

133 FERC ¶ 61,158
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Ozark Gas Transmission, L.L.C.

Docket No. RP11-1495-000

ORDER INSTITUTING INVESTIGATION AND SETTING MATTER FOR
HEARING PURSUANT TO SECTION FIVE OF THE NATURAL GAS ACT

(Issued November 18, 2010)

1. As discussed in more detail below, based upon our review of publicly available information on file with the Commission, it appears that Ozark Gas Transmission, L.L.C. (Ozark) may be substantially over-recovering its cost of service and fuel and lost and unaccounted-for gas, causing Ozark's existing rates to be unjust and unreasonable. Therefore, the Commission will initiate an investigation, pursuant to section 5 of the Natural Gas Act (NGA), to determine whether the rates currently charged by Ozark are just and reasonable and set the matter for hearing. The Commission directs Ozark to file a full cost and revenue study within 75 days of the issuance of this order.

I. Background

2. Ozark owns and operates approximately 565 miles of jurisdictional interstate natural gas pipelines in Arkansas, Missouri, and Oklahoma, with a capacity of 500 million cubic feet per day. Ozark provides to shippers firm and interruptible transportation services, no-notice transportation service, park and loan service, and transportation aggregation balancing service.

3. Ozark's current transportation and storage rates were established as part of a settlement filed on October 27, 2000, in an NGA section 4 rate case.¹ The settlement also provided for Ozark to recover its system's fuel requirements and lost and unaccounted for (LAUF) gas through fixed fuel retention percentages, without any true-up mechanism. The fuel retention percentages provided by the settlement were 1.3 percent for transportation using mainline receipt points, and 4.49 percent for transportation at receipt points upstream of the mainline.² On September 25, 2008, the

¹ *Ozark Gas Transmission, L.L.C.*, 93 FERC ¶ 61,281 (2000).

² *Id.*

Commission issued an order that, among other things, permitted Ozark to remove the 4.49 percent fuel retention percentage from its tariff.³ Ozark's current fuel retention percentage for forwardhaul transportation service remains at 1.3 percent. The settlement imposed a moratorium on Ozark filing a new section 4 rate case until October 31, 2002. Ozark is currently under no obligation to file a new rate case.

II. Discussion

4. In March 2008, the Commission issued Order No. 710,⁴ a Final Rule to change the forms and reporting requirements for interstate natural gas pipelines to enhance the transparency of financial reporting and better reflect current market and cost information relevant to interstate natural gas pipelines and their customers. The revised forms included FERC Form No. 2 (Form 2), the annual report for major natural gas companies, and FERC Form No. 3-Q (Form 3-Q), and the quarterly financial report of natural gas companies, electric utilities and licensees. The Commission stated that the revised forms and reporting requirements would provide, in greater detail, the information the Commission needs to carry out its responsibilities under the NGA to ensure just and reasonable rates. Included in the changes were new reporting requirements that require natural gas companies to provide detailed information regarding the acquisition and disposition of fuel use and lost and unaccounted-for gas.⁵ The Commission required major interstate pipelines to use the revised Form 2 in making their annual reports beginning in calendar year 2008.

5. The Commission has reviewed the cost and revenue information provided by Ozark in its Form 2 for the years 2008 and 2009. Based upon our review of this cost and revenue information, the Commission estimates Ozark's return on equity for calendar years 2008 and 2009 to be 27.81 percent and 31.01 percent, respectively. Based upon these figures, the Commission is concerned that Ozark's level of earnings may be

³ *Ozark Gas Transmission, L.L.C.*, 124 FERC ¶ 61,290 (2008). Ozark's 4.49 percent fuel retention rate applicable to receipts upstream of mainline locations was rendered moot by Ozark's 2005 spindown of gathering pipelines. Accordingly, Ozark deleted the 4.49 percent fuel retention rate from its tariff. *Id.* P 11.

⁴ *Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines*, Order No. 710, 73 FR 19389 (Apr. 10, 2008), FERC Stats. & Regs. ¶ 31,267 (2008), *reh'g and clarification*, Order No. 710-A, 123 FERC ¶ 61,278 (2008).

⁵ Order No. 710 at P 16.

substantially exceeding its actual cost of service, including a reasonable return on equity. A description of how the Commission arrived at these figures is set forth below.⁶

6. Based upon the information provided by Ozark in its Form 2 for 2008, the Commission calculated Ozark's cost of service to be \$15.6 million for 2008, excluding equity return and related income taxes. Next, the Commission compared Ozark's cost of service to Ozark's 2008 Form 2 adjusted reported revenues of \$33.8 million. The difference between Ozark's adjusted reported revenues and the estimated cost of service is \$18.2 million, before income taxes. After taking into consideration income taxes, Ozark's return totals approximately \$11.1 million. This equates to an estimated return on equity of 15.25 percent.

