131 FERC ¶ 61,037
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Duke Energy Guadalupe Pipeline, Inc. Docket Nos. PR05-17-000
PR05-17-005

ORDER ON REHEARING

(Issued April 15, 2010)

1. On April 18, 2008, the Commission issued an order (April 18 Order) [1] concerning the rates charged by Duke Energy Guadalupe Pipeline, Inc. (Guadalupe)[2] for transportation service under section 311 of the Natural Gas Policy Act of 1978 (NGPA).[3] The Commission also established a paper hearing on the issue of Guadalupe's return on equity (ROE). In this order, the Commission determines Guadalupe's ROE and grants in part and denies in part its request for rehearing of the April 18 Order.

I. Background

2. This proceeding has an extensive procedural history with numerous orders and rehearing requests filed by the two active parties, Guadalupe and Mewbourne Oil Company (Mewbourne). On August 1, 2005, Guadalupe filed a petition for rate approval for firm and interruptible transportation services rendered under NGPA section 311. Among other things, Guadalupe proposed a maximum system-wide base rate for firm and interruptible transportation service of \$0.1906 per MMBtu, plus a 1.85 percent Fuel and Lost and Unaccounted For (LAUF) gas charge, and a maximum parking and lending rate

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[1] *Duke Energy Guadalupe Pipeline, Inc.*, 123 FERC ¶ 61,057 (2008) (April 18 Order).

[2] On January 1, 2007, Duke Energy Guadalupe Pipeline, Inc. changed its name to DCP Guadalupe Pipeline, LLC.

[3] 18 C.F.R. § 385.713 (2009).

of $0.1906 per MMBtu. Guadalupe proposed a total cost-of-service of $17,400,716, based on its actual costs for the 12-month period ending March 31, 2005, with certain adjustments. Guadalupe's proposed rate design volumes were based on its throughput for the same period, with a downward adjustment to account for base period discounts. Guadalupe also proposed an ROE of 14 percent.

3. On November 18, 2005, Guadalupe filed an Offer of Settlement that outlined the proposed settlement of issues reached by Guadalupe and Commission Staff. The settlement provided for a maximum system-wide base rate for firm and interruptible transportation service of $0.1810 per MMBtu, plus the same 1.85 percent LAUF gas charge that Guadalupe proposed in its initial filing of the rate case. Mewbourne, a producer, filed comments opposing the settlement.

4. On December 29, 2005, the Commission issued an order approving the settlement stating that no party objected to the settlement's maximum base rate of $0.1810 per MMBtu. On January 7, 2006, Mewbourne filed a request for rehearing arguing that the Commission erred in finding that no party objected to the settlement's maximum base rate. Mewbourne further asserted that it had opposed this rate in its objection and argued that the rate would provide Guadalupe with an excessive return on equity.

5. On June 2, 2006, the Commission granted rehearing of its approval of the settlement and agreed that Mewbourne had in fact opposed the settlement's base rate.[4] The Commission also stated that, pursuant to Rule 602 of its Rules of Practice and Procedure,[5] the Commission may approve an uncontested settlement agreement upon a finding that the agreement is fair and reasonable and in the public interest. However, when a settlement is contested, the Commission must make an independent finding supported by substantial evidence in the record that the proposal as a whole will establish rates consistent with the statutory standard, here that the rate be "fair and equitable" under the NGPA.[6] Consequently, the Commission found that, because the agreement was contested, it could only approve the settlement if the Commission could find on the merits that the overall $0.1810 per MMBtu settlement transportation rate is less than or equal to the fair and equitable transportation rate the Commission would approve based on a merits resolution of all issues concerning Guadalupe's cost-of-service and rate

[4] *Duke Energy Guadalupe Pipeline, Inc*., 115 FERC ¶ 61,289 (2006) (June 2, 2006 Order).

[5] 18 C.F.R. § 385.602(g)(3) (2009).

[6] June 2, 2006 Order, 115 FERC ¶ 61,298 at P 11.

design volumes.[7] The Commission also determined that the present record was insufficient to make such a finding, and the Commission granted Mewbourne's rehearing request and instituted a Staff Panel proceeding.

6. Guadalupe requested rehearing of the June 2, 2006 Order alleging, among other things, that the Commission erred in its decision to overturn its previous approval of the Settlement; this rehearing request was subsequently denied by the Commission on July 21, 2006 (July 21 Order).[8] Guadalupe also requested rehearing of the Commission's July 21 Order.

7. On July 26, 2006, a Staff Panel was conducted with the parties. On April 18, 2008, the Commission issued a decision that, among other things, denied Guadalupe's request for rehearing of the July 21 Order, reaffirmed the rejection of the Settlement, and decided all issues concerning Guadalupe's proposed rates, except its ROE.[9] Specifically, the April 18 Order rejected Guadalupe's proposed adjustments to its cost-of-service (COS) and rate base that reflected known and measurable changes that Guadalupe expected to incur during the remainder of 2005 because such adjustments are against Commission policy. The Commission further held that Guadalupe had not met its burden of proof to support a discount adjustment to its rate design volumes in connection with discounts given to its affiliates; therefore, this adjustment was rejected.

8. Contemporaneously with the issuance of the April 18 Order in this proceeding, the Commission issued its *Policy Statement on the Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*.[10] In that policy statement, the Commission announced that it would permit master limited partnerships (MLPs) to be included in gas pipeline proxy groups, and the Commission set forth its policy concerning the Discounted Cash Flow (DCF) analysis of MLPs. Therefore, the April 18 Order determined that, before the Commission could resolve the issue of Guadalupe's ROE, further procedures were necessary to allow the parties to present additional evidence and argument in light of the policy statement. The Commission directed parties to file initial

[7] *Id*. at P 12.

[8] *Duke Energy Guadalupe Pipeline, Inc*., 116 FERC ¶ 61,080 (2006) (July 21 Order).

[9] *See* April 18 Order, 123 FERC ¶ 61,057.

[10] *Policy Statement on the Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity, 123* FERC ¶ 61,048 (2008) (*Proxy Group Policy Statement).*

briefs, reply briefs and rebuttal briefs on the above issues within 60, 90, and 105 days of the date of the order, respectively. Guadalupe was the only party that filed a brief.

9. On January 15, 2009, in *Kern River Gas Transmission Co.*,[11] the Commission issued its first order applying the *Proxy Group Policy Statement* in an individual case. In that order, the Commission held that the proxy group used to determine the pipeline's ROE must be based on proxy company data for the same test period as used to determine the rest of its cost-of-service, and the Commission analyzed the appropriateness of including various specific corporations and MLPs in the proxy group used in that case. Accordingly, on February 27, 2009, the Commission sent Guadalupe a data request asking it to file an updated DCF analysis and supporting documentation using data for each proposed proxy firm from Guadalupe's 12-month period ending March 31, 2005. [12] The Commission further requested Guadalupe to explain the reasons for any revised proxy group that Guadalupe might select in light of the *Kern River* decision. Guadalupe filed its response on March 9, 2009. Again no party filed a reply brief.

