FEDERAL ENERGY REGULATORY COMMISSION

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Commission Proposes to Modify Rate of Return Standards For Interstate Gas, Oil Pipeline Companies

The Federal Energy Regulatory Commission today proposed to modify its standards to allow the use of master limited partnerships in the composition of proxy groups used to determine the returns on equity in rates charged by interstate natural gas and oil pipeline companies.

The Commission's proposed Policy Statement seeks public comment on proposed modifications to its calculation of rates of return on equity that address myriad changes in the natural gas and oil pipeline industries, since these businesses increasingly are organized as master limited partnerships.

"Master limited partnerships' businesses are more narrowly focused on pipeline activities than most diversified energy companies," Chairman Joseph T. Kelliher said. "The Commission seeks to explore how best to include in proxy groups firms whose business risks more closely correspond to the risks of the pipelines whose rates we regulate. Our proposed policy change includes important rate protections."

The Commission uses a Discounted Cash Flow (DCF) model that incorporates the use of proxy groups to develop a range of reasonable returns earned on investments in companies with corresponding risks for determining the return on equity to establish rates for natural gas and oil pipeline companies. The Commission then assigns a rate of return on equity within that range to reflect specific risks of that pipeline when compared to the proxy group companies.

The Commission traditionally has required each company to include in the proxy group information to satisfy the following three standards: 1) the company stock must be publicly traded; 2) the company must be recognized and tracked by an investment information service such as Value Line; and 3) pipeline operations must constitute a large portion of the company's business.

The third standard only could be satisfied if a company's pipeline business accounted for, on average, at least 50 percent of a company's assets or operating income over the most recent three-year period.

But over the past four years, the Commission has observed that fewer interstate natural gas companies can satisfy the third requirement. This reflects the increasing numbers of mergers, acquisitions and other sweeping corporate changes in the natural gas industry. Similar activities have been observed in the oil pipeline industry.

The modified approach suggested by the proposed Policy Statement will offer jurisdictional pipelines the opportunity to present evidence on which specific firms should be included in a natural gas or oil pipeline proxy group. Master limited partnerships and other pass-through entities would be allowed if their cash distributions are capped at their reported earnings for purposes of determining the dividend yield that is one component of determining their return on equity under the DCF mechanism. The Commission also proposes that parties in rate cases will be required to demonstrate the master limited partnerships included in a proxy group have reasonably stable earnings.

The proposed Policy Statement would be applied to all oil and gas pipeline rate cases that are pending before FERC's administrative law judges if it becomes effective. The Commission also said it proposes to consider on a case-specific basis whether to apply the proposed Policy Statement to cases in which hearings have been completed.

Comments on the proposed Policy Statement are due within 30 days of publication in the *Federal Register*. Reply comments are due 50 days after publication in the *Federal Register*.

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