UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Enbridge Pipelines (KPC) Docket No. CP96-152-030

ORDER ON REMAND

(Issued October 8, 2004)

1. In an order issued on August 12, 2003,[1] the United States Court of Appeals for the District of Columbia Circuit vacated and remanded the initial rates approved by the Commission for Kansas Pipeline Company (Kansas Pipeline), now Enbridge Pipelines (KPC) (Enbridge KPC).[2] For the reasons discussed herein, the Commission finds that the proper initial rates are lower than the previously approved rates. The Commission further finds that Enbridge KPC's equitable arguments do not support waiving its refund obligation. Therefore, the Commission finds it is in the public interest to direct Enbridge KPC to file a refund plan calculating the refunds that would be due to its customers and including its proposal for how it will make any required refunds.

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[1] *Missouri Public Service Commission v. FERC*, 337 F.3d 1066 (D.C. Cir. 2003).

[2] In 1999, Midcoast Energy Resources, Inc. acquired Kansas Pipeline. Midcoast, in turn, was purchased by Enbridge Pipelines on May 11, 2001. *See Enbridge Pipelines*, 100 FERC ¶ 61,260 at 61,930 (2002).

I. **Background**

2. In an order issued on November 2, 1995,[3] the Commission found that three affiliated and interconnected natural gas pipelines – KansOk Partnership (KansOk), Kansas Pipeline Partnership (KPP), and Riverside Pipeline Company (Riverside) – were being operated as an integrated interstate pipeline system by a fourth affiliated company, Kansas Pipeline Operating Company. The system was used to transport gas produced in Oklahoma to markets in the Kansas City metropolitan area in Kansas and Missouri.[4] The Commission determined that the facilities and services were subject to its jurisdiction under the Natural Gas Act (NGA).[5] The Commission ordered the affiliates, collectively Kansas Pipeline, to file an application pursuant to section 7(c) of the NGA for the requisite certificate authority to operate the pipeline system and transport gas in interstate commerce.

3. On October 3, 1997, the Commission issued an order granting Kansas Pipeline a certificate to operate its interstate pipeline system.[6] However, the Commission found that

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[3] *KansOk Partnership, et al*., 73 FERC ¶ 61,160, *stayed*, 73 FERC ¶ 61,293 (1995).

[4] KansOk operated its facilities in Oklahoma as an intrastate pipeline but all but a de minimus amount of its throughput was transported to the Kansas border under section 311 of the Natural Gas Policy Act (NGPA) at rates approved by the Commission for KansOk's interstate services. *See KansOk Partnership,* 58 FERC ¶ 61,152 (1992). At the Kansas border, the gas entered 1-mile long facilities owned by Riverside, which operated as an interstate pipeline regulated by the Commission. *See Riverside Pipeline Company*, 48 FERC ¶ 61,309 (1989). Riverside delivered gas to KPP, which operated as a Hinshaw pipeline in Kansas, subject to regulation by the Kansas Corporation Commission (Kansas Commission). KPP also delivered gas into Riverside's two-mile long pipeline segment which crossed the Kansas border into Missouri. KPP made its deliveries to Riverside under a limited jurisdiction NGA certificate issued by the Commission pursuant to section 284.224 of the regulations. For services under the limited jurisdiction certificate, the Commission authorized KPP to charge rates approved by the Kansas Commission. *See Kansas Pipeline Company, L.P.*, 49 FERC ¶ 61,235 (1989).

[5] *KansOk Partnership, et al.*, 73 FERC ¶ 61,160 at 61,480-81.

[6] *Kansas Pipeline Company, et al*., 81 FERC ¶ 61,005 (1997).

Kansas Pipeline had failed to justify a number of cost components used to calculate its proposed rates. Consequently, the October 1997 Order approved initial rates substantially lower than Kansas Pipeline's proposed rates. Whereas Kansas Pipeline’s proposed maximum reservation charge for service traversing all three of its service zones was $26.3721/Dth, the Commission approved a maximum 3-zone reservation charge of $15.8619/Dth.

4. Kansas Pipeline asserted that the approved initial rates were too low to recover its operating expenses and make the required payments on its outstanding loans, including a $91 million primary loan borrowed by an affiliate, Syenergy Pipeline Company (Syenergy), which owned 99.9 percent of the partnership interests in KPP, KansOk, and Riverside. Kansas Pipeline maintained that the approved initial rates would prevent it from complying with the debt coverage condition in the loan instrument, potentially resulting in default and bankruptcy.

5. Based on Kansas Pipeline’s allegations, the Commission stayed its October 1997 order pending rehearing.[7] During the stay period, KansOk, KPP, and Riverside continued to provide service at their currently effective filed rates. Their cumulative reservation charges totaled $19.9907/Dth,[8] which was higher than the 3-zone reservation charge approved by the Commission ($15.86/Dth) but lower than Kansas Pipeline’s proposed 3-zone reservation charge ($26.37/Dth).[9]

6. While rehearing of the October 1997 Order was pending, Kansas Pipeline filed a motion stating it would dismiss its judicial appeal of the Commission’s jurisdictional determination if it was permitted to charge initial section 7 rates which, in effect, grandfathered the rates being charged by KansOk, Riverside and KPP (motion rates). Kansas Pipeline emphasized that the existing rates had been negotiated by the three pipeline affiliates with their shippers, including the two largest shippers, Missouri Gas Energy (Missouri Gas), which provides local distribution service in the portion of the

[7] *Kansas Pipeline Company, et al*., 81 FERC ¶ 61,250 (1997).

[8] KansOk’s reservation charge was $4.1179/Dth and included the cost of upstream capacity leased from Transok. KPP’s reservation charge for service traversing its two service zones in Kansas was $15.2864/Dth. Riverside’s reservation charge was $0.5864/Dth.

[9] *Kansas Pipeline Company, et al*., 82 FERC ¶ 61,094 (1998).

Kansas City metropolitan area in Missouri, and Kansas Gas Service Company, which provides local distribution service in the portion of the Kansas City metropolitan area in Kansas.

7. On April 30, 1998, the Commission issued an order granting Kansas Pipeline authority to charge its motion rates as initial section 7 rates, effective May 11, 1998.[10] The Commission stated that, but for the filing of Kansas Pipeline's motion rates, the Commission would have adjusted Kansas Pipeline's initial rates on rehearing based on convincing arguments in its rehearing request. The Commission explained that such adjustments would have resulted in its approving a 3-zone reservation charge of $20.7117 per Dth for Kansas Pipeline, which was higher than the motion rates' cumulative reservation charge of $19.9907 which included the rates being charged by KansOk, Riverside and KPP.

8. The Missouri Public Service Commission (Missouri PSC) and Williams Natural Gas Company (Williams) sought rehearing. In response to the Commission's description of the rate adjustments it would have made on rehearing, but for Kansas Pipeline's filing its motion rates, the Missouri PSC and Williams argued that such adjustments would make unjustified departures from the Commission's established ratemaking policies. Therefore, they disagreed with the Commission's conclusion that approval of Kansas Pipeline's motion rates was appropriate because they were lower than the rates the Commission would have approved on rehearing. On April 2, 1999, the Commission issued an order denying the requests for rehearing.[11] The Missouri PSC sought judicial review.

9. On December 15, 2000, the court issued its first order remanding Kansas Pipeline's initial section 7 rates to the Commission.[12] The court held that the Commission had failed to adequately explain the rationale for its approval of Kansas Pipeline's motion rates and demonstrate that such action was in the public interest.

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[10] *Kansas Pipeline Company, et al*., 83 FERC ¶ 61,107 (1998). The April 30, 1998 order lifted the stay of the October 3, 1997 Order, effective May 11,1998.

[11] *Kansas Pipeline Company, et al*., 87 FERC ¶ 61,020 (1999).

[12] *Missouri Public Service Commission v. FERC*, 234 F.3d 36 (2000) (*Missouri I*).

10. On November 9, 2001, the Commission issued its order on remand setting forth its reasons, discussed below, for affirming its approval of Kansas Pipeline's motion rates as its initial rates.[13] The Missouri PSC filed jointly with the Kansas Commission for rehearing. Kansas Gas also sought rehearing. On March 28, 2002, the Commission issued an order denying rehearing of its order on remand.[14]

11. The pipeline continued to collect its motion rates as its initial section 7 rates until November 9, 2002, the effective date of the rates approved in Enbridge KPC's section 4 rate case in Docket No. RP99-485-000.[15]

II. The Court's *Missouri II* Decision

12. On August 12, 2003, the court issued its order vacating and remanding the Commission's orders in response to *Missouri I*.[16] The court gave several reasons for rejecting the Commission's primary rationale that approval of Kansas Pipeline's motion rates was in the public interest because Kansas Pipeline's financial integrity would be jeopardized if its initial rates were too low to meet the debt coverage condition of the $91 million loan secured by its facilities.

13. First, the court found that the Commission's action failed to give appropriate weight to record evidence that the loan was the not the result of an arms'-length transaction[17] and that the proceeds of the loan did not bear a reasonable nexus to the value of the facilities used to provide service to ratepayers.[18] The court also found that,

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[13] *Kansas Pipeline Company*, 97 FERC ¶ 61,168 (2001).

[14] *Kansas Pipeline Company*, 98 FERC ¶ 61,343 (2002).

[15] *Enbridge Pipelines*, 102 FERC ¶ 61,304 (2003).

[16] *Missouri Public Service Commission v. FERC*, 337 F.3d 1066 (D.C. Cir. 2003) (*Missouri II*).

[17] *Id*. at 1072-73, *citing* 83 FERC ¶ 61,107 at 61,507 (1998) (Commission's finding that Syenergy secured the $91 million loan in order to purchase its 99.9 percent interests in its affiliates, KansOk, Riverside, and KPP).

[18] *Id*., *citing* record evidence that more than $7 million of the loan proceeds was used to pay stockholder and partnership distributions and that over $3 million of the proceeds was unaccounted for.

even assuming the loan agreement had been entered into at arms' length and was otherwise reasonable, the Commission's heavy reliance on the loan instrument's debt coverage condition was not justified. The court reached this conclusion because the Commission had not addressed the likelihood that default on the loan condition would actually lead to foreclosure, bankruptcy, or Kansas Pipeline's being forced out of business.[19] Further, the court found that the Commission should have given more consideration how, rather than merely acknowledge the possibility that, a reorganization in bankruptcy might have been beneficial to the pipeline and its customers.[20]

14. Under the circumstances, the court found that, regardless whether the loan was legally binding, it was not reasonable to permit Kansas Pipeline's recovery of debt service on the loan pending further consideration in its upcoming section 4 rate case. Further, because the Commission had not relied on the debt coverage condition at the time it approved Kansas Pipeline's motion rates, the court found that the Commission had erred on remand by not taking into account the fact that the loan had been paid off.

15. The court also held the Commission's responsibility could not be satisfied by relying on a prior regulator's approval of rates without knowing and considering that regulator's rationale.[21] In addition, the court concluded that it was not reasonable to assume that Kansas Pipeline's motion rates would not be exploitative of Kansas Pipeline's shippers because they were the same rates negotiated by the shippers with KansOk, Riverside, and KPP.

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[19] *Id*.

[20] *Id*.

[21] As discussed above, *supra* n. 4, the Commission had approved Riverside's rates for service using its state border-crossing facilities. KansOk's rate for NGPA section 311 service in Oklahoma had been approved by the Commission based on its cost-of-service ratemaking principles. However, for KPP's service under its limited-jurisdiction certificate issued pursuant to section 284.224 of the regulations, the Commission authorized KPP to charge its rates approved by the Kansas Commission. *See* 49 FERC ¶ 62,235 (1989). As discussed above, KPP's reservation charge for service traversing both of its zones in Kansas was $15.2864/Dth. Thus, KPP's rates approved by the Kansas Commission accounted for approximately 75 percent of the 3-zone reservation charge ($19.9907/Dth) included in Kansas Pipeline's motion rates approved by this Commission.

16. The court cited the Commission's responsibility to make an independent judgment of the reasonableness of proposed rates, taking into account such factors as whether the pipeline lacks market power and whether the interests of its shippers are likely to be aligned with ultimate consumers' interests. The court concluded that the Commission's failure to do its own cost-based rate analysis had negated the intended purpose of the contingency provision in Missouri Gas Energy's contract requiring that its rates be adjusted to reflect the rates ultimately approved by the Commission. Therefore, the court found that this consequence was at odds with the Commission's conclusion that approving Kansas Pipeline's motion rates would allow shippers to realize the benefits of their bargains with Kansas Pipeline's predecessors.[22]

17. Holding that the Commission's orders in response to *Missouri I* had not justified Kansas Pipeline's initial section 7 rates, in *Missouri II* the court again remanded with the direction that the Commission address the question of an appropriate refund.[23]

III. Additional Pleadings In Response To *Missouri II*

18. On October 3, 2003, Enbridge KPC filed a motion seeking the Commission's issuance of an order finding that Enbridge KPC has no refund obligation relating to the initial section 7 rates approved for in this proceeding. Enbridge KPC's pleading sets forth its legal and equitable arguments, as discussed below, in support of its position.

19. On October 20, 2003, the Missouri PSC filed an answer in opposition to Enbridge KPC's motion. As discussed below, the Missouri PSC seeks issuance of an order directing Enbridge KPC to make refunds.

20. On March 24, 2004, Enbridge KPC filed a motion seeking expedited issuance of a Commission order finding that Enbridge KPC has no refund obligations. Enbridge KPC's March 24 pleading also responds to the Missouri PSC's arguments in its October 20, 2003 pleading.

21. On April 8, 2004, the Missouri PSC filed an answer to Enbridge KPC's pleading filed on March 24, 2004.

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[22] *Missouri II* at 1076.

[23] *Id*. at 1077-78.

22. Procedural Rule 385.213(a)(2) of the Commission's regulations provides that answers may not be made to answers unless otherwise ordered by the decisional authority. In this instance, the Commission finds good cause to admit the parties' above-referenced answers because they provide information which has aided the Commission's decisionmaking process.

