ARCO Pipe Line Company
Opinion No. 351-A
53 FERC ¶ 61,398 (1990)

On July 18, 1990, the Federal Energy Regulatory Commission (Commission) issued Opinion No. 351 (ARCO Pipe Line Company, 52 FERC ¶ 61,055) which resolved several issues with respect to the rates that ARCO Pipe Line Company (ARCO) could charge for the transportation of oil and oil products on its pipeline system. On August 17, 1990, ARCO and the Association of Oil Pipe Lines (AOPL acting as an amicus curiae) filed for rehearing of Opinion No. 351. The rehearing issues all related to ARCO's rate base. The Commission denied the rehearing requests.

In Opinion No. 154-B, the Commission adopted net depreciated trended original cost (TOC) as the appropriate rate base methodology for oil pipelines. TOC replaced the valuation rate base used previously by the Interstate Commerce Commission. Opinion No. 154-B also adopted a starting or transition rate base for existing plant in order to bridge the transition from valuation to TOC. (Williams Pipe Line Company, 31 FERC 61,377 at 61,833 (1985)).

On rehearing of Opinion No. 351, ARCO contended that it should be entitled to amortize the write-up in the starting rate base as a cost of service expense. The Commission disagreed with ARCO relying upon its earlier reasoning. (See ARCO Pipe Line Company, Opinion No. 351-A, 53 FERC ¶ 61,398 at 62,383-62,386 (1990)). The Commission added additional reasoning to support its position on starting rate base.

ARCO also contended on rehearing that the Commission erred in adopting the weighted cost of capital approach rather than the "two rate base" approach advocated by ARCO. (Id. at 62,387). The Commission disagreed with ARCO and will continue to use the weighted cost of capital approach. It countered ARCO's claim of confiscation by stating that the starting rate base write-up is not related to equity capital. The entire starting rate base is an artificial construct derived as a one-time formula to bridge the transition from valuation to TOC. (Id. at 62,388, 62,389). However, the Commission did allow ARCO to increase the equity component of its rate base to include deferred earnings. (Id. at 62,389).

With regard to rate base crediting, Opinion No. 351 held that ARCO must credit its deferred tax balances against its rate base. The Commission rejected ARCO's position that the time value of the deferred tax balances should be a revenue credit to its cost of service as opposed to a rate base credit approach. (Id. at 62,389, 62,390). ARCO claimed on rehearing that competitive pressures constrain its ability to earn its authorized return including the full return on its deferred tax balance. (Id. at 62,390). The Commission denied rehearing and adhered to its finding in Opinion No. 351. The Commission also noted that ARCO's contentions about risks and competition were misplaced. The Commission stated that it is ARCO's responsibility to insure that funds are available to pay its taxes when they became due. Furthermore, any risk that funds will not be available when the taxes are due falls squarely on ARCO. (Id. at 62,390). Finally, the Commission noted again that the ratepayers should not provide ARCO with a return on cost-free capital. (Id. at 62,390).

<u>ARCO Pipe Line Company</u>,
Opinion No. 351-A,
Opinion and Order Granting In Part
and Denying In Part Rehearing
53 FERC ¶ 61,398 (1990)

[¶ 61,398]

ARCO Pipe Line Company, Docket Nos. IS86-3-001, IS87-1-002 and IS87-13-001

Opinion No. 351-A; Opinion and Order Granting in Part and Denying in Part Rehearing

(Issued December 18, 1990)

Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, Jerry J. Langdon and Branko Terzic.

[Note: Opinion No. 351 and Order Affirming in Part and Modifying in Part Initial Decision, issued July 18, 1990, appears at 52 FERC ¶ 61,055.]

