UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Composition of Proxy Groups	)	
for Determining Gas and	)	**Docket No. PL07-2-000**
Oil Pipeline Return on Equity	)	

POST-TECHNICAL CONFERENCE COMMENTS OF THE NATIONAL ASSOCIATION OF PUBLICLY TRADED PARTNERSHIPS

The National Association of Publicly Traded Partnerships joins with the Interstate Natural Gas Association of America (INGAA) and the Association of Oil Pipelines (AOPL) in asserting that the evidence presented at the January 23, 2008 technical conference is persuasive that the current DCF formula using five-year IBES projections as the measure of short-term growth, weighted at two-thirds, and GDP as the measure of long-term growth, weighted at one-third, is as appropriate for MLPs as it is for C-corporations. The testimony of the NAPTP witnesses, who provided the Commission with the benefit of their real-world experience in managing and raising capital for an MLP with substantial interstate pipeline assets (Park Shaper of Kinder Morgan Energy Partners) and in analyzing such MLPs from the investor's point of view (Yves Siegel of Wachovia Capital Markets), converged with the more academic testimony offered by the INGAA,AOPL, and TransCanada witnesses on this conclusion. NAPTP submits that these experts' discussions of MLP growth were more credible in many respects that those of the individuals seeking a lower assumed growth rate for MLPs, who had not had the experience of either managing an MLP or providing investors with the most accurate possible picture of individual MLPs' growth prospects.

I. Summary of Positions

While we will not repeat all of the analysis set forth at the technical conference and in the post-conference briefs filed by other associations, NAPTP would like to reiterate these key points that we believe are supported by the evidence:

1. The five-year IBES projections continue to be the appropriate measure of short-term growth, keeping in mind that the relevant growth is in distributions, not earnings per share.
2. After all the analysis on the numerous factors that may affect MLPs' long-term growth is exhausted, there is no reason to conclude that unadjusted GDP is any less appropriate a measure for long-term growth in the DCF model for MLPs than it is for C-corporations, because:
    a. MLP growth is no less sustainable over the long term than the growth of C-Corporations, as growth depends on the quality of a company's assets and its management, not on its business structure or its policy with regard to distribution of earnings;
    b. There is an important distinction between the growth required for the limited partnership interests and growth for the MLP entity as a whole, and using a long-term growth rate less than GDP in the DCF model risks producing an ROE that is insufficient for the MLP entity; and
    c. While it is in fact impossible to predict long-term growth with any certainty, GDP stands as a reasonable proxy, and MLP growth has been above GDP more often than not.

II. IBES Projections Are the Appropriate Measure of Short-Term Growth

While participants differed on the extent to which the five-year IBES projections have over- or underestimated actual distribution growth (*see* Moul, Tr. 37 (underestimated), Barry, Tr. 22 and Solomon, Tr. 139 (overestimated)) there appears that to be general agreement that MLP distributions do show substantial rates of growth in the short term and that continued use of these projections in the DCF model is appropriate. As some of the panelists noted (*see* Moul, Tr. 38; Horst, Tr. 93) and Commissioner Spitzer agreed, (Tr. 99), the various items that may affect the growth rate expected by the market, such as the effect of IDRs to the general partner, are already factored into these projections.

NAPTP emphasizes strongly that the appropriate measure to look at is not growth in *earnings* per share (EPA), but in *distributions* per share. As Yves Siegel explained, neither analysts nor investors look at earning when analyzing MLPs; cash flow and distributions are the primary concern (Tr. 32-33, 54-56). Mr. Siegel added that even analysts projecting who phrase their projections in terms of EPS growth are really looking at cash flow. (Tr. 33, 56). Professor Williamson agreed that "when MLP analysts report to IBES, they are likely to be reporting distribution growth rather than income growth." (Tr. 19) Nonetheless, while we would prefer that the Commission focus on distributions, if for some reason five-year projections of distributions are not easily obtainable, earnings growth rates track distribution growth rates closely enough that using earnings per share projections for MLPs as well as for corporations will yield acceptable results. (Vilbert, Tr. 26)