10. In light of the fact that Mewbourne, the only other active party in this case, did not file any reply opposing Guadalupe's filings on the ROE issue, the Commission's Dispute Resolution Service contacted the parties to offer its services to resolve this case by settlement. The parties agreed to meet, but their discussions failed to produce a settlement.

11. Accordingly, below the Commission first addresses Guadalupe's request for rehearing of the April 18 Order and then determines Guadalupe's ROE.

II. Request for Rehearing

12. Guadalupe identifies the following issues on rehearing stating the Commission should reconsider the April 18 Order's: (1) disallowance of certain adjustments to Guadalupe's cost-of-service; (2) disallowance of certain adjustment to Guadalupe's rate base; and (3) disallowance of Guadalupe's affiliate discount adjustment. The Commission grants rehearing in part of the discount adjustment issue and denies rehearing in all other respects.

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[11] *See Kern River Gas Transmission Co.*, 126 FERC ¶ 61,034 (2009) (*Kern River*).

[12] Commission Staff, February 27, 2009, Data Request at 1.

A. Cost-of-Service Adjustments

13. In its filing in this rate case, Guadalupe based its cost-of-service on its actual costs during the twelve-month period ending March 31, 2005. However, it made several adjustments to its Operations and Maintenance (O&M) expenses to reflect "known and measurable changes" that Guadalupe expected to incur during the remaining nine months of 2005. Guadalupe claims that these expenses included: (1) Guadalupe's share of compressor upgrade costs on the West Texas Line, (2) escalation and management fees on the West Texas Line pursuant to an operating agreement, (3) pipeline integrity projects, and (4) expected increased spending based upon the 2005 operating budget. In its initial rate filing in this case, Guadalupe stated that the adjustments increased its cost-of-service by $1,266,843. In its August 9, 2006 brief following the Staff Panel, Guadalupe stated that the actual O&M expenses it had incurred for these purposes during the remainder of 2005 totaled $787,038.[13]

14. The Commission disallowed the above adjustments on the ground that they reflected expenses outside the 12-month actual period ending March 2005.[14] The Commission stated that this was inconsistent with *Transok, Inc*., in which the Commission held that the "Commission's regulations simply require that section 311 rates be cost-based, and do not require a 'test-period' concept of ratemaking. Instead, the Commission's practice for section 311 ratemaking has been to use actual costs for a given 12-month period."[15]

15. On rehearing, Guadalupe asserts that *Transok* does not require rejection of its proposed adjustment. It contends that while *Transok* stated that a test period is not required under section 311 ratemaking, it does not hold that all adjustments outside a given 12-month period are prohibited. Guadalupe also claims that *Transok* holds that actual costs should be used, but does not hold that those costs may never be adjusted.

16. Likewise, Guadalupe states the other cases cited in the April 18 Order do not support a blanket prohibition on adjustments outside the 12-month period in an NGPA section 311 rate proceeding. Guadalupe argues that in *Mustang Fuel Corp.,* the Commission denied a pipeline's proposed adjustments outside the 12-month period because the pipeline "never explained what specific adjustments were made and the basis

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[13] Guadalupe, August 9, 2006, Initial Brief Attachment, Response No. 3 to Staff Panel Data Requests.

[14] *See* April 18 Order, 123 FERC ¶ 61,057 at P 14.

[15] *Transok, Inc*., 70 FERC ¶ 61,177, at 61,554 (1995) (*Transok*).

for any of the adjustments."[16] Therefore, Guadalupe contends that *Mustang Fuel* only stands for the proposition that unexplained adjustments will be disallowed. Guadalupe alleges that this proposition is clearly outlined in the *Mustang Fuel* rehearing order in which the Commission rejected the pipeline's rehearing request on the adjustment issue. Guadalupe avers that in the *Mustang Fuel* rehearing, the Commission stated that "[o]ur reason for rejecting Mustang's adjustments was that they were not adequately explained."[17] Thus, Guadalupe argues the clear implication of *Mustang Fuel* is that the Commission will accept adjustments that are supportable and explainable.

17. Guadalupe asserts the April 18 Order also does not acknowledge more recent cases in which section 311 rates that contained adjustments outside of the 12-month period were approved by the Commission. Guadalupe cites *Bridgeline Gas Distribution LLC* [18] and *Washington Gas Light Co.*[19] as examples of such instances. In *Bridgeline*, Guadalupe states the pipeline filed a cost and revenue study in support of its existing rates which included cost data "for the twelve months ending March 31, 2005, as adjusted for known and measurable changes."[20] Guadalupe argues the Commission held that the data submitted by Bridgeline supported a continuation of the pipeline's rates for its services.[21] Moreover, Guadalupe avers that the Commission approved rates filed in *Washington Gas,* which included cost-of-service data adjusted for known and measurable changes.[22] Consequently, Guadalupe contends that Commission precedent clearly permits adjustments for known and measurable changes outside the 12-month period in an NGPA section 311 rate proceeding.

18. Finally, Guadalupe alleges that its adjustments were adequately supported. Guadalupe states, as required by the standard outlined in *Mustang Fuel*, it explained what adjustments were made and provided the basis for those adjustments. Therefore,

[16] *Mustang Fuel Corp*., 31 FERC ¶ 61,265, at 61,528 (1985), *reh'g granted in part*, 36 FERC ¶ 61,001 (1986) (*Mustang Fuel*).

[17] *Id.* at 61,003.

[18] *Bridgeline Gas Distribution LLC*, 113 FERC ¶ 61,322 (2005) (*Bridgeline*).

[19] *Washington Gas Light Co*., 115 FERC ¶ 61,143 (2006) (*Washington Gas*).

[20] *Bridgeline*, 113 FERC ¶ 61,322 at P 2.

[21] *Id.*

[22] *Washington Gas*, 115 FERC ¶ 61,143 at P 1.

Guadalupe states the Commission should grant rehearing and accept Guadalupe's adjustments to its cost-of-service.

Discussion

19. In NGPA section 311 rate cases, the Commission's practice has been to determine rates based on actual costs for a given 12-month period before the proposed rates go into effect, without any adjustment for subsequent changes.[23] This policy requires pipelines to submit the most up to date cost information for the Commission's determination during section 311 rate cases at the time of filing. Guadalupe seeks, instead, to use a more complex test period methodology similar to that which the Commission uses in interstate pipeline rate cases under the Natural Gas Act (NGA). For the reasons discussed below, the Commission reaffirms that the interstate pipeline test period methodology is not appropriate for NGPA section 311 rate cases.