IV. Review Of Initial Section 7 Rates

23. In the October 3, 1997 Order approving initial rates for Kansas Pipeline in this proceeding, the Commission did not depart from its customary ratemaking practices as it did in subsequent orders. Therefore, the Commission believes the October 1997 Order provides an appropriate starting point for properly calculating initial rates in a manner consistent with the court's findings in *Missouri II*. Further, while the Missouri PSC and Enbridge KPC argue for different adjustments to the October 1997 Order's approved rate base and cost-of-service, both parties indicate agreement that it is appropriate that the Commission's review begin with that order's findings.[24]

24. Approval of Kansas Pipeline's motion rates resulted in the Commission's not fully addressing all of the arguments raised on rehearing of the October 1997 Order. In this order, the Commission is addressing those arguments, as well as additional issues raised in the pleadings filed by Enbridge KPC and the Missouri PSC subsequent to the court's issuance of its *Missouri II* decision. Based on the Commission's review of these issues in light of the court's findings, the Commission is making adjustments to the October 1997 Order's approved cost of service and rates, as discussed below.

[24] *See* Enbridge KPC's October 3, 2003 motion at 15 ("The starting point for deriving NGA section 7 initial rates in this proceeding is the $21,817,483 cost of service determined in the Commission's October 3, 1997 Order."). *See, also,* the Missouri PSC's October 20, 2003 answer at 13 ("This process does not require full-blown rate proceedings. ... [T]he obvious starting point for such an analysis is the findings that the Commission has already made on the basis of the record in its October 3, 1997 Order in this case.").

A. Rate Base and Cost-of-Service Adjustments

1. Acquisition Premium

25. In Kansas Pipeline's certificate application, it proposed to include in its rate base acquisition premiums totaling $13,347,716 and associated depreciation expense of $323,264 in cost of service. The acquisition premiums represented amounts paid in excess of book value for various assets acquired by Kansas Pipeline's predecessors during the period October 1989 to October 1991.

26. The Commission's October 3, 1997 Order rejected Kansas Pipeline's proposed inclusion of the acquisition premiums in rate base and associated depreciation expense in cost of service. The Commission cited its general policy of using the original cost concept. This policy limits a pipeline to including no more than facilities' depreciated original cost in rate base.[25] The Commission requires any amount in excess of facilities' depreciated original cost to be recorded in Account No. 114, Gas Plant Acquisition Adjustments. Generally, amounts recorded in Account No. 114 and related amortization are excluded from rates.

27. The Commission makes exceptions only when a pipeline can show that its acquisition of existing facilities at more than their net book value will result in substantial benefits to ratepayers.[26] As set out in *Longhorn Partners Pipeline*,[27] this "substantial benefits" test requires a pipeline seeking rate base treatment for an acquisition premium to meet a two-prong test. First, the pipeline must show that the facilities will be converted from one public use (*e.g.*, transporting crude oil) to a different public use (*e.g.*, transporting natural gas) or that the assets will be placed in FERC-jurisdictional service for the first time.[28] Second, the pipeline must also show clear and convincing evidence

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[25] *See United Gas Pipe Line Company*, 25 FPC 26 at 30 (1961).

[26] *See*, *e.g.*, *Cities Service Gas Company*, 4 FERC ¶ 61,268 at 61,596 (1978) (Commission approved inclusion of full purchase price in rate base because gas consumers would be benefited by Cities Services' converting 473-mile crude oil pipeline purchased at more than net book value, rather than constructing new gas pipeline at significantly greater cost.).

[27] 73 FERC ¶ 61,355 (1995) (*Longhorn*).

[28] *Id*. at 61,112.

that its acquisition of the facilities will still provide substantial, quantifiable benefits to ratepayers even if the full purchase price, including the portion above depreciated original cost, is included in rate base.[29]

28. As explained by the Commission in Enbridge KPC's section 4 rate proceeding, when the acquisition premiums at issue here were paid, the facilities were already being used to provide gas service.[30] Thus, the acquisitions did not result in the facilities being used to provide a different kind of public service. Further, there is insufficient record evidence to determine that the acquisitions resulted in any of the facilities being used for FERC-jurisdictional gas service for the first time. As discussed above, prior to the Commission's assertion of full jurisdiction on November 2, 1995, portions of what became the Kansas Pipeline system were being used by KPP to provide service under a limited-jurisdiction NGA certificate and by KansOk to provide jurisdictional service under section 311 of the NGPA. Moreover, the Commission's assertion of full jurisdiction over KPP's and KansOk's facilities was based on a determination that they were being operated on an integrated basis with Riverside's interstate facilities as a single interstate system.[31]

29. In view of the above considerations, the Commission finds that Enbridge KPC cannot meet its first hurdle, which is to demonstrate that the acquisition premiums in question resulted in facilities being converted to a new use or to FERC-jurisdictional gas service for the first time. That being the case, when the acquisition premiums were paid, the sellers of the facilities may already have recovered significant portions of their acquisition costs through charges for services that were FERC-jurisdictional services, notwithstanding that the Commission had not yet asserted full jurisdiction. Consequently, inclusion of the premiums in the rate base used to calculate Kansas Pipeline's initial section 7 rates could result in gas customers' ultimately paying more than the acquisition or construction costs of the companies that first used the facilities for jurisdictional interstate services.

30. Even if the record demonstrated that the acquisitions at issue resulted in the facilities being converted to natural gas service or to FERC-jurisdictional service for the first time, the second prong of the *Longhorn* test requires that a pipeline also establish

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[29] *Id*.

[30] *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P55 (2002).

[31] *KansOk Partnership*, *et al.*, 73 FERC ¶61,160 at 61,486 (1995).

what benefits consumers will realize from the acquisition.[32] To meet this test, the pipeline must present evidence by which the alleged benefits can be measured in dollar terms.[33] The pipeline also must show that the benefits are commensurate with the amount of the acquisition premium and that those benefits are the result of the pipeline's decision to pay more than the facilities' depreciated original cost.[34] The Commission has stated this burden may be practically "impossible" to meet.[35]

31. In its November 3, 1997 request for rehearing of the Commission's October 3, 1997 Order in this proceeding, Kansas Pipeline asserted that it had presented evidence that the acquisitions at issue had resulted in a yearly cost savings of $4.5 million in operating and maintenance expenses, demonstrating a measurable benefit over time when compared to the acquisition premiums totaling $13,347,716. As explained by the Commission in Enbridge KPC's section 4 rate proceeding, the benefit of alleged savings must be compared to the total acquisition costs (at least $34.9 million), not just the acquisition premiums. In this case, the alleged annual savings are less than thirteen percent of the total costs of the facilities for which acquisition premiums were paid. Further, the record contains no evidence that the alleged savings were passed on to ratepayers.[36]

32. Kansas Pipeline also asserted in its November 3, 1997 rehearing request that, notwithstanding the acquisition premiums, the assets in question nevertheless were acquired for less than it would have cost to reproduce the facilities. Specifically, Kansas Pipeline argued that it had shown that acquiring the facilities was $114.3 million cheaper than constructing identical pipeline facilities.[37] As explained by the Commission in

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[32] *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 52.

[33] *Id*. at P 49.

[34] *Id*. at P 50-50, *citing Chevron U.S.A. Inc.*, 81 FERC ¶ 61,183 at 61,901-902 and 61,906 (1997); *Crossroads Pipeline Co.*, 71 FERC ¶ 61,076 (1995); and Northern Natural Gas Co., 33 FERC ¶ 61,030 (1985), *order on reh'g*, 35 FERC ¶ 61,114 (1986). *See also Arkla Energy Resources*, 61 FERC ¶ 61,004 at 61,037-39 (1992), *reh'g denied*, 68 FERC ¶ 61,331 (1994).

[35] *Id*. at P 53, *quoting United Gas Pipe Line Company*, 25 FPC 26, 51. (1961).

[36] *Id*. at P 56.

[37] *Id*. at P 55.

Enbridge KPC's section 4 rate proceeding, this is an inapposite comparison for measuring consumer benefit where, as here, facilities were already being used to provide natural gas services prior to the acquisitions in question and continued to provide the same services.[38]

33. Kansas Pipeline also asserted that its predecessors' acquisitions of facilities to serve the Kansas City metropolitan gas market had created competition resulting in specific, tangible and measurable benefits to ratepayers, since that market was formerly dominated by Williams Natural Gas Company. Kansas Pipeline argued that it had provided evidence showing that the new competition had resulted in lower-priced gas service with an aggregate economic impact ranging between $125 million to $350 million.[39] The Commission rejected this argument in Enbridge KPC's section 4 rate proceeding because the alleged benefits were not specific, measurable and tangible.[40]

34. That conclusion is not changed by the evidence referenced by Kansas Pipeline in its November 3, 1997 rehearing request in this proceeding. That evidence was a report prepared by an independent consultant retained by Kansas Pipeline. The report included a table indicating that the introduction of market competition by Kansas Pipeline's predecessors had resulted in consumers' realizing cumulative savings of $127 million during the period 1986 through 1991. Most of the claimed monetary benefits were attributable to years prior to 1990. However, the largest portion of the total acquisition premiums at issue was attributable to the premium paid for the majority interest in Kansas Pipeline's predecessor KPP, when its assets were purchased in June of 1990. Thus, the bulk of the claimed benefits had already occurred before the payment of that acquisition premium.

35. In view of the above considerations, the Commission will not approve rate base treatment for the acquisition premiums that Kansas Pipeline sought to include in rate base for purposes of its initial section 7 rates. For the same reasons, the Commission will not approve the inclusion of associated depreciation expense in cost of service.

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[38] *Id*. The Commission noted that the record included evidence that Enbridge KPC's estimate of $114 million significantly inflated the cost of constructing new facilities. *Id*. at n. 83.

[39] Kansas Pipeline's November 3, 1997 Request for Rehearing at 39.

[40] *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 13-21.

2. Past Regulatory Expenses

36. Kansas Pipeline originally proposed to amortize $6,670,134 of past period regulatory and litigation expenses over a three-year period by including $2,223,337 in its rates each year. These expenses include two different groups of costs: (1) regulatory expenses incurred in proceedings before the Kansas Commission and the Missouri PSC,[41] and in connection with related state court appeals and remand actions (the state costs); and (2) regulatory expenses incurred before this Commission in connection with the show cause proceeding addressing the Commission's jurisdiction and the instant section 7 certification proceeding (the section 7 costs). The state costs represent over sixty percent of the total past period regulatory expenses, while the section 7 costs represent almost forty percent.

37. In its October 3, 1997 Order, the Commission rejected the $2,223,337 in past legal costs, but approved Kansas Pipeline's uncontested proposal to include $474,478 in normal Account No. 928 regulatory expenses. The Commission stated that the prior period costs are not includable in current rates without prior approval by the Commission to allow special deferred treatment of past period costs, and that neither it nor the Kansas Commission had provided such prior approval for their recovery. However, in the April 30, 1998 order in this proceeding, the Commission stated that, were it not approving the motion rates, it would have granted the pipeline's rehearing request to permit its recovery of the past period regulatory costs because Kansas Pipeline was changing its regulatory authority.[42]

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[41] The state commission expenses include costs incurred to participate in state rate proceedings and costs incurred to obtain the Kansas Commission's approval for certain new contracts.

[42] The April 30, 1998 Order in this proceeding cited *Texas Eastern Transmission Corporation* (*Texas Eastern*), 58 FERC ¶ 61,295 (1992), as precedent for permitting a pipeline to recover past period regulatory costs. That case involved polychlorinated biphenyl (PCB) contamination in the pipeline's system. The contamination resulted in substantial environmental assessments and remediation costs and the potential for an extraordinary level of liability. Texas Eastern and its customers reached a settlement that provided for the pipeline's recovery of regulatory costs that it incurred. Since the Commission approved a settlement in the Texas Eastern proceeding, it is not precedent for approval of the past regulatory costs as issue in this case.

38. In its most recent pleadings, Enbridge KPC continues to argue that its initial section 7 rates should reflect the annual amortization of the $2,223,337 in past regulatory expenses. It asserts that the costs at issue involve normal, routine expenses principally incurred before the Kansas Commission and in the Docket No. CP96-152-000 show cause/certificate proceeding. With respect to the state regulatory costs, Enbridge KPC maintains that they are the remaining costs that were being amortized as routine regulatory costs in the rates approved by the Kansas Commission for Kansas Pipeline's predecessor, KPP. It states that if the costs are not recovered in Kansas Pipeline's initial section 7 rates, they will never be recovered. Enbridge KPC argues that its predecessors' transition to Commission jurisdiction should not prevent recovery of these costs.

39. The Missouri PSC's position on this issue is that these legal bills and other regulatory expenses are not properly includable in Kansas Pipeline's rates because they relate to a past period. The Missouri PSC further argues that the pipeline should not be permitted to recover the past period regulatory expenses because they were incurred in an effort to avoid the Commission's jurisdiction.

40. The Commission permits pipelines to include in their cost-of-service an amount to recover regulatory costs projected to be incurred during the period that the rates will be in effect. Thus, the regulatory cost component of a pipeline's operating and maintenance expense normally does not include any amortization of regulatory costs incurred in the past. Further, while the Commission allows a pipeline to include in its proposed cost of service an amount to recover projected regulatory expenses, the Commission's general policy and regulations require that pipelines' projections are representative of their ordinary and recurring regulatory expenses. Thus, in projecting future regulatory expenses, a pipeline is required to exclude not only past regulatory expenses, but also any non-recurring expenses that it may have incurred during the relevant test period, thereby including only the ordinary and recurring expenses that it incurred during the test period.[43]

[43] *Boston Edison Company*, 8 FERC ¶ 61,077, 61,281 (1979). More specifically, the Commission requires a pipeline's projection of future regulatory expenses to be based on a three-year average of its actual, representative costs incurred in the test year (the most recent twelve-month period for which data is available) and the preceding two twelve-month periods. 18 C.F.R. § 154.303(a) (4) (2004). The resulting projection is included in the pipeline's proposed cost of service and reflected in Account No. 928, Regulatory Commission Expense.

