

# REPORT OF THE COMMITTEE ON OIL PIPELINE REGULATION\*

## I. ORDER 561

On October 22, 1993, the Federal Energy Regulatory Commission (FERC) released a final rule (Order 561) entitled *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992* (Final Rule).<sup>1</sup> In the Final Rule, the Commission established indexing as the generally applicable ratemaking methodology. The Commission also adopted cost-of-service and market-based rates as alternatives, under certain circumstances, to the indexing methodology. The Final Rule also permits initial rates to be based on agreed-upon rates, so long as one non-affiliated shipper agrees to the rates. Finally, the Final Rule established procedures for streamlining Commission action on oil pipeline rates.

The index to be used is the Producer Price Index for Finished Goods (PPI-FG) minus one percent.<sup>2</sup> According to the Commission, the PPI-FG “comes the closest of all the indices considered in this rulemaking to tracking the historical changes in the actual costs of the product pipeline industry.”<sup>3</sup> The Final Rule does, however, include a provision that will require the Commission to review the index every five years to ensure that the index in use reflects actual cost changes experienced by the industry.

The index methodology is to be applied to all existing rates that were deemed just and reasonable by Congress via the Energy Policy Act of 1992 (EPACT).<sup>4</sup> When a pipeline files to change a rate, it must file with the Commission the following: a cover letter describing the basis for the proposed change (i.e., that it is to change rates according to the index); the revised tariff; supporting information, including a showing of the revised rate compared with the previous rate for the same movement of petroleum, the applicable annual ceiling level, and a calculation of the applicable ceil-

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1. Order 561, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, III F.E.R.C. STATS. & REGS. ¶ 30,985, 58 Fed. Reg. 58,753, 65 F.E.R.C. ¶ 61,109 (1993) (to be codified at C.F.R. pts. 341-45, 347, 360, 361, 375) [hereinafter Order 561].

2. The Commission’s Notice of Proposed Rulemaking (NOPR), 58 Fed. Reg. 37,671 (1993), proposed to cap rates based on the Gross Domestic Product Implicit Price Deflator (GDP). The Commission staff’s earlier proposal had by contrast, suggested the use of the Producer Price Index for Finished Goods minus one percent. The NOPR offered the following reasons for basing the index on the GDP: it is the best indicator of inflation in the overall economy; it is totally independent of the behavior of any pipeline; and, it will free the Commission from the difficulties associated with the construction of an oil pipeline industry cost index. The NOPR also stated that “no other general inflation index is better than the GDP deflator in predicting future costs in the oil pipeline industry.” 58 Fed. Reg. 37,671, at 37,677. The NOPR would have applied the GDP without upward or downward adjustment.

3. Order 561, III F.E.R.C. STATS. & REGS. ¶ 30,985, at 30,951, 58 Fed. Reg. 58,753, at 58,760.

4. 42 U.S.C.A. §§ 13,201-556 (West Supp. 1993).

ing level performed in accordance with section 342.3(d); and a certificate of service.<sup>5</sup>

Pipelines are prohibited from filing rates that exceed the index level. They are, however, permitted to file for rate increases up to the index ceiling any time during the year. The index is cumulative from year to year.

When challenging indexed rates, "a protest must allege reasonable grounds for believing that the discrepancy between the actual cost increase to the pipeline and the proposed change in rate is so substantial that the proposed rate change is not just and reasonable within the meaning of the ICA."<sup>6</sup> Complainants will continue to bear the burden of proof to show that a rate is unjust and unreasonable. Rates not in effect during the grandfathered statutory period that are increased will be considered only prima facie lawful. A protester will only have to show "reasonable grounds" to challenge those rates. Protests must be filed within fifteen days of the filing of a rate change.

Cost-of-service ratemaking may be used, under limited circumstances, to justify a higher rate than would be permitted under the indexing methodology. A pipeline will, however, be required to show circumstances beyond its control which do not permit the pipeline to recover its prudently incurred costs through the indexing system.<sup>7</sup> The Final Rule "will permit a pipeline to depart from indexing, and make a cost-of-service showing to justify a rate higher than the applicable ceiling, when it can demonstrate that it is affected by uncontrollable circumstances that preclude it from recovering all of its prudently incurred costs under the indexing system."<sup>8</sup> This section will permit pipelines to file for cost-of-service rate increases when, for example, safety or environmental regulations, or natural disasters, preclude them from recovering their prudently incurred costs. The cost-of-service rate must be based on the methodology set forth in *Williams Pipe Line Co.*<sup>9</sup>, commonly referred to as Opinion 154-B.<sup>10</sup> The Commission apparently did not consider a stand-alone cost justification for cost-of-service rates. Pipelines will still be permitted to seek market-based rates under the current procedures set forth in *Buckeye Pipe Line Co.*<sup>11</sup>

Rates for changed services that are agreed to by the pipeline and all shippers will be permitted to take effect. However, rates that are the product of negotiation may be challenged by protest or complaint. The Commission stated that:

Because the rate will reflect the concurrence of all customers, the Commission will require such a challenge to show the same circumstances that a challenge to an indexed rate must show—reasonable grounds for believing that there is a discrepancy between the negotiated rate and the pipeline's cost of service

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5. Order 561, III F.E.R.C. STATS. & REGS. ¶ 30,985, at 30,954 (1993).

6. *Id.* at 30,955.

7. *Id.* at 30,956.

8. *Id.* at 30,957.

9. 31 F.E.R.C. ¶ 61,377 (1985).

