UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Composition of Proxy Companies	)	
For Determining Gas and Oil	)	Docket No. PL07-2-000
Pipeline Return on Equity	)	

REPLY COMMENTS OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA ON PROPOSED POLICY STATEMENT

In response to the Commission's "Proposed Policy Statement,"[1] issued on July 19, 2007, the Interstate Natural Gas Association of America ("INGAA") hereby submits comments in reply to other parties that have filed initial comments in this proceeding. Specifically, INGAA responds primarily to parties that (1) oppose the Commission's proposal to include Master Limited Partnerships ("MLPs") in the proxy group used to establish rates of return on equity ("ROE") for natural gas pipelines under the Discounted Cash Flow ("DCF") methodology; and/or (2) support the Commission's proposal to cap MLP distributions included in the DCF formula at or below an MLP's earnings. For ease of reference, INGAA will refer to these parties collectively as the Opposing Commenters.[2]

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

[2] These parties include the Natural Gas Supply Association ("NGSA"), the Public Service Commission of New York ("PSCNY"), Indicated Shippers, the Canadian Association of Petroleum Producers ("CAPP"), the Northern Municipal Distributor Group and Midwest Region Gas Task Force Association ("NMDG/MRGTF") and the Society for the Preservation of Oil Pipeline Shippers ("Oil Pipeline Shippers").

SUMMARY

None of the parties submitting comments opposing the inclusion of MLPs in the proxy group, or supporting a cap on MLP distributions, have provided any evidence or coherent rationale in support of their arguments. The major theme advanced by the Opposing Commenters is that there are differences between the MLP and corporate structure that make inclusion of MLPs in the proxy group inappropriate. However, while there certainly are differences between corporations and MLPs, none of the differences cited to by these parties are relevant to the DCF model, and no party has shown that any such difference renders the inclusion of MLPs in the proxy group inappropriate.

While MLPs typically emphasize the distribution of cash to their investors and corporations tend to retain more of their cash for future growth, both strategies are compatible with the DCF methodology, which incorporates both current cash payments and projected growth to derive an expected ROE. Moreover, whether the different tax consequences of the MLP versus corporate structure are beneficial or harmful may depend on a number of factors unique to each investor. Such tax differences do not render MLPs ineligible for inclusion in the proxy group because they are considered by investors in evaluating the price of an MLP unit. As recently reiterated by the D.C. Circuit in the *Petal* case,[3] the lynchpin test for inclusion in the proxy group is commensurate risk.

Some Opposing Commenters contend it is not necessary to include MLPs in the proxy group because there may be enough other proxy group candidates that are not MLPs. However, the existence of other potential proxy group candidates says nothing

[3] *Petal Gas Storage, L.L.C. v. FERC,* Case No. 04-1166, 2007 U.S. App. LEXIS 18656 (D.C. Circuit August 7, 2007).

about the propriety of including MLPs in the proxy group as proposed by the Commission. While INGAA does not necessarily agree that inclusion of some of the non-MLP companies proposed for inclusion in the proxy group would be appropriate, it is not necessary for the Commission to decide that issue here. Even if the Commission were to conclude in future pipeline proceedings that one or more of the other corporations proposed to be included in the proxy group was appropriate, that would not justify the exclusion of MLPs.

Finally, the Opposing Commenters support the proposed earnings cap on MLP distributions for the reasons stated by the Commission. Some of these parties even propose to lower the cap to some percentage of earnings based on the fact that corporations often pay only a percentage of their earnings in dividends. However, these parties never explain why including uncapped distributions in the DCF model would be inappropriate. In fact, the Opposing Commenters offer no analysis whatsoever of the purpose or theoretical methodology underlying the DCF formula. Rather, these parties simply assume that because MLPs focus on providing cash to their investors, instead of earnings, a cap is necessary. Moreover, while the Opposing Commenters repeat the Commission's concerns that MLP distributions include a return of capital or would result in a double recovery of depreciation, no party explains how there would be a double recovery of depreciation, how it could be determined that investors receive a return of their capital, or why that would matter to the DCF analysis, if true.

