Federal Energy Regulatory Commission
October 19, 2006
Open Commission Meeting
Statement of
Chairman Joseph T. Kelliher

Item G-1: Kern River Gas Transmission Company (RP04-274-000)

"Perhaps the Commission's most important responsibility with respect to the regulation of interstate natural gas pipelines is protecting shippers by setting rates that are just and reasonable. A just and reasonable rate also reflects the risks that face interstate pipelines, and gives them an opportunity to earn a reasonable profit.

If we do our job well, shippers are protected against exploitation. If we do our job well, pipelines will continue to invest in expansion of interstate pipeline network.

In recent years, the Commission has authorized 9,300 miles of interstate natural gas pipelines. Our actions have gone far towards developing a robust natural gas pipeline network, a network that serves both shippers and the nation well.

This is an important order. The Initial Decision attracted substantial attention when it was issued a few months ago. Many took it as a sign that the Commission may be considering a fundamental change in policy, one that offers fewer incentives to invest in expansions of the pipeline network.

Our order generally affirms the Initial Decision, but reverses the administrative law judge's findings on three issues, namely the return on equity, corporate income tax allowance, and weighted average cost of debt in designing rates. With respect to the return on equity, our order sets the return at 11.2 percent, rather than the 9.34 percent adopted by the administrative law judge.

The calculation of pipeline rates has been made more difficult by some of the changes that have occurred within the pipeline industry, including consolidation of pipelines, the integration of pipelines into other businesses, and the adoption of the master limited partnership structure by a growing number of pipelines. As a result of these changes, there are relatively few pipelines that meet our historical test, and for purposes of the Discounted Cash Flow methodology we are required to include companies in the proxy group that are not pure pipelines, making the necessary and appropriate adjustments.

In short, the Commission has been adjusting its ratemaking policies to reflect dynamic changes that have occurred and are still occurring in the pipeline sector.

The order addresses the issue of to what extent the Commission should include master limited partnerships in the proxy group. We do not include master limited partnerships in the proxy group we use today. We use the same proxy group as in *High Island Offshore Systems (HIOS)*, which meet the criteria in *HIOS* and *Williston*. We do not foreclose non-master limited partnership pipelines from proposing to include master limited partnerships in proxy groups in the future, with appropriate adjustments. Based on the record before us, we conclude Kern River has not supported the particular adjustments to master limited partnership distributions proposed here.

This order shows that the Commission remains dedicated to protecting shippers, but recognizes the need to develop a strong interstate natural gas pipeline network."