7. This estimated return on equity of 15.25 percent, however, does not include the sale of any excess gas retained by Ozark. Ozark reports in its 2008 Form 2 that it collected \$15.0 million in revenue from the sale of shipper-supplied gas. When the revenue for the gas sold by Ozark is considered, Ozark's estimated return on equity for 2008 totals 27.81 percent.

8. An identical analysis, based on the cost and revenue information provided by Ozark in its 2009 Form 2, generated a similar estimated return on equity. Based upon Ozark's 2009 Form 2, the Commission calculated Ozark's cost of service for 2009 to be \$18.6 million, exclusive of equity return and related income taxes. Next, the Commission compared this cost of service to Ozark's 2009 Form 2 reported revenues, as adjusted, which total \$49.0 million. The difference between Ozark's adjusted reported revenues and the estimated cost of service is \$30.5 million, before income taxes. After taking into consideration income taxes, Ozark's net return totals approximately \$18.5 million. This equates to an estimated return on equity of 25.63 percent. Consistent with the analysis described above for 2008, when accounting for \$6.4 million of revenue Ozark generated from the sale of shipper-supplied gas for 2009, Ozark's estimated return on equity for 2009 was 31.01 percent.

9. The Commission finds that, based upon its preliminary analysis of the information provided by Ozark in its Form 2 for 2008 and 2009, Ozark's currently effective tariff rates, including fuel and LAUF retention percentages, may be unjust and unreasonable. The Commission's analysis of this information indicates that Ozark's currently effective tariff rates may allow Ozark to recover revenue substantially in excess of its estimated costs of service and fuel and LAUF gas. While NGA section 4 permits Ozark to seek

⁶ Details of the Commission's derivation of the return on equity are fully set forth in the Appendix to this order. The Appendix, where applicable, provides a page and line reference to Ozark's Form 2 for 2008 and 2009 for each item utilized by the Commission in its calculations.

authorization from the Commission to adjust its rates to establish just and reasonable rates, Ozark has not filed a general NGA section 4 rate case in over ten years. Accordingly, the Commission will initiate an investigation to examine the justness and reasonableness of Ozark's rates pursuant to section 5 of the NGA and set the matter for hearing.⁷

10. As the Commission has done in other cases initiating section 5 investigations of a pipeline's rates,⁸ it directs Ozark to file a cost and revenue study. The filing should be made within 75 days of the date this order issues and include all the schedules required for submission of a section 4 rate proceeding as set forth in section 154.312 of the Commission's regulations.⁹ Because the Commission is seeking actual cost and revenue information for the latest 12-month period available, the Commission provides the following clarification as to the data to be filed by Ozark. The information submitted by Ozark must exclude any adjustments or projections that may be attributable to a test period referenced in the schedules and statements set forth in section 154.312 of the regulations.¹⁰ Thus, Ozark should not file nine months of post-base period adjustment data required by section 154.303(a) at this point in the proceeding. Additionally, because Ozark does not have an NGA section 4 burden in this section 5 proceeding and will be

⁷ In this order, we make no finding as to what would constitute a just and reasonable return on equity for Ozark. That is among the issues set for hearing by this order and should be decided consistent with the Commission's Policy Statement *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 (2008).

⁸ See, e.g., *Natural Gas Pipeline Company of America LLC*, 129 FERC ¶ 61,158 (2009), *reh'g denied*, 130 FERC ¶ 61,133 (2010); *Northern Natural Gas Co.*, 129 FERC ¶ 61,159 (2009), *reh'g denied*, 130 FERC ¶ 61,134 (2010); and *Great Lakes Gas Transmission Limited Partnership*, 129 FERC ¶ 61,160 (2009), *reconsideration denied*, 130 FERC ¶ 61,132 (2010). As the Commission explained in the rehearing orders, "[s]ections 10(a) and 14(a) of the NGA authorize the Commission to require [the pipeline] to submit the information required by the [order instituting investigation] in order to carry out its responsibility under NGA section 5 to ensure that the pipeline's rates are just and reasonable." See, e.g., *Natural Gas Pipeline Company of America*, 130 FERC ¶ 61,133 at P 16.

⁹ 18 C.F.R. § 154.312 (2010).