41. In *Tarpon Transmission Company*, the Commission made an exception to its general policy to permit Tarpon to amortize non-recurring, extraordinary expenses it had incurred in litigating the proper interpretation of a rate adjustment provision in its tariff.[44] The Commission found that the expenses were non-recurring regulatory expenses in that they were caused by "the unusual litigation occasioned by the Court's remand of the Commission's original interpretation of section 10.5 of Tarpon's tariff."[45] The Commission further found that the expenses were extraordinary in that they nearly equaled Tarpon's overall annual cost of service. In addition, the Commission emphasized that it was permitting the past regulatory costs to be amortized in future rates "only because they are costs incurred in litigating what those future rates should be and thus related to future rates and services."[46] Since *Tarpon*, the Commission has continued to hold that pipelines will be permitted to amortize regulatory expenses from earlier periods in current rates only if extraordinary circumstances demonstrate that such treatment is justified.[47]

42. The approximately $6.6 million in regulatory expenses at issue here were incurred prior to the effective date of Kansas Pipeline's initial rates.[48] Therefore, because they are past costs and not a projection of future regulatory costs, the regulatory costs may not be included in Kansas Pipeline's cost-of-service unless they fall within the *Tarpon* exception to the Commission's ordinary policy against amortization of past regulatory costs in current rates.

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[44] *Tarpon Transmission Company*, 57 FERC ¶ 61,371 (1991), *order on reh'g*, 58 FERC ¶61,354, 62,181-184 (1992), *order on reh'g*, 59 FERC ¶ 61,241 (1992) (*Tarpon*).

[45] *Tarpon*, 59 FERC at 61,820.

[46] 58 FERC ¶61,354 at p. 62,184 (1992).

[47] *Williston Basin Interstate Pipeline*, 67 FERC ¶ 61,137 at 61, 364 (1994), *reh'g denied*, 71 FERC ¶ 61,019 at 61,077 (1995); and *Williams Natural Gas Company*, 77 FERC ¶ 61,277 at 62,180 (1996).

[48] As reflected in Appendix 19 to Kansas Pipeline's November 3, 1997 Request for Rehearing of the Commission's October 3, 1997 order, $6,678,305 was the total actual regulatory costs incurred by the pipeline and its predecessors as of September 30, 1997.

43. The Commission denies Enbridge KPC's request to include the $6.6 million of regulatory expenses in Kansas Pipeline's cost-of-service. As a threshold matter, neither Kansas Pipeline nor Enbridge KPC has adequately supported the claimed past regulatory expenses. First, Kansas Pipeline's initial filing, subsequent data responses, and its November 3, 1997 request for rehearing, as well as Enbridge KPC's more recent pleadings in this case, fail to provide support for the assertion that the Kansas Commission authorized the amortization of the claimed state regulatory costs in the rates approved for Kansas Pipeline's predecessor, KPP. Kansas Pipeline maintained that Mr. Howard Lubow's affidavit attached to Kansas Pipeline's November 3, 1997 request for rehearing provided the support that such amortization had been approved. However, as the Missouri PSC points out, it does not provide such support.

44. Second, even if it was clear that the Kansas Commission had approved the regulatory costs for recovery in KPP's rates, the *Missouri II* court has held that the Commission may not simply rely on a prior regulator's decisions to approve rates or the costs underlying those rates without making an independent assessment or at least knowing and discussing the state's rationale for approval.[49] The record in this proceeding includes only a summary amortization schedule filed by Kansas Pipeline for all of its claimed regulatory and litigation costs, listing the amounts and identifying the proceedings in which they were incurred.[50] The schedule includes no supporting detail as to the nature of the expenses or other evidence that they were reasonable. While Kansas Pipeline claims that the claimed state regulatory expenses were prudently incurred in the course of providing utility service, the pipeline has not provided enough information for the Commission to make its own determinations regarding the claimed state regulatory expenses.

45. Similarly, there is not enough information in the record to allow recovery of the section 7 regulatory expenses. As stated above, Appendix 19 of Kansas Pipeline's November 3, 1997 request for rehearing quantifies the costs related to each proceeding, but with no supporting documentation that would permit the Commission to find the costs and their recovery reasonable.

46. However, even if the past regulatory expenses were adequately supported, the Commission finds that they would not qualify for recovery under the *Tarpon* exception.

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[49] *Missouri II*, 337 F.3d at 1077.

[50] Appendix 19 of Kansas Pipeline's November 3, 1997 Request for Rehearing.

Under *Tarpon*, to qualify for amortization in Kansas Pipeline's cost-of-service, the past regulatory expenses would have to be both non-recurring and extraordinary.

47. The bulk of the regulatory expenses at issue here are not unusual, non-recurring costs. As discussed above, Enbridge KPC states that both the state costs and section 7 costs were "routine and normal" regulatory expenses.[51] While the section 7 costs arguably could be deemed non-recurring as they resulted from the show cause and section 7 certificate proceeding, the state costs are non-recurring regulatory expenses only in the sense that they were incurred before the Kansas Commission prior to this Commission's assertion of jurisdiction.

48. However, even if we were to find that both the section 7 costs and the state costs were unique, non-recurring expenses, it is not clear that such costs would justify a departure from the Commission's usual ratemaking policy. The total past regulatory costs at issue here would increase the October 1997 order's approved annual cost-of-service by approximately twenty-five percent, whereas the past regulatory expenses at issue in *Tarpon* nearly equaled the pipeline's total annual cost-of-service.

49. Moreover, other extraordinary factors in *Tarpon*, that are not present here, mitigated in favor of the pipeline's being allowed to recover its legal costs in that case. First, as indicated, *supra*, the Commission determined that Tarpon's past regulatory costs were directly related to future service, since they were incurred in litigating the extent to which the subject tariff provision should govern Tarpon's future rates. The state costs incurred by Kansas Pipeline's predecessors were unrelated to Kansas Pipeline's future section 7 rates or service under Commission jurisdiction. Similarly, the costs incurred in litigating the show cause proceeding were unrelated to Kansas Pipeline's future service. Finally, while the regulatory expenses incurred in this section 7 proceeding were related, in part, to Kansas Pipeline's future rates, the section 7 expenses were not incurred as the result of a legal error on the Commission's part, as in *Tarpon*. Rather, the section 7 regulatory expenses resulted from the pipeline's opposition to Commission jurisdiction and delay in acceding to such jurisdiction.

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[51] March 24, 2004 Motion for Summary Disposition and Request for Expedited Action of Enbridge KPC at 20.

50. In *Tennessee Gas Pipeline Company*,[52] the Commission emphasized that *Tarpon* was "a unique case that justified the special treatment granted" and found that "the truly exceptional circumstances involved in *Tarpon* that justified the allowance of the regulatory asset treatment of Tarpon's inordinate legal costs" did not exist in Tennessee's case.[53] For the same reasons, as explained above, the Commission rejects Enbridge KPC's request to include $2.2 million per year in its initial rates' cost of service as amortization of past period regulatory expenses.

3. <u>Accumulated Deferred Income Tax</u>

51. The October 3, 1997 Order approved a rate base that was reduced by $9,215,025 to reflect Accumulated Deferred Income Tax (ADIT). This amount represented Kansas Pipeline's book deferred income tax balance. In its rehearing request, the pipeline argued that the Commission should remove from the ADIT balance amounts relating to those items the October 3, 1997 Order had already removed from rate base. These amounts included deferred taxes relating to market entry costs, acquisition premiums, and project development costs.

52. In its April 30, 1998 Order, the Commission agreed with Kansas Pipeline that for amounts disallowed from rate base "the applicant does not bear the responsibility for the corresponding rate base offset included in the ADIT."[54] The Commission found that, were it not approving the motion rates, the pipeline's ADIT balance should be reduced by $8,777,814, so that the rate base deduction for ADIT would be only $437,211, not $9,215,025.

53. The Missouri PSC acknowledges that revisions to the rate base reduction for ADIT may be appropriate. However, the Missouri PSC requests that the pipeline be required to make a compliance filing to verify its proposed ADIT amount. In its March 24, 2004 motion, Enbridge KPC asserts that its Appendix C to that motion includes sufficient information relating to ADIT.[55]

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[52] 73 FERC ¶ 61,083 (1995).

[53] *Id*. at 61,209.

[54] 83 FERC ¶ 61,107 at 61,508 (1998).

[55] Appendix C of Enbridge KPC's March 24, 2004 motion was previously included by Kansas Pipeline as Appendix 30 to its November 3, 1997 request for rehearing of the October 3, 1997 Order. Both contain references to information Kansas

(continued…)

54. The Commission will grant conditional approval for the pipeline to remove amounts from the ADIT balance consistent with the Commission's discussion in the October 1997 Order. However, Appendix C of Enbridge KPC's March 24, 2004 filing does not provide adequate information to support the ADIT amounts claimed by the pipeline. Therefore, approval for the revisions to the rate base deduction for ADIT will be subject to the pipeline's making a compliance filing to verify the basis for its ADIT balances for: (1) project development costs; (2) net debt expenses, (3) market entry costs; and (4) acquisition premiums. In its compliance filing, the pipeline must file its general ledger entries which comprise these amounts, along with its journal voucher entries, used to develop the general ledger entries.

4. Debt Expenses

55. In the October 3, 1997 Order, the Commission rejected Kansas Pipeline's proposal to include in its rate base $7,084,806 for debt expense and $508,586 for depreciation and amortization expense related to the debt expense.[56] These debt expenses reflect transaction costs (such as prepaid interest and settlement expenses) incurred in consolidating and refinancing the preexisting debts of Kansas Pipeline's predecessors into a single, $91 million loan. As discussed above, the $91 million loan was borrowed by an affiliate, Syenergy, which owned 99.9 percent of the partnership interests in Kansas Pipeline's predecessors: KPP, KansOk, and Riverside. The loan was secured by those companies' facilities, which became the Kansas Pipeline system.

56. In the October 3, 1997 Order in this proceeding, the Commission held that, pursuant to section 154.312(f) of its regulations,[57] Kansas Pipeline's claimed debt expenses should be recovered through the interest rate on debt component of Kansas Pipeline's capitalization, not by including the costs in its rate base. The Commission cited section 154.312(f) of its regulations,[58] *Statement F-1. Rate of Return Claimed*, which relates to the information that must be filed by a pipeline with tariff filings to support its claimed rates of return. The October 3, 1997 Order stated that Kansas

Pipeline filed on February 18, 1997 in response to staff requests for information made during the February 6 and 7, 1997 technical conference.

[56] 81 FERC ¶ 61,005 at 61,020.

[57] 18 C.F.R. § 154.312(f) (2004).

[58] 18 C.F.R. § 154.312(f) (2004).

Pipeline would be allowed to revise the interest component of its capitalization to include an apportioned amount of the claimed debt expenses associated with the amount of debt provided for in rate base, which the Commission determined to be 21.5 percent. The Commission then recalculated the interest rate on debt to include these expenses, increasing it to 9.97 percent from the 9.64 percent rate reflected in Kansas Pipeline's certificate application.

57. In the April 30, 1998 Order, the Commission suggested that, but for Kansas Pipeline's filing its motion rates, the Commission would have granted rehearing to allow Kansas Pipeline to include the claimed prepaid debt expenses in rate base.[59] The Commission noted that section 154.312(e) of the regulations, *Statement E. Working Capital*, permits pipelines to include certain working capital prepaid expenses in rate base.[60] The Commission further noted that inclusion of the debt expenses in rate base would increase Kansas Pipeline's approved overall cost-of-service by $1.1 million.

58. In its latest pleadings, Enbridge KPC continues to seek rate base treatment for prepayment expenses associated with debt expenses. Enbridge KPC acknowledges that such treatment would be a departure from the Commission's customary practice in section 4 rate proceedings. However, Enbridge KPC argues that equitable considerations justify this departure.

59. The Missouri PSC continues to maintain its position that the proper treatment of prepaid debt costs is as a cost of capital, which may be considered in determining Kansas Pipeline's approved rate of return, but exclude such expenses from rate base as they were by the October 3, 1997 Order. In support of its position, the Missouri PSC argues that the prepaid interest expenses claimed by the pipeline are more closely aligned with cost of capital than with working capital. The Missouri PSC reached this conclusion by reasoning that the prepayments of interest were akin to the payment of points to refinance an existing loan, which increases the interest expense associated with the debt.

60. Since the costs at issue were incurred to consolidate and refinance the preexisting debts into the Syenergy loan, the Commission agrees with the Missouri PSC that those costs are appropriately treated as costs of debt capital, properly reflected through rate of return, and not through rate base as working capital costs. Working capital consists of

[59] 83 FERC ¶ 61,107 at 61,508.

[60] 18 C.F.R. § 154.312(e) (2004).

cash and other liquid assets, such as materials and supplies, which a company must have on hand to meet the current costs of operations until it is reimbursed by its customers. While prepayments for working capital assets are eligible for rate base treatment, it would not be appropriate to treat interest prepayments and settlement expenses paid to refinance or reacquire debt as prepayments for working capital assets.

61. As the Missouri PSC points out,[61] the Commission explained in *Northwest Pipeline Corporation* [62] why its policy does not permit the kind of debt transaction costs claimed by Enbridge KPC to be included in a pipeline's rate base:

> [U]tility management is under a duty to act prudently to take advantage of changing interest rates and provide the consumer with the lowest embedded debt costs. The Commission, therefore, permits pipelines to reflect legitimately incurred discounts and redemption premiums by amortizing such costs over the remaining original life of the retired debt. This method provides the pipeline with reasonable recovery of such costs.
>
> This policy, however, does not include reflection of carrying charges regardless of whether the pipeline experiences a gain or incurs a cost. When pipelines realize gains from refinancing debt, the Commission does not require the pipeline to reduce its rate base by the amount of the gains. Similarly, pipelines are not permitted to recover carrying charges when they incur costs to refinance the debt.[63]

62. As the Missouri PSC notes,[64] in Enbridge KPC's section 4 rate case, the Commission concluded that its policy, regulations, and precedent dictated the exclusion of the pipeline's debt expenses from rate base.[65] Instead, the Commission required that

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[61] October 20, 2003 Answer of Missouri PSC at 16.

[62] 71 FERC ¶ 61,253 at 61,995-96 (1995) (*Northwest*). The Commission's policy is reflected in section 154.312(h)(7) of its regulations. 18 C.F.R. § 154.312(h)(7) (2004).

[63] *Id.* at 61,996.

[64] October 20, 2003 Answer of Missouri PSC at 16.

