123 FERC ¶ 61,287
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 502

BP Pipelines (Alaska) Inc.	Docket No. IS05-82-002
ConocoPhillips Transportation Alaska Inc.	Docket No. IS05-80-002
ExxonMobil Pipeline Company	Docket No. IS05-72-002
Koch Alaska Pipeline Company LLC	Docket No. IS05-96-002
Unocal Pipeline Company	Docket No. IS05-107-001
State of Alaska	Docket No. OR05-2-001
v.	
BP Pipelines (Alaska) Inc.	
ExxonMobil Pipeline Company	
ConocoPhillips Transportation Alaska, Inc.	
Unocal Pipeline Company	
Koch Alaska Pipeline Company	
Anadarko Petroleum Corporation	Docket No. OR05-3-001
v.	
TAPS Carriers	
BP Pipelines (Alaska) Inc.	Docket No. OR05-10-000
BP Pipelines (Alaska) Inc.	Docket No. IS06-70-000
ExxonMobil Pipeline Company	Docket No. IS06-71-000
ConocoPhillips Transportation Alaska, Inc.	Docket No. IS06-63-000
Unocal Pipeline Company	Docket No. IS06-82-000
Koch Alaska Pipeline Company	Docket No. IS06-66-000
Anadarko Petroleum Corporation	Docket No. OR06-2-000
v.	
TAPS Carriers	

OPINION AND ORDER ON INITIAL DECISION

Issued: June 20, 2008

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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OPINION NO. 502

APPEARANCES

Robin O. Brena, Esq., Joseph S. Koury, Esq., David W. Wensel, Esq., Andrew T. Swers, Esq., Anthony S. Guerriero, Esq., Jeffrey G. Disciullo, Esq., Paula T. Vrana, Esq., and Sherri B. Manuel, Esq., on behalf of Anadarko Petroleum Corporation.

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William D. Booth, Esq., David M. Conelly, Esq., Carmen L. Gentile, Esq., Kate Giard, Chairman, Mark Johnson, Commissioner, James H. McGrew, Esq., Robert Royce, Esq., and *Janis Wilson, Commissioner*, on behalf of the Regulatory Commission of Alaska.

Dennis H. Melvin, Esq. and Marcia A. Lurensky, Esq., on behalf of FERC Staff.

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TABLE OF ABBREVIATIONS

ADIT	Accumulated Deferred Income Tax
AFUDC	Allowance for Funds Used During Construction
ALJ	The FERC Administrative Law Judge who presided over the hearings held on the TAPS Rates Case.
Anadarko	Anadarko Petroleum Company
ANS	Alaska North Slope, an oil producing region.
ANS Crude	Alaska North Slope crude petroleum
APB	Allowance Per Barrel
Anadarko/Tesoro	Anadarko/Tesoro Petroleum Corporation
BP	BP Pipelines (Alaska) Inc.
CRN	Cost of Reproduction New
DCF	Discounted Cash Flow
Designated Carriers	The Designated TAPS Carriers are BP Pipelines (Alaska) Inc. (BP), ExxonMobil Pipeline Company (ExxonMobil), Koch Alaska Pipeline Company, LLC (KAPL), and Unocal Pipeline Company (Unocal).
DOJ	Department of Justice
DR&R	Dismantlement, Removal & Restoration
E&P	Exploration and Production
FERC	Federal Energy Regulatory Commission
Flint Hills	Flint Hills Resources Alaska, LLC
ICA	Interstate Commerce Act

ICC	Interstate Commerce Commission
ID	Initial Decision
ISA	Intrastate Settlement Agreement
MLP	Master Limited Partnership
NAPS	New Alaska Pipeline System
NGA	Natural Gas Act
Petro Star	Petro Star Inc.
RCA	Regulatory Commission of Alaska
ROE	Return on Equity
SAC	Stand-Alone Cost
SRB	Starting Rate Base
SRB Write-Up	Portion of the SRB that exceeds the carrier's depreciated original cost rate base.
Staff	FERC Trial Staff
State	The State of Alaska
TAPS	Trans Alaska Pipeline System
TAPS Carriers	The TAPS Carriers are BP, ConocoPhillips Transportation Alaska Inc. (ConocoPhillips), ExxonMobil, KAPL, and Unocal.
Tesoro	Tesoro Petroleum Corporation
TOC	Trended Original Cost
TSA	TAPS Interstate Settlement Agreement
TSM	TAPS Settlement Methodology

TSM-6	TSM Computer Model
UJI	Undivided Joint Interest
Union	Union Oil Company of California
Valdez	Valdez Marine Terminal

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

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OPINION NO. 502

OPINION AND ORDER ON INITIAL DECISION

(Issued June 20, 2008)

1. This order addresses briefs on and opposing exceptions to an Initial Decision (ID) issued on May 17, 2007, by the Presiding Administrative Law Judge (ALJ) in the captioned proceeding.[1] The ID set forth the ALJ's findings concerning the Trans Alaska Pipeline System (TAPS) Carriers' 2005 and 2006 interstate rate filings for TAPS. The ID found that the proposed interstate rates for 2005 and 2006 are not just and reasonable, determined the components for establishing the rates for 2005 and 2006 and ordered limited refunds.

2. In this order, the Commission affirms the ALJ on all issues. The Commission also clarifies and modifies the ALJ on certain issues.

I. Background

3. Crude oil streams produced from different fields on the Alaska North Slope (ANS) are commingled into a common stream and shipped to market in a single pipeline, TAPS. The ANS crude petroleum (ANS crude) is injected into TAPS at Pump Station No. 1. Return streams from three refineries alongside TAPS are also commingled into TAPS. The common stream is delivered at the southern terminus, the Valdez Marine Terminal (Valdez).

4. ANS crude began flowing on TAPS in 1977, and protracted litigation ensued over initial rates until 1985. In 1985, six of the then eight owners[2] entered into a settlement agreement, the TSA, which established the TAPS Settlement Methodology (TSM). The TSA provided for the use of the TSM to establish the interstate rates to be charged to

[1] *BP Pipelines (Alaska), Inc.*, 119 FERC ¶ 63,007 (2007). On May 31, 2007, the ALJ issued an errata to the ID with changes to certain items. *BP Pipelines (Alaska), Inc.*, 119 FERC ¶ 63,008 (2007). We will refer to both as the ID. The TAPS Carriers' motion for oral argument in this proceeding is denied.

[2] As a result of mergers and consolidation there are now five owners of TAPS.

shippers on TAPS until the year 2011, i.e., the estimated remaining useful life of the pipeline.

5. The TSA set the amount of the rates and refunds until 1985. Rates would then be set on an annual basis under the TSM provisions governing, among other things, rate base, depreciation and taxes. The financial impact of the settlement was to "front-end load" the rates in the early pre-settlement years, and to provide for diminishing rates commencing with the rates filed under the settlement in December 1985.

6. The settlement was challenged by several parties, including the two remaining TAPS owners.[3] The Commission severed the protesting parties, approved the settlement as uncontested, concluded that the settlement was fair and reasonable and in the public interest, declined to impose the terms of the settlement on the non-settling parties and set their protests for hearing.[4] The two remaining TAPS owners subsequently joined the settlement.

7. After the hearing, the Commission found that no party was aggrieved by its approval of the settlement, and terminated the rate proceedings. The Commission, however, observed that, "since the settlement rates were never adjudicated to be just and reasonable," a non-party to the settlement could protest a proposed change in rate in the TAPS Carriers'[5] subsequent rate filings.[6] The U.S. Court of Appeals for the District of Columbia Circuit affirmed the Commission's rulings emphasizing that approval of the

[3] The two remaining TAPS owners were Amerada Hess Pipeline Corporation and Sohio Pipe Line Company.

[4] *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064, *reh'g denied*, 33 FERC ¶ 61,392 (1985).

[5] The TAPS Carriers are BP Pipelines (Alaska) Inc. (BP), ConocoPhillips Transportation Alaska Inc. (ConocoPhillips), ExxonMobil Pipeline Company (ExxonMobil), Koch Alaska Pipeline Company, LLC (KAPL), and Unocal Pipeline Company (Unocal).

[6] *See Trans Alaska Pipeline System*, 35 FERC ¶ 61,425, at 61,977 n.17 (1986).

settlement "did not in any manner determine that the rates established under it are (or will be) just and reasonable."[7]

8. The terms of the TSA provide it to run until the end of 2011, but also permit termination at the end of 2008. Under section I-8 of the TSA, a party can seek to renegotiate the agreement within a two-year period beginning January 1, 2007. If the parties fail to renegotiate within the two-year period, the State of Alaska (State) and/or any of the TAPS owners can give a 30-day written notice terminating the TSA as early as December 31, 2008. The State has already invoked this provision, sending to each of the five current TAPS owners a notice of renegotiation on January 1, 2007.

9. In 1985, the Commission issued Opinion No. 154-B,[8] which established the generic principles for setting just and reasonable oil pipeline rates.

10. Until 2005 there were no protests to the TAPS Carriers' interstate rate filings. However, in addition to the interstate tariffs, the State regulates the intrastate shipments of ANS crude, which consists of approximately ten percent of the volumes of oil on TAPS. As explained *infra*, the intrastate rate tariffs were litigated prior to 2005.

11. In December 2004, the TAPS Carriers filed their interstate rates for 2005, which ranged from $3.52 to $3.97 per barrel, for the transportation of ANS crude oil from Pump Station No. 1, to the southern terminus of TAPS at Valdez.[9] On December 15, 2004, the State filed a protest of the TAPS Carriers' 2005 filed rates and a complaint with respect to the TAPS Carriers' 2003 and 2004 filed rates (State's 2005 Protest and Complaint).

12. In its 2005 Protest and Complaint, the State alleged that the TAPS Carriers' 2005 filed rates (1) violated the unjust discrimination and undue preference provisions of sections 2 and 3(1) of the Interstate Commerce Act (ICA), and (2) were inconsistent with

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[7] *Arctic Slope Regional Corp. v. FERC*, 832 F.2d 158, 162 (D.C. Cir. 1987), *cert. denied*, 488 U.S. 868 (1988).

[8] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985) (*Williams*) (Opinion No. 154-B).

[9] Each carrier filed distinct rates for services on that carrier's share of capacity on TAPS.

the terms of the TSA. The State also complained that the TAPS Carriers' 2003 and 2004 interstate tariffs impermissibly included certain expenses.

13. On December 16, 2004, Anadarko Petroleum Company (Anadarko) filed a protest and complaint (Anadarko's 2005 Protest and Complaint) alleging that the TAPS Carriers' 2005 filed rates were unjust, unreasonable and otherwise unlawful. Subsequently, Tesoro Petroleum Corporation (Tesoro) was granted intervention in both Anadarko's 2005 Protest and Complaint proceeding and the State's 2005 Protest and Complaint proceeding.[10]

14. Prior to the TAPS Carriers' 2005 rate filings, the Regulatory Commission of Alaska (RCA) ordered the TAPS Carriers to follow a different methodology for the TAPS intrastate rates, which resulted in the TAPS Carriers filing intrastate rates substantially lower than the interstate rates.[11]

15. On July 20, 2005, the TAPS Carriers filed a petition pursuant to section 13(4) of the ICA requesting the Commission to (1) investigate the 2005 intrastate rates imposed by the RCA, (2) find such intrastate rates unduly preferential and unjustly discriminatory

[10] On or about December 1, 2006, and November 30, 2007, respectively, each of the TAPS Carriers filed rates for 2007 and 2008 as required by the TSA. The filings were protested. By order issued December 28, 2006, and December 28, 2007, the Commission accepted for filing and suspended each of the rate filings, making them effective January 1, 2007, and January 1, 2008, respectively, subject to refund. *See BP Pipelines (Alaska) Inc.*, 117 FERC ¶ 61,352 (2006), and *Unocal Pipeline Company*, 121 FERC ¶ 61,300 (2007). The Commission also ordered that further proceedings regarding the 2007 and 2008 rates be held in abeyance, subject to the outcome of the instant proceeding involving the 2005 and 2006 rates.

[11] On February 15, 2008, the Supreme Court of the State of Alaska in *Amerada Hess Pipeline Corporation v. Regulatory Comm'n of Alaska*, Opinion No. 6231, Alaska Supreme Court Case No. S-12231 (*Amerada Opinion*), affirmed the RCA's ruling that intrastate rates filed by the TAPS Carriers using the TSM were unjust and unreasonable and set just and reasonable rates based on cost-based ratemaking principles.

against and an undue burden on interstate commerce, and (3) raise the 2005 intrastate rates to the level of the 2005 filed interstate rates.[12]

16. In December 2005, the TAPS Carriers filed their interstate rates for 2006, which ranged from $3.78 to $4.41 per barrel, for the transportation of ANS crude oil from Pump Station No. 1 to Valdez. On December 14, 2005, Anadarko/Tesoro filed a joint protest and complaint of the TAPS Carriers' 2006 filed rates (Anadarko/Tesoro's 2006 Protest and Complaint), alleging that the 2006 rates were unjust, unreasonable, unduly discriminatory and otherwise unlawful. On that same day, the State filed a protest of the TAPS Carriers' 2006 filed rates and a complaint with respect to the TAPS Carriers' 2004 and 2005 filed rates (State's 2006 Protest and Complaint).

17. In its 2006 Protest and Complaint, the State alleged that the TAPS Carriers' 2006 filed rates (1) violated the unjust discrimination and undue preference provisions of sections 2 and 3(1) of the ICA, (2) were inconsistent with the terms of the TSA.

18. Arctic Slope Regional Corporation (Arctic), Flint Hills Resources Alaska, LLC (Flint Hills), Williams Alaska Petroleum, Inc. (Williams), Petro Star Inc. (Petro Star), ConocoPhillips, and the RCA each moved to intervene in one or more of the proceedings described above.

19. Except to the extent that issues were withdrawn or severed, the foregoing protests and complaints and the TAPS Carriers' section 13(4) petition were consolidated and set for hearing.

II. The ID Rulings

20. On May 17, 2007, the ALJ issued the ID on the issues raised in the consolidated proceedings. The ID found that the TAPS Carriers had failed to prove that the proposed rate increases in their 2005 and 2006 tariffs were just and reasonable. The ALJ ordered limited refunds to all TAPS shippers under ICA section 15(7) and rejected the alternative remedy of awarding damages solely to the complainants under ICA section 13(1). The ALJ directed the TAPS Carriers to make a compliance filing after issuance of a Commission final order establishing rates in conformance with the findings in the ID.

[12] Petition of the TAPS Carriers for the Commission to Investigate and Set Intrastate Rates and Motion to Consolidate Proceedings, Docket No. OR05-10-000.

21. The following were the main rulings in the ID, generally in the order they appeared therein:

Burden of Proof: The TAPS Carriers have the burden of proof with respect to showing their filed rates and TSM are just and reasonable. ID at P 15.

TSM Applicability: The TSM did not establish just and reasonable rates. Non-signatories have the right to challenge the justness and reasonableness of the TSM rates. ID at P 53. The TAPS Carriers must prove that each component of the TSM-based rates is cost based and just and reasonable, which the TAPS Carriers failed to do. ID at P 62.

Rate Base: The appropriate rate base is derived following the Opinion No. 154-B analysis and conforms to original costs ratemaking standards. ID at P 95. Therefore, the appropriate property balances for original investment, additions and retirements are contained in the TAPS Carriers' annual rate filings, which Anadarko/Tesoro used. ID at P 96.

Deferred Return Amounts Already Collected: The deferred return amounts were collected under the TSM through the TAPS Carriers' use of a 100 percent equity structure and the allowance per barrel (APB). ID at P 107.

Starting Rate Base Write-up: The TAPS Carriers are not entitled to a Starting Rate Base (SRB) write-up because the TAPS Carriers' assets were never valued under the valuation methodology. ID at P 123.

Dismantlement, Removal & Restoration (DR&R): The TSA clearly provided for the recovery of DR&R costs through transportation rates and the actual DR&R collections have totaled over $1.5 billion. However, there are issues of (a) what earnings these DR&R funds have accrued and (b) what will be the ultimate dismantlement costs at the end of the useful life of the pipeline. Until these determinations are made, there can be no overcollection. ID at P 150. On these issues, the ALJ's rulings are:

> **Accrued Earnings**: Rejection of (1) the use of the TAPS Carriers' parents' return on equity (Anadarko/Tesoro proposal) as inconsistent with the ID holdings with respect to return issues and (2) the use of the risk-free earnings rate of the U.S. Treasury securities (the TAPS Carriers' proposal) as too low and not recognizing that the TAPS Carriers did not have separate accounts for DR&R collected funds. The TAPS Carriers' Ex. ATC-130, which uses Moody's Aa bond rating for each year is adopted as modified. ID at P 159.
>
> **No Continued DR&R Collections:** Because the TAPS Carriers failed to cost justify additional collection of DR&R expenses through future rates, DR&R

expenses are not permitted to be collected in the cost based 2005 and 2006 TAPS Carriers' rates. ID at P 160. However, the amounts are inconsequential from a rate effect standpoint (about $2.4 million in 2005 and $2.2 million in 2006, and less than $2 million in the years 2007-2011).

