

## *Report of The Committee On Natural Gas Rate and Accounting Regulations*

### *A. Rate of Return*

In *East Tennessee Natural Gas Co. v. FERC*, 686 F.2d 430 (6th Cir. 1982) petition for rehearing and suggestion for rehearing en banc pending, the United States Court of Appeals for the Sixth Circuit affirmed a Federal Energy Regulatory Commission ("Commission") order establishing a 12.33 percent rate of return on common equity. Although the Court recognized that the rate is low and not all of the Commission's reasoning could be accepted, the company failed to meet the burden of showing that the rate was outside the zone of reasonableness. Although the Court held that the Commission's decision was not unreasonable at the time it was made, it stated that hindsight reveals that a 12.33 percent rate of return is clearly inadequate in light of the continued high interest rates. It encouraged the Commission to reopen the rate proceeding on its own initiative.

On April 6, 1982, the Commission issued Opinion No. 71-A, *Arkansas Louisiana Gas Company*, 19 FERC ¶ 61,012 (1982) appeal filed sub nom., *City of Winfield, Kansas v. FERC*, No. 82-4219 (5th Cir. June 10, 1982), reaffirming its earlier conclusion that the appropriate lower limit on the zone of reasonableness used to determine the rate of return should be 12 percent on remand from the Fifth Circuit. *Arkansas Louisiana Gas Co. v. FERC*, 654 F.2d 435 (5th Cir. 1981). On remand, the Commission expressed a reliance on Opinion No. 70, *Consolidated Gas Supply Corp.*, 10 FERC ¶ 61,029 (1980), in which the Commission adopted a 12 percent floor. The Commission clarified that it had not adopted the initial decision's reliance on the cost of living index in reaching its conclusion. The Commission did, however, find that the appropriate equity return within the zone is 13.5 percent rather than the 12.5 percent it had previously ordered.

In another proceeding involving Arkansas-Louisiana Gas Company, an Administrative Law Judge issued an initial decision rejecting the rate of return presentations of both the company and the Commission Staff. *Arkansas-Louisiana Gas Co.*, 19 FERC ¶ 63,008 (1982). The ALJ stated that he had "no alternative" but to recommend that the company be allowed the 12.5 percent rate of return approved in Opinion No. 71 or whatever other rate the Commission finally approves in that proceeding. See discussion of Opinion No. 71-A, *supra*.

On August 6, 1982, an Administrative Law Judge issued an initial decision recommending a 17 percent rate of return on a common component of 51.47 percent for Tennessee Gas Pipeline Company. *Tennessee Gas Pipeline Co.*, 20 FERC ¶ 63,039 (1982). The Commission Staff had recommended a 13 percent rate of return on common equity. The ALJ rejected the Staff's argument that, because this is a period of highly volatile inflation, bonds have become riskier than equity.

The ALJ was persuaded by evidence which showed that from November 1980 through August 1981, the average yield on long-term U.S. government bonds was 12.90 percent, the average yield on Moody's public utility bonds rated A averaged 15.33 percent, and the average yield on Tenneco's debentures and notes was 14.33 percent. Moreover, during the calendar year 1981 and the first five months of 1982, comparable interest rates were as high or higher. The ALJ also found that a 17 percent return on common equity resulted in a reasonable risk premium over the interest levels on high quality debt at the time the rates were in effect.

On November 5, 1982, an initial decision was issued in *Consolidated Gas Supply Corp.*, 21 FERC ¶ 63,027 (1982), recommending a 16.75 percent return on equity.

The Administrative Law Judge accepted Consolidated's discounted cash flow analysis and Staff's comparable earnings test and CAPM study.

The Judge determined that the 16.75 percent rate of return on equity should be based on a hypothetical capital structure consisting of 50 percent debt, 10 percent preferred stock, and 40 percent common equity. Consolidated advocated continued use of its parent company's capital structure (38.3 percent debt, 2.3 percent preferred stock, and 59.4 percent common equity).

Judge Nancy agreed with the Commission Staff and the New York Public Service Commission that Consolidated Supply has lower risks and more stable income than other companies in the Consolidated Natural system. This relatively lower risk, he explained, is due to Consolidated Supply's ability to pass through about 90 percent of its total operating and maintenance expenses to ratepayers via a PGA clause. He found that contrary to the pipeline's contention, this benefit is not offset by increased marketing risks.

On October 13, 1982, Administrative Law Judge Bruce L. Birchman, issued an initial decision in *Pacific Gas Transmission Co.*, 21 FERC ¶ 63,004 (1982), in which he approved a common cost of equity capital of 17 percent applicable to all rate schedules. Intervenors had argued that customers who receive no benefits from Pacific's "prebuild" facilities used to transport gas for Pacific Interstate Transmission Company should not be charged any capital costs associated with those facilities. Judge Birchman rejected this argument, stating that investors look to a company's overall risks and furnish capital to the entire company rather than to any particular portion of the enterprise.