In its initial comments, INGAA demonstrated that higher distributions are offset through the other variables in the DCF formula, including lower projected growth rates and proved through a regression analysis performed by its expert, Dr. J. Stephen Gaske,

that there is no correlation between the level of a company's distributions or dividends and the level of the ROE calculated by the DCF formula.[4] Quite simply, high distributions do not produce high ROEs under the DCF formula because the other variables in the formula adjust in a manner that reduces the ROE. In contrast to this proof, the parties supporting the cap on distribution offer only conclusory assertions that a cap is needed to equate MLP distributions to corporate dividends.

COMMENTS

A. No Party Has Provided any Evidence or Coherent Rationale Supporting a Cap on MLP Distributions.

Several parties support the Commission's proposal to cap an MLP's distributions to be included in the DCF model at the level of the MLP's earnings. Other parties propose to go a step further and limit an MLP's distributions to a fraction of its earnings in an attempt to equate MLP distributions with the level of corporate dividends.

The parties supporting the earnings cap proposed by the Commission, or a percentage of earnings cap, exhibit a fundamental misunderstanding of the DCF model. CAPP, for example, contends (at 4-5) that MLP distributions must be capped at earnings, or some percentage thereof, to allow such distributions to serve as a surrogate for corporate dividends. In its view, unless MLPs' distributions are reduced to the level of

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[4] Dr. Gaske's regression analysis demonstrated with actual market data that there is no relationship between the payout ratios of MLPs and their DCF estimates. See in particular Chart II-B on page 9 of Exhibit A to INGAA's Initial Comments, which shows no relationship between payout ratios and DCF results when distributions exceed earnings (*i.e.*, the payout ratio exceeds 1.0). The data on this chart are scattered randomly and the R-square statistic is 0.0, where 0.0 is the lowest possible value, which indicates no relationship whatsoever between payout ratios and DCF results for MLPs when distributions exceed earnings.

corporate dividends, the conceptual underpinnings of the DCF analysis would be undermined. CAPP's conclusion that MLP distributions must be adjusted to approximate corporate dividends is based on the notion that "[t]he conceptual framework of the DCF methodology is that the 'yield' of an investment is the measure of its *earnings*, more precisely, the measure of earnings that are paid to investors periodically." CAPP Comments at 4-5 (emphasis added). Similarly, Indicated Shippers contend (at 20) that because financial analysts focus on an MLP's cash flow rather than its earnings, including MLPs in the proxy group would result in a "mismatch."

However, as INGAA explained at length in its initial comments, and in the attached analysis of Dr. Gaske, the DCF method is a measure of the present value of the *cash* to be distributed by a company to its investors over the long-term. Earnings, on the other hand, are a function of accounting principles that are not germane to the DCF analysis. Thus, the entire premise of capping an MLP's distributions at the level of the MLP's earnings, or worse yet at a percentage of an MLP's earnings, is inconsistent with the DCF model, and is fundamentally flawed. Contrary to the contentions of these parties, capping distributions at an MLP's earnings, or a fraction thereof, would result in a "mismatch" with the DCF formula.

As pointed out in INGAA's initial comments, the proposed earnings cap ignores the fact that higher distributions are offset with lower growth rate projections in the DCF analysis, a fact that is acknowledged by the Commission in the Proposed Policy Statement. Only one party supporting the cap even addresses this critical fact. PSCNY takes issue with the Commission's conclusion that the DCF analysis already accounts for high MLP distributions through lower growth projections. It suggests (at 8) that the

Commission's study of IBES growth forecasts of eleven companies, which found that MLP growth rates averaged nearly 300 basis points lower than corporate growth rates, does not amount to substantial evidence. PSCNY, however, does not challenge the validity of the Commission's study or explain why the Commission's analysis does not constitute substantial evidence.