III. GDP is as Appropriate a Measure of Long-Term Growth for MLPs as for Corporations

A. MLP Growth Rates Are Sustainable Over the Long Term

With all participants agreeing (albeit grudgingly on the part of Patrick Barry[1]) that the current short-term growth measure is acceptable for MLPs as well as corporations, the primary issue remaining unsettled is that of long-term growth rates, and in particular, whether MLPs' distribution policies render their growth rates less sustainable than those of corporations, requiring that a long-term growth rate that is less than GDP by some amount be used in the calculation of DCF for MLPs. This question was the subject of extensive debate and analysis; however, at the end, after all analysis on the numerous factors that may affect MLPs' long-term growth has been exhausted, there was no reason to conclude that unadjusted GDP is any less appropriate a measure for long-term growth in the DCF model for MLPs than it is for C-corporations.

First it is important to note that the idea that the 2.5% long-term growth rate used by Yves Siegel in his MLP reports represents the appropriate measurement of long-term growth for MLPs should have been laid to rest by his statement at the technical conference. Mr. Siegel made clear in his statement that the long-term growth rate assumptions that are cited in his and other analysts' reports are used as a conservative number to plug into their models for valuation purposes only and should *not* be seen as a long-term growth projection. (Tr. 34). Although he focuses only on MLPs, Mr. Siegel also stated his belief that other analysts use the same rate for both corporations and MLPs. (Tr. 116) Mr. Siegel's statements have been confirmed by a Morgan Stanley energy and pipeline analyst

[1] "New York believes that using IBES projections for short-term growth is likely to provide the least wrong answer with respect to distribution growth." Tr. 23.

who follows both MLP and corporate energy companies, and who explicitly stated in a report issued shortly after the technical conference that Morgan Stanley uses the same long-term growth rate assumptions for both:

> "At Morgan Stanley, we assume that an MLP will increase its cash flow ~1.5%-3.0% per year beyond 2012. Importantly, we make the same assumption in forecasting long-term growth for our C-Corp companies. Furthermore, Analysts in other sectors take a similar view on long term growth ~1.5%-3.0%. The rationale is to err on the side of conservatism rather than making a statement about actual long-term growth.[2]

With that matter clarified, the absolutely critical point made at the conference is that, as Park Shaper stated, "The ability to grow is the same, regardless of corporate structure and dividend policy" (Tr.102), and as Michael Vilbert noted, "there's no reason at all that the MLP cannot grow as fast as a C-corporation. If there are good opportunities for investments, they'll take them in just like a C-corporation and grow every bit as fast." (Tr. 25)

There was widespread agreement among the panelists that the most important determinant of future growth for any company is not its organizational structure, nor the manner in which capital investments are funded. What matters are the nature of the company's assets and the skill of the company's management in selecting the right capital investments at the right time and in extracting the most growth from the assets acquired. How the return on those investments is divided among the various equity holders is not important either; all that matters is that it is sufficient to satisfy all of them. Even Patrick Barry agreed with Park Shaper that all this was true as a matter of traditional economic

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[2]Sean Maher, *MLPs: Stewards of Capital & Leaders of Infrastructure,* Pipeline MLPs: What's in the Pipeline?, January 28, 2008, p. 3 (copy attached).

finance theory (Tr. 102), and the actual long-term growth of the MLPs that have been around for several years demonstrates that it is more than just theory.

To begin with, Mr. Shaper's remarks and his clarification of the distributable cash flow equation should have laid to rest the notion that MLPs are paying their investors more cash than they have available or are failing to retain the cash they need to maintain their assets and operations. In fact, according to Yves Siegel, not only do MLPs retain sufficient cash for this purpose, they maintain a cushion above sufficiency because of the importance of ensuring future distribution growth (Tr. 56).

In addition, it should now be clear that the inclusion of depreciation in the equation for distributable cash flow does not result in some sort of double counting (it is simply adding back in the depreciation amount that has been subtracted in calculating earnings under accounting conventions), nor in the MLP distributing cash it does not have. Depreciation is simply an accounting concept that has no effect on cash flow. Mr. Shaper's explanation of distributable cash flow made all this very clear and is included below in its entirety, because we believe it is crucial to understanding why MLP growth is, in fact, completely sustainable (Tr. 57-59).

