

134 FERC ¶ 61,061
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Kinder Morgan Interstate Gas Transmission, L.L.C. Docket No. RP11-1494-001

ORDER GRANTING IN PART AND DENYING IN PART REHEARING

(Issued January 28, 2011)

1. On November 18, 2010, the Commission found that Kinder Morgan Interstate Gas Transmission, L.L.C. (Kinder Morgan) may be substantially over-recovering its cost of service and fuel and lost and unaccounted-for gas (LAUF). Therefore, the Commission initiated an investigation, pursuant to section 5 of the Natural Gas Act (NGA), to determine whether the rates currently charged by Kinder Morgan are just and reasonable and set the matter for hearing.¹ The Commission also directed Kinder Morgan to file a full cost and revenue study within 75 days of the issuance of the order.²

2. On December 17, 2010, Kinder Morgan filed a request for rehearing of the November 2010 Order. As discussed below, the Commission grants in part and denies in part the request for rehearing.

I. Background

3. Kinder Morgan owns and operates approximately 5,100 miles of interstate natural gas pipelines in Colorado, Kansas, Missouri, Nebraska, and Wyoming. It also operates a natural gas storage facility in Cheyenne County, Nebraska, that has about 10 billion cubic feet of firm capacity commitments. Kinder Morgan provides to shippers firm and interruptible transportation and storage services, as well as a no-notice transportation service and a park and loan service.

4. Kinder Morgan's current transportation and storage rates were established as part of a settlement filed on November 3, 1999 in its NGA section 4 rate case in Docket

¹ *Kinder Morgan Interstate Gas Transmission LLC*, 133 FERC ¶ 61,157 (2010) (November 2010 Order).

² *Id.*, P10; Ordering Paragraph (D). Kinder Morgan filed to comply with this directive on January 24, 2011.

No. RP98-117-000, *et al.*³ The settlement also provided for Kinder Morgan to recover its system's fuel requirements and LAUF gas through fixed fuel retention percentages, without any tracking or true-up mechanism. Kinder Morgan's current fuel retention percentages, as provided for in the settlement, are 3.30 percent for mainline transmission services and 2.50 percent for storage services. The settlement imposed a five-year moratorium on Kinder Morgan filing a new NGA section 4 rate case or filing to modify its fuel and LAUF percentages from the approval date of the settlement. The settlement also imposed a five-year moratorium on parties challenging, under section 5 of the NGA, the level of Kinder Morgan's settlement rates or fuel and LAUF retention percentages. Kinder Morgan is currently under no obligation to file a new rate case.

5. In the November 2010 Order, the Commission stated that it had reviewed the cost and revenue information provided by Kinder Morgan in its Form 2 for the years 2008 and 2009. Based upon its review of this information, the Commission estimated Kinder Morgan's return on equity, excluding excess shipper-supplied fuel retained by Kinder Morgan, for 2008 and 2009 to be 15.25 percent and 17.81 percent, respectively. Taking into account the estimated value of excess shipper-supplied fuel retained by Kinder Morgan, its estimated return on equity for 2008 and 2009 totaled 27.10 percent and 29.25 percent, respectively.

6. Based upon its preliminary analysis of the information provided by Kinder Morgan in its Form 2 for 2008 and 2009, the Commission determined that Kinder Morgan's currently effective tariff rates may allow Kinder Morgan to recover revenue substantially in excess of its estimated costs of service and fuel and LAUF gas. The Commission noted that Kinder Morgan had not filed a general NGA section 4 rate case in over 12 years and determined that it would initiate an investigation to examine the justness and reasonableness of Kinder Morgan's rates pursuant to section 5 of the NGA and set the matter for hearing.⁴

7. Consistent with its action in other cases initiating NGA section 5 investigations of a pipeline's rates,⁵ the Commission directed Kinder Morgan to file a cost and revenue

³ This uncontested settlement was approved by the Commission on December 22, 1999. *KN Interstate Gas Transmission Co.*, 89 FERC ¶ 61,323 (1999). Kinder Morgan was formerly KN Interstate Gas Transmission Company.

⁴ The Commission specifically made no finding as to what would constitute a just and reasonable return on equity for Kinder Morgan but rather set such determination for hearing by this order to be decided consistent with the Commission's Policy Statement in *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 (2008).

⁵ *Citing, Natural Gas Pipeline Company of America, LLC*, 129 FERC ¶ 61,158 (2009), *reh'g denied*, 130 FERC ¶ 61,133 (2010) (*Natural*); *Northern Natural Gas Co.*,

study within 75 days to include all the schedules required for submission of a section 4 rate proceeding as set forth in section 154.312 of the Commission's regulations.⁶ However, because the Commission was seeking actual cost and revenue information for the latest twelve month period available, the Commission clarified that the information submitted by Kinder Morgan must exclude any adjustments or projections that may be attributable to a test period referenced in the schedules and statements set forth in section 154.312 of the regulations.⁷ Thus, the Commission directed that Kinder Morgan should not file nine months of post-base period adjustment data required by section 154.303(a) at this point in the proceeding. Additionally, because Kinder Morgan does not have an NGA section 4 burden in this section 5 proceeding, the Commission stated that Kinder Morgan did not need to file the Statement P as required by section 154.312(v) of the Commission's regulations at this juncture.⁸

II. Rehearing Request

8. On rehearing, Kinder Morgan focuses solely on the Commission's directions requiring Kinder Morgan to file a cost and revenue study. Kinder Morgan argues that it does not contest the Commission's authority to collect readily available data contained in its books and records to support its revenues and costs. However, Kinder Morgan asserts that the November 2010 Order ignores the limitations on the Commission's authority under section 5 of the NGA and exceeds the Commission's authority to request information. Kinder Morgan asserts that the Commission erred by requiring it to submit the cost and revenue data in the precise format and schedules

129 FERC ¶ 61,159 (2009), *reh'g denied*, 130 FERC ¶ 61,134 (2010) (*Northern*); and *Great Lakes Gas Transmission Limited Partnership*, 129 FERC ¶ 61,160 (2009), *reconsideration denied*, 130 FERC ¶ 61,132 (2010) (*Great Lakes*). As the Commission explained in these rehearing orders, "[s]ections 10(a) and 14(a) of the NGA authorize the Commission to require [the pipeline] to submit the information required by the [order instituting investigation] in order to carry out its responsibility under NGA section 5 to ensure that the pipeline's rates are just and reasonable." *See, e.g., Natural*, 130 FERC ¶ 61,133 at P 16.