PSCNY instead points to what it refers to as a similar analysis contained in the record in *Kern River*, which showed an average of only 116 basis points. However, the schedule relied upon by the Commission in *Kern River* did not present a meaningful comparison. The schedule relied upon in *Kern River* compared the average IBES growth projection for the MLPs with the growth projections of the four corporations that the Commission included in the proxy group in that case, three of which were primarily distribution companies. *See Kern River Gas Transmission Co.,* 117 FERC ¶ 61,077 at P 151 (2006). Thus, the average projected growth rate of the corporate group examined in *Kern River* reflected the lower risks, and therefore lower projected growth rates, of companies that had primarily distribution operations.[5]

It cannot be seriously disputed that because MLPs pay out more of their cash flow in distributions, they reinvest less for growth, and therefore have lower projected growth rates than corporations. In fact, PSCNY's challenge to this logical conclusion is internally inconsistent with its other argument that MLPs cannot sustain growth because they distribute their cash rather than reinvest it in growth projects.

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[5] In fact, if these same three primarily distribution companies were eliminated from the larger corporate group analyzed by the Commission in the Proposed Policy Statement, the average IBES growth rate of the corporate group would be 10 ½ percent, and the differential in growth rates between MLPs and corporations would exceed 400 basis points.

PSCNY further argues (at 10) that even if the IBES growth projections adequately reflect analysts' expectations of lower MLP growth prospects, those lower projections are not captured in the long-term growth rate if the Commission uses GDP as the measure for second-stage growth. PSCNY suggests that because the recent GDP has been comparable to IBES five-year growth rates, the use of GDP may overstate the long-term growth rates of MLPs, and there should be some recognition of the lower long-term growth rates of MLPs in the DCF formula.

INGAA has two responses. First, the fact that GDP recently has not been much different than IBES growth rate projections does not necessarily mean that GDP overstates long-term growth. It could just as likely mean that IBES five-year projections are also a good measure of long-term growth and should be used as the sole measure of growth in the DCF formula. Second, PSCNY's suggestion that an adjustment be made to reflect the lower long-term growth of MLPs as compared to GDP is another example of cherry-picking. Assuming, *arguendo,* any validity to PSCNY's premise, if GDP is adjusted downward to reflect an assumed lower long-term growth rate of MLPs, it must be adjusted upward for corporations, which may be assumed to have a higher growth rate than GDP. Indeed, INGAA suggests that there may no longer be a need for the use of GDP at all, and that company-specific IBES 5-year growth projections are currently a better indicator of the long-term growth prospects of the specific natural gas companies included in the proxy group than the nation's GDP.

Finally, while the parties opposing the inclusion of MLPs in the proxy group repeat the Commission-advanced rationale that MLP distributions contain a return of capital, none of these parties explains the basis for this assumption or why it matters to

the DCF analysis. The Oil Pipelines reference (at 8-9) a few statements provided by MLPs to their limited partners with the Form K-1, which state that the cash distribution received should be treated as a return of capital which reduces the limited partner's tax basis. INGAA believes that these statements may have added to the confusion surrounding the Commission's "return of capital" rationale. As shown by the excerpts from these statements referenced by the Oil Pipeline Shippers, the MLPs clearly are not attempting to differentiate their distributions between a portion that is a return on capital (*i.e.,* earnings) and a part that is a return of capital (*i.e.,* amount exceeding earnings), as the Commission appears to believe.

Rather, these statements suggest that the entire distribution is a "return of capital" to the limited partner solely from a tax perspective. A limited partner pays taxes on its share of partnership income or losses, and the distribution it receives reduces its tax basis. The use of the phrase "return of capital" is simply a short-hand reference to the fact that the limited partner's tax basis, which typically is initially set at the partner's capital contribution, is being reduced by the level of the distribution. The MLPs' use of this phrase does not reflect an attempt by MLPs to assess what part of an annual distribution, if any, is a return of the investor's capital contribution that will be paid back over the long-term.

B. To the Extent There are Differences Between Corporations and MLPs, None Has Been Shown to Be Relevant to the DCF Analysis.

In an effort to demonstrate that inclusion of MLPs in a proxy group would be inappropriate, several parties emphasize that MLPs differ from corporations in various respects. However, these parties do not explain how such differences impact the DCF

analysis or are even relevant to it. Indeed, as discussed below, some of these alleged differences are not differences at all.

