy).²⁸ The stated reason for issuing this statement was to eliminate the ambiguity between the use of rolled-in rates rather than incremental rates by the FERC. The Commission explained that "pricing policies . . . [are] important both for pipelines and their customers, because they need to know the rates that will be charged in order to make appropriate decisions"²⁹

Under the Pricing Policy the Commission makes a determination of which method should be used at the time the pipeline submits its request for a certificate. If rolled-in pricing³⁰ is requested, the FERC then evaluates the "system-wide benefits of the project and the rate impact on existing customers."³¹ A presumption exists in favor of rolled-in rates as long as the increase to pre-expansion customers is less than five percent.³² If the resulting rates increase with the use of the rolled-in cost recovery exceeds five percent, the expansion pipeline has the burden of demonstrating the benefits of the expansion are proportionate to the rate increase.³³

This policy shift was stated to benefit parties by providing them with more precise criteria. Although the FERC has a long-standing policy of favoring rolled-in rates, this Pricing Policy refined the criteria for using rolled-in rates when the resulting rate increase is higher than five percent.³⁴

B. Administrative Law and the FERC

Consistent use of a test, such as *Battle Creek*, by an agency creates reliance by numerous entities. Federal agencies, such as the FERC, are not generally free to change established policy whenever they choose, unless they provide an adequate explanation.³⁵ When the FERC departs from precedent, there must be a record conveying reasons for such change. "Where an agency departs from established precedent without a reasoned explanation, its decision will be vacated as arbitrary and capricious In determining whether an agency has provided a reasoned explanation for departing from precedent . . . the court looks only to the reasons given by the agency."³⁶ *Algonquin Gas Transmission Co. v. FERC*³⁷ and *ANR Pipeline Co. v. FERC*³⁸ provide relevant examples of this principle.

28. *Id.*

29. *Id.* at 61,914.

30. For the purpose of this Note, the terms pricing and cost recovery are used interchangeably.

31. 71 F.E.R.C. ¶ 61,241, at 61,915.

32. *Id.*

33. *Id.* at 61,916.

34. 71 F.E.R.C. ¶ 61,241 (1995). See *Consolidated Edison Co. of New York v. FERC*, DOCKET NO. 97-1554 (D.C. Cir. 1999) to see how the court has refined the *Battle Creek* test in light of the FERC's 1995 Pricing Policy.

35. Bernard Schwartz, *Administrative Law Cases During 1996*, 49 ADMIN. L. REV. 519 (1997).

36. *ANR Pipeline Co. v. FERC*, 71 F.3d 897, 901 (D.C. Cir. 1995).

37. *Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305 (D.C. Cir. 1991).

38. *ANR Pipeline*, 71 F.3d at 897.

1. *Algonquin Gas Transmission Co. v. FERC*

The court in *Algonquin* concluded the FERC failed to provide an adequate record explaining the benefits an expansion facility would provide to pre-expansion companies. Acknowledging the Commission's authority to change the cost recovery method if it finds the use of the requested method unjust or unreasonable, the court explained,³⁹ "what we do require . . . is that the Commission, before ordering a roll-in under 5(a), [of the Natural Gas Act⁴⁰] offer more than a conclusionary statement that the existence of system-wide benefits renders it unjust to allocate facilities costs incrementally."⁴¹

In *Algonquin*, Algonquin Gas Transmission Company (Algonquin) proposed to construct an expansion to provide new services⁴² and applied to the FERC for a rate increase to recover the expansion costs.⁴³ At a hearing, the FERC staff argued that all of the costs of the expansion should be rolled-in to the rate base.⁴⁴ However, the Administrative Law Judge (ALJ) ruled that the FERC staff failed to demonstrate that incremental rates were unjust or unreasonable. After the ALJ's decision, Algonquin negotiated a settlement with the other parties in which *inter alia*, incremental rates would continue on certain services.⁴⁵ Algonquin filed the settlement with the FERC as a contested settlement. The Commission approved the agreement, but ordered that all of the costs be recovered on a rolled-in basis. Since the FERC staff failed to prove that incremental rates were unjust in the ALJ hearing, Algonquin argued that the FERC's action to apply rolled-in rates was wrong and appealed.⁴⁶