[65] *See* 100 FERC ¶ 61,260, 61,123-130 (2002), *reh'g denied*, 102 FERC ¶ 61,310 (2003). In the section 4 rate case, the pipeline sought rate base treatment for $13 million of debt expenses consisting of (1) approximately $4.5 million of debt issuance expenses

(continued…)

the reacquired debt costs be amortized over the remaining life of the original debt being retired, and included in the debt cost portion of the pipeline's overall return.[66]

63. Enbridge KPC argues that the Commission's determinations in the section 4 rate case based on the Commission's traditional policies are irrelevant where the issue is whether a departure from section 4 ratemaking principles in this section 7 proceeding is warranted by equitable considerations. However, Enbridge KPC's primary equitable argument is that the possibility of foreclosure on the pipeline's Syenergy loan justified a transition or grace period before the pipeline was required to establish new rates in a section 4 rate case where the Commission's traditional ratemaking policies would be applied. The court has rejected this argument because by the time the Commission pursued this rationale, the Syenergy loan had been paid off and financial disaster was no longer a realistic possibility.[67] Enbridge KPC has advanced no other convincing justification for a departure from the Commission's customary policy regarding the type of debt expenses at issue here.

64. Finally, in its request for rehearing of the October 3, 1997 Order, Kansas Pipeline argued that contrary to the Commission's ruling in that order, the Commission generally allows recovery of the transaction costs arising from financing or refinancing of utility operations.[68] Kansas Pipeline also argued that its lenders required that these debt costs be included in its proposed rate base as a condition to obtaining the Syenergy note, and that rate base treatment was approved by the Kansas Commission in two 1991 accounting orders.[69] Kansas Pipeline further asserted that the Commission had not found any portion of the debt expenses to be imprudent, excessive, or unrelated to the company's utility business, and that the consolidation of the preexisting debts into a loan with a lower interest rate saved ratepayers $2.2 million annually.

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incurred when the Syenergy loan was originally secured in 1991, and (2) an $8.7 million prepayment penalty incurred by Midcoast when it paid off the Syenergy loan in 1999.

[66] 100 FERC ¶ 61,260 at 61,942-47; 61,963-64.

[67] *Missouri II*, 337 F.3d at 1075.

[68] In support, Kansas Pipeline cited System Energy Resources, Inc., 54 FERC ¶ 62,149 (1990) (fee paid to an underwriter is properly included in interest Account 431 as a debt expense), and System Energy Resources, Inc. 48 FERC ¶ 61,321 (1989) (fees paid for letter of credit included in Account 427, interest on long-term debt).

[69] November 3, 1997 Request for Rehearing of Kansas Pipeline at 45.

65. The Commission is permitting recovery of the subject debt expenses by increasing the pipeline's interest rate on debt from 9.64 to 9.97 percent; the Commission simply is not allowing Enbridge KPC to recover a return on such debt expenses by including it in rate base. Regardless of whether inclusion of the debt expenses in rate base was a lender condition to obtaining the Syenergy loan or whether the Kansas Commission approved rate base treatment, the pipeline is now subject to federal jurisdiction, and the court has emphasized the Commission's responsibility to make its own independent assessment. The court has also found that, regardless of the possible outcome that foreclosure on the Syenergy loan might have had at one time, it is inappropriate for the Commission's current review to take the Syenergy loan into consideration, since that loan has been paid off. As discussed above, since the costs at issue were incurred to consolidate and refinance the preexisting debts into the Syenergy loan, it is appropriate that these costs be treated as costs of debt capital, which are properly reflected through rate of return. It would not be appropriate to treat such costs as prepayments for working capital or operating assets includible in rate base.

5. <u>Gas Plant in Service</u>

66. The Commission's October 3, 1997 Order stated that the plant balances included in Kansas Pipeline's filing of January 23, 1996 were no longer up-to-date.[70] Therefore, the Commission adjusted these 1995 balances to reflect Kansas Pipeline's September 1996 plant records. The 1996 plant records showed an actual Account No. 101 balance of $68,541,159, which was $926,905 less than Kansas Pipeline projected in its January 23, 1996 filing, and an actual accumulated reserve for depreciation balance of $20,597,493.

67. Kansas Pipeline argued in its request for rehearing of the October 1997 Order that the Commission's approach to adjusting net plant was flawed. Specifically, Kansas Pipeline argued that since the $68 million September 1996 actual gas plant balance the Commission adopted entirely excluded the pipeline's claimed acquisition premium and certain market entry costs, these exclusions from gas plant balance should have been reflected by also excluding accumulated depreciation for the two excluded gas plant items from the depreciation reserve balance adopted by the Commission. Kansas Pipeline therefore argues that the accumulated reserve for depreciation should be reduced by approximately $3 million.

[70] 81 FERC ¶ 61,005 at 61,020. Kansas Pipeline's January 1996 application contained cost-of-service data for the twelve months ending September 30, 1995.

68. As stated in the April 30, 1998 Order on rehearing,[71] the Commission agrees with the Kansas Pipeline's proposed adjustment to accumulated reserve for depreciation. In the October 1997 Order, the Commission used an actual gross gas plant balance as of September 30, 1996 of $68,541,159, reduced by $20,597,493 for accumulated reserve for depreciation, resulting in a net plant balance of $47,943,666. Appendix 16 to the pipeline's request for rehearing of the October 1997 Order reflects a slightly different 1996 accumulated reserve for depreciation of $20,434,926, which the Commission adopts here. Appendix 16 shows that the accumulated reserve for depreciation associated with the two excluded items is $3,111,655. Thus, the accumulated reserve for depreciation should be reduced by this amount to $17,323,271 to reflect the Commission's exclusion of the claimed acquisition premium and market entry costs from gas plant in service.

69. The gas plant component to rate base should be the difference between the $68,541,159 in gross plant and the $17,323,271 revised accumulated reserve for depreciation, which produces a net plant balance of $51,217,888.

70. In its October 20, 2003 answer, the Missouri PSC argues that Enbridge KPC's request to update its plant balances is not supported by cost-of-service principles because the pipeline is attempting to adjust one item of its cost structure while the remaining costs are based on an annual test period.[72] The Missouri PSC claims that this kind of "spot adjustment" violates the Commission's requirements that all costs should be synchronized within a 12-month test period. The Missouri PSC had also sought rehearing of the Commission's statement in its April 30, 1998 Order that, if not for Kansas Pipeline's filing its motion rates, the Commission would grant rehearing to allow the pipeline's request to use updated, *i.e.*, 1996, gas plant balances. The Missouri PSC argues that if gas plant balances were going to be updated, use of 1996 gas plant balances would create inconsistencies since there were more recent, *i.e.*, 1997, balances available, and the Commission had continued to use ADIT and amortization of regulatory expense balances as of September 30, 1995.

71. It is unclear to what the Missouri PSC is objecting. The Missouri PSC seems to object to an alleged attempt by Enbridge KPC to update the plant balance that was used for cost-of-service in the October 1997 Order. However, Enbridge KPC has not requested, and the Commission is not approving here, the use of a different gross plant

[71] 83 FERC ¶ 61,107 at 61,507 (1998).

[72] October 20, 2003 Answer of Missouri PSC at 15.

balance than that used in the October 1997 Order. Both the October 1997 Order and this order utilize the actual gross plant balance as of September 30, 1996 of $68,541,159. The Commission's is not approving the pipeline's requested adjustment to the October 1997 plant balance in order to "update" the plant balance with more recent figures; rather, the Commission is approving the adjustment based on its determination, explained above, to correct the accumulated reserve for depreciation to reflect excluded acquisition premium and market entry costs.

72. If the Missouri PSC's objection is to the Commission's original updating, in its October 1997 Order, of the estimated 1995 gross plant balances included in Kansas Pipeline's application to the actual 1996 gross plant balances, there is nothing inappropriate about such updating. There is no requirement per se that all cost-of-service items must be estimated, or actual, or perfectly synchronized. Frequently, particularly in the context of establishing initial section 7 rates in a certificate proceeding, the Commission uses a combination of both estimated and actual cost items. For example, in section 7 certificate proceedings, it is almost always necessary for the Commission to rely on estimated operation and maintenance expenses. However, in some instances where a pipeline has received construction authority and approval of initial rates in a section 7 certificate proceeding, the pipeline will know its actual plant costs before it places its new facilities in service and the initial rates become effective. In such cases, the Commission will permit plant costs to be updated with actual plant costs. Permitting the use of Kansas Pipeline's actual 1996 plant balances here is consistent with this practice.

73. Further, the Commission denies the Missouri PSC's request that the Commission use 1997 balances. Since actual plant balances for that time period do not appear to be in the record in this case, the Missouri PSC's request would entail unnecessary and inordinate delay.

74. Nevertheless, the Commission agrees with the Missouri PSC that the ADIT and unamortized past regulatory expense balances should be synchronized by date with the plant balances used for rate base purposes. Therefore, when Kansas Pipeline makes its compliance filing to verify the basis for its ADIT balances, as required above, it also must use its ADIT balances as of September 30, 1996 so that they are synchronized with the gas plant balances sanctioned here. Of course, with respect to the regulatory expense balances, the unamortized balance for past regulatory expenses will be zero, consistent with the Commission's ruling in this order.

6. <u>Operation and Maintenance Expenses</u>

75. In its October 3, 1997 Order, the Commission accepted Kansas Pipeline's projections of operation and maintenance expenses of $11,015,007 to be used in

establishing its initial section 7 rates. The Commission noted that Kansas Pipeline's actual costs of $10,207,237 for the period ending December 31, 1996 were $807,770 less than Kansas Pipeline's projected amount.[73] In subsequent orders, the Commission did not address this item any further.

76. The Missouri PSC's position, as reflected in its October 20, 2003 and April 8, 2004 pleadings, is that the October 1997 cost-of-service contains $807,770 of excess operation and maintenance expenses, since the Commission acknowledged in the October 1997 Order that the amount of operation and maintenance expenses it was approving was $807,770 more than the company's actual operation and maintenance expenses.

77. The Commission does not agree that the level of projected operation and maintenance expenses permitted by the October 1997 cost-of-service provides for an "excess" cost allowance. As discussed above, it typically is necessary for the Commission to permit certificate applicants to estimate their operation and maintenance costs in establishing initial section 7 rates, since the applicants generally cannot project such expenses based on actual experience, either because the applicant is an existing pipeline seeking to construct expansion facilities for new services or a new market entrant seeking to construct an entirely new pipeline system.

78. Furthermore, it is not clear that the actual operation and maintenance expenses incurred during the year ended December 31, 1996 are any more reasonable than Kansas Pipeline's estimates of what its expenses would be after its initial section 7 rates became effective. While each of Kansas Pipeline's predecessors had its own operational experience, the Commission's assertion of jurisdiction required a corporate reorganization, and the new legal entity's operation and maintenance costs could not be expected to perfectly mirror the predecessors' expenses. Under these circumstances, the Commission believes it was appropriate to adhere to its usual practice in section 7 certificate proceedings and allow the use of estimated operation and maintenance costs. Further, the resulting projections do not appear unreasonable on their face when compared to past actual expenses, and there is no record evidence that any specific expenses are overstated.

79. In view of the above considerations, the Commission will permit Kansas Pipeline's rates to be based upon its original estimates of operation and maintenance expenses, consistent with Commission's determination in its October 1997 Order.

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[73] 81 FERC ¶ 61,005 at 61,021 (1997).

7. **Transok Lease**

80. In its certificate application, Kansas Pipeline proposed to retain 90,000 MMcf per day of upstream pipeline capacity on Transok, Inc. (Transok) that Kansas Pipeline's predecessor, KansOk, had leased under a long-term lease. The lease agreement made it possible for KansOk's customers to use capacity on Transok, an intrastate pipeline in Oklahoma, as if it were an extension of KansOk's system. Kansas Pipeline requested authority to retain this leased capacity.

81. In its October 3, 1997 Order, the Commission considered whether Kansas Pipeline was required by Order Nos. 636, 636-A, and 636-B and Commission precedent to assign the Transok capacity to its customers. The Commission found in the October 1997 Order that Kansas Pipeline had not demonstrated that the Transok capacity was vital to its operations and services.[74] The Commission also found that Kansas Pipeline's proposed tariff gave its two largest customers first priority for scheduling deliveries using the leased capacity, making the proposed tariff discriminatory in nature. The Commission therefore required Kansas Pipeline to offer the leased Transok capacity to its firm customers for reassignment. Accordingly, the cost-of-service and initial rates approved by the October 1997 Order were based on the removal of these costs from Kansas Pipeline's rate base and cost-of-service.[75]

82. On rehearing, Kansas Pipeline convincingly argued that the lease of upstream pipeline capacity was vital to its operations and services. Its two major shippers, MGE and Kansas Gas, agreed, supporting Kansas Pipeline's retention of the lease. In its April 30, 1998 Order, the Commission reversed its position and permitted Kansas Pipeline to retain the Transok lease. [76]

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[74] 81 FERC ¶ 61,005 at 61,025 (1997).

[75] *Id*. at 61,021 and 61,025.

[76] 83 FERC ¶ 61,107 at 61,509 (1998). The Commission's consideration of the Transok lease issue in the April 30, 1998 Order was not part of its discussion of cost-of-service issues raised on rehearing, which was provided to justify approval of Kansas Pipeline's motion rates by explaining that, but the filing of the motion rates, the Commission would have approved higher rates on rehearing. Since the approved motion rates reflected the inclusion of the costs of leasing upstream pipeline capacity on Transok's system, the capacity lease issue was limited, for practical purposes at that time,

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83. Since the October 1997 Order's approved cost-of-service excluded the Transok lease costs, Enbridge KPC requests that these costs be added to the October 1997 Order's approved cost-of-service. The Missouri PSC agrees that the cost of the Transok lease is a legitimate item to be included in Kansas Pipeline's cost-of-service.

84. The record demonstrates that the upstream Transok capacity was vital to Kansas Pipeline's system's operations and services. Further, there is no dispute that the costs of the Transok lease are appropriate for inclusion in Kansas Pipeline's cost-of-service.[77] These findings are consistent with the cost-of-service treatment accorded the Transok lease in Enbridge KPC's section 4 rate case, where the company's inclusion of the Transok lease in cost-of-service was not contested.

85. In view of the above considerations, the October 1997 Order's approved cost-of-service will be increased to include the $1,319,699 annual cost attributable to the Transok lease.[78]

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to whether Kansas Pipeline would be allowed to retain the upstream capacity or required to assign the capacity to its shippers.

