UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's Policy for Determining Return on Equity	**§ § §**	**Docket No. PL19-4-000**

COMMENTS OF PLAINS PIPELINE, L.P.

Plains Pipeline, L.P. ("Plains") hereby submits comments in response to the "Inquiry Regarding the Commission's Policy for Determining Return on Equity" that was issued by the Federal Energy Regulatory Commission ("FERC" or "Commission") on March 21, 2019 in the above captioned docket ("NOI"). The Commission issued the NOI following the decision of the U.S. Court of Appeals for the District of Columbia Circuit in *Emera Maine v. Federal Energy Regulatory Commission*,[1] to request information and stakeholder views to help it explore "whether, and if so how, it should modify its policies concerning the determination of the return on equity ("ROE") to be used in designing jurisdictional rates charged by public utilities," and "whether any changes to its policies concerning public utility ROEs should be applied to interstate natural gas and oil pipelines."[2]

As set forth in more detail below, Plains is submitting these comments to confirm (i) Plains' support of the comments that the Association of Oil Pipelines ("AOPL") is filing in this docket, including AOPL's recommendation that the Composite Method[3] be used to calculate an oil pipeline's ROE, (ii) a forward looking market risk premium should be used by the Commission to calculate the ROE for an oil pipeline company, (iii) the Commission should not

[1] *Maine v. FERC*, 854 F.3d 9, 23 (D.C. Cir. 2017).
[2] NOI at 1.
[3] "Composite Method" has the meaning ascribed to it in Section III.1 herein.

employ an outlier test when calculating the ROE for an oil pipeline proxy group because the ROE in oil pipeline cases has typically relied on the median, and (iv) it is inappropriate for the Commission to cut the long-term growth rate in half for master limited partnerships ("MLPs") that are part of an oil pipeline proxy group.

I. COMMUNICATIONS AND CORRESPONDENCE

Pursuant to Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010, the names and mailing addresses of the persons designated to receive service and to whom correspondence and communications concerning this proceeding should be addressed are as follows:

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II. DESCRIPTION OF PIPELINE ASSETS OWNED BY PLAINS

Plains owns and operates an extensive network of crude oil pipelines in the United States, which includes over 6,300 miles of gathering and trunk pipelines. Its pipeline and gathering systems are located in almost all of the major crude oil producing regions of the United States, including the Permian Basin, the Western United States, the Rocky Mountains, the Gulf Coast, and the Central United States. A significant number of those pipelines are subject to the Commission's jurisdiction, and Plains currently operates those assets under FERC Tariff Nos. 71.9.0 – 142.0.0. Plains' total transportation revenues in 2018 were approximately $1.3 billion, with barrel-miles totaling approximately 189 billion.

In addition to operating the above-referenced assets, Plains also owns an equity, non-controlling interest in White Cliffs Pipeline LLC, BridgeTex Pipeline Company, LLC, Eagle Ford Pipeline LLC, Caddo Pipeline LLC, Saddlehorn Pipeline Company, LLC, Diamond Pipeline LLC, STACK Pipeline LLC, Advantage Pipeline Holdings LLC, and Midway Pipeline LLC, with interests ranging from 20% to 50%. A majority of these pipeline systems also transport crude oil in interstate commerce, subject to the jurisdiction of the Commission.

III. COMMENTS

1. Plains supports the use of the Composite Method to calculate the ROE for an oil pipeline company.

In the NOI, the Commission asks interested parties to submit comments in response to a variety of questions related to the determination of the ROE is to be used when designing rates for entities subject to the jurisdiction of the Commission, including oil pipelines. In particular, the Commission asks whether it should move away from its historic reliance on the Discounted Cash Flow methodology ("DCF Method") and towards a Composite Method in order to calculate a regulated entity's ROE.[4] The Composite Method that the Commission has proposed would combine the results yielded from a DCF Method analysis, a Capital Asset Pricing Model ("CAPM") analysis, a Risk Premium analysis, and an Expected Earnings analysis.[5]

Plains is a member of AOPL, and, as set forth in the affidavit of Christopher J. Herbold attached hereto as Attachment A, understands that AOPL intends to submit comments in response to the NOI on behalf of its members ("AOPL Comments").[6] Mr. Herbold states that he, along with other members of management at Plains, have had an opportunity to review a draft of

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[4] NOI at 21, 29-30.