[Opinion No. 351-A; Text]

On July 18, 1990, the Commission issued Opinion No. 351 in this proceeding.[1] Opinion No. 351 resolved a number of issues with respect to the rates that ARCO Pipe Line Company (ARCO) charges for the shipment of crude oil through its pipeline system. On August 17, 1990, ARCO and the Association of Oil Pipe Lines (AOPL), as *amicus curiae*, filed requests for rehearing of several issues resolved in Opinion No. 351.[2] Those issues all relate to ARCO's rate base. As discussed below, the Commission denies rehearing.[3]

Rate Base in General

In Opinion No. 154-B,[4] the Commission adopted net depreciated trended original cost (TOC) as the appropriate form of rate base for oil pipelines.[5] Because TOC replaced the valuation rate base used by the Interstate Commerce Commission (ICC) to regulate oil pipelines,[6] Opinion No. 154-B also adopted a starting or transition rate base in dollars for existing plant in order "to bridge the transition from valuation to TOC."[7]

Amortization of Starting Rate Base

1. Opinion No. 351

ARCO's starting rate base is higher than the net depreciated original cost of its assets.[8] The difference between the starting rate base and net depreciated original cost

[1] *ARCO Pipe Line Co.*, 52 FERC ¶ 61,055 (1990) (hereafter Opinion No. 351).

[2] The AOPL's motion for leave to file its request for rehearing as *amicus curiae* is granted.

[3] The Commission concludes that no arguments have been raised which warrant further discussion of the issues entitled in Opinion No. 351 as "AFUDC in Starting Rate Base" and "Deferred Tax Deduction-Before or After Trending." Hence, ARCO's and the AOPL's rehearing requests with respect to those issues are denied without discussion.

[4] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, *order on reh'g*, 33 FERC ¶ 61,327 (1985).

[5] *See* Opinion No. 351, at p. 61,237, n.10 for a description of TOC.

[6] *See* Opinion No. 351, at p. 61,232 for a description of valuation.

[7] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at p. 61,833.

[8] The starting rate base is the sum of the equity ratio times the net reproduction portion of the valuation rate base and the debt ratio times net depreciated original cost. Opinion No. 154-B adopted the date certain of June 30, 1985, for determining the capital structure to derive the starting rate base. Opinion No. 351 rejected ARCO's contention that

is known as the write-up in starting rate base. Opinion No. 351 concluded that ARCO is not entitled to amortize the write-up in starting rate base as a cost-of-service expense. Opinion No. 351 stated

> As the ALJ found, the ICC did not permit the amortization of the write-up in the [valuation] rate base so there can be no claim of investor reliance. In addition, there has been no showing that the write-up in the starting rate base represents deferred earnings. The fact that under the valuation method there was no amortization of the difference between valuation and net depreciated original cost is evidence that the difference did not represent deferred earnings. The valuation methodology was a fair value methodology and not the equivalent of TOC where the write-up does represent deferred earnings. The shift from a valuation to a TOC methodology does not transform the write-up into deferred earnings or any other expense. Accordingly, the denial of amortization does not constitute confiscation. The claim that newer pipelines will not be able to compete because their allowed rate will be higher than those of older pipelines, even if true, is no justification for permitting the older pipelines to collect a phantom cost which would be a windfall to these older pipelines. Last, the write-up should not be permanent even though it is not amortized as an expense. This is because the ICC depreciated valuation for return purposes despite computing depreciation solely on original cost.[9]

2. Rehearing Contentions

Both ARCO and the AOPL argue that the Commission erred by not permitting the amortization of the write-up in the starting rate base as a cost-of-service expense. They emphasize that the Commission adopted a starting rate base in order to "replicate the results that would have obtained if Opinion No. 154-B's [TOC] methodology had been in place from the outset."[10] They contend that ARCO should be permitted to recover fully its rate base just as newer pipelines are entitled to both a return on and a return of their trended rate base from the outset. The AOPL states that this argument applies whether or not there is an explicit showing of deferred earnings.