The FERC based its determination to employ rolled-in rates on two findings. Looping the pipeline would decrease the pressure in the main line, thus reducing the likelihood of rupture. Looping, the FERC asserted, would also ensure that if a rupture did occur, service would continue via an extra line.⁴⁷ In addition, the Commission argued that a present roll-in was necessary to avoid an unjust result should Algonquin expand its system in the future.⁴⁸ Its reasoning

39. *Algonquin Gas*, 948 F.2d at 1313.

40. The Natural Gas Act § 5 (a) states:

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State Commission, or gas distribution company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate.

15 U.S.C. § 717d (1994).

41. *Algonquin Gas*, 948 F.2d at 1313.

42. In 1984 and 1985, three new firm sales services were offered. Algonquin constructed new facilities in order to provide the expanded service. In 1986, Algonquin offered a second storage service that it provided under already existing facilities. For this storage, the customers paid on an incremental basis. *Algonquin Gas*, 948 F.2d at 1309

43. *Id.* at 1310.

44. 47 F.E.R.C. ¶ 61,048, at 61,278.

45. *Algonquin Gas*, 948 F.2d at 1310.

46. *Id.*

47. *Id.*

48. *Id.* at 1314.

was that if the pipeline later expanded to benefit everyone, the pre-expansion customers would be unjustly enriched.

The court considered whether substantial evidence showing that incremental cost recovery would be unjust and unreasonable supported the FERC's order to implement rolled-in rates. No one argued that the FERC lacked authority to require rolled-in cost recovery under the policy if other forms of pricing would be unjust and unreasonable. The argument ultimately accepted by the circuit court in *Algonquin*, was that there must be an adequate record reflecting substantial evidence that incremental rates would be unjust.⁴⁹ The FERC failed to provide such a record.

2. *ANR Pipeline Co. v. FERC*

Along with providing an adequate record, the FERC must also follow its own policies in order to maintain some uniformity and consistency. In order to avoid an Administrative Procedure Act (APA)⁵⁰ claim that the Commission acted arbitrarily and capriciously, the FERC must follow certain guidelines when departing from a well-established precedent. *ANR Pipeline v. FERC* provides an example of how the court views the FERC's departure from precedent.

At issue in this case was the FERC's decision to allow Michigan Consolidated Gas Company (MichCon)⁵¹ to blend pricing rates.⁵² ANR was a competitor of MichCon and claimed that the use of this rate method was unfair.⁵³ ANR claimed the FERC acted arbitrarily and capriciously by allowing MichCon to use such rates. ANR argued that FERC Order No. 636⁵⁴ declared the use of blended rates in interstate transportation services to be anti-competitive.⁵⁵ The argument presented by ANR was that there should be adequate reason for departing from the precedent as set forth in Order No. 636.⁵⁶

The United States Court of Appeals, District of Columbia Circuit agreed with ANR and ruled that if the FERC departs from a policy followed as precedent, a reasoned explanation for doing so must be contained in the record.⁵⁷ The court determined that Order No. 636 precluded the use of blended rates and that the FERC failed to provide a reasoned explanation of why the problems

49. *Id.* at 1312.

50. 5 U.S.C. § 706 (1994).

51. Michigan Consolidated Gas Co. operates an interstate gas pipeline which provides the same service which ANR offers. *ANR Pipeline*, 71 F.3d at 898.

52. *Id.* The court was unclear as to the definition of blended rates in this case.

53. *Id.* at 897-98.

54. Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of The Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 57 Fed. Reg. 13,267, III F.E.R.C. STATS & REGS. ¶ 30,939 (1992), *Order on Reh'g*, Order No. 636-B, 57 Fed. Reg. 57,911 (1992), 61 F.E.R.C. ¶ 61, 272 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and vacated and remanded in part*, *United Dist. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996) *cert. denied*, 117 S. Ct. 1723 (1997), Order No. 636-C, 78 F.E.R.C. ¶ 61,186 (1997).

55. *ANR Pipeline*, 71 F.3d at 898.

56. *Id.*

57. *Id.* at 901.

envisioned by Order No. 636 would not apply to MichCon. The court concluded that if a reasoned explanation is not provided, the act of the Commission is arbitrary and capricious and in violation of the APA.⁵⁸

III. STATEMENT OF THE CASE

In May 1991, Great Lakes Gas Transmission Company⁵⁹ (Great Lakes) sought a rate increase with the FERC, to provide money for an expansion of facilities.⁶⁰ The requested expansion was a combination of constructing new lines along with looping projects on the Great Lakes system. The Great Lakes pipeline extends⁶¹ from Emerson, Manitoba, to St. Clair, Michigan.⁶² The cost of the expansion totaled \$557 million, which was over fifty-eight percent of Great Lakes' rate base at the time.⁶³

Great Lakes sought rolled-in recovery of the expansion cost.⁶⁴ Since the expansion benefited the expansion customers more, the pre-expansion customers argued that rolling-in the cost was unreasonable.⁶⁵ They claimed that "the result [of] allowing rolled-in costs would force existing customers to subsidize the customers who received the benefits of the new services provided by the expansion."⁶⁶

The FERC determined in Great Lakes Opinion 367 (Opinion No. 367), that in order to allow rolled-in cost recovery, Great Lakes would have to demonstrate that the operational benefits of the new facility to the existing customers would be commensurate with the rate increase.⁶⁷

Great Lakes argued that incremental rates would be, among other things, unreasonable, complex to administer, and contrary to the FERC's goal of efficiency. According to Great Lakes, incremental rates would unreasonably discriminate between customers since purchasers buying the same service would pay drastically different prices. The share of the expansion each customer would pay under incremental rates would depend upon the time at which the customer entered the system.⁶⁸ Great Lakes claimed that all customers benefited from the

58. *ANR Pipeline*, 71 F.3d at 902-3.

59. Great Lakes Gas Transmission Limited Partnership is equally owned by the Coastal Corporation and TransCanada Pipelines Limited. *About Great Lakes*, (visited Jan. 8, 1998) <<http://www.greatlakesgas.com/COMPANY/index.htm>>.

60. *Great Lakes Gas Transmission Limited Partnership*, 57 F.E.R.C. ¶ 61,140 (1991). The expansions at issue consisted of three projects. They are as follows: (1) seventeen mainline loop sections which would be used to increase transportation services to TransCanada located from Emerson, Manitoba to the St. Clair delivery point; (2) 2.9 mile loop in Wisconsin, meter stations, and compression stations near Muttonville, Michigan; and (3) construct and operate a 2.9 mile loop, meter stations and delivery points as well as increase transportation services for Northern Minnesota Utilities. *Id.* at 61,513-14.

61. *See* Appendix A.

62. Opinion No. 367, *Great Lakes Transmission Co.*, 57 F.E.R.C. ¶ 61,140, at 61,513.

63. *Id.* at 61,512.

64. *Id.* *See* appendix B for the progeny of decisions resulting from the Great Lakes' controversy.

65. *Id.* at 61,512-13.

66. *Id.* at 61,512.

