

**UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

Transwestern Pipeline Company, LLC § Docket No. RP06-____-000

**PREPARED DIRECT TESTIMONY
OF
STEPHEN D. MCGREGOR**

1 **Q. Please state your name and business address.**

2 A. My name is Stephen D. McGregor. My business address is 5444 Westheimer
3 Rd., Houston, TX 77056.

4 **Q. On whose behalf are you testifying in this proceeding?**

5 A. I am testifying on behalf of Transwestern Pipeline Company, LLC
6 (“Transwestern”).

7 **Q. What are your responsibilities with Transwestern?**

8 A. I am Vice President-Tax for Southern Union Company, with responsibility for
9 strategic and transactional tax matters including research and planning, audits and
10 compliance activities for federal, state, local and international taxes.

11 **Q. Please describe briefly your education and professional background.**

12 A. I was employed by Southern Union in 1998 as its Tax Manager and promoted to
13 Tax Director and Vice President in 1999 and 2001, respectively. Prior to joining
14 Southern Union, I was employed with The PIC Group in Austin, Texas (1996-
15 1998); Coopers & Lybrand (now PricewaterhouseCoopers LLP) in Fort Worth,
16 Texas (1993-1996); Practitioners Publishing Company in Fort Worth, Texas

(1990-1993); and KPMG Peat Marwick (now KPMG) in Austin, Texas and Montvale, New Jersey (1982-1988).

I am a Certified Public Accountant with a Bachelor of Accounting/Finance degree from Baylor University and a Master of Professional Accounting degree specializing in Taxation from the University of Texas at Austin. I am active in a number of professional organizations including: American Gas Association (former chairman of Tax Committee); Interstate Natural Gas Association of America; Tax Executives Institute; Council on State Taxation; and, American Institute of Certified Public Accountants.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the calculation of Transwestern's income tax allowance pursuant to the Commission's Policy Statement on Income Tax Allowances, 111 FERC ¶61,139 (2005) ("Policy Statement").

Q. What exhibit are you sponsoring in this proceeding?

A. I am sponsoring the following exhibit:

<u>Exhibit No.</u>	<u>Reference</u>	<u>Description</u>
TW-55	Schedule H-3(3), p.1	Computation of Effective Income Tax Rate, Twelve Months Ended May 31, 2006, As Adjusted
	Schedule H-3(3), p. 2	Calculation of State Income Tax Rates, Twelve Months Ended May 31, 2006, As Adjusted

1 **Q. Were such exhibits prepared by you or under your supervision and**
2 **direction?**

3 A. Yes.

4 **Q. Is Transwestern itself subject to income taxes?**

5 A. No. As a limited liability company, Transwestern is a pass-through entity for tax
6 purposes and, therefore, is not itself subject to income taxes. However, the
7 owners of Transwestern are subject to actual or potential income tax liability on
8 their shares of Transwestern's income.

9 **Q. Does the Commission's Policy Statement authorize an income tax allowance**
10 **in the case of an interstate pipeline that is a pass-through entity for income**
11 **tax purposes?**

12 A. Yes. The Policy Statement authorizes an income tax allowance in cases where
13 partnerships or similar pass-through entities own the assets of a regulated public
14 utility to the extent that the owner or owners of the pass-through entity are subject
15 to actual or potential income tax liability on their shares of the pass-through
16 entity's income.

17 **Q. What factors does the Commission consider when authorizing an income tax**
18 **allowance for a pipeline that is a pass-through entity for income tax**
19 **purposes?**

20 A. The Commission considers the pipelines' owners and their tax status. If there is
21 more than one level of pass-through entities, the Commission evaluates the owner
22 where ultimate tax liability resides and whether such owner has actual or potential

1 income tax liability on income from the pipeline (Id. at P 42.) An income tax
2 allowance is authorized regardless of the type of entity or individual which
3 ultimately owns the public utility assets, “provided that an entity or individual has
4 an actual or potential income tax liability to be paid on that income from those
5 assets.” (Policy Statement, 111 FERC ¶61,139 at P 32.)