⁶ November 2010 Order, 133 FERC ¶ 61,157 at P 10, *citing*, 18 C.F.R. § 154.312 (2010).

⁷ The Commission allowed that Kinder Morgan may, if fully supported, reflect changes to costs and revenues for a known and measurable change that took place during the 12-month period. For example, if a general pay raise became effective during month 5 of the 12-month period, an adjustment to the cost of service could be made to annualize the impact of this cost change. 133 FERC ¶ 61,157 at n.11.

⁸ November 2010 Order, 133 FERC ¶ 61,157 at P 10, *citing*, *Pub. Serv. Comm'n of New York*, 115 FERC ¶ 61,368, at P 6 (2006).

required of a pipeline voluntarily filing a proposed change in its rates pursuant to NGA section 4 and in particular by requiring the calculation of rates as specified in the Commission's regulations prescribing the filing of Schedule J.

9. In addition to complaining that the Commission ordered it to provide information as if it were voluntarily proposing to change rates under section 4, Kinder Morgan also argues that the Commission erred by precluding Kinder Morgan from including any test period adjustments in its cost and revenue study. Kinder Morgan asserts that this violates the Commission's test period regulations for section 4 filings set forth in 18 C.F.R. § 154.303. Kinder Morgan asserts that forward-looking test period adjustments are an essential component of establishing just and reasonable rates.

10. Specifically, Kinder Morgan argues that in order for the Commission to require it to change its rates pursuant to NGA section 5, the Commission must satisfy a two-part test. Kinder Morgan asserts that the Commission must find, after a hearing, that the existing rates are unjust and unreasonable or otherwise unlawful.⁹ Kinder Morgan asserts that after making such a determination, the Commission must then "fix" the just and reasonable rate to be thereafter observed.¹⁰ Kinder Morgan argues that only after the Commission has set out its case on replacement rates—and not at the time required in the November 2010 Order—should Kinder Morgan have to respond by filing its own just and reasonable replacement rates. Kinder Morgan argues that by compelling it to file rates now, the Commission is reversing the burden of proof.

11. Kinder Morgan asserts that rather than shouldering the burden of proof the Commission shifts this burden to Kinder Morgan because Schedule J-2 (Derivation of Rates) of section 154.312 requires a pipeline to "[s]how the derivation of each rate component of each rate." 18 C.F.R. § 154.312(p)(2). Kinder Morgan argues that this requires it to undertake studies and make allocations of costs and volumes for each of the various components, which is a burden that properly belongs with the Commission in a section 5 proceeding.¹¹

⁹ Kinder Morgan Rehearing Request at p. 4 (citing *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 183-84 (D.C. Cir. 1986)).

¹⁰ *Id.* (citing *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1578 (D.C. Cir. 1993)).

¹¹ Kinder Morgan asserts that the November Order's directives to undertake these studies and allocations is complicated further by the fact that Kinder Morgan must fit the studies and allocations into zones and rates which were derived from a black box settlement, not from a rate design and cost allocation methodology proposed by Kinder Morgan. Kinder Morgan Rehearing Request at p. 12 and fn.6 (citing *KN Interstate Gas Transmission Co.*, 89 FERC ¶ 61,323 (1999)).

12. Kinder Morgan asserts that the Commission has exceeded its authority under the NGA by requiring Kinder Morgan to file the equivalent of a section 4 case, but calling it a cost and revenue study. Kinder Morgan asserts that it is not proposing to change its rates and should not be compelled to produce a series of statements and schedules that require it to engage in numerous studies to allocate costs and volumes so as to derive new rates as if it were proposing to change its rates. Kinder Morgan argues that there is no meaningful difference between what the Commission directed Kinder Morgan to submit and the type of filing requirements the court rejected in *Public Service Commission* and *Consumers Energy*.¹²

13. Kinder Morgan asserts that the Commission recently relied on *Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18, 38 (D.C. Cir. 2002) (*INGAA*) to justify an order compelling a pipeline to derive new rates and file a cost and revenue study in the form required by section 154.312 of the Commission's regulations.¹³ Kinder Morgan states that the Court in *INGAA* noted that simply stating that the Commission would shoulder the section 5 burden, as it has done in this proceeding, would not be enough for the Commission to meet its burden. Kinder Morgan states that the Court held that the Commission's decision to require that the pipeline include certain information on *pro forma* tariff sheets relevant to its compliance with the regulation governing segmentation was not a violation of the NGA. However, Kinder Morgan argues that the Commission's directive requiring that Kinder Morgan generate new rates is not the kind of factual information that was required in *INGAA* and envisioned by section 10 of the NGA.

14. Further, Kinder Morgan states that section 16 of the NGA does not justify the filing requirement imposed on it because that section merely gives the Commission the power to take such actions as are "necessary or appropriate to carry out the provisions of [the NGA]." Therefore, it argues that the Commission may not use its section 16 authority to cross the boundaries between NGA sections 4 and 5 and justify its requirement that Kinder Morgan file a derivation of rates.

15. Lastly, Kinder Morgan argues that the November 2010 Order requires that it derive rates based upon the latest twelve month period available, and that it precludes any test period adjustments. Kinder Morgan argues that test period adjustments have significant consequences to just and reasonable rates because they allow the pipeline to update its data to include additional plant, operating expenses, changes in revenues,

¹² *Id.* at pp. 6-8, (citing *Pub. Serv. Comm'n of New York v. FERC*, 866 F.2d 487, 492 (D.C. Cir. 1989) (*Public Service*); *Consumers Energy Co. v. FERC*, 226 F.3d 777 (6th Cir. 2000) (*Consumers Energy*)).

¹³ Kinder Morgan Rehearing Request at p. 9 (citing *Natural*, 130 FERC ¶ 61,133 at P 17 (2010)).

volume changes, and to adjust billing determinants. Kinder Morgan adds that such adjustments are required by Commission regulation and are essential to determining just and reasonable rates.

