

## REPORT OF THE COMMITTEE ON OIL PIPELINE REGULATION\*

In 1994, the Federal Energy Regulatory Commission (FERC or Commission) streamlined its procedures for establishing and reviewing oil pipeline rates (Order 561-A), clarified the standards for cost-of-service rates (Order 571-A), and clarified the standards for market-based rates (Order 572-A). The Commission also launched a new rulemaking concerning ADR applicable to all FERC proceedings (which may raise a question of consistency with the ADR procedures for oil pipelines adopted in Order 561). Beyond this rulemaking activity, the FERC and its Administrative Law Judges adjudicated a variety of rate issues involving both lower 48 pipelines and the Trans-Alaska Pipeline System (TAPS). Several of these cases reached new issues concerning the Commission's jurisdiction and the requirements of the Energy Policy Act of 1992, still others filled in the contours of earlier rulings concerning light-handed regulation and the proper rate treatment of leases.

This report is divided into three sections. The first will discuss the regulations and policies adopted in the Energy Policy Act rulemakings. The second will discuss lower 48 rulings adopted since the last report of the committee. The final section will discuss new decisions concerning TAPS.

### I. COMMISSION RULEMAKINGS

Title XVIII of the Energy Policy Act of 1992 (EPAcT)<sup>1</sup> contains the following provisions relating to oil pipeline ratemaking methodology:

- (1) [E]stablishment of "a simplified and generally applicable ratemaking methodology for oil pipelines . . . .";<sup>2</sup> and (2) "[A] final rule to streamline procedures . . . relating to oil pipeline rates in order to avoid unnecessary regulatory costs and delays."<sup>3</sup>

As discussed below, the FERC adopted final rules in response to EPAcT that became effective January 1, 1995.

#### A. *Order 561-A*

On July 28, 1994, the FERC released Order No. 561-A,<sup>4</sup> an order on rehearing modifying Order 561 in certain limited respects. Twenty-five of the forty-two parties to the rulemaking sought changes in the Final Rule or challenged various aspects of the Commission's authority or conclusions.

---

\* The Committee on Oil Pipeline Regulation would like to acknowledge the efforts of Bradley S. Lui in assisting in the preparation of this report.

1. 42 U.S.C.A. § 7172 notes (West Supp. 1994). References to title XVIII or EPAcT are to sections 1801-04, as set out in the notes of § 7172. *Id.*

2. *Id.* (§ 1801(a) of the notes).

3. *Id.* (§ 1802(a) of the notes).

4. Revisions to Oil Pipeline Regulations Pursuant to Energy Policy Act of 1992, 59 Fed. Reg. 40,243 (1994) (Order No. 561-A) (codified at 18 C.F.R. pts. 341-343).

The Commission rejected almost all of these, making two minor changes in tariff filing requirements<sup>5</sup> and one substantive change broadening the circumstances under which pipelines may use the cost-of-service methodology for changing rates.<sup>6</sup> Order 561-A reaffirmed the Commission's commitment to a ratemaking methodology that focuses on changes in rates—existing rates that were established as just and reasonable by “statutory edict.”<sup>7</sup> As its simplified, generally applicable ratemaking methodology, the Commission reaffirmed its adoption of an indexing approach.

In addition, the Order explains the Commission's rationale for rejecting the index favored by the pipeline industry for establishing annual rate ceilings.<sup>8</sup> The Commission also explained its rejection of pipeline arguments that new, affirmative rate filing requirements under the indexing system were beyond the Commission's statutory authority or inconsistent with the statutory scheme or burden of proof.<sup>9</sup> Also rejected was the claim that protests of rates below the applicable rate ceiling should not be allowed.<sup>10</sup> However, the Commission made it clear that not every divergence between costs and rates was protestable—there must be a “substantial divergence” to justify departure from the index,<sup>11</sup> and protests will be limited to the “increment of the rate increase.”<sup>12</sup> Also rejected were the following proposals: (1) use of market forces to justify an initial rate;<sup>13</sup> (2) acceptance of negotiated initial rates that do not have the agreement of a non-affiliated shipper;<sup>14</sup> and, (3) a variety of miscellaneous challenges to tariff filing requirements and other procedures.<sup>15</sup>

Finally, the Commission made it clear that Order 561 did not resolve the issue of whether fully-allocated costs had to be used to determine proper rates for any movement. The Commission explained that this issue was within the parallel rulemaking on cost-of-service rate filings, that it had not previously been determined in a “fully litigated case,” and that “proponents of ‘stand-alone’ cost methodology or other costing methodologies”

---

5. *Id.* at 40,253-54 (requiring protestors of tariff filings to detail the nature and substance of their economic interest); *id.* at 40,255 (extending to 30 days the time for filing supplements for suspended tariffs).

6. *Id.* at 40,253 (replacing “uncontrollable circumstances” test with standard of prudently incurred costs resulting in a substantial divergence between costs and the index-based ceiling rate).

7. *Id.* at 40,244. The reference is to the grandfathering provisions in section 1803 of EPAAct.

8. *Id.* at 40,245-48.

9. 59 Fed. Reg. at 40,248-50.

10. *Id.* at 40,250-52.

11. *Id.* at 40,251 (emphasis in original).

12. *Id.* The Commission therefore rejected the claim of some shippers that the “whole rate” had to be examined in the event of a protest. The Commission noted that EPAAct had protected from further scrutiny “the vast majority of rates in existence on the date of enactment,” and that “a protest against a proposed change in a grandfathered rate” was not a lawful basis for overriding that protection. *Id.*

13. *Id.* at 40,252.

14. *Id.* at 40,252-53.

15. 59 Fed. Reg. at 40,254-56.

were “not precluded from advocating such methodologies in individual cases.”<sup>16</sup>

### B. *Cost-of-Service Rate Filings—Order 571*

As a companion to Order 561, the Commission published a notice of inquiry (NOI) concerning information required to be included in cost-of-service rate filings.<sup>17</sup> On July 28, 1994, the FERC issued a Notice of Proposed Rulemaking that addressed comments filed in response to the NOI.<sup>18</sup> The Commission proposed revisions to FERC Form 6 together with specific requirements for cost-of-service filings in furtherance of shipper and Commission scrutiny of rates and the rate ceiling index. The proposed rule also included reporting requirements relating to depreciation studies.

#### 1. Revision to FERC Form 6

The Commission proposed extensive revisions to FERC Form 6. Additional reporting requirements include total annual cost-of-service (as calculated under the Order 154-B methodology), operating revenues, and throughput.<sup>19</sup> The form also was updated “to delete information not relevant to the Commission’s regulatory responsibilities under the ICA.”<sup>20</sup> Generally, the revisions portend a major shift in emphasis away from reporting basic financial accounting information in favor of disclosing more specific data permitting (i) shipper evaluation “of whether a proposed rate change substantially exceeds the pipeline’s changes in costs;” (ii) “adequate preliminary review of a pipeline’s cost-of-service showings;” and, (iii) “shipper comparison of indexed rate changes with changes in costs incurred.”<sup>21</sup> The Commission estimated that the public reporting burden imposed on oil pipelines would be reduced by approximately seven percent.<sup>22</sup>

#### 2. Cost-of-Service Filing Requirements

The Commission noted a lack of consensus among the NOI commenters on whether there are ways to simplify and streamline use of the Opinion 154-B methodology, which was made an option available under some circumstances under Order 561. The requirements are intended “to establish an initial case for cost-of-service rates” by including “an up-to-

---

16. *Id.* at 40,253.

