

## The Process of Negotiating Settlements at FERC

EPRG Working Paper 1105

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The Federal Energy Regulatory Commission (FERC) has jurisdiction over rate cases involving interstate oil and gas pipelines and electricity transmission systems. A high and possibly increasing proportion of rate cases before it are settled by negotiation between the parties, rather than by litigation.

Settlement makes a dramatic difference to processing times. In the late 1990s, the average time to settle most gas pipeline cases was about one year, plus the time for FERC to approve them (which ranged from about 1 to 13 months with a median of about 3 ½ months). One of the two litigated cases took about 3½ years to process, the other about 5½ years.

Why are such a high proportion of cases settled at FERC? How does FERC do it? There seems to have been no account of how the settlement process actually works in practice, and what if any role the regulatory body plays other than in approving (or rejecting) the proposed settlement, and litigating in the event of non-agreement. In Florida and Canada the parties themselves seem to negotiate the settlements with little or no role for the regulator. It might be assumed that the same is the case at FERC.

In fact, however, the opposite is the case. FERC Trial Staff are actively involved at each stage of the settlement process. They present what is known as a 'first settlement offer' in response to a pipeline proposal to change rates. This is Trial Staff's own view of what would be a reasonable outcome. Thereafter, Trial Staff actively seek to facilitate agreement between the parties, including by multilateral and bilateral discussions and by presenting further counter offers as necessary.

This paper provides an account of how settlement processes at FERC actually work in practice with respect to gas pipeline rate cases. (A section at the end of the paper explains the main respect in which the process for dealing with electricity transmission systems is different.) The paper sets out what each party and FERC does at each stage of the process. To give some indication of the time involved at each stage, it presents data from the 12 pipeline cases brought during fiscal years 2008 and 2009, of which 9 have so far been settled, and notes a few 2010 cases that are still in process.

The aim of the paper is not to appraise settlement in general or in particular cases. Rather, it is to provide an understanding of the role that the regulatory body actually plays in one particular settlement process that has been remarkably successful over a long period of time. This is of interest in its own right, but could also be of relevance in other contexts where future regulatory arrangements are under discussion.

In summary, FERC encourages negotiated settlements, and explains that it could not regulate without them. It observes that the use of settlements better addresses all parties' concerns, dramatically limits the time, expense and resources devoted to these cases, and provides an outcome more acceptable to the parties. In recent years, about 90 per cent of gas and electricity rate cases have been settled, for periods ranging from 3 to 5 years ahead. How is this achieved?

FERC has a tight timetable for a hearing process, then Trial Staff play an active role in facilitating negotiation and settlement to obviate the need for hearing. In the gas pipeline sector in the last couple of years, the median time to reach a full and uncontested settlement of a section 4 rate increase proposal, and to get it certified before the Commission, has been about 8 months. This comprises three main steps.

- During the first 3 months after a tariff change is filed, Trial Staff and others request information from the company then Trial Staff table a first settlement offer.
- Settlement discussions, led by Trial Staff, typically lead to agreement in principle in the next 2 ½ months, just before testimony would otherwise need to be filed.
- It takes a further 2 ½ months for the parties to finalise the settlement document and for the Administrative Law Judge to certify the settlement as uncontested.

In the absence of complications, the Commission typically approves the settlement within another 3 months.

Thus, the parties are typically able to negotiate gas pipeline rates, for a period of about 3 to 5 years ahead, on the basis of an intensive period of negotiations of less than 3 months, plus a comparable period of preparatory questioning and analysis by FERC and themselves, and a subsequent period of drafting and processing the settlement. Moreover, of the three recent section 5 cases brought by FERC itself, with a view to reducing tariffs, two were settled and disposed of within 7 months. The third was discontinued by FERC at the request of the pipeline's Customer Group.

The above are median times of successfully settled cases: each case will differ somewhat. There may be a few more non-unanimous and partial settlements nowadays, which take more time to process, but staff still play an active role in such cases. On the other hand there are also some recent 'pre-settlements' that take even less time to process. Compared to the time that litigation might take – measured in years – or to the time that a UK price control review takes – steadily increasing from about one year in the 1980s to 2, 3 or even 4 years to set a 5 year control – settlement is a remarkably efficient process.

The two key characteristics of the FERC process seem to be 1) that at an early stage the regulatory Trial Staff indicate their thinking on some of the key parameters as a basis for informed discussion by the parties, and 2) that the regulatory aim is to bring the parties into agreement, not to impose a preconceived settlement upon them. Having given a lead, FERC seeks to facilitate the market process, not to replace it.

Does this settlement process lead to fair and efficient outcomes? The proof of the pudding is in the eating. Settlement is now actively chosen by all parties – utility, customers, interstate and state regulators – in some 90% of all rate cases at FERC. It has been consistently preferred, in essentially its present form, over a period of at least 35 years, and in some form for about 45 years. This is a remarkable record of survival in an activity – utility regulation – that has been characterised by no little reform and change over the last half century. There would seem to be ample scope for econometric and other research, at FERC and elsewhere, to understand more precisely what factors are conducive to settlement and what tend to hinder it.

Is the FERC approach of relevance elsewhere? In the UK, for example, there is interest in the concept of settlements, but also a concern about loss of access to regulatory information, opinion and guidance. A better understanding of the range of practice in existing



jurisdictions should provide reassurance and facilitate the design of appropriate arrangements. This is not to argue that arrangements at FERC are directly applicable in the UK or elsewhere. Many utility customers there may be smaller and relatively less-informed than appear before FERC, and UK regulatory bodies do not have separate trial staff and independent ALJs. On the other hand, some commentators seem to go too far in claiming that the use of negotiated settlements would require far-reaching reforms to British regulatory procedures and laws. The main potential relevance of FERC experience is to suggest the possibility of regulatory staff playing a more active role in facilitating settlement. However, discussion of implications for UK policy lies outside the scope of the present paper.

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Publication                January 2011  
Financial Support        ESRC Follow-on Fund