> There's been a lot of discussion about earnings and distributions. Why don't we talk about the difference, real quick? I mean, from the back of the envelope -- and this captures, you know, 90 to 99 percent of the differences -- what MLPs will do, distributable cashflow that Yves was talking about, is actually even greater than distributions.
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> Typically, MLPs will distribute some amount that's under their level of distributable cashflow, so distributable cashflow is the measure of cash that they've generated.
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> Well, all that really is, is net income or earnings. Adding back depreciation -- depreciation is a non-cash item; it is an accounting item. The amount of depreciation that any entity recognizes, is dictated by GAAP, and there is some flexibility in there, but it has nothing to do with what you're actually spending in

> order to maintain your assets. So you add back depreciation, because that's not a cash item, and then you take off the cash that you actually are spending in order to maintain your assets, which is sustaining capital expenditures or maintenance capital expenditures, depending upon what you want to call it.
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> And that gets you to the number that Yves talks about, that I talk about, that MLP investors pay attention to, which is distributable cashflow, and the distributions are some level under that. There is nothing about distributable cashflow, that is not sustainable and that cannot grow. Yes, in many cases, it is greater than net income, and it's greater than net income -- think about the two adjustments I just talked about: You add back depreciation, you take off your sustaining capital expenditures.
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> If your sustaining capital expenditures are less than your DD&A, less than your depreciation, then you're going to end up with a number, your distributable cashflow is going to be greater than your earnings.
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> But there is nothing about that, that is not sustainable. There's nothing about that in here -- I mean, let me be clear again that I'm talking about accounting depreciation. There's nothing about that, that can't grow.
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> And so adjusting a growth rate to say only the earnings portion of that can grow and this remaining portion that is greater than earnings, can't grow, in my mind, is completely arbitrary, and I don't think reflects reality, and I don't think reflects investors' expectations.

Paul Moul reinforced Mr. Shaper's remarks by pointing out that the quality of management plays a much more important role in the growth equation than the structure of the business: "To the extent that management can get more productivity out of a given set of assets, you're going to have growth." (Tr. 59). Mr. Williamson also pointed out the important role that the management of each MLP plays in long-term growth (Tr. 18, 19, 109).

Mr. Shaper and other panelists pointed out several other reasons why distributing rather than retaining earnings should not affect long-term growth. First, as Mr. Shaper pointed out (Tr. 11), the assets in many MLPs generate organic growth, which does not require new investment.

In addition, the choice to distribute available cash flow simply affects the method by which growth is financed, not how much growth will occur. Corporations are likely to finance some or all of their growth via retained earnings, while an MLP must go to the capital markets to raise equity or debt. While this may not be as easy as reaching into a corporate bank account, it has, for a number of years, proven to be an effective method for MLPs to increase their assets, revenue, and hence, distributions. Anyone observing the growth in Kinder Morgan over the course of a decade from a company with $304 million in assets and $71 million in revenue tone with $12 billion in assets and $9 billion in revenue,[3] or Enterprise Products Partners from $1.5 billion in assets and 1.3 billion in revenues in 1999 to $16 billion in assets and $17 billion in revenues in 2007[4], would be hard pressed to say that retained earnings are a prerequisite to sustained growth.

As both Park Shaper in his statement and NAPTP in previous submissions have noted, the discipline imposed by the fact that MLPs must persuade the market to invest in their expansion projects makes them efficient users of capital and helps guarantee that the investments made by MLPs will in fact result in earnings growth, a constraint that is less present for corporations. This could conceivably result, as Mr. Shaper noted (Tr. 12), in a growth rate for MLPs that is higher than that of corporations.

As Michael Vilbert noted, pipeline assets do not have different risk characteristics when they are held by an MLP than they do when they are held by a corporation. Nor do factors such as the general partners' incentive distribution rights affect the overall equation: "The way the equity holders divide up their portion of the risk and the return,

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[3] As reported in 10-Ks for 1996 and 2006, respectively. Assets had reached $14 billion by the end of third quarter 2007.