10. The Commission, in a footnote, purports to reiterate its position that the Opinion 154-B system-wide revenue requirement should be fully allocated among pipeline segments.

11. Opinion 360, 53 F.E.R.C. ¶ 61,473 (1990).

that is so substantial as to render the rate unjust and unreasonable within the meaning of the ICA.<sup>12</sup>

Initial rates may be established either by “a cost-of-service showing . . . or through agreement of the pipeline and potential shippers, at least one of which must not be affiliated with the pipeline.”<sup>13</sup>

Compared to the Staff Proposal and the Notice of Proposed Rulemaking (NOPR), the level of specificity required for filing a protest has been reduced. Under the Final Rule, a protest must only show “reasonable grounds” that a proposed rate change under indexing exceeds the pipeline’s actual cost increases.

The Commission also made the following changes:

(1) Parties may file a protest only if they can show “substantial economic interest.” According to the Final Rule, “[t]he key factor in determining standing should be the magnitude of the economic stake of the person seeking standing to challenge a proposed rate.”<sup>14</sup>

(2) Protests and complaints must allege “reasonable grounds” for believing that the rate in question is outside the zone of reasonableness. According to the Commission, “[t]hese procedures merely specify, in advance and with general applicability, what showing pipelines must make to put forth a prima facie case justifying a rate change under the indexing system, and what showing a protestant must make to rebut that case.”<sup>15</sup>

(3) A pipeline filing a rate increase may request that protests to the rate increase be faxed to the pipeline.<sup>16</sup>

(4) Staff-initiated investigations will occur only in the “most unusual circumstances,” but the Commission did not rule out Staff investigations entirely.<sup>17</sup>

(5) The Oil Pipeline Board was eliminated.<sup>18</sup>

(6) Alternative dispute resolution (ADR) procedures were adopted.<sup>19</sup>

(7) Proration policies, among other things, must be set forth in tariffs.<sup>20</sup>

Along with Order 561, the Commission issued two companion Notices of Inquiry (NOI). The first NOI concerned Market-Based Ratemaking for Oil Pipelines.<sup>21</sup> The second NOI focused on Cost-of-Service Filing and Reporting Requirements for Oil Pipelines.<sup>22</sup>

#### *A. Notice of Inquiry: Market-Based Rates*

In its NOI concerning market-based ratemaking, the Commission stated that it was “inviting comment on a number of issues . . . [in order to

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12. Order 561, III F.E.R.C. STATS. & REGS. ¶ 30,985, at 30,959.

13. *Id.* at 30,960.

14. *Id.* at 30,964.

15. *Id.* at 30,964-65.

16. *Id.* at 30,966.

17. *Id.* at 30,967.

18. *Id.*

19. *Id.* at 30,970.

20. *Id.*

21. 65 F.E.R.C. ¶ 61,110 (1993)(FERC Docket No. RM94-1-000).

22. 65 F.E.R.C. ¶ 61,111 (1993)(FERC Docket No. RM94-2-000).

achieve] . . . a consensus on the standards to be used in determining whether a pipeline lacks significant market power."<sup>23</sup>

### B. Notice of Inquiry: Cost-of-Service Ratemaking

In its NOI pertaining to cost-of-service filing and reporting requirements, the Commission sought comments on the appropriate information to be included by oil pipelines with their cost-of-service rate filings and whether any revisions were necessary to the FERC Form 6. The Commission stated that, although it was not then proposing any changes or any new cost-of-service filing requirements, it was

[i]nviting comment on what action would be appropriate in order to develop a notice of proposed rulemaking and thereafter a final rule with respect to cost-of-service rate filings that will be supported by a consensus of the oil pipeline industry and its customers and will become effective on January 1, 1995, the effective date of the Commission's indexing system adopted in the Final Rule on Revisions to Oil Pipeline Regulations.<sup>24</sup>

The Commission indicated that oil pipelines should now be required to submit cost-of-service information when making a cost-of-service rate filing. According to the Commission, "requiring cost-of-service rate filing information is necessary because pipeline shippers need to have access to accurate and up-to-date cost data to appropriately analyze a pipeline's rates filed under the cost-of-service alternative to determine whether those rates should be challenged."<sup>25</sup>

Under the new rules, the Commission's staff will no longer be performing depreciation studies for oil pipelines. Instead, pipelines will now be required to perform such studies. The Commission also inquired whether it should establish additional requirements with respect to the information pipelines must file in a depreciation study and, if so, what information should be required.

## II. ABANDONMENT CASES

A major issue before the Commission this year was the question of FERC's jurisdiction over partial abandonments of service. In particular, *ARCO Pipe Line Co.*<sup>26</sup> centered on whether a pipeline may discontinue shipping in one direction even though the pipeline will continue to ship in another direction. In *Chevron Pipe Line Co.*,<sup>27</sup> the Commission ruled that it does not have the authority to prevent a pipeline from temporarily suspending a service.

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23. Notice of Inquiry, *Market-based Ratemaking for Oil Pipelines*, IV F.E.R.C. STATS. & REGS. ¶ 35,527, at 35,705, 58 Fed. Reg. 58,814, at 58,815 (1993) (codified at 18 C.F.R. Chapter I).

24. Notice of Inquiry, *Cost-of-Service filing with Reporting Requirements for Oil Pipelines*, IV F.E.R.C. STATS. & REGS. ¶ 35,528, at 35,710, 58 Fed. Reg. 58,817 (1993) (codified at C.F.R. pts. 341 & 352).

25. IV F.E.R.C. STATS. & REGS. ¶ 35,528, at 35,711 (1993).

26. 64 F.E.R.C. ¶ 61,281 (1993).