¹⁰ Ozark may, if fully supported, reflect changes to costs and revenues for a known and measurable change that took place during the 12-month period. For example, if a general pay raise became effective during month 5 of the 12-month period, an adjustment to the cost of service could be made to annualize the impact of this cost change.

filing testimony in response to other parties, Ozark does not need to file the Statement P required by section 154.312(v) of the Commission's regulations at this juncture.¹¹

11. Finally, due to the potential for continued over recovery of revenues, the Commission will establish a date for an initial decision from an administrative law judge. Such a date will expedite the proceeding. We believe that conducting the hearing in this case pursuant to the Administrative Law Judges' Track II Hearing Timeline is reasonable, with an initial decision to issue within 47 weeks of the designation of the presiding judge.

The Commission orders:

(A) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Natural Gas Act, particularly section 5 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Natural Gas Act, a public hearing shall be held concerning whether Ozark's rates are unjust, unreasonable, or otherwise unlawful.

(B) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose pursuant to 18 C.F.R. § 375.304, shall, within thirty (30) days of the date of this order, convene a prehearing conference in these proceedings in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426. The prehearing conference shall be held for the purpose of clarification of the positions of the participants and consideration by the presiding judge of any procedural issues and discovery dates necessary for the ensuing hearing. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Commission's Rules of Practice and Procedure.

(C) The Commission directs that the hearing be conducted pursuant to the Track II Hearing Timeline and that an initial decision be issued in this proceeding within 47 weeks of the designation of the presiding judge, as discussed in the body of this order.

(D) Ozark shall file a cost and revenue study within 75 days of this order. The filing should include only actual data for the latest 12-month period available as of the date of this order. The filing should include all of the schedules required for the submission of a section 4 rate proceeding as set forth in section 154.312 of the Commission's regulations (18 C.F.R. § 154.312), as modified above.

¹¹ See *Pub. Serv. Comm'n of New York*, 115 FERC ¶ 61,368, at P 6 (2006).

(E) Any person wishing to become a party to this proceeding must file a notice of intervention or motion to intervene, as appropriate, in accordance with Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214). Such notice or motion must be filed within 30 days of the date of this order. The Commission encourages electronic submission of interventions in lieu of paper using the "eFiling" link at <http://www.ferc.gov>. Persons unable to file electronically should submit an original and 14 copies of the protest or intervention to the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426.

By the Commission. Commissioners Spitzer and Moeller concurring with separate statements attached.

(S E A L)

Kimberly D. Bose,
Secretary.

Appendix

<u>OZARK</u>	<u>Reference</u>	<u>Line</u>	<u>2009 (as adjusted)</u>	<u>2008</u>
Rate Base				
Gas Plant in Service	p. 110; ln. 2	1	\$238,734,208	\$236,518,135
Accumulated Depreciation	p. 110; ln. 5	2	(\$110,038,927)	(\$107,941,473)
Gas Stored - Base Gas				
Account 117.1 (Base Gas)	p. 220; ln. 5, col. b	3	\$0	\$0
Account 117.2 (System Balancing)	p. 220; ln. 5, col. c	4	\$1,325,947	\$277,435
Working Capital				
Prepayments	p. 230a; ln. 6	5	\$162,860	\$126,240
Materials and Supplies	p. 111; ln. 45	6	\$104,543	\$127,084
ADIT				
Account 190	p. 235; ln. 7, col. k	7	\$1,030	\$0
Account 282	p. 275; ln. 7, col. k	8	(\$1,904,763)	\$0
Account 283	p. 277; ln. 7, col. k	9	(\$19,067)	\$0
Regulatory Assets (For Rate Case Purposes)	p. 232	10	\$0	\$0
Regulatory Liabilities (For Rate Case Purposes)	p. 278	11	\$0	\$0
Total Rate Base	Sum: Ins. 1-11	12	\$128,365,831	\$129,107,421
Capital Costs				
Cost of Debt	p. 218a; col. d	13	7.96%	7.96%
Capitalization				
Debt	p. 218a; col. c	14	43.54%	43.54%
Equity	p. 218a; col. c	15	56.48%	56.48%
Weighted Cost of Debt	Line 13 * Line 14	16	3.47%	3.47%
Taxes				
Composite Tax Rate	p. 122.5	17	39.00%	39.00%
Cost of Service				
Interest on Debt	Line 12 * Line 16	18	\$4,448,882	\$4,474,584
Other Taxes	p. 114; ln. 14, col. c	19	\$2,150,311	\$1,867,144
Depreciation	p. 337; ln. 12, col. h	20	\$2,507,383	\$2,159,322
O&M				
Production & Gathering	p. 317; ln. 30	21	\$0	\$0
Net Storage Costs	p. 322; ln. 177 (less ln. 106)	22	\$0	\$0
Net Transmission Costs	p. 323; ln. 201 (less ln. 184)	23	\$6,672,728	\$2,795,758
A&G	p. 325; ln. 270	24	\$2,797,153	\$4,282,764
Cost of Service Excl. Return & Income Taxes	Sum: Ins. 18-24	25	\$18,576,457	\$15,579,572
Operating Revenues				
ACA Revenues	p. 300; ln. 21, col. d	26	\$374,900	\$313,650
Exclude Sales for Resale (Act. 480-484)	p. 301; ln. 4, col. f	27	\$0	\$0
Other Revenues	p. 301; ln. 21, col. f	28	\$55,054,642	\$53,895,763
Exclude Commercial & Industrial Sales	p. 301; ln. 2, col. f	29	\$0	\$0
Exclude Fuel Recoveries	p. 305 and p. 307	30	\$0	\$0
Exclude Account 495	p. 308; ln. 40	31	(\$6,394,504)	(\$20,403,444)
Total Adjusted Revenue	Sum: Ins. 26-31	32	\$49,035,038	\$33,805,969
Income				
Income Before Income Taxes	Line 32 - Line 25	33	\$30,458,581	\$18,226,397
Income Taxes	Line 33 * Line 17	34	\$11,878,846	\$7,108,295
Net Income	Line 33 - Line 34	35	\$18,579,734	\$11,118,102
Equity Rate Base	Line 12 * Line 15	36	\$72,501,021	\$72,919,871
Total Estimated ROE Excl. Fuel	Line 35 / Line 36	37	25.63%	15.25%
Revenue from Shipper Supplied Gas	p. 308; ln. 10	38	\$6,394,504	\$15,023,113
Total Estimated ROE Incl. of Fuel	(Line 35 + (1 - Line 17) * Line 38) / Line 36	39	31.01%	27.81%