No Rate Base Credit: The TAPS Carriers are not required to credit rate base since the front-loaded collection of DR&R means that the fund outstrips the TAPS current rate base and probably eventual funding needed for DR&R. ID at P 163.

Accounting for Funds: The TAPS Carriers are required to account for the DR&R funds collected and the accrued earnings thereon annually by reporting such amounts on FERC Form 6. ID at P 169.

Refunds: Refunds are not ordered at this time because the final amount of DR&R costs is speculative at this time. ID at P 163. Also, the question of whether refunds are necessary is premature. Flint Hills' request that a refund of one-half of the DR&R collected be given to past shippers in the interest of intergenerational equity due to the unsettled nature of the final DR&R cost issue, is rejected.

Capital Structure: It is inappropriate to use the TAPS Carriers' parents' capital structure and its resulting approximately 71 percent equity ratio. Instead, the Master Limited Partnership (MLP) oil pipeline proxies are used resulting in an equity ratio of 45 percent in 2005 and 42 percent in 2006. ID at P 201.

Return On Equity: Anadarko/Tesoro's return on equity (ROE) is adopted. This is not significantly different from what the TAPS Carriers' proposed ROE. ID at P 216.

Risk Premium: No risk premium because the TAPS Carriers did not demonstrate that TAPS is still risky. ID at P 218-220.

Cost of Debt: Anadarko/Tesoro's cost of debt is selected contingent upon the cost of debt calculation performed on a consistent basis with the capital structure determination. ID at P 221-223.

Return on Investment: The Anadarko/Tesoro proposal is used since it is driven by the capital structure selected, and thus the resulting debt/equity ratio. ID at P 224-225.

Designated Carriers'[13] SAC Presentation: The Stand-Alone Cost (SAC) methodology as support for the Designated Carriers' assertion that their rates are just and reasonable, is rejected.

Refunds: Refunds are limited for 2005 and 2006 to the difference between the TSM-based 2004 rates and the TSM-based higher 2005 and 2006 rates. ID at P 243-244.

Uniform Rate: A single uniform interstate rate is required for all TAPS Carriers. ID at P 256.

Opinion No. 154-B Rates – SRB: Anadarko/Tesoro's purported representation of the Opinion No. 154-B methodology is adopted, which yields a rate of $2.04 in 2006. No allowance of SRB. ID at P 263.

State Discrimination Claim: As a result of adopting the Anadarko/Tesoro proposed lower interstate rates, the State's discrimination claim is rendered moot because the interstate rates are being lowered and will be close to the existing intrastate rates. ID at P 263.

TAPS Carriers' ICA Section 13(4) Petition: As a result of adopting the Anadarko/Tesoro 154-B lower interstate rates, the TAPS Carriers' ICA section 13(4) petition is moot because the difference in the intrastate and interstate rates is minimal. ID at P 271.

22. Briefs on Exceptions were filed by TAPS Carriers, Flint Hills, RCA, the State, Anadarko/Tesoro (jointly), FERC Trial Staff (Staff), and Petro Star. Briefs Opposing Exceptions were filed by all of these parties.

III. Commission Determination

23. In the following sections, the Commission describes the issues raised by the parties in their briefs, the parties' positions on those issues, and the Commission's determinations with respect to such issues.

[13] The Designated TAPS Carriers are BP, ExxonMobil, KAPL, and Unocal.

Issues I and II: Which parties bear the burden of proof and should the TSM be used to set the TAPS rates?

I. ALJ's Findings

24. The TAPS Carriers filed their 2005 and 2006 rate filings in accordance with the TSM. The protesters argued that the TSM does not result in just and reasonable rates, and the TSM should not be the governing methodology for TAPS. Rather, they contended, the TAPS rates should be governed by Opinion No. 154-B.

25. The TAPS Carriers asserted that the issue presented in this proceeding was the application of the TSM to the TAPS Carriers' 2005 and 2006 tariffs, namely, did the filings correctly apply the TSM methodology in calculating the filed rates. The TAPS Carriers also asserted that since the TSM has evolved over time, it is now binding on all parties who utilize TAPS, non-settling, as well as, settling parties.

26. The ALJ rejected the TAPS Carriers' position and held that the Commission's orders approving the TSA indicated that the Commission intended the TSM to govern TAPS unless or until a challenge was filed by a non-signatory. Nothing, she concluded, has occurred since to change that result. Thus, "the Commission's statement that 'the Carriers cannot rely on the approved settlements to establish the justness of … filed rate changes' remains intact and has not been reversed by the Commission."[14]

27. The ALJ found no merit in the TAPS Carriers' contention that protesters were equitably estopped from challenging the TSM or the filed rates. The ALJ also rejected the TAPS Carriers' "public interest" argument "since the applicable ratemaking standards perform a balancing act that protect investors' rate of return expectations." The ALJ further rejected Flint Hills' position that the TSA should be allowed to run its course since it would shortly expire on its own.

28. The ALJ then held that to establish "just and reasonable" rates, the guidelines in Opinion No. 154-B should be used. Under those standards, each component of the cost of service must be supported. The TAPS Carriers bear the burden of proving that the TSM and the rates it produces are just and reasonable, which requires the TAPS Carriers to provide cost justification for each element of the TSM. Thus, the ALJ held the TAPS Carriers must submit evidence to support a finding that each element of the TSM is either

[14] ID at P 27; *see Trans Alaska Pipeline Sys.*, 35 FERC ¶ 61,425 at 61,978 n.17.

cost-based or that the deviation from cost-based rates is justified. The ALJ found that the TAPS Carriers did not introduce such evidence, and without such evidence, the TAPS Carriers fail to meet their burden of proving the TSM and the rates it produces are just and reasonable. Accordingly, the ALJ held the rates determined by the TSM cannot be found just and reasonable.

II. Exceptions

29. The TAPS Carriers argue that the ID conflicts with the Commission's policy favoring the negotiated resolution of regulatory disputes. In this case, the TSA was negotiated as an integrated package and the ID has created a hybrid methodology for TAPS that consists of elements of the Opinion No. 154-B methodology and elements that are clearly and unequivocally drawn from the TSM. This attempt, to meld Opinion No. 154-B with selected pieces of the TSM, assert the TAPS Carriers, completely disregards the longstanding principle that settlements that are "negotiated as a package" must be enforced as a package.

30. The TAPS Carriers assert that the ID erred in the following ways: (1) in holding that the TAPS Carriers (a) should bear the burden of proving that the TSM produces just and reasonable rates, and (b) must justify each element of the TSM to satisfy their burden of proof that the 2005 and 2006 filed rates are just and reasonable; (2) in concluding that the TAPS Carriers failed to prove that their 2005 and 2006 filed rates are just and reasonable, and that such rates are not cost-justified; (3) in concluding that the TSM is not binding on all parties; (4) in failing to limit the scope of this case to the issue specified by the Commission order setting this matter for hearing which was "application of the TSM to the [TAPS Carriers'] 2005 [and 2006] tariffs;"[15] and, (5) in holding that the TAPS Carriers could not meet their burden of proving that their filed rates are just and reasonable by comparing the filed rates to rates calculated in accordance with the Commission's Opinion No. 154-B ratemaking standard.

31. The TAPS Carriers assert that the ID erroneously held that the TAPS Carriers "bear the burden of proving that the TSM produces just and reasonable rates,"[16] which "necessarily requires the TAPS Carriers to provide cost justification for each element of the TSM" when they did not bear such a burden. Here, the TAPS Carriers argue, the

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[15] *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376, at P 10 (2004).

[16] ID at P 15.

TAPS Carriers in their 2005 and 2006 rate filings did not propose to modify the TSM or to challenge the TSM methodology. Rather, protesters challenged the TSM methodology and seek a change. In these circumstances, the TAPS Carriers contend, since they are not proposing to change an existing ratemaking methodology, the proponent of the change bears the burden of proving both that "the existing provision is unjust or unreasonable and that the proposed replacement is just and reasonable."[17] Further, they assert, the cases cited in the ID,[18] do not support shifting the burden of proof regarding TSM to the TAPS Carriers. Those cases, they contend, stand for the proposition that an interstate gas pipeline carrier bears the burden of proof with respect to "each component of the pipeline's cost of service" that "is an integral part of the pipeline's proposed overall rate increase."[19] The TAPS Carriers claim that they have provided each of the just and reasonable rates in accordance with Opinion No. 154-B. Accordingly, the TAPS Carriers argue they have met their burden.

32. The TAPS Carriers except to the ID's finding that the TSM is not binding on all parties to TAPS rate proceedings. The TAPS Carriers assert that the ID disregarded the Commission's clear ruling in *Amerada Hess Pipeline Corp.* (*Amerada Hess*) that "[t]he TSM formula is now binding on the TAPS Carriers, all parties to TAPS rate proceedings, as well as the Commission. The TAPS Carriers may not establish rates on any other basis."[20] The TAPS Carriers state that in *Amerada Hess* the issue was the recovery of certain costs challenged by the non-signatories to the TSA, and the order concluded that the TAPS Carriers were not entitled to recover certain costs through the TSM, costs that would otherwise have been recoverable under the standard ratemaking methodology and ordered refunds. Thus, the TSM was applied to all parties, non-settling as well as settling parties to the TSA. Moreover, the TAPS Carriers argue since non-settling parties obtained the lower rates and refunds from *Amerada Hess*, they should not now be

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[17] *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 186-87 (D.C. Cir. 1986) (*Sea Robin*).

[18] *Williston Basin Interstate Pipeline Co.*, 107 FERC ¶ 61,164 (2004) and *Northern Border Pipeline Co.*, 89 FERC ¶ 61,185 (1999).

[19] *Farmers Union Central Exchange Inc. v. FERC*, 734 F.2d 1486, 1501 (D.C. Cir. 1984), *cert. denied, Association of Oil Pipelines v. Farmers Union Central Exchange*, 469 U.S. 1034 (1984) (*Farmers Union II*).

[20] *Amerada Hess*, 79 FERC ¶ 61,300, at 62,358 (1997).

permitted to argue that the TAPS Carriers' filed rates be governed by a methodology other than the TSM, and should be estopped from challenging the lawfulness of the TSM.

33. The TAPS Carriers also contend that the ID disregarded the limited scope of the issues set for hearing in this proceeding, which was limited to whether the filed rates followed the TSM. The TAPS Carriers assert that they presented evidence demonstrating that they properly applied the TSM in calculating their filed rates. However, the ID failed to recognize that the Commission did not set for hearing whether the TSM should continue to be used in setting TAPS ceiling rates.[21]

34. The TAPS Carriers assert that the TSM is a cost-based ratemaking methodology that produces just and reasonable rates over the term of the TSA, as the parties intended when executing the TSA. Moreover, the ID disregarded evidence establishing that the TAPS Carriers' filed rates are *considerably lower* than the cost of service rates computed pursuant to the Commission's Opinion No. 154-B methodology for the same years.

35. The TAPS Carriers argue that the ID erred in concluding that the TAPS Carriers did not meet their burden of "provid[ing] cost justification for each element of the TSM"[22] because the "applicable ratemaking standards" do not require that each element of a ratemaking methodology be cost-justified. In *Farmers Union II*, the court stated that the Commission has a "substantial discretion in its ratemaking determinations" and while the most useful and reliable starting point for rate regulation is an inquiry into costs, "[a]t the same time, non-cost factors may legitimate a departure from a rigid cost-based approach," provided only that "each deviation … must be found not to be unreasonable and to be consistent with the Commission's statutory responsibility" to serve public interest.[23]

36. The TAPS Carriers assert that the ID was clearly misguided in concluding that the TAPS Carriers must still prove each element of the TSM to meet their burden.[24] The ID held that the TSM plays no role in a defense of rates under the Opinion No. 154-B methodology. Instead, the TAPS Carriers argue that their obligation is to show that they

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[21] ID at P 63.

[22] *Id.* P 62.

[23] *Farmers Union II*, 734 F.2d at 1501.

[24] ID at P 64.

used the proper Opinion No. 154-B inputs for each cost of service element, and that when those elements were combined in the Opinion No. 154-B formula, the end result was a rate no higher than the filed rates. The TAPS Carriers assert that is precisely what they did in this proceeding and what they did not do, was use inputs that have meaning only within the context of the TSM.

37. Moreover, the TAPS Carriers contend, considering the significant public interest factor relevant to this proceeding, the Commission could and should exercise its "substantial discretion in its ratemaking determinations" to conclude that the TAPS Carriers' filed rates are lawful, even without resorting to the Opinion No. 154-B and SAC showings.

38. Finally, the TAPS Carriers assert that the public interest requires maintaining the TSM-compliant 2005 and 2006 rates. That public interest is in the furtherance of the energy infrastructure which requires that long-standing settlements be permitted to run their course so as to not impair investors' willingness to invest in such projects based upon settlements approved by the Commission.

39. Flint Hills argues that the ALJ erred in not allowing the TSA and TSM to run their full course. Flint Hills notes that the early termination provision in the TSA has been triggered so there is an "all but guaranteed termination [of the TSA] at the end of 2008." Thus, Flint Hills claims the overriding public interest is to allow the TSM ratemaking to run its full course so that the parties thereto, and the shippers, all realize the full benefits of the desired levelized rates over the full term of the TSA. This, Flint Hills argues, avoids rewarding any non-signatories for clearly opportunistic actions at the very end of TSA's life, after reaping the economic benefits during the two decades before.

40. Flint Hills also asserts the ALJ erred in rejecting the "public interest," i.e., the importance of upholding settlements, as a basis for permitting the TSM to govern. Flint Hills states that the Commission, when it approved the TSA, described it as "a comprehensive cost-based methodology that provides a rational and predictable tariff profile over time which is economically efficient," and the Commission approved it "because it is fair and reasonable and in the public interest."[25]

[25] *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,140.

41. Flint Hills contends that two recent Commission decisions,[26] support allowing the TSA and TSM to continue through the end of 2008. It argues that *Kern River* is analogous to this proceeding since it involved levelized rates, and the purpose of the TSM was to establish levelized rates over the life of the TSA (the assumed life of TAPS when it was executed and approved by the Commission).

42. In *Kern River,* the Commission stated that to achieve the agreed levelized rates, "at the heart of any levelization plan it is inherent in any such plan that the levelized rate will remain in effect for the entire agreed upon period."[27] Thus, Flint Hills argues, the same principle fully applies to the TSM; it must continue to set the resulting levelized rates over the life of the TSA previously approved by the Commission.

43. Flint Hills asserts that the ALJ erroneously ignored Flint Hills' proposal that the TSM continue to apply to all except the one shipper, Tesoro, and one producer which is not a shipper on TAPS, Anadarko, the only non-signatories to the TSA who challenged the continued use of the TSA and the TSM to set interstate rates on TAPS. Under its proposal, Flint Hills states the lower Opinion No. 154-B methodology-based interstate rates would apply to Tesoro's interstate shipment of Anadarko's produced barrels. This alternative would further the public policy interests of favoring settlements while, at the same time, honoring the Commission's prior pronouncement that non-signatories could challenge the TSM, and would give Anadarko and Tesoro the benefit of that successful challenge. Flint Hills states that Commission precedent supports this proposal.[28]

44. In fact, Flint Hills claims *Amerada Hess*[29] involved a non-party to the TSM, and that party received a different result from what the TSA provided. Therefore, Flint Hills

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[26] *Texaco Refining and Marketing, Inc. v. SFPP, L.P.*, 117 FERC ¶ 61,285 (2006) (*Sepulveda*) and *Kern River Gas Transmission Corp.*, 117 FERC ¶ 61,077 (2006) (Opinion No. 486) (*Kern River*).

[27] *Kern River*, 117 FERC ¶ 61,077 at 61,326.

[28] Flint Hills *cites New England Power Co.*, 71 FERC ¶ 61,222 (1995); *Cove Point LNG Ltd. Partnership*, 98 FERC ¶ 61,270 (2002); *Tennessee Gas Pipeline Co.*, 81 FERC ¶ 61,090 (1997), where the Commission authorized both a settlement and litigated rate.

[29] *Amerada Hess*, 51 FERC ¶ 63,004 (1990).

argues the Commission should correct the ALJ's "all or nothing" approach and apply a non-TSM based rate only to protesters or non-signatories to the TSA.

III. Commission Determination

45. We find no merit in the exceptions filed. The TAPS Carriers assert that the ID erroneously placed the burden on the TAPS Carriers for justifying each element of their proposed rate increase. They argue, the burden of proving the unlawfulness of the existing rate, and the reasonableness of a replacement rate, falls upon protesters Anadarko/Tesoro. However, in this case each of the TAPS Carriers' filings for 2005 and 2006 proposed an increase over the existing rates.[30] Thus, the ALJ correctly found that the burden was on the proponent of the increase in rates, the TAPS Carriers.