1. Some of the Alleged Differences Between MLPs and Corporations are Illusory.

The Oil Pipeline Shippers appear to believe that the inclusion of MLPs is improper because they depend on outside sources of capital to fund new or replacement construction or partially fund their distributions. Oil Pipeline Shippers Comments at 6-7. However, the Commission correctly acknowledged in the Proposed Policy Statement (at P 23) that corporations also rely on external sources of capital, which is a method of raising capital that is neither unique to MLPs nor improper for any reason.

APGA points out (at 9) that an MLP's general partner "calls all of the shots" with little or no supervision by common unit holders. Oil Pipeline Shippers (at 4-5) note that incentive payments to general partners can amount to up to 50% of distributed cash. These statements simply note that MLP general partners, like corporate management, manage the business of the company and are compensated for such management responsibilities through incentive payments.

NGSA claims (at 5-6) that MLPs have lower stock share valuations as compared to corporations, which results in higher yields. NGSA offers no support for this contention, and it is contradicted by other parties that suggest that MLPs are tax advantaged, which would theoretically result in higher stock prices. *See, e.g.,* CAPP at 9; Indicated Shippers at 22. In any event, the price of a corporation's stock, as well as the price of a partnership's unit share, is determined by the market. Since the DCF methodology is based in part on the value of an investment as determined by the market,

any difference in the price of MLP shares as compared to corporate stock is accounted for in the DCF formula.

2. Other Asserted Differences Between MLPs and Corporations are Not Relevant to the DCF Methodology.

a. The Fact that MLPs Generally Distribute More Cash to Investors than Corporations and Reinvest Less Cash for Growth is Not Inconsistent With the DCF Model.

Most of the parties proposing to exclude MLPs from the proxy group rely on the fact that a major objective of MLPs is to generate cash flow for investors. APGA for instance states (at 10) that MLPs and corporations are driven by totally different business models – MLPs function to generate and distribute as much cash as possible whereas corporations view themselves as ongoing businesses that use retained earnings plus capital raised in the market to ensure sustained growth while at the same time producing a good return for their shareholders. The implication of this statement is that because an MLP's business model is to distribute more cash to investors in the short-term, and retain less cash for re-investment for future growth, an MLP is not a legitimate ongoing business, but is rather somewhat of a maverick that does not deserve to be included in a DCF proxy group.

However, neither APGA nor any other party demonstrates why an MLP's objective of distributing more of its cash flow is inconsistent with the DCF model. Because the DCF model takes into account both current distributions and long-term growth, it does not matter whether a company's business strategy is to focus more on current distributions or long-term growth. As the Commission noted, these two variables logically offset each other in the DCF formula. At bottom, the DCF model is premised on the stream of cash flow investors expect to receive over the long-term, and either

decision a company makes, (1) to place greater emphasis on current cash flow; or (2) to place greater emphasis on future growth, is completely consistent with that model.

APGA states (at 11) the Commission has recognized that different payout/retention ratios may be important in implementing the DCF methodology. It notes that in *Southern California Edison Co.,* 92 FERC ¶ 61,070 (2000), the Commission rejected the two-stage growth approach for electric companies because the payout ratios of such companies were greater in comparison to natural gas pipelines. However, the Commission's action in *Southern California* does not suggest, as APGA contends, that including companies with high payout ratios in the DCF analysis would be inappropriate. Rather, it suggests that the Commission may wish to reconsider the need for a two-stage measure of growth and whether the use of GDP to measure individual companies' anticipated growth is appropriate.

b. Tax Differences Between MLPs and Corporations are Not Germane to the DCF Methodology.

Several of the Opposing Commenters point out that an MLP itself is not taxed. Rather, the income or loss of an MLP is flowed through to its limited partners. Indicated Shippers states (at 22) that the "non-taxable" nature of MLP distributions makes them non-comparable to corporate dividends.