17. *Cost-of-Service Filing and Reporting Requirements for Oil Pipelines; Notice of Inquiry*, 58 Fed. Reg. 58,817 (1993).

18. *Cost-of-Service Filing and Reporting Requirements for Oil Pipelines; Notice of Proposed Rulemaking*, 59 Fed. Reg. 40,493 (1994).

19. *Id.* at 40,495-97.

20. *Id.* at 40,496. The Commission noted that there had been only “cosmetic changes” to the form since regulatory responsibility for oil pipelines was transferred to the FERC in 1977. *Id.*

21. *Id.* at 40,495.

22. *Id.* at 40,494.

date overall cost-of-service for the pipeline, calculated in accordance with Opinion No. 154-B methodology.”<sup>23</sup>

### 3. Depreciation Studies

Order 561 shifted from the Commission to pipelines the responsibility of performing depreciation studies to establish revised depreciation rates.<sup>24</sup> To that end, the NOPR set out requirements for the minimum information required from pipelines to fully explain and justify new or changed depreciation rates.<sup>25</sup>

On October 28, 1994, the FERC released Order 571, “Cost-of-Service Reporting and Filing Requirements for Oil Pipelines”<sup>26</sup> which adopted the filing requirements set out in the proposed rule with minor modifications and clarifications. Order 571 sets forth the basic purpose of the filing requirements in relation to its Order 561 decision to maintain cost-based rates as an alternative to indexing as a means to establish just and reasonable rates. In rejecting commenter challenges to its authority to impose the proposed requirements, the Commission characterized the requirements as “threshold filing requirements” that “are the means . . . necessary for a pipeline to make a prima facie demonstration” by addressing “the threshold issue” of whether there is such a “substantial divergence between the actual costs experienced by the pipeline and the rate resulting from application of the index such that rates at the indexed ceiling level would preclude the pipeline from charging a just and reasonable rate,” thereby “warrant[ing] a cost-of-service filing.”<sup>27</sup> The Commission made clear that, absent a challenge, the prima facie showing would be all the information necessary to justify a cost-based rate. Conversely, if there is a challenge, the burden on the pipeline to meet the “substantial divergence” test may require it to address matters of rate design or cost allocation (that were not finally resolved in prior rate proceedings), as well as issues relating to the prudence of pipeline costs.<sup>28</sup>

The cost-of-service filing requirements in the final rule closely track those in the proposed rule. The following information is required in cost-of-service rate filings:

- *Statement A - Total Cost of Service:*  
Calculation of the pipeline’s total cost-of-service from Statements B-G.
- *Statement B - Operation and Maintenance:*  
Operation, maintenance, administrative and like expenses for the applicable test period.
- *Statement C - Overall Rate of Return:*  
Derived rate of return on rate base, weighting return on debt capital and the real rate of return on equity capital.

---

23. *Id.* at 40,497-98.

24. Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992, 58 Fed. Reg. 58,753 (1993) (to be codified at 18 C.F.R. pt. 375).

25. 59 Fed. Reg. 40,493, at 40,498 (1994).

26. 59 Fed. Reg. 59,137 (1994) (to be codified at 18 C.F.R. pts. 342, 346, 347).

27. *Id.* at 59,139.

28. *Id.* at 59,139-40.

- *Statement D - Income Taxes:*  
Calculation of the Income Tax Allowance.
- *Statement E - Rate Base:*  
Calculation of rate base under Opinion No. 154-B methodology.
- *Statement F - AFUDC:*  
Calculation of the Allowance for Funds Used During Construction.
- *Statement G - Revenue:*  
Revenue at the effective, proposed and indexed ceiling rates for the year of experience under scrutiny.<sup>29</sup>

In rejecting any specified simple percentage variation, Order 571 makes clear that “whether a substantial divergence exists should be determined on the facts of individual cases, not generically.”<sup>30</sup> The Commission also reaffirmed the fundamental shift in the purpose of the revised Form 6 from its predecessor: instead of “book equity figures . . . required for financial reporting purposes,” the new form will facilitate derivation of an Opinion 154-B trended original cost rate base, which “entails complex calculations to derive annual figures for equity and equity returns. . . .”<sup>31</sup>

The revised Form 6 will be effective for reporting year 1995 and is due March 31, 1996. Electronic filing of the form, as proposed in the NOPR, has been temporarily deferred, pending development of an electronic version of the form. The new schedule, page 700, also must be filed separately for calendar years 1993 and 1994 by March 31, 1995, absent any earlier rate change filing.<sup>32</sup>

The Final Rule also requires that pipelines file detailed justifications for new or changed depreciation rates. Minor changes in the filing requirements suggested by commenters, relating primarily to concerns about confidential/proprietary or unavailable information, were made in the Final Rule.<sup>33</sup>

#### 4. Order 571-A

On December 28, 1994, the Commission issued Order 571-A which denied the Association of Oil Pipelines’ request for rehearing of Order 571.<sup>34</sup> The Commission rejected a variety of objections to section 346.1(c) as inconsistent with section 6(3) of the Interstate Commerce Act (ICA) together with arguments that the new filing requirements were unduly burdensome to pipelines. Rehearing was granted on the issue that the depreciation study requirements could result in the disclosure of confidential shipper information in contravention of the ICA. The regulations were modified to provide that any confidential information required by part 347 of the regulations, release of which would violate section 15(13) of the ICA, must be provided in a format that will protect individual shippers. Clarification was granted on the point that new page 700 of Form 6 is not

---

29. *See id.* at 59,140-41, 59,146-47 (emphasis added).

30. *Id.* at 59,142.

31. *Id.*

32. 59 Fed. Reg. at 59,139 and 59,142.

33. *Id.* at 59,144-45.

34. 69 F.E.R.C. ¶ 61,411 (1994).

intended to show what a just and reasonable rate should be. The amendment to the regulations became effective January 1, 1995.