6 **Q. Please identify the owners of Transwestern.**

7 A. Transwestern is wholly-owned by Transwestern Holding Company, LLC, which
8 is wholly-owned by CrossCountry Energy, LLC, which is wholly-owned by CCE
9 Holdings, LLC. The ownership of CCE Holdings, LLC is divided among
10 multiple entities: (1) 49.9 percent is held by CCE Acquisition, LLC, which is
11 wholly-owned by Southern Union Company, a Delaware corporation (2) .1% by
12 CCEA Corp., which is indirectly wholly-owned by Southern Union Company, a
13 Delaware Corporation; (3) 30.02 percent is held by EFS-PA, LLC, which is
14 wholly-owned by General Electric Credit Corporation of Tennessee, a Tennessee
15 corporation, which is wholly-owned indirectly by General Electric Company; (4)
16 9.40 percent is held by CDPQ Investments (U.S.) Inc., a Delaware corporation;
17 (5) 5.08 percent is held by Lake Bluff, Inc., a Delaware corporation, which is
18 wholly-owned directly by NML Securities Holdings, LLC, which is wholly-
19 owned directly by the Northwestern Mutual Life Insurance Company; (6) 2.115
20 percent is held by Kings Road Holdings I LLC, which is wholly-owned by Kings
21 Road Investments, Ltd., a Cayman Island exempt company with limited liability;
22 and (7) 3.385 percent is held by Merrill Lynch Ventures L.P. 2001.

1 **Q. Are the owners of Transwestern subject to actual or potential income tax**
2 **liability with respect to income from Transwestern?**

3 **A.** Yes. Southern Union Company (an aggregate 50 percent), General Electric
4 Company (30.02 percent), CDPQ Investments (U.S.) Inc. (9.40 percent), and the
5 Northwestern Mutual Life Insurance Company (5.08 percent) are corporations
6 that are subject to the corporate marginal tax rate of 35 percent. Kings Road
7 Holdings I LLC (2.115 percent) has elected to be treated as a corporation for tax
8 purposes and is subject to the corporate marginal tax rate of 35 percent. Thus,
9 96.615 percent of Transwestern's income is ultimately received by corporations
10 subject to actual or potential income tax liability at the corporate marginal tax rate
11 of 35 percent. The remaining 3.385 percent ownership is held by a limited
12 partnership, Merrill Lynch Ventures L.P. 2001. This type of partnership typically
13 involves a general partner, generally a corporation, which owns 1 percent of the
14 partnership, with the remaining 99 percent held by individuals. Individuals
15 undertaking investments of the type offered by Merrill Lynch Ventures LP 2001
16 are generally high-income individuals and, therefore, subject to a marginal tax
17 rate of 35 percent. However, with respect to individuals, the Commission has
18 adopted "a presumption of [a] 28 percent marginal tax bracket for entities other
19 than those filing an 1120 corporate return." SFPP, L.P., 113 FERC ¶61,277 at P
20 32 (2005). Because the 3.385 ownership of Merrill Lynch Ventures, L.P. 2001 is
21 such a small part of Transwestern's overall ownership, I have applied the
22 Commission's presumption of 28 percent for individuals to 99 percent of the

3.385 percent ownership and the corporate marginal tax rate of 35 percent to 1 percent.

Q. Have you calculated a federal income tax rate for Transwestern?

A. Yes. I have calculated a federal income tax rate based on the ownership percentages and the marginal federal income tax rates discussed above. As shown on Page 1 of Exhibit No. TW-55, this results in an overall rate of 34.7654 percent for calculating Transwestern's federal income tax allowance.

Q. Should Transwestern's income tax allowance also reflect actual or potential liability for state income taxes?

A. Yes. Page 2 of Exhibit No. TW-55 shows state income tax rates for purposes of calculating Transwestern's state income tax allowance. States generally tax corporations based on the portion of the corporation's income that is allocated to each state where it does business. Transwestern does business in 5 states that must be considered in this analysis: Arizona, Colorado, New Mexico, Oklahoma and California. The marginal corporate tax rate of each of these states is weighted using the factors established by each state. Such factors include the percentage of sales, property, payroll or traffic (MMBtu miles) for Transwestern in the state. For example, Arizona gives Transwestern's sales, property, payroll and traffic in Arizona the following weights: 50 percent, 25 percent, 25 percent and zero percent. Such weights are multiplied by the percentage of such factors for Transwestern in Arizona, the results are added together and the total is multiplied by the Arizona marginal tax rate to yield an effective state tax rate for Arizona. A