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Ozark Gas Transmission, L.L.C.

Docket No. RP11-1495-000

(Issued November 18, 2010)

SPITZER, Commissioner, concurring:

I generally support our initiation of an investigation under Section 5 of the Natural Gas Act (NGA)¹ against Ozark Gas Transmission, L.L.C. (Ozark). I am writing separately, however, to express my views on the context of this review.

Last year for the first time since issuing Order No. 636, we initiated NGA § 5 proceedings against three interstate natural gas pipelines. At that time I noted that competition works best where the prices for essential services accurately reflect the costs associated with providing those services.² Ozark's last general NGA § 4 rate case proceeding was resolved through an uncontested settlement approved by the Commission in 2000.³ Therefore, the issue in the instant case is whether Ozark's rates remain just and reasonable.

Based upon Staff's review of the pipeline's Form No. 2 for the years 2008 and 2009, Staff estimates that Ozark's return on equity (ROE) for 2008 was 15.25 percent and 25.63 percent for 2009. By Staff's calculation, revenues from purported fuel sales increase the ROE to 27.81 percent for 2008 and 31.01 percent for 2009. Ozark has fixed fuel reimbursement rates that are not subject to a tracker or true-up mechanism.

Interstate natural gas pipelines frequently require that customers contribute a small percentage of the volumes of natural gas tendered for transportation service to provide fuel for compressors and to make up for lost and unaccounted-for gas. The Commission established its current policy concerning the in-kind recovery of fuel and unaccounted-for

¹ 15 U.S.C. § 717d.

² *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299 at P 210 (2004).

³ *See Ozark Gas Transmission, L.L.C.*, 93 FERC ¶ 61,281 at 61,942 (2000).

gas in *ANR Pipeline Co.*⁴ As relevant here, the Commission ruled that pipelines had two options to recover these costs. Consistent with section 284.10(c)(2) of our regulations, the first option allows a pipeline to establish a fixed fuel retention percentage in a general NGA § 4 rate case, and leave that percentage unchanged until the pipeline files its next general NGA § 4 rate case. The second option allows a pipeline to include in its tariff a mechanism permitting periodic changes in its fuel retention percentage outside of a general NGA § 4 rate case, as allowed by section 154.403 of the Commission's regulations. If a pipeline chooses the second option, it must include in its tariff a mechanism to true-up any over- and under-recoveries of fuel, absent agreement otherwise by interested parties.⁵ In 2008, the Commission terminated a fuel Notice of Inquiry where it had inquired as to the appropriate rate methodology to be used by interstate natural gas pipelines for compressor fuel and lost and unaccounted-for gas.⁶

Ozark is located in an area that may be impacted by new shale gas plays. Our actions today are not intended to upset the competitive market framework of natural gas pipeline regulation. Nor does this proceeding signal a departure from my commitment to natural gas infrastructure development to transport these production finds.