*C. Market-Based Ratemaking—Orders 572/572-A*

As a companion to Order 561, the Commission published an NOI concerning market-based ratemaking.<sup>35</sup> A Notice of Proposed Rulemaking was issued on July 28, 1993.<sup>36</sup>

On October 28, 1994, the FERC issued Order 572, "Market-Based Ratemaking for Oil Pipelines."<sup>37</sup> Following receipt of comments from eleven parties, the Commission adopted its proposed procedural rule, with minor modifications and clarifications. Order 572 sets forth the Commission's rationale for maintaining market-based ratemaking as one of two exceptions to the generally applicable indexing approach of Order 561.<sup>38</sup> The Commission first explained its rejection of the argument that market-based ratemaking is not needed, noting that it is a complementary method that comports with the EAct and the Interstate Commerce Act (ICA),<sup>39</sup> and that it "will be of use in circumstances where the oil pipeline needs the flexibility to . . . engage in competitive pricing in order to react to changes in market conditions. . . ."<sup>40</sup>

The Commission then explained why it was not adopting market-based ratemaking as the generally applicable methodology, nor adopting substantive standards and guidelines to streamline market power determinations.<sup>41</sup> Its rationale was multifaceted: (1) the applications for market-based rates would, in essence, be requests for a waiver of the maximum rate allowed under the indexing method, as rates under the index-based ceiling could be filed without justification; (2) it was improper under the ICA to presume the existence of sufficient competition to set rates within the just and reasonable range; (3) the procedures it was adopting appropriately streamlined the market power determination process, in the spirit of the EAct; and, (4) at this time, the Commission lacks sufficient experience, and there is insufficient consensus, regarding the content of proposed market power screens, guidelines, and rebuttable presumptions to warrant anything more than continued pursuit of these issues cautiously on a case-by-case basis to ensure that markets are not simply assumed to be competitive.<sup>42</sup>

The Commission addressed the issue of protection of confidential shipper information in the final rule. The information required to be filed is

---

35. 58 Fed. Reg. 58,814 (1993).

36. 59 Fed. Reg. 39,985 (1994).

37. 59 Fed. Reg. 59,148 (1994) (to be codified at 18 C.F.R. pt. 348).

38. The other alternative is cost-of-service ratemaking.

39. 49 U.S.C. app. 1 (1988).

40. 59 Fed. Reg. 59,148, at 59,150 (1994).

41. Various legal arguments grounded in the EAct and ICA, and advanced by the AOPL and some pipelines to support such standards, were rejected as collateral attacks on Order No. 561. *Id.* at 59,150-51.

42. *Id.* at 59,151-52. The Commission likewise saw no need, beyond consideration in individual cases, for generalized mechanisms to monitor or constrain market-based rates, such as price caps, term limits, rate triggers, and the like. *Id.* at 59,153-54.

intended to identify the geographic area and products to be analyzed to establish the relevant markets that are to be the subject of the market power determination. Specifically, the following information is required as part of an application for market-based rates:

- *Statement A - Geographic Market:*  
A description of the geographic market, by origin and destination, where the pipeline lacks significant market power, and an explanation of their appropriateness to the task of evaluating market power. Proponents of corridor markets will bear the burden of demonstrating their relevance to the determinations required.<sup>43</sup>
- *Statement B - Product Markets:*  
Identification of the product market for which the pipeline seeks to establish that it lacks significant market power. Crude oil is distinguished from petroleum products, but further subcategorization is left to case-by-case determination. In addition, even though delivered commodity prices will ordinarily be the relevant framework for analysis, some cases may be based solely on transportation rates. In either case, the purpose is to allow the Commission to assess market power *vis-a-vis* shippers.<sup>44</sup>
- *Statement C - Pipeline Facilities and Services:*  
A description of, and all pertinent data on, the pipeline's facilities and services in the relevant markets described above. Examples include capacity, throughput, and mileage.<sup>45</sup>
- *Statement D - Competitive Alternatives:*  
A description of, and all pertinent data on, transportation alternatives in competition with the pipeline in the relevant markets and other competition constraining its rates in these markets. Examples include regulated and private pipelines passing near or through, or with one or more terminals in, the geographic market; barges, trucks and refineries in the geographic market.<sup>46</sup>
- *Statement E - Potential Competition:*  
Available evidence, or best estimates from public information, about the cost of entry by a potential competitor in a market, including distance from the pipeline's terminal and major consuming markets.<sup>47</sup>
- *Statement F - Maps:*  
General system and market-specific maps of the pipeline's principal transportation facilities, points of service, direction of flow, terminal locations, major consuming markets, and the location of alternatives.<sup>48</sup>
- *Statement G - Market Power Measures:*  
Calculations of market concentration, using the Herfindahl-Hirschman Index (HHI), based on receipt in origin markets and deliveries in destination markets, and including the competitive alternatives listed in Statements D and E. Market share calculations may be based on capacity, but delivery-based calculations must also be submitted.<sup>49</sup>
- *Statement H - Other Factors:*  
A description of any other factor that bears on the issue of pipeline market power, and an explanation of its pertinence. Examples include:

---

43. 59 Fed. Reg. at 59,154-55 (emphasis added).

44. *Id.* at 59,155-56 (emphasis added).

45. *Id.* at 59,156 (emphasis added).

46. *Id.* at 59,156-57 (emphasis added).

47. *Id.* at 59,157 (emphasis added).

48. *Id.* (emphasis added).

49. 59 Fed. Reg. at 59,157-58 (emphasis added). The HHI is explained earlier in the Commission's analysis. *Id.* at 59,153 n.32.

exchanges, excess capacity, competition with vertically integrated companies, buyer power, and pipeline profitability.<sup>50</sup>

• *Statement I - Proposed Testimony:*

Sworn testimony supporting the application that will also serve as a pipeline's case-in-chief if the application is set for hearing.<sup>51</sup>

The final procedural rules are largely unchanged. Protests, unaided by discovery, must be submitted within sixty days, setting forth detailed grounds for opposing an application. Thereafter, the application may be ruled on summarily or subjected to additional procedures, including discovery and a hearing, which is not automatic.<sup>52</sup> No procedures were adopted in connection with a protest of rates already allowed to be set under the market-based methodology, but the Commission noted its expectation that a protestant would detail the change of circumstances justifying the protest.<sup>53</sup>

On December 28, 1994, the Commission issued Order 572-A which denied the Association of Oil Pipelines' request for rehearing of Order 572.<sup>54</sup> The Commission rejected procedural objections of section 342.4(b) and the merits of the argument advanced on reconsideration that it had improperly modified the rate change provisions of the ICA, and that it had treated market-based rates and cost-of-service based rates inconsistently. The final rule became effective January 1, 1995.

#### *D. Alternative Dispute Resolution*

In Order 561, the Commission adopted alternative dispute resolution (ADR) procedures applicable to oil pipeline rate proceedings<sup>55</sup> intended to complement the Commission's Rules of Practice and Procedure.<sup>56</sup> The new ADR procedures are based on the mandatory requirements in section 1802(e) of the EPCA relating to oil pipeline ratemaking and on the Administrative Dispute Resolution Act of 1990.<sup>57</sup>

On November 10, 1994, the Commission issued a Notice of Proposed Rulemaking (NPR) on ADR.<sup>58</sup> The NPR proposes to amend the Commission's Rules of Practice and Procedure to implement a number of ADR techniques when all the participants to a dispute agree to their use, and to improve and expedite the settlement process, as set forth in rules 601 through 603 of the Rules of Practice and Procedure.<sup>59</sup> The NPR is not limited to oil pipeline matters; it is proposed for general applicability "to facilitate the use of ADR in Commission proceedings and to provide gui-

---

50. *Id.* at 59,158 (emphasis added).