16. Kinder Morgan asserts in order to meet the first prong of its obligations under section 5 of the NGA, the Commission must find that the rate currently in effect is no longer just and reasonable and to accomplish that the Commission must review a current and complete picture of a pipeline's cost of service and revenue. Kinder Morgan argues that to create such a picture, the Commission must consider both base period data as well as forward-looking test period adjustments to determine a pipeline's cost of service and billing determinants. 18 C.F.R. § 154.303 ("Statements A through M, O, P, and supporting schedules, in § 154.312 . . . must be based upon a test period"). Kinder Morgan asserts that because the Commission has the burden of proof in this proceeding, it also has the burden to establish what adjustments to the base period data are appropriate before determining that the existing rates are no longer just and reasonable. Further, Kinder Morgan asserts that even if the Commission can meet the first prong of the section 5 test in order to fix a new just and reasonable rate, it must develop a full and complete record.¹⁴ Kinder Morgan argues that the Commission has no foundation to contend that it can determine a "just and reasonable" replacement rate simply by reviewing unadjusted base period data.

17. Kinder Morgan argues that if it cannot account for adjustments permitted by the Commission's regulations and precedents, the record in this proceeding will consist of a single snapshot in time containing an incomplete representation of data and this will limit the Commission's analysis to develop and justify rates to be imposed for a future period. Kinder Morgan also argues that to exclude known and measurable adjustments when deriving rates that can only be implemented on a prospective basis is an abuse of the Commission's discretion and that if the Commission does not modify this decision, the Commission will not be able to set just and reasonable rates at the conclusion of this case.

18. Kinder Morgan asserts that this requirement to exclude adjustment data is an unexplained change in Commission policy in that the commission failed to explain why it mandated that Kinder Morgan must exclude any adjustments or projections that may be attributable to a test period referenced in the schedules and statements set forth in section 154.312 of the regulations. Kinder Morgan argues the Commission has previously

¹⁴Kinder Morgan Rehearing Request at p. 14 (citing *Sebring Utils. Comm'n v. FERC*, 591 F.2d 1003, 1013 (5th Cir. 1979)).

allowed such adjustments in other cases¹⁵ and that this failure to explain its action falls short of reasoned decision making.¹⁶

III. Discussion

19. Kinder Morgan's contentions on rehearing center on the Commission's requirements concerning the cost and revenue study to be filed by Kinder Morgan. In particular, Kinder Morgan contends that the Commission erred in directing (1) that it file all data schedules and derive rates as required by section 154.312 and (2) that it exclude from its cost and revenue study the test period adjustments permitted by section 154.303 to reflect projected cost and revenue changes during the nine-month period after the twelve months of actual data included in the study.

20. For the reasons discussed below, the Commission generally denies Kinder Morgan's request for rehearing. However, the Commission clarifies that its directive to exclude test period adjustments from the cost and revenue study was not intended to preclude consideration in this section 5 proceeding of evidence concerning changes in Kinder Morgan's cost and revenues occurring after the twelve-month period covered by that study. In addition, the Commission clarifies the appropriate base and adjustment period to be used in this section 5 proceeding in which the Commission has directed the use of a Track II hearing timeline.

A. Requirement to File All Schedules Required by § 154.312

21. Kinder Morgan contends that the Commission lacks the authority in an NGA section 5 proceeding to require it to submit a cost and revenue study including all the schedules required for submission of a section 4 rate proceeding as set forth in section 154.312 of the Commission's regulations, with the exception of a Statement P. Kinder Morgan argues that this requirement disregards the boundaries between sections 4 and 5 of the NGA as set forth by the courts,¹⁷ and effectively requires it to submit an NGA section 4 rate filing. The Commission disagrees.

¹⁵ Kinder Morgan Rehearing Request at p. 16-17 (citing, *Natural*, 129 FERC ¶ 61,158 (2009); *Northern*, 129 FERC ¶ 61,159 (2009); and *Great Lakes*, 129 FERC ¶ 61,159 (2009)).

¹⁶ Kinder Morgan Rehearing Request at p. 17 (citing *Panhandle E. Pipe Line Co. v. FERC*, 196 F.3d 1273, 1275 (D.C. Cir. 1999); *Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 69 (D.C. Cir. 1999)).

¹⁷ Kinder Morgan Request for Rehearing at p. 9 (citing *Western Resources*, 9 F.3d at 1578; *Consumers Energy*, 226 F.3d 777; *Pub. Serv. Comm'n of New York v. FERC*, 866 F.2d 487 (D.C. Cir. 1989) (*Public Service*)).

22. Contrary to Kinder Morgan's assertions, requiring a pipeline to supply the Commission with an informational filing as directed by the November 2010 Order does not improperly transform this section 5 proceeding into a section 4 proceeding. NGA section 4(c) requires the pipeline to file with the Commission, and keep open for public inspection, "schedules showing all rates and charges" for jurisdictional services. Section 4(d) states that a pipeline may propose to change those rates by "filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect." The November 2010 Order did not require Kinder Morgan to file any change in its existing rate schedules, and thus did not require Kinder Morgan to make a section 4 filing, or place any section 4 burden on Kinder Morgan to support its existing rates or the rate in the required cost and revenue study.

23. The November 2010 Order directed Kinder Morgan to file information that the Commission needs to carry out its responsibilities under NGA section 5 to ensure that rates are just and reasonable. The Commission recognizes that, consistent with *Western Resources*,¹⁸ in order to require Kinder Morgan to reduce its rates, the Commission will have the burden under NGA section 5 both to show that Kinder Morgan's current rates are unjust and unreasonable and that any new rates imposed by the Commission are just and reasonable. The November 2010 Order clearly stated a number of times that the Commission was acting under NGA section 5,¹⁹ and expressly recognized that "Kinder Morgan does not have an NGA section 4 burden in this section 5 proceeding"²⁰

24. Sections 10(a) and 14(a) of the NGA authorize the Commission to require Kinder Morgan to submit the information required by the November 2010 Order in order to carry out its responsibility under NGA section 5 to ensure that the pipeline's rates are just and reasonable.²¹ Section 10(a) permits the Commission to require any and all reports that

¹⁸ 9 F.3d at 1578.