67. This new test is called the Commensurate Benefits Test. 57 F.E.R.C. ¶ 61,140 at 61,521.

68. *Id.* at 61,514.

expansion since it created a protection against interruption in service.⁶⁹ Great Lakes also maintained that a rolled-in rate would be less complex to administer.⁷⁰ With incremental rates, Great Lakes would have to calculate each customer's bill by determining when they entered the system and what percentage of the expansion to charge the customer. Finally, Great Lakes asserted that the use of rolled-in rates would be consistent with the FERC's economic goals of efficiency⁷¹ as espoused in the Pricing Policy.⁷²

Rejecting these arguments, the FERC abandoned the *Battle Creek* test and ordered the use of incremental rates over the objections of Great Lakes. By using a "commensurate benefits test,"⁷³ the FERC examined "projected throughput and fuel savings, the operational benefits of the new facilities, the level and extent of past curtailments, and alternative incremental rates,"⁷⁴ and concluded that Great Lakes arguments against incremental rates were insufficient. The FERC ordered incremental cost recovery.⁷⁵

Through this opinion, the FERC altered its long-standing policy of preferring rolled-in rates and increased the burden an expanding pipeline must meet in order to recover expansion costs on a rolled-in basis. In comparison, *Battle Creek* only required a showing that the expansion was to be integrated with the existing system, and that there was some benefit to pre-expansion customers. The commensurate benefits test takes this one step further and requires the benefits to the existing pipeline be proportionate with the increase in the rate. The FERC explained its departure from *Battle Creek* by saying, "[m]ore recently, the Commission's focus on the value of the benefits of expansions to the systemwide customers has intensified as costs have risen considerably in relation to the benefits. Accordingly, in these circumstances, rolling-in costs is increasingly difficult to justify on equitable grounds consistent with *Battle Creek*."⁷⁶ The FERC denied rehearing of the Great Lakes controversy in Great Lakes Opinion No. 368⁷⁷ (Opinion No. 368).⁷⁸ Great Lakes' reason for expansion was to service TransCanada and Midland Cogeneration. Since the use of

69. *Id.*

70. *Id.* at 61,516.

71. When discussing claims of economic efficiency, Great Lakes asserted six arguments. They are: (1) rolled-in pricing allows customers to be able to compare, on a reasonable basis, rates and services between competing pipelines and determine which one they should choose; (2) rolled-in treatment will send a better indicator to incite future growth of pipeline transmission lines; (3) if incremental rates were the required pricing method, customers would not expand unless the costs are less than the benefits; (4) rolled-in rates meet the FERC's Policy Statement Goal; (5) incremental rates could cause the capacity of the pipelines to be under-supplied; (6) rolled-in pricing is consistent with the Transit Treaty and the Free Trade Agreement. 57 F.E.R.C. ¶ 61,140 at 61,516.

72. *Id.* (citing *Policy Statement with Respect to the Design of Interstate Natural Gas Pipeline Rates*, 53 F.E.R.C. ¶ 61,273 (1990)).

73. This test is similar to the Pricing Policy *supra* II(B)(2). It evaluates whether the benefits are proportionate with the rate increase. This is the prevailing policy of the FERC today.

74. *Great Lakes Gas Transmission Ltd. Partnership*, 62 F.E.R.C. ¶ 61,101, 61,714 (1993).

75. *Id.*

76. 57 F.E.R.C. ¶ 61,140, at 61,521.

77. Opinion No. 368, *Great Lakes Gas Transmission*, 57 F.E.R.C. ¶ 61,141 (1991).

78. *Id.*

incremental rates shifted a large part of the total expansion cost to TransCanada,⁷⁹ they appealed.⁸⁰

The issue on appeal⁸¹ was whether the FERC's departure from its *Battle Creek* test was arbitrary and capricious and in violation of the Natural Gas Act.⁸² TransCanada argued that when the expansion project commenced, it relied on the FERC's application of certain long observed policies.⁸³ Because of this reliance, TransCanada argued that the Commission could not suddenly change such policies without giving adequate notice and providing a fair hearing on the matter in accordance with the APA.⁸⁴ In response, the FERC argued to the court that *Algonquin* required a change to the stricter commensurate benefit test.⁸⁵ The *TransCanada* court rejected this argument noting that although *Algonquin* requires the FERC to identify the benefits to pre-expansion customers, there is no requirement that the benefits be proportionate to the cost of the rate increase.⁸⁶ *Algonquin* requires only that the FERC offer more than a conclusory statement listing the system-wide benefits.⁸⁷