51. *Id.* (emphasis added).

52. *Id.* at 59,158-59.

53. *Id.* at 59,158.

54. 69 F.E.R.C. ¶ 61,412 (1994).

55. 58 Fed. Reg. 58,753 (1993) (to be codified at 18 C.F.R. § 343.5).

56. 18 C.F.R. pt. 385 (1994).

57. 5 U.S.C. § 571-83 (Supp. IV 1992), amended by Pub. L. 102-354, 106 Stat. 944 (1992).

58. 59 Fed. Reg. 59,715 (1994).

59. *Id.* at 59,721, 59,724.

dance for such proceedings.”<sup>60</sup> The NOPR states that “[t]he new ADR provisions are intended to supplement existing Commission settlement regulations, and not to limit or replace them in any way.”<sup>61</sup>

## II. LOWER 48 PIPELINE RULINGS

### A. SFPP, L.P.

The principal legal issues decided in this case during the past year included the interpretation of section 1803(b)(2) of the EPAct, and the ability of an oil pipeline to raise market power defenses in a complaint proceeding. In addition, testimony has now been filed by the complainants and the FERC’s staff, raising a wide range of challenges to SFPP’s rates and practices.

The market power defense issue emerged early in the case when protestant Chevron, U.S.A. Products Company (Chevron) argued that SFPP must justify its rates on a cost-of-service basis. The FERC addressed this contention on several occasions, most recently in response to a petition for rehearing filed by Chevron. The Commission held that “market forces may be relevant to demonstrating the justness and reasonableness of rates under the [Interstate Commerce Act],” and therefore may be raised as part of a pipeline’s defensive case.<sup>62</sup>

The EPAct issue arose following the filing of a complaint by Navajo Refining Company. SFPP conceded that section 1803 (b)(2) of the EPAct—which exempts a shipper complaining about a grandfathered rate from having to meet the “changed circumstances” standard of section 1803(b)(1) if that shipper had been precluded during the statutory period from challenging the rates at issue—was applicable to Navajo. ARCO Products Company and Texaco Refining and Marketing, Inc. thereafter filed a complaint of their own, and argued that they too should not be required to show changed circumstances. SFPP responded that the section 1803(b)(2) exemption should be read only to apply to Navajo, and that other parties may not “piggy-back” on Navajo’s complaint. In an order dated April 20, 1994, the Commission held that the filing of Navajo’s complaint removed the “changed circumstances protection from SFPP’s existing west line rates,” and that ARCO, Texaco, and Chevron (which also had challenged the West Line rates) therefore need not meet that standard.<sup>63</sup>

---

60. *Id.* at 59,720.

61. *Id.* A detailed discussion of FERC ADR procedures, actual or proposed, is beyond the scope of this Report. However, should the general ADR NOPR become a Final Rule, oil pipeline practitioners before the FERC need to be aware of both sets of ADR regulations and sensitive to any prospect for procedural inconsistencies and other possible incongruities of application as between them.

62. *SFPP, L.P.*, 66 F.E.R.C. ¶ 61,210, at 61,480 (1994) (citing *Buckeye Pipe Line Co.*, 45 F.E.R.C. ¶ 61,046 (1988)).

63. *SFPP, L.P.*, 67 F.E.R.C. ¶ 61,089, at 61,255 (1994).

On rehearing, the Commission reversed its holding that shippers other than Navajo may avoid the changed circumstances standard.<sup>64</sup> The Commission based its holding on section 1803(b)(2), which it concluded is limited to a complainant who was specifically subject to a contractual bar, and thus “requires Chevron and ARCO/Texaco to meet the changed circumstances standard in pursuing their complaints.”<sup>65</sup>

The direct testimony of the complainants raised numerous challenges to SFPP’s rates. Several of the complainants’ testimony was based on separate cost-of-service calculations for the East and West Lines, rather than on an integrated system basis. The presentations also generally utilized the capital structure of the master limited partnership (MLP)—which was formed in December, 1988—rather than using the predecessor company’s capital structure as of June 30, 1985 (or that of its parent) for SFPP’s starting rate base. Each complainant excluded most or all of SFPP’s civil and regulatory litigation expenses from the cost-of service calculations, and most also excluded SFPP’s income tax allowance on the ground that it is a limited partnership which pays no income taxes.

The FERC’s staff filed direct testimony similar to that of the complainants. Like the complainants, the staff utilized the capital structure of the MLP, rather than that of the predecessor pipeline or parent company, for the starting rate base. Contrary to its position in the case involving Lakehead Pipe Line Company, Limited Partnership, the staff argued that SFPP’s rates should be calculated without an income tax allowance because SFPP, as a limited partnership, pays no income taxes.

#### *B. Lakehead Pipe Line Co., L.P.*

Administrative Law Judge Terrill issued an Initial Decision resolving Phase I issues in this case in December 1993.<sup>66</sup> On October 31, 1994, the ALJ issued an Initial Decision denying the Motion for Partial Summary Disposition filed by Lakehead Pipe Line Company, Limited Partnership (Lakehead), and addressing Phase II issues.<sup>67</sup>

In its Motion for Partial Summary Disposition, Lakehead objected to the inclusion in Phase II of issues regarding (1) the appropriate cost of debt used in evaluating Lakehead’s costs; and, (2) the appropriate throughput used in Lakehead’s rate calculations, on the ground that the party seeking to include those issues failed to present any direct testimony regarding them. In essence, Lakehead argued that the party raising those issues, Marysville Fractionation Partnership (MFP), could not meet its burden of going forward in its challenge to Lakehead’s rates because it failed to pres-

---

64. *SFPP, L.P.*, 68 F.E.R.C. ¶ 61,105, at 61,581-82 (1994); *see also SFPP, L.P.*, 68 F.E.R.C. ¶ 61,306 (1994).

65. *SFPP, L.P.*, 68 F.E.R.C. ¶ 61,105, at 61,581 (1994).

66. *Lakehead Pipe Line Co.*, 65 F.E.R.C. ¶ 63,021 (1993). Phase I involved rate issues through July 5, 1993; it also involved one additional issue relating to Lakehead’s rules regarding transportation of natural gas liquids. Phase II involved rate issues beginning July 6, 1993. By stipulation of the parties, all rate issues decided in Phase I will govern the outcome of Phase II.