1 similar calculation is performed for the other four states. When the effective
2 corporate state tax rates for each of the five states are added together, the effective
3 state tax rate applicable to the corporations having ownership interests in
4 Transwestern is 5.8134 percent, as shown on Page 2 of Exhibit No. TW-55. A
5 similar calculation was performed utilizing the marginal tax rate for individuals
6 for each of the five states, resulting in an effective state tax rate applicable to
7 individuals of 5.5079 percent, as shown on Page 2 of Exhibit No. TW-55. Such
8 calculation reflects a conservative approach because an individual is taxed at the
9 higher of the rate applicable in the state of residence or the rate of the state in
10 which the business generates its income. As shown on Page 1 of Exhibit No.
11 TW-55, applying the 5.8134 percent corporate state tax rate to the corporate
12 ownership percentages and the 5.5079 percent individual state tax rate to the
13 individual ownership percentage results in an overall state tax rate of 5.8033
14 percent.

15 **Q. Does this conclude your prepared direct testimony?**

16 **A. Yes.**

AFFIDAVIT

STATE OF TEXAS §

COUNTY OF HARRIS §

Stephen D. McGregor, being first duly sworn according to law, deposes and says: that he has read and is familiar with the contents of the attached "Prepared Direct Testimony of Stephen D. McGregor", submitted on behalf of Transwestern Pipeline Company, LLC in the above entitled proceeding which accompanies this affidavit; that if asked the questions contained in said prepared direct testimony, affiants answers in response thereto would be as shown in said testimony; and the facts contained in said testimony are true to the best of affiants knowledge, information, and belief, and that affiant hereby adopts the aforesaid direct testimony as his own.

/s/ Stephen D. McGregor
Stephen D. McGregor

Subscribed and sworn to before me, a Notary Public in and for the State of Texas, this
26th day of September, 2006.

/s/ Ruthann Frausto
Notary Public

TRANSWESTERN PIPELINE COMPANY, LLC

Computation of Effective Income Tax Rate
Twelve Months Ended May 31, 2006, As Adjusted

Line No.	Taxable Owner	Type of Entity	Profit % Ownership (a)	Statutory Federal Rate (b)	Weighted Federal Rate Col (a) x Col (b) (c)	Federal Benefit on State Income Tax Col (b) x Col (g) (d)	Effective Federal Rate Col (c) - Col (d) (e)	State Rates 1/ (f)	Weighted State Rate Col (a) x Col (f) (g)
1	Southern Union Company	Corporation	50.0000%	35.00%	17.5000%	-1.0173%	16.4827%	5.8134%	2.9067%
2	General Electric Company	Corporation	30.0200%	35.00%	10.5070%	-0.6108%	9.8962%	5.8134%	1.7452%
3	CDPQ Investments (U.S.) Inc.	Corporation	9.4000%	35.00%	3.2900%	-0.1913%	3.0987%	5.8134%	0.5465%
4	Northwestern Mutual Life Insurance Co. (Lake Bluff Inc.)	Corporation	5.0800%	35.00%	1.7780%	-0.1034%	1.6746%	5.8134%	0.2953%
5	Merrill Lynch Ventures L.P. 2001 (GP 1%)	Corporation	0.0339%	35.00%	0.0118%	-0.0007%	0.0111%	5.8134%	0.0020%
6	Merrill Lynch Ventures L.P. 2001 (LP 99%)	Individual	3.3512%	28.00%	0.9383%	-0.0517%	0.8866%	5.5079%	0.1846%
7	Kings Road Holdings I LLC	Corporation	2.1150%	35.00%	0.7403%	-0.0431%	0.6973%	5.8134%	0.1230%
8	Total				34.7654%	-2.0182%	32.7472%		5.8033%
9	Overall Effective Income Tax Rate - Line 8, Columns (e) + (g)								38.5505%

1/ See page 2 of Schedule H-3(3), line 11, columns (u) and (x).