ARCO also attacks Opinion No. 351's rationale that the write-up does not represent deferred earnings. ARCO refers to Opinion No. 154-B, where the Commission put the burden on participants (other than the pipeline) to show that pipeline investors did not rely on the future recovery of deferred earnings under the valuation method. ARCO concludes that, therefore, the unrebutted presumption in this proceeding is that ARCO "in fact *did* defer earnings under valuation."[11] Both ARCO and the AOPL take

(Footnote Continued)

June 30, 1985 should not be so used because its parent's capital structure was atypical on that date owing to its issuing new debt to purchase its own common stock to avoid any hostile takeover bids. Opinion No. 351 stated that ARCO had not shown that its parents' capital structure at June 30, 1985, did not represent ARCO's risks and that "The Commission adheres to June 30, 1985, as the appropriate date to use to derive the starting rate base because that date *is the date of transition to the trended original cost methodology.*" Opinion No. 351, at p. 61,234 n.19. No one seeks rehearing. However, the AOPL argues that, in light of the arbitrary selection of June 30, 1985, as the starting rate base date and the large number of corporate restructurings in the mid-1980's, the Commission should "maintain a flexible attitude toward the selection of a [starting rate base] date" to avoid unrepresentative and artificial capital structures. Request for Rehearing at 10 n.16. The Commission reiterates that the starting rate base should be derived using a capital structure as of June 30, 1985, unless it is shown that the capital structure is not representative of the pipeline's risks.

[9] *Opinion No. 351, at p. 61,237.*

[10] AOPL's Request for Rehearing at 11. ARCO states that the starting rate base is a market-oriented transition rate base which was adopted "to approximate the result that would have been achieved if oil pipelines had been on a TOC methodology (at least with respect to their equity investment) all along." ARCO's Request for Rehearing at 19.

[11] *Id.* at 21. (ARCO's emphasis).

issue with Opinion No. 351's reliance on the fact that the ICC did not allow amortization of the difference between valuation and net depreciated original cost. ARCO asserts that this "may well be evidence that investors did not recover *enough* of a return of capital under the valuation methodology."[12] The AOPL argues that the ICC's failure to permit that amortization is not relevant for TOC regulation because TOC is a departure from the ICC's regulatory practices. In any event, the AOPL points out that the ICC's valuation rate base for return purposes did not amortize to zero but rather stopped amortizing at about 10 percent of its value. The AOPL asserts that the write-up in the starting rate base should either be amortized as an expense or be permanent. ARCO concurs in that conclusion.[13]

Last, both ARCO and the AOPL contend that amortization of the write-up in the starting rate base is warranted to promote competition between older and newer pipelines by "ensuring a level playing field"[14] and by eliminating cost-of-service distortions from amortizing post-starting rate base write-ups and not pre-starting rate base write-ups.[15] ARCO further states:

> The effect of this policy choice [of no amortization of the write-up as a cost-of-service expense] will be that in marginal cases this artificial regulatory constraint on the older pipeline may well affect the economic viability of a new competing pipeline. Moreover, where direct competition does not automatically compel the new pipeline to charge the artificially low rate imposed on the older pipeline, the new pipeline may be given an edge in the competition for financing of new projects.[16]

3. Discussion

The Commission denies rehearing and adheres to the discussion in Opinion No. 351. In addition, the Commission supplements that discussion as follows. First, both the AOPL and ARCO misinterpret the function of the starting rate base. The starting rate base was adopted as a transition to the new TOC regulation for existing plant. The particular starting rate base formula was adopted in lieu of using either a pipeline's most recent valuation or net depreciated original cost as the starting rate base. The starting rate base was adopted for the purpose of determining return on and not return of capital. While Opinion No. 154-B stated that the starting rate base formula was adopted because it would "more closely approximate the TOC rate base that would have existed," the point was not to pretend that TOC had been in place from the outset. Rather, the point was to achieve a transition, in lieu of valuation, which transition would "more closely approximate the TOC rate base that would have existed *had the ICC not written-up debt.*"[17] This was appropriate "to ensure that the equity holder does not benefit from the write-up of debt-financed assets, such as was the case with the ICC valuation rate base."[18] Hence, the adoption of the starting rate base was not meant to replicate the results of TOC with its capitalization into rate base of deferred equity earnings for future amortization as an expense.

In addition, ARCO misinterprets the right of participants in a rate case to challenge the pipeline's right to a starting rate base. It is true that the burden is on the participants to show "that a pipeline was not relying on future earnings under the

[12] *Id.* (ARCO's emphasis).