¹⁹ *See, e.g.*, November 2010 Order, 133 FERC ¶ 61,157 at P 1 ("Therefore, the Commission will initiate an investigation, pursuant to section 5 of the Natural Gas Act ((NGA)), to determine whether the rates currently charged by Kinder Morgan are just and reasonable and set the matter for hearing."); *id.* at P 8 ("Accordingly, the Commission will initiate an investigation to examine the justness and reasonableness of Kinder Morgan's rates pursuant to section 5 of the NGA and set the matter for hearing.").

²⁰ *Id.* P 10.

²¹ NGA section 10 states "Every natural-gas company shall file with the Commission such... special reports as the Commission may by . . . order prescribe as necessary or appropriate to assist the Commission in the proper administration of this Act."

are “necessary or appropriate to assist the Commission in the proper administration of [the NGA].” Section 10(a) also permits the Commission to “prescribe the manner and form in which such reports shall be made, and require from such natural gas companies specific answers to all questions upon which the Commission may need information.”²² Similarly, section 14 permits the Commission “to investigate any facts, conditions, practices, or matters which it may find necessary or proper . . . to aid in the enforcement of the provisions of this chapter.”

25. In *Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18, 38 (D.C. Cir. 2002) (*INGAA*), the United States Court of Appeals for the District of Columbia Circuit rejected a contention similar to that made by Kinder Morgan in the instant proceeding. In that case, the Commission in Order No. 637 had directed each pipeline to file *pro forma* tariff sheets showing how it intended to comply with a regulation requiring pipelines to permit segmentation²³ or to explain why its system’s configuration justified curtailing segmentation rights. As in the instant proceeding, the pipelines contended that requiring them to submit these filings impermissibly shifted the burden of proof, and the Commission had, in essence, required pipelines to make section 4 filings to defend their current rates. The court rejected this argument, finding that the Commission had stated that it “will indeed shoulder the burden under § 5 of the NGA.” *INGAA*, 285 F.3d at 38. As pertinent here, the court expressly stated that:

As to the Commission’s determination **to extract information from pipelines relevant to the practical issues, we see no violation of the NGA.** The Commission has authority under § 5 to order hearings to determine whether a given pipeline is in compliance with FERC’s rules,

²² Kinder Morgan asserts that the Commission relied on NGA sections 10 and 16 as authority for its action in *Natural*, 130 FERC ¶ 61,133 at P 17, 19. Kinder Morgan states that it expects the Commission to resurrect this argument in the instant case even though the November 18 Order did not expressly cite NGA sections 10 and 16 as authority to require Kinder Morgan to submit the subject information. Kinder Morgan Rehearing Request at p. 11 and fn.5. However, in the November 2010 Order the Commission cited *Natural*, *inter alia*, and again explained that, “[s]ections 10(a) and 14(a) of the NGA authorize the Commission to require [the pipeline] to submit the information required by the [order instituting investigation] in order to carry out its responsibility under NGA section 5 to ensure that the pipeline’s rates are just and reasonable.” 130 FERC ¶ 61,133 at fn.9, (citing, *Natural*, 130 FERC ¶ 61,133 at P 16. The Commission clarifies here that it relies on NGA sections 5, 10, and 14 to require Kinder Morgan to submit the subject information.

²³ 18 C.F.R. § 284.7(d) (2010).

15 U.S.C. § 717d(a), and **under § 10 and § 14 to require pipelines to submit needed information for making its § 5 decisions**, 15 U.S.C. §§ 717i & 717m(c). *Id.* (emphasis added).

The same conclusion applies here, since the November 2010 Order clearly states that the Commission has the burden in this NGA section 5 proceeding.

26. Kinder Morgan argues that NGA section 10 does not authorize the Commission to require a cost and revenue study of the type at issue here, because the required study goes beyond a compilation of factual data by the pipeline, as contemplated by section 10(a). Kinder Morgan points out that section 154.312(p)(2) requires a pipeline to submit a Schedule J-2 showing “the derivation of each rate component of each rate.” Kinder Morgan states that this requires a pipeline with different customer classes to show the derivation of rates for each customer class, including a break-down of cost components for each such class. In addition, Kinder Morgan asserts that pipelines with rate zones must also show “the costs detailed by each rate zone, and the factors underlying that allocation, such as contract demand, annual billing determinants, three-day peak, etc. and any load factor adjustments.”²⁴ Kinder Morgan argues that these requirements are not simple extractions of information. Rather, they require Kinder Morgan to undertake studies and make a multitude of allocations of costs and volumes for each of the various rate components, which it states is a burden that properly belongs with the Commission in a section 5 proceeding.

27. The Commission finds this argument to be without merit. The Commission recognizes that completing the cost and revenue study required by the November 2010 Order will require Kinder Morgan to set forth how costs are allocated among its services and rate zones, the “formulae used in the allocation,” and “the factors underlying the allocation of costs,”²⁵ as well as other matters such what its return on equity should be.²⁶ However, this fact does not transform that study into an NGA section 4 filing. The November 2010 Order’s request for this information is similar to Order No. 637’s directive, affirmed in *INGAA*, that pipelines file *pro forma* tariff sheets showing how they intended to comply with the new segmentation regulation or explain why they should be exempted from that requirement. Contrary to Kinder Morgan’s suggestion that the Commission directive at issue in *INGAA* was limited to requiring pipelines to provide

²⁴ Kinder Morgan Rehearing request at p. 9, *citing* § 154.310 and § 154.312(o)(3).

²⁵ 18 C.F.R. § 154.312(b)(1) (2010).

²⁶ 18 C.F.R. § 154.312(f) (2010).

“factual information” relevant to segmentation,²⁷ the requirement to file *pro forma* tariff sheets went beyond a requirement simply to provide such factual information. It required each pipeline to state in its compliance proceeding how it believed shippers on its system should be permitted to segment their capacity in light of the operational requirements of their systems and to propose specific tariff language implementing the pipeline’s proposed segmentation plan.²⁸

28. The Commission readily admits that the information that it has requested from Kinder Morgan is the type of information necessary to craft rates. Whether rates are changed pursuant to the procedures and burdens in NGA section 4 or in NGA section 5, the same information and calculations are required to determine the rates. The pipeline’s cost of service must be determined, including an appropriate return on equity, and that cost of service must be allocated among the pipeline’s various services, and per unit rates must be determined for each service. Therefore, it cannot be surprising that the Commission has requested that Kinder Morgan provide most of the same information it would require had Kinder Morgan filed to change its rates under NGA section 4, particularly since the required information is in the hands of Kinder Morgan. In this regard, the Form 2 does not require pipelines to provide the information necessary to allocate costs among customers or to derive per-unit rates, such as the contract demands of the shippers in each customer class, annual billing requirements, zonal throughput, how much throughput flowed at a discount and what those discounts were.