20. Under the Commission's test period regulations applicable to interstate pipelines,[24] the pipeline's rates are based on actual data for a 12-month base period, as adjusted for known and measureable changes that will occur during the following nine months (adjustment period). The regulations require that the base period end no more than four months before the pipeline makes its filing,[25] and the adjustment period must begin immediately after the base period.[26] Generally, this results in the adjustment period ending the day before the pipeline's rates take effect after the five-month suspension period permitted by NGA section 4.[27] The regulations also require that the known and measureable changes projected in the pipeline's filing actually become effective within the adjustment period,[28] and they require the pipeline to update its test period projections with actual data for the adjustment period when it becomes available.[29]

[23] *See, e.g.*, *Transok*, 70 FERC at 61,554; *See also Lear Petroleum Corp.*, 42 FERC ¶ 61,015 (1988).

[24] 18 C.F.R. § 154.303 (2009).

[25] 18 C.F.R. § 154.303(a)(1) (2009).

[26] 18 C.F.R. § 154.303(a)(2) (2009).

[27] *Williston Basin Interstate Pipeline Co.*, 87 FERC ¶ 61,265, at 62,021 (1999).

[28] 18 C.F.R. § 154.303(a)(4) (2009).

[29] 18 C.F.R. § 154.311(a)(b) (2009).

21. Consistent with the NGPA's goal of encouraging intrastate pipelines to participate in the interstate pipeline grid, Congress intended that rate regulation of intrastate pipelines under the NGPA be less burdensome than rate regulation of interstate pipelines under the NGA.[30] As the D.C. Circuit held in *Associated Distributors v. FERC*,[31]

> In § 311 Congress gave FERC broad authority to prescribe terms of transportation thereunder; it surely did not contemplate that FERC would use this authority to duplicate the regulatory scheme in place under the NGA . . . . Congress underscored this distinction in NGPA § 601(a)(2), providing that transportation in interstate commerce under § 311 shall not trigger the Commission's NGA jurisdiction. This seems an unequivocal expression of intent that NGPA regulation should not replicate the burdens of the NGA.

22. As part of this less burdensome approach to ratemaking for intrastate pipelines, the Commission does not require those pipelines to comply with the detailed requirements in sections 154.311 through 154.312 concerning the data that interstate pipelines must file to support an NGA section 4 rate filing. In addition, an intrastate pipeline filing a petition for rate approval under section 284.123 may immediately place the proposed rate into effect, subject to refund, without providing 30 days notice of the rate change as required by NGA section 4(d) or being subject to a five-month rate suspension as permitted by NGA section 4(e).[32]

23. It is consistent with this less burdensome approach to ratemaking for NGPA section 311 intrastate pipelines to determine their rates based on actual costs for a recent 12-month base period before those rates go into effect,[33] without also duplicating the nine-month adjustment period for known and measureable changes used in interstate

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[30] *Arkansas Western Gas Co*., 56 FERC ¶ 61,407, at 62,476-7 (1991), *reh'g denied*, 58 FERC ¶ 61,092 (1992).

[31] 824 F.2d 981, 1039-40 (D.C. Cir. 1987).

[32] 18 C.F.R. § 284.123(b)(2)(i) (2009). Also, as in this case, when an intrastate pipeline's rate filing is contested, the Commission uses advisory, non-evidentiary proceedings to resolve the issues, rather than setting the case for an evidentiary hearing before an Administrative Law Judge, as it does for interstate pipeline rate cases. *GulfTerra Texas Pipeline, L.P.*, 109 FERC ¶ 61,350, at P12 (2004).

[33] If significant changes in the pipeline's costs or volumes occur during the 12-month period, the Commission would consider proposals to annualize those changes.

pipeline rate cases. As described above, the nine-month adjustment period used in interstate pipeline rate cases is tied to the fact that rate increases proposed by interstate pipelines will not take effect until six months after the pipeline makes its rate filing, after both the 30-day notice period and five-month suspension. As a result, an interstate pipeline's one-year base period generally ends nine months before its proposed rates take effect, rendering the base period data relatively stale by the time the proposed rates take effect. The nine-month adjustment period allows for the updating of that data, while not permitting use of data from the period after the rates take effect, which would be contrary to the requirement of section 284.10(c)(2) that rates be based on projected units of service.

24. However, there is no such six-month delay between the date of an intrastate pipeline's rate filing and the effective date of its proposed rates. For example, in this case, the 12-month base period ended on March 31, 2005 and Guadalupe made its filing and put its proposed rates into effect only four months later on August 1, 2005. Therefore, in an NGPA section 311 rate case, there is less need to update stale 12-month base period data than in an NGA section 4 rate case. In addition, if a nine-month adjustment period were permitted in an NGPA section 311 rate case, that period would continue for a number of months after the intrastate pipeline's rates took effect, thus violating our policy that rates be based on projected units of service, not actual occurrences during the period the rates are in effect.

25. In addition, our authorization for interstate pipelines to project known and measurable changes expected to occur during the nine-month adjustment period is coupled by a requirement that those pipelines subsequently file actual data for that period. This permits the Commission to verify that the projected changes did take place and also to determine if any offsetting cost decreases occurred during that period. If the Commission were to permit intrastate pipelines to project known and measurable changes, the Commission would require intrastate pipelines to make similar filings of actual data for the adjustment period. As a result, the processing of NGPA section 311 cases would be complicated by the need to wait until after the end of the nine-month adjustment for the filing of actual data for that period.

26. Nothing in the precedent discussed by Guadalupe requires us to grant its request for rehearing on this issue. In *Transok*, the Commission developed the pipeline's rates based on actual data for an annual base period ending four months before its rate filing. The Commission rejected the pipeline's proposal to include adjustments to its rate base and depreciation allowance to reflect plant additions expected to be placed into service during the six months after the annual base period of actual costs.[34] The Commission

[34] *Transok*, 70 FERC at 61,554.

pointed out that its practice for section 311 ratemaking has been to use actual costs for a given 12-month period, as the Commission has done in this case.[35] The Commission also found that the pipeline had not provided updated cost-of-service or throughput volumes for the adjustment period, which could include other changes that would reduce the pipeline's rates. In this case, Guadalupe has provided the actual expenses it incurred during the remainder of 2005 for the O&M items for which it projected known and measurable changes.[36] However, Guadalupe did not provide a complete updated cost-of-service or throughput volumes for the remainder of 2005, as would be required if the Commission were to adopt for intrastate pipelines the same test period methodology it uses for interstate pipelines regulated under the NGA.

27. While Guadalupe argues that *Mustang Fuel* merely stands for the proposition that unexplained adjustments will not be allowed, the Commission disagrees. In *Mustang Fuel*, the Commission clearly stated that, "Staff used the most recent, actual cost-of-service and average rate base for twelve months in the record. Under these circumstances, we prefer Staff's approach of using actual figures without adjustment."[37] Further, while the Commission did state in the *Mustang Fuel* rehearing that unsupported adjustments cannot be accepted to meet Mustang's burden of proof, we also stated that "[a]ctual cost data is therefore more reliable and probative."[38] Thus, the Commission did not accept adjustments for claimed known and measurable changes such as Guadalupe is seeking here.[39]

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[35] *Id*.