27. 64 F.E.R.C. ¶ 61,213 (1993).

On July 12, 1993, Total Petroleum, Inc. (Total) filed a protest and request for summary rejection of ARCO Pipe Line Company's (ARCO) proposed FERC Tariff No. 1836. This tariff would have affected shipments of petroleum products between Ardmore, Oklahoma and Eules, Texas. Total claimed that it shipped petroleum products on ARCO's pipeline and that ARCO's proposed tariff would add new language that would give unduly preferential treatment to northbound shippers. In particular, Total noted that the proposed tariff would allow for southbound service only upon the completion of northbound movements. According to Total, on June 8, 1993, the Chairman and Administrative Officer of the Oil Pipeline Board had rejected a tariff proposed by ARCO for this segment of the line on the ground that the proposed tariff violated the Interstate Commerce Act (ICA). In particular, the Chairman and Administrative Officer found that ARCO's proposed tariff fails to fully address those shippers who nominate southbound movements to points in Texas. ARCO proposes to offer this service only after northbound movements have been nominated by shippers "to points in Oklahoma, Kansas, Missouri, and Iowa, for which there are published tariffs."<sup>28</sup> Total argued that the newly proposed tariff likewise gave northbound shippers preferential access to capacity, to the exclusion of southbound shippers. Total requested that ARCO's proposed tariff either be summarily rejected or investigated to determine whether it was unjust, unreasonable, or unduly discriminatory.

On September 8, the Commission issued an order accepting for filing, and suspending ARCO's tariff supplements, subject to investigation, stating:

ARCO's filing and Total's protest raise a threshold question of first impression. The Commission has held quite specifically that it does not have jurisdiction over oil pipeline abandonments, and, thus, does not have the authority to suspend cancellation tariffs. However, both the *ARCO* and *Chevron* cases involved complete abandonment of service. Here, ARCO is not taking the pipeline totally out of operation. . . . Thus, this situation is factually different from both *ARCO* and *Chevron* because the proposed cancellation is not for purposes of terminating all service on the pipeline, but only to cancel the flow on the pipeline in one direction.<sup>29</sup>

While the Commission generally suspends tariffs for only one day, in this matter of first impression, it suspended ARCO's tariffs for seven months, to become effective April 9, 1994. The Commission also directed parties to file initial briefs within 30 days and reply briefs within 45 days.

The issue of service termination has been taken up in four past FERC decisions: *Chevron Pipe Line Co. (Chevron)*,<sup>30</sup> *Texaco Pipeline, Inc. (Texaco)*,<sup>31</sup> *ARCO Pipe Line Co. (ARCO)*,<sup>32</sup> and *Cheyenne Pipeline Co. (Cheyenne)*.<sup>33</sup> Total vigorously argued that its facts differed from the facts

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28. 64 F.E.R.C. ¶ 61,281, at 62,984 (1993).

29. *ARCO Pipe Line Co.*, 64 F.E.R.C. ¶ 61,281, at 62,985 (1993).

30. 64 F.E.R.C. ¶ 61,213 (1993).

31. 58 F.E.R.C. ¶ 62,051 (1992).

32. 55 F.E.R.C. ¶ 61,420 (1991).

33. 19 F.E.R.C. ¶ 61,077 (1982).

addressed in *Chevron*, *ARCO*, and *Texaco*. If the Commission finds that it has jurisdiction over the instant proposal to modify service, the suspension of ARCO's cancellation tariff will remain in place for the full seven months. A finding of no jurisdiction will result in the suspension being lifted. As of this writing, the Commission has not finally ruled on this matter.

In *Chevron* the issue was whether a pipeline could temporarily suspend a service. Croydon Resources, Inc. (Croydon) filed a complaint regarding Chevron's plan temporarily to suspend service so that Chevron could conduct maintenance and safety inspections on its barge dock. On August 5, the Commission issued an order dismissing Croydon's complaint. The Commission also denied Croydon's request for emergency action, and consolidation and its exceptions to the order of the Oil Pipeline Board. The Commission held that Chevron has the responsibility to maintain a safe facility, and, if Chevron deems it necessary to suspend operations, the Commission cannot prevent Chevron from so doing. The Commission stated that to order Chevron to stay open or provide a new service "would be an assertion of jurisdiction . . . which the Commission does not have under the Interstate Commerce Act."<sup>34</sup> The Commission rejected, for lack of evidence, both Croydon's claim that Chevron was manipulating the price of crude and its claims that Chevron was receiving deliveries at the Ship Dock from barges.

### III. LAKEHEAD

In *Lakehead Pipe Line Co., Ltd. Partnership*,<sup>35</sup> the Administrative Law Judge (ALJ) issued an Initial Decision (ID) resolving Phase I issues. In the ID, the ALJ ruled that net depreciated trended original cost (TOC) is the appropriate standard by which to evaluate Lakehead's tariffs.<sup>36</sup> Under that standard, the ALJ decided, Lakehead's tariff rates for the period May 3, 1992, through July 5, 1993, were "not just and reasonable in a number of regards."<sup>37</sup> The ALJ also ruled that the rates superseded by the rates under investigation provided a floor below which no refunds would be ordered. Lakehead's prior rates were just and reasonable for the purpose of determining refunds, according to the ALJ, due to the effect of the EPACT.<sup>38</sup> Significantly, the ALJ also required Lakehead to provide break-out and storage facilities to prospective shippers of natural gas liquids, "to the degree that there is a need for such facilities," and to con-

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34. 64 F.E.R.C. ¶ 61,213, at 62,616.