67. *Lakehead Pipe Line Co.*, 69 F.E.R.C. ¶ 63,006 (1994).

ent direct evidence regarding those issues. The ALJ rejected this argument and held that MFP could meet its burden solely through cross-examination of Lakehead's witnesses.<sup>68</sup> Since MFP did elicit testimony on these issues through cross-examination, the existence of genuine issues of material fact precluded the granting of Lakehead's Motion for Partial Summary Disposition.<sup>69</sup>

In reviewing the merits of both issues, the ALJ found in favor of Lakehead. On the cost of debt issue, the ALJ concluded that MFP had failed to provide substantial, probative, and reliable evidence contesting Lakehead's management decisions with respect to its choice of financing (which was at a fixed rate).<sup>70</sup> On the throughput issue, the ALJ rejected MFP's argument that an increase in Lakehead's physical capacity will necessarily result in increased throughput in the future, primarily because prorationing on the system is determined by Lakehead's upstream supply source.<sup>71</sup> The ALJ concluded that Lakehead's throughput figure, which was based upon actual volumes for the first eight months of 1993 and forecasted volumes for the final four months of 1993, was reasonable.<sup>72</sup>

In addition to the cost of debt and throughput issues, the Phase II Initial Decision addressed issues regarding the appropriate depreciation expense and rate of return on equity to be used in evaluating Lakehead's rates. With respect to the depreciation issue, Lakehead supported a test year depreciation expense amount of \$20.3 million, which was stipulated to by the FERC's Staff. That figure was based on depreciation rates prescribed by the Oil Pipeline Board (Board) in 1990, using a truncation date of 2010.<sup>73</sup> Protestant Canadian Association of Petroleum Producers (CAPP) disputed the depreciation expense by contending that Lakehead had based its calculation on an inappropriate truncation date, which, CAPP argued, should be the year 2017 rather than 2010. Lakehead contended that because the Commission delegated to the Board its statutory authority to set depreciation rates,<sup>74</sup> those depreciation rates could not be varied in a rate proceeding, particularly on the basis of a challenge to a single element. Rather the rates could only be changed after a comprehensive review in accordance with Commission regulations. Lakehead also argued that the record supports the depreciation expense as filed.

The ALJ rejected Lakehead's first argument and held that Board-prescribed depreciation rates are subject to Commission review and oversight whenever a protestant brings forth credible evidence attacking their validity.<sup>75</sup> Nevertheless, the ALJ held that Board-prescribed depreciation rates are to be accorded a presumption that they are just and reasonable.<sup>76</sup>

---

68. *Id.* at 65,025.

69. *Id.*

70. *Id.* at 65,036.

71. *Lakehead Pipe Line Co.*, 69 F.E.R.C. ¶ 63,006, at 65,038 (1994).

72. *Id.*

73. *See Lakehead Pipe Line Co.*, 52 F.E.R.C. ¶ 62,003 (1990).

74. *See* 18 C.F.R. § 375.306(f) (1994).

75. *Lakehead Pipe Line Co.*, 69 F.E.R.C. ¶ 63,006, at 65,028 (1994).

76. *Id.* at 65,029.

Addressing the evidence put forth by CAPP in support of a truncation date of 2017, the ALJ found that although CAPP had presented credible evidence in support of its position, its focus on an alternative truncation date alone did not provide sufficient evidence to rebut the presumption of justness and reasonableness of Lakehead's depreciation expense.<sup>77</sup> The ALJ stated that CAPP "should have offered . . . alternative depreciation rates based on a comprehensive study which considered the physical characteristics of Lakehead's pipeline."<sup>78</sup>

CAPP also contested Lakehead's use of a nominal equity rate of return of 12.75% for the period July 6, 1993, forward, which had been stipulated to by FERC's Staff. Advocating the application of an alternative version of the discounted cash flow (DCF) methodology to that used by Lakehead, CAPP argued that the investor expected growth rate for dividends used in Lakehead's analysis did not sufficiently reflect lower long-term growth rate expectations. The ALJ agreed with CAAP and concluded that the short-term five-year dividend growth rate of 11.76% should be averaged with the long term growth rate of 5.9%—which was adopted from the Energy Information Agency's forecast of Gross Domestic Product Growth—in the DCF analysis. A recalculation of Lakehead's DCF analysis using the lower 8.83% average growth rate resulted in a return on equity of 11.81% rather than 12.75%.<sup>79</sup>

Just prior to the issuance of the Initial Decision addressing the Phase II issues, Lakehead filed new tariffs effective on November 30, 1994. On November 29, 1994, the Board suspended these tariffs and allowed them to become effective subject to investigation and refund.<sup>80</sup> The investigation has been stayed pending the outcome of Phases I and II, both of which are presently before the Commission on exceptions.

### C. *Williams Pipe Line Co.*

On July 28, 1994, the Commission issued another order addressing the level of competition that warrants a reduced level of regulation.<sup>81</sup> In *Williams Pipe Line Co.*,<sup>82</sup> the Commission generally affirmed the standards established by the ALJ in his market power analysis but reversed the ALJ's findings relating to market power in certain of Williams's markets.

---

77. *Id.*

78. *Id.*

79. *Lakehead*, 69 F.E.R.C. ¶ 63,006, at 65,035 (1994).

80. *Lakehead Pipe Line Co.*, 69 F.E.R.C. ¶ 62,174 (1994).

81. In accordance with the procedures adopted by the Commission in *Buckeye Pipeline Co.*, 44 F.E.R.C. ¶ 61,066 (1988), *order on reh'g*, 45 F.E.R.C. ¶ 61,046 (1988), *Opinion and Order on Initial Decision*, 53 F.E.R.C. ¶ 61,473 (1990), *order on reh'g*, 55 F.E.R.C. ¶ 61,084 (1991), Williams elected to bifurcate this proceeding. In Phase I, Williams has the opportunity to prove that it does not have market power in the relevant markets and is therefore entitled to "light handed" regulation. In Phase II of such a proceeding, the Commission reviews the cost data in light of the market power determination and establishes just and reasonable rates for the pipeline. The July 28, 1994 opinion was limited to the first phase of the *Buckeye* bifurcated approach.

82. 68 F.E.R.C. ¶ 61,136 (1994).

The Commission affirmed and adopted the ALJ's decision to limit the scope of Phase I of this proceeding to a determination of Williams's market power in the relevant markets. Next, the Commission affirmed the ALJ's definition of the relevant product market as "pipelineable petroleum products" as well as the definition of the relevant geographic market as pipeline destinations using the Department of Commerce's Bureau of Economic Analysis Economic Areas (BEAs).

For purposes of analyzing the relevant markets, the Commission accepted the use of the Herfindahl-Hirschman Index (HHI) as an initial screen for market concentration. The Commission found that the ALJ's decision to use an HHI value of 2500 as an initial screen was adequate in light of his examination of other factors. The Commission also affirmed the ALJ's decision to use capacity data (rather than deliveries at a given destination) in calculating HHIs. In addition to the capacity of other oil pipelines, the Commission affirmed the ALJ's consideration of the capacity of competing barges, refiners of crude, and trucks.

In his initial decision, the ALJ had determined that truck-delivered capacity should be included in a market's HHI calculation to the extent that trucks could effectively carry products from outside sources into the BEA. The ALJ found that trucks could be cost-competitive at a range of approximately 65 to 70 miles. The Commission found this to be reasonable in some cases, but noted that judgments about the validity of external source competition in a market are best made on a market-by-market basis in the context of all the facts.