[36] As described above, the actual expenses were $787,038, as compared to the $1,266,843 it had estimated.

[37] *Mustang Fuel*, 31 FERC at 61,528.

[38] *Mustang Fuel*, 36 FERC at 61,003.

[39] The 12 months of actual data the Commission used in *Mustang Fuel* was for a period after the rates at issue took effect. However, it appears that the record in that case did not contain actual, unadjusted cost data for a period before the rates took effect. In any event, that case was litigated before the Commission issued Order No. 436, requiring intrastate pipelines to perform NGPA section 311 service on an open access basis and before the Commission established its policy that rates for open access transportation service should be based on projected units of service. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. [Regulations Preambles 1982-1985]* ¶ 30,665 (1985), *vacated and remanded, Associated Gas Distributors v. F.E.R.C.*, 824 F.2d 981 (D.C. Cir. 1987), *readopted on an interim basis,*

(continued…)

28. In addition, Guadalupe argues that the Commission's precedent of using 12-month's of actual costs has exceptions by citing the *Washington Gas* and *Bridgeline* decisions; however, these two cases are distinguishable from the instant one and the Commission's decisions in them did not represent an actual change in our established practice on the use of 12 months of actual cost data. In both cases, the pipelines were proposing to continue their existing rates, and thus the Commission's review of the pipelines' filings was limited to determining whether the filed cost and revenue information indicated that it should initiate a proceeding to lower the pipeline's current rates.

29. In *Washington Gas*, the Commission's order states that Washington Gas filed updated cost, revenue and throughput data to comply with a May 1, 2003 Order[40] based on its cost-of-service for the 12 months ending December 31, 2004, as adjusted for known and measure changes. The order further stated that, based on the above filing, Washington Gas had justified the continuation of its current maximum rates. Although the order states that Washington Gas' cost data was adjusted for known and measurable changes, a simple review of the cost data submitted by Washington Gas shows that actually no adjustments were made to the cost-of-service data. In fact, the submission by Washington Gas only included the company's 12-month actual cost-of-service data. Therefore, the Commission's acceptance of a compliance filing in *Washington Gas* did not constitute a change to our existing precedent in section 311 rate proceedings because we did not approve cost data with known and measurable changes.

30. With regard to the *Bridgeline* case, Bridgeline submitted a cost and revenue study for the 12-month period ending March 31, 2005, as adjusted for known and measurable changes. The study was submitted in compliance with the Commission's September 23, 2003 Letter Order approving a settlement in Docket No. PR02-14-001.[41] The analysis of Bridgeline's cost and revenue study showed a revenue deficiency of approximately $4.8 million dollars. Based on the results of this study, the Commission determined that

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Order No. 500, 52 Fed. Reg. 30,334 (Aug. 14, 1987), III FERC Stats. & Regs. ¶ 30,762 (1987), *remanded*, *American Gas Assoc. v. FERC*, 888 F. 2d 136 (D.C. Cir. 1989), *readopted*, Order No. 500-H, 54 Fed. Reg. 52,344 (Dec. 21, 1989), III FERC Stats. & Regs. ¶ 30,867 (1989), *reh'g granted in part and denied in part*, Order No. 500-I, 55 Fed. Reg. 6605 (Feb. 26, 1990), III FERC Stats. & Regs. ¶ 30,880 (1990), *aff'd in part and remanded in part*, *American Gas Assoc. v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990).

[40] *Washington Gas Light C*o., 103 FERC ¶ 61,107, at P 5 (2003).

[41] 104 FERC ¶ 61,313 (2003).

Bridgeline's currently effective transportation and storage rates should be continued. While the Commission approved the continuation of Bridgeline's rates based on an adjusted cost study, a review of this study shows that if the known and measurable changes had been excluded, the results of the financial analysis would have been a revenue deficiency greater than $4 million.

31. In any event, the acceptance of a cost study with known and measurable adjustments was an anomaly which was not consistent with the Commission's normal practice on the use of 12 months of actual cost-of-service data. This anomaly does not change our well established practice and we see no reason to deviate from that policy in this instance. Accordingly, we affirm our decision in the April 18 Order to disallow Guadalupe's proposed adjustments to its cost-of-service for "known and measurable changes" slated to occur during the remainder of 2005 or outside of the given 12-month cost period.

B. <u>Rate Base</u>

32. In its rate filing in this case, Guadalupe also made several adjustments to the cost of its plant in its rate base calculation to reflect known and measurable investments in additional plant which Guadalupe expected to make throughout the remainder of 2005. Guadalupe itemized and provided dollar amounts for each of the items for which it sought adjustments. These adjustments increased the plant investment in Guadalupe's proposed rate base by $1,776,958. The Commission rejected these adjustments for the same reasons that it rejected the Guadalupe's cost-of-service adjustments. On rehearing, Guadalupe alleges that the April 18 Order is incorrect because adjustments outside the 12-month base period are not prohibited in section 311 rate proceedings. Consequently, Guadalupe asserts the Commission should grant rehearing and accept its adjusted rate base.

33. Based on the Commission's decision above, we deny Guadalupe's request to restore the $1,776,958 adjustment to its rate base because such costs occurred outside the 12-month base period; therefore, including them in rate base is contrary to Commission policy concerning NGPA section 311 rates. Moreover, Guadalupe has provided no information to indicate what its actual plant investments were during the remainder of 2005 or whether the facilities in question were actually placed into service by the end of 2005.

C. <u>Discount Adjustment</u>

34. In the petition for rate approval, Guadalupe proposed to reduce the volumes it uses to design rates to reflect discounts it provided during the 12-month base period, including discounts given to one of its affiliates (Affiliate 1). Guadalupe provided an attachment in support of its proposed discount which compared the discounted rates offered to both Affiliate 1 and non-affiliates that occurred during the base period.

35. In the April 18 Order, the Commission approved the proposed discount adjustment in connection with Guadalupe's discounts to non-affiliates. However, the Commission rejected any discount adjustment for the discounts given to Guadalupe's Affiliate 1. The Commission explained that to the extent a pipeline was required during the test period[42] to give discounts either to attract or retain load, it need not design its rates on the assumption that such discounted volumes would flow at maximum rates. While the Commission generally presumes that a pipeline's discounts to non-affiliates are required to meet competition, there is a much heavier burden on the pipeline to justify its discounts to affiliates. That is because, unlike with discounts to non-affiliates, pipelines have incentives to offer affiliates discounts not required by competition.