The questions in this case are whether Ozark's rates remain just and reasonable and whether revenues from fuel sales combined with other revenues result in an ROE outside a range of reasonableness. I recognize that a rate case may be a costly endeavor for all parties, may create uncertainty during a lengthy litigation process, and may not always result in a rate reduction. Although the Commission bears the initial burden in this proceeding, I nevertheless believe that it may be in the best interest of the pipeline, its

⁴ 108 FERC ¶ 61,050 (2004), *order inviting comments*, 109 FERC ¶ 61,038 (2004), *order on reh'g and compliance filing*, 110 FERC ¶ 61,069 (2005), *order on compliance filing*, 111 FERC ¶ 61,290 (2005)(ANR).

⁵ ANR, 110 FERC ¶ 61,069 at P 18-28.

⁶ See *Fuel Retention Practices of Natural Gas Cos.*, *FERC Statutes and Regulations* ¶ 35,556 (2007), *notice terminating proceeding*, *FERC Statutes and Regulations* ¶ 35,560 (2008)(The Commission recognized that fixed fuel retention method "gives pipelines an incentive to minimize their fuel use through more efficient operations" and that such efficiencies "could benefit customers when the pipeline files its next general [NGA §] 4 rate case." The Commission recognized however that "until the pipeline does file a new [NGA §] 4 rate case" the pipeline would retain the benefit from any savings. The Commission also reasoned that "a fixed fuel retention percentage avoids potentially disruptive changes in the pipeline's fuel rates outside a general [NGA §] 4 rate case, thereby giving customers the benefit of greater certainty as to the pipeline's fuel rates.").

shippers, and the Commission to resolve this dispute expeditiously and consensually, rather than through litigation.⁷ Reaching a settlement could provide just and reasonable rates more rapidly than through a long and costly litigation process.⁸ Consequently, I would encourage the parties to negotiate amongst themselves or to “file a motion requesting the appointment of a settlement judge with the presiding officer, or if there is not presiding officer for the proceeding, with the Commission,”⁹ during the ambitious Track II hearing schedule.

For these reasons, I respectfully concur in the Order.

Marc Spitzer
Commissioner

⁷ The Commission has long encouraged the consensual resolution of proceedings by settlement. *See Columbia Gas Transmission Corp., et al.*, 64 FERC ¶ 61,366 (1993). *See also United Municipal Distributors Group v. FERC*, 732 F.2d 202 (D.C. Cir. 1984), *aff'g United Gas Pipeline Co.*, 22 FERC ¶ 61,094 (1983), *reh'g denied*, 23 FERC ¶ 61,101 (1993).

⁸ *See Natural Gas Pipeline Company of America LLC*, 132 FERC ¶ 61,082 (2010); and *Great Lakes Gas Transmission Limited Partnership*, 132 FERC ¶ 61,041 (2010).

⁹ 18 C.F.R. § 385.603(c) (2010).

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Kinder Morgan Interstate Gas Transmission LLC Docket No. RP11-1494-000

Ozark Gas Transmission, L.L.C. Docket No. RP11-1495-000

(Issued November 18, 2010)

MOELLER, Commissioner, *concurring*:

Upon review of the 2008 and 2009 FERC Form No. 2 data filed by Kinder Morgan and Ozark, I find that the Commission has sufficient cause to launch these rate investigations pursuant to section 5 of the Natural Gas Act. Our preliminary analysis suggests that both of these pipelines are substantially over-recovering its cost of service, particularly when adjustments for fuel and LAUF are included.

Moreover, more than a decade has passed since the rates for these pipelines have been reviewed and it is noteworthy that neither pipeline is obligated to file a new rate case. However, I am also mindful that there may be other factors that we have not considered in our analysis that could have a direct impact on the rates being charged by these pipelines.

Pipeline fundamentals inevitably change from the static base year and the rates should reflect this change. Whether these changes stem from the discovery of new supply areas or reflect an evolution in shipper behavior or changes in demand, the factors upon which rates are developed continuously change. The fact is that the Commission may not always be aware of these changes. Accordingly, while I believe that the data collected by Form No. 2 is both instructive and persuasive, it is not determinative.

During the coming weeks, I encourage Kinder Morgan and Ozark, along with its customers, our Trial Staff, and other interested parties to work together to negotiate a settlement, or if necessary, cooperate to facilitate an expedited hearing.

Philip D. Moeller
Commissioner