TRANSWESTERN PIPELINE COMPANY, LLC

Calculation of State Income Tax Rates
Twelve Months Ended May 31, 2006, As Adjusted

Line No.	State 1/	Sales (a)	Sales % (b)	Sales Weight (c)	Sales Factor (d)	Beginning 5/ Property (e)	Ending Property (f)	Rent Expense (g)	Average Property (h)	Property % (i)	Property Weight (j)	Property Factor (k)	Payroll (l)	Payroll % (m)	Payroll Weight (n)	Payroll Factor (o)
1	Arizona 4/	\$ 68,079,773	28.7850%	50.00%	14.3925%	\$ 367,639,033	\$ 367,639,033	\$ 9,320	\$ 367,648,353	33.9776%	25.00%	8.4944%	\$ 1,356,183	10.2700%	25.00%	2.5675%
2	AZ - Total	236,511,434				1,076,439,359	1,076,439,359	5,590,976	1,062,030,335				13,205,330			
3	Colorado 2/	1,842,214	0.7789%	33.33%	0.2596%	21,049,278	21,049,278	-	21,049,278	1.9454%	33.33%	0.6485%	183,378	1.3925%	33.33%	0.4642%
4	CO - Total	236,511,434				1,076,439,359	1,076,439,359	5,590,976	1,062,030,335				13,205,330			
5	New Mexico 2/	140,755,614	59.5132%	33.33%	19.8377%	551,692,129	551,692,129	1,582,768	553,274,897	51.1330%	33.33%	17.0443%	5,836,161	44.9528%	33.33%	14.9843%
6	NM - Total	236,511,434				1,076,439,359	1,076,439,359	5,590,976	1,062,030,335				13,205,330			
7	Oklahoma 3/	803,522	0.3397%	0.00%	0.0000%	12,541,814	12,541,814	-	12,541,814	1.1591%	33.33%	0.3864%	51,376	0.3891%	33.33%	0.1297%
8	OK - Total	236,511,434				1,076,439,359	1,076,439,359	5,590,976	1,062,030,335				13,205,330			
9	California 4/	-	0.0000%	50.00%	0.0000%	890,383	890,383	-	890,383	0.0823%	25.00%	0.0206%	-	0.0000%	25.00%	0.0000%
10	CA - Total	236,511,434				1,076,439,359	1,076,439,359	5,590,976	1,062,030,335				13,205,330			
11	Total															

		Traffic Units MMBTU Miles	Traffic % (p)	Traffic Weight (q)	Traffic Factor (r)	Corporate Rate			Individual Rate		
						Sum of Factors (s)	Marginal Tax Rate (t)	Effective Rate (u)	Sum of Factors (v)	Marginal Tax Rate (w)	Effective Rate (x)
1	Arizona 4/	80,578,127,006	36.2947%	0.00%	0.0000%	25.4544%	6.97%	1.7737%	25.4544%	4.54%	1.1556%
2	AZ - Total	222,010,972,111									
3	Colorado 2/	2,183,972,564	0.9837%	0.00%	0.0000%	1.3722%	4.63%	0.0635%	1.3722%	4.63%	0.0635%
4	CO - Total	222,010,972,111									
5	New Mexico 2/	116,018,290,883	52.2579%	0.00%	0.0000%	51.8663%	7.50%	3.9418%	51.8663%	8.20%	4.2530%
6	NM - Total	222,010,972,111									
7	Oklahoma 3/	176,640,643	0.0796%	33.33%	0.0265%	0.5426%	6.00%	0.0326%	0.5426%	6.25%	0.0339%
8	OK - Total	222,010,972,111									
9	California 4/	-	0.0000%	0.00%	0.0000%	0.0206%	8.84%	0.0018%	0.0206%	9.30%	0.0019%
10	CA - Total	222,010,972,111									
11	Total										5.8134%

1/ Beginning in 2008 the Texas franchise tax is being replaced with a gross margins tax. Initial estimates indicate tax will be less than \$10,000 and, therefore, immaterial.

2/ Colorado and New Mexico - Sales, Property & Payroll - 3 Factor

3/ Oklahoma - Property, Payroll & Traffic Units - 3 Factor

4/ Arizona and California - Property, Payroll & 2 x Sales Factor

5/ Due to the San Juan Expansion placed in service in 2005, the ending property balance was also used as the beginning property balance to more accurately estimate average property.