36. The April 18 Order thus stated that Guadalupe has the burden in this case of showing that its discounts to affiliates were required by competition. The Commission stated that Guadalupe must provide information concerning how the level of the discounts to affiliates was determined and why it was necessary to grant those discounts, for example, by identifying the transportation and/or fuel alternatives available to the affiliated customer that gave rise to the decision to discount or by showing that it was routinely unable to collect its maximum rate on a particular segment, so that the affiliate merely received the same level of discount granted to its non-affiliated shippers.[43]

37. The Commission held that Guadalupe failed to meet this burden. Specifically, the April 18 Order noted that Guadalupe sought to show that the discounts to Affiliate 1 were required by competition by asserting that it offered similar discounts to non-affiliated shippers for similar service. It relied on Attachment 1 to Appendix B in its initial brief[44] to make this showing. However, the Commission stated that the rates shown in that attachment were based on the entire dollar amount paid by each shipper, including cash payments for fuel use. The April 18 Order further observed that "including cash payments for fuel distorts the analysis, because Guadalupe recovers fuel costs from interstate customers through an in-kind fuel reimbursement percentage, while recovering fuel costs from at least some intrastate customers through cash payments. It thus appears that the rates shown on Attachment 1 to Appendix B include the entire amount some shippers paid for service on Guadalupe, including both the base transportation rate and the fuel charge, but only include the base transportation rates paid

[42] Consistent with the discussion in the preceding section, the 12-month base period constitutes the entire "test period" in an NGPA section 311 rate proceeding.

[43] *See EPGT Texas Pipeline, L.P.*, 99 FERC ¶ 61,295, at 62,255 (2002) (*EPGT*).

[44] *See* Guadalupe, August 9, 2006, Attachment 1 to Appendix B to Initial Brief.

by other shippers."[45] The Commission considered this an "apples to oranges comparison" that did not provide a reliable basis for determining whether Guadalupe offered similar discounts to both its affiliate and non-affiliates. The Commission also pointed out that Guadalupe had only sought a discount adjustment with respect to discounts of its base rates. Therefore, for purposes of analyzing whether Guadalupe's Affiliate 1 discounts were similar to its discounts to non-affiliates, the relevant comparison should be to the base transportation rates paid by each shipper, excluding any cash payments for fuel.

38. On rehearing, Guadalupe claims the Commission's analysis of Attachment 1 relied on Footnote 1 in Guadalupe's initial brief. Guadalupe asserts the footnote in question stated, "for comparison purposes, rate represents agreed upon rate before adjustments were made to remove value associated with fuel."[46] Guadalupe states that this footnote was incorrect because the rates shown in Attachment 1 to Appendix B did not contain any amounts for fuel use. Guadalupe asserts the footnote should have stated that the rates shown in the attachment represent agreed upon rates after adjustments were made to remove the value associated with fuel. Guadalupe also contends, because the rates shown for non-affiliates do not include any fuel costs, the figures in Attachment 1 to Appendix B correctly compared the rates paid by both Guadalupe's Affiliate 1 and non-affiliates, and there was no distortion in the analysis because the rates paid by Affiliate 1 and non-affiliates are comparable. Moreover, Guadalupe notes that some of the rates and corresponding volumes provided in its initial Response to Standard Data Request 8[47] for this affiliate were also incorrect. To clarify the information regarding the discount adjustments and fuel volumes, Guadalupe provided a revised answer to Standard Data Request 8 which was affixed to its request for rehearing.

39. Next, Guadalupe states the April 18 Order claims that it did not provide sufficient information about each discount offered to Affiliate 1 to show: (1) how the level of each discount was determined; (2) why it was necessary to grant those discounts; (3) the rates available to the affiliate on other pipelines for the transactions in questions; and (4) that the level of discounts to the affiliate was necessary to retain it as a customer. Guadalupe maintains that the Commission's conclusions were mistaken because Guadalupe did provide adequate information to the Commission supporting its affiliate discounts.

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[45] April 18 Order, 123 FERC ¶ 61,057 at P 40.

[46] *See* Guadalupe, August 9, 2006, Initial Brief at Attachment 1, note 1.

[47] *See* Guadalupe, August 1, 2005, Response to Data Request No. 8 to Staff Standard Data Request.

Guadalupe argues that in *Trunkline Gas Co*., the Commission held that in order to support affiliate discounts, a pipeline could "show that it was routinely unable to collect its maximum rate on a particular segment so that the affiliate merely received the same level of discount granted to non-affiliate shippers. In addition, the pipeline must compare discounts given to non-affiliates by zone or distance to show that affiliates and non-affiliates were treated similarly when they were in similar situations."[48] Based on the *Trunkline* standard, Guadalupe claims that it has provided the Commission with sufficient evidence to meet its burden of proof.

40. Guadalupe avers it has clearly demonstrated that the Affiliate 1 discounts were necessary to retain the affiliate as a customer. Specifically, Guadalupe states that Attachment 1 to Appendix B shows that Affiliate 1 only transported natural gas during a portion of the base period, from October 2004 – March 2005. After March 2005, Guadalupe states this affiliate transported natural gas on another system for six months because the affiliate received better rates from the other pipeline. Guadalupe argues that Affiliate 1's decision to leave the system when more favorable options were available supports a finding that Guadalupe needed to offer discounts to retain the affiliate as a customer.

41. Guadalupe also contends, as outlined in Attachment 1 to Appendix B, that the level of discounted rates paid by Affiliate 1 and non-affiliates was the same and therefore supported by Commission policy. Guadalupe avows that the Commission allows pipelines to provide a discount because otherwise "there would be a disincentive for pipelines to discount their rates to capture marginal firm and interruptible business."[49] Guadalupe avers that providing such discounts benefits all customers because it allows a pipeline to maximize throughput and thus spread fixed costs over more units of service.

42. Finally, Guadalupe asserts that there is significant competition for natural gas transportation service in the area where Guadalupe provides transportation service. In fact, Guadalupe asserts the April 18 Order allowed discounts to Guadalupe's non-affiliates based on the assumption that there was competition on the Guadalupe system; based on this assumption, Guadalupe states the Commission should also allow discounts to Guadalupe's affiliate. Guadalupe further argues, because of competition, information on the rates charged by similar pipelines is confidential and usually unavailable to a pipeline's competitors. Guadalupe further alleges that, by requiring it to supply information generally not available, the April 18 Order essentially repeals the

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[48] *Trunkline Gas Co.*, 90 FERC ¶ 61,017 at 61,096 (2000) (Trunkline).

[49] *See EPGT*, 99 FERC at 62,255.

Commission's policy allowing discount adjustments in order to meet the requirements of competition. Consequently, Guadalupe states the Commission should reconsider its decision regarding the discounts to Affiliate 1.