The *TransCanada* court did not decide whether incremental rates should or could be used. Instead, it concluded the FERC had not sufficiently explained its decision to discard the *Battle Creek* test in favor of the commensurate benefits

79. TransCanada is the largest customer of Great Lakes and benefited most from the expansion projects. The transportation going to TransCanada is over half of the capacity that Great Lakes possesses. Opinion No. 368, 57 F.E.R.C. ¶ 61,141 (1991).

80. Opinion No. 367 covered the expansion, which would service TransCanada and Northern Minnesota. Opinion No. 368 covered the expansion servicing TransCanada and Midland. TransCanada sued to challenge the commensurate benefits test since they had the most to lose by the opinions. Northern Minnesota and Midland intervened in the proceedings. *TransCanada Pipelines Limited*, 24 F.3d at 306.

81. The petitioners also argued on this appeal that the FERC had unfairly imposed retroactive penalties and that the use of a paper hearing was inappropriate and contrary to the APA. *Id.* This Note only addresses the discussion of the FERC's departure from precedent.

82. *TransCanada*, 24 F.3d at 307.

83. TransCanada did not expect to have to finance the bulk of the project when the expansion began. Based on the *Battle Creek* test, they expected all of the pre-expansion customers to pay part of the cost recovery.

84. *Id.* at 308. The APA states:

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning of applicability of the terms of an agency action. The reviewing court shall: (1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency action, findings, and conclusions found to be (2)(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2)(B) contrary to constitutional right, power, privilege, or immunity; (2)(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (2)(D) without observance of procedure required by law; (2)(E) unsupported by substantial evidence in a case . . . or otherwise reviewed on the record of an agency hearing provided by statute; or (2)(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. 5 U.S.C. § 706 (1994).

85. *TransCanada*, 24 F.3d at 308-9.

86. *Id.*

87. *Id.* at 309-10.

test.⁸⁸ The court remanded the case to the Commission with direction to re-analyze its conclusion⁸⁹ and explain the reasons why it was changing policy.⁹⁰

Rather than explain its policy change, the FERC readopted the *Battle Creek* test. The Commission's explanation for readopting this test echoed the argument of Great Lakes. It was not appropriate, the Commission concluded, to apply the commensurate benefits test because "it was unfair to apply a new policy, without notice, to projects constructed in good faith reliance on the established Commission policy in effect at the time of the certification and construction of the expansion facilities."⁹¹ Although the FERC's Pricing Policy had intervened, the FERC decided to apply the policy that was in place at the time the case began.⁹² The Commission believed it would be unfair to apply, retroactively, the Pricing Policy.

But the clock could not be turned back. Because this conflict was ongoing since 1991, the incremental shippers overpaid via rolled-in rates, while the pre-expansion shippers underpaid. There was no easy way for the FERC to undo the grim results of what had occurred.⁹³ The FERC ordered that the resulting refunds and surcharges from this situation be paid without interest. Litigation resulting from the switch back to *Battle Creek* was imminent.⁹⁴

IV. ANALYSIS

A. *Southeastern Michigan Gas Co., v. FERC*

With the revival of the *Battle Creek* test and rolled-in pricing, Southeastern Michigan Gas, along with other pre-expansion shippers, sought court review of the FERC's orders implementing rolled-in recovery of costs. They argued that the FERC's action was arbitrary and capricious when it changed direction on remand and reapplied the *Battle Creek* test. The pre-expansion shippers argued that the FERC's decision to use the commensurate benefits analysis was final and that by readopting the *Battle Creek* test the FERC exceeded its authority. *TransCanada* only required clarification of the switch to the commensurate benefits analysis. The remand was limited, according to the pre-expansion shippers, to permitting the FERC to explain its policy change in a more detailed fashion. It was inappropriate for the FERC to re-evaluate the decision and consequently change the earlier findings.⁹⁵

88. *TransCanada* 24 F.3d at 309.