35. 65 F.E.R.C. ¶ 63,021 (1993).

36. *Id.* at 65,131-32 (citing *Williams Pipe Line Co.*, 31 F.E.R.C. ¶ 61,377, at 61,833, *aff'd*, 33 F.E.R.C. ¶ 61,327 (1985)).

37. 65 F.E.R.C. ¶ 63,021, at 65,128.

38. *Id.* EPACT bestows a presumptive just-and-reasonable status (grandfathering) on tariffs unprotested during the one-year period immediately preceding EPACT's enactment. The ALJ found that the protestants had failed to adequately challenge Lakehead's prior rates so as to prevent grandfathering. In reaching that conclusion, the ALJ differed with both the Commission Staff and the protestants.

struct such facilities if necessary.<sup>39</sup> Additional details and other highlights of the ID are as follows:

(1) Certain Canadian interests had argued that, in lieu of conventional refunds, credits should be applied against Lakehead's future revenue requirement. The Canadian interests claimed that the producers of crude shipped on Lakehead (rather than the shippers themselves) bore the brunt of the excessive tariff charges. The ALJ rejected their contentions, stating that "courts generally do not consider who bears the ultimate burden of unreasonable charges."<sup>40</sup> The ALJ also found unpersuasive the argument of Canadian interests that due to netback pricing for Canadian crude, a "retroactive refund of any over-collection of transportation revenue provides shippers with an unearned windfall and denies producers, who have paid the higher suspension period rates, the benefit of the establishment of just and reasonable rates."<sup>41</sup>

(2) No showing was made demonstrating that the use of TOC in evaluating Lakehead's rate reasonableness would discourage oil production in the fields served by Lakehead (and connecting pipelines).<sup>42</sup>

(3) Lakehead was permitted to use a starting rate base (SRB) as described in FERC Opinion No. 154-B. The appropriate capital structure for SRB purposes was found to be Lakehead's capital structure on June 30, 1985 of 68.31% equity and 31.69% debt.<sup>43</sup>

(4) To ascertain the allowance for funds used during construction, a 15.75% return on equity was used, in accordance with a stipulation between Lakehead and the Commission Staff. Rate base updates for SRB write-up amortization, test-year plant in service, adjusted cost of service, interest expense and return, were also adopted pursuant to the stipulation.<sup>44</sup>

(5) Although Lakehead is a partnership, it was directed to include an income tax allowance based on the corporate income tax rate in its cost of service.<sup>45</sup>

(6) The ALJ also ordered the pipeline to refund all funds over-collected due to its "excessively rapid amortization of oil loss expenses."<sup>46</sup>

(7) The pipeline's hydrostatic testing was deemed prudent and, therefore, the cost of the testing was to be included in Lakehead's cost of service on the basis of a five-year amortization. Separately, oil loss expenses were to be determined on a six-year average basis, while regulatory expenses (litigation costs) were to be amortized over three years.<sup>47</sup>

The ALJ's decision regarding the NGL break-out and storage of NGLs is worth noting in detail. Marysville vigorously contended throughout the case that Lakehead's tariff rules and practices regarding NGLs violated various provisions of the ICA. Given the facts asserted by Marysville (which were largely undisputed by Lakehead), the ALJ generally sided with Marysville on the NGLs issue, finding the pipeline's failure to provide storage and break-out facilities to be unlawful in light of sections 1(4) and 1(6) of the ICA and the United States Supreme Court's decisions in *United*

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39. *Id.* at 65,144.

40. *Id.* at 65,131.

41. *Id.* (quoting Canadian Initial Brief at pp 74-75).

42. *Id.* at 65,134.

43. *Id.* at 65,136-37.

44. *Id.* at 65,137.

45. *Id.* at 65,138-39.

46. *Id.* at 65,147.

47. *Id.* at 65,139-40.

*States v. Baltimore & O.R.R.*,<sup>48</sup> and *Chicago & North Western Ry. v. Ochs*.<sup>49</sup> Upon deciding that the pipeline is a "through route" and that NGL facilities are "part and parcel of" the transportation services necessary to shippers on the route, the ALJ concluded:

Lakehead's tariff requirement that a prospective NGL shipper provide its own [storage and break-out facility] imposes an onerous burden on a new shipper, which must acquire land, comply with environmental tankage requirements, construct a facility which is compatible with Lakehead's technical requirements and operate the facility. For [these] reasons, Lakehead is ordered to construct [storage and break-out] facilities for the use of NGL shippers to the degree that there is a need for such facilities.<sup>50</sup>

The ALJ went on to note that, although the pipeline's "current practice of transporting NGLs only for shippers who provide their own [storage and break-out facilities] is a violation of the ICA. However, the record fails to establish or even suggest any specific remedy for this violation."<sup>51</sup> The ALJ therefore ordered Lakehead to propose remedial steps of its own design consistent with the ID, including the possibility of alternatives to constructing break-out and storage facilities for prospective NGL shippers.

On related issues, the ALJ also found unlawful Lakehead's practice of reserving the rights to (1) require shippers of NGLs to provide "buffer materials" to preserve the integrity of crude oil batch-shipped after the NGLs, and (2) refuse to commingle the NGLs of one shipper with the NGLs of another shipper. The ALJ ordered the pipeline to revise its tariffs to implement lawful rules in these two areas.

#### IV. LEASE CASES

A recurring theme in 1993 at the FERC was the question of whether or not a pipeline may base its rates on the cost of leasing capacity from another pipeline. In five cases, pipelines that proposed initial rates allegedly based on the cost of a lease found their tariffs protested.<sup>52</sup> In three of the cases, the parties settled.<sup>53</sup> The other two cases are still pending before the Commission.