Discussion

43. The question of adjusting rate design volumes to account for discounts has been addressed in a number of rate cases.[50] In these cases, the Commission has stated that discounts benefit all customers, including captive customers who do not receive discounts, because the discounts allow the pipeline to maximize throughput and spread fixed cost recovery over more units of service. The Commission has also held that, to the extent a pipeline was required during the test period to give discounts either to attract or retain load, it does not need to design its rates based on the assumption that discounted volumes would flow at maximum rates. To obtain such a discount, the Commission held that the pipeline has the burden of proving that discounts reflected in its discount adjustment were appropriate and that its throughput projections are reasonable. The Commission, however, has made a distinction between discounts to non-affiliates and discounts to affiliates. In order to obtain an affiliate discount adjustment in a section 311 rate proceeding, the Commission has ruled that a pipeline has a heavy burden of showing that its discounts are required to meet competition.[51]

44. In our decision on Guadalupe's affiliate discounts, the Commission ruled that the pipeline failed to meet its burden of proving that the Affiliate 1 discounts were required by competition.[52] The Commission also opined that Guadalupe had not provided enough evidence to show that the discounts given to Affiliate 1 were reasonable and not unduly discriminatory. The Commission's analysis of the pipeline's discounts to Affiliate 1 was based on the figures in Guadalupe's Attachment 1 to Appendix B showing the rates paid by both Guadalupe's affiliates and non-affiliates. According to the information provided by Guadalupe, these figures included the entire dollar amount paid by each shipper,

[50] *See, e.g.*, *Williston Basin Interstate Pipeline*, 67 FERC ¶ 61,137 (1994); *Panhandle Eastern Pipe Line Co*., 71 FERC ¶ 61,228 (1995); *Northwest Pipeline Corp.*, 71 FERC ¶ 61,253 (1995); *Panhandle Eastern Pipe Line Co*., 74 FERC ¶ 61,109 (1996); *Williams Natural Gas Co*., 77 FERC ¶ 61,277 (1996), *reh'g denied*, 80 FERC ¶ 61,158 (1997); *Iroquois Transmission System, L.P*., 84 FERC ¶ 61,086 (1998), *reh'g denied*, 86 FERC ¶ 61,261 (1999); *Williston Basin Interstate Pipeline*, 84 FERC ¶ 61,081 (1998); *Northwest Pipeline Corp*., 87 FERC ¶ 61,266 (1999); and *Trunkline.*, 90 FERC ¶ 61,017.

[51] *EPGT*, 99 FERC at 62,255.

[52] April 18 Order, 123 FERC ¶ 61,057 at P 39-40.

including cash payments for fuel use. The Commission concluded that including cash payments in the figures was incorrect and the information could not be used to verify that Guadalupe provided similar discounts to its affiliates and non-affiliates. However, based on Guadalupe's resubmission of a corrected response to Standard Data Request 8, the Commission determines that the pipeline has met this burden with respect to all of its discounts with the exception of one.

45. Specifically, Guadalupe's revised response to Standard Data Request 8 shows the rates associated with specific volumes which were calculated "net of fuel." Guadalupe stated in its revised response that some of these transactions were backhauls, which were not subject to a fuel charge and thus were too low. Guadalupe in its revised response stated that it has reconciled this oversight by associating the volumes of gas with the correct rates for the months when the transportation occurred. The attachment to Guadalupe's revised response now appropriately shows corresponding transactions of like kind between its affiliates and non-affiliates. The Commission finds this information shows that the majority of the discounts to Guadalupe's Affiliate 1 were necessary for competition and therefore reasonable and not unduly discriminatory. In all but one case, Guadalupe's Affiliate 1 has paid equal to or in excess of the rate charged to a non-affiliate.

46. Although Guadalupe has provided justification for certain discounts, it has still failed to justify the $0.01 discounted rate for 1,802,530 Dth to its Affiliate 1 shown on line number three of its revised response to Standard Data Request 8. That discounted rate is $0.02 less than the next lowest discounted rate charged, and Guadalupe has not provided any explanation why that transaction required a lower discounted rate than any of its discounts to non-affiliates. Therefore, with the exception of this discount, Guadalupe has shown that its discounts to Affiliate 1 were required by competition and just and reasonable and not unduly discriminatory. Accordingly, the Commission will allow these discount adjustments.

III. Return on Equity

A. Background

47. In its August 1, 2005 filing, Guadalupe proposed a capital structure of 70.8 percent equity and 29.2 percent debt.[53] Guadalupe requested a 14 percent return on the equity portion of its rate base. In support of its proposed return on equity, Guadalupe submitted

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[53] *See* Exhibit B Schedule 6 of Duke Guadalupe's Request for Rate Approval filed on August 1, 2005 in Docket No. PR05-17-000. This capital structure percentage was the capital structure of Guadalupe's parent company.

a discounted cash flow (DCF) study based on January to June 2005 data for a proxy group consisting of nine firms, including both corporations and MLPs. That DCF study produced a range of reasonable returns of 9.1 to 14.1 percent. The median return was 11.1 percent. Guadalupe requested that its return be set near the top of the range, at 14 percent, arguing that its risk is higher than average. Among other things, Guadalupe argued that it has relatively high risk because it obtains most of its revenues from volumetric rates, unlike interstate pipelines. It also pointed out that the proxy group included corporations with significant local distribution activities which are less risky than Guadalupe's pipeline business.

48. Mewbourne, the only other party in the proceeding, did not oppose Guadalupe's proposed capital structure or present any DCF study of its own. However, it argued both at the Staff Panel and in its initial and reply briefs following the Staff Panel that Guadalupe's risk is relatively low, and therefore its ROE should be set below the 11.1 median of Guadalupe's DCF study, at 10.6 percent. Mewbourne emphasized that Guadalupe has relatively low financial risk because of its equity-rich capital structure. Mewbourne also stated that a significant portion of the transportation service Guadalupe provides is for its affiliates, thereby reducing any risk associated with its volumetric rates.

49. While the April 18 Order decided all other issues raised at the Staff Panel, the Commission determined that additional procedures were necessary to permit resolution of the issue of Guadalupe's ROE. Contemporaneously with the April 18 Order, the Commission issued the *Proxy Group Policy Statement*, modifying the Commission's policies concerning the composition of proxy groups used in natural gas and oil pipeline rate cases. Therefore, the April 18 Order established a paper hearing on issues related to determining Guadalupe's ROE, including the composition of the ROE proxy group, the Discounted Cash Flow (DCF) analysis of the firms included in the proxy group, and related issues of risk. Guadalupe was the only party that filed a brief in response to the April 18 Order.

50. After Guadalupe filed its initial brief, the Commission issued Opinion No. 486-B in *Kern River Gas Transmission Co.*,[54] determining the appropriate proxy group in that proceeding consistent with the *Proxy Group Policy Statement*. Specifically, the Commission held that the proxy group used to determine Kern River's ROE must be determined based on proxy company data for the same test period as used to determine the rest of its cost-of-service. Based on that data, Opinion No. 486-B adopted a proxy group consisting of five firms: two corporations, Kinder Morgan Inc. (Kinder Morgan)

[54] *Kern River Gas Transmission Company*, 126 FERC ¶ 61,034 (2009) (Kern River).

and National Fuel Gas Co. (National Fuel), and three master limited partnerships (MLP), Northern Border Partners, L.P. (Northern), TC Pipelines, L.P., and Kinder Morgan Energy Partners, LP (KM Energy).[55]

51. On February 27, 2009, after the issuance of Opinion No. 486-B, the Commission sent a data request asking Guadalupe to file an updated DCF analysis and supporting documentation using data for each proposed proxy firm from Guadalupe's 12-month base period ending March 31, 2005. The Commission further requested Guadalupe to explain the reasons for any revised proxy group that Guadalupe might select in light of the recent *Kern River* decision.