[4] As reported in the 10-K for 1999, the September 30, 2007 10-Q (assets) and January 28, 2008 press release announcing 2007 results (attached).

does not affect the overall cost of capital for the assets." (Tr. 26) This is one reason why it is so important to look at the rate of return required by the entity as a whole rather than only the limited partners; looking only at the limited partners' return does not give the whole picture and may be responsible for many of the misconceptions regarding MLP growth that have been expressed during these proceedings. Moreover, as Paul Moul pointed out, many of the pipelines now owned by MLPs were formerly held by corporations, and their nature and growth potential did not change when their ownership structure was reorganized. (Tr. 36).

As stated in our previous submissions, the evidence already exists that MLPs can sustain and have sustained growth over the long run. The experience of Kinder Morgan, Enterprise, and other long-term MLPs shows that—as Mr. Shaper and other panelists urged—if a proposed investment or acquisition is in fact sound and likely to produce growth, the markets will provide the capital. And to the extent that an MLP or any other entity is able to identify investments that will earn a reasonable return and persuade the capital markets that they will earn a reasonable return, there is theoretically no limit on how much they can grow. Conversely, a corporation could be sitting on an enormous amount of retained earnings, but if there are no sound investment opportunities, it will not grow (Tr. 41-45)

Figure 1 below presents an exhibit similar to one in our previous submission which shows the distribution histories of several pipeline MLPs that might be included in a proxy group.[5] The figure makes it clear that distributions for pipeline MLPs that have been in

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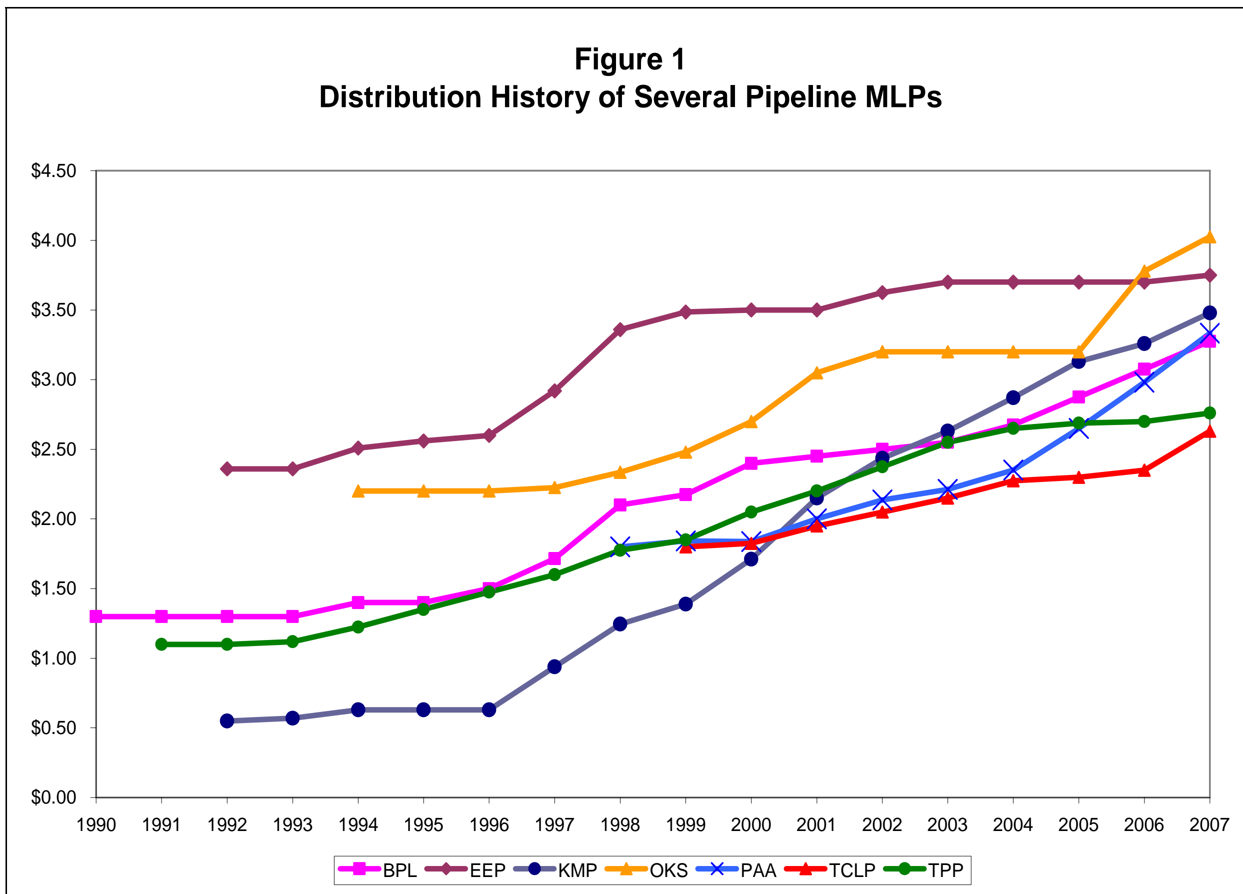
[5] The companies are Buckeye Partners (BPL), Enbridge Energy Partners (formerly Lakehead Pipe Line Partners)(EEP), Enterprise Products Partners (EPD), ONEOK Partners (formerly Northern Border Partners)(OKS); Plains All American Pipeline (PAA), TC Pipelines (TCLP), and TEPPCO Partners (TPP).