29. Accordingly, the requirement that Kinder Morgan show the derivation of each rate component of each rate will provide relevant information for the section 5 proceeding by showing, among other things, how Kinder Morgan believes costs should be allocated among services to derive per-unit rates, how the necessary calculations are performed, and what information is necessary to make those calculations. As Kinder Morgan points out, if the Commission satisfies its burden to show that Kinder Morgan’s existing rates are over-recovering its cost of service and thus are unjust and unreasonable, section 5 also places on the Commission the burden of showing that the replacement rates its orders are just and reasonable. This will require the Commission to allocate Kinder Morgan’s costs among its various customer classes and rate zones in order to derive just

²⁷ Kinder Morgan states that the *INGAA* Court held that the Commission’s decision to require that the pipeline include certain information in *pro forma* tariff sheets relevant to its compliance with the regulation governing segmentation was not a violation of the NGA but argues that the directive that Kinder Morgan generate new rates “is not the kind of factual information required by *INGAA* and envisioned by section 10 of the NGA.” Kinder Morgan Rehearing Request at p. 11.

²⁸ See, e.g., *Columbia Gas Transmission Corp.*, 100 FERC ¶ 61,084, at P 12-14 (2002), describing the pipeline’s virtual pool proposal in light of its assertion that physical pathing was not operationally feasible on its system.

and reasonable per-unit rates for each of Kinder Morgan's services. Therefore, Kinder Morgan's method of doing this and the information necessary to make the required calculations is squarely within the scope of this proceeding.

30. Kinder Morgan asserts that the Commission cannot compel it to state how it believes its per-unit rates should be derived, including formulas for allocating costs among its services and rate zones, or provide the relevant information for making those calculations, until "after the Commission has set out its case on replacement rates."²⁹ However, in determining just and reasonable replacement rates in a section 5 proceeding, the Commission takes into account the fact that the NGA delegates to the pipeline the primary initiative to propose rates. Therefore, if there is more than one just and reasonable method of allocating costs among customer classes or rate zones or doing other calculations necessary to derive per unit rates, the Commission uses the pipeline's proposed method regardless of the existence of other just and reasonable methods.³⁰ In these circumstances, requiring Kinder Morgan to state how it believes its costs should be allocated among services and rate zones to derive per-unit rates will allow the other participants and the Commission to use Kinder Morgan's preferred method or shoulder the burden of showing that Kinder Morgan's method is not among the possible just and reasonable methods and a different method is just and reasonable. It will also enable the participants to obtain and place in the record the information necessary to make the required rate calculations, including Kinder Morgan's costs detailed by each rate zone, and such cost allocation factors as contract demand, annual billing determinants, and three-day peak.

31. In short, the Commission's requirements concerning the cost and revenue study do not shift either the burden of production or the burden of persuasion to Kinder Morgan. To the contrary, those requirements give Kinder Morgan an opportunity to set forth its preferred methods of deriving per-unit rates, so that the participants and the Commission can take those preferences into account in undertaking their burdens under NGA section 5 to show that Kinder Morgan's existing rate are unjust and unreasonable and any replacement rates are just and reasonable.

32. Further, the Commission's November 2010 Order specifically exempted Kinder Morgan from submitting certain types of information in order to ensure that it avoided placing any inappropriate burden on Kinder Morgan in this proceeding:

Additionally, because Kinder Morgan does not have an NGA section 4 burden in this section 5 proceeding and will be filing testimony in response

²⁹ Kinder Morgan Rehearing Request at p. 12.

³⁰ *ANR Pipeline Co.*, 110 FERC ¶ 61,069 at P 49 (2005), *citing Consolidated Edison Co. v. FERC*, 165 F.3d 992, 998 1002-1004 (D.C. Cir. 1999).

to other parties, Kinder Morgan does not need to file the Statement P required by section 154.312(v) of the Commission's regulations at this juncture. *Natural*, 130 FERC ¶ 61,133 at P 10 (footnote omitted).

33. The court decisions set forth by Kinder Morgan do not prohibit the Commission's actions as suggested by Kinder Morgan. In *Public Service*, the Commission expressly required that a pipeline file rates under NGA section 4 every three years. The Commission determined that this action was necessary because of the inadequate protection provided by NGA section 5 and concluded that good cause existed to require periodic section 4 refilings. The court found that the Commission had improperly shifted the burden of proof from the Commission to the pipeline.³¹ However, the court found that in that proceeding "the Commission has made clear that its purpose in requiring a § 4 filing was precisely to avoid the 'insufficient protection' afforded by [NGA] § 5, see *Ozark Gas Transmission System*, 39 FERC ¶ 61,142 at 61,512, i.e., to avoid its procedural constraints." *Id.* at 491. In this case, unlike *Public Service*, the Commission has not required Kinder Morgan to file new rate schedules under NGA section 4, and the Commission fully recognizes that it is proceeding under NGA section 5, and bears the burden to make the findings required by section 5 in order to modify Kinder Morgan's rates.

34. In *Consumers Energy Company v. FERC*,³² the Commission required a Hinshaw pipeline performing certain NGA jurisdictional services to file, at three-year intervals, petitions "for rate approval to justify its current rate or to establish a new maximum rate." The court held that it was unclear whether the Commission intended to require the pipeline to make periodic NGA section 4 filings modifying its rates, or simply require periodic informational filings. Finding that the Commission lacked authority to order pipelines to make NGA section 4 filings, the court remanded the case to the Commission.³³ However, the court also stated:

³¹ *Public Service*, 488 F.2d. at 490-92.

³² *Consumers Energy*, 226 F.3d 777.