[5] NOI at 20.

[6] Affidavit of Christopher J. Herbold at P 4 ("Herbold Affidavit"). A copy of the Herbold Affidavit it attached hereto as Attachment A.

the AOPL Comments, and this review showed, among other things, that AOPL supports the use of the Composite Method to calculate the ROE for an oil pipeline company with assets subject to the jurisdiction of the Commission.

Plains agrees with AOPL's support of the Composite Method.[7] The Composite Method utilizes multiple methodologies to produce a ROE for an entity with regulated assets, and in doing so, reflects Plains' understanding that investors use more than one type of analysis to evaluate an investment opportunity.[8] In addition, it is Plains' belief that all four methods are viable methods to value equity of an MLP.[9] Importantly, the DCF Method, CAPM, and Expected Earnings methods all take into consideration an entity's growth rate, and both the CAPM and Risk Premium methods consider the riskiness of an investment in an entity, as compared to a "risk free" investment.[10]

As Mr. Herbold states, the Composite Method also reflects the fact that Plains evaluates pipeline investment opportunities utilizing multiple methodologies to produce a ROE.[11] Investments must be expected to generate returns at least equal to Plains' cost of capital (based on 55% equity funding and 45% debt funding) plus a risk premium based on the attributes of the individual investment opportunity.[12] Notably, Plains embeds its expected growth rates in its cost of equity assumptions.[13]

For these reasons and the reasons set forth in the AOPL Comments, Plains supports the use of the Composite Method to calculate the ROE for an oil pipeline company with assets subject to the jurisdiction of the Commission.

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7 Herbold Affidavit at P 5.
8 *Id.*
9 *Id.*
10 Herbold Affidavit at P 6.
11 *Id.*
12 *Id.*
13 *Id.*

2. The Commission should use a forward looking market risk premium when calculating the ROE for a regulated oil pipeline company.

As the NOI notes, one of the factors in a CAPM calculation is the Market Risk Premium, which is calculated by subtracting the risk-free rate from the market return.[14] This calculation can be performed either on a historical or a prospective basis.[15] To calculate a historical Market Risk Premium, an analyst will compare historic market returns to some measure of the risk free rate of return. To calculate a prospective Market Risk Premium, an analyst will compare expected market returns to some measure of the expected risk free rate of return.[16]

As Mr. Herbold states in his affidavit, Plains believes that a prospective market risk premium should be used to calculate CAPM under the Composite Method because the use of a prospective rate is particularly appropriate in the context of setting rates that an oil pipeline will be allowed to charge in the future.[17] The purpose of the ROE calculation is not to determine what returns have been achieved, but rather to set a reasonable rate going forward.[18] For this reason, reliance on a historical market risk premium is not appropriate in this context.[19]

3. The Commission should not exclude outliers when determining the proxy group for an oil pipeline company.

The DCF Method, as well as the Composite Method, both rely on a "proxy group" of publicly traded liquids pipelines companies. In the NOI, the Commission asks whether it should employ a test to remove both high-end and low-end outliers from the proxy group.[20]

Plains submits that the outlier test is inappropriate in the context of calculating a ROE for an oil pipeline proxy group, specifically, because the ROE in oil pipeline cases has typically

[14] NOI at 11.
[15] NOI at 11-12.
[16] *Id.*
[17] Herbold Affidavit at P 7.
[18] *Id.*
[19] *Id.*
[20] NOI at 25.

relied on a median.[21] This fact stands in sharp contrast to the electric companies involved in the *NETO* case that prompted the issuance of the NOI.[22] In that case, the Commission calculated both a zone of reasonableness and a specific ROE using a midpoint.[23] Both the zone of reasonableness and the midpoint can be strongly influenced by high or low earners. In that instance, use of outlier testing of some sort could be beneficial.[24] By contrast, a high or low earner will have little impact on the median, meaning that an outlier test for determining an oil pipeline proxy group has little, if any, value.[25]

4. There is no valid basis to reduce the long-term growth rates for MLPs for purposes of calculating the ROE under the DCF Method.