[77] The Missouri PSC argued that the October 1997 Order's cost-of-service should be reduced by $807,770, so that it would reflect actual rather than projected operation and maintenance expenses. However, the Missouri PSC requested that such an adjustment be effected indirectly by reducing the allowed Transok lease costs by $807,770, rather than by a direct reduction in operation and maintenance expenses. This request is moot, since the Commission has determined, as discussed above, that the October 1997 Order's cost-of-service reflected an appropriate amount for operation and maintenance expenses. In any event, if an adjustment were necessary to disallow excess operation and maintenance expenses, the Commission would do so directly, not indirectly by reducing the allowed Transok lease costs as requested by the Missouri PSC.

[78] Although Enbridge KPC in its October 3, 2003 pleading requests that annual Transok lease costs of $1,319,699 be added to the October 1997 cost-of-service, in its most recent March 24, 2004 pleading, it requests an adjustment of $1,504,589 for the Transok lease costs. *See* Revised Appendix B to Enbridge KPC's March 24, 2004 filing. This amount represents the weighted, average annual Transok lease costs paid by Enbridge KPC from May 11, 1998 to November 8, 2002, since the annual Transok lease cost had increased beginning November 1, 1998. However, the Commission finds it is appropriate to use the as-filed $1,319,699 cost of the Transok lease, rather than a weighted average amount, reflecting subsequent increases in the cost of the lease.

8. <u>Capital Structure and Rate of Return</u>

86. In computing the rates set forth in the October 3, 1997 Order in this proceeding, the Commission utilized Kansas Pipeline's proposed hypothetical capital structure of 50 percent debt and 50 percent equity and proposed 13.5 percent rate of return on equity. The resulting weighted rate of return was 11.735 percent and the resulting pretax weighted rate of return was 16.072 percent.

87. The Missouri PSC continues to object to the pipeline's proposed 13.5 percent rate of return on equity and use of a 50/50 hypothetical capital structure, because the pipeline was largely funded by debt. In its October 20, 2003 pleading, the Missouri PSC states that the record in this case indicates a capital structure containing over 90 percent debt, leaving less than 10 percent for equity capital as of September 30, 1996.

88. The Missouri PSC acknowledges that 90 percent debt constitutes a thick debt component but states that the Commission could grant Kansas Pipeline a higher return on equity capital to compensate for the greater financial risk implied by such a capital structure. Alternatively, the Missouri PSC argues that if the Commission continues to use a hypothetical capital structure, such as 50 percent debt and 50 percent equity, the pipeline's rate of return should be lower to reflect the reduced financial risk.

89. With respect to capital structure, the Commission's policy is to use a capital structure that is based on real entities that obtain financing for the pipeline -- the pipeline itself or a company associated with the pipeline.[79] This policy is applied unless the capital structure of the entity securing the financing is anomalous. The anomalies include circumstances where either (a) the capital structure of the financing entity is not representative of the regulated pipeline's risk profile, or (b) the capital structure is different from the capital structures approved by the Commission for other pipelines or, if a Discounted Cash Flow (DCF) analysis is performed, outside the range of the proxy group used in the DCF analysis. If either of these circumstances exists, then a hypothetical capital structure may be appropriate.

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[79] *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 P 185 (2002); *See also Transcontinental Gas Pipe Line Corp*., 90 FERC ¶ 61,279 at 61,298 (2000); and *Transcontinental Gas Pipe Line Corp*., 84 FERC ¶ 61,084 at 61,414-15 (1998) (Opinion No. 414-A).

90. Here, Syenergy is the company that is associated with the pipeline and which obtained the financing, largely through a $91 million loan secured by Kansas Pipeline's assets.[80] As suggested by the Missouri PSC, the data supplied by Kansas Pipeline as Appendix 12 to its November 3, 1997 rehearing request support a finding that Syenergy's capital structure was approximately 90 percent debt, 10 percent equity.

91. The next question is whether using Syenergy's capital structure would produce either of the anomalous circumstances described above. First, we consider whether Syenergy's capital structure is representative of Kansas Pipeline's risk profile. If there were evidence that Syenergy issued its debt in order to finance non-pipeline activities that have risks different from Kansas Pipeline's risks, that could justify use of a hypothetical capital structure. For example, in *Transcontinental Gas Pipe Line Corp.*,[81] the Commission held that the capital structure of Transco's parent was not representative of Transco's risk profile because the parent's debt included debt issued by a different pipeline subsidiary, as well as debt incurred in connection with the parent's non-pipeline business. However, in this case there is no evidence that Syenergy's debt was devoted to anything other than Kansas Pipeline's assets. Thus, Syenergy's high debt ratio exists because Kansas Pipeline was financed primarily with debt, not because some of the debt was incurred for reasons unrelated to Kansas Pipeline. Consequently, the high debt ratio is reflective of Kansas Pipeline's risks, and there is no difference in risk profile that would dictate the use of a hypothetical capital structure in this case.

92. Having found that Syenergy's capital structure was representative of Kansas Pipeline's risk profile, using a hypothetical capital structure may still be appropriate if Syenergy's capital structure is different from the capital structures approved by the Commission for other pipelines or outside the range of the capital structures of pipelines that would constitute an appropriate proxy group. This part of the analysis is performed primarily to determine if the equity component of the capital structure of the financing entity (either the pipeline or its parent) is atypically high.

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[80] *Kansas Pipeline Company et al.*, 83 FERC ¶ 61,107. *See also* Kansas Commission's Order Entitled "In the Matter of the Application of Kansas Natural Partnership for an Order Approving a Lien on Public Utility Property, and Approving the Pledging of Credit for an Affiliate, and Special Accounting Orders." Docket No. 178,513-U 92-KNPG-100-S.

[81] 71 FERC ¶ 61,305 at 61,194 (1995) (*Transco*).

93. Equity capital is generally more costly than debt capital. Thus, capital structures with higher debt components can result in lower costs to customers.[82] Therefore, imputing hypothetical debt to a pipeline that has a capital structure with a very high equity component can be appropriate "to protect rate payers from excessive capital charges"[83] if the company has failed to take sufficient advantage of lower-cost debt in financing its operations. As the Commission stated in Opinion No. 414-A:

> The standard to be applied remains whether the capital structure will produce just and reasonable rates. To meet this standard the pipeline must demonstrate that its proposed equity ratio is not excessive in light of the ratios approved by the Commission in other recent cases.[84]

94. No DCF analysis was performed in this proceeding. However, the Commission has the experience of using various proxy groups in performing DCF analyses over the years and knowledge regarding the capital structures of the interstate pipelines generally. Therefore, the Commission recognizes that Syenergy's capital structure of 10 percent equity and 90 percent debt is atypically high in debt and low in equity as compared to the capital structures of other pipelines.[85] Nevertheless, the Commission believes that in this

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[82] *See Transcontinental Gas Pipe Line Corporation*, 71 FERC ¶ 61,305 at 62,192-94 (1995).

[83] *Communications Satellite Corp. v. FCC,* 611 F.2d 883, 902-909 (D.C. Cir. 1977).

[84] *Transcontinental Gas Pipe Line Corp.*, 84 FERC ¶ 61,084 at 61,415 (1998).

[85] In certificate proceedings, new market entrants seeking to construct new pipeline systems tend to have higher debt components than established pipelines. For instance, the Discovery Gas Transmission project referenced by the Missouri PSC was capitalized 80 percent with debt, 78 FERC ¶ 61,194 at 61,841-42 (1997), and many other new pipelines constructed during the same time period were more heavily capitalized with debt than the industry as a whole. *See, e.g., Millenium Pipeline Company, L.P.*, 100 FERC ¶ 61,277 at 62,149 (2002) (approving capital structure with 70 percent debt component; 14 percent rate of return on equity); *Vector Pipeline, L.P.,* 85 FERC ¶ 61,083 at 61,303 (1998) (approving capital structure with 75 percent debt component; 14 percent rate of return on equity); *Alliance Pipeline, L.P.*, 80 FERC ¶ 61,149 at 61,592 (1997) (approving capital structure with 70 percent debt component; 14 percent rate of return on equity); *Maritimes & Northeast Pipeline, L.L.C.,* 76 FERC ¶ 61,124 at 61,672 (1996)

(continued…)

proceeding it is appropriate to use the actual capital structure of Syenergy at the time, rather than developing a hypothetical capital structure that imputes a higher equity component. As the Commission stated in *Transco*, "[i]n general, the Commission does not impute equity because this can over compensate the equity holder at the expense of the ratepayer."[86] Moreover, as discussed above, Syenergy's actual capital structure was reflective of the risk profile of Kansas Pipeline.

95. The Commission acknowledges, however, that while a higher debt component alleviates the ratepayer's burden of higher costs associated with thicker equity, it also makes the equity investor's stake less secure by increasing financial risk.[87] It follows that using Syenergy's actual capital structure requires that the Commission allow a higher return on equity than it would if it used a hypothetical capital structure and imputed additional equity. However, in the circumstances of this case, use of a hypothetical capital structure for the purpose of justifying a lower return on equity would be no "more than a device to mask an otherwise anomalous return as something more appealing."[88] Since Syenergy's capital structure was representative of its risk profile (and that of Kansas Pipeline, as discussed above), investors would have necessarily focused on that capital structure when choosing whether to invest in Kansas Pipeline. Investors expect a higher return "to compensate for the perceived riskiness of investing in a pipeline operating under a higher debt load."[89] The Commission concludes that use of Synergy's actual capital structure, accompanied by an adjustment to the rate of return on equity that would otherwise apply under a DCF analysis, is superior to developing a hypothetical capital structure.

(approving capital structure with 75 percent debt component; 14 percent rate of return on equity); *Portland Natural Gas Transmission System*, 76 FERC ¶61,123 at 61,661 (1996) (approving capital structure with 75 percent debt component; 14 percent rate of return on equity); *Kern River Gas Transmission Co.*, 50 FERC ¶ 61,069 at 61,150 (1990) (approving capital structure with 70 percent debt component; 14 percent rate of return on equity).

[86] *Transco*, 71 FERC ¶ 61,305 at 62,193, n.14.

[87] *Id*. at 62,193 (1995).

[88] *North Carolina Utilities Commission v. FERC*, 42 F.3d 659, 664 (D.C. Cir. 1995).

[89] *Id*.

96. As stated above, the Commission did not perform a DCF analysis to support the capital structure rates of return underlying the cost-of-service approved in the October 3, 1997 Order in this proceeding. However, as the Missouri PSC states in its October 20, 2003 Answer, the Commission did perform a DCF analysis in the process of establishing the cost-of-service approved in its February 27, 1997 Order in *Discovery Gas Transmission, L.L.C.*[90] That DCF analysis provides guidance here.

97. In *Discovery*, the Commission performed a DCF analysis that produced a range of rates between 9.56 percent and 12.54 percent on equity for the proxy group but granted Discovery a rate of return on equity of 14.0 percent. The Commission went outside the range because it determined that in addition to certain greater business risks, Discovery also had higher relative financial risk than the proxy group since its equity ratio was only 20 percent (making its debt component 80 percent). In the instant case, the Commission believes that because Syenergy's capital structure was so overwhelmingly financed by debt, a similar allowance for equity capital should apply. Therefore, the Commission will set Kansas Pipeline's initial section 7 rates using a 14 percent rate of return on equity.

B. <u>Initial Section 7 Rates</u>

98. As explained above, the Commission is making various changes to the rate base and cost-of-service findings of the October 3, 1997 Order. The net effect of these adjustments is to increase the cost-of-service approved by the October 1997 Order. Although the Commission has estimated the revised cost-of-service, as discussed below, the Commission cannot determine the exact cost-of-service, since the Commission is requiring Enbridge KPC, *supra*, to utilize its ADIT balances as of September 30, 1996 so that they are synchronized with its gas plant balances. Accordingly, Enbridge KPC is directed to make a compliance filing within thirty days of the date of this order proposing revised tariff sheets consistent with the Commission's findings in this order. Enbridge KPC is further directed to provide the additional information as required herein, and to provide workpapers supporting the calculation of revised rates.

99. Nevertheless, the Commission is able to estimate that, with the adjustments to the October 1997 cost-of-service required by this order, the approved annual cost-of-service for the initial rates is approximately $22.6 million, slightly higher than the $21.8 million cost-of-service approved in the October 1997 Order. As explained below, the annual revenues the Commission estimates were collected by the motion rates that were in effect

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[90] 78 FERC 61,194 at 61,841-42 (1997) (*Discovery).*

as initial rates for the period in question exceed the approximate $22.6 million cost-of-service approved here.

100. In the April 30, 1998 Order, the Commission found that if it were to adjust the October 1997 initial rates based on the rehearing arguments it found persuasive, such adjustments would result in a $29.8 million cost-of-service.[91] The Commission also recalculated initial rates based on the hypothetical $29.8 million cost-of-service. The Commission's comparison of the recalculated initial rates based on the $29.8 million cost-of-service with the motion rates demonstrated that the motion rates were slightly lower than the recalculated initial rates. Therefore, the Commission estimates that the annual revenue Kansas Pipeline has collected under the motion rates is also slightly lower than the revenue Kansas Pipeline would have collected under the hypothetical recalculated initial rates. However, that amount of revenue collected by the motion rates is significantly greater than the revenue that would have obtained from the $22.6 million cost-of-service that the Commission is approving here, creating a potential refund obligation.

101. Below, the Commission first addresses Enbridge KPC's argument that the Commission should waive any refunds that are due, and concludes there is no equitable reason to waive refunds. Thus, in the final section of this order, the Commission requires a refund plan calculating the refunds that would be due to each customer and how the pipeline proposes to comply with any refunds ultimately ordered by the Commission.

V. Enbridge KPC'S Request For Waiver Of Refund Obligation

102. The *Missouri II* court has held that the Commission did not justify its departures from traditional ratemaking policies in order to grant Kansas Pipeline's motion to grandfather its predecessors' existing rates as initial section 7 rates. As noted above, application of the Commission's customary cost-based ratemaking principles in this order will yield rates lower than the approved motion rates. When a pipeline has collected excessive rates as a result of the Commission's error, the appropriate remedy usually is to order refunds to put the parties, as closely as possible, "in the position they would have

[91] The Commission stated that the adjustments would result in a total cost of service of "$28,436,306.00 and the inclusion of the Transok lease." 83 FERC ¶ 61,107 at 61,511 (1998). Since the annual Transok lease costs are $1,319,699, this is equivalent to $29.8 million.

been in had the error not been made."[92] However, Enbridge KPC argues the Commission should exercise its discretion to waive any refund obligation based on Enbridge KPC's view of the equities in this case, as discussed below.