In each instance, the protestors argued that a pipeline is not permitted to justify its rates on the basis of the cost of the lease agreement. According to the protestors, it is contrary to Commission policy to base a rate on the cost of a lease. The protestors argued that Commission policy<sup>54</sup> and

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48. 333 U.S. 169 (1948).

49. 249 U.S. 416 (1919). The ALJ also cited *Joint Petition—General Motors Corp. and Long Island Ry.*, 351 I.C.C. 691 (1976).

50. 65 F.E.R.C. ¶ 63,021, at 65,144.

51. *Id.*

52. *Koch Pipeline, Inc.*, 63 F.E.R.C. ¶ 62,104 (1993); *Koch Pipeline, Inc.*, 63 F.E.R.C. ¶ 62,214 (1993); *Exxon Pipeline Co.*, 64 F.E.R.C. ¶ 62,067 (1993); *Phillips Pipe Line Co.*, 65 F.E.R.C. ¶ 62,089 (1993); *Total Pipeline Corp.*, 65 F.E.R.C. ¶ 62,266 (1993).

53. *Koch Pipeline, Inc.*, 65 F.E.R.C. ¶ 61,325 (1993); *Koch Pipeline, Inc.*, 65 F.E.R.C. ¶ 62,088 (1993); *Exxon Pipeline Co.*, 65 F.E.R.C. ¶ 61,326 (1993).

54. The protestors cited *Williams Pipe Line Co.*, 31 F.E.R.C. ¶ 61,377 (1985).



rulings by the court of appeals<sup>55</sup> have established that the purchase of a pipeline may not be used as a basis for increasing pipeline rates. Neither the Commission, or an ALJ, has ruled on the specific issue of whether or not the cost of a lease can be used as part of the justification for an oil pipeline's rate.

*A. Trans Alaska Pipeline System (TAPS) Quality Bank*

This proceeding is known as the TAPS Quality Bank case.<sup>56</sup> It has been protracted and very complex, but an order that may offer the prospect of finality was issued on November 30, 1993.<sup>57</sup> The Commission modified and adopted the settlement submitted in the case on August 27, 1993. As its final decision on the merits of the proceeding, thereby resolving or disposing of all the relevant contentions raised by the parties, including those of parties who contested the settlement, including Conoco, Inc. (Conoco),<sup>58</sup> Tesoro Alaska Petroleum Co. (Tesoro), ARCO Alaska, Inc. (ARCO) and Arco Transportation Alaska, Inc. (ATA).<sup>59</sup>

The settlement adopted a distillation approach to valuing on a comparative basis the different crude oil streams shipped and commingled on TAPS. The approach is implemented by an "assay methodology" that divides each crude stream into eight component parts. In adopting the settlement, the FERC retained the assay methodology, but modified those provisions dealing with (1) the assay treatment and valuation of the distillate and resid cuts, (2) valuations adjusted for sulfur, and (3) the method for ascertaining values for some of the nine components. As to the third consideration, the Commission decided that market prices alone should be used for valuation purposes, rather than the valuation mechanisms combining market prices with other factors as proposed in the settlement. The FERC recognized, however, that the distillation approach resulted in a "simulation of a real market, and not a real market itself."<sup>60</sup>

The FERC cited "changed circumstances" as the primary reason for adopting the settlement. In the Commission's view, changes in the qualities of the shipper streams tendered to the pipeline<sup>61</sup> required the imple-

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55. The protestors cited *Farmers Union Cent. Exch., Inc., v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1034 (1984).

56. TAPS is owned by Amerada Hess Pipeline Corp., ARCO Pipeline Co., BP Pipelines (Alaska), Exxon Pipeline Co., Mobil Alaska Pipeline Co., Phillips Alaska Pipeline Co., and Unocal Pipeline Co. (collectively, Carriers). 64 F.E.R.C. ¶ 63,008, at 65,023 n.1 (1993).

57. *Trans Alaska Pipeline System*, 65 F.E.R.C. ¶ 61,277 (1993).

58. Conoco was joined throughout the case by Oxy USA, Inc., also a producer and shipper on TAPS.

59. Those parties supporting the Settlement Agreement were: State of Alaska (Alaska), Amoco Production Co. (Amoco), BP Exploration (Alaska) Inc. (BP), Exxon Co., U.S.A. (Exxon), Mapco Alaska Petroleum Inc. (Mapco), Petro Star, Inc. (Petro Star), Phillips 66, a Division of Phillips Petroleum Co. (Phillips), and all of the TAPS Carriers except ATA.

60. 65 F.E.R.C. ¶ 61,277, at 62,287 (1993).

61. The changes in shipper streams referenced by the FERC have occurred due to the increased injection of natural gas liquids (NGLs) into oil tendered to TAPS and the tendering of an additional refinery stream at the Golden Valley Electric Association (GVEA). 65 F.E.R.C. ¶ 61,277, at 62,286 n.40.

mentation of a new Quality Bank, one that would reasonably account for "the differences in the market value[s] of the TAPS streams."<sup>62</sup> According to the FERC, the assay methodology will accomplish that goal and will supersede the current, gravity-based Quality Bank.