³³ Subsequently, in *Consumers Energy Co.*, 94 FERC ¶ 61,287 (2001), the Commission issued an order on remand from the court in *Consumers Energy*. The Commission stated:

We now clarify that, under our NGA section 10(a), 15 U.S.C. § 717i(a), authority, we are requiring Consumers to submit, on or before December 1, 2001, data and information we need to monitor Consumers' rates in accordance with NGA section 5. Accordingly, the rates approved for Consumers in the April 15, 1999 letter order are accepted, to be effective as proposed, subject to the condition that Consumers must file cost and

(continued...)

Should FERC wish [the Pipeline] **to make periodic informational filings, it may of course so require pursuant to § 10(a) of the NGA.** This will allow FERC to do what it insists it has been trying to do all along, and will permit both sides to get what they have assured us they want. *Id.* at 781 (emphasis added).

35. Here, consistent with *Consumers Energy*, the Commission has expressly stated that it is not requiring Kinder Morgan to file revised rate schedules under NGA section 4, but is simply requiring an informational filing of the type the court held is permissible under NGA section 10(a). Accordingly, the above cases do not prohibit the Commission from requiring information in the instant proceeding as suggested by Kinder Morgan.

B. Exclusion of Test Period Adjustments

36. Kinder Morgan also contends that the Commission erred in precluding it from including any test period adjustments in the cost and revenue study. Kinder Morgan argues that to create a complete view of just and reasonable rates, the Commission must consider both base period data as well as forward-looking test period adjustments to determine a pipeline's cost of service and billing determinants as required by its regulations. Kinder Morgan argues that to exclude known and measurable adjustments when deriving rates that can only be implemented on a prospective basis is an abuse of the Commission's discretion and that it constitutes an unexplained change in Commission policy.

37. As discussed below, the Commission clarifies that its directive concerning the cost and revenue study required by the November 2010 Order was not intended to preclude consideration in this section 5 proceeding of evidence concerning changes in Kinder Morgan's cost and revenues occurring after the twelve month period covered by that study. However, the Commission rejects any contention that the Commission must consider cost and revenue changes occurring during a full nine-month adjustment period of the type provided for in the Commission's regulations and precedent applicable to section 4 rate cases or that the Commission has somehow violated NGA section 4 or 5 by the requirements set forth in the November 2010 Order.

38. When the Commission determines just and reasonable rates, whether in a section 4 or a section 5 proceeding, the Commission projects the pipeline's costs and volumes for the period when the new rates will be in effect, based upon the pipeline's actual costs and volumes during a prior period before the new rates take effect. The Commission's

throughput data and other information on or before December 1, 2001, sufficient to allow the Commission to determine whether any change in Consumers' rate pursuant to NGA section 5, which would apply prospectively, should be ordered. This cost and throughput data should be in the form specified in § 154.313 of the regulations. *Id.* at fn.8.

method of doing this in a section 4 rate case initiated by the pipeline is set forth in its test period regulations in section 154.303. Those regulations are tailored to the normal procedural schedule in a section 4 rate proceeding. In particular, the requirements concerning the commencement and duration of the base and adjustment periods are designed so that the overall test period generally ends the day before the pipeline's proposed rate increase takes effect, subject to refund, after a five-month suspension. As the Commission explained in *Williston III*:

The rates for pipelines are based on actual data for a one-year base period, as adjusted to reflect known and measurable changes that will occur within the following nine months (adjustment period). The regulations require that the base period used by the pipeline end no more than four months before the pipeline makes its filing. The adjustment period must begin immediately after the base period. Generally, the nine-month adjustment period ends ... the day before the pipeline's rates take effect after a five month suspension period. The rate factors (including costs and volumes) may be adjusted for changes in revenues and costs during the adjustment period. However, those changes must be known and measurable with reasonable accuracy at the time of the filing. And both the regulations in effect when *Williston* made this filing and the current regulations expressly require that the changes "become effective within" the adjustment period.³⁴

39. While the pipeline's proposed rates take effect upon the simultaneous conclusions of the test and suspension periods, in a section 4 rate case, the rates remain subject to refund until after the hearing and a Commission order on the merits. Further, section 154.311 of the Commission's regulations requires that, within 45 days after the end of the test period, the pipeline update statements and schedules that include test period data with actual data.³⁵ This ensures that actual data for the adjustment period is available sufficiently before the hearing so that participants have an opportunity to perform discovery and prepare testimony for the hearing based on actual data for the entire test period, including the adjustment period. For example, in a case conducted under the Track III hearing timeline generally used for major pipeline section 4 rate cases, the 45-day update filing would be submitted approximately 28 weeks after the appointment of

³⁴ *Williston Basin Interstate Pipeline Co.*, 87 FERC ¶ 61,265, at 62,021 (1999) (*Williston III*) (footnotes omitted).

³⁵ 18 C.F.R. § 154.311 (2010).

the ALJ, and the hearing would commence 14 weeks later.³⁶ Thus the parties have somewhat more than three months in which to conduct discovery and prepare testimony concerning the updated data before the hearing commences.

40. As a result, when the Commission determines just and reasonable rates in a section 4 rate case, there is a fully developed hearing record concerning the pipeline's actual costs and revenues during the last twelve months of the test period (i.e., the last three months of the base period and the nine-month adjustment period). Accordingly, the Commission generally uses such data to project the pipeline's costs and volumes because the most recent actual data before the filed rates took effect provides the best evidence for what the costs and volumes will be after the proposed rates take effect.³⁷ While the Commission generally makes its merits holdings in a section 4 rate case a year or more after the pipeline's proposed rates take effect, the Commission's section 4 refund authority allows the Commission to apply its holdings retroactively back to the time the proposed rates took effect. In short, the section 154.303 test period regulations permit the pipeline's rates in a section 4 rate case to be determined based on cost and volume data from a test period immediately preceding the effective date of those rates, but at the same time provide all interested participants a full opportunity to litigate the reliability and accuracy of the test period data for purposes of projecting the pipeline's costs and volumes.