There is no substance to this line of argument. First, as a factual matter, MLP distributions are tax-deferred, not tax free.[6] As discussed above, distributions reduce the

[6] The first tax is paid at the unit holder level.

tax basis of a limited partner's investment, which results in a greater tax when the investment is sold.[7]

Second, the Opposing Commenters that refer to the tax differences between MLPs and corporations do not indicate why such differences are relevant to the DCF analysis. The implication seems to be that MLPs should not be included in the proxy group because they confer a tax advantage on investors. However, the Opposing Commenters do not even agree on whether MLP units offer a tax benefit or disadvantage. While CAPP and Indicated Shippers suggest that MLPs are tax-advantaged, NGSA (at 6-7) contends that tax law discourages investors in IRAs and tax-deferred accounts from buying MLPs and that other investors tend to steer away from MLP units due to the complexity of filing tax returns based on a Form K-1. These comments illustrate that whether the tax aspects of owning an MLP unit as compared to a share of corporate stock are beneficial or harmful depends on many factors unique to each investor, including its taxpayer status, income tax bracket and level of sophistication.

In any event, the taxation of MLPs and their limited partners is irrelevant to the DCF analysis because any perceived benefit or disadvantage is taken into account by investors and is reflected in the market price of MLP units. Thus, for instance, if investors perceive a tax-advantage, the price of an MLP unit would theoretically increase and the distribution yield would correspondingly be lower. Thus, the DCF analysis by

[7] *See Inquiry Regarding Income Tax Allowance,* 111 FERC ¶ 61,139 at n.35 (2005) for an explanation of the adjustment to a limited partner's capital account (*i.e.,* its tax basis) for MLP income, losses and distributions.

definition accounts for any tax differences and there is no reason to exclude MLPs from a DCF proxy group due to such differences.[8]

c. Only Differences in the Risk Comparability of Proxy Group Companies are Relevant to the DCF Methodology.

The DCF approach measures the return that investors expect to earn commensurate with the risk of the security. Thus, as the Court recently stated in *Petal, supra,* companies included in the proxy group in the DCF model must have comparable risks. As Dr. Gaske noted in his analysis attached to INGAA's Initial Comments (at 2), an efficient market will automatically adjust the components of the DCF formula because the risk of an investment – not the level of any single variable – is the element that determines the level of return required. Thus, as long as the proxy companies have commensurate risk (*i.e.,* are primarily in the same line of business and face a similar degree of competition) other differences, such as the ones claimed in the comments of the Opposing Commenters, are reconciled by the market and do not affect the validity of the DCF analysis.[9]

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[8] Indicated Shippers argue (at 21) that long-term growth expectations of MLPs and corporations are not comparable because the performance of MLPs depends more on monetary policy and the direction of interest rates. Again, even if true, this fact does not make MLPs more or less risky than corporations, and any perceived advantage or disadvantage will be reflected in the stock price and growth rate components of the DCF formula.

[9] The Opposing Commenters do not agree whether the MLP structure makes MLPs more or less risky than corporations. Compare CAPP at 9 (MLPs have lower risk due to tax-favored status) with PSCNY at 9 (MLPs face greater risk from rising interest rates and tighter access to capital).

C. The Existence of Other Potential Corporate Proxy Companies Does Not Render the Inclusion of MLPs in the Proxy Group Inappropriate.

Several parties contend that it is not necessary to include MLPs in the proxy group because there may be enough natural gas pipeline corporations to form a group. According to Indicated Shippers (at 17) and PSCNY (at 18), such potential candidates include Williams, El Paso, Southern Union, TransCanada and Spectra. At the present time, it may not be appropriate to include one or more of these companies due to either abnormal financial condition, a lack of a sufficient track record or non-comparable risk. Whether these companies may be eligible for inclusion in a proxy group in the future should be decided in future individual cases, consistent with the principle of commensurate risk as articulated in *Petal*. In any event, even if one or more of these companies were determined to be eligible for inclusion in a future proxy group, such a determination would not suggest that MLPs should be excluded. Given that major interstate pipelines are evaluating plans to establish MLPs, it is imperative that MLPs be included in the proxy group.

Similarly, PSCNY contends (at 13-17) that due to the "methodological complications" of including MLPs in the proxy group, the Commission should reconsider the use of diversified natural gas companies, or even electric utilities, in the proxy group, with an adjustment as required by *Petal.* As a threshold matter, PSCNY has not demonstrated any "methodological complications" associated with the inclusion of MLPs. Moreover, as the Commission suggests in the Proposed Policy Statement (at P 17), it would be more straightforward to use companies with comparable risks, than to use less risky companies, and then have to attempt to determine what an appropriate adjustment should be to reflect the risk differential. The fewer comparable-risk

companies included in the proxy group, the more difficult it becomes to determine what the target return, and thus what the required adjustment, should be.

