

121 FERC ¶ 61,165
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeem G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellingshoff.

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

NOTICE OF TECHNICAL CONFERENCE AND
REQUEST FOR ADDITIONAL COMMENTS

(Issued November 15, 2007)

1. On July 19, 2007, the Commission issued a proposed policy statement, concerning the composition of the proxy groups used to determine gas and oil pipelines' return on equity (ROE) under the Discounted Cash Flow (DCF) method.¹ Initial and reply comments were due on August 30 and September 19, 2007 respectively. In this notice, the Commission is requesting additional comments on or before December 14, 2007, solely on the issue of master limited partnership growth rates. The Commission is also establishing a technical conference for further consideration of that one issue. The technical conference will be held on January 8, 2008. The technical conference will be organized around panels whose members will be selected from among the parties who file comments. However, all parties and the public are invited to attend. Additional comments on the growth rate issue discussed at the technical conference will be due on January 25, 2008.

I. Background

2. The Commission uses a DCF financial model to develop a range of returns earned on investments in companies with corresponding risks for determining the ROE for natural gas and oil pipelines. In the proposed policy statement, the Commission proposed to modify its current policy regarding the composition of the proxy group used in its DCF analysis to allow master limited partnerships (MLPs) to be included in the proxy group. The proposed policy statement found that cost of service ratemaking requires that firms in the proxy group be of

¹ *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 120 FERC ¶ 61,068 (2007).

comparable risk to the firm whose ROE is being determined in a particular rate proceeding. The proposed policy statement found that expanding the proxy group to include MLPs whose business is more narrowly focused on pipeline activities would help provide a more representative proxy group. The Commission proposed to cap the cash distribution used to determine an MLP's return under the DCF method at the MLP's reported earnings. The Commission found that this was necessary to exclude that portion of an MLP's distributions constituting return *of* equity. The Commission also proposed to require a showing that the MLP has had stable earnings over a multi-year period, so as to justify a finding that it will be able to maintain the current level of cash distributions in future years. The proposed policy statement found that these requirements should render the MLP's cash distribution comparable to a corporation's dividend for purposes of the DCF analysis. Under the proposed policy, the Commission would leave to individual cases the determination of which specific MLPs and corporations should be included in the proxy group.

3. Interested parties filed some twenty-two initial comments and fourteen reply comments, which focused on three issues: (1) whether MLPs should be included in the gas pipeline proxy group at all; (2) whether the proposed cap on the MLP cash distributions used in the DCF analysis is necessary or adequate; and (3) whether the short and long term growth component of the DCF model should be modified given the financial practices of MLPs. Other points include the potential distorting effects of MLP tax treatment, the payouts by MLPs, the general partner's incentive distributions, and the relative returns to the limited and general partners. One party requested a technical conference to discuss the issues.

4. Based on its review of the comments to date, the Commission believes that there is adequate material in the record to address most issues without additional comments or addressing them at the technical conference. These include: (1) whether the Commission should permit MLPs to be included in the proxy group for both gas and oil pipelines; (2) the proposed earnings cap on the MLPs' distributions; and (3) whether the Commission should explore other means of determining the equity cost of capital at this time.

5. However, the Commission concludes that the current record is inadequate for deciding how an MLP's growth should be projected for purposes of the DCF analysis. Currently, the Commission projects growth in dividends based on an average of short- and long-term growth projections, with two-thirds weight given to the short-term growth forecast and one-third weight given to the long-term growth forecast. The Commission uses the five-year growth forecasts published by the Institutional Brokers Estimate System (IBES) for the short-term growth forecast; long-term growth is based on forecasts of the growth of the economy as a whole, as reflected in Gross Domestic Product (GDP). The commenters generally

agree that MLPs will have lower growth potential than corporations, because of their distributions in excess of earnings. However, the existing record is insufficient for the Commission to determine (1) whether its current method of projecting growth adequately reflects the lower growth potential of MLPs, particularly over the long term,² and (2) if not, what alternative method should be used to project the growth of MLPs.