One component of calculating the ROE using the DCF Method involves using gross domestic product as a proxy for long-term growth.[26] When the Commission is relying on a proxy group comprised of MLPs, the Commission requires the long-term growth rate to be reduced by 50 percent.[27] As the Commission noted in the NOI, it previously justified this requirement by finding that "MLPs have less growth potential than corporations, because they generally distribute to partners an amount in excess of their reported earnings."[28]

As Mr. Herbold states in his affidavit, Plains does not believe that the reduction to the long-term growth rate for MLPs was ever appropriate, as investors have always expected growth from MLPs.[29] In addition, Plains submits that to the extent there was such a basis for this reduction, it is no longer appropriate because, in recent years, MLPs have been retaining more of

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21 Herbold Affidavit at P 8.
22 *NETO*, 165 FERC ¶ 61,030 (2018).
23 *Id.*
24 Herbold Affidavit at P 8.
25 *Id.*
26 NOI at 6; Herbold Affidavit at P 9.
27 NOI at 8 n.20; Herbold Affidavit at P 9.
28 *Id.*
29 Herbold Affidavit at P 10.

their cash flow than during the period the Commission reviewed when it ordered the long-term growth rates to be cut.[30] Many MLPs have been retaining more of their earnings in order to fund new projects.[31] For example, in 2018 and forecasted 2019, Plains has retained/will retain an average of 50 percent of its cash flow available for distribution, primarily to fund projects.[32] As a result, the long-term growth rates for MLPs in a proxy group should be treated the same as the long-term growth rates for corporations that are members of a proxy group.[33]

IV. CONCLUSION

For the reasons stated above, Plains respectfully request that the Commission modify its policies concerning the determination of the ROE to be used in designing jurisdictional rates charged by oil pipeline companies in the manner described herein.

Respectfully submitted,

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Date: June 26, 2019

[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*

ATTACHMENT A

UNITED STATES OF AMERICA
BEFORE THE
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Inquiry Regarding the Commission's Policy for Determining Return on Equity	**§ § §**	**Docket No. PL19-4-000**

AFFIDAVIT OF CHRISTOPHER J. HERBOLD ON BEHALF OF PLAINS PIPELINE, L.P.

1. My name is Christopher J. Herbold. I am the Senior Vice President and Chief Accounting Officer of Plains All American Pipeline, L.P. ("PAA"), which is the parent company of Plains Pipeline, L.P. ("Plains"). My office is at 333 Clay Street, Suite 1600, Houston, Texas 77002.

2. I joined PAA in 2002 from Arthur Andersen, LLP. In my role at PAA, I oversee the accounting and financial reporting functions.

3. The purpose of my affidavit is to respond to certain questions raised by the Federal Energy Regulatory Commission ("FERC" or "Commission") in the "Inquiry Regarding the Commission's Policy for Determining Return on Equity" that it issued on March 21, 2019 in the above captioned docket ("NOI").

I. <u>The Composite Method</u>

4. Plains is a member of the Association of Oil Pipelines ("AOPL"), and I understand that AOPL intends to submit comments in response to the NOI on behalf of its members ("AOPL Comments"). I, along with other members of management at Plains, have had an opportunity to review a draft of these comments. This review

showed that, among other things, the AOPL Comments support the use of the Composite Method to calculate the return on equity ("ROE") for an oil pipeline company with assets subject to the jurisdiction of the Commission.

5. Plains agrees with AOPL's support of the Composite Method, which would combine the results yielded from the Commission's Discounted Cash Flow methodology ("DCF Method"), a Capital Asset Pricing Model ("CAPM") analysis, a Risk Premium analysis, and an Expected Earnings analysis in order to calculate a regulated entity's ROE. The Composite Method utilizes multiple methodologies to produce a ROE for an entity with regulated assets, and in doing so, reflects Plains' understanding that investors use more than one type of analysis to evaluate an investment opportunity. In addition, it is Plains' belief that all four methods are viable methods to value equity of a master limited partnership ("MLP"). Importantly, the DCF Method, CAPM, and Expected Earnings methods all take into consideration an entity's growth rate and both the CAPM and Risk Premium methods consider the riskiness of an investment in an entity, as compared to a "risk free" investment.