If, for example, several risk-comparable MLPs were included in a proxy group, it may be appropriate to include one or more diversified natural gas companies in the group as well, and to place the pipeline whose rates are being set at the top of the range. *See Petal,* slip op. at 7. However, if no MLPs were included in the group, determining the benchmark against which an adjustment should be made may be quite difficult. In any event, whether or not a particular company should be included in a proxy group, and what risk-associated adjustment to the DCF result would be needed, should be left to individual pipeline proceedings.[10]

D. No Party Has Offered Any Evidence that MLP Distributions are Not Sustainable.

In its Initial Comments, INGAA demonstrated through the financial analysis and thorough review of historical data presented by Dr. Gaske that MLPs are able to sustain distributions, notwithstanding their relatively lesser reliance on retained earnings to do so. Dr. Gaske discussed how MLPs have been able to sustain growth by retaining and reinvesting cash flow, and borrowing and issuing equity to add facilities that are accretive

[10] PSCNY's reliance (at 16) on Standard & Poor's credit ratings for the proposition that it would be wrong to assume that LDC or electric companies are less risky than pipelines, misses the mark. The degree to which pipelines, LDCs and electric companies are subject to competitive pressure, not credit risk, is the primary driver of the comparative risk analysis. Because LDCs and electric utilities are provided with franchised service territories by state law, they have been, and continue to be, less risky, and for this reason, among others, have been excluded from natural gas pipeline proxy groups. *See, e.g., Williston Basin Interstate Transmission Co.,* 87 FERC ¶ 61,264 at 62,007 (1999); *Mountain Fuel Res. Inc.,* 28 FERC ¶ 61,195 at 62,370 (1984) (LDCs); *Williston Basin Interstate Transmission Co.,* 104 FERC ¶ 61,036 at P 43 (2003) (electric utilities); *Kern River, supra,* 117 FERC ¶ 61,077 at P 158 (electric utilities).

to earnings. Dr. Gaske supported his analysis by demonstrating the actual growth of six MLPs over periods averaging ten years.

In contrast, the Opposing Commenters offer nothing more than conclusory statements that MLPs cannot sustain growth due to their relatively higher payout ratios as compared to corporations. PSCNY, for example, states (at 9) that MLPs generally can *only* generate growth through external debt or equity, and simply concludes (at 6-7) without any support that ultimately such a growth strategy is unsustainable. As an initial matter, the notion that growth through issuance of debt cannot be sustained is itself suspect given that lenders presumably would not loan money to companies they believed could not sustain growth. As mentioned below, natural gas companies own long-lived pipeline assets that fund growth regardless of the organizational structure the company chooses. As Dr. Gaske points out, there are several ways for MLPs to fund the acquisition and maintenance of their assets to grow besides retained earnings, and they have in fact sustained such growth to date.

NGSA argues (at 7) that incentive payments made by MLPs to general partners will prevent MLPs from generating stable earnings. Again, there is no evidence that such payments prevent long-term growth in earnings, let alone growth in distributions. The Commission has never examined corporate management compensation and incentive bonuses to determine whether such payments would prevent the corporation from enjoying sustained growth, and there is no reason to suggest that MLP growth will suffer from such payments. Moreover, inasmuch as these incentive payments are tied to distributions to limited partners, the less cash an MLP generates, the less these incentive payments will be. Thus, if these incentive payments do stunt an MLP's growth, the

payments will be correspondingly reduced, freeing internal cash flow to fund future growth.