52. On March 9, 2009, Guadalupe filed its response to the Commission's data request stating that it had adopted the identical five firms for the proxy group used by the Commission in *Kern River*. Guadalupe states that it estimated the cost of equity for each pipeline in the proxy group using the DCF methodology approved in the *Proxy Group Policy Statement* and financial data for the test period that was used for the rest of Guadalupe's cost-of-service, 12 months ending March 31, 2005.

53. First, Guadalupe asserts that it calculated an adjusted dividend yield by increasing the historical six-month dividend yield (January – June 2005) by one-half the near-term growth rate. Afterwards, Guadalupe states that it calculated a composite growth rate, consisting of a short-term growth rate and a long-term growth rate for each pipeline.

54. To determine the short-term growth rate for each pipeline, Guadalupe contends that it used the IBES short term growth rates as published by Standard and Poor's June 2005 Earnings Guide. To determine the long-term growth rate, Guadalupe avers that it used the simple average of the growth rate projections in the: Gross Domestic Product (GDP) by Global Insight; Energy Information Administration; and Social Security Administration from 2009 through end of the forecast horizon. Guadalupe states that it reduced the long-term growth rate for pipelines organized as MLPs by one-half based on the Commission's decision in the *Proxy Group Policy Statement*.

55. Next, Guadalupe avers that it calculated the composite growth rate for each firm by weighting the IBES growth rate two-thirds and weighting the GDP growth rate corresponding to the pipeline's organizational form by one-third. Based on the above calculations, Guadalupe contends the outcome of its DCF study is as follows:

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[55] *Id*. P 131.

Company Name	Organizational Form	Cost of Equity
Kinder Morgan	Corporation	13.47
Northern	MLP	11.64
KM Energy	MLP	11.26
TC Pipelines	MLP	11.12
National Fuel	Corporation	9.15

The median of the 9.15 to 13.47 percent range established by Guadalupe's DCF study is 11.26 percent. Guadalupe urges the Commission to adopt these figures as they are based on the decisions in the *Proxy Group Policy Statement* and *Kern River*.

56. In both its initial brief in the paper hearing and its response to the data request, Guadalupe asserts the Commission should grant its proposal for a ROE of 14 percent, which Guadalupe requested in its August 2, 2005 rate application. Guadalupe alleges that its return on equity should be set near the high point of the range because it faces significantly greater risk than the other pipelines in the proxy group. First, Guadalupe asserts that it faces greater risk because a sizeable portion of Guadalupe's revenues are derived from volumetric rates as compared to the proxy group pipelines, most of which have interstate pipeline business and rates based on the Straight Fixed Variable (SFV) rate design. Unlike the pipelines that have an SFV rate design with demand charges and largely long-term firm shippers, Guadalupe states that it does not have a guaranteed revenue stream. Guadalupe contends it obtains revenues only when natural gas is moving on the Guadalupe pipeline system.

57. Guadalupe argues the Commission has recognized the correlation between risk and the use of volumetric rates rather than an SFV rate design in the proceedings *Mojave Pipeline Company*[56] and *Transcontinental Gas Pipe Line Corporation*.[57] In *Mojave,* Guadalupe states the Commission affirmed the ALJ's reduction of the company's ROE from 14 to 11.75 percent. Guadalupe argues the ALJ had determined that Mojave faced only moderate business risk largely as a result the company's risk being reduced by the

[56] *Mojave Pipeline Co*., 81 FERC ¶ 61,150 (1997) (Mojave).

[57] *Transcontinental Gas Pipe Line Corp*., 80 FERC ¶ 61,157 (1997) (Opinion No. 414).

required shift to a SFV rate design. In Opinion No. 414, Guadalupe asserts the Commission stated:

> The Commission agrees that Transcontinental's allocation of a substantial portion of its costs for recovery through its interruptible [commodity] rates does place Transcontinental at somewhat more risk. . . . On balance we find Transcontinental's risk of under recovery somewhat offsets the advantages of its lengthy contract terms.[58]

Guadalupe states that, unlike *Mojave*, it typically uses a non-SFV rate design. Guadalupe also asserts that it largely relies on volumetric rates to recover its cost-of-service like Opinion No. 414. Thus, Guadalupe alleges that it encounters more risk than the conventional interstate pipelines operated by the firms in the proxy group.

58. Guadalupe claims that it faces greater competitive risk relative to the pipelines in the proxy group. Guadalupe avers that it operates in the competitive Texas market which contains a vast number of interstate and intrastate pipelines operating throughout the state. Guadalupe further asserts that it operates in the most competitive part of Texas between two market hubs (Waha and Katy) where shippers have multiple alternatives to Guadalupe for moving their gas to the marketplace.

59. Moreover, Guadalupe argues that the competitive environment in which it operates affects the pipeline's throughput, the price it can charge for service, and its ability to recover its cost of providing service. Guadalupe states the Commission recognized that uncertainty regarding throughput can cause increased business risk in *Corpus Christi LNG, L.P*.[59] Guadalupe claims the Commission recognized this risk as a factor in its approval of the pipeline's 14 percent ROE. Guadalupe asserts, because it faces similar business risks regarding the uncertainty over its throughput, the Commission should also approve a 14 percent ROE for Guadalupe.

60. No party filed a reply to Guadalupe's response to the data request.

B. <u>Discussion</u>

61. NGPA section 311(a)(2)(B) provides that the rates charged by an intrastate pipeline for interstate service "shall be fair and equitable and may not exceed an amount

[58] *Id.* at 61,676.

[59] *See Corpus Christi LNG, L.P.*, 111 FERC ¶ 61,081 (2005).

which is reasonably comparable to the rates and charges which interstate pipelines would be permitted to charge for providing similar transportation service." In order to determine an intrastate pipeline's ROE for section 311 transportation service, the Commission generally uses the same proxy group as has been used in recent NGA section 4 rate cases.[60] The Commission finds that Guadalupe's proposal to use the same proxy group as the Commission approved in *Kern River* is consistent with this policy. In addition, Guadalupe's DCF analysis of each proxy firm is consistent with the methodology approved in the *Proxy Group Policy Statement*. Therefore, the Commission adopts Guadalupe's proposed proxy group and the results of the DCF study performed by Guadalupe.