[13] *Id.* at 22 p. 23.

[14] *Id.* at 19.

[15] AOPL's Request for Rehearing at 12.

[16] ARCO's Request for Rehearing at 22, 23.

[17] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377, at p. 61,836. (Emphasis added).

[18] *Id.*

valuation methodology."[19] However, as indicated above, the starting rate base replaced the valuation rate base on which a pipeline earned a return on capital through a rate of return on rate base. Hence, the future earnings referred to are earnings that would have been recovered through the allowance for earnings on rate base and not through amortization of the write-up in the valuation rate base over net depreciated original cost. This analysis is confirmed by ICC practice, which did not permit amortization of that write-up as an expense to be collected from ratepayers. Similarly, ARCO's assertion that it may not have recovered enough capital under the ICC valuation methodology is in error. First, ARCO was given the full opportunity to collect depreciation with respect to its assets. Second, the ICC's valuation formula for determining return allowance was a fair value methodology with no capitalized deferred return.[20] This is again evidenced by the ICC not permitting amortization of the write-up above net depreciated original cost.

The Commission also fails to see the promotion of competition as a policy reason for allowing ARCO to amortize the write-up of the starting rate base over net depreciated original cost. First, there is a level playing field with respect to capitalized amounts attributable to deferred earnings because older and newer pipelines are subject to TOC with respect to return on total rate base. Second, there is no cost-of-service distortion because the write-ups in the starting rate base do not represent a deferred expense and are, therefore, irrelevant to cost-of-service comparisons. Third, the Commission repeats that it is not appropriate to promote competition under a cost-based regulatory scheme by permitting older partially depreciated pipelines to recover a phantom cost.[21] Last, the rates of older pipelines are not "artificially" low. If they are low, it is caused at least in part by the fact the pipeline has previously recovered its investment in plant through rates paid by ratepayers in past periods.

Finally, the Commission rejects the AOPL's and ARCO's contention that the write-up in the starting rate base should be permanent. The write-up is a transitional measure which should be decreased over time. It is true that the ICC's valuation rate base did not fully amortize. But it is not appropriate to continue this aspect of the flawed ICC valuation methodology because the pipeline should not earn a return on assets that have been fully depreciated.

Application of Rate of Return to Rate Base

1. Opinion No. 351

As discussed above, Opinion No. 154-B adopted a starting rate base for existing oil pipelines which is higher than the net depreciated cost of the pipeline's assets. The starting rate base is the sum of the equity ratio times the net reproduction part of the valuation rate base and the debt ratio times net original cost. The issue resolved in Opinion No. 351 was whether ARCO's return allowance should be determined by using the traditional weighted cost of capital approach where the weighted cost of debt and equity capital is multiplied times a single figure rate base to determine overall return in dollars or by using two rate bases consisting of a rate base for equity and a separate rate base for debt. Opinion No. 351 concluded that ARCO's return allowance should be

[19] *Williams Pipe Line Co.*, 33 FERC ¶ 61,327, at p. 61,641.

[20] Opinion No. 351, at p. 61,237, quoted p. 2, *supra*.

[21] Contrary to ARCO's view, the starting rate base is not a market-oriented rate base (see n.*10*, *supra*). Rather, TOC is an original cost rate base with a transitional rate base to move from ICC valuation to this Commission's TOC regulation.

derived using the weighted cost of capital approach of a single rate base. Opinion No. 351 stated:

> [T]he Commission adheres to the weighted cost of capital approach for oil pipelines. The *starting rate base was adopted as a one-time adjustment to arrive* at an appropriate rate base to be trended under the TOC methodology. The starting rate base was a means of bridging the "transition from valuation to TOC." The formula for deriving the starting rate base did not permently assign dollars to equity and debt rate bases. Rather, the formula yielded a single number starting amount to be used [in] lieu of the replaced valuation rate base in the new original cost regime as a derived starting value for the existing plant or assets in service. An apt analogy is construction work in progress where plant is constructed, for example, using 100-percent equity capital but put into rate base when there is both debt and equity capital. The 100-percent equity rate base is converted through the weighted cost of capital approach into a rate base, in effect, financed now at the debt and equity ratios. In sum, rate base is a single amount rate base value which adjusts to the debt and equity ratio as would a net original cost rate base.[22]