business for several years, including one that is two decades old, are continuing to grow at a healthy rate. It can also be seen that growth rates are not necessarily dictated by the length of time an MLP—or any company—has been in existence.

As Mr. Moul pointed out (Tr.113-114), an inherent problem with making assumptions about what happens in the short vs. the long term is that companies that are in business for a long time tend to move through cycles of high growth and low growth, rather than experience rapid growth for a few years followed by eternal slow growth. Some MLPs shown in Figure 1, most notably Kinder Morgan, grew their distributions at a slow rate in their first years, then picked up and have been growing at a high rate ever since. Others have had a sharp acceleration of growth several years into their existence.



Source: Partnership reports; compiled by Wachovia Capital Markets LLC

B. MLP Growth is not Lower Than GDP Growth Over the Long Term

As was noted in several comments at the technical conference, whether the entity is a corporation or an MLP, it is impossible to predict with any certainty what its actual growth rate will be more than a few years into the future—the GDP growth rate is a proxy[6] (Moul, Tr. 35-36; Solomon, Tr. 97-98; Vilbert, Spitzer and Williamson, Tr. 107-110). It is considered a reasonable proxy for a number of reasons. As noted during the conference (Tr. 96), while there will be year-to-year variations, it is a reasonable assumption that any individual business will, over the long run, grow at about the same average rate as the

[6] Or as Paul Moul noted, it is a general growth rate, as opposed to the company specific rates used for short-term growth (Tr. 36)

general economy. Moreover, the GDP is a neutral benchmark that has been maintained by the federal government for a substantial amount of time, allowing analysts to have confidence in the data and to discern trends and cycles.

Because the GDP is used as a reasonable proxy for long-term growth and is not intended to be any sort of precise projection, it does not make sense to insist that the GDP be made more precise by adjusting it downwards for the various factors that some believe—erroneously in our view—to affect MLP growth. At least one panelist asserted that GDP is in fact an overly conservative assumption for MLPs' long-term growth.[7]

Most importantly, the historical evidence shows that the growth rates of the older pipeline MLPs over the past decade have not been consistently lower than GDP; to the contrary, they have more often been higher, particularly in the past decade. Figure 2 shows the average and median annual growth rate for the seven potential proxy group members whose distributions are charted in Figure 1, compared to the nominal GDP growth rate for the same period. As can be seen in Figure 2, since 1990 the relationship has varied from year to year—as it no doubt does for corporations— but particularly in the past decade, the growth rate for these MLPs has often exceeded the GDP growth rate.