46. The TAPS Carriers' reliance on *Sea Robin* is misplaced, and the ALJ properly cited *Northern Border*, which addressed a situation similar to the instant one. *Sea Robin* concerned cost allocation matters, i.e., how costs are allocated among the pipeline's customers, whereas this case involves an increase in the pipeline's overall cost of service.[31] Accordingly, consistent with *Northern Border* and *Williston Basin*, the TAPS Carriers have the "burden of supporting each component of the cost of service, the unchanged as well as the changed components." The ID correctly held that the TAPS Carriers must demonstrate the justness and reasonableness of the overall proposed rates, not merely the increases related to the changed components of those rates.

47. Most importantly, the TSA did not grant the TAPS Carriers the right to collect the TSM maximum ceiling rates for any future years. Rather, when the TSM was approved, the Commission and the parties all understood that "the settlement merely sets maximum tariffs. It does not preclude lower future tariffs."[32]

48. We agree with the ID that the TSM cannot be used to determine just and reasonable rates for TAPS. The ID referred to the Commission's 1985 approval of the

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[30] *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 at P 1 ("all of the subject filings propose increases to the existing rates"), and *BP Pipelines (Alaska) Inc.*, 113 FERC ¶ 61,332, at P 1 (2005).

[31] ID at P 228 (*citing Northern Border*, 89 FERC ¶ 61,185).

[32] *Trans Alaska Pipeline System*, 35 FERC ¶ 61,425 at 61,981.

TSA. As set forth in the background, after two carriers, who first opposed the settlement, joined it, there remained one objecting non-carrier, non-shipper, party, Arctic. The Commission approved the TSA, as an uncontested settlement, but did not impose the settlement upon Arctic.

49. In approving the TSA, the Commission did not rule that either the settlement rates or the TSM rate methodology were just and reasonable. Rather, the Commission evaluated the TSA under the standard applicable to uncontested settlements under the Commission's regulations at Rule 602(g).[33] It was in that context, namely an uncontested settlement, that the Commission approved it under the Commission's regulations governing uncontested settlements, finding it to be "fair and reasonable and in the public interest." This was not a determination that the rates were just and reasonable. The Commission was emphatic in assuring the remaining non-settling party before it, Arctic, as well as any other non-settling parties, that they would have the right at any time to seek lower future TAPS rates that are just and reasonable:

> Approval of the settlement does not in any way affect Arctic's rights. If Arctic wishes to litigate just and reasonable rates, Arctic will have the opportunity to do so in the future. This is because under the terms of the settlement, specifically section I-4, the TAPS Carriers will make annual filings of the maximum interstate tariffs. We view these filings as rate filings under the ICA, and Arctic will have the opportunity to protest these filings as it would any rate change filing under the ICA. The burden of showing that the new rate is just and reasonable will be on the TAPS Carriers, pursuant to section 15(7) of the ICA which provides that in any "hearing involving a change in rate . . . the burden of proof shall be upon the carrier to show that the proposed changed rate . . . is just and reasonable . . ." The carriers cannot rely on the approved settlements to establish the justness of these filed

[33] *Id.* at 61,977. Commission Regulation section 385.602(g) has always provided that the Commission may approve an uncontested settlement "upon finding that the settlement appears to be fair and reasonable and in the public interest." *See* 18 C.F.R. § 385.602 (2007).

> rate changes, since the settlement rates were never adjudicated to be just and reasonable.[34]

50. Similarly, the court in affirming the Commission's actions in *Arctic Slope Regional Corporation v. FERC*, emphasized that:

> FERC's approval of the settlement did not in any manner determine that the rates established under it are (or will be) just and reasonable; that the settlement would be of no precedential value in future rate challenges.[35]

51. Thus, the TSM cannot be imposed on non-settling parties unless it meets the just and reasonable standard.

52. The TAPS Carriers argue that the ID will have a "chilling" effect on future investment because the ID refused to enforce the terms of the TSA. The TAPS Carriers are incorrect. First, as discussed above, the ID's establishment of just and reasonable rates is fully consistent with the TSA and the assurances given to shippers when the TSA was approved by the Commission.

53. The TAPS Carriers incorrectly argue that the ID conflicts with the Commission's general oil pipeline ratemaking framework. In fact, all parties agreed that Opinion No. 154-B is the applicable ratemaking standard for this case.[36] In this case, the TAPS Carriers are obligated to support each of the individual rate elements of their filed rates, and cannot simply support the rate level of their filed rates. The TAPS Carriers' failure of proof is particularly egregious here, where the TSM was recognized as a rate method with "specific" rate elements that reflect what was collected through prior rates.[37]

54. It cannot be disputed that the approval of the TSA and the TSM was not a finding on the merits of the justness and reasonableness of the rates established thereunder. To overcome the consequences of the limited nature of the Commission's approval of the

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[34] *Id.*

[35] *Arctic Slope*, 832 F.2d at 163.

[36] ID at P 72, 81.

[37] *See Amerada Hess*, 79 FERC ¶ 61,300 at 62,358.

TSA and that the TSA did not establish just and reasonable rates, the TAPS Carriers contend the TSM has somehow "evolved" into a just and reasonable rate-setting mechanism, that is now binding upon all parties, so the issue is whether the 2005 and 2006 filed rates comply with the TSM.

55. We reject the contention for a number of reasons. First, there is no merit to the TAPS Carriers' claim that the language of the suspension orders limited the issues to mechanical compliance with the TSM. The protests and complaints regarding the TAPS Carriers' 2005 and 2006 filings included the issues of the justness and reasonableness of the TSM rates, and how to develop just and reasonable rates. The suspension orders in this proceeding recognized those issues and established hearing procedures specifically "to examine the issues raised in the complaints."[38]

56. To support the claim that TSM is now binding on all, not merely the signatories to the TSA, the TAPS Carriers rely primarily on *Amerada Hess*. However, *Amerada Hess* simply states that rates on TAPS are set in accordance with the TSM, which has been true until the instant proceeding. That case does not even mention the words "just and reasonable." The TAPS Carriers seize upon the following language in that case "the TSM formula is now binding on the TAPS Carriers, all parties to the TAPS rate proceedings, as well as the Commission. The TAPS Carriers may not establish rates on any other basis."[39] The TAPS Carriers ignore that the issue addressed involved recording and recovery of oil spill costs. The Commission denied the recovery of the costs, and explained generally how the TSM worked, noting that the language of the TSM did not allow oil spill costs to be recovered in any year, and required full refunds.

57. We agree, as the ALJ stated,[40] that *Amerada Hess* clearly did nothing more than note that the accounting dispute and the issues relating to refunds that were the subject of the order, had to be determined in compliance with the TSM, i.e., no other account interpretations could be used. This statement hardly can be considered the Commission

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[38] *BP Pipelines (Alaska) Inc.*, 110 FERC ¶ 61,129, at P 3 (2005); *BP Pipelines (Alaska) Inc.*, 114 FERC ¶ 61,174, at P 16 (2006), and to "examine the issues raised in the protests." *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 at P 10; *BP Pipelines (Alaska) Inc.*, 113 FERC ¶ 61,332 at P 20-21.

[39] *Amerada Hess*, 79 FERC ¶ 61,300 at 62,357-58.

[40] ID at P 26.

ruling that rates under the TSM were just and reasonable rates, and are binding on all parties.

58. There is no merit to the TAPS Carriers' claim that the TSM is a cost-based methodology. They refer to their proxy Opinion No. 154-B and SAC presentations as support for the specific rates at issue. Clearly a number of elements within the TSM are unrelated to costs of providing service, or are otherwise inappropriate for cost-based ratemaking.[41]

59. Since the TAPS Carriers have not justified any of the elements that determine the TSM rate, the ID properly held that failure was a ground to reject the TSM as an appropriate method for setting the TAPS rates.[42]

60. Finally, the TAPS Carriers urge that for "public interest" reasons, the TSM should be permitted to set the TAPS rate. The public interest the TAPS Carriers refer to is that the sanctity of settlements should be preserved so that the expectations of settling parties including infrastructure investors of future rates are maintained. The ALJ held that the "so-called public interest does not negate the requirement that the rate be just and reasonable." That standard strikes the necessary balance since it considers both the pipeline's interests and the shipper interests and allows investors to receive a reasonable return on their investment. In approving the TSA, the Commission provided, as explained *supra*, that shippers could, in the future, seek to establish just and reasonable rates on TAPS. Moreover, establishing just and reasonable rates for non-signatory shippers in this proceeding is exactly what the parties, and the Commission, contemplated when the Commission accepted the TSA. It hardly undermines reliance on settlement

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[41] Staff noted the following elements as inconsistent with cost-based ratemaking: (1) inflation-adjusted, non-cost-based APB; (2) 100 percent equity capital structure assumption; (3) subjective projections of costs and throughput; (4) depreciable useful life of the line that is known to be too short; (5) true-up mechanism that guarantees cost recovery; (6) cost allocation/rate design mechanism that allows costs properly allocated to intrastate rates, but disallowed by the RCA, to be reallocated to the interstate rates; and (7) DR&R collections that are premised on assumptions that have changed or proven to be false.

[42] ID at P 62-64 (*citing Southern Company Services*, 80 FERC ¶ 61,318, at 62,089 n.64 (1997)).

agreements when the result here is exactly what the Commission stated could occur in the future.

61. The TAPS Carriers' generalized public policy arguments do not even approach the requirements set forth in *Farmers Union II*, when non-cost consideration might be appropriate. Accepting the TAPS Carriers' position would render the just and reasonable standard meaningless, which we decline to do.

62. Flint Hills' exceptions raise the same public interest grounds for continuing the TSM even if the rates established thereunder are not just and reasonable. For the same reasons discussed above, we find no merit in Flint Hills' exceptions.[43] Flint Hills' reliance on *Kern River* as a ground for continuation of the TSM, is misplaced. In that case the Commission agreed with the ALJ that continuation of levelized rates "can produce just and reasonable rates,"[44] so there was no reason to require replacing the levelized rate with traditional depreciation methodology. Here, on the other hand, continuation of the TSM would not result in just and reasonable rates. Thus, the ID properly held the TSM could no longer set the TAPS rates.

63. Since we have concluded that the ID properly rejected the TSM or the governing methodology, it follows, as all parties agreed, that Opinion No. 154-B and the Commission's cost of service regulations must apply for determining the lawfulness of the TAPS Carriers' 2005 and 2006 rates. The parties disagree as to which amounts are the proper inputs under the Opinion No. 154-B guidelines.

64. The ID concluded that the appropriate balances to be used are those in the TAPS Carriers' annual filings, and must reflect "the actual amounts collected by the TAPS Carriers even if that means using amounts other than those found in Form 6."[45] The arguments with respect to the proper Opinion No. 154-B inputs are addressed in the individual sections which we now consider.

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[43] Flint Hills' exception that the TSM should continue to apply to all except the protesters, is addressed in Issue III.K.

[44] *Kern River*, 117 FERC ¶ 61,077 at P 29.

[45] ID at P 85.

Issue III.B.1: What are the appropriate property balances for original investment, additions, retirements, and accumulated depreciation?

I. ALJ's Findings

65. The ALJ found that the appropriate property balances for original investment, additions, and retirements are contained in the TAPS Carriers' annual rate filings.[46] The ALJ also found that the $450 million of original investment has been properly excluded from the TAPS Carriers' rate base, since the TAPS Carriers fully recovered this amount via amortization from 1978 through 1984 under the TSM. The ALJ also concluded that the amount of accumulated depreciation contained in the TAPS Carriers' annual rate filings will be used in the Opinion No. 154-B methodology.[47]

II. Exceptions

66. The TAPS Carriers argue that the ID erred[48] in applying the TSA "depreciation" in the Opinion No. 154-B calculation rather than relying on the depreciation rates prescribed by the Commission in 1982 (1982 Stipulation).[49] The TAPS Carriers state that section III-12 of the TSA plainly indicates that the 1982 Stipulation was expected to remain in place for all purposes other than the settling parties' dealings with one another under the

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[46] The ALJ stated that the amounts for 2005 are as follows (in millions): Carrier Plant in Service - $10,294.12, Additions - $14.855, Net Retirements - $0.796, Non-Depreciable Plant - $68.161, Ineligible Plant - $97.24. Anadarko/Tesoro's Initial Br. at 44; Ex. A/T-144, WP-2 at 5, ln. 1, 2, 3, 11, and 17 ("Col. 2004"). The amounts for 2006 are as follows (in millions): Carrier Plant in Service - $10,308.96, Additions - $19.991, Net Retirements - $0.000, Non-Depreciable Plant - $68.161, Ineligible Plant – $120.14. *See* Anadarko/Tesoro's Initial Br. at 44; Ex. A/T-146, WP-2 at 4, ln. 1-3, 11 and 17 ("Col. 2005").

[47] The accumulated depreciation reserve (in millions) is as follows: (1) for 2005 - $8,631.59 as shown in Ex. A/T-144, Stmt. E, ln. 6 and (2) for 2006 - $8,689.82, as shown in Ex. A/T-146, Stmt. E, ln. 6.

[48] ID at P 101.

[49] *Trans Alaska Pipeline System*, 20 FERC ¶ 61,352 (1982).

TSA.[50] The TAPS Carriers also state that the same intent is evident in section III-5 of the TSA, which clearly indicates that the prescribed depreciation rates approved in 1982 remained in effect for all other purposes not related to the TSA – such as assessing the lawfulness of TSM-compliant rates for non-settling parties.[51] The TAPS Carriers argue that the ID's reading of these provisions conflicts both with the literal language of the TSA and its overall purpose. The TAPS Carriers state that the depreciation factors' sole purpose in the TSA was to define the depreciation element of the formula agreed upon between the TAPS Carriers and the State and was not intended to set rates or be relied upon by third parties. Thus, the TAPS Carriers argue that there was no inconsistency between the TSA and the 1982 Stipulation since the TSM factors applied solely to the settling parties for purposes of their contractual agreement, and for all other purposes, the 1982 Stipulation remained in effect as if the TSA did not exist.

67. The TAPS Carriers state that there are several additional factors that rebut the ID's conclusion (1) the TAPS Carriers continued to record straight-line depreciation using a 2011 end date in their Form 6 annual reports, even after approval of the TSA;[52] (2) the 1982 Stipulation expressly provided that the depreciation amounts recorded from 1977-81 were not subject to adjustment or refund after the Stipulation was approved; and[53] (3) the Commission's orders approving the TSA were entirely consistent with the 1982 Stipulation remaining applicable to challenges by non-settling parties.[54] In addition, the TAPS Carriers argue that the ID did not justify the weight given to the fact that the 1982 Stipulation was not used to set rates prior to this case,[55] since no litigated rates were set for TAPS using any depreciation methodology. The TAPS Carriers claim that absent an explicit decision modifying or rescinding the 1982 Stipulation, it remains in effect.[56]

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[50] Ex. ATC-14 at 32.

[51] *Id.* at 30.

[52] Ex. ATC-172 at 23-25.

[53] Ex. ATC-42 at 1-2; *see also* Ex. ATC-14 at 12.

[54] Ex. ATC-42 at 6.

[55] ID at P 92.

[56] *See e.g., Texas Gas Transmission Corp. v. FPC*, 441 F.2d 1392, 1394 (6th Cir. 1971); *see also Tennessee Gas Pipeline Co.*, 40 FERC ¶ 61,140 (1987).

68. The TAPS Carriers also state that the ID incorrectly downplayed the significance of Order No. 456, which issued contemporaneously with the approval of the TSA.[57] The TAPS Carriers contend that in Order No. 456, the Commission strongly reaffirmed that book depreciation using the depreciation rates prescribed by the Commission would be the basis for depreciation expense in the Opinion No. 154-B methodology.[58] Accordingly, the TAPS Carriers argue that the relevant depreciation for the TAPS Carriers was the straight-line depreciation recorded in Form-6 from mid-1977 forward in accordance with the 1982 Stipulation. In addition, the TAPS Carriers emphasize that this result is in no way unfair to non-settling parties, since there is no possibility of double recovery and excluding TSM elements in litigation with third parties is fully consistent with the balance struck by the Commission in approving the TSA.[59]

69. The ALJ relied upon *Sepulveda* and other cases in concluding the appropriate balances to be used are those in the annual filings to prevent double recovery.[60] The TAPS Carriers argue that those cases relied on by the ID are inapplicable. The TAPS Carriers assert that the distinctions between *Sepulveda* and this case are stark. Specifically, the TAPS Carriers state that first, the contracts in *Sepulveda* were directly between SFPP and the complaining shippers, unlike the TSA, which was an uncontested settlement not involving the shippers. Second, the TAPS Carriers argue that there were no provisions in the SFPP contracts limiting the ability of the shipper parties to rely on those contracts, in sharp contrast with the TSA provisions disavowing any third-party beneficiary rights. Third, they argue that the contracts in *Sepulveda* were fully performed on both sides, i.e. both parties received the full benefit of their bargain, in contrast to this case where the non-settling parties are attempting to rely on amounts derived from the TSA without giving the TAPS Carriers the full benefit of the settlement they signed. Finally, in *Sepulveda*, SFPP never filed its rates in tariff form,[61] and therefore those rates were never subject to challenge under the Commission's Opinion No. 154-B

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[57] ID at P 101 n.77.