2. Rehearing Contentions

Both ARCO and the AOPL argue that the Commission erred in adopting the weighted cost of capital approach rather than the two rate base approach. The AOPL argues that the "weighted cost of capital approach does not give ARCO an opportunity to earn its authorized return on equity [and] [i]nstead systematically understates ARCO's real rate of return and confiscates ARCO's earnings by applying a debt return to equity investment."[23] ARCO similarly argues that "Since these deferred earnings are by definition all on the equity side (in that they represent deferred equity earnings), this distorted [weighted cost of capital approach] invariably results in applying a portion of the nominal debt return to a portion of the rate base that is theoretically intended to receive a real equity rate of return." [24] ARCO adds that the instant issue is the same for both new pipelines without a starting rate base and for old pipelines with a starting rate base "because the issue arises as a result of the trending of the equity rate base [for both new and old pipelines]." [25] ARCO further contends that Opinion No. 351's reliance on the argument that the starting rate base is a one-time adjustment is inapt because the issue is whether the deferred earning component of the rate base will be subject to a "real" rate of return as it contends.[26]

Last, the AOPL, using the Commission's example in Opinion No. 351, illustrates its view that the weighted cost of capital approach is confiscatory. The assumptions are a starting rate base of $1,200 consisting of $500 derived from the reproduction portion of the starting rate base formula and $700 from the original cost portion of the starting rate base formula and a net depreciated original cost of $1,000.[27] Also assume further the following capital ratios and costs:

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[22] Opinion No. 351, at p. 61,242 (Footnotes omitted).

[23] AOPL's Request for Rehearing at 17.

[24] ARCO's Request for Rehearing at 14.

[25] *Id.* at 15.

[26] ARCO also reiterates the claim that Opinion No. 154-B explicitly supports its method. Opinion No. 351 concluded that Opinion No. 154-B did not support ARCO's approach and, in fact, supports the weighted cost of capital approach. Opinion No. 351, at p. 61,242. In any event, as the AOPL recognizes, Opinion No. 154-B does not dispose of the merits of the matter.

[27] The assumptions with respect to the starting rate were debt and equity ratios of 70 percent and 30 percent, respectively, reproduction cost of $1,667 and net depreciated original cost of $1,000. The $1,200 starting rate base was derived by adding the product

Debt	70%	8%	5.6
Equity	30%	9% [28]	2.7
			8.3

This produces a total return allowance of $99.60 (8.3 percent times $1,200) under the weighted cost of capital approach. Under the two rate base approach, ARCO would be entitled to $45 of equity return (9 percent times $500) and $56 of debt return (8 percent times $700), a total return allowance of $101.

The AOPL argues that the weighted cost of capital approach short changes ARCO's real rate of return on equity as shown as follows. ARCO's actual allowed debt is $56 which when subtracted from $99.60 leaves $43.60 for equity. This return of $43.60 amounts to an 8.72 percent real return on equity ($43.60 divided by $500) as opposed to the allowed return of $45 based on the allowed equity rate of return of 9 percent. The AOPL observes correctly that the $1.40 difference is exactly equal to the difference between the costs of debt and equity (9 percent − 8 percent = 1 percent) times both the difference between the equity ratio of the rate base and book capital structure ($500/$1200 = 41.67 percent minus 30 percent = 11.67 per cent), and total rate base of $1,200.[29] The AOPL states that this mathematical exercise shows that the weighted cost of capital approach, in effect, applies the cost of debt to a portion of the pipeline's equity rate base.[30] Both the AOPL and ARCO observe that adjusting the assumptions could reverse the situation. A nominal debt rate of 10 percent produces a higher overall return under the weighted cost of capital approach than under the two rate base approach. ARCO adds that the problem is that the deferred earnings are capitalized into rate base without a corresponding adjustment to the equity capital amount of the capital structure.