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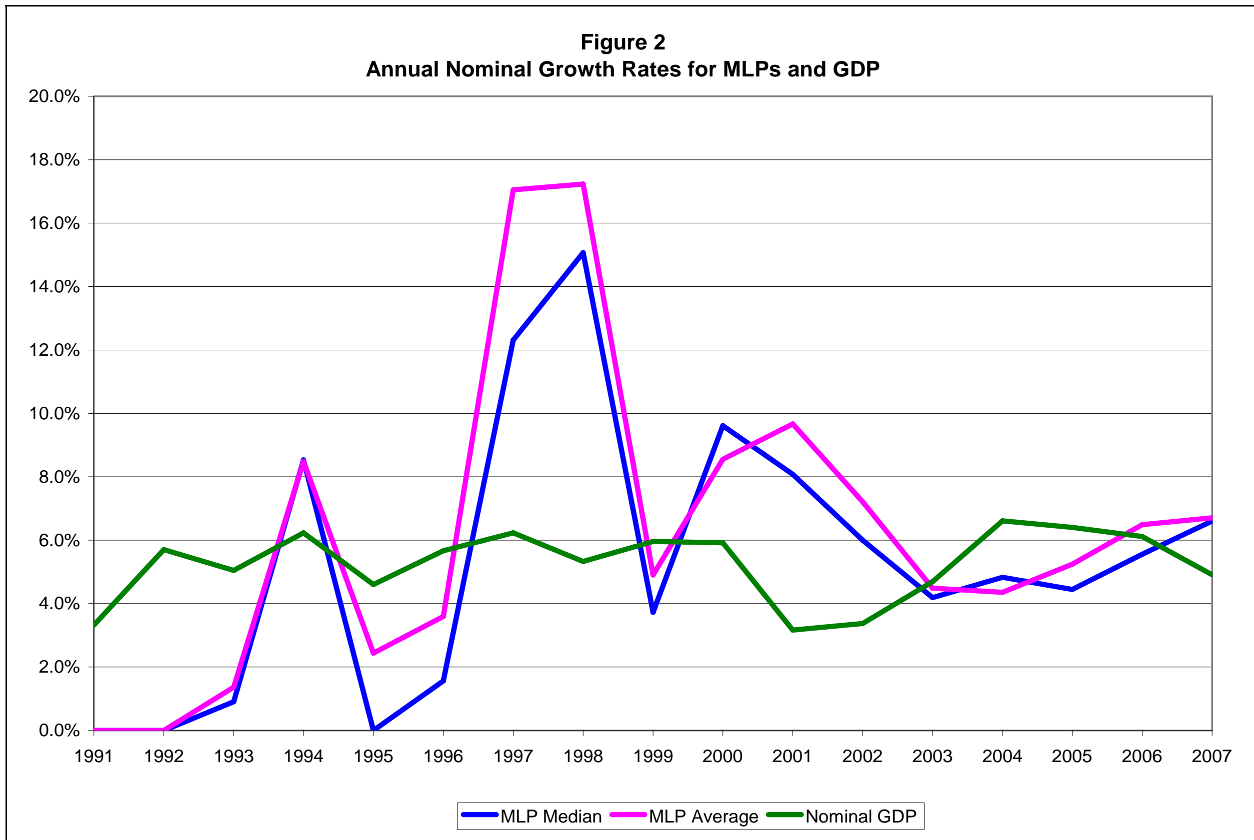
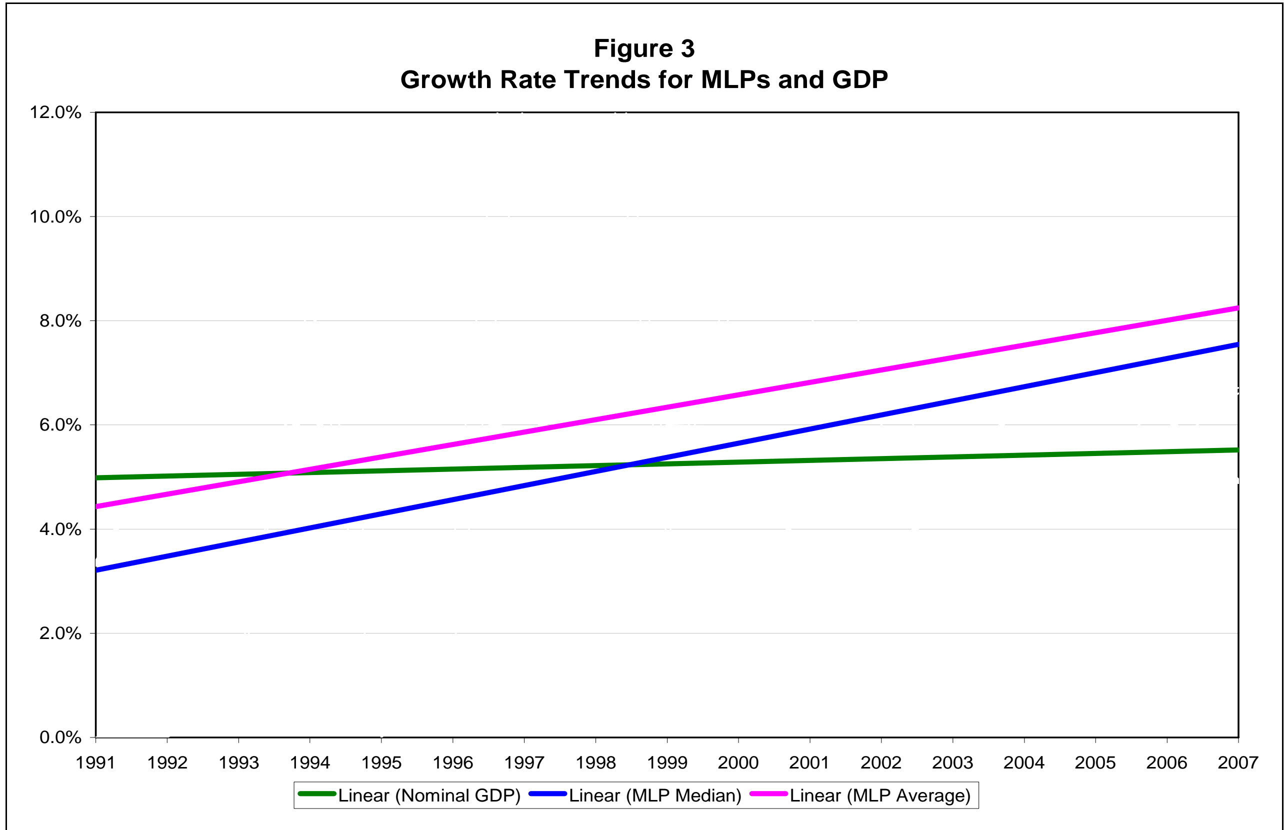
[7] "If any of our proxy companies actually reach a growth rate for the limited partners, of GDP, they're very likely to go out of business. I would expect that well before they reach that stage, the managements would figure out some way to get a higher growth rate for their limited partners." (Vilbert, Tr. 109)