The Commission agreed with the ALJ's approach of including private pipelines and certain pipelines without terminals in calculating HHIs where construction of new terminals or pipelines likely would occur with economic success. The Commission also affirmed the ALJ's ruling that potential competition is properly weighed in the analysis of market power.

The Commission affirmed the ALJ's determination that other factors considered relevant to the determination of competitiveness included the oil pipeline's market share, availability of excess capacity, and buyer power. The Commission accepted the ALJ's refusal to accord significance to exchanges, the fact that an oil pipeline company was part of a vertically integrated conglomerate, or profitability.

The ALJ examined thirty-three markets in which Williams delivered product and found ten with market power.<sup>83</sup> While the Commission affirmed the ALJ's finding that 2500 is an adequate HHI for initial screening purposes, the Commission noted that "choosing any single HHI value as a threshold for screening markets is much less important than carefully weighing . . . relevant factors that might contribute to or detract from market power."<sup>84</sup> Examining seven of the markets presumed by the ALJ to be competitive, the Commission found Williams had failed to demonstrate

---

83. These markets are: Duluth, Rochester, Omaha, Grand Island, Sioux Falls, Aberdeen, Cedar Rapids, Waterloo, Ft. Dodge, and Sioux City.

84. *Williams Pipe Line Co.*, 68 F.E.R.C. at 61,676.

that it lacks market power.<sup>85</sup> The Commission also found that Williams had not demonstrated that it lacked market power in BEAs Topeka and Quincy. The Commission directed the ALJ to proceed with Phase II of the proceeding for the purpose of establishing base rates for the nineteen markets where Williams failed to establish that it lacks market power.

*D. Experimental Market-Based Rates—Buckeye Pipe Line*

Before issuing Order 561, the Commission approved an experimental market-based rate program for the pipeline operations of Buckeye Pipe Line Company, L.P.<sup>86</sup> On December 6, 1994, the Commission granted Buckeye's unopposed request to continue that program for an indefinite period after January 1, 1995, the effective date for index-based ratemaking under Order 561.<sup>87</sup> The Buckeye rates are market-based, subject to a cap that differs from the rate ceiling index approach of Order 561.<sup>88</sup>

The Commission reviewed the three-year history of Buckeye's experimental program, including rate changes, the lack of protests of rate changes, and the absence of complaints against existing rates. Based on its findings and conclusions that Buckeye's program "is more stringent than Order No. 561;" that it has proven effective "in establishing just and reasonable rates;" that "there is no cost shifting among rates;" and, that "the Buckeye program has received universal acceptance by all shippers on the Buckeye systems," the Commission granted the extension.<sup>89</sup>

*E. Lease Cases*

A continuing theme in 1994 at the FERC was the question of whether a pipeline may lease capacity from another pipeline and base its rates on something other than the lessor pipeline's rates. Four pipelines leasing space and proposing initial rates for the leased space at a rate other than the lessor's tariff rate found their tariffs protested.<sup>90</sup> Two of these pipelines resolved the issue through settlement in 1993. Of the two remaining pipelines, one has a unilateral settlement pending before the Commission as a contested settlement and, at the end of the year, an initial decision was issued, requiring it to exclude from its rates the costs of its leased space.

Each of the underlying lease arrangements was for a limited term. At the end of the lease by Phillips Pipe Line, it offered a unilateral settlement agreement to roll back its rates for the lease period to the level of the

---

85. These markets are: Springfield (MO), Eau Claire, Des Moines, Kansas City, Lincoln, Fargo, and Grand Forks.

86. *Buckeye Pipe Line Co.*, 69 F.E.R.C. ¶ 61,302 (1994).

87. For competitive markets, the cap has two parts: a 15 percent real increase over any two-year period and individual rate increases subject to the change in the GNP implicit price deflator plus two percent. For other markets, the cap is an index geared to rates in the competitive markets. *Id.*

88. *Id.* at 62,162.

89. *Id.* at 62,163.

90. *Koch Pipelines, Inc.*, 63 F.E.R.C. ¶ 62,104 (1993); *Koch Pipelines, 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); *Phillips Pipe Line Co.*, 66 F.E.R.C. ¶ 62,095 (1994); *Total Pipeline Corp.*, 65 F.E.R.C. ¶ 62,260 (1993); *Total Pipeline Corp.*, 66 F.E.R.C. ¶ 62,187 (1994).

lessor's rates. Staff and the protestor opposed the settlement, arguing that the proposed agreement left unresolved the recurring legal question concerning the validity of "lease-and-raise practices." The ALJ ultimately certified the settlement to the Commission as "contested" along with two questions of law:

If a crude oil or petroleum product pipeline carrier leases throughput capacity on another pipeline and proposes to charge rates that are higher than those of the lessor, and chooses to justify those rates on a cost-of-service basis, whose costs will be used as the basis for the rate—the lessor's, the lessee's or someone else's? If a crude or petroleum product pipeline chooses to justify its rates for leased capacity on a non-cost basis, what methodologies are available?<sup>91</sup>

*Phillips Pipe Line Co.* was pending before the Commission as of the beginning of 1995.

In *Total Pipe Line Corp.*, the dispute focused on the differences between Total's rate of 75-cents for space it leased from ARCO pipeline and ARCO Pipeline's rate of 71-cents for the same space. Total defended its rates by relying on rates for comparable service and arguing that its rates fell within the "zone of reasonableness" established by *Farmers Union II*, especially when comparing the additional benefits offered by Total's service to the lessor's service.

On December 28, 1994, Judge Nelson released an initial decision rejecting Total Pipeline Corporation's rates because they were not just and reasonable. Relying upon both *Williams Pipe Line Co.*<sup>92</sup> and *Farmers Union II*, the judge held that a lease was analogous to a sale for purposes of excluding the transaction's excess costs from rates, that the doctrine of the *Williams/Farmers Union II* cases applies to leases as well as to sales, and that Total had failed to show by clear and convincing evidence that it met the *Williams/Farmers Union II* test that its lease provides substantial benefits to rate payers so as to justify a higher rate. The ALJ found that Total's argument that its different approach to reserving capacity, nominating space, and allocating oversubscribed capacity, and accommodating shippers of different crude types amounted to substantial benefits.<sup>93</sup>

#### F. Cases on Jurisdiction

A number of cases arose this year concerning the scope of Commission jurisdiction over pipelines and pipeline services. One such case involves a petition filed by a refiner and its pipeline affiliate seeking determination that private, proprietary pipeline facilities are not subject to the ICA.<sup>94</sup> In another case where the Commission disclaimed ICA jurisdiction, oral argument was heard on a shipper appeal of the Commission's finding

---

91. *Phillips Pipe Line Co.*, 68 F.E.R.C. ¶ 63,001 at 65,002 (1994) (citing *Williams Pipeline Co.*, 21 F.E.R.C. ¶ 61,260 (1982), remanded on other grounds sub nom. *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984), cert. denied, 469 U.S. 1034 (1984) (*Farmers Union II*)).

92. 21 F.E.R.C. ¶ 61,260 (1994).