3. Discussion

As indicated above, in the Commission's illustration, the pipeline would be entitled to an overall return allowance of $99.60 under the weighted cost of capital approach of Opinion No. 351 and $101.00 under the two rate base approach recommended by the AOPL and ARCO. The $1.40 difference is attributable to the fact that the Opinion No. 351 approach applies the weighted overall cost of capital of 8.3 percent to the $200 difference between the starting rate base and net depreciated original cost ($16.60) while the two rate base approach applies the real equity rate of return of 9 percent to the $200 ($18.00). The same situation would exist for a newer pipeline without a starting rate base because the TOC rate base would be higher than net depreciated original cost owing to the write-up for deferred earnings. However, as both the AOPL and ARCO admit, a debt rate higher than the real rate of return will produce the opposite result where the pipeline would recover more under the weighted cost of capital approach than under the two rate base approach.

First, the Commission sees no confiscation issue with respect to ARCO because its allowed weighted cost of capital is higher than its allowed real rate of return on equity of 10.3 percent (14.1 percent minus 3.8 percent inflation factor).[31] In addition, even if

(Footnote Continued)

of 30 percent times $1,667 ($500) to the product of 70 percent times $1,000 ($700).

[28] The nine percent is a real or inflation free rate of return on equity determined by subtracting the inflation rate from the nominal (inflation included) rate of return on equity.

[29] $1.40 = 1% x 11.67% x $1,200.

[30] The AOPL also notes that the $1.40 shortfall is magnified to $2.80 when the pipeline's tax allowance is considered assuming a 50-percent tax rate.

[31] Opinion 351, at p. 61,244 and n.59.

an oil pipeline's debt rate of return is lower than its real equity rate of return, as in the illustration, there would be no confiscation in not creating two rate bases so that the write-up in the starting rate base is designated as pertaining to equity. This is because the write-up is not related to equity capital. As stated earlier, the write-up in the starting rate base, as with the write-up in the valuation rate base, does not represent capitalized deferred earnings on equity capital.[32] Rather, the entire starting rate base is merely an artificial construct derived by a one-time formula to bridge the transition from valuation to TOC.

The situation with respect to the treatment of deferred TOC earnings capitalized into rate base for amortization is closer. As stated above, ARCO is not affected because its weighted cost of capital is higher than its real equity rate of return of 10.3 percent. However, it is appropriate to discuss this issue under the assumption that the weighted cost of capital is lower than the real equity rate of return to provide guidance to the industry with respect to deferred TOC earnings capitalized into rate base for amortization. As an aid to the discussion, the Commission will assume a TOC rate base of $1,300 with an increment relating to starting rate base of $100 and a net depreciated original cost of $1,000. The $200 difference between $1,200 ($1,300 – $100) and $1,000 represents the deferred earnings capitalized as a result of trending but not yet amortized. There is no doubt that the $200 represents deferred earnings on equity and that the pipeline is entitled to recover the $200 as a cost-of-service expense. The issue is whether, in the meantime, the pipeline is entitled to earn an equity rate of return or an overall rate of return on the $200. The former could be accomplished by either the two rate base approach or as observed by ARCO, by using one rate base and increasing the equity capital ratio to account for the $200. This latter situation puts the issue in proper perspective by highlighting the key question of the nature of the $200. The Commission believes that the $200 is the functional equivalent of an equity investment in the enterprise because it represents deferred equity earnings. Hence, the pipeline should adjust its capital structure by including the $200 as equity capital. Hence, rehearing is granted in part. ARCO will be required to adjust its equity capital to account for earnings capitalized into rate base under TOC.[33]

Deferred Taxes — Rate Base Crediting

1. Opinion No. 351

Opinion No. 351 described the instant issue as follows:

> ARCO calculates its income tax allowance or expense using the normalization method. Under that method, ARCO, for example, accelerates its depreciation expense for tax purposes, but computes its tax expense for rate purposes as if it were paying the higher taxes required by its book depreciation method (such as straight-line). The difference between the book or rate tax expense amount and the actual tax amount is placed in a deferred tax reserve account. Later, when the depreciation expense amounts reverse so that taxable income is higher than book (rate) income because depreciation as a tax expense is less than depreciation as a book (rate) expense, ARCO will use its deferred tax balances to pay the higher taxes that it does not collect in its current cost of service.[34]

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[32] The ICC permitted an overall return on the valuation rate base which covered both debt and equity.