62. We now turn to an analysis of Guadalupe's relative risk within the range of ROEs established by the proxy group in order to determine where in that range to set Guadalupe's ROE. Guadalupe argues for an ROE of 14 percent because it alleges that the pipeline faces greater competitive and economic risk than the firms in the proxy group. As held in *Transcontinental Gas Pipe Line Corp.*, the Commission assumes that most pipelines falls into a broad range of average risk, absent highly unusual circumstances that indicates an anomalous or low risk as compared to other pipelines.[61] Therefore, unless a party makes a very persuasive case in support of the need for an adjustment and the level of the adjustment proposed, the Commission will set the pipeline's return at the median of the range of reasonable returns.[62]

63. In this instance, Guadalupe has not made such a showing. In arguing that it faces substantial economic risk, Guadalupe emphasizes the fact that it charges volumetric rates for its NGPA section 311 transportation service. However, during the base period, Guadalupe provided approximately three-quarters of its interstate service to Affiliate 2

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[60] *EPGT Texas Pipeline, L.P.*, 99 FERC ¶ 61,295, at 62,250-1 (2002) (*EPGT*); *Bay Gas Storage Co*., 111 FERC ¶ 61,345, at PP 31-32 (2005); *Cranberry Pipeline Corp*., 112 FERC ¶ 61,268, at PP 26-27 (2005).

[61] *Transcontinental Pipeline Corp*., 90 FERC ¶ 61,279, at 61,936 (2000) (*Transco*). The Commission explained, "The tools available to the Commission for determining the return on equity to be awarded a particular pipeline are blunt. Therefore, the Commission is skeptical of its ability to make carefully calibrated adjustments within the zone of reasonableness to reflect the generally subtle differences in risk among pipelines."

[62] *Id*.

and that affiliate paid Guadalupe's maximum rate.[63] Thus, Guadalupe's business risk is limited by the fact Affiliate 2 is its largest NGPA section 311 interstate customer and that customer pays the maximum rate.

64. In addition, even assuming Guadalupe has somewhat higher than average business risk, that risk is offset by its unusually low financial risk. Guadalupe's capital structure contains only 29.2 percent debt, as compared to 70.8 percent equity. In Opinion No. 414-A,[64] the Commission found that Transco's debt ratio of 42.42 gave it relatively low financial risk. The Commission held that this lower financial risk offset the fact, determined in Opinion No. 414, that Transco recovered a substantial portion of its costs through volumetric interruptible rates. Opinion No. 414-A accordingly determined that Transco faced average risk, and set Transco's ROE at the median of the range of reasonable returns.[65] Guadalupe's debt ratio of 29.2 percent is significantly lower than Transco's debt ratio of 42.42 percent, thus giving Guadalupe even lower financial risk than Transco.

65. In fact, Guadalupe's capital structure has a proportion of equity at the very high end of what the Commission has approved as reasonable.[66] The Commission has long

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[63] Guadalupe, August 1, 2005 Attachment 6 at 101.

[64] *See Transcontinental Gas Pipe Line Corp*., Opinion No. 414-A, 84 FERC ¶ 61,084 (1998), *reh'g denied*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998), *petition for review denied*, *North Carolina Utilities Commission v. FERC*, D.C. Cir. Case No. 99-1037 (February 7, 2000) (*per curiam*); *See also* Opinion No. 414, 80 FERC at 61,654, note 3.

[65] *See* Opinion No. 414-A at 61,427-3.

[66] *See Panhandle Eastern Pipe Line Co.*, 71 FERC ¶ 61,228 (1995) (61.79 percent equity), *Panhandle Eastern Pipe Line Co.*, 74 FERC ¶ 61,109 (1996) (59.97 percent equity), *Pacific Gas Transmission Co.*, 62 FERC ¶ 61,109 (1993) (68.86 percent equity), Opinion No. 414-A (57.58 percent equity) *Williams Natural Gas Co.*, 84 FERC ¶ 61,080 (1998) (64.29 percent equity), *Bay Gas Storage Co. Ltd.*, 111 FERC ¶ 61,345 (2005) (53.72 percent equity), *Transco*, 90 FERC ¶ 61,279 (60.2 percent equity), *Iroquois Gas Transmission System, L.P.*, 86 FERC ¶ 61,261 (1999) (35.209 percent equity). Moreover, in the following cases, the Commission imputed a capital structure well below Guadalupe's 70.8 percent equity because the actual capital structures claimed by the pipelines exceeded a reasonable level. *See KansOk Partnership*, 71 FERC ¶ 61,340 (1995) (The Commission imputed a 50-50 capital structure after finding that both KansOk and the pipeline that provided its financing had atypical capital structures of 100

(continued…)

recognized that an equity-rich capital structure increases costs to ratepayers,[67] because a pipeline's cost of equity is higher than its cost of debt.[68] While the Commission is accepting Guadalupe's proposed capital structure with its high equity ratio, the Commission finds that such a capital structure should not be accompanied with a return on equity above the median.

66. Finally, the *Corpus Christi* order, relied on by Guadalupe, is distinguishable from this case. In *Corpus Christi*, the Commission approved Cheniere Corpus Christi Pipeline's (Cheniere) proposed capital structure of 50 percent debt and 50 percent equity along with Cheniere's proposed return on equity of 14 percent. The circumstances here differ from that of Guadalupe as Cheniere at the time of approval was a new pipeline company with no operating history, whereas Gaudalupe is a long-established pipeline. Further, the Commission recognized that the risk to Cheniere was greater than other pipeline companies, because Cheniere, unlike Gaudalupe, had a substantially leaner capitalization than that generally found for other much larger capitalized parents of Commission-regulated parents. Further, the Commission took into account that the major source of gas receipts would come from a single source, the Corpus Christi LNG terminal.

67. For these reasons, we will place Guadalupe in the middle range of the proxy group and approve a return of equity of 11.26 percent.

<u>The Commission orders</u>:

(A) The request for rehearing is granted in part and denied in part as discussed within the body of this order.

(B) The Commission establishes the return on equity as discussed within the body of this order.

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and 90 percent equity, respectively); *Louisiana Intrastate Gas Corp.*, 50 FERC ¶ 61,011 (1990) (55 percent equity); *Tarpon Transmission Co*., 41 FERC ¶ 61,044 (1987) (45 percent equity); *Alabama-Tennessee Natural Gas Co*., 38 FERC ¶ 61,251 (1987) (45 percent equity).

[67] *See Transcontinental Gas Pipe Line Corp*., 71 FERC ¶ 61,305 (1995); *see also* Opinion No. 414-A, 84 FERC at 61,412.

[68] For example, in this case Guadalupe's cost of debt is 7.38 percent (Guadalupe Response 4B to Staff Data Request), as compared to the 11.26 ROE we approve in this order.

(C) Guadalupe is ordered to file revised rates based on the decisions made herein within 30 days of the issuance of this order.

(D) Refunds, if any, should be issued within 30 days of the approval of the final rate approved by the Commission.

(E) Guadalupe is required to file a new petition for rate approval by May 1, 2011.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.