A. Kansas Pipeline's Withdrawal of Jurisdictional Appeal in Reliance on Commission's Approval of Motion Rates

1. Enbridge KPC's Arguments

103. Enbridge KPC argues that its predecessor, Kansas Pipeline, relied on the approval of its motion rates in giving up its judicial challenge of the jurisdictional ruling. Enbridge KPC asserts that Kansas Pipeline assumed that its approved initial section 7 rates were not subject to refund and, therefore, that it would not lose the benefit of its bargain.[93]

104. Enbridge KPC further asserts that Kansas Pipeline could have taken a number of other actions, but did not, based on the Commission's approval of the motion rates. In addition, Enbridge KPC argues that Kansas Pipeline's decision to accede to the Commission's jurisdiction both avoided further litigation of that issue and accelerated the section 4 rate proceeding, which resulted in lower rates. Enbridge KPC argues that requiring it to make refunds will diminish the incentive for parties to concede or settle disputed issues, which will lead to increased litigation.

2. The Commission's Response

105. Kansas Pipeline's request for approval of its motion rates in exchange for its accession to the Commission's jurisdiction was not pursuant to a formal settlement agreed to by all parties. Indeed, the motion was opposed by the Missouri PSC, the Kansas Commission, Kansas Gas, Missouri Gas Energy and Williams Natural Gas Company. Further, at the time Kansas Pipeline moved on May 6, 1998, to dismiss its appeal of the Commission's jurisdictional ruling, the 30-day period for the filing of

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[92] *CPUC v. FERC*, 988 F.2d 154, 162 (D.C. Cir. 1992), *citing Consumers' Counsel, State of Ohio v. FERC*, 826 F.2d 1136, 1139 (D.C. Cir. 1987), and *Tennessee Valley Municipal Gas Ass'n v. FPC*, 470 F.2d 466 (D.C. Cir. 1972). *See also Grynberg v. Rocky Mountain Natural Gas Co.*, 93 FERC ¶ 61,180 at 61,594 (2000); and *Ensign Oil & Gas, Inc.*, 71 FERC ¶ 61 204 at 61,750 (1995).

[93] Enbridge KPC's October 3, 2003 motion at 12.

requests for rehearing of the Commission's April 30, 1998 Order approving the motion rates had not elapsed. Thus, when Kansas Pipeline withdrew that judicial appeal, Kansas Pipeline had no certainty either that the Commission would not modify Kansas Pipeline's initial section 7 rates on rehearing or that the motion rates would not be challenged judicially.

106. Parties did seek rehearing, and then judicial review, of the Commission's approval of the motion rates. In *Missouri I*, the court remanded Kansas Pipeline's initial rates to the Commission. After the Commission affirmed its approval of the motion rates in its orders on remand in response to *Missouri I*, parties continued to litigate. Now, the court has remanded again in its *Missouri II* decision, finding that the Commission's previous orders have failed to justify its approval of Kansas Pipeline's motion rates. As explained by the Supreme Court in upholding a Commission decision to order refunds of initial section 7 rates,[94] judicial appeal prevents an order from becoming final and "judicial review at times results in the return of benefits received under the upset administrative order." Since pending judicial review prevented Kansas Pipeline's initial section 7 rates from becoming final, it was not reasonable for Kansas Pipeline to assume that the motion rates became immune to any refund requirement at the time the Commission found that approval of the motion rates as Kansas Pipeline's initial section 7 rates was in the public interest.

107. In support of its argument based on detrimental reliance, Enbridge KPC cites *Panhandle Eastern Pipe Line v. FERC*.[95] In that case, the Commission found that Panhandle owed refunds. However, the Commission also found that its error had prevented Panhandle from pursuing an alternative method of recovering production-related expenses in its rates. Taking that consideration into account, the Commission waived interest on Panhandle's required refunds, and the court upheld the waiver of interest. Unlike the situation in *Panhandle*, the Commission's error in this proceeding did not prevent Kansas Pipeline from collecting expenses that it was entitled to recover. Rather, as discussed herein, the Commission finds that its error resulted in Kansas Pipeline's collecting rates that recovered costs which the pipeline either imprudently incurred or has failed to justify.

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[94] *United Gas Improvement Co. et al. v. Callery Properties, Inc. et al.*, 382 U.S. 223 at 229 (1965).

[95] 95 F.3d 62 (D.C. Cir. 1996) (*Panhandle*).

108. Further, Enbridge KPC's argument of detrimental reliance reflects an incorrect assumption that the Commission would not have approved Kansas Pipeline's motion rates but for its agreement to withdraw its judicial challenge to the Commission's assertion of jurisdiction. This is an overreaching assumption. In the April 30, 1998 Order that approved the motion rates, the Commission made only a "passing reference" to Kansas Pipeline's statement that it would withdraw its judicial appeal of the jurisdictional issue if its motion rates were approved.[96] The Commission subsequently emphasized that Kansas Pipeline's withdrawal of that appeal was not a decisive factor in the Commission's decision to approve the motion rates or in its decision to affirm those rates when they were remanded by the court's *Missouri I* decision.[97]

109. Enbridge KPC emphasizes that Kansas Pipeline's agreement to accede to Commission jurisdiction avoided further litigation on that issue. Enbridge KPC also emphasizes that when the Commission decided to approve Kansas Pipeline's motion rates rather than affirm the October 1997 Order's cost-based rates, the Commission decided that it should accelerate the section 4 rate case that resulted in a reduction in the pipeline's rates. In this regard, Enbridge KPC states that the rate case will result in Missouri Gas paying approximately $26.9 million less for firm transportation service over the remainder of its 15-year service contract.[98]

110. In view of the procedural history and protracted nature of this proceeding, it is not clear that parties have been spared substantial litigation expense and burden by the removal of the jurisdictional issue. Further, since the court has held that the Commission has not justified its approval of Kansas Pipeline's motion rates as its initial section 7 rates, the Commission's acceleration of the pipeline's first section 4 rate case has proven to be a prudent decision.

111. In any event, while Enbridge KPC emphasizes that its first section 4 rate case would have been delayed if the pipeline had not acceded to Commission jurisdiction when it did, that argument ignores the fact that the pipeline resisted NGA jurisdiction

[96] *See Missouri II*, slip op. at 4.

[97] 98 FERC ¶ 61,343 at 62,469. The court agreed that the Commission had made it clear that it would not have approved the motion rates "simply to resolve the jurisdictional issue." *Missouri II* at 7-8, *quoting* 98 FERC ¶ 61,343 at 62,460.

[98] Enbridge KPC's March 24, 2004 motion at 9.

from the time the Commission issued its show cause order on May 31, 1995,[99] until the pipeline filed its motion rates on February 27, 1998. If the pipeline had acknowledged the Commission's jurisdiction earlier, a section 4 rate case could have been concluded with revised rates taking effect earlier than November 9, 2002, the effective date of the rates approved in the section 4 rate case in Docket No. RP99-485-000.[100] Conclusion of the section 4 rate case at an earlier date would have resulted in greater benefits to the pipeline's customers, since the reduced rates would have taken effect earlier.

112. Under the circumstances, the fact that Kansas Pipeline eventually acceded to Commission jurisdiction does not create an equitable consideration supporting waiver of refunds. Indeed, waiving refunds in this case could create an incentive for companies to resist Commission jurisdiction in the future in order to postpone having their rates reviewed under the stricter scrutiny applied in section 4 rate cases. Further, since the court has directed the Commission to address the issue of refunds, the Commission does not agree with Enbridge KPC's assertion that requiring refunds in this case will diminish parties' incentives to enter into formal settlement agreements.

B. Reliance on State Jurisdictional Status

1. Enbridge KPC's Arguments

113. Most of Enbridge KPC's interstate pipeline system is in Kansas. Prior to the Commission's assertion of jurisdiction, the facilities in Kansas were operated by KPP as a Hinshaw gas pipeline system regulated by the Kansas Commission. While almost all of KansOk's service was interstate service for which this Commission had approved cost-based rates, KansOk operated its facilities in Oklahoma as a purported intrastate pipeline exempt from this Commission's NGA jurisdiction. Historically, only Riverside's relatively minor state border-crossing facilities were regulated by this Commission as fully jurisdictional interstate facilities.

114. Enbridge KPC emphasizes that the unique circumstances in this proceeding militates against the Commission's requiring refunds now. Enbridge KPC emphasizes that the Commission's assertion of jurisdiction does not change the fact that its predecessors had theretofore operated as three separate companies. Further, Enbridge

[99] *KansOk Partnership et al*., 71 FERC ¶ 61,242 (1995).

[100] *Enbridge Pipelines (KPC)*, 102 FERC ¶ 61,304 (2003).

KPC argues that its predecessors relied upon state regulation in developing much of the present interstate pipeline system. In view of these considerations, Enbridge KPC asserts that it would not be fair for the Commission to view the company as a typical interstate pipeline in deciding whether it is appropriate to require refunds of initial section 7 rates.[101]

2. The Commission's Response

115. The court has found that, regardless of the "unique circumstances" in this case, the Commission erred in departing from its usual cost-based ratemaking policies in order to ensure that Kansas Pipeline would be able to continue servicing the debt service on the $91 Syenergy million loan secured by its facilities. The Commission had been concerned that its assertion of jurisdiction could have the immediate consequence of causing Kansas Pipeline to default on the terms of the loan agreement.[102] The Commission also had believed it was appropriate under the circumstances to give Kansas Pipeline a grace period within which it could prepare and adjust to federal regulation under section 4 of the NGA.[103]

116. As discussed above, the court found the Commission's concerns insufficient to justify its departures from its customary cost-based ratemaking policies since the Syenergy loan was not the result of an arms-length transaction, had not resulted in any benefits to the pipeline customers and, in any event, the potential consequences of Kansas Pipeline's defaulting on the loan were entirely speculative.[104] Further, since the Commission did not originally rely on the debt coverage condition at the time it approved Kansas Pipeline's initial rates, the court has instructed the Commission that its review of the pipeline's initial rates now must consequently take into account the fact that the loan has been paid off.

117. The court also has held the Commission's responsibility was not satisfied by relying on the Kansas Commission's approval of rates since the record in this proceeding is insufficient for this Commission to ascertain and evaluate the Kansas Commission's

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[101] Motion at 11.

[102] *Kansas Pipeline Company*, 97 FERC ¶ 61,168 at 61,789 (2001).

[103] *Kansas Pipeline Company*, 97 FERC ¶ 61,343 at 61,457 (2002).

[104] *Missouri II*, 337 F.3d at 1072-73.

rationale.[105] In addition, the court has held that it was not reasonable to assume that Kansas Pipeline's motion rates would not be exploitative of Kansas Pipeline's shippers because they were the same rates negotiated by the shippers with KansOk, Riverside, and KPP. This assumption resulted in Missouri Gas's being deprived of its contract contingency provision requiring that its rates be adjusted to reflect the rates ultimately approved by the Commission.[106]

118. As shown above, Enbridge KPC's equitable arguments against its being required to make refunds are the same arguments the court rejected as a basis for the Commission's departures from cost-based ratemaking in order to approve Kansas Pipeline's motion rates as a means of ensuring its continued financial viability. The Commission therefore concludes that these equitable considerations relating to prior reliance on state regulation do not justify the Commission's granting Enbridge KPC's request for relief in the form of a waiver of refunds.[107]

119. In any event, Kansas Pipeline violated NGA certificate requirements and strenuously opposed the Commission's assertion of jurisdiction. Under the

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[105] As discussed above, *supra* n. 4, the Commission had approved Riverside's rates for service using its state border-crossing facilities. KansOk's rate for NGPA section 311 service in Oklahoma had been approved by the Commission based on its cost-of-service ratemaking principles. However, for KPP's service under its limited-jurisdiction certificate issued pursuant to section 284.224 of the regulations, the Commission authorized KPP to charge its rates approved by the Kansas Commission. *See* 49 FERC ¶ 62,235 (1989). As discussed above, KPP's reservation charge for service traversing both of its zones in Kansas was $15.2864/Dth. Thus, KPP's rates approved by the Kansas Commission accounted for approximately 75 percent of the 3-zone reservation charge ($19.9907/Dth) included in Kansas Pipeline's motion rates approved by this Commission.

[106] *Missouri II* at 1076.

[107] *See Anadarko Petroleum Corp. v. FERC* (*Anadarko*), 196 F.3d 1264, 1268 (D.C. Cir. 1999). In upholding the Commission's denial of a generic waiver of interest on refunds, the *Anadarko* court agreed that producers were repeating the same equitable arguments they had made against the imposition of refunds, which the court already had rejected. Thus, the court found that the Commission could only have waived interest if it assessed the equities in a manner contrary to the court's decision that refunds should be required.

circumstances, the Commission finds that the reliance on state regulation does not present a compelling equitable reason to waive Enbridge KPC's refund obligations. The Commission is not requiring Enbridge KPC to calculate refunds for amounts its predecessors collected prior to the Commission's assertion of jurisdiction.

C. Consumer Benefits from Kansas Pipeline System

1. Enbridge KPC's Arguments

120. Enbridge KPC asserts that in weighing the equities with respect to potential refunds, the Commission should consider the fact that the development of Enbridge KPC's present interstate system by its predecessors provided customers in the Missouri and Kansas markets with significant benefits that otherwise would not have been forthcoming.[108] Enbridge KPC states that its predecessors' development of their systems provided consumers with a competitive option to the existing service providers that provided a check on the rates charged by those providers and provided supply security to those markets. Since much of the present system is constituted by pipeline facilities that were converted from crude oil to natural gas service, Enbridge KPC also argues that the present system was created at significantly less cost than constructing all new facilities.