Based on their speculation that MLPs cannot sustain growth, both PSCNY and NGSA propose that MLPs be included in the proxy group only if they can show a five-year history of stable earnings. NGSA states (at 8) that MLPs that show "significant fluctuations and volatility" of earnings should be eliminated. As INGAA noted in its Initial Comments, however, earnings may fluctuate for numerous reasons that have nothing to do with long-term sustainability. In fact, as the American Gas Association ("AGA") indicates (at 6), a requirement of stable earnings over some specified number of years may exclude a newly formed MLP due to a lack of a history of earnings as an MLP, despite the fact that such MLP may be a good proxy based on its relative risk. AGA correctly notes that the underlying assets of such an MLP may have a long and significant history of earnings that stem from its natural gas operations. The fact is, the underlying nature of the pipeline business, including its long-lived assets, is more indicative of a natural gas pipeline's ability to sustain growth than its chosen organizational structure.

If the Commission wishes to review the sustainability of an MLP's growth, there is no need for a rigid test to do so. Given the lack of any evidence suggesting that MLPs cannot sustain growth, and the evidence that exists to the contrary, parties opposing inclusion of any MLP due to non-sustainability should have the burden to demonstrate that an MLP should not be included in the proxy group due to an inability to sustain growth.

E. The Commission Should Hold that Parties May Propose Other Approaches for Either Determining ROE or Providing a Check on the DCF Results.

APGA suggests (at 4-5) that methods for determining ROE other than the DCF model should be explored. Similarly, NGSA states (at 2) that the Proposed Policy Statement should be adopted as an interim measure until a long-term solution that departs from the DCF method can be developed. NGSA suggests that a new proceeding should be initiated to devise a different approach.

As INGAA stated in its Initial Comments, the Commission's proposal to include MLPs in the DCF proxy group is a step in the right direction. This proposal, however, will produce a valid basis for determining ROEs for natural gas pipelines only if the market-based components of the DCF model are permitted to operate without artificial caps. Clearly, unless the Commission removes the proposed cap, other methodologies, or other changes to the DCF methodology that will provide pipelines with adequate ROEs, would need to be explored. In any event, INGAA agrees that the DCF methodology is not necessarily the only financial model that should be considered by the Commission. INGAA does not interpret the Proposed Policy Statement to limit the freedom of parties in individual proceedings to propose other methodologies as either an alternative to, or check upon, the DCF methodology.

F. Whether the Policy Statement Should be Applied to Pending Proceedings Should Be Determined in Such Proceedings, and Not in the Policy Statement

Indicated Shippers and NGSA contend that the Proposed Policy Statement should not be applied to pending cases, and in particular to cases where the hearing has been concluded. The focus of these comments relates to the question of whether the Proposed

Policy Statement should be applied to the rate case of Kern River Transmission Company that is pending rehearing of Opinion No. 486.[11] In light of the arguments made that pertain to that particular proceeding, INGAA believes the Commission should address the question of the applicability of the Proposed Policy Statement on rehearing of Opinion No. 486, and not in the Policy Statement.

CONCLUSION

Parties opposing the inclusion of MLPs in the proxy group have not demonstrated any theoretical inconsistency between the MLP structure and the DCF analysis. Nor have such parties shown any basis for capping the level of distributions to be included in the DCF formula at or below an MLP's earnings. At bottom, these parties' arguments rest primarily on the flawed assumption that an MLP's business strategy of providing more of their cash flow to investors is inconsistent with the DCF model. As demonstrated fully in INGAA's Initial Comments, however, the DCF model takes into account both current yield and expected growth and a company's emphasis on either component will be reflected in the formula through adjustments to the other component.

Neither has any party demonstrated a need for an "earnings stability" test to determine if an MLP can sustain growth. There is no evidence supporting the notion that MLP growth is non-sustainable and that the stability of a company's past earnings is a prerequisite for sustainable future growth. The burden should be on parties opposing the inclusion of any MLP in the proxy group due to non-sustainability to prove its case.

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[11] *Kern River Gas Transmission Co.,* 117 FERC ¶ 61,077 (2006).

Consequently, INGAA respectfully urges the Commission to issue a Policy Statement that (1) allows MLPs to be included in the proxy group without any artificial cap on the level of distributions to be included in the DCF formula; and (2) requires any party opposing the inclusion of an MLP to demonstrate that such MLP cannot sustain the level of its current distributions.

Respectfully submitted,

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