89. Courts have recently become more willing to remand a case to an agency for clarification rather than remanding the decision after vacating it. See e.g., Ronald M. Levin, "Vacation" At Sea: Judicial Remands and the APA, 21 ADMIN. & REG. LAW NEWS 4 (1996).

90. *Id.* at 311.

91. *Id.* at 61,427.

92. Order on Remand, *Great Lakes Transmission Ltd. Partnership*, 72 F.E.R.C. ¶ 61,081, 61,429 (1995).

93. Lori A. Burkhardt, *FERC Flipflops on Great Lakes Case*, 133 No.17 PUB. UTIL. FORT. 59 (1995).

94. The FERC ordered Great Lakes to refund the excess paid by the incremental shippers with no interest. The pre-expansion shippers were charged a rate increase (some experienced an increase of up to 66%). *Id.*

95. *Southeastern Mich.*, 133 F.3d at 38.

The pre-expansion shippers next claimed that the FERC acted arbitrarily and capriciously by considering reliance of the expansion shippers on the *Battle Creek* precedent when the expansion began. The court in *Southeastern Michigan* ruled that the FERC "did not premise readoption of *Battle Creek* on the expansion shippers' reliance upon the outcome of the *Battle Creek* test; it merely concluded that the expansion shippers were entitled to rely on their expectations that [the] FERC would apply that test to [the] Great Lakes . . . petition."⁹⁶ The court went on to state that it is reasonable for parties involved in administrative proceedings to rely on the consistency of administrative application.⁹⁷ The finding in ANR that the FERC must not depart from a long-standing policy without a well-reasoned explanation supports this outcome.⁹⁸

V. CONCLUSION

Southeastern Michigan refines the legal fabric defining what the FERC can and cannot do. First, the FERC may change long held policy, as long as it provides adequate explanation for doing so. However, the explanation must be more than a conclusive statement conveying the change in policy is a positive thing.⁹⁹ There must be a reasoned analysis of why the change is necessary. As long as there is a reasoned analysis, the decision to change policy will stand. Although there is a long-standing policy by the FERC to prefer rolled-in rates, the FERC has refined the scope of when to use them. By issuing the Pricing Policy, the FERC is closer to the commensurate benefits analysis than the *Battle Creek* test, however it appears that the FERC may change direction at any time.

Southeastern Michigan also illustrates that once the court remands a case to the FERC, the Commission may proceed in any manner it chooses. The FERC may re-evaluate the whole decision and make changes not prohibited by the remanding court. This could give the FERC wide latitude to test the waters of new ideas and analysis. On one hand, although not likely, the FERC could change a long-standing policy with little or no explanation in order to test the water, reverting to the old policy if challenged. This could prove to be a nightmare to companies who rely on the FERC's regularity and consistency. The *Southeastern Michigan* court stated that when the FERC is deciding which policy it should use, it may consider reliance of the parties on prior administrative proceedings and rules. However, this rule is not absolute. If the Commission wants to change policy, it may do so if adequate reasons for the change are provided, even if one can demonstrate reliance.¹⁰⁰

96. *Id.*

97. The court determined that the application of the *Battle Creek* test was appropriate and not arbitrary and capricious. The case went on to decide that the FERC's decision not to award interest for the period in which the use of incremental rates had been mistakenly applied was an error. The court reversed the FERC's decision and thus allowed the companies to charge interest from the date of the original order granting incremental rates. *Id.*

98. *See supra* Section II.

99. *TransCanada*, 24 F.3d at 309.