The Commission decided that no refunds would be ordered,<sup>63</sup> and that the new Quality Bank would become effective December 1, 1993. Recognizing the additional time that the TAPS Carriers will need to implement the new Quality Bank, the FERC granted the Carriers leeway regarding the actual starting date of the new Quality Bank, subject to a refund obligation beginning December 1, 1993. Therefore, if prior to the actual starting date, any shipper pays more or receives less than it is entitled to under the new Quality Bank, the Carriers will have to make the shipper whole.

In the Order, the FERC prohibited the Carriers from including the ownership dispute provision of the Settlement Agreement in their filed tariffs. The FERC stated that, although it did not disapprove of the proposed settlement agreed to by BP and Exxon (and objected to by ARCO Transportation Alaska, Inc. and Tesoro), the issue was outside the scope of its jurisdiction.

Finally, the FERC addressed and disposed of arguments against the settlement or for other relief. It found that Conoco had not been deprived of due process. Furthermore, it held that it was neither violated its rules of practice by adopting a methodology different from that in the Initial Decision in the case, nor condoned improper "re-litigation." The FERC cited for support Rule 602(b)(1), which allows any participant in a proceeding to submit an offer of settlement at any time. The FERC explained that it enjoys considerable discretion and flexibility under Rule 602. The Commission concluded that adopting and modifying the settlement was a proper exercise of that discretion and flexibility.

Finally, the FERC ordered the TAPS Carriers to file new tariffs within thirty days, consistent with the order, to implement the new methodology effective December 1, 1993.

#### *B. Trans Alaska Pipeline System (TAPS) Pumpability*

On July 15, 1993, the Presiding ALJ issued an Initial Decision on whether "the use of pumpability factors [to calculate tariffs] result in rates that are unjust and unreasonable under [section] 1(5) of the ICA; unjustly discriminatory under [section] 2 of the ICA; and/or unduly or unreasonably preferential under [section] 3 of the ICA."<sup>64</sup> The ALJ ruled that the use of pumpability factors resulted in rates that violated sections 1(5) and (2) of the ICA. The ALJ ordered refunds in the case of proposed rate increases and denied refunds in the case of proposed rate decreases. The ALJ also

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62. 65 F.E.R.C. ¶ 61,277, at 62,286.

63. Tesoro Alaska Petroleum Co. (Tesoro) argued that shippers adversely affected by the NGLs and the GVEA refinery stream should be entitled to a *retroactive* adjustment of past Quality Bank calculations. Tesoro characterized the adjustment as a redistribution of past Quality Bank payments, rather than as a refund. The FERC rejected Tesoro's view.

64. 64 F.E.R.C. ¶ 63,008, at 65,023 (1993).

denied reparations and ordered the TAPS Carriers to file revised tariffs within thirty days.

This case began on December 19 and 20, 1991, when Arco Alaska, Inc. (AAI) and Conoco, Inc. (Conoco), respectively, filed protests to the TAPS Carriers' use of pumpability factors in their ratemaking methodology. Below is a list of the stipulated issues and the ALJ's ruling on each issue.

1. Does the use of pumpability factors to calculate the tariff rates at issue in this proceeding result in rates that are:
  - a. unjust and unreasonable under section 1(5) of the ICA;

The ALJ stated that for rates to be just and reasonable under section 1(5), they must fall in a zone of reasonableness, reflecting cost incurrence. Generally the statute is satisfied by the current methodology—cost-based ratemaking. To be valid, however, “costs must be allocated to customers to the extent practicable, based on the true cost of servicing those customers.”<sup>65</sup> The ALJ noted, however, that there are instances in which rates do not have to be cost-based. In this proceeding, the TAPS Carriers had based their methodology on opportunity costs involved in shipping heavy crude versus light crude and their respective use of capacity on the TAPS. The ALJ found, however, that “the evidence shows that heavy petroleum's relative use of capacity has not resulted in greater fixed cost incurrence. Because the current methodology allocates greater fixed costs to heavy petroleum based on relative use of capacity it is not just and reasonable.”<sup>66</sup>

- b. unjustly discriminatory under section 2 of the ICA;

The ALJ found that, although the TAPS Carriers charged different rates for different services based on the different petroleum streams, “the tariff differentials charged by TAPS Carriers are not justified by the differences in circumstances and conditions of service because pumpability factors are used to allocate costs that do not vary by relative use of capacity, and indeed, that do not vary at all between petroleum streams.”<sup>67</sup> Therefore, the ALJ ruled, the pumpability factor of the TAPS Carriers' current methodology was violative of section 2 of the ICA.<sup>68</sup>

- c. unduly or unreasonably preferential under section 3 of the ICA?

In order to prove a violation of this section of the ICA, the ALJ stated that Protestants had to prove the following three elements: “(1) a disparity in rates; (2) that the complaining party [was] competitively injured . . .; and (3) that the Carriers [were] the source of the allegedly preferential treat-

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65. *Id.* at 65,030.

66. *Id.* at 65,032.

67. *Id.*

68. *Id.*

ment.”<sup>69</sup> The ALJ found that since the protestants showed that different rates were charged for each petroleum stream, disparity was established. The ALJ also noted that since the TAPS Carriers were responsible for charging the different rates, the third part of the test was met. However, with regard to competitive injury, the ALJ held that protestants had failed to offer evidence of such injury, and therefore, had failed to meet their burden under section 3 of the ICA.<sup>70</sup>

2. If the Commission finds for the Protestants on issue number 1, how should the tariff rates for the alternative petroleum streams be calculated?