6. Therefore, the Commission has determined that the current record must be supplemented before the Commission can resolve the issue of how to project MLP growth rates, if the Commission ultimately decides to permit the use of MLPs in the proxy group. In addition, the Commission recognizes that the various components of the DCF model interact with one another, with the result that the appropriate growth projection for MLPs necessarily depends to some extent on whether the Commission caps the distributions used to determine an MLP's dividend yield. Parties should focus their comments and discussion at the technical conference on the issue of the appropriate MLP growth projection and, in particular, the appropriate growth projection if the Commission, as recommended by certain parties, does not cap the distributions used to determine dividend yield. In order to adequately consider the issue of whether to cap such distributions, the Commission needs a more complete record on the issue of growth projections.

II. Request for Comments and Notice of Technical Conference

7. The Commission requests that the parties submit additional comments on the issue of the appropriate growth component to be used in the Commission's DCF model in the context discussed above, when determining the equity cost of capital for an MLP. The comments must be filed on or before December 14, 2007.

8. The Commission is also establishing a staff led technical conference to discuss the MLP growth issue to be held on Tuesday, January 8, 2008. This conference is intended to be a working session focused solely on the appropriate growth component to be used in the Commission's DCF model when determining the equity cost of capital for an MLP. It is, therefore, not appropriate to discuss at this technical conference how the other components of the DCF model should be

²See *MLPs: Safe to Come Back into the Water*, Wachovia Capital Markets, LLC, Equity Research Department, at 9-10 (August 20, 2007), attached to the initial comments of Enbridge Energy Partners, L.P. and cited to in the reply comments of NYPSC at 5, using a projected MLP long term annual growth rate of 2.5 percent. Currently, GDP is projected to grow at a rate of approximately 4.5 percent.

applied in determining the equity cost of capital of an MLP. The conference will be organized into a limited number of panel discussions.

9. Parties interested in serving on a panel should so indicate in their comments. To ensure that all points of view are represented and to help the conference move expeditiously, the Commission encourages parties sharing the same position to coordinate their efforts and designate one speaker to represent their shared position.

10. The Commission emphasizes that industry growth rates are a highly technical, if critical issue. For this reason the Commission strongly urges any party filing comments, or participating in a panel, to provide technical analyses and utilize a speaker at the conference who can respond to technical questions from the staff. The list of prospective panel members will be announced in a later notice.

11. All parties, whether or not selected to participate in a panel, may file post-conference comments on or before January 25, 2008. The post-conference comments should address only the MLP growth projection issue discussed at the conference. For more information about the conference or participation in panels, please contact John Robinson by e-mail at john.robinson@ferc.gov or by phone at 202-502-6808.

III. Procedure for Comments

12. The comments requested by this notice must refer to Docket No. PL07-2-000, and must include the commentor's name, the organization it represents, if applicable, and its address. To facilitate the Commission's review of the comments, commentors are requested to provide an executive summary of their position. Additional issues the commentors wish to raise should be identified separately. The commentors should double space their comments.

13. Comments may be filed on paper or electronically via the eFiling link on the Commission's web site at <http://www.ferc.gov>. The Commission accepts most standard word processing formats and commentors may attach additional files with supporting information in certain other file formats. Commentors filing electronically do not need to make a paper filing. Commentors that are not able to file comments electronically must send an original and 14 copies of their comments to: Federal Energy Regulatory Commission, Office of the Secretary, 888 First Street N.E., Washington, D.C. 20426.

14. All comments will be placed in the Commission's public files and may be viewed, printed, or downloaded remotely as described in the Document

Availability section below. Commentors are not required to serve copies of their comments on other commentors.

IV. Document Availability

15. In addition to publishing the full text of this document in the *Federal Register*, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through the Commission's Home Page (<http://www.ferc.gov>) and in the Commission's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426.

16. From the Commission's Home Page on the Internet, this information is available in the Commission's document management system, eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number (excluding the last three digits) in the docket number field.

17. User assistance is available for eLibrary and the Commission's web site during normal business hours. For assistance, please contact the Commission's Online Support at 1-866-208-3676 (toll free) or 202-502-6652 (e-mail at FERCOnlineSupport@ferc.gov or the Public Reference Room at 202-502-8371, TTY 202-502-8659 (e-mail at public.referenceroom@ferc.gov).

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.