6. The Composite Method also reflects that Plains evaluates pipeline investment opportunities by utilizing multiple methodologies to produce a ROE. Investments must be expected to generate returns at least equal to our cost of capital (based on 55 percent equity funding and 45 percent debt funding) plus a risk premium based on the attributes of the individual investment opportunity. Notably, Plains embeds its expected growth rates into its cost of equity assumptions.

II. <u>Prospective Risk Premium</u>

7. A prospective market risk premium should be used to calculate CAPM under the Composite Method because the use of a prospective rate is particularly appropriate in the context of setting rates that a liquids pipeline will be allowed to charge in the future. The purpose of the ROE calculation is not to determine what returns have been achieved, but rather to set a reasonable rate going forward. For this reason, a reliance on a historical market risk premium is not appropriate in this context.

III. <u>Outlier Testing</u>

8. The outlier test is inappropriate in the context of calculating a ROE for a liquids pipeline proxy group, specifically, because the ROE in liquids pipeline cases has typically relied on a median. This fact stands in sharp contrast to the electric companies involved in the *NETO* case[1] that prompted the issuance of the NOI. In that case, the Commission calculated both a zone of reasonableness and a specific ROE using a midpoint. Both the zone of reasonableness and the midpoint can be strongly influenced by high or low earners. In that instance, use of outlier testing of some sort could be beneficial. By contrast, a high or low earner will have little impact on the median, meaning that an outlier test for determining a liquids pipeline proxy group has little, if any, value.

[1] *NETO*, 165 FERC ¶ 61,030 (2018).

IV. Long-Term Growth Rates

9. It is my understanding that one component of calculating the ROE using the DCF Method involves using gross domestic product as a proxy for long-term growth.[2] I further understand that when the Commission is relying on a proxy group comprised of MLPs, the Commission requires the long-term growth rate to be reduced by 50 percent.[3] As the Commission noted in the NOI, it previously justified this requirement by finding that "MLPs have less growth potential than corporations, because they generally distribute to partners an amount in excess of their reported earnings."[4]

10. Plains does not believe that the reduction was ever appropriate as investors have always expected growth from MLPs. In addition, Plains submits to the extent there was ever a basis for this reduction, it is no longer appropriate because, in recent years, MLPs have been retaining more of their cash flow than during the period the Commission reviewed when it ordered the growth rates to be cut. Many MPLs have been retaining more of their earnings in order to fund new projects. In 2018 and forecasted 2019, Plains has retained/will retain an average of 50 percent of its cash flow available for distribution, primarily to fund capital projects. As a result, the long-term growth rates for MLPs in a proxy group should be treated the same as the long-term growth rates for corporations that are members of a proxy group.

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[2] NOI at 6.

[3] NOI at 8, n 20.

[4] *Id*.

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VERIFICATION

Christopher J. Herbold, being first duly sworn, declared that the statements set forth in this attached Affidavit of Christopher J. Herbold are true and correct to the best of his knowledge, information and belief.

Christopher J. Herbold

SUBSCRIBED AND SWORN TO before me, a Notary Public in and for the State of Texas, County of Harris this 24th day of June, 2019.

MONYA CHURCHILL
Notary Public, State of Texas
My Comm. Exp. November 26, 2021
Notary ID# 55082-5

Monya Churchill
Notary Public

My commission expires: 11/26/21

CERTIFICATE OF SERVICE

Pursuant to Rule 2010 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, 18 C.F.R. § 385.2010 (2019), I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Federal Energy Regulatory Commission in this proceeding.

Dated at Houston, Texas, this 26th day of June, 2019.

Respectfully submitted,

/s/ Nicholas M. Moore

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