The ALJ ruled out the use of Ramsey Pricing,<sup>71</sup> stating that such a system “would violate the ICA . . . [because] there is no evidence, and it is highly unlikely, that demand elasticity measures different cost incurrence for any fixed or variable costs.”<sup>72</sup> The ALJ stated that the following factors must be taken into consideration when deciding upon a rate methodology:

- (1) If, relative to standard petroleum, a cost differs due to a non-standard petroleum stream’s characteristics, that cost is to be allocated using a factor that accurately measures the different cost incurrence. Thus, any costs that differ due to relative use of capacity are to be allocated using pumpability factors when relative use of capacity measures the cost differences.
- (2) Costs that do not differ due to the non-standard petroleum streams’ characteristics are to be allocated equally on a nominal barrel basis.<sup>73</sup>

The ALJ also stated that:

- (1) [Fixed] costs shall be allocated equally on a nominal barrel basis;<sup>74</sup>
- (2) Fuel and DRA (Drag Reducing Agents) Costs are to be allocated based on witness Baskurt’s first methodology;<sup>75</sup>
- (3) Return on investment is to be allocated equally on a nominal barrel basis;<sup>76</sup>

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69. *Id.*

70. *Id.*

71. Ramsey Pricing would base costs on demand elasticity. 64 F.E.R.C. ¶ 63,008, at 65,033.

72. *Id.*

73. *Id.*

74. *Id.*

75. 64 F.E.R.C. ¶ 63,008, at 65,034. Baskurt’s first methodology consists of the following:

- (1) Calculate the total costs of fuel and DRA on the system at the [projected average volume of] total TAPS throughput assuming this throughput consists of 100% standard petroleum.
- (2) Calculate the per barrel costs of fuel and DRA for the standard petroleum from the results of the above Item 1.
- (3) Calculate the declined [or increased] throughput that results from substituting the heavier [or lighter] petroleum [using a 75% standard petroleum/25% non-standard petroleum blend for linearity], keeping the fuel and DRA costs calculated in the above Item 1 constant.
- (4) Calculate the per barrel costs of fuel and DRA for the heavier [or lighter] petroleum by distributing the total costs calculated in the above Item 1 to the new throughput calculated in the above Item 3.
- (5) The difference in the per barrel costs calculated in the above Items 2 and 4 [multiplied by 4] is the per barrel surcharge for the heavier petroleum. *Id.*

76. *Id.* at 65,035.

(4) Because the Protestants proved that the heavier petroleums do not result in increased variable costs other than for fuel and DRA, "variable costs other than fuel and DRA are to be allocated equally on a nominal barrel basis."<sup>77</sup>

(5) "[T]he evidence does not support applying a rate to the GVEA [Golden Valley Electrical Association] Return Stream that is different from the rate of the petroleum stream deemed delivered at the GVEA connection and then returned to TAPS."<sup>78</sup>

(6) "[E]ach TAPS Carrier is assured that it will receive its share of the revenue requirement, including interest, no matter what cost allocation formula is used."<sup>79</sup>

3. If the Commission finds that the use of Pumpability Factors results in rates that are unjust and unreasonable under section 1(5); unjustly discriminatory under section 2; and/or unduly or unreasonably preferential under section 3 of the ICA, is the relief available prospective only?

The ALJ ruled that the TAPS Carrier's rates were found to violate sections 1(5) and 2 of the ICA. The ALJ then stated that it was up to him to determine whether or not refunds were appropriate. The ALJ ruled refunds should be ordered dating back to January 2, 1992, and January 2, 1993, for those rates that have been increased. The ALJ also denied Conoco's request for reparations, noting that Conoco was not a shipper on TAPS, was not in privity with the TAPS Carriers, and lacked standing to seek reparations.<sup>80</sup>

4. Which parties have the burden of proof and has it been met?

The ALJ noted that generally when a carrier's rates are protested, the burden of proof lies with the carrier. The ALJ pointed out, however, that the Commission may decide which party should bear the burden of proof after a full hearing. The ALJ noted that in this proceeding, the protestants were challenging an aspect of a tariff that the TAPS Carriers had not proposed to change. The ICA provides that in such circumstances, the burden of proof lies with the protestant. Therefore, the ALJ ruled that, the ultimate burden of persuasion is determined by the ICA, which allocates the burden to protestants.<sup>81</sup>

5. What should be included in the tariff sheets?<sup>82</sup>

In response to those parties who opposed the inclusion of this issue in this proceeding, the ALJ noted that section 6(1) of the ICA states that "the

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77. *Id.*

78. *Id.* at 65,036.

79. *Id.*

80. *Id.* at 65,039.

81. *Id.* at 65,038-39.

82. The ALJ noted that the Indicated TAPS Carriers (ARCO Transportation Alaska, Inc., Exxon Co., U.S.A., and MAPCO Alaska Petroleum, Inc.) opposed the inclusion of this issue; Staff, Conoco and Alaska supported its inclusion; and the remaining parties took no position.