The ALJ also approved a debt tracker which requires PGT to track changes in the cost of \$145 million of debt subject to variable rates of interest for the duration of the underlying seven-year credit arrangement. He concluded that the inclusion of a debt tracker will enhance Pacific's ability to improve and maintain its credit rating and to attract capital.

#### B. Rate Base

On April 15, 1982, an initial decision was issued in *Arkansas Louisiana Gas Co.*, 19 FERC ¶ 63,008 (1982), *aff'd* Opinion No. 160, 22 FERC ¶ 61,125 (1983), in which the Administrative Law Judge disallowed the inclusion in rate base of a storage facility and associated cushion gas because it was not "placed in service" by the end of the test period. The ALJ stated that a storage field cannot be said to have been "placed in service" until the base pressure is attained so that the storage field will perform its function. "That point in time occurs when the necessary volume of cushion gas is in place and injections of working gas are contemplated to commence shortly thereafter."

#### C. Test Year

On December 8, 1982, the Commission ordered Southern Natural Gas Company to file revised tariff sheets reflecting a working capital allowance for gas prepayments based on a nine-month adjustment period. *Southern Natural Gas Co.*, 21 FERC ¶ 61,284 (1982). Although section 154.63 (d)(2)(i) of the Commission's regulations allows companies to make adjustments to its test period data based on "changes in revenues and costs which are known and measurable" at the time of the filing and which will become effective within nine months after the last month of available actual experience utilized in the filing, Southern made adjustments for

changes in projected gas prepayments occurring up to thirteen months beyond the nine-month adjustment period. The Commission noted that Southern did not file a request for waiver of the regulations nor did its rate filing contain any suitable basis to support a finding of good cause for granting a waiver.

On April 15, 1982, an initial decision was issued which adjusted test year data on the basis of actual data for the adjustment period. *Arkansas Louisiana Gas Co.*, 19 FERC ¶ 63,008 (1982), *aff'd*, Opinion No. 160, 22 FERC ¶ 61,125 (1983). Section 154.63(e)(2) of the Commission's regulations provides that data supporting a request for a rate increase should be based on a test period consisting of a base period of 12 months and an adjustment period of nine months immediately following the base period. The base period data are to be adjusted for changes in revenue and costs which are "known and measurable with reasonable accuracy at the time of filing" and will occur during the adjustment period. The Administrative Law Judge approved the use of actual rather than projected figures for the adjustment period where such data are available and where no party has engaged in dilatory tactics in order to delay the proceedings until actual data are available.

#### D. Cost Allocation and Classification

On June 2, 1982, an Administrative Law Judge issued an initial decision recommending that Southern Natural Gas be required to reinstitute mileage-based zone rates. *Southern Natural Gas Co.*, 19 FERC ¶ 63,060 (1982). Previously, in Opinion No. 83, 10 FERC ¶ 61,287 (1980), the Commission approved a settlement agreement providing for a phased change from a mileage-based zone system to uniform system rates. This change was brought about by the commencement of LNG deliveries in 1978 at the eastern end of Southern's system. The change back to the old standard was ordered because Southern was no longer receiving Algerian LNG and the Southern system had reverted to substantially the same status as prior to the introduction of LNG. Because, in terms of distance, load factor, and load density, the facts are similar to those existing prior to the introduction of LNG, a return to a 100 percent mileage method for allocating costs between jurisdictional and nonjurisdictional customers and among jurisdictional customers is appropriate.

The ALJ approved Southern's use of the *Seaboard* method for allocating costs between jurisdictional and nonjurisdictional customers and the *United* method for allocating costs among jurisdictional customers until the Commission order is issued in this case and, at that point, the *Seaboard* method will be used. The ALJ concluded that forcing Southern to retroactively switch to the *Seaboard* method could result in undercollections.

#### E. PGA Filings

On March 11, 1982, the United States Court of Appeals for the Fifth Circuit affirmed a Commission order which directed an investigation under section 5 of the Natural Gas Act to determine whether United Gas Pipe Line Company's PGA clause was just and reasonable and resulted in a fair allocation of costs to the pipeline's customers. *Laclede Gas Co. v. FERC*, 670 F.2d 38 (5th Cir. 1982). Laclede contested the Commission's decision to investigate United's PGA tariff provision under section 5 of the Natural Gas Act alone, thereby precluding any refund of amounts which might ultimately be found unreasonable.

The Fifth Circuit agreed with Laclede that United "opened to Commission scrutiny" under section 4 the propriety of the PGA clause contained within its filed

In *Southern Union Gathering Co. v. FERC*, 687 F.2d 87 (5th Cir. 1982), the Fifth Circuit held that it lacked jurisdiction to review an order rejecting a proposed increase in the company's gathering allowance because the company had failed to exhaust its administrative remedies. The company failed to seek rehearing of an appeal of an order of the Director, Office of Pipeline and Producer Regulations, which was effectively denied by the Commission's inaction on the matter. The Fifth Circuit rejected the company's contention that it had satisfied the rehearing requirement by appealing the OPR order to the Commission.

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