100. The FERC has made a valiant effort in the issue of rolled-in versus incremental rates. By the issuance of the Pricing Policy, it is apparent that the FERC is seeking to give guidance to the pipeline companies and their customers of what to expect for pricing issues. Although the FERC is able to change

On the other hand, an agency may truly reach another decision after it examines all of the information necessary to clarify its decision. This could be a benefit to the system. On remand, it is the agency's duty to identify the reasons for making its decision. If the previous decision is determined to be the wrong one, the agency should have the obligation to change the result.

After this decision, one should view policies of the FERC with the knowledge that change can occur at any time if the Commission provides proper reasoning. The District of Columbia Circuit has made it clear in cases such as *Southeastern Michigan* that it will allow an agency to return to a previous policy if initiation of a new policy is challenged.¹⁰¹ The lesson gained by this is to be careful when relying on such policies. Reliance on such policies can be costly. The court ordered Great Lakes to issue refunds, without interest, to all shippers who had over paid using the incremental cost recovery, while at the same time, collect surcharges from those who had underpaid.

Although the FERC appeared weak in the abandonment and then re-adoption of *Battle Creek*, the result of *Southeastern Michigan* provides some clarity to the FERC's authority to change policy in mid-stream. This clarification, whether one agrees or disagrees with the result, is positive. When knowledge is available that the FERC has potential to change policy at any time, parties may make necessary adjustments to account for such a risk.¹⁰²

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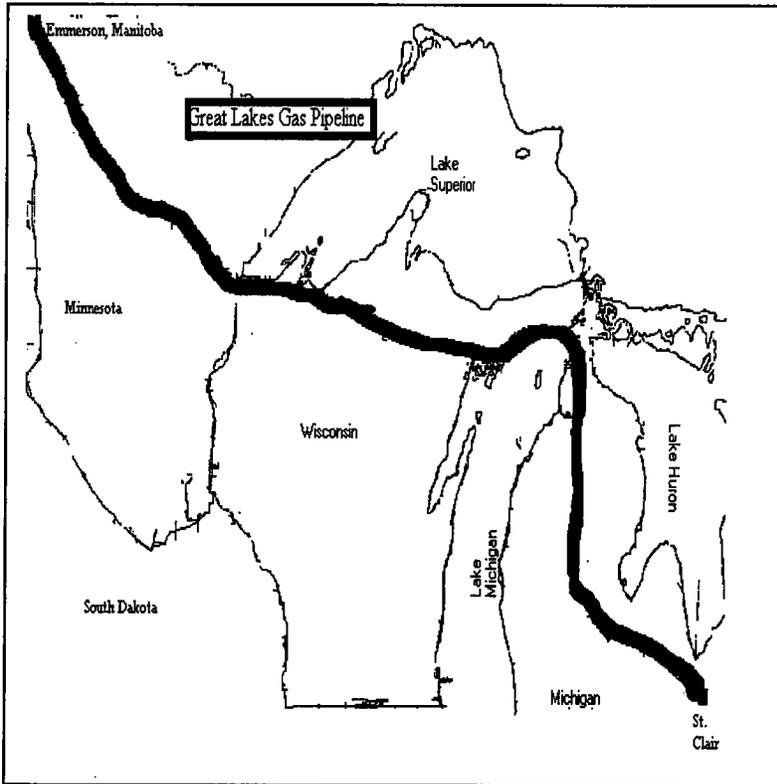
policy as stated in this Note, the commensurate benefits analysis, appears as the prevailing policy for the time being.

101. See also, *Radio Television S.A. DEC v. FCC*, 130 F.3d 1078 (D.C. Cir. 1997). In this non-energy case, the court ruled that an agency may change direction on remand, even if the ultimate finding is contrary to the original holding.

102. Since the court used the *Battle Creek* test to determine cost recovery, the holding with regards to rolled-in versus incremental cost recovery should be viewed with caution. The Pricing Policy will govern such a situation in the future.

APPENDIX A

* This map was modified from one provided by Great Lakes



APPENDIX B