[33] The adjustment to equity capital would be derived by adjusting the debt and equity ratios into dollar amounts based on the rate base amount and by adding to the equity amount the amount of earnings capitalized into the rate base under TOC.

[34] Opinion No. 351, at pp. 61,237-38.

Opinion No. 351 held that ARCO must credit its deferred tax balances against its rate base and rejected ARCO's and the AOPL's position that the time value of the deferred tax balances should be a revenue credit to ARCO's cost of service at the risk-free rate of interest as opposed to the rate base credit approach. Opinion No. 351 stated:

> ARCO is not entitled to earn a return from ratepayers on cost-free capital. This is because its shareholders' capital is not at risk. In addition, ARCO is not entitled to any ratepayer compensation for any loss or diminishing of this noninvestor capital on its part. To conclude, ARCO must credit its deferred taxes against its rate base because this is the Commission's long standing method of ensuring that it does not earn a return on cost-free capital.[35]

2. Rehearing Contentions

The AOPL seeks rehearing as follows:

> In a nutshell, the revenue credit approach to the treatment of the ADIT [accumulated deferred income tax] balance accomplishes a rate base reduction by using only the risk-free component of the pipeline's return. This is an eminently fair approach. It neither confers a windfall on the pipeline's shippers, who bear no risk on the ADIT balance and therefore deserve no risk premium on the ADIT balance, nor deprives pipelines of compensation for the risk of holding that balance. In contrast, requiring an oil pipeline to exclude the ADIT balance from rate base effectively credits shippers with an unwarranted premium (represented by the value of the risk-premium return embedded in the pipeline's allowable rate of return) for risks they do not bear. Viewed against this background, the ARCO revenue credit approach to the ADIT balance strikes a fair balance of shipper and carrier interests in an intensely competitive industry.[36]

The AOPL also states that "competitive pressures constrain on oil pipeline's ability to earn its authorized return," including the full return on its deferred tax balance.[37] ARCO also seeks rehearing based on its similar arguments in its Brief on Exceptions and defers to the AOPL for additional argument.

3. Discussion

The Commission denies rehearing and adheres to its discussion in Opinion No. 351. However, the Commission amplifies that discussion as follows. The AOPL's contentions about risk and competition are misplaced. First, ARCO has collected in its rates in advance the funds necessary to meet its future tax obligations. It is, therefore, ARCO's responsibility to ensure that funds are available to pay its taxes when they become due. Any risk that funds will not be available when the taxes are due falls squarely on ARCO because it has control over the management of the cash it has collected. That is, ARCO has fully collected in its rates the income taxes associated with the services provided and it, and not its ratepayers, should bear any asserted "burdens" associated with the deferred tax funds. Last, ARCO's ratepayers are not receiving a risk premium on the deferred balances when they are credited to rate base. Rather, they are not providing ARCO with a return on cost-free capital.

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[35] *Id.* at p. 61,238.

[36] AOPL's Request for Rehearing at 26.

[37] *Id.*

Conclusion

The AOPL asks the Commission, in light of the diverse nature and circumstances (such as competition) of the oil pipeline industry to "clarify Opinion No. 351 by indicating that it is not intended to be the definitive interpretation of Opinion No. 154-B principles applicable to all oil pipelines."[38] The Commission declines to so clarify. However, as with any Commission opinion, the parties to subsequent proceedings may present facts and arguments to demonstrate that the rulings of Opinion No. 351 should not be applied in the particular proceeding.

The Commission orders:

Rehearing of Opinion No. 351 is granted in part and denied in part as set forth in the body of this order.