Carriers' tariffs must state either (1) all surcharges and when these surcharges are applicable or (2) all rates, including surcharges, and when these rates are applicable."<sup>83</sup> The ALJ also stated that carriers must include the calculation of surcharges and an accompanying explanation for the surcharge, as well as prorationing rules. The ALJ also stated that carriers must include the method for assigning capacity when prorationing occurs. According to the ALJ, "[w]ithout this information, the Shippers and the Commission cannot determine whether assignment of capacity is performed in a non-discriminatory and non-preferential manner."<sup>84</sup> The ALJ also stated that: "[t]hese requirements do not impose an undue burden on TAPS Carriers. All the calculations required in the tariffs will already be performed when determining rates. Additionally, TAPS Carriers can limit their filings by appointing an agent to file duplicative information as a tariff on behalf of all Carriers."<sup>85</sup>

#### V. WILLIAMS PIPE LINE COMPANY

On June 30, 1993, the Commission issued an order on complaint in which it granted in part and denied in part several shippers'<sup>86</sup> request for an order directing Williams Pipe Line Co. (Williams) to (1) cease levying unauthorized charges, (2) pay reparations to the shippers, and (3) be subjected to sanctions for violations of the ICA.<sup>87</sup> The gravamen of the shippers' complaint was that Williams, a common carrier, had violated the ICA and Commission regulations by imposing charges related to the transportation of petroleum products that were not included in its tariff. Specifically, Williams had attempted to implement a three-cent Product Transfer Order (PTO) charge and a two-cent Product Authorization (PA) charge. At issue, according to the Commission, was whether the charges were jurisdictional and should have been included in Williams' tariff. The shippers argued that the charges were part of interstate transportation rates and therefore were subject to the rules and regulations of the ICA. Williams, on the other hand, contended that such charges were "bookkeeping services" that were not related to regulated transportation services. Williams argued that the only purpose of the charges was to facilitate a shipper's bookkeeping for the petroleum products the shipper sells, trades, or otherwise transfers to a third party subsequent to shipment through the Williams' system. Williams also posited that because the service was voluntary, it would not fall under the ICA.

The Commission ruled that the PTA and PA charges were, in fact, subject to the ICA. The Commission stated:

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83. 64 F.E.R.C. ¶ 63,008, at 65,039.

84. *Id.* at 65,040.

85. *Id.*

86. This proceeding was initiated by Conoco Inc., Kerr-McGee Refining Corp., and Texaco Refining & Marketing, Inc. (collectively, Shippers). On February 22, 1993, Conoco Inc. withdrew from this proceeding.

87. *Kerr-McGee Refining Corp. and Texaco Refining & Mktg. Inc., v. Williams Pipe Line Co.*, 63 F.E.R.C. ¶ 61,349 (1993).

[T]he ICA is remedial in nature and is to be liberally construed to effect its purposes. Exemptions from the ICA are to be narrowly construed and very limited. As one early court pointed out, the ICA was not enacted for the benefit of the carriers, but to protect passengers, shippers, and consignees from unreasonable and unfair discrimination.<sup>88</sup>

The Commission based its reasoning on section 1(3) of the ICA which defines transportation to include "all services in connection with the receipt, delivery, . . . transfer in transit, . . . storage, and handling of property transported."<sup>89</sup> The Commission also noted that:

Section 1(6) requires common carriers to establish just and reasonable regulations and practices affecting, *inter alia*, 'all other matters relating to or connected with the receiving, handling, transporting, storing, and delivery of property subject to the provisions of this chapter which may be necessary or proper to secure the safe and prompt receipt, handling, transportation, and delivery of property.'<sup>90</sup>

The shippers also argued that Williams had not offered justification for basing the PTO and PA charges on a per-barrel-shipped basis. They contended that Williams was doing little more than an administrative task in assessing the PTO and PA charges and had not justified the need to base the PTO and PA charges on a volumetric basis. Williams responded that the shippers had failed to show that the charges in question exceeded just and reasonable levels. The Commission conceded that the record on this matter was not well developed. Nevertheless, in light of its determination that the charges were jurisdictional under the ICA, Williams was required to file supporting information if it wished to continue to impose the PTO and PA charges on a volumetric basis.

In response to the shippers' request for reparations, the Commission again found inadequate record evidence to determine whether the PTO and PA charges were excessive. Accordingly, it required Williams to submit information supporting the level of the PTO and PA charges and the amounts of such charges paid by the shippers, and deferred a determination on the reparations claim. Williams was granted a stay of the Commission's order, pending action on several requests for rehearing.

#### A. SFPP

*SFPP, L.P.*,<sup>91</sup> is a pending rate case that commenced with a suspension order on September 29, 1992.<sup>92</sup> On November 24, the ALJ ordered SFPP to file a revenue and cost study. The ALJ required SFPP to file schedules showing its rate base, revenues, and cost of service for calendar year 1993

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88. 63 F.E.R.C. ¶ 61,349, at 63,219.

89. *Id.*

90. *Id.*; Interstate Commerce Act § 1(6), 49 U.S.C. § 10,702 (1988).

91. 60 F.E.R.C. ¶ 62,252 (1992).

92. In an April 4, 1993 Order on Exceptions, the Commission reversed part of the Oil Pipeline Board's suspension order and transformed the matter into a complaint proceeding. 63 F.E.R.C. ¶ 61,014 (1993). The matter is still in a preliminary stage.

in accordance with (1) *Lakehead Pipe Line Co.*,<sup>93</sup> (2) *Williams Pipe Line Co.*, Opinion 154-B,<sup>94</sup> and (3) a discussion at a prehearing conference.

*B.* Also of Note:

In the matter of the *Williams Pipe Line Co.* rate case,<sup>95</sup> the Commission has had under advisement, since January, 1992, the ALJ's Initial Decision.<sup>96</sup> In *Pennzoil Exploration & Production Co. v. FERC*<sup>97</sup> there was a jurisdictional skirmish. The case is now pending in the US Court of Appeals for the D.C. Circuit.

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93. 8 F.E.R.C. ¶ 61,089 at 61,352 (1979).

94. 31 F.E.R.C. ¶ 61,377 (1985).

95. *Id.*

96. 58 F.E.R.C. ¶ 63,004 (1992).

97. No. CIV.A.93-0534, 1993 WL 475486 (E.D. La. Nov. 4, 1993).