41. Kinder Morgan contends that the Commission must use the same base and adjustment period in a section 5 case, as in a section 4 case, despite the significant procedural differences between the two types of proceedings. The Commission rejects this contention. While we are using the schedules and statements in the section 154.312 regulations³⁸ as a template for the cost and revenue study, the section 154.303 test period regulations do not apply to section 5 proceedings, such as the instant case. Subpart D of Part 154 of the Commission regulations, which includes sections 154.303 and 154.312, only applies to interstate pipelines filing for a change in rates or charges – i.e. a section 4 rate proceeding. Section 154.301, the first section of subpart D, makes this clear:

Except for changes in rates pursuant to subparts E, F, and G, of this part, any natural gas company filing for a change in rates or charges, except for a

³⁶ Under the Track III hearing timeline the hearing commences 42 weeks after the appointment of the ALJ.

³⁷ See, e.g., *Williston Basin Interstate Pipeline Co.*, 84 FERC ¶ 61,081 (1998); *Williston III*, 87 FERC ¶ 61,265.

³⁸ Because Kinder Morgan does not have an NGA section 4 burden in this section 5 proceeding and will be filing testimony in response to other parties, the November 2010 Order did not require Kinder Morgan to file the Statement P required by section 154.312(v) of the Commission's regulations at this juncture.

minor rate change, must submit, in addition to the material required by subparts A, B, and C of this part, the Statements and Schedules described in § 154.312.³⁹

42. Second, because of the very different procedural posture of a section 5 proceeding, as compared to a section 4 rate case, the section 154.303 provisions concerning the timing and duration of the base and adjustment periods are not suited to a section 5 proceeding. As explained above, the nine-month adjustment period provided by section 154.303 takes into account the fact that section 4 permits the Commission to suspend a pipeline's proposed rate increase for five months, with the result that there is generally a nine-month period between the base period used by the pipeline in its section 4 rate filing and the date its proposed rate increase takes effect subject to refund.⁴⁰ However, in a section 5 proceeding, there is no comparable nine-month period between the base period and the effective date of a rate change, because the Commission has neither rate suspension nor refund authority in a section 5 proceeding. Thus, the reason for setting the length of the adjustment period at nine months does not exist in a section 5 proceeding.

43. As in a section 4 proceeding, interested participants must be provided an opportunity to fully litigate the accuracy and reliability of the test period data for purposes of projecting the pipeline's costs and volumes. This includes an opportunity to perform discovery and prepare testimony for submission at the hearing concerning the appropriate cost and volumes projections to be made based on that data. That opportunity can only take place after completion of the test period and after actual data for that test period is made available to the participants.⁴¹ It follows that, because the Commission can only make its section 5 determinations effective prospectively, there must inevitably be a significant lag between the end of whatever test period is used in a section 5 proceeding and the effectiveness of any reduced just and reasonable rates resulting from the section 5 proceeding.

³⁹ 18 C.F.R. § 154.301 (2010).

⁴⁰ Usually, the base period ends three months before the pipeline makes its filing. That three-month period, together with the 30-day notice period before the suspension order and the five-month suspension, add up to nine months.

⁴¹ For example, if the actual data made available after the end of the test period showed that the pipeline had entered into discounted rate transaction during the final months of the test period, there should be an opportunity for the participants to conduct discovery concerning whether competition requires those discounts. Such evidence would be relevant to a determination whether the pipeline's rate design volumes should be reduced to account for discounts.

44. Therefore, while the Commission applies the same basic test period concepts in section 5 proceedings as in section 4 rate proceedings, the particular test period requirements applicable to section 4 proceedings under section 154.303 must be modified and adapted to the realities of a section 5 proceeding. While the Commission cannot use a test period immediately preceding the effective date of its section 5 rate determinations, it does expect to make those determinations, based on actual cost and volume data from as recent a twelve-month period as possible.

45. To this end, the November 2010 Order required Kinder Morgan to submit a cost and revenue study for the latest twelve month period available. The Commission stated that the study could include adjustments to reflect known and measurable changes that took place during the twelve month period, but the Commission required Kinder Morgan to exclude any adjustments for changes it projects may occur after the twelve-month period. The Commission did this in order to obtain a study showing Kinder Morgan's actual costs and revenues during the most recent twelve-month period undistorted by projections of changes that may or may not occur in the future. Such a study should provide all participants with a baseline of actual annual costs and revenues, which can then be used as a starting point for further analysis of Kinder Morgan's costs and revenues.

46. By restricting the cost and revenue study to the most recently available actual costs and revenues, the Commission did not intend to preclude Kinder Morgan and other participants from subsequently presenting evidence in the proceeding supporting adjustments to Kinder Morgan's cost and revenues to reflect changes occurring after the twelve-month period covered by that study. The Commission recognizes that, as in a section 4 rate case, there is an interest in determining rates based on cost and revenue data as close in time as possible to the effectiveness of the rates in question. Such data would generally be most representative of the pipeline's costs and revenues once any revised rates take effect.

47. However, the interest in using recent data must be balanced with the interest in providing all participants an opportunity to develop a full record concerning what just and reasonable rates should be developed based on the data from whatever annual period is used for projecting the pipeline's cost and revenues. In this proceeding, as in other section 5 proceedings, due to the potential for continued over-recovery of revenues by Kinder Morgan, the November 2010 Order established a date for an initial decision in order to expedite the proceeding.⁴² Accordingly, this proceeding is being conducted in accordance with the Track II hearing timeline, with the hearing to take place and the initial decision to be issued within 32 and 47 weeks, respectively, of the designation of the presiding judge.

⁴² November 2010 Order, 133 FERC ¶ 61,157 at P 11. *See, e.g., Indicated Shippers v. Sea Robin Pipeline Co.*, 76 FERC ¶ 61,151 (1996) (*Sea Robin*).