121. Enbridge KPC cites *Consumer Federation*, in which the court held that the Commission had exceeded its authority and neglected its rate control responsibilities by attempting to remedy a supply shortfall in the interstate gas market by exempting from the certification requirements in section 7 of the NGA certain temporary producer sales of gas to pipelines facing curtailment of service. In setting aside the Commission's orders and remanding the issue of whether to order refunds of the excessive rates paid to producers, the court stated that "[w]hile full refund under an invalid order is a sound basic rule, it may be offset, at least in part, by . . . the fact that consumers may have had the benefit of an increase in supply that would not have been forthcoming under section 7 procedures, albeit at an excessive price . . . ."[109]

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[108] Enbridge KPC relies on *Consumer Federation of America v. FPC*, 515 F.2d 347 (D.C. Cir.), *cert. denied*, 423 U.S. 906 (1975) (*Consumer Federation*).

[109] *Id*. at 359.

2. **<u>The Commission's Response</u>**

122. In the above section of this order addressing the acquisition premiums paid by Kansas Pipeline's predecessors, the Commission has described in detail Enbridge KPC's arguments regarding alleged benefits to consumers as the result of the development of the present pipeline system. Since the pipeline system was already fully developed and in service when the Commission approved Kansas Pipeline's motion rates as its initial rates, none of those benefits resulted from the Commission's error in deciding to grandfather the existing rates being charged by Kansas Pipeline's predecessors. Further, while the Commission would not dispute that the presence of Enbridge KPC's pipeline system probably continues to benefit consumers by creating competition, the same could be said of many, if not most, pipelines that have been required to make refunds.

123. This case does not involve the same equitable considerations as *Consumer Federation*. But for the Commission's error at issue in that case, producers might have continued to withhold gas supplies needed in the interstate market. The court therefore concluded that, notwithstanding that the producers' prices were found excessive, consumers may have received a benefit that could be an appropriate consideration in determining how much producers should be required to refund. In this case, Kansas Pipeline's predecessors were already providing service. Therefore, the Commission's error resulted in improper rates with no countervailing benefit to consumers.

D. **<u>Commission's Reliance in Section 4 Proceeding on Approval of Motion Rates in Section 7 Proceeding</u>**

1. **<u>Enbridge KPC's Arguments</u>**

124. Enbridge KPC asserts that certain final and nonappealable findings in the section 4 rate case in Docket No. RP99-485-000 were based on rulings in this section 7 certificate proceeding. Enbridge KPC argues that those findings in the rate case will be undercut if refunds now are required in this proceeding. As its only example, Enbridge KPC raises the Commission's denial of the pipeline's proposal to amortize past regulatory expenses in its section 4 rates.

125. In the section 4 proceeding, Kansas Pipeline had proposed to amortize $5.7 million of regulatory expenses in its prospective section 4 rates through an annual amortization amount of $1,085,358. These were regulatory expenses that already had been incurred for the section 4 rate case and the still pending section 7 certificate

proceeding.[110] Relying on its traditional policy of permitting a pipeline to include only a projected amount for ordinary and recurring regulatory expenses that it could be expected to incur in the future, the Commission rejected Kansas Pipeline's proposed $1,085,358 amortization amount since it reflected an amortization of lump sum amounts incurred in the past and, thus, was not a projection of future regulatory expenses.[111]

126. The Commission acknowledged, though, that in unusual circumstances, it will permit a pipeline to amortize extraordinary, nonrecurring regulatory expenses incurred in the past, citing *Tarpon Transmission Company*.[112] However, the Commission declined to reach the issue whether the $5.7 million of regulatory expenses sought by Kansas Pipeline qualified as extraordinary, nonrecurring expenses because it determined that even if they were extraordinary, nonrecurring costs that could be amortized, Kansas Pipeline would have already recovered more than the $5.7 million of extraordinary costs through the section 7 initial rates it had been collecting since May 11, 1998.[113]

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[110] The Missouri PSC indicates in its April 8, 2004 Answer at page 15 that Enbridge KPC's claimed $5.7 million in regulatory expenses in the section 4 rate case included $3.2 million in legal and consulting fees relating to this section 7 proceeding that were incurred from 1995 to 1999. Because the past regulatory costs previously claimed by the pipeline in this section 7 proceeding included costs incurred up to September 30, 1997, it appears that the costs sought in the section 4 case may have included some of the same costs previously sought in this section 7 proceeding.

[111] 100 FERC ¶ 61,260 at P 359. The Commission used, instead, the pipeline's normal recurring regulatory expense of $64,692 as the projection of future regulatory expense and disallowed the difference in establishing the pipeline's new section 4 rates. *Id*. at P 366.

[112] *Tarpon Transmission Company*, 57 FERC ¶ 61,371 (1991), *order on reh'g*, 58 FERC ¶61,354, 62,182 (1992), *order on reh'g*, 59 FERC 1¶ 61,241 (1992) (*Tarpon*).

[113] In the section 4 rate case, the Commission noted that the motion rates approved as the pipeline's initial section 7 rates reflected a cost of service that was comparable to the cost of service in the April 1998 Order that the Commission said it would have used to compute the pipeline's initial rates on rehearing if the pipeline had not filed its motion rates. 100 FERC ¶ 61,260 at P 365. Since the April 1998 Order's recomputed cost of service reflected the pipeline's request to amortize $2.2 million in past regulatory expenses annually, the Commission concluded in the section 4 rate case that the

(continued…)

127. Therefore, in view of the Commission's stated reasoning, Enbridge KPC asserts that it would be unfair to require that it refund amounts attributable to past regulatory expenses. Enbridge KPC argues that the Commission's reliance in the section 4 case on the level of costs collected through the initial rates approved on April 30, 1998 requires the Commission to leave undisturbed the amounts deemed collected through those initial rates.

2. **<u>The Commission's Response</u>**

128. The Commission does not believe that its actions in the section 4 rate case should affect the level of refunds ordered in this section 7 proceeding. It is true that the Commission in the section 4 rate case declined to consider on the merits whether the regulatory expenses sought in that case might be recoverable as extraordinary, non-recurring costs under the *Tarpon* exception because it found that more than the $5.7 million of expenses had been collected through the section 7 initial rates approved by the April 30, 1998 Order. However, Enbridge KPC could have raised any concerns over the basis for the Commission's refusal to permit amortization of the $5.7 million of regulatory expenses in its section 4 rates in the section 4 rate case.

129. Enbridge KPC did seek rehearing of the Commission's disallowance of regulatory expenses in the section 4 cost of service, specifically requesting rehearing of the amount of regulatory expenses the Commission permitted Enbridge KPC to include in its Account No. 928. However, Enbridge KPC did not seek rehearing of the Commission's refusal to reach the issue whether the $5.7 million of regulatory expenses were recoverable as extraordinary, non-recurring expenses, or otherwise take issue with the Commission's reliance on non-final section 7 initial rates. Nor did it seek judicial review of the Commission's orders in the section 4 rate case.

130. The pipeline maintains in its March 24, 2004 motion that it did not seek rehearing and judicial review on this issue in the section 4 rate case because it was not "aggrieved" within the meaning of section 19 of the NGA. Therefore, the pipeline asserts that it could not have sought rehearing on the grounds that the Commission failed to consider the

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pipeline's initial section 7 rates had already collected $8 million attributable to past regulatory expenses. *Id*.

regulatory expenses as extraordinary, non-recurring expenses entitled to the type of exception granted in *Tarpon*.[114]

131. The Commission does not agree with Enbridge KPC that it was foreclosed from seeking rehearing or clarification of the basis for the section 4 decision, and thereby preserving its rights on rehearing. Enbridge KPC was aggrieved by the section 4 decision because it denied Enbridge KPC's request to amortize the past regulatory expenses in its section 4 rates and left the pipeline open to the possibility that if the initial rates were not affirmed by the court and the Commission did not allow the recovery of the past regulatory expenses in the initial rates, the pipeline would be unable to recover the regulatory expenses sought in the section 4 proceeding. Therefore, Enbridge KPC could have requested the Commission to reach the merits of the *Tarpon* issue in the section 4 rate case on the ground that the Commission's rationale for not reaching the merits did not take into account the possibility that the section 4 rates could change following judicial review. Enbridge KPC cannot complain that it has been unfairly prejudiced by a finding in the section 4 case that relied on the pipeline's recovery of regulatory expenses under its initial rates, when it knew the level of initial rates was not final, but chose not to challenge the Commission's underlying rationale of the section 4 order or to reserve its rights in the section 4 proceeding.

132. Even if the Commission reached an incorrect conclusion in the section 4 rates regarding the past regulatory expenses at issue there, attempting to remedy such a mistake by approving recovery of the past regulatory expenses in this proceeding would amount to "the tail wagging the dog," as the Missouri PSC argues.[115] The Commission must determine the appropriate section 7 initial rates on the record in this proceeding and not base the initial rates on rulings made by the Commission in other subsequent cases.

133. Furthermore, the Commission has now addressed in this order the merits of whether the past regulatory expenses sought in this proceeding are extraordinary, non-recurring expenses, recoverable under the *Tarpon* exception. As discussed *supra*, this Commission has held that neither the state regulatory expenses, nor the section 7 regulatory expenses, may be recovered as extraordinary, non-recurring expenses. Thus, had the Commission reached the issue on its merits in the section 4 proceeding, the

[114] March 24, 2004 Motion for Summary Disposition and Request for Expedited Action of Enbridge KPC at 21.

[115] October 20, 2003 Answer of the Missouri PSC at 9.

Commission would have found that the $3.2 million of regulatory expenses related to the section 7 case sought in the section 4 case did not qualify as extraordinary, non-recurring costs. Further, the Commission most likely would have found that the $2.5 million of regulatory expenses related to the section 4 rate case also would not have qualified as extraordinary, non-recurring costs, as they were typical costs associated with a regular, garden-variety rate case.

E. Conclusion Regarding Equitable Considerations

134. The Missouri PSC has prevailed in its judicial appeal from the Commission's decision to approve the Kansas Pipeline's motion rates that grandfathered its predecessors' existing rates. The pipeline has not provided any sound equitable reason for the Commission to waive refunds, which would be tantamount to permitting the pipeline charge the unlawful motion rates for the locked-in period.[116] However, before reaching a final determination regarding Enbridge KPC's refund obligations, the Commission will require the pipeline to file a refund plan as discussed below.

VI. Refund Period And Refund Plan

135. The Commission has determined above that the correct initial rates that Kansas Pipeline should have charged its customers are lower than the rates it actually collected, and that there is no equitable reason to excuse Enbridge KPC from making refunds. Therefore, the Commission is requiring Enbridge KPC to calculate the refunds that would be due its customers based on the difference between the initial rates Kansas Pipeline collected from its customers and the lawful initial rates established in this order, along with interest calculated in accordance with section 154.501 of the Commission's regulations.[117] Within thirty days of the date of the date of this order, Enbridge KPC

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[116] *See Panhandle Eastern Pipe Line Co.*, 63 FERC ¶ 61,130 at 61,835 (1993) (where the Commission's original ruling requiring full refunds with interest was based in part on the equitable ground that "as the proponents of the action held to be erroneous on appellate review, [the pipeline petitioners have] less justification to seek the benefit of the Commission's exercise of [its] equitable remedial authority than the customers who were required to pay the illegal charge.") Although the *Pandhandle* court affirmed the Commission's later waiver of the interest on refunds, it found the Commission's reasoning to be strong. 95 F.3d 62 at 72.

[117] 18 C.F.R. § 154.501 (2004).

must file a refund plan indicating amount of refunds that would be due to each customer, showing all calculations and separately stating estimated interest. The refund plan must also include Enbridge KPC's proposal for how it will make any refunds required.

136. If the Commission orders refunds in a subsequent order, Enbridge KPC will make refunds to only one of its two major customers, Missouri Gas, and its smaller customers. Kansas Gas, Kansas Pipeline's/Enbridge KPC's other major customer, has waived its right to receive refunds in this proceeding as part of a comprehensive settlement approved by the Kansas Commission resolving all matters in litigation among Enbridge KPC, Kansas Gas, and the Kansas Commission.[118] The settlement agreement was subject to this Commission's approval of tariff provisions to be filed by Enbridge KPC to implement several negotiated rate agreements with Kansas Gas. The Commission granted such authorization on June 6, 2003.[119]

137. The only remaining question is, for what period must potential refunds be calculated? There is no dispute between the parties that the appropriate refund period would end on the date the section 4 rates became effective, November 9, 2002. However, Enbridge KPC and the Missouri PSC do not agree on the appropriate date for the commencement of refunds.

138. The Missouri PSC maintains that the appropriate refund period would extend back to December 2, 1997, the date that the initial rates under the Commission's October 3, 1997 Order issuing certificates to Kansas Pipeline would have become effective[120] had the Commission not granted a stay of the October 3, 1997 Order.[121] However, it asserts

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[118] *See* Article VI of May 1, 2003 Settlement Agreement. The Kansas Commission granted the parties' joint motion for approval of the settlement by order issued May 9, 2003 in Docket No. 02-KGSG-329-PGA.

[119] *Enbridge Pipelines (KPC)*, 103 FERC ¶ 61,305 (2003) and *Enbridge Pipelines (KPC)*, 105 FERC ¶ 61,015 (2003).

[120] The October 3, 1997 Order lifted a 1995 stay of the Commission's assertion of jurisdiction, effective 60 days from the issuance of that order, *i.e*., December 2, 1997, so that the Commission's assertion of jurisdiction and the initial rates would have become effective on that date. 81 FERC ¶61,005 at 61,034 (1997).

[121] On November 25, 1997, the Commission issued an order granting Kansas Pipeline's request for an extension of the 1995 stay with respect to the determinations in the October 3, 1997 order. *Kansas Pipeline Company, et al.* 81 FERC ¶ 61,250 (1997).

(continued…)

that there are two distinct sub-periods within the December 2, 1997 to November 9, 2002 refund period.

139. For the period December 2, 1997 to May 11, 1998 (the effective date of the motion rates and date the 1997 stay was lifted), the Missouri PSC requests that the Commission direct Kansas Pipeline to refund the difference between the rates the Commission permitted Kansas Pipeline to charge during this period the stay continued in effect, and the rates that would have gone into effect on December 2, 1997 absent the stay, *i.e.*, the October 3, 1997 rates. The Missouri PSC asserts that this is what Kansas Pipeline agreed to in its 1997 request for an extension of the stay.[122]

140. For the period May 11, 1998 to November 8, 2002, the Missouri PSC requests that the Commission direct Kansas Pipeline to refund the difference between the rates the Commission allowed Kansas Pipeline to charge (the motion rates) and properly calculated cost-based rates (using the October 3, 1997 cost-of-service with any appropriate downward adjustments).