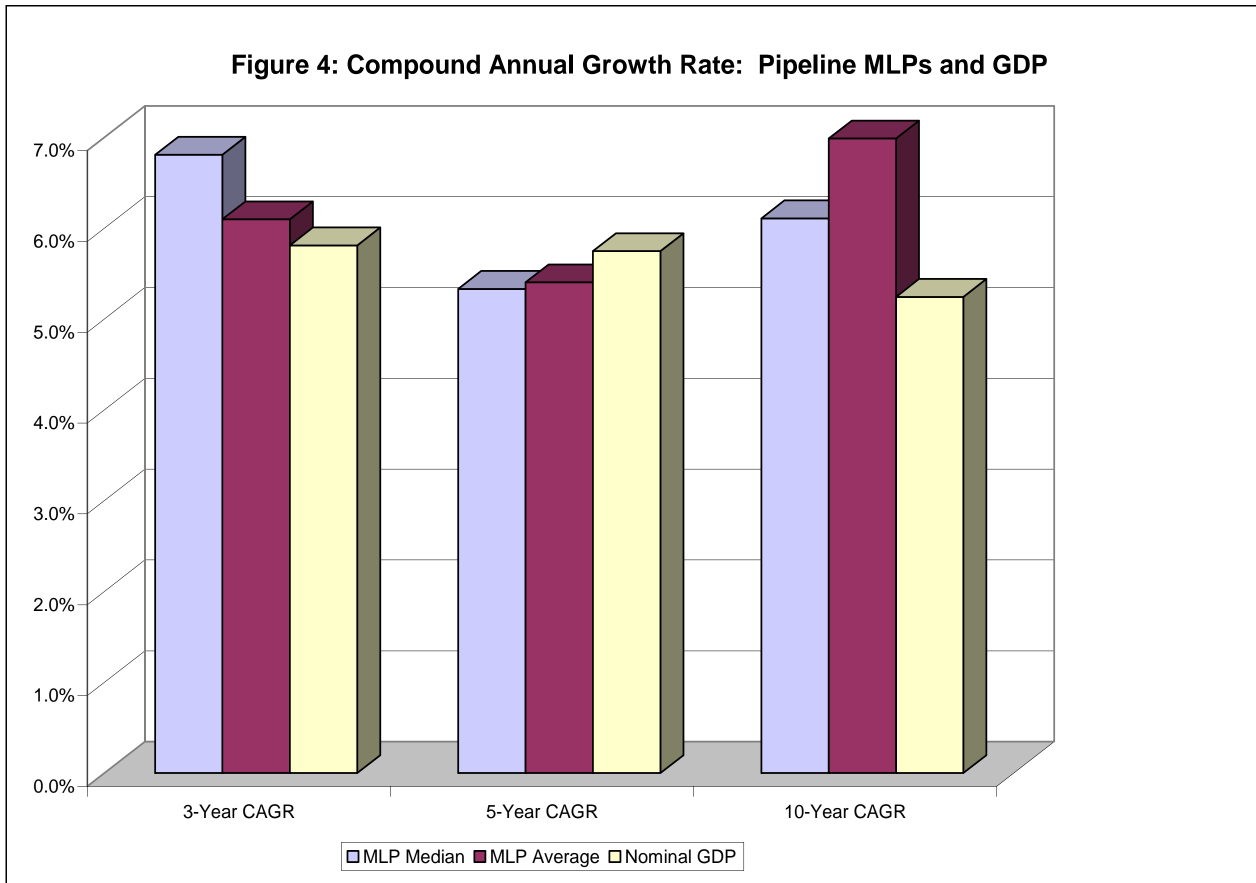
Source: Partnership reports, Bureau of Economic Analysis; compiled by Wachovia Capital Markets LLC