48. Consistent with that timeline, the participants have agreed to a procedural schedule under which (1) staff and intervenors will file direct testimony by April 14, 2011, (2) Kinder Morgan will file answering testimony by May 24, 2011, (3) staff and intervenors will file cross-answering and rebuttal testimony by June 16, (4) final discovery requests will be due by June 20, 2011, and (5) the hearing will commence on June 29, 2011.⁴³

49. Based on this timeline, it is clear that any updated data to be used in this case must be limited to an adjustment period substantially shorter than the nine-month adjustment period used in a section 4 rate case. Kinder Morgan's cost and revenue study uses an annual period ending on October 31, 2010; therefore a nine-month adjustment period forward from that date would not end until July 31, 2011, one month after the hearing is to be held. Moreover, actual data for such an adjustment period would likely not be available until mid September 2011 (i.e., 45 days after the end of the nine-month adjustment period), which would be two and a half months after the hearing and after the reply briefs are due (currently August 29, 2011). Such actual data is necessary to show whether any projected changes "become effective within" the adjustment period, as would be required in a section 4 rate case. In short, a nine-month adjustment period would prevent the parties from performing discovery and preparing testimony for the hearing based on actual data for the test period.⁴⁴

50. Therefore, while we will permit an adjustment period, it must be abbreviated. Based on the current procedural schedule, it would appear that the last month for which actual data could reasonably be expected to be available sufficiently in advance of the hearing would be approximately February 2011. Kinder Morgan should be able to complete providing actual data for the period through February to all participants by mid-April, approximately two and a half months before the June 29, 2011 commencement of the hearing. Kinder Morgan could then propose in its answering testimony (currently due May 24, 2011) adjustments based on such actual data and staff and the other intervenors could address those adjustments, as well proposing their own adjustments in rebuttal testimony (currently due June 16, 2011). The ALJ may also consider adjustments to the current procedural schedule to account for the use of data after the period covered by the cost and revenue study, as requested by the participants in the proceeding.

51. While Kinder Morgan may experience further changes in its costs and revenues after the cut-off date for updated cost and revenue data in this proceeding, there must be

⁴³ *Kinder Morgan Interstate Gas Transmission, L.L.C.*, Docket No. RP11-1494-000 (Jan. 11, 2011) (Order Establishing Procedural Schedule).

⁴⁴ *See also SFPP, L.P.*, 129 FERC ¶ 61,050 (2009) (Commission clarified that it did not intend to modify the proposed base period or adjustment period; Commission trial staff had argued that without such clarification the adjustment period would have ended *after* the hearing and accordingly, a new procedural schedule would have been warranted) (emphasis added).

such a cut-off date.⁴⁵ Otherwise, the participants would be faced with a constantly moving target, and the section 5 proceeding would never end.

52. Accordingly, the Commission disagrees with Kinder Morgan to the extent that it contends that in a section 5 proceeding the Commission must use a test period that includes the full nine-month adjustment period used in section 4 proceedings. In the three orders establishing section 5 proceedings in November 2009,⁴⁶ the Commission simply stated that the pipelines did “not need to file nine months of post-base period adjustment data required by section 154.303(a)” with their cost and revenue studies. Because these three proceedings were either settled or terminated, the Commission never decided what adjustment period, if any, should be used to determine whether the pipelines rates were unjust and unreasonable. As the Supreme Court has specifically acknowledged, the “just and reasonable” standard was not intended to imply any particular methodology of ratemaking: “Under the statutory standard of ‘just and reasonable’ it is the result reached, not the method employed which is controlling.”⁴⁷

53. Also, in *Sea Robin*, the Commission rejected a contention similar to that raised by Kinder Morgan here regarding the need to use a nine-month adjustment period in a section 5 rate case. Following a complaint filed by the Indicated Shippers, the Commission determined that Sea Robin’s revenues appeared to exceed its cost of service causing its rates to be unjust and unreasonable. Accordingly, acting under section 5, the Commission established a hearing to investigate Sea Robin’s rates and directed Sea

⁴⁵ *Kansas Gas and Electric Co.*, 25 FERC ¶ 61,171 at 61,473 (1983). The Commission explained that:

[t]he parties opposing a rate increase often invest substantial time and money probing the utility's cost data. When the utility is permitted to submit new data in the course of the proceeding, it often becomes necessary for intervenors to scrap much of their original investigations and begin anew. If the utility can show that certain costs have increased from its actual or estimated test period costs, the intervenors can sometimes show that other costs have declined or that revenues have increased. Unless and until a line is drawn somewhere, there is no end to such a rate proceeding.

Id.

⁴⁶ *Great Lakes*, 129 FERC ¶ 61,160; *Northern*, 129 FERC ¶ 61,159; *Natural*, 129 FERC ¶ 61,158.

⁴⁷ *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S. Ct. 281, 287, 88 L. Ed. 333 (1944).

Robin to file a cost and revenue study similar to the cost and revenue study Kinder Morgan was directed to file in the instant proceeding. The Commission directed that the cost and revenue study should include actual data for the latest 12-month period, “but should not include a traditional test period – 12 months of actual data and a nine month test period that includes projections.”⁴⁸ The Commission rejected a challenge to its decision to exclude the nine-month adjustment period from Sea Robin’s cost and revenue study, stating:

[T]he Commission disagrees that the use of a twelve-month base period, as annualized to reflect trends experienced during the base period, is inconsistent the Commission’s test period policies. This method, like that of the traditional test period which relies on 12 months of actual experience as adjusted by nine months of known and measurable projections, relies on present evidence to predict future activity.⁴⁹

Similarly, the Commission finds that the test period method adopted here, which relies on the most recent actual data available based on the procedural schedule, is reasonably consistent with the Commission’s traditional test period methodology and will be appropriate for determining just and reasonable rates.

54. Finally, while the Commission continues to require Kinder Morgan to file a cost and revenue study which excludes any adjustments for a change it projects may occur after the twelve month period used in that study, the Commission will grant rehearing in part to permit Kinder Morgan to include certain information with the study required by the November 2010 Order. Specifically, consistent with our clarification above that an abbreviated adjustment period may be used in this section 5 proceeding, the commission will permit Kinder Morgan to include, with the cost and revenue study required by the November 2010 Order, a separate cost and revenue study which does reflect adjustment for changes Kinder Morgan projects will occur during a time frame which may reasonably be taken into account in this proceeding consistent with the discussion above. This will give Kinder Morgan an opportunity to present the adjustments it believes are necessary to correctly calculate its rates.

55. Therefore, as discussed above, Kinder Morgan’s Request for Rehearing of the November 2010 Order is granted in part and denied in part.

⁴⁸ *Sea Robin*, 76 FERC at 61,826 & n.16.

⁴⁹ *Indicated Shippers v. Sea Robin Pipeline Co.*, 81 FERC ¶ 61,146, at 61,655 (1997).

The Commission orders:

Kinder Morgan's Request for Rehearing of the Commission's November 2010 order is granted in part and denied in part as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.