141. Enbridge KPC's position is that refunds cannot extend back to December 2, 1997 because, it asserts, the Commission's jurisdiction over Kansas Pipeline did not take effect until May 11, 1998, due to the stay of the October 3, 1997 Order.[123] Enbridge KPC states that the exercise of the Commission's remedial authority cannot predate the effectiveness of its jurisdiction. Enbridge KPC argues that the effect of permitting refunds back to December 2, 1997 would be to extend the Commission's rate jurisdiction back to that date, but leave intact the May 11, 1998 effective date of the Commission's general jurisdiction. It states that the Commission in its April 30, 1998 Order and February 3, 1998 Order clarifying the 1997 stay order has already rejected such a "hybrid regulatory

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In subsequent orders, the Commission clarified that it was staying both the rate determinations and the Commission's assertion of jurisdiction in the October 3, 1997 order until 60 days after an order on the merits of the petitions for rehearing of the October 3, 1997 Order. Ultimately, the Commission lifted the stay only 10 days after the April 30, 1998 Order on rehearing approving the motion rates, *i.e.*, on May 11, 1998.

[122] Answer of Missouri PSC at 5 *citing* Kansas Pipeline's November 10, 1997 "Emergency Motion for Extension of Stay" at 10.

[123] March 24, 2004 Motion for Summary Disposition and Request for Expedited Action at 24.

regime" whereby Kansas Pipeline would have been operating under its Kansas Commission rates, but not its Kansas Commission tariff.[124]

142. It is unclear, however, what date Enbridge KPC believes is the earliest date at which it could be subject to a refund obligation. Enbridge KPC either believes refunds should extend back to May of 1998, at the earliest, or to April 3, 1999, the date of the Commission's order denying rehearing of its approval of the motion rates.[125]

143. The Commission will require Enbridge KPC to calculate its potential refunds to its customers based on the difference between the rates Kansas Pipeline collected [126] and the correct, cost-based rates determined by this order, with interest, for the period December 2, 1997 to November 9, 2002. Refunds calculated in this way, back to December 2, 1997, would put Kansas Pipeline's customers in the position they would have been in had the proper initial rates determined herein been placed into effect from the start – *i.e.*, as of the date the initial rates would have become effective under the October 3, 1997 Order, had they not been stayed.

144. The Commission rejects the argument that it cannot require refunds beginning on December 2, 1997 because its remedial authority cannot predate the effectiveness of its jurisdiction. The Commission possessed jurisdiction over Kansas Pipeline during the

[124] 83 FERC ¶ 61, 107 at 61,513 (1998); and 82 FERC ¶ 61,094, 61,359 (1998) ("The November 25 Order stayed in all material respects, the effectiveness of the Commission's October 3 Order, ...").

[125] On the first page of its October 3, 2003 pleading, Enbridge KPC describes the locked-in refund period as "May 1998 through October 2002," but later states that "the earliest date that refunds could conceivably be deemed appropriate is April 3, 1999, the date the Commission issued its order denying rehearing of its decision to approve the motion rates." Motion of Enbridge KPC at 15, n.38.

[126] From December 2, 1997 to May 11, 1998, Kansas Pipeline collected the existing rates of its predecessors, and from May 11, 1998 to November 9, 2002, Kansas Pipeline collected the motion rates. While these two sets of rates should be the same rates, to the extent that Kansas Pipeline charged slightly different rates for the two sub-periods, its calculation of refunds should reflect that difference.

1997 stay period. The Commission cannot stay its jurisdiction over a pipeline;[127] it can stay only its implementation, or assertion, of that jurisdiction. The October 3, 1997 Order asserted the Commission's jurisdiction over Kansas Pipeline. It lifted the Commission's earlier stay of the November 2, 1995 Order first asserting jurisdiction over Kansas Pipeline, issued a section 7 (c) certificate of public convenience and necessity to Kansas Pipeline, established a rate base and cost-of-service for Kansas Pipeline, authorized initial rates, and imposed a number of certificate conditions and filing requirements. The November 25, 1997 Order granting the stay of the October 3 Order did not stay the Commission's jurisdiction over Kansas Pipeline, but merely stayed "Kansas Pipeline's obligation to comply with the October 3 Order"[128] until the Commission acted on the petitions for rehearing of the order.

145. Thus, while the Commission stayed most aspects of its October 3, 1997 exercise of jurisdiction, it still retained jurisdiction over Kansas Pipeline. Without jurisdiction over Kansas Pipeline, the Commission could not have authorized the three predecessor pipelines comprising Kansas Pipeline to continue to provide the preexisting services and collect the preexisting rates during the stay period, or provided in its later February 3, 1998 clarifying order for the Kansas Commission to continue to act in all Kansas Pipeline Partnership matters pending before it. Indeed, when the Commission first stayed the effectiveness of its original November 2, 1995 Order's exercise of jurisdiction, the Commission nevertheless required Kansas Pipeline to file the section 7 (c) certificate application, which, without jurisdiction over Kansas Pipeline, the Commission would not have been able to require.

146. Further, neither the 1995 stay order, nor the 1997 stay order, delayed the implementation of jurisdiction because the Commission was unsure whether Kansas Pipeline was a jurisdictional entity. The 1995 stay extension was granted in order to ease Kansas Pipeline's transition to Commission jurisdiction and to avoid a service disruption during the winter heating season in the process. The 1997 stay was granted to preserve the status quo until the Commission could fully consider the arguments regarding the impact the October 3, 1997 rates would have on Kansas Pipeline's financial viability.

[127] *See Brooklyn Union Gas Company v. FERC*, 627 F.2d 462, 466 (D.C. Cir. 1980); and *Texaco, Inc. v. FPC*, 474 F.2d 416, 420 (D.C. Cir. 1972). *See also Transcontinental Gas Pipe Line Corporation*, 2 FERC ¶ 61,209 at 61,481 (1978).

[128] 81 FERC ¶61,250 at 62,135 (1997).

147. The Commission concludes that it would be a proper exercise of its jurisdiction to require Enbridge KPC to make any appropriate refunds of rates charged during the December 2, 1997 to May 11, 1998 stay period. The Commission could require refunds even for the period prior to the Commission's November 2, 1995 initial determination of jurisdiction, since the Commission has the power to establish remedies for actions taken or omitted by a natural gas company prior to the exercise of its jurisdiction, if the Commission later determines that it had jurisdiction over the company at the time of the earlier actions.[129]

148. Moreover, not only does the Commission have the authority to require refunds back to December 2, 1997, but, as explained below, Kansas Pipeline represented in its 1997 request for a stay of the October 1997 Order that it would make refunds of rates collected during the December 2, 1997 to May 11, 1998 period the stay was in effect.

149. The rates approved by the October 3, 1997 Order would have gone into effect on December 2, 1997, had Kansas Pipeline not requested in an emergency motion that the Commission stay the rate determinations of the October 3, 1997 Order (by extending the existing stay of the implementation of the November 2, 1995 Order finding Kansas Pipeline jurisdictional), until the Commission addressed its arguments on rehearing that the October 3, 1997 rates would cause irreparable financial harm. To satisfy the standard the Commission uses for granting a stay,[130] Kansas Pipeline assured the Commission that other parties would not be harmed by an extension of the stay on the basis that the preexisting rates would be charged, and that they would be collected subject to refund with interest. Kansas Pipeline stated:

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[129] *See Borough of Ellwood City v. FERC*, 583 F.2d 648 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 946 (1979) (where court held that "considerations of administrative practicality preclude requiring the Commission to search decades into the past in order to enforce every failure to comply with the regulatory scheme"). In the same order, the court nevertheless acknowledged that the sales at issue "were always subject to the Commission's jurisdiction," even before the Commission exercised such jurisdiction. *Id*. at 646).

[130] The Commission's standard is to issue a stay where justice so requires. *See City of Tacoma*, 85 FERC ¶ 61,130 at 61,478 (1998), *order denying reh'g and granting stay*, 87 FERC ¶ 61,197 at 61,732 (1999). In deciding whether justice so requires, the Commission considers various factors, including whether issuance of a stay would substantially harm other parties. *See also* Guardian Pipeline, L.L.C., 96 FERC ¶ 61,204, 61,869 (2001).

> This stay can be tailored to avoid any risk or injury to other parties, if the Commission permits Kansas Pipeline to charge its existing rates (subject to refund) while the stay is in effect. The difference between the rates that Kansas Pipeline charges during the period that the stay remains in effect, and the rates set in the October 3 Order (even if modified on rehearing) would be refunded, to the extent that they result in any overpayment by Kansas Pipeline's customers.
>
> Under this approach, Kansas Pipeline's customers would continue to pay the rates that are currently in effect under the Commission's existing stay. Further, any refunds ultimately ordered would earn interest, using the Commission's approved interest rate. Accordingly, no party would be prejudiced by Kansas Pipeline's requested extension of the existing stay.[131]

Later in its stay request, Kansas Pipeline further expressed its intent that the preexisting rates be collected subject to refund.[132]

150. Kansas Pipeline clearly committed to make refunds to its customers so that the customers would not be harmed by the stay. That commitment was essential to the Commission's being able to find that the requested stay could be granted, over the objections of MGE, Kansas Gas, the Missouri PSC, and Williams Natural Gas Pipeline, without creating the potential for irreparable harm to other parties.

151. Consequently, it would not be unfair to require Enbridge KPC to abide by the bargain Kansas Pipeline made to obtain the stay of the October 3, 1997 Order, and make refunds back to December 2, 1997. The Commission agrees with the Missouri PSC that, since the pipeline obtained a stay based on an understanding that it would make

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[131] Kansas Pipeline's November 10, 1997 "Emergency Motion for Extension of Stay" at 10.

[132] It stated, "Kansas Pipeline only requests that, during the period of the stay and pending the Commission's rehearing of the October 3 Order, the Commission permit Kansas Pipeline to continue to charge Western and MGE (*subject to refund*) the transportation rates included in their respective existing agreements." *Id*. at 12 (emphasis added). Kansas Pipeline again emphasized that "since these rates would be collected *subject to refund*, these customers should be economically indifferent as to the stay." *Id*. at 13 (emphasis added).

appropriate refunds attributable to the stay period, it is circular and illogical for the pipeline to now argue that the Commission lacks authority to require refunds for the stay period because the Commission stayed its assertion of jurisdiction.

152. Finally, the Commission is requiring that Enbridge KPC calculate refunds using the cost-based rates derived from this order for the entire December 2, 1997 to November 9, 2002 period, rather than using two different groups of lawful rates from which to calculate refunds for two separate sub-periods, as the Missouri PSC suggests.[133] It is not clear from Kansas Pipeline's 1997 stay request that the refunds which Kansas Pipeline contemplated would be due for the period the stay was in effect would be based on the exact October 3, 1997 rates, and not, instead, on the October 3, 1997 rates -- as later modified.[134] While in this order the Commission has used the October 3, 1997 rates as a starting point for determining the proper initial rates for Kansas Pipeline, the Commission has modified those rates herein to arrive at the lawful, cost-based initial rates that are in the public interest. There can only be one set of correct, lawful initial rates, and therefore, regardless of whether the originally determined initial rates were stayed, the lawful rates apply "initially" -- usually from the start of service, but in this case, from the Commission's originally ordered effective date of initial section 7 rates, that is, December 2, 1997.[135]

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[133] As stated, *supra*, the Missouri PSC requests that for the sub-period of December 2, 1997 to May 11, 1998, the Commission require Enbridge KPC to refund the difference between the rates that were collected and the October 3, 1997 rates (rather than the lawful rates determined in this order).

[134] Nor does Kansas Pipeline's belief that the rates collected during the period the stay was in effect would be refunded amount to a binding commitment on its part to make refunds or to make refunds of the difference between the amounts collected and the October 3, 1997 rates.

[135] Transcontinental Gas Pipe Line Corp. v. FERC, 54 F.3d 893, 899 (D.C. Cir. 1995) (where court, in finding that initial section 7 rates finally determined after service begins normally apply retroactively to the start of service, stated the "[t]he norm makes a good deal of sense, as it means that the 'right rate', *i.e.*, whatever rate the Commission lawfully determines to be right, is applied throughout the period despite the Commission's initial uncertainty and delay.").

The Commission orders:

(A) The approved initial rates for Kansas Pipeline/Enbridge KPC pursuant to section 7 of the NGA shall be calculated using the $21.8 million cost-of-service and rate base approved by the October 3, 1997 order in this proceeding, as adjusted: (1) to remove from the Accumulated Deferred Income Tax (ADIT) balance deferred taxes related to market entry costs, acquisition premiums, net debt expenses, and project development costs; (2) to utilize ADIT balances as of September 30, 1996; (3) to reduce the accumulated reserve for depreciation to reflect the Commission's exclusion of acquisition premium and market entry costs from gas plant in service, and thereby increase the net gas plant balance; (4) to include in the cost-of-service the annual cost of the Transok lease; and (5) to utilize a capital structure of 90 percent debt and 10 percent equity, and a rate of return on equity of 14 percent.

(B) In accordance with the findings in this order, for the period December 2, 1997 through November 8, 2002, Enbridge KPC shall calculate the amount of the refund that would be due to each of its customers based on the difference between the rates collected and the initial section 7 rates calculated based on the cost-of-service findings discussed more fully in the body of this order. Enbridge KPC shall also estimate the amount of interest that would be due to each customer.

(C) Enbridge KPC shall make a compliance filing within thirty days of the date of this order proposing revised tariff sheets consistent with the Commission's findings in this order.

(D) In the compliance filing required by ordering paragraph (C), above, Enbridge KPC shall: (1) utilize its ADIT balances as of September 30, 1996; and (2) verify the basis for its ADIT balances for (a) market entry costs, (b) acquisition premiums, (c) net debt expenses, and (d) project development costs, as discussed more fully in the body of this order.

(E) Within thirty days of the date of this order, Enbridge KPC shall file a refund plan indicating the amount of the refund due to each customer. The refund plan must show all calculations that would form the basis for the refund amounts and separately stated estimates of the interest due. The refund plan shall include Enbridge KPC's proposal for how it will make any refunds required.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.