93. *Total Pipeline Corp.*, 69 F.E.R.C. ¶ 63,018 (1994).

94. See *Hunt Refining Co.*, 59 Fed. Reg. 17,360 (1994) (Petition for Exemption from Jurisdictional Status).

that the ICA does not control pipelines operating wholly on the Outer Continental Shelf.<sup>95</sup>

Pipelines also have been seeking the FERC's jurisdiction over facilities previously considered non-jurisdictional. In one such instance, a shipper has opposed the assertion of the FERC's jurisdiction.<sup>96</sup> In another, the shippers favor Commission oversight but claim that the carrier must refund "all revenues above variable operation and maintenance costs" collected from commencement of operations to the date of issuance of a Commission order.<sup>97</sup> The carrier has argued that the delay in filing a tariff was the result of considerable uncertainty in its jurisdictional status.<sup>98</sup>

One pending jurisdictional issue was resolved when the Commission affirmed the holding of a decision issued last year that commingling of interstate and intrastate shipments "does not change the inherent jurisdictional nature" of either type of shipment.<sup>99</sup> The pipeline had argued that Federal ratemaking agencies have jurisdiction over the transportation of commingled products. The Commission distinguished ICA jurisdictional provisions from those of other ratemaking statutes, finding that "section 13(4) of the ICA [only] empowers the Commission to cure any undue, unreasonable, or unjust discrimination against or burden on interstate commerce resulting from state regulation."<sup>100</sup>

#### G. *ARCO Pipe Line Co.*

On February 2, 1994, the Commission issued an order resolving the question of whether it has the authority to prohibit a partial abandonment of oil pipeline service. In *ARCO Pipe Line Co.*,<sup>101</sup> the FERC held that it does not have jurisdiction to block a pipeline from discontinuing service in one direction while continuing to provide service on the same pipeline in the opposite direction. As a result, the Commission lifted a seven-month suspension of ARCO's cancellation tariff.

### III. ALASKA RULINGS

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

TAPS is a common stream pipeline that transports petroleum with different characteristics from producing fields on Alaska's North Slope to the Port of Valdez. Because TAPS is the only practical means of transporting petroleum from the North Slope, and batch shipping is infeasible, each shipper on TAPS receives the commingled TAPS stream at Valdez. The

---

95. *Shell Oil Co. v. FERC*, No. 92-1634 (D.C. Cir. Oct. 28, 1994) *appealing Bonito Pipe Line Co.*, 61 F.E.R.C. ¶ 61,050 (1992).

96. *Kenai Pipe Line Co.*, 67 F.E.R.C. ¶ 62,105 (1994); *Kenai Pipe Line Co.*, 67 F.E.R.C. ¶ 62,203 (1994).

97. *Gaviota Terminal Co.*, 66 F.E.R.C. ¶ 62,122 (1994); *Gaviota Terminal Co.*, 67 F.E.R.C. ¶ 61,358 (1994).

98. *Gaviota Terminal Co.*, 67 F.E.R.C. ¶ 61,358, at 62,248.

99. *Amoco Pipeline Co.*, 67 F.E.R.C. ¶ 61,378, at 62,293 (1994), *aff'g* 62 F.E.R.C. ¶ 61,119 (1993).

100. *Id.* at 62,296.

101. 66 F.E.R.C. ¶ 61,159 (1994).

system used to make monetary adjustments among TAPS shippers to account for differences in the value of the petroleum stream tendered to TAPS by an individual shipper and the commingled stream the shipper receives from TAPS at Valdez is called the "quality bank."

Since 1984, quality bank adjustments on TAPS have been made using a gravity-based methodology. This methodology was the product of a settlement between the TAPS Carriers and Mapco (an Alaska refiner that takes petroleum from TAPS at an intermediate point along the pipeline, refines a portion of the oil, and returns the remaining stream to TAPS), and was approved by the FERC.

Beginning in 1989, the settlement methodology was challenged in protests and complaints filed with both the FERC and the Alaska Public Utilities Commission (APUC). The protesting parties argued that changes in the petroleum streams tendered to TAPS had rendered the gravity methodology unjust and unreasonable. After joint hearings, each agency's ALJ issued a decision concluding that a new methodology should be used, although the ALJs disagreed as to what the new methodology should be.

The two commissions then ordered a series of settlement conferences, mediated by the FERC Chief ALJ Wagner, which ultimately resulted in an offer of settlement that was supported by several of the parties and opposed by other parties. The centerpiece of the offer of settlement was a distillation-based methodology. Hearings were conducted concerning the settlement offer.

The commissions ultimately adopted a distillation-based methodology, but changed several elements of the specific methodology set forth in the offer of settlement. Several parties have petitioned for review of the FERC's order (and appealed from the APUC's order). The D.C. Circuit will hear oral argument on the petitions for review of the FERC's order in February 1995.

#### *B. TAPS Pumpability Case*

On July 13, 1994, the FERC issued its order on exceptions to the presiding ALJ's initial decision.<sup>102</sup> In that order, the FERC reversed the findings of the ALJ and held that the use of pumpability factors to calculate tariffs for the TAPS does not result in tariffs that are unjust, unreasonable, unjustly discriminatory, or unduly preferential in violation of the ICA. Requests for rehearing were filed by various parties and on December 6, 1994, the FERC issued an order denying rehearing.<sup>103</sup> The ALJ had determined that the use of pumpability factors resulted in rates that were unjust and unreasonable in violation of section 1(5) of the ICA and in rates that were unjustly discriminatory in violation of section 2 of the ICA.

The carriers operating TAPS use pumpability factors to construct different rates for different types of petroleum. Pumpability factors are an

---

102. *Amerada Hess Pipeline Corp.*, 68 F.E.R.C. ¶ 61,057 (1994). The ALJ's initial decision, 65 F.E.R.C. ¶ 61,277 (1993), was discussed in the 1994 Committee Report. 15 Energy L.J. 203 (1994).

103. *Amerada Hess Pipeline Corp.*, 69 F.E.R.C. ¶ 61,297 (1994).

outgrowth of the settlement agreement between the State of Alaska and the carriers, which established a methodology for TAPS tariffs (TSM). Pumpability factors cause heavier petroleum streams (petroleum of relatively lower API gravity and higher viscosity) to have higher tariffs than lighter petroleum streams (petroleum of relatively higher API gravity and lower viscosity). The opponents of the use of pumpability factors argued that their use resulted in unlawful rates because pumpability factors do not reflect differences in cost between transporting heavier petroleum streams and lighter petroleum streams. The protesting parties argued that pumpability factors are irrelevant because TAPS was no longer operating at maximum throughput.

The Commission held that the use of pumpability factors did not render the TAPS tariffs unjust and unreasonable. In discussing its findings, the Commission stated that pumpability factors accurately measured relative use of capacity of TAPS by different petroleum streams, and that apportioning fixed costs on the basis of use of capacity was acceptable even when TAPS is not operating at capacity and where fixed costs did not vary with relative use of capacity.<sup>104</sup> The Commission concluded, moreover, that it was "not required to adhere rigidly to a strict cost-incurrence basis for determining rates," and that the use of pumpability factors were justified by the unique circumstances surrounding the TSM.<sup>105</sup>

The Commission also held that the use of pumpability factors did not cause the TAPS tariffs to be unjustly discriminatory or unduly preferential. The Commission reiterated its finding that it was not limited to an assessment of cost-related factors. It justified its conclusion by noting that any rate differentials were caused by the pumpability factors which it had found valid under section 1(5).<sup>106</sup> In addition, in its order denying rehearing, the Commission stated that the differences in the density and viscosity of the petroleum result in heavier petroleum, using more pipeline capacity than lighter petroleum. These are significant differences in the circumstances of service which justify the rate difference.<sup>107</sup>

Several parties have filed petitions for review of the Commission orders in this proceeding with the D.C. Circuit as of the end of 1994. The court has not yet set a briefing and argument schedule.

### C. 1994 Tariff Case (Phase I)

On December 22, 1994, the Presiding ALJ ruled against the State of Alaska in the first phase of a hearing on its protest of the 1994 Trans Alaska Pipeline System (TAPS) tariffs.<sup>108</sup> The hearing involved Alaska's challenge to the inclusion in the 1994 TAPS tariffs of the cost to the TAPS Carriers of settling lawsuits with private litigants concerning the Exxon

---

104. *Amerada Hess Pipeline Corp.*, 68 F.E.R.C. ¶ 61,057, at 61,192.

105. *Id.* at 61,193.

106. *Id.* at 61,193.

107. *Id.* at 61,194.

108. *Amerada Hess Pipeline Corp.*, 69 F.E.R.C. ¶ 63,017 (1994) [hereinafter *Hess Slip Opinion Version*].

Valdez oil spill (EVOS) and the litigation expenses associated with the oil spill lawsuits.<sup>109</sup>

Alaska argued against the inclusion in the TAPS tariffs of the litigation and settlement costs (LS Costs) on two grounds: (1) that the costs were the result of imprudence; and, (2) that they are not operating expenses within Account 610 of the Uniform Systems of Accounts Prescribed for Oil Pipeline Companies Subject to the Provisions of the Interstate Commerce Act (FUSA),<sup>110</sup> and as such are not includible in the TAPS tariffs under the TAPS Settlement Agreement which, in relevant part, defines the TAPS revenue requirement as comprising those expenses “includible in Account 610.”<sup>111</sup> The FERC, with the concurrence of the Alaska Public Utilities Commission (with which the FERC is holding concurrent proceedings), ordered the presiding ALJ to decide what it termed the “threshold” question of whether the EVOS litigation and settlement costs are “properly recorded in Account 610,”<sup>112</sup> stating that “under the TAPS Settlement Methodology the particular [FERC] account in which a cost is recorded determines whether the cost is recoverable in the TAPS Carriers rates.”<sup>113</sup>

After hearing and post-hearing briefing, the ALJ issued an Initial Decision in favor of the TAPS Carriers. The ALJ rejected State and the FERC staff’s arguments that the LS Costs are not operating expenses within the ambit of the regulations’ omnibus operating expense account (Account 610), but instead should have been recorded as extraordinary expenditures in Account 680 or as unusual or infrequent expenditures in Account 665.

The ALJ ruled that the State and the FERC staff had the “burden of demonstrating that the evidence clearly shows that the costs should be recorded in Account 680 (‘extraordinary’ and ‘material’) or Account 665 (‘unusual or infrequent’ and ‘material’),”<sup>114</sup> and had failed to carry their burden. The Presiding Judge found that there was an insufficiently clear showing that the costs were the result of an unusual and/or infrequent event and that, “[a]t best, the State and Staff show that the EVOS [costs]

---

109. Alaska protested the tariff filings with respect to other expenditures, including expenditures for corrosion repair and remediation, for public relations and for post-retirement benefits other than pensions. The Oil Pipeline Board suspended the tariffs for one day, and consolidated the issues (other than corrosion repair) for hearing. *Amerada Hess Pipeline Corp. et al.*, 65 F.E.R.C. ¶ 62,259 (1993).

110. 18 C.F.R. pt. 352 (1994).

111. *Hess Slip Opinion Version*, *supra* note 108, at 4. The TAPS Settlement Agreement, which governs the calculation of tariffs on the TAPS, was executed by the State and the TAPS Carriers in 1985 and subsequently approved by the FERC. *Trans Alaska Pipeline Sys.*, 33 F.E.R.C. ¶ 61,064 (1985); *Trans Alaska Pipeline Sys.*, 35 F.E.R.C. ¶ 61,425 (1986), *aff’d*, *Arctic Slope Regional Corp. v. FERC*, 832 F.2d 158 (D.C. Cir. 1987), *cert. denied*, 488 U.S. 868 (1988).

112. *Amerada Hess Pipeline Corp. et al.*, 67 F.E.R.C. ¶ 61,064 at 61,188 (1994), *aff’d*, 67 F.E.R.C. ¶ 61,284 (1994).

113. *Amerada Hess Pipeline Corp.*, 67 F.E.R.C. ¶ 61,284, at 61,991 (1994). The TAPS Carriers apparently dispute that this “threshold” determination resolves the question of the contractual intent of the TAPS Settlement Agreement with respect to the protested expenses. *Hess Slip Opinion Version*, *supra* note 108, at 4 n.7.

114. *Amerada Hess Pipeline Corp. et al.*, 69 F.E.R.C. ¶ 63,017, at 65,132 (1994).

might be an extraordinary item."<sup>115</sup> In addition, the ALJ, using a five-year average of TAPS Carrier income, found that the LS costs were, in any event, not material "for five of the seven TAPS Carriers" because the costs did not amount to 10% of those Carriers' income within the meaning of the regulations' definition of materiality.<sup>116</sup> Accordingly, the ALJ concluded that the costs were properly recorded to Account 610 (operating expenses) of FUSA.<sup>117</sup>

Phase II of the proceeding, which is scheduled for hearing in June 1995, will address the question of the prudence of the LS Costs, as well as the expenditures relating to public relations and post-employment benefits other than pensions.

#### *D. TAPS Electrical Code Case*

At the end of 1994, the TAPS Carriers filed proposed 1995 tariffs that called for an increase over 1994 tariff levels. The State of Alaska protested the 1995 tariffs on a number of grounds, including the incorporation into the tariffs the costs of repairing and remedying National Electrical Code violations. The State of Alaska alleged that these costs were incurred as a result of imprudent management of TAPS and therefore should be disallowed. The Oil Pipeline Board suspended the rates and allowed them to become effective subject to refund. The case was currently in the early stages of discovery at the end of 1994.

---

115. *Hess Slip Opinion Version, supra* note 108, at 20.

116. *Hess Slip Opinion Version, supra* note 108, at 31 (citing General Instruction 1-6(f)).

117. *Hess Slip Opinion Version, supra* note 108.