To provide a clearer picture of how MLP growth rates compare to the GDP growth rate over the long term, Figure 3 plots a linear trend line for each of the rates shown in Figure 2. As can be seen, average and median MLP growth are both trending upwards at a higher rate than the nominal GDP.



Source: Partnership reports, Bureau of Economic Analysis; compiled by Wachovia Capital Markets LLC

Finally, Figure 4 compares the median and average MLP, and the nominal GDP, three-year, five-year, and ten-year compound annual growth rates (CAGR). While the five-year MLP CAGRs are slightly below those of GDP, over the truly long term the MLP CAGRs are significantly higher than that of the GDP.



Source: Partnership reports, Bureau of Economic Analysis; compiled by Wachovia Capital Markets LLC

In short, there is no basis for arbitrarily assigning some number lower than GDP as the long-term growth rate for MLPs and to do so would pose a serious risk of underestimating growth. When the need to provide an adequate return to all MLP equityholders is considered, the risk becomes even stronger.

IV. Conclusion

NAPTP believes that the evidence presented at the Technical Conference and in the instant and prior comments that we have submitted clearly shows that the notions that MLP growth rates are inherently lower than those of corporations and that they should be

assumed to be lower than the GDP growth rate in the DCF calculation are fallacies. If the Commission is to continue using GDP growth as a proxy for the long-term growth rate in its DCF calculations—and we believe that it is a reasonable proxy—it must use the same, undiscounted growth rate for MLPs that it uses for corporations.

In addition, as discussed in detail in our previous comments, the Commission must view the MLP as an entity and should ensure that the resulting ROE will provide a sufficient return to all MLP equity holders, not just the limited partners. This is an additional and extremely important reason that any discounting of the GDP as part of the DCF calculation for MLPs would be inappropriate.