[58] Order No. 456, FERC Stats. & Regs. ¶ 30,712 (1986).

[59] *See* Tr. 5278, Tr. 5227 (Mr. Sullivan).

[60] *Sepulveda*, 117 FERC ¶ 61,285.

[61] *Id.* P 4, 11, 18.

methodology,[62] whereas here, the TAPS Carriers' annual tariff filings with the Commission since 1986 could be challenged by any non-settling party.

70. In addition, the TAPS Carriers argue that the ID's reliance on *Entergy Services, Inc.* (*Entergy*) and *Kern River*, actually supports the TAPS Carriers' position in this case.[63] Specifically, the TAPS Carriers assert that *Entergy* supports the view that the straight-line depreciation recorded on the TAPS Carriers' books for the past 30 years should be used to determine their current rate base.[64] They also contend that *Kern River* supports the fact that there is no basis for permitting non-settlings parties to rely selectively on the terms of a settlement, thereby denying the pipeline the benefit of a consistently applied methodology.[65]

71. The TAPS Carries state that the ID's reliance on a number of record references to support its conclusion that the TSM depreciation be used in setting just and reasonable rates for TAPS, does not justify overriding the clear legal principles, discussed above, that show the proper depreciation as straight-line depreciation. The TAPS Carriers argue that the correct depreciation for an Opinion No. 154-B cost of service model is a question of law for the Commission to resolve, not an issue on which the credibility of witnesses, or the weight of evidence, is determinative.[66] Moreover, the TAPS Carriers assert that the ID's findings on witness credibility are unsubstantiated and inaccurate.[67]

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[62] *Id.* P 11.

[63] *Entergy Services, Inc.*, 109 FERC ¶ 61,095 (2004); *Kern River*, 117 FERC ¶ 61,077.

[64] *Entergy*, 102 FERC ¶ 63,016, at P 98, 100 (2003).

[65] *Kern River*, 117 FERC ¶ 61,077 at P 37-44.

[66] The TAPS Carriers argue that the summary disposition before the hearing indicates that all parties agree this is an issue of law and not a disputed issue of fact. *See* TAPS Carriers' Brief on Exceptions at n.73.

[67] *E.g.*, ID at P 84 n.56, 154, 96 n.61.

72. Specifically, the TAPS Carriers state that the ID's[68] reliance on the TAPS Carriers' representations to the Commission at the time of the TSA is in error, since those documents: (1) were not drafted or submitted by the TAPS Carriers;[69] (2) did not represent that the TSM depreciation was intended to have any meaning outside the context of the settlement; and (3) simply described the function of the TSM depreciation schedule within the TSM model.[70] The TAPS Carriers also state that the ID's reliance on the reply comments of six of the TAPS Carriers in support of the TSA[71] and witness statements[72] is in error. The TAPS Carriers argue that the settling Carriers never suggested that the 1982 Depreciation Stipulation would not continue to apply to non-settling parties just as it did before the settlement with the State.[73] In addition, the TAPS Carriers argue that the ID is not aided by the fact that TSM Computer Model (TSM-6) included some actual data for past periods[74] because the settling parties were able to manipulate the rate elements within the TSM to serve their own ends, but did not contemplate that the individual elements such as depreciation, taken in isolation, would produce the same results in a different methodology.[75] The TAPS Carriers also argue that the ID's insistence on attributing conventional regulatory meanings to the TSM labels is both inexplicable and unjustified.[76] Furthermore, the TAPS Carriers state that

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[68] ID at P 99.

[69] The TAPS Carriers argue that those documents are: Ex. ATC-15 (submitted by the State and the Department of Justice (DOJ)), Ex. ATC-30 (consultant for the State), and the Commission's own approval order.

[70] Ex. ATC-15 at 34-35; Ex. ATC-30 at 9; *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,139.

[71] ID at P 99.

[72] *Id.* P 98 n.66, 100 n.69.

[73] Ex. A/T-75 at 11-12, 37, 44, 67 n.36.

[74] ID at P 100.

[75] Ex. ATC-12 at 30; Ex. ATC-30 at 14; Ex. ATC-135 at 39.

[76] The TAPS Carriers argue that this same confusion is evident in the ID's reliance on Sheet N of the TSM model. ID at P 100 n.70.

the ID's reliance on certain internal reports and communication documents from the TAPS Carriers' files in prior litigation is irrelevant[77] since none of the documents address the relevant depreciation schedule for setting a litigated rate in response to a protest at the Commission.[78] The TAPS Carriers also argue that BP's memorandum from 1989, responding to a State study estimating the TAPS Carriers' profitability, is irrelevant.[79] Therefore, the TAPS Carriers argue that neither the documents cited by the ID, nor any relevant legal authorities support the ID's reliance on the TSM depreciation.

73. The TAPS Carriers further argue that the ID improperly excluded $450 million from the property balances used to determine the TAPS Carriers' 2005-06 rate base, on the claim that the $450 million was already fully recovered.[80] The TAPS Carriers state that one of the assumptions used to calculate rate ceilings under the TSM is that $450 million of original rate base was amortized over the period from 1978 through 1984, the years prior to the TSM. The TAPS Carriers state that since it was a hypothetical assumption, no amortization occurred and thus, there is no basis for excluding the $450 million on the ground that it was already fully recovered.

74. The TAPS Carriers assert that the ID's assumption that the hypothetical amortization of the $450 million within the TSM model reduced the TAPS Carriers' refund liability for the period 1977-84, is specious.[81] The TAPS Carriers contend that the TSA explicitly stated no refunds of any kind for 1977-81.[82] Given that fact and the fact that the TAPS Carriers were not permitted to collect any additional revenue for that period, the TAPS Carriers argue that the notion that their rates for 1978-81 included an amortization of any part of $450 million is factually impossible.

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[77] ID at P 101 n.72.

[78] *Id. (citing* Ex. A/T-192 at 2 and Ex. A/T-186).

[79] *Id.* P 101 (*citing* Ex. A/T-188 at 1; Ex. A/T-188 at 8).

[80] ID at P 97.

[81] *Id.* n.62.

[82] Ex. ATC-14 at 12.

75. In addition, the TAPS Carriers argue that for 1982-85, the TSA contained an exhibit with specific stipulated rates for those years that formed the basis for the agreed-upon refunds.[83] The TAPS Carriers stress that nothing in the TSA or the Commission orders approving it, suggested that the Commission adopted any amortization or exclusion of the $450 million for that period. Indeed, continue the TAPS Carriers, the Commission expressly stated that if a non-settling party wanted to exclude amounts from rate base, it could attempt to do so using the record complied in Docket No. OR78-1.[84] Therefore, the TAPS Carriers argue that since no opposing party made the requisite imprudence showing with respect to the $450 million in this case, there is no basis for excluding any of the TAPS Carriers' gross carrier property balance.[85]

III. Commission Determination

76. The Commission affirms the ALJ's finding that the appropriate balances for accumulated depreciation in the Opinion No. 154-B methodology are contained in the TAPS Carriers' annual rate filings.[86] The Commission also affirms the ALJ's finding that the $450 million of original investment has been properly excluded from the TAPS Carriers' rate base.[87] To hold otherwise would allow the TAPS Carriers to receive benefits related to accumulated depreciation more than one time.

77. The Commission finds that the TAPS Carriers' arguments for use of the 1982 Stipulation are without merit. The Commission notes that the ALJ properly recognized[88] that the 1982 Stipulation was specifically replaced by the TSA because the 1982 Stipulation was inconsistent with the TSA since it used straight-line depreciation and the

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[83] *Id.* at 53.

[84] *Trans Alaska Pipeline System*, 35 FERC ¶ 61,425 at 61,890.

[85] The TAPS Carriers argue that the ID's reliance on *Sepulveda*, at P 97 of the ID, is inapposite. *See* TAPS Carriers' Brief on Exceptions at section V.C.1.c.(4).

[86] ID at P 101.

[87] *Id.* P 97.

[88] *Id.* P 98, 101.

TSA used accelerated depreciation, as evident by the language in the 1982 Stipulation,[89] the orders accepting the TSA[90] and the comments concerning the TSA submitted by the TAPS Carriers in 1985.[91]

78. The Commission states that the orders accepting the TSA and the accelerated depreciation schedule plainly afforded non-signatories to the TSA the right to a just and reasonable rate. Contrary to the TAPS Carriers' claim that section III-12 of the TSA confirms the 1982 Stipulation's ongoing status for non-parties to the settlement, section III-12[92] simply acknowledges that, to the extent the settlement adopted 2011 as the final year for depreciation, it was consistent with the earlier 1982 Stipulation.[93] In addition, sections III-12 and III-5 of the TSA provide further evidence that the TSA took precedence over the 1982 Stipulation because they render any provision inconsistent with the TSA as no longer operable.[94] The TAPS Carriers' argument that section III-5 does not override the 1982 Stipulation, contradicts not only the assurances in the TAPS

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[89] Ex. ATC-42 at P 5, 6, 8.

[90] *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,139; *Trans Alaska Pipeline System*, 35 FERC ¶ 61,425 at 61,977.

[91] Ex. A/T-75 at 44; Ex. A/T-79 at 16-17.

[92] Section III-12 of the TSA specifically provides that "[u]nless otherwise provided, this Agreement shall continue in full force and effect through 31 December 2011. State and TAPS Carriers agree that the use of the year 2011 as the final year for depreciation of TAPS is consistent with the intent of the Stipulation dated 11 February 1982 and approved by FERC. Nothing contained in that Stipulation or any other stipulation shall cause this Agreement to be null and void in whole or part."

[93] The TAPS Carriers' implication that the refund forgiveness in the TSA was based on straight-line depreciation from the 1982 Stipulation is incorrect since the TSA reached its no-refund result by using accelerated factors for the recovery of depreciation, deferred return and DR&R.

[94] Ex. A/T-190. Section III-5 of the TSA specifically provides that "[a]ny stipulation or agreement previously entered into in the TAPS Proceeding by the parties to this Agreement shall continue to be, to the extent not inconsistent with the Agreement, in full force and effect between the parties to this Agreement."

Carriers' reply comments,[95] i.e., that each of them was consenting to change the 1982 Stipulation depreciation schedule and that the Settlement proceeding was the appropriate proceeding in which to do it[96] but the fact that the shippers on TAPS have paid approved final rates beginning in 1977 on the basis of the accelerated TSM depreciation factors. Finally, the result sought by the TAPS Carriers implies that the Commission knowingly and purposely accepted an accelerated depreciation methodology for determining past and current revenue collections from shippers under TSM, but at the same time fully intended to construct future just and reasonable rates for those same shippers by applying a straight-line assumption that ignored actual investment recovered. That argument is an untenable proposition because it would allow the TAPS Carriers to obtain the depreciation benefit not just one time but two times.

79. The Commission also finds no merit to the TAPS Carriers' Form 6 arguments. The Commission affirms the ALJ's finding[97] that the TSM filings and the accelerated depreciation pattern reflected in the TSM formula, were used to establish the TAPS Carriers' refund obligations before 1985 and set the TAPS Carriers' rates for the last twenty years, not the Form 6's or the balances reflected therein.[98] The TAPS Carriers' Form 6 property balances reflect nothing more than the straight-line accounting convention required in the Commission's regulations for general reporting purposes,[99] not ratemaking purposes.[100] In addition, the ALJ properly noted that there is a question

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[95] Ex. A/T-75.

[96] *See* TAPS Carriers' Brief on Exceptions at 54 n.63, where the TAPS Carriers argue that "if the TSA had been intended to supersede the Depreciation Stipulation, the settling parties could easily have said so." That is exactly what the TAPS Carriers did in their reply comments which argued for approval of the TSA.

[97] ID at P 84, 85, 96, 101.

[98] Tr. 1541-42 (Washington). Form 6 is an annual report of oil pipeline companies and is designed to collect financial and operational information from oil pipeline companies subject to the jurisdiction of the Commission. 18 C.F.R. § 357.2 (2007).

[99] Order No. 571, FERC Stats. & Regs. ¶ 31,006 at 31,169, *affirmed Association of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

[100] *Id.* at 31,167; Tr. 5249-50, Tr. 5632-33 (Mr. Sullivan); *see* ID at P 84, n.55, P 101, n.75.

about the quality of the TAPS Carrier's Form 6 data.[101] Furthermore, the ALJ properly rejected the TAPS Carriers' arguments pertaining to FERC Form 73 and statement that book depreciation rates, such as those in Form 6, are used for cost of service purposes,[102] since the FERC Form 73 Order was not a rulemaking about ratemaking and FERC Form 73 was later revised to apply to only some oil pipeline companies.[103]

80. The Commission further finds that the TAPS Carriers' attempt to distinguish *Sepulveda* from the instant case through minor points unrelated to the ultimate outcome, were properly rejected by the ALJ.[104] The Commission finds that the TAPS Carriers' contention that the contracts in *Sepulveda* differed from the TSA because *Sepulveda* contracts were between the pipeline and the shippers, whereas the TSA did not involve the shippers, is immaterial, since what matters is the fact that money was already collected, and not how the money was collected.

81. The TAPS Carriers also contend that SFPP contracts did not have provisions disavowing third-party beneficiary rights, as the TSA does. The Commission finds that there is no indication in *Sepulveda*, nor any evidence in this proceeding, regarding whether such provisions were or were not in the SFPP contracts. Moreover, as the ALJ properly recognized the parties to a settlement cannot disavow or otherwise restrict a third-party's legal rights when determining a just and reasonable rate.[105] The TAPS Carriers' argument that the TSA expressly disavows any third-party beneficiary rights is a clear attempt to use the agreement of the settling parties to restrict the rights of a non-settling party, which is improper.

82. In addition, the TAPS Carriers' suggestion that it is improper to recognize the accelerated recovery of any of the investment until all of the investment is collected

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[101] ID at P 101, n.71.

[102] *Id.* P 101.

[103] Tr. 5569-78 (Mr. Sullivan); Order No. 656, FERC Stats. & Regs. ¶ 31,183 at 31,562.

[104] ID at P 83.

[105] *Id.*

under the TSA, as was the case with the contracts in *Sepulveda*, is without merit.[106] The Commission finds that the ALJ properly noted that the significance of *Sepulveda* is in the Commission's refusal to allow any over-recovery of investment, and nothing there suggests that it was at all contingent upon the percentage of investment actually collected thus far.[107] Finally, the Commission finds that the TAPS Carriers' allegation that there is significance in the fact that the *Sepulveda* rates were not filed or subject to challenge but the TAPS rates were filed and went unchallenged for some years, is without merit. The Commission emphasizes that the orders approving the TSA guaranteed shippers the right to seek and obtain a just and reasonable rate and anticipated that a non-signatory could challenge the TSM rates at any time.[108] Therefore, in keeping with the holdings in *Sepulveda*, these recoveries of investment must be recognized for ratemaking purposes.

83. Moreover, the Commission finds no merit to the TAPS Carriers' arguments concerning *Kern River* and *Entergy*. In *Kern River*, the Commission specifically noted that Kern River was required to create a regulatory asset that recognized the difference between book (straight-line) depreciation in its accounting books and what it collects in rates pursuant to the levelized rates.[109] The Commission confirmed that the regulatory asset must be recognized as an adjustment to the rate base for ratemaking purposes, "thereby preventing Kern River from over-collection."[110] In *Entergy*, a case involving a switch from a non-levelized to a levelized approach to depreciation, the result was the same.[111] In other words, *Entergy* recognizes that allowing costs to be recovered twice is

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[106] Flint Hills also makes a similar argument. *See* Flint Hills' Brief on Exceptions at 27-28.

[107] ID at n.52.

[108] *Trans Alaska Pipeline System*, 35 FERC ¶ 61,425 at 61,977, n.17; ICA sections 1(5), 13(1), and 15(1).

[109] Flint Hills emphasizes that regulatory asset accounting is not required for oil pipelines, and that it only began to be implemented on the gas side after the TSA was signed. *See* Flint Hills' Brief on Exceptions at 28-30. However, the Commission notes that the point in *Kern River* is not the form by which the depreciation actually recovered was recognized, but the fact that it was recognized.

[110] *Kern River*, 117 FERC ¶ 61,077 at P 47-48.

[111] *Entergy*, 102 FERC ¶ 63,016 at P 98; 105 FERC ¶ 61,319, at P 4-5 (2003).

not just and reasonable[112] and *Kern River* recognizes that the Commission's objective is to ensure that entities do not double recover their investment.[113] Therefore, the Commission finds that the ALJ properly relied on these cases to determine that the TAPS Carriers must recognize the previous recoveries of their investment, otherwise there will be an unjust and unreasonable double recovery.[114]

84. Therefore, the Commission finds that the TAPS Carriers' arguments against the cases relied on by the ID are without merit. Accordingly, the Commission affirms the ALJ's reliance on these cases as support for the finding that the TAPS Carriers cannot recover costs already collected.

85. Furthermore, the Commission finds that the ALJ properly found the TAPS Carriers' witnesses not credible since they espoused positions that were inconsistent with the TAPS Carriers' annual rate filing, the facts of the case and Commission policy and precedent.[115] The Commission also finds that the TAPS Carriers' argument that the ALJ inappropriately relied on various pieces of evidence such as the settlement order, reply comments of six of the TAPS Carriers, the TAPS Carriers' representations at the time of the TSA, etc., is meritless.[116] The Commission states that the ALJ discussed the record evidence demonstrating that the TAPS Carriers in fact recovered accelerated depreciation under the TSA. Therefore, there is no doubt that the TAPS rates were front-loaded to specifically include accelerated depreciation.

86. The Commission also finds that the ALJ properly recognized the $450 million of rate base previously amortized and recovered,[117] as well as all the other costs recovered in

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[112] *See Entergy*, 102 FERC ¶ 63,016 at P 98-100; 105 FERC ¶ 61,319 at P 4.

[113] *Kern River*, 117 FERC ¶ 61,077 at P 48.

[114] ID at P 82-85.

[115] *Id.* P 84, 96, 154.

[116] *Id.* P 99.

[117] Tr. 2998-3002 (Mr. Van Hoecke); Ex. A/T-35 at 33 n.17; *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,141; 35 FERC ¶ 61,425 at 61,982.

rates before and after 1985.[118] The ALJ then correctly concluded that the $450 million must be recognized in future rates. Although the TSA does not specifically say so, there is record evidence that this exclusion and subsequent amortization of $450 million represents the resolution of the imprudence claims made against the TAPS Carriers.[119] The ALJ also properly recognized that the same rationale against double recovery of investment applies here just as it does to any other part of the investment that was already recovered in rates.[120] The Commission finds that the TAPS Carriers' arguments seeking to ignore the $450 million recovered investment are inconsistent, irrelevant and misleading.[121] Therefore, the Commission finds that the TAPS Carriers already received the benefits of the amortization in the form of forgiven and reduced refunds and cost-based, just and reasonable ratemaking requires that these benefits be recognized in future rates.

Issue III.B.2: Are the TAPS Carriers entitled to an adjustment to rate base for deferred returns, and if so, what is the appropriate amount?

I. ALJ's Findings

87. The ALJ found it irrelevant whether the TSM calculation of deferred returns was inconsistent with the Opinion No. 154-B calculations and the Commission's pronouncement implementing Opinion No. 154-B in *Lakehead Pipeline Company*.[122] The ALJ agreed with Staff and Anadarko/Tesoro, that the deferred return amounts were

[118] ID at P 97; The Commission states that the refund forgiveness from 1977-1981, the reduced refund liability for 1982-1985 and the TSM rate calculations beginning in 1986, were all premised on the collection of specific amounts of depreciation, deferred returns and $450 million of amortized plant.

[119] Ex. A/T-35 at 10, 32-33 n.17; Ex. ATC-15 at 32-33.

[120] *Id.*

[121] The Commission notes that all the reasons regarding prohibition against a double-recovery of expense, require the TAPS Carriers' arguments be rejected. *See Sepulveda*, 117 FERC ¶ 61,285.

[122] *Lakehead Pipeline Company*, 71 FERC ¶ 61,338 (1995) (Opinion No. 397); *reh'g denied*, 75 FERC ¶ 61,181, at 61,591 (1996) (Opinion No. 397-A) (*Lakehead*).

already collected via the TSM through the TAPS Carriers' use of a 100 percent equity structure and APB. The ALJ also found that the ruling in *Sepulveda* applied in the instant case, where when setting a cost-based rate for the future there is no need to allow an additional adjustment for inflation already recognized and collected in rates.[123] The ALJ further rejected the TAPS Carriers' attempt to use the Form 6 deferred return amounts and found that the TAPS Carriers' TSM filings contain the appropriate amounts for deferred return. Therefore, the ALJ concluded that the appropriate adjustment and amounts for deferred returns are reflected in Anadarko/Tesoro's Opinion No. 154-B cost of service presentation. The amount of deferred return in 2005 and 2006 is $198.31 million[124] and $175.283 million, respectively.[125]

II. Exceptions

88. Flint Hills and the TAPS Carriers argue that the ALJ erred by not including the appropriate amount of deferred return in the ordered ratemaking methodology. Flint Hills states that if the TSM is not continued and a proper Opinion No. 154-B ratemaking methodology not substituted, an additional deferred return of $0.10 per barrel needs to be included. Flint Hills and the TAPS Carriers also argue that the ALJ also erred by stating that the "deferred return amounts have already been collected via the TSM through the Carrier's use of a 100% equity structure and APB."[126] The TAPS Carriers further argue that the ALJ erred by holding that Opinion No. 154-B rates should be calculated using the amounts labeled "deferred return" in the TSM, even though those amounts are inconsistent with Opinion No. 154-B.[127]

89. Specifically, Flint Hills and the TAPS Carriers argue that the ALJ's reference to 100 percent equity and the APB clearly involves rate of return and the use of past earned returns to reduce rate base is retroactive ratemaking. Flint Hills contends that eliminating

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[123] *Sepulveda*, 117 FERC ¶ 61,285 at P 12-16.

[124] Ex. A/T-144, WP2 at 5:18 (Col. "2004").

[125] Ex. A/T 146, WP2 at 4:18 (Col. "2005").

[126] ID at P 107.

[127] *Id.* P 106.

deferred return is retroactive ratemaking.[128] Flint Hills argues that the ALJ improperly relies on Dr. Olson's testimony that "there is no accepted theory of ratemaking that justifies a lower current revenue requirement based on the level of past returns,"[129] to limit the amount of deferred return in her Opinion No. 154-B methodology.[130]

90. Flint Hills and the TAPS Carriers also argue that the ALJ incorrectly cites Staff's reliance on *Sepulveda*[131] to reject the TAPS Carriers' contention that *Lakehead*[132] requires the calculation of deferred return with the pipelines' rate base beginning December 31, 1983, stating that "the Carriers cannot backcast and recreate rates."[133] Flint Hills and the TAPS Carriers point out that the Commission, in *Lakehead*, noted that the starting point was when the new methodology became effective for oil pipelines and further assert that new rates did not have to be filed to activate the methodology. In addition, Flint Hills and the TAPS Carriers submit that FERC noted that the Trended Original Cost (TOC) methodology was adopted for all pipelines[134] and thus, there must be a deferred return component of rate base that begins December 31, 1983. Therefore, Flint Hills argues that since the Anadarko/Tesoro case does not have a deferred return component of rate base that begins December 31, 1983, it must fail.

91. The TAPS Carriers also argue that the primary difference between deferred return in the TSM and deferred return calculated under Opinion No. 154-B is the amortization schedule. They also argue that in contrast to Opinion No. 154-B, the TSM depreciation and recovery of deferred return are subtracted from the rate base *before* applying the inflation factor, the TSM depreciation factors are front-loaded and the TSM carrier

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[128] Ex. FHR-1 at 8.

[129] *Id.* ln. 8-10.

[130] ID at P 107.

[131] *Sepulveda*, 117 FERC ¶ 61,285 at P 12-16.

[132] *Lakehead,* 75 FERC ¶ 61,181 at 61,591.

[133] ID at P 108.

[134] *Lakehead*, 75 FERC ¶ 61,181 at 61,591.

property base excluded $450 million of original cost for settlement purposes only.[135] Therefore, the TAPS Carriers argue that TSM deferred return is simply not consistent with or appropriate for use in an Opinion No. 154-B methodology.

92. The TAPS Carriers further argue that the ALJ's claim that calculating deferred return consistent with Opinion No. 154-B would allow "double recovery,"[136] is based on the false assumption that the TAPS Carriers have collected more "deferred return" under the TSM than they are entitled to under a properly applied Opinion No. 154-B methodology. The TAPS Carriers state that while its Opinion No. 154-B rate base as of December 31, 1983, is roughly the same as the rate base in the TSM as of that date,[137] the TAPS Carriers have recovered substantially less revenue since that time under the TSM then they would have recovered under Opinion No. 154-B.[138] Thus, the TAPS Carriers assert that there has been no "double recovery" of deferred return.

93. Flint Hills also argues that Anadarko/Tesoro did not address in its Opinion No. 154-B rate, the deferred returns resulting from post-1985 plant additions. Flint Hills asserts that the TAPS Carriers' deferred earnings included earnings from inclusion of SRB in their Opinion No. 154-B rate and deferred earnings arising from the inflation component of the fixed annual real rate of return of 6.4 percent specified in the TSM for the life of the TAPS Interstate Settlement Agreement (TSA).[139] Flint Hills argues that Anadarko/Tesoro did not use in its Opinion No. 154-B rate, the TAPS Carriers' entire amount of deferred earnings and even excluded the deferred earnings associated with an SRB.[140] Therefore, Flint Hills contends that since Anadarko/Tesoro failed to recognize

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[135] *See* Ex. ATC-12 at 32; Ex. ATC-116 at 17; Ex. ATC-172 at 51-53, 57.

[136] ID at P 106.

[137] *Compare* Ex. ATC-135 at 39 ($8.75 billion Opinion No. 154-B rate base as of December 31, 1983) *with* Tr. 5991-92 (Mr. Grasso) ($8.2 billion TSM rate base as of December 31, 1983).

[138] Ex. ATC-172 at 50.

[139] Flint Hills' Post-Hearing Initial Brief at 29 and 38-39.

[140] *See* Ex. A/T-143 at 17, Illustration No. 6; *see also* Anadarko/Tesoro's Post-Hearing Initial Brief at 59.

the deferred return for the post-1985 plant additions, it understated the amount of deferred return included in any new Opinion No. 154-B rates.

94. Furthermore, Flint Hills contends that the TAPS Carriers are entitled to deferred earnings of $32.91 million in 2006.[141] Flint Hills states that deferred earnings were provided for in the Commission approved TSA. The settlement's return on equity since 1985 was 6.4 percent plus inflation. Flint Hills argues that Anadarko/Tesoro's deferred earnings component improperly eliminates the inflation component of the settlement return. Therefore, the deferred return component of the new rate base must be continued and, accordingly, the $0.10 per barrel of deferred return must be added to the ALJ's replacement ratemaking methodology.[142]

III. Commission Determination

95. The Commission affirms the ALJ's ruling that the appropriate adjustment and amounts for deferred returns are reflected in Anadarko/Tesoro's Opinion No. 154-B cost of service presentation and the amount of deferred return in 2005 and 2006 is $198.31 million and $175.283 million, respectively.

96. The TAPS Carriers' argument that the deferred amounts from 1983 forward should be completely restated, results in an excessive and therefore unjust and unreasonable deferred return balance of over $1 billion,[143] compared to the balance of $175 million reported by the TAPS Carriers in their 2006 rate filings.[144] As the ALJ noted, this appears to be another attempt by the TAPS Carriers to overstate elements of their cost-based rate filing to justify the recovery of returns more than once.[145] Therefore,

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[141] *See* Ex. A/T-143 at 10:13, Illustration No. 2.

[142] For 2006, the cents per barrel amount is calculated by dividing the revenue amount, in this case $32.91 million, by the TAPS throughput of 326.795 million barrels. *See* Ex. A/T-143 at 10:19, Illustration No. 2.

[143] Ex. A/T-140 at 79 (Mr. Brown); Ex. A/T-3 at 40; Ex. A/T-79 at 22 (Mr. Sullivan).

[144] Ex. ATC-90 through Ex. ATC-94, Statement E, ln. 17; Ex. A/T-140 at 76-77, 79 at n.22 (Mr. Brown).

[145] ID at P 109.

the Commission finds that the TAPS Carriers' contention that it is appropriate to restate all the assumptions and recast the deferred earnings reflected in their rate filings, is a rehash of arguments regarding property balances, and for the same reasons given above that those arguments were invalid, we find them invalid here.

97. Specifically, the Commission finds that the TAPS Carriers' arguments concerning the inclusion of an SRB and the $450 million for deferred earnings purposes were addressed and properly rejected in sections III.B.5 and III.B.6 of the ID, respectively, and for the same reasons are not appropriate here. In fact, the ALJ acknowledged that Anadarko/Tesoro and Staff raised legitimate arguments why there should be no allowance for deferred return from prior periods based on the TSM's actual operation.[146] Particularly, the amount included in the TSM formula for deferred return on remaining investment was calculated using a 100 percent equity structure,[147] which incorrectly assumes that the pipeline was constructed with all equity and therefore, overstates the deferred return, and ultimately violates the principle of Opinion No. 154-B that deferred returns are not allowed on debt-financed rate base.[148] Furthermore, given that the TAPS Carriers' TSM formula for deferred return on remaining investment was calculated using a 100 percent equity structure and therefore overstated the deferred return, and that deferred returns are not allowed on debt-financed rate base, Flint Hills' argument that the Anadarko/Tesoro case must fail because it does not have a deferred return component beginning in December 31, 1983, is inapposite.

98. In addition, the Commission finds that Flint Hills' argument that the TAPS Carriers would be entitled to more deferred return balances if the TSM recognized post-1985 additions and an inflation component in the return on them, is inaccurate since the TSM method did provide for deferred returns on these additions, and Flint Hills' deferred

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[146] *Id.* P 107, 108 n.90; The ALJ's suggestion that there be no further allowance for deferred return was not the result of overcollections as the TAPS Carriers suggest, but because inflation was already collected.

[147] Ex. ATC-14, sections II-6, II-7, II-8; Ex. A/T-3 at 39 (Mr. Brown); Ex. A/T-79 at 23 (Mr. Sullivan).

[148] *See Williams*, 31 FERC ¶ 61,377 at 61,834 n.19, 61,835; Ex. A/T-3 at 39-41 (Mr. Brown).

return recalculation using some other TSM method essentially amounts to retroactive ratemaking.[149]

99. The Commission also finds that the TAPS Carriers' suggestion that the ALJ's double recovery conclusion was based upon an equity assumption,[150] confuses the ALJ's conclusion to accept the TSM deferred returns for ratemaking purposes with the ALJ's conclusion that allowing the TAPS Carriers to restate their actual deferred earnings would result in the double recovery of deferred earnings already included and paid in past rates.[151] The ALJ's double recovery conclusion was based upon the fact that the TAPS Carriers' Opinion No. 154-B proxy overstated the deferred returns that actually remain to be paid under the TSM.

100. In addition, the Commission finds that the ALJ correctly relied on *Sepulveda*.[152] In *Sepulveda*, the Commission found that when setting a cost-based rate for the future, there is no need to allow an additional adjustment for inflation already recognized and collected in rates.[153] Similarly, in the instant case, the APB allowance in the TSM formula, beginning in 1990, already reflected an adjustment to return that incorporated inflation from 1983 forward.[154] The TAPS Carriers' suggestion that the Commission's ruling in *Sepulveda* resulted from "unique" circumstances is without merit, since the unique circumstance in that case is the same in the instant case, i.e., the past rates were not based on valuation or Opinion No. 154-B and, as a result, all costs were already recovered including all of the equity return.[155]

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[149] Ex. A/T-3 at 52, ln. 13-14.

[150] ID at P 106-07.

[151] *Compare* ID at P 108 n.90, *with* P 106-07.

[152] ID at P 108.

[153] *Sepulveda*, 117 FERC ¶ 61,285 at P 12-16.

[154] Ex. ATC-14, section II-7(b).

[155] *Sepulveda*, 117 FERC ¶ 61,285 at P 12, 18.

101. The Commission also finds that the Commission's ruling in *Sepulveda* is fully consistent with its earlier findings in *Lakehead*. In *Lakehead*, the pipeline charged Interstate Commerce Commission approved rates, based on its valuation methodology, for many years,[156] including 1983.[157] The Commission ultimately adopted a cost-based, Opinion No. 154-B methodology for the future for Lakehead and determined that the appropriate starting point for trending an oil pipeline's rate base under TOC was the date the new methodology became operative for oil pipelines, i.e., 1983.[158] Since Lakehead's rates using a valuation methodology did not include a deferred return cost component, the Commission began a deferred return balance as of 1983. However, in the instant case, the deferred balances and the annual deferred costs for every year of TAPS operation, including 1983,[159] were already accounted for under the TSA as reflected in supporting workpapers for every TSM filing. Therefore, the Commission finds no merit to the TAPS Carriers' claim that their rates were based on a valuation methodology before 1985 and as a result, their situation is comparable to *Lakehead*, since the TAPS Carriers' rates, beginning in 1977, were based on the TSA, which specifically included a deferred return component.

102. The Commission also finds that contrary to the TAPS Carriers' assertion that the ID erred in holding that Opinion No. 154-B rates should be calculated using the amounts in the TSM, it makes no difference how the deferred returns were calculated under the TSM, or whether they represent more or less than deferred returns typically calculated under Opinion No. 154-B. The Commission stresses that the TSM calculations, including the calculation of deferred returns, were the basis of the rates actually filed with the Commission, actually paid by the shippers and actually collected by the TAPS Carriers over the years. Therefore, the Commission finds that the $175 million shown in the TAPS Carriers' 2006 filings and adopted by the ALJ represents the amount of deferred returns uncollected as of 2006.[160]

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[156] *Lakehead*, 71 FERC ¶ 61,338 at 62,306.

[157] Tr. 2090-91 (Mr. Ganz); Tr. 3017-18 (Mr. Van Hoecke).

[158] *Lakehead*, 71 FERC ¶ 61,388 at 62,306; *reh'g denied*, 75 FERC ¶ 61,181 at 61,591.

[159] Tr. 5102 (Mr. Brown).

[160] ID at P 109, 110.

Issues III.B.3 and III.B.4: What is the appropriate amount of AFUDC and ADIT?

I. ALJ's Findings

103. The ALJ stated that the amounts used by Anadarko/Tesoro reflect the amount of allowance for funds used during construction (AFUDC) actually collected by the TAPS Carriers,[161] and therefore found that the appropriate amounts of AFUDC to include in rate base are listed in Ex. A/T -144 Stmt. F (2005), Ex. A/T-146, Stmt. F (2006). The ALJ also stated that the appropriate amounts of accumulated deferred income tax (ADIT) are reflected in the TAPS Carriers' annual rate filings as stated by Anadarko/Tesoro and Staff. Thus, the ALJ found that amount of ADIT is $46.20 million[162] for 2005 and $43.00 million for 2006.[163] No party contested this finding.

II. Commission Determination

104. The Commission affirms the ALJ's rulings, in this respect.

Issue III.B.5: Are the TAPS Carriers entitled to an SRB write-up, and if so what is the appropriate amount?

I. ALJ's Findings

105. The ALJ concluded that the TAPS Carriers are not entitled to an SRB write-up because the TAPS Carriers' assets were never under the valuation methodology. The ALJ based this finding on the fact that the TAPS Carriers never relied on valuation to calculate their rates, the TAPS Carriers' interim rates were not final and subject to refund, the final rates were based on the TSM, the Commission never issued the TAPS Carriers a valuation report and the TAPS Carriers' rates were not calculated using the valuation methodology when Opinion No. 154-B was issued.

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[161] Ex. A/T-3 at 31 (Mr. Brown); Tr. 5930, Tr. 5954-55, Tr. 5983 (Mr. Grasso); Tr. 5824-25 (Mr. Grasso).

[162] Anadarko/Tesoro's Initial Brief at 64; Ex. A/T-144, Stmt. E, ln. 11.

[163] Anadarko/Tesoro's Initial Brief at 64; Ex. A/T-146, Stmt. E, ln. 11.

II. Exceptions

106. Flint Hills claims that the ALJ erred by not including any SRB in the replacement methodology based on her conclusion that the TAPS Carriers' assets were never valued under the valuation methodology.[164] The TAPS Carriers claim that the ALJ erroneously denied the TAPS Carriers an SRB write-up.

107. Flint Hills and the TAPS Carriers argue that prior to Opinion No. 154-B, which was issued in 1985, Opinion No. 154 inherited the valuation methodology from the ICC.[165] Therefore, Flint Hills and the TAPS Carriers argue that the TAPS Carriers' interstate rates for 1977 through at least 1984 were filed under the only ratemaking methodology in existence, the ICC's valuation methodology.

108. Flint Hills and the TAPS Carriers also argue that it is clear that the interim rates established for TAPS, were based on the ICC's valuation methodology.[166] Flint Hills and the TAPS Carriers claim that prior to the TSM, all TAPS rates in effect were filed under the ICC valuation methodology, as shown in the initial rate filings.[167] Flint Hills points out that Anadarko/Tesoro's witness, Mr. Sullivan, agrees and even further agrees that the initial rates were in effect for seven months.[168] Thus, Flint Hills and the TAPS Carriers argue that prior to the TSA, the only TAPS rates established by an agency order and made effective were the temporary rates which the ICC ordered using a valuation method.[169]

109. Flint Hills and the TAPS Carriers further argue that FERC was working on valuation-based rates for TAPS when FERC changed from a valuation basis to an

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[164] ID at P 123-25.

[165] *Williams*, 21 FERC ¶ 61,260, at 61,614-17 and n.295 (1982) (Opinion No. 154).

[166] Ex. ATC-206 at 406.

[167] *See e.g.*, Ex. ATC-206 at 3, 18-19, 155 and 209.

[168] Tr. 5332:15-25 (Mr. Sullivan).

[169] Ex. A/T-157; Tr. 5799:19 – Tr. 5800:14 (Mr. Grasso).

Opinion No. 154-B basis.[170] Consequently, the TAPS Carriers submitted their TSA to FERC when FERC had not yet established a final valuation methodology. However, Flint Hills argues, due to the timing of the change in methodologies and the amount of time TAPS was in operation, Flint Hills believes that FERC would have granted an SRB. Flint Hills further argues that even though entering into and approval of the TSA negated the need at that time for an SRB, there is not reason to not include it now, under a proper Opinion No. 154-B methodology.

110. Flint Hills also believes that the ALJ failed to recognize that the TAPS Carriers filed their initial rates during a period with a great deal of uncertainty for the oil pipeline industry and its regulators. Flint Hills emphasizes that it took years to transfer jurisdiction from the ICC to FERC, and therefore, the only rates TAPS Carriers filed were based on the ICC's valuation methodology. Moreover, Flint Hills states that FERC found in Opinion No. 154-B that the SRB was needed because pipeline investors relied on a rate base adjusted for inflation.[171] Therefore, Flint Hills contends that the increase in the TAPS interstate rates with the addition of the SRB, results in a total revenue impact of $322.52 million, or $0.99 per barrel.[172]

111. The TAPS Carriers also argue that the ALJ erroneously ruled that the TAPS Carriers should not be permitted to include the SRB write-up in the Opinion No. 154-B rate base and therefore treated them differently from other oil pipelines in existence as of the date of Opinion No. 154-B. The TAPS Carriers assert that the only post-Opinion No. 154-B oil pipeline decision that resulted in rates without an SRB write-up is *Kuparuk*,[173] which, in contrast to TAPS, did not begin operations until October 1984, nine months after the December 31, 1983 valuation date in Opinion No. 154-B,[174] and did not seek an SRB write-up.

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[170] *See e.g.*, Ex. ATC-207; Ex. ATC-208.

[171] Opinion No. 154-B, 31 FERC at 61,836.

[172] $95.02 million ($0.29 per barrel) plus $227.5 million ($0.70 per barrel); *See* Ex. A/T-80 at 30:11, Illustration 7, and at 32:6.

[173] *Kuparuk Transportation Co.*, 45 FERC ¶ 63,006 (1988), *aff'd as modified*, 55 FERC ¶ 61,122 (1991) (*Kuparuk*).

[174] *Kuparuk*, 55 FERC ¶ 61,122 at 61,363.

112. The TAPS Carriers stress that the ICC imposed interim rates until the initially-filed rates were permitted to go into effect, subject to refund.[175] The TAPS Carriers argue that the ALJ's support for her finding that the TAPS Carriers did not rely on the valuation methodology because the interim rates were not final and subject to refund and when the final rates were set on TAPS, those rates were based on the TSM and not the valuation methodology, is incorrect. TAPS Carriers assert that the interim rates were based on valuation and were never changed when the TSA was approved by the Commission, no refunds were ordered for the interim rate period and the settlement did not provide the TAPS Carriers with any revenues in excess of those allowed by the interim rates for that period.[176] As a result, the TAPS Carriers argue the interim rates became the final rates for the period to which they applied. Therefore, the TAPS Carriers assert that the ALJ's finding that the test for entitlement to the SRB is a Commission determination of a "final rate" using valuation, would nullify the SRB component of the Opinion No. 154-B methodology, which is unreasonable.

113. Finally, the TAPS Carriers argue that the ALJ erred by rejecting an SRB write-up based on the fact that the Commission never issued the TAPS Carriers a valuation report.[177] The TAPS Carriers claim that the issuance of a final valuation report does not test whether a carrier is entitled to the SRB write-up, but whether the pipeline's owners relied on the valuation methodology, which the TAPS' owners did.[178]

III. Commission Determination

114. The Commission affirms the ALJ's finding that the TAPS Carriers are not entitled to an SRB write-up. Contrary to Flint Hills' and the TAPS Carriers claim, the TAPS Carriers did not rely on the valuation methodology, and never had an approved rate calculated under a valuation formula. In fact, the TAPS Carriers' refunds, final rates, and revenue requirements were all established by the Commission under the TSM. The

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[175] Ex. ATC-206 at 296-99.

[176] *See* Ex. ATC-15 at section II-1; *see also Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,138; 35 FERC ¶ 61,425 at 61,982.

[177] ID at P 124.

[178] *See* Opinion No. 154-B, 31 FERC at 61,836; *Lakehead*, 71 FERC ¶ 61,338 at 62,311; *reh'g denied*, 75 FERC ¶ 61,181 at 61,591.

TAPS Carriers' own witness, Dr. Kalt, acknowledged that their rates were finalized on the basis of TSA, a TOC methodology,[179] not on valuation. Therefore, the SRB write-up, which was intended to bridge the transition from valuation rate base to TOC rate base, is irrelevant.

115. The Commission finds that the contentions that the TAPS Carriers' investors expected a return on investment of the valuation methodology, are without merit since the owners knew that the valuation methodology, including its cost of reproduction new (CRN) component, were unlikely to be used to set TAPS rates due to "a period of great uncertainty for the oil pipeline industry."[180] The TAPS Carriers' rates also were never going to be regulated under the ICC valuation methodology as demonstrated by Judge Kane's Initial Decision,[181] the D.C. Circuit's remand of Judge Kane's Initial Decision,[182] and the TSA.[183] Thus, there was no reason to issue a valuation order.[184]

116. In addition, the Commission finds that the TAPS Carriers' assertion that the ID treated them differently from other oil pipelines in existence as of the date of Opinion No. 154-B by not giving them an SRB write-up, is without merit. First, the Commission has not allowed an SRB write-up for any oil pipeline whose rates have never been established under the valuation methodology. Second, the TAPS Carriers' attempt to distinguish

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[179] Ex. ATC-113 at 17:3-4 (Dr. Kalt).

[180] Flint Hills' Brief on Exceptions at 45.

[181] *Trans Alaska Pipeline System*, 10 FERC ¶ 63,026, at 65,181-82 (1980). Judge Kane specifically rejected the ICC valuation methodology as a basis for establishing rates on TAPS in 1980.

[182] *Trans Alaska Pipeline System*, 21 FERC ¶ 61,092, at 61,285 (1982). From FERC's first contact with the regulation of TAPS, it was apparent there was no predisposition that the valuation methodology would be used to determine final rates.

[183] *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,138 n.6. The Commission did not consider or apply the valuation approach in settling final rates for TAPS, but instead based the rates upon the TSM.

[184] *See* Ex. A/T-139; Ex. A/T-79 at 20.

Kuparuk,[185] where the Commission did not order an SRB fails, since the TAPS Carriers mistakenly claim that *Kuparuk* did not start operations until 1984, when in fact Kuparuk, as well as, Sepulveda were in existence in 1983.[186] Sepulveda was not allowed an SRB and therefore, the TAPS Carriers have not been treated differently than the other pipelines in the cited proceedings.

117. Furthermore, the Commission finds that based on Opinion No. 154-B, an SRB cannot be calculated without a valuation report.[187] The TAPS Carriers never petitioned the Commission to issue a report. The TAPS Carriers arguments on a final report not being part of the valuation "test" and their attempt to issue one should be rejected. Further, a fundamental component in calculating the SRB write-up is the CRN calculated by the ICC or the Commission. The Commission agrees with the ALJ's finding that neither the ICC nor the Commission ever issued a section 19(a) valuation[188] for any TAPS Carriers implying that the TAPS Carriers were forced to prepare their own CRN. In doing so, Mr. Ganz, the sole TAPS Carrier witness supporting the CRN calculations, did not follow the ICC precedent on how to properly calculate CRN. He admitted that he took estimates from the TAPS Carriers' books and records without adjustment, made no attempt to investigate and eliminate costs associated with duplication of effort and refused to reflect the $450 million reduction – resolved in the TSA – in his CRN calculations.[189] Thus, even if we were to accept a section 19(a) valuation from a pipeline, the one provided by the TAPS Carriers is unacceptable for these reasons.

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[185] *Kuparuk*, 45 FERC ¶ 63,006 at 65,045, *aff'd as modified*, 55 FERC ¶ 61,122 at 61,364 n.12.

[186] *See Sepulveda*, 112 FERC ¶ 63,020, at P 24 (2005).

[187] Opinion No. 154-B, 31 FERC at 61,836 n.40.

[188] 49 U.S.C. § 19(a) (1988).

[189] *See* Tr. 1985-2009 (Mr. Ganz).

Issue III.B.6: What is the appropriate amount of other rate base items?

I. ALJ's Findings

118. The ALJ already found that the $450 million will be excluded from rate base. Thus, the ALJ concluded that there are no other material rate base items at issue with the exception of the DR&R rate base credit issue.

II. Exceptions

119. Flint Hills argues that the ALJ erred by not including the appropriate transition costs in the ordered ratemaking methodology. Flint Hills states that it discussed two transition costs, the deferred return component of rate base related to post-1985 investment[190] and the net carryover provision of $0.25 per barrel for 2004 and $0.21 per barrel for 2005. Flint Hills argues that the Commission has recognized the need for the inclusion of transition costs in the new ratemaking methodology's rate base.[191]

120. Flint Hills also argues that the net carryover provision allows the recovery of under-recovered revenue for the years 2005 and 2006, which is akin to stranded costs in the event of a change in ratemaking methodologies.[192] Flint Hills asserts that under the net carryover provision, the TAPS Carriers expected to recover costs not recovered in the present year. Flint Hills claims that the under-recovered revenue amounts represent real unrecovered costs and thus appropriate transition costs. Therefore, Flint Hills claims that in 2005 and 2006, net carryover amounts of $85.48 million or $0.25 per barrel and $68.25 million or $0.21 per barrel,[193] respectively, should be included in the revenue requirement of the Opinion No. 154-B ratemaking methodology. Flint Hills emphasizes

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[190] *See* Issue III.B.2 *supra*.

[191] *See* Opinion No. 154-B, 31 FERC at 61,835; *California Independent System Operator Corp.*, 104 FERC ¶ 61,062 (2003); *ARCO Pipeline Co.*, 52 FERC ¶ 61,055 (1990); *United Distribution Companies v. FERC*, 88 F.3d 1105, 1178 (D.C. Cir. 1996); Order No. 636, FERC Stats. and Regs. ¶ 30,939 at 30,457.

[192] *See Central Vermont Pub. Serv. Corp. v. FERC*, 214 F.3d 1366, 1367 (D.C. Cir. 2000).

[193] *See* Ex. A/T-11 at 31:16; Ex. A/T-80 at 36:12.

that these amounts are true-up amounts resulting from estimates that are part of the TSM process and since they are part of an existing, approved rate methodology, they should not be eliminated if the ratemaking methodology changes from TSM to Opinion No. 154-B.

III. Commission Determination

121. The Commission affirms the ALJ's finding that the $450 million should be excluded from rate base when the new Opinion No. 154-B rates become effective. In addition, the Commission rejects Flint Hills' assertion that carry-over charges of $85.48 million or $0.25 per barrel for 2005 and $68.25 million or $0.21 per barrel for 2006 should be included in the revenue requirement of the Opinion No. 154-B methodology.

122. As an initial matter, the Commission notes that there was no testimony or evidence offered at the hearing to support this claim, nor did the TAPS Carriers suggest it. In addition, after noting that oil pipeline rates as a general matter must be cost-based, the only exception,[194] or transition cost, that Opinion No. 154-B allows is the one which it defines as the SRB, and even that may not be permitted if a particular pipeline is not entitled to it, as is the case here. Thus, Flint Hills is asking for transition costs that Opinion No. 154-B does not allow.

123. In addition, the Commission finds that Flint Hills' transition costs would improperly allow the TAPS Carriers to bring forward a portion of the non-cost-based TSM revenue requirement by simply tacking it onto otherwise just and reasonable rates.[195] Moreover, the Commission notes that Flint Hills even recognizes that the amounts the TSM characterizes as net carryover, actually represent part of the TSM revenue requirement that was not recovered due to inexact estimates used when calculating the specific rates.[196] Therefore, allowing the collection of net carryover for 2005 and 2006 is tantamount to going back and correcting those estimates, the essence of retroactive ratemaking, which is considerably different from the cases cited by Flint Hills allowing utilities to recover legitimate stranded costs that they reasonably expected to recover.

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[194] Opinion No. 154-B, 31 FERC at 61,833-35.

[195] *See Louisiana Public Service Commission v. FERC*, D.C. Cir. No. 05-1161 (April 3, 2007).

[196] Flint Hills' Brief on Exceptions at 55.

Issue III.B.7: Should asserted DR&R collections and earnings be credited against rate base, and if so, what is the appropriate amount?

I. ALJ's Findings

124. The ALJ deferred discussion of this issue to Issue III.E.

II. Commission Determination

125. Consistent with the ID, the Commission will address this issue in Issue III.E below.

Issue III.D: What is the appropriate Depreciation expense?

I. ALJ's Findings

126. First, the ALJ found that the correct plant balances are those proposed by Anadarko/Tesoro as discussed in section III.B.1. The ALJ then stated that the Anadarko/Tesoro depreciation study will be used. Second, the ALJ found that the correct end-life of TAPS is 2034 as corroborated by several witnesses.[197] Therefore, the ALJ concluded that the correct depreciation expense balances are those proposed by Anadarko/Tesoro.[198] No party contested this finding.

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[197] The ALJ pointed to Ex. A/T-141 at 4; Ex. A/T-79 at 18-19; Ex. ATC-4 at 46; Ex. ATC-154 at 4; Ex. A/T-32 at 4 (TAPS right-of-way-extended to 2034); TAPS Carriers' Reply Br. at 56.

[198] The ALJ ruled that the depreciation expense for 2005 is $14.06 million. Ex. A/T-144, Stmt. B4, ln. 6. The depreciation factor for 2005 is 3.8095. A/T-142; Tr. 5745-46 (Mr. Grasso describes the calculation of the depreciation factor). The depreciation expense for 2006 is $13.48 million. Ex. A/T-146 Stmt. B4, ln. 6; Ex. A/T-142. Anadarko/Tesoro note that Mr. Grasso agreed that for 2006 it would be appropriate to modify the depreciation factor to reflect one year less of remaining life (from 3.8 percent to 3.9 percent). Mr. Grasso verified that the change would increase depreciation expense slightly, but would not impact the overall TAPS rate. Anadarko/Tesoro's Initial Br. at 75; Tr. 5988-89 (Mr. Grasso).

II. Commission Determination

127. The Commission affirms the ID related to the appropriate depreciation expense.

Issue III.E: What is the appropriate DR&R expense?

I. DR&R Expense

A. ALJ's Findings

128. The ALJ concluded that the TSA included the recovery of DR&R and those amounts were collected in rates. The ALJ found that the amount of DR&R collections and earnings to date will be calculated using the methodology in Ex. ATC-130[199] (page 1 of 2) with modifications.[200] The ALJ found that the TAPS Carriers have not cost justified additional collections of DR&R expense through future rates and, accordingly, the expense is not permitted to be collected in the cost based 2005 and 2006 TAPS Carriers' rates, consistent with Commission policy.[201]

B. Exceptions

129. Staff and Anadarko/Tesoro state that the ALJ erred by failing to adopt past earnings rates that are consistent with earnings actually achieved by the TAPS Carriers' parents on the DR&R collections. Staff and Anadarko/Tesoro contend that the record

[199] Ex. ATC-130 is the DR&R earnings calculation using the actual Moody's Aa bond rating for each year.

[200] The modifications are (1) Ex. ATC-130 shall be modified to replace the "Adjusted DR&R Allowance" for years 1977 through 1981 with the amounts from the "1985 TSM Model" column in Ex. ATC-126 (*see also* Ex. A/T 149 column "Actual DR&R Collections") for years 1977 through 1981, and (2) Ex. ATC-130 "Moody's Aa" column shall be utilized to calculate the TAPS Carriers' after tax accumulated balance for every year starting with 1977 through 2005 and starting in 2006 and forward, the earning on DR&R shall be calculated using the TAPS Carriers' weighted average nominal after tax cost of capital.

[201] *See Sabine River Authority*, 10 FERC ¶ 61,241, at 61,451 (1980) (*Sabine*); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, at 593, 596 (1942).

indicates that the TAPS Carriers collected in excess of $1.5 billion from ratepayers for DR&R by the end of 2004, $1.283 billion of which the TAPS Carriers received by the end of 1989.[202] Staff states that the ID adopts two different earnings rates to apply to these collections, the actual Moody's Aa bond rate to the collections from 1977-2005, and the TAPS Carriers' weighted average nominal after tax cost of capital to reflect future earnings.[203] Staff and Anadarko/Tesoro except to the past rate because it does not reflect the uses to which the DR&R funds were put.

130. Staff and Anadarko/Tesoro argue that the ALJ erred by not recognizing that it was the TAPS Carriers' parents who received and had free rein over the DR&R monies. Staff and Anadarko/Tesoro state that these prepayments represented unrestricted retainage earnings that the TAPS Carriers' parents used for their general corporate purposes. Staff and Anadarko/Tesoro submit that the record clearly reflects that the TAPS Carriers collected DR&R prepayments in jurisdictional rates, and distributed the DR&R prepayments to their corporate parents, who used the funds as unrestricted equity capital.[204] Staff and Anadarko/Tesoro also state that the parent companies' returns on the pre-collected DR&R funds are fully documented in the record.[205] Based on these returns, the actual earnings on the $1.5 billion in DR&R funds collected through 2005 is $15.8 billion and the total DR&R collections and earnings balance through 2005 is $17.3 billion. Staff and Anadarko/Tesoro state that the result indicated a DR&R balance at the end of 2005 of $17.3 billion, which not only reflects the fact that the parents held the DR&R money all this time, but represents the time value of that money to them.

131. Staff and Anadarko/Tesoro argue, however, that the ALJ rejected using the parents' return on equity for various reasons. Staff and Anadarko/Tesoro state that the ALJ's first reason, that there was no precedent cited for using the parents' return,[206] is

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[202] Ex. A/T-149; A/T-3 at 76; A/T-33; A/T-42; A/T-43; Tr. 955 (Dr. Toof); ID at P 150.

[203] ID at P 155, 158.

[204] ID at P 151, 154; Ex. A/T-160 at 42-43; Tr. 6505-06, Tr. 6529-31 (Mr. Hanley); Tr. 5513 (Mr. Sullivan); Tr. 6040-41 (Mr. Grasso); Tr. 4030-31 (Mr. Olson).

[205] Ex. A/T-160 at 42; Ex. A/T-173.

[206] ID at P 153.

unimportant in light of the uncontroverted fact that the parents held all the DR&R money. The ALJ's second reason, that it was necessary for her to find a balance between the earning rate of a risky investor and the risk-free rate of the TAPS Carriers',[207] is not required by the Commission's precedent, nor is it necessary when the evidence in the record demonstrates where the money was held, how it was used, and what its time value was. Staff states that the ALJ's third reason, that using actual Moody's Aa bond rates was consistent with the TSM's use and Anadarko/Tesoro's general approach,[208] does not reflect what actually happened.

132. Staff and Anadarko/Tesoro argue that the parents did not invest the DR&R funds in Moody's Aa bonds and therefore, the actual Moody's Aa bond rates are no more reflective of the actual time value of the funds to the parents than are the risk-free rates which the ALJ rejected.[209] Staff and Anadarko/Tesoro assert that the only rates that indicate the actual time value to the entities which actually held the DR&R funds are the common equity returns of the parents.

133. Therefore, Staff and Anadarko/Tesoro argue that if the Commission does not recognize the earnings actually realized by the parents on the DR&R funds from 1977-2005, it could easily adopt the Commission-approved returns that were realized by the TAPS Carriers during this time period. Staff and Anadarko/Tesoro contend that this is consistent with the ALJ's earnings recommendation for the future,[210] as well as with traditional Commission practice.[211]

134. In addition, Anadarko/Tesoro argue that allowing the DR&R recovery to generate windfall profits for the TAPS Carriers and their parents at the expense of their ratepayers contravenes the long-established principle that regulated entities should not earn a profit

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[207] *Id.* P 154.

[208] *Id.* P 155.

[209] *Id.* P 154.

[210] *Id.* P 158.

[211] *Kuparuk*, 55 FERC ¶ 61,122 at 61,382-83.

on the collection of an expense item.[212] Anadarko/Tesoro also argue that using the TAPS Carriers' parent companies' actual historic earnings is fully consistent with the parent companies' legal obligation to perform DR&R under the terms of both the federal and state right-of-way agreements. Therefore, Anadarko/Tesoro state that the record demonstrates that using the ALJ's approach results in the TAPS Carriers receiving a windfall of $14.5 billion.[213]

135. The TAPS Carriers state that the appropriate earnings rate to attribute to any presumed DR&R collections is the "risk-free" rate.[214] The TAPS Carriers state it is undisputed that the TAPS Carriers and their parent companies have unlimited liability for the DR&R obligations and their attendant costs, and that they will be responsible for those costs regardless of what DR&R amounts were collected or earned on those collections.[215] The TAPS Carriers argue that since shippers bear no risk for any potential shortfall between DR&R collections/earnings and the ultimate costs of satisfying the DR&R obligation, the only prudent investment strategy is to place DR&R collections in an investment where there is no risk of loss of principle, which yields a "risk-free" rate of interest.[216] Thus, the TAPS Carriers assert that it is inequitable to give the shippers the benefit of an earnings rate in excess of a risk-free rate when they bear no risk whatsoever and therefore, it is unreasonable to impute to the collections any higher earnings rate.

136. The TAPS Carriers argue that the use of TSM-6 amounts for 1977-1981 is inappropriate. The TAPS Carriers contend that record evidence does not support the use of the hypothetical DR&R amounts assumed by Dr. Horst for the years 1977-1981, which were generated by TSM-6. The TAPS Carriers assert that the TSM-6 amounts do not

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[212] *ITT World Communications, Inc. v. FCC*, 725 F.2d 732, 739 n.13 (D.C. Cir. 1984); *Sabine*, 10 FERC ¶ 61,241 at 61,451; *see also FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, at 593-96; Tr. 5507-08 (Mr. Sullivan); Tr. 4387-90 (Mr. Ives); Tr. 6040-41 (Mr. Grasso).

[213] *Compare* Ex. A/T-149 ($17.3 billion), *with* Ex. ATC-130, ID at P 155-59 ($2.83 billion).

[214] Ex. ATC-113 at 41-45.

[215] *Id.* at 63.

[216] *Id.* at 41-42.

represent DR&R allowances actually collected in TAPS tariffs and emphasize that the actual DR&R allowances included in rates for 1977-1981 were significantly less than the allowances in TSM-6,[217] as indicated by Dr. Toof's replacement of the hypothetical TSM-6 amounts used in Ex. A/T-30 with actual amounts collected by the TAPS Carriers.[218]

137. The TAPS Carriers argue that the ALJ's support for using the hypothetical TSM-6 allowances is that Dr. Toof's Ex. ATC-126, column "1985 TSM Model" contains the same numbers as Ex. A/T-30 for the same years, suggesting that Dr. Toof agreed with Anadarko/Tesoro's use of the TSM-6 allowances for 1977-1981. The TAPS Carriers assert that conclusion is incorrect and stress that Dr. Toof explained that the figures in the "1985 TSM Model" column are not the amounts he recommended be used, but are the hypothetical amounts shown in TSM-6.[219] The TAPS Carriers assert that the column in Ex. ATC-126 headed "Actual" reflects the actual amounts included in the TAPS Carriers' rates for DR&R during 1977-1981, which Dr. Toof recommended including in the DR&R calculation in this case.[220] Therefore, the TAPS Carriers argue that the ID erred in using TSM-6 amounts for the DR&R allowance for 1977-1981.

C. Commission Determination

138. The Commission affirms the ALJ's use of Moody's Aa bond rate to calculate the TAPS Carriers' after tax accumulated balance for the years 1977 through 2005.[221] The Commission finds that the ALJ properly considered the record and concluded that the actual Moody's Aa bond rate was the most reasonable approach, was consistent with the approach used in the TSA, and was equitable under the circumstances.[222]

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[217] *See* Ex. ATC-127; ATC-115 at 36.

[218] Ex. ATC-130.

[219] Ex. ATC-115 at 34-35.

[220] *Id.* at 37.

[221] ID at P 155.

[222] Ex. ATC-130; Ex. A/T-30; Ex. ATC-115 at 32-33, 41; Ex. ATC-115 at 45.

139. The Commission finds that the ALJ appropriately rejected Anadarko/Tesoro's proposed earnings rate based on the TAPS Carriers' parent's earning rate.[223] The Commission finds that the record is clear that the parents' rate is too high[224] because basing such a return on the parents' capital structure would be based on 100 percent equity since the parents' capital structure does not have a debt component. Because the parents do not have a debt component and equity returns are substantially higher than debt costs, the return would be skewed unnaturally high, thus resulting in an inaccurate DR&R calculation of over $17 billion. Furthermore, as the ALJ properly noted, neither Staff nor Anadarko/Tesoro cited any precedent for use of the parents' rate. Therefore, the Commission finds the record does not support Anadarko/Tesoro's proposal to use the parents' rate and that using a 100 percent equity component to calculate return results in an unjust and unreasonable rate.

140. The Commission also finds that the ALJ appropriately rejected the TAPS Carrier's proposed risk-free interest rate.[225] The Commission finds that the record is clear that the risk-free rate is too low because it fails to take into account that the TAPS Carriers had free rein to use the DR&R funds as they pleased.[226] Further, the TAPS Carriers stated that its DR&R funding part of the carrier rate is based on earning a reasonable return to cover its DR&R funding costs. Therefore, based on the TAPS Carriers' own testimony regarding return on its DR&R funding, the lack of any additional support by the TAPS Carriers for their proposed rate, and the fact that Dr. Kalt's testimony[227] for the TAPS Carriers was found not credible,[228] the Commission finds that the record does not support the TAPS Carriers' proposal to use the "risk free" rate.

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[223] ID at P 153.

[224] Ex. ATC-113 at 42.

[225] ID at P 154.

[226] *See* Ex. ATC-113 at 38-39; Staff's Initial Brief at 68-71; Anadarko/Tesoro's Initial Brief at 76-77.

[227] Ex. ATC-113 at 38-45.

[228] ID at P 154.

141. The Commission also affirms the ALJ's finding that the correct amounts for the DR&R allowance for 1977-1981 are the TSM-6 amounts.[229] The Commission finds that the record is clear that the TSM-6 was used to calculate the TAPS Carriers' revenue requirements and refund liabilities from the period from 1977-1985 under the TSA.[230] Therefore, the TAPS Carriers' arguments against use of the TSM-6 amounts for 1977-1981, are rejected.

142. The Commission further affirms the ALJ's finding that the TAPS Carriers have not cost justified additional collections of DR&R expense through future rates and that the DR&R expense should not be collected in the 2005 and 2006 Carriers' cost-based rates.[231]

II. Rate Base Credit

A. ALJ's Findings

143. The ALJ found that the final amount of DR&R costs is speculative at this point and therefore, concluded that at this time the TAPS Carriers are not required to credit rate base or refund any amounts.

B. Exceptions

144. Staff argues that the ALJ erred by failing to credit rate base for any of the accumulated DR&R funds. Staff asserts it is well-established Commission practice to credit ratepayer prepayments of expenses such as DR&R against the rate base of the pipeline, and that precedent should be followed here.[232] Staff also asserts that the ALJ inappropriately relied upon a distinction between the accrual method in *Kuparuk* and the annuity method in the TSM and a concern that crediting rate base would prevent the

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[229] *Id.* P 156.

[230] Ex. A/T-140 at 96; Ex. A/T-32 at 25, 107; Ex. A/T-44 at ln. 117; Ex. A/T-196 at 229-31, 236-37; Staff's Initial Brief at 68; Ex. A/T-95 at ln. 117.

[231] ID at P 160.

[232] *Kuparuk,* 55 FERC ¶ 61,122 at 61,381-83; *see also* Staff's Brief on Exceptions at n.60.

TAPS Carriers from earning interest on the DR&R funds sufficient to cover the DR&R costs.[233]

145. Staff proposes to take the balance of DR&R funds up to this point, and treat at least a portion of that amount as a credit to rate base for 2005 and beyond. Staff emphasizes that if a credit is taken, it must recognize and account for the future earnings on the credited amount, consistent with *Kuparuk* and other prepayment cases.

146. Staff asserts that the ALJ's protocol for calculating the current size of the DR&R funds shows that the current DR&R balance well exceeds the amount needed to cover the current DR&R cost estimate. Staff states that therefore, the ALJ's concern that the TAPS Carriers will be prevented from earning additional interest sufficient to cover the estimated DR&R costs, is baseless. In addition, the rate base credit only recognizes the time value of the funds from 2005 and beyond and only accounts for the future earnings on those dollars once, and therefore, in TAPS' future rate cases, the ALJ's future earnings rate assumption would not apply to the amounts credited to rate base, consistent with *Kuparuk*. Therefore, Staff asserts that consistent with Commission precedent, there should be a future rate base credit for DR&R up to the level of remaining rate base.[234]

147. Anadarko/Tesoro state that to ensure that the DR&R crediting option is fully preserved in the event the ALJ's related decisions may be modified on review, it request that the Commission retain the option of implementing a DR&R rate base credit as necessary to protect the ratepayers.

C. Commission Determination

148. The Commission affirms the ALJ's finding that "at this time the TAPS Carriers are not required to credit rate base or refund any amounts." The Commission agrees with the ALJ's finding that the TAPS Carriers effectively distinguished *Kuparuk* from the

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[233] ID at P 161-62.

[234] Staff states that it recognizes that the future earnings rate adopted by the ALJ is essentially equivalent to a rate base credit. *See* ID at P 158. Staff states that it is willing to accept that result for all of the DR&R funds in lieu of a rate base credit if (1) the Commission affirms the ALJ's ruling with respect to the future earnings rate and those earnings are properly accounted for by the TAPS Carriers; and (2) refunds of DR&R overcollections are guaranteed.

instant case by noting that in *Kuparuk*, the DR&R did not exceed the rate base and the Commission adopted an accrual methodology for DR&R amounts, while the DR&R here was collected based on the annuity method.[235] In addition, the Commission notes that although the ALJ did not require the TAPS Carriers' to credit rate base for DR&R, the ALJ properly noted the concern regarding DR&R expense is what earnings these funds have accrued and what the ultimate DR&R costs will be at the end of the useful life of the pipeline. Moreover, the Commission finds that for the reasons discussed below concerning other remedies, we also reject Staff's arguments and address Anadarko/Tesoro's.

III. Other Remedies

A. ALJ's Findings

149. The ALJ required the TAPS Carriers to account for the DR&R funds collected and the earnings on such funds by maintaining an accounting of the DR&R and earnings to date using the methodology prescribed[236] and reporting such amounts on Form 6 on a yearly basis,[237] using the amounts from the corrected Ex. ATC-130 up to 2005. The ALJ stated that starting in 2006, the annual reports shall show the sums credited yearly to DR&R earnings based on the TAPS Carriers' weighted average nominal after tax cost of capital. The ALJ also stated that while the question of the ultimate cost of DR&R lingers, the question of whether refunds are necessary is premature. Therefore, the ALJ did not require the TAPS Carriers to credit rate base or refund any DR&R at this point. The ALJ reiterated, however, that the TAPS Carriers will be required to maintain an accounting of the DR&R amounts collected and returns on such amounts in their Form 6 report.

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[235] *Kuparuk*, 55 FERC ¶ 61,122 at 61,382; Ex. ATC-115 at 33.

[236] ID at P 159-60.

[237] In *Kuparuk*, the Commission required an internal accounting for DR&R and details in annual reports of the sums credited to the DR&R fund. 55 FERC ¶ 61,122 at 61,382.

B. Exceptions

150. Staff argues that the ALJ erred by not fully addressing DR&R overcollections and therefore failed to make a definitive finding that the TAPS Carriers are required to refund DR&R collections and earnings that exceed their DR&R requirement.[238] Staff states that although the ALJ noted that the TAPS Carriers' witness, Mr. Browning, estimated the actual cost of performing DR&R in 2005 as $2.63 billion[239] and agreed that the current DR&R balance probably already outstrips what the eventual DR&R task will require,[240] the ALJ determined that there can be no determination of overcollections due to the uncertainty of the actual DR&R obligation and expense required years from now.[241] Staff asserts that if the ALJ's decision is affirmed, then the TAPS Carriers will be presumed to have accumulated DR&R funds of $2.9 billion, which exceeds the TAPS Carriers' latest DR&R estimate by $270 million.[242] Staff states that the record in this proceeding indicates that the TAPS Carriers' estimate of $2.63 billion in 2005 is the best DR&R estimate available, and if a reasonable rate is used to reflect earnings on the DR&R collection thus far, the current DR&R balance represents a sizable overcollection as compared to that estimate.[243]

151. Staff argues that any DR&R amounts collected and earned in excess of the amount needed to fund the DR&R expense should be refunded by the TAPS Carriers, regardless of whether the DR&R overcollection is based on current DR&R estimates or eventual DR&R expenses. However, continues Staff, inasmuch as the ALJ deemed it premature to determine whether overcollections existed, she did not fully address the question of

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[238] ID at P 150-51.

[239] *Id.* P 150 n.106.

[240] *Id.* P 163.

[241] *Id.* P 150.

[242] Ex. SOA-13.

[243] Staff states that it is telling that the TAPS Carriers did not ask for any further DR&R allowance in their interstate rates and have waived the DR&R allowance in their intrastate rates since 1997. ID at P 160.

refunds,[244] and only noted that to the extent that there is a surplus in DR&R funds once the work is implemented, the surplus may need to be refunded.[245] Therefore, Staff requests that the Commission confirm its established policy that (1) DR&R allowances are no more or less than prepayments of specific expenses that are not intended to be over or under funded,[246] and (2) when DR&R overcollections occur refunds are expected to be paid.[247]

152. Flint Hills argues that the ALJ erred by not ordering at least a partial refund of DR&R amounts collected.[248] Flint Hills states that the DR&R funds were collected on an accelerated basis based on an assumed life of TAPS until 2011, and as a result, essentially all of the DR&R funds are collected, despite the fact that the life of TAPS now extends until 2034. Consequently, Flint Hills argues that the principle of intergenerational equity requires that part of the DR&R funds be collected from future shippers and paid to past shippers. Specifically, Flint Hills argues that to achieve intergenerational equity and just and reasonable future TAPS interstate rates, an amount equal to half of the DR&R funds already collected should be paid by TAPS' shippers during the period 2007-2034, and disbursed monthly on a percentage allocation basis to shippers who paid those funds during the period 1978-2006. Flint Hills asserts that this avoids the need to address refunds when TAPS does cease operation in 2034 or thereafter.

153. Flint Hills states that the TAPS Carriers must account for the DR&R funds collected and earnings on such funds,[249] as well as the credits thereto. Flint Hills also

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[244] ID at P 169.

[245] *Id.* P 165 (*citing Kuparuk*, 55 FERC ¶ 61,122 at 61,382); ID at P 168.

[246] *See Sabine*, 10 FERC ¶ 61,241 at 61,451; *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 593-596; ID at P 160 n.117.

[247] *See Kuparuk*, 55 FERC ¶ 61,122 at 61,382; *Tarpon Transmission Co.*, 57 FERC ¶ 61,371, at 62,245 (1991) (*Tarpon*); *Endicott Pipeline Company*, 55 FERC ¶ 63,028, at 65,162 (1991) (*Endicott*).

[248] ID at P 163-65.

[249] *Id.* P 160, 167, 169.

states that since any actual DR&R expenditures incurred by the TAPS Carriers in connection with the Strategic Reconfiguration Initiative will be addressed in Phase II of this proceeding, the issue of the amount of DR&R to be refunded at the approximate mid-point of TAPS' life can and should be addressed in Phase II, and therefore, the TAPS Carriers can be ordered to prepare and produce a DR&R cost estimate based on 2008 dollars.

154. Anadarko/Tesoro argue that the ALJ erred by deferring DR&R refunds and overcollections to the end of the pipelines' life.[250] Anadarko/Tesoro request that the Commission modify the ID by clarifying that the TAPS Carriers will be required to refund any overcollections of DR&R[251] and addressing the issue of DR&R overcollections and refunds now.

155. Anadarko/Tesoro stress that the Commission must address the remaining DR&R issues now for the following reasons (1) the ID's DR&R earnings rate through 2005 is too low,[252] which significantly understates the amount the TAPS Carriers have overcollected as of today;[253] (2) the TAPS Carriers are permitted to keep their current overcollections of DR&R for several more decades and even under the ALJ's approach,[254] the TAPS Carriers overcollected DR&R through 2005 by $200 million;[255] (3) overcollections of DR&R will continue to grow at an accelerated rate for several more

[250] ID at P 163-64.

[251] Anadarko/Tesoro raise the same arguments as Staff.

[252] *Id.* P 155, 158.

[253] Anadarko/Tesoro state that if DR&R earnings are calculated using the TAPS Carriers' parents' actual earnings rates, the TAPS Carriers already overcollected DR&R by $14.5 billion through 2005. Ex. A/T-149.

[254] ID at P 155-59.

[255] Ex. ATC-130 ($2.83 billion) minus Ex. ATC-157 at 3-6, Ex. ATC-159 at 4 ($2.63 billion).

decades;[256] (4) overcollections may be expected to continue to grow well past the ID's[257] 2034 date used to calculate the depreciation expense;[258] (5) some DR&R may be performed during the life of TAPS;[259] and (6) delaying the resolution of overcollections and refunds of DR&R for several decades does a disservice to both the TAPS Carriers and their ratepayers.

156. Anadarko/Tesoro state that the ALJ's treatment of DR&R fails to ensure available DR&R funds at the end of the pipeline's life. Anadarko/Tesoro argue that even though the ALJ required the TAPS Carriers to maintain an accurate accounting of past and future DR&R collections and earnings DR&R fund,[260] the ALJ did not require the TAPS Carriers to establish an actual or segregated DR&R fund as Anadarko/Tesoro suggested.[261] Anadarko/Tesoro claim that the ALJ's fund amounts to a "virtual" DR&R fund, which does not ensure that the DR&R funds collected from ratepayers will be available at the end of the pipeline's life to perform DR&R activities or, if appropriate, make refunds to shippers. Therefore, Anadarko/Tesoro request that the Commission ensure that the DR&R funds will be available for the refund of any overcollections by requiring a segregated DR&R fund or by obtaining adequate parental guarantees covering DR&R refunds, similar to those provided to the RCA.[262] Anadarko/Tesoro also request the Commission clarify that these end-of-life DR&R issues may be raised and revisited, without prejudice, in future TAPS proceedings.

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[256] Anadarko/Tesoro emphasize that based on the ID's findings, the DR&R fund of $2.83 billion through 2005 may be expected to grow at 8.60 percent, while the DR&R expense of $2.63 billion may be expected to grow at 3.42 percent, resulting in 5.18 percent grown rate for DR&R collections. ID at P 158.

[257] ID at P 133.

[258] *See* Ex. A/T-32 at 4, 6, 7; Ex. ATC-4 at 46.

[259] Anadarko/Tesoro state for example the DR&R expenses associated with the current strategic reconfiguration project to decommission several pump stations on TAPS.

[260] ID at P 166-69.

[261] Ex. A/T-3 at 81, Ex. A/T-140 at 83.

[262] *See* Ex. A/T-138 at Tab P-03-04.

157. The TAPS Carriers state that the ALJ's requirement of an accounting and FERC Form 6 reporting, which is to facilitate possible refunds, is unlawful.[263] The TAPS Carriers argue that the record does not support the finding that the purported collections are measurable at this time or that they are either prepayments or potentially subject to refund. Therefore, the TAPS Carriers emphasize that it serves no purpose to account for or report the DR&R amounts and such a requirement is contrary to law.

158. The TAPS Carriers argue that apart from the TSM, there can be no specification of the DR&R collection amounts. The TAPS Carriers contend that contrary to record evidence, the ALJ erroneously presumed that specific amounts collected in the TAPS Carriers' rates are identifiable as DR&R collections. Specifically, the TAPS Carriers argue that the TSA shows that (1) the DR&R allowance was a schedule of negotiated amounts and only an element in the TAPS Carriers' formula for determining their ceiling rates each year; (2) the TAPS Carriers were not required to place the amounts in that schedule in a separate account or fund, or account separately for those amounts or any presumed earnings on those amounts; and (3) there was no suggestion that any amounts collected in the TAPS Carriers' rates would be traceable to any of the amounts in the TSM formula.[264] Accordingly, the TAPS Carriers maintain that it is not possible to accurately account for and report on their FERC Form Nos. 6, an amount for DR&R collections and earnings thereon, as the ID assumes.[265]

159. The TAPS Carriers also argue that their DR&R collections are not prepayments and are not subject to refund. The TAPS Carriers state that the ALJ erroneously relied on *Kuparuk* for justifying that the DR&R allowances in the TSA are prepayments that may be subject to refund.[266] The TAPS Carriers argue that the DR&R payments in *Kuparuk* are distinguishable from the DR&R allowances in this case, for the same reasons the ID rejected a DR&R rate base credit.[267] Specifically, the TAPS Carriers emphasize that an accrual method was adopted in *Kuparuk* and the instant case involves an annuity method. Therefore, the TAPS Carriers argue that the ALJ's observations regarding *Kuparuk*

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[263] ID at P 165-67.

[264] Ex. ATC-14 at 18, 36, 54.

[265] ID at P 160, 163.

[266] *Kuparuk*, 55 FERC ¶ 61,122.

[267] ID at P 161-62.

contradict her finding that the DR&R amounts at issue here are prepayments subject to refund.

160. In addition, the TAPS Carriers argue that contrary to the ID,[268] an accounting for DR&R amounts is barred by the rule against retroactive ratemaking, which prohibits attempts to recoup past costs or refund collections from prior periods.[269] The TAPS Carriers assert that the instant case is distinguishable from *Kuparuk* since neither prior Commission orders nor the TSA mention a refund condition and the ICA only permits refunds to suspended rates in section 15(7) and reparations to existing rates subject to a complaint in section 13(1). Consequently, emphasize the TAPS Carriers, directing refunds to shippers for amounts collected in rates not subject to protest or complaint is forbidden by the rule against retroactive ratemaking.[270] Furthermore, the TAPS Carriers argue that the ID fails to respond to this argument by rejecting it based on the fact that the remedy in this case, the accounting requirement, is forward looking.[271] However, the TAPS Carriers assert that it is unclear from the ID that the accounting requirement in fact is only forward-looking, based on the ALJ's conclusion that "the amount of DR&R collections and earnings to date" shall be calculated according to the methodology in Ex. ATC-130, as modified.[272] The TAPS Carriers assert that such an accounting requirement is not forward-looking but implicates amounts collected prior to 2005.[273]

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[268] *Id.* P 168.

[269] The TAPS Carriers also argue that accounting to facilitate refunds of DR&R collections and earnings thereon in final TAPS rates constitutes an impermissible taking of property without due process. *See Atchison, T. & S.F. Ry. v. Arizona Grocery Co.*, 49 F.2d 563, 569 (9th Cir. 1931), *aff'd Arizona Grocery Co. v. Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932).

[270] *Public Util's. Comm'n. of California v. FERC*, 894 F.2d 1372, 1383-84 (D.C. Cir. 1990) (*California*).

[271] ID at P 168.

[272] *See e.g.*, ID at P 159.

[273] The TAPS Carriers argue that the ID's distinction of *Tarpon*, 57 FERC ¶ 61,371 at 62,234, as "inapplicable since the accounting requirement only concerns the 2005 rates forward" fails as well. ID at P 168 n.126. *See also Sea Robin*, 795 F.2d 182.

C. Commission Determination

161. The Commission affirms the ALJ's finding that refunds at this point in time, regarding the DR&R collections, are premature. As the ALJ properly noted, the concern regarding DR&R expense is what earnings these funds have accrued and what the ultimate dismantlement costs will be at the end of the useful life of the pipeline. However, the Commission notes that this finding does not preclude the possibility of refunds being issued when such collections of DR&R are realized and quantified. Until such a determination is made, any assertions of overcollections for DR&R expenses are rejected as not supported by the record. Therefore, Anadarko/Tesoro's request for addressing the issue of DR&R overcollections and refunds now rather than at the end of the pipeline's life, is rejected.

162. The Commission rejects Flint Hills' argument for partial refunds of DR&R amounts as speculative, since the actual DR&R expenses are not known until the end of the pipeline and if the refund is granted, it should be when all final costs are known.

163. The Commission also rejects the TAPS Carriers' arguments that the ALJ's requirement of an accounting and FERC Form 6 reporting is unlawful, an impermissible taking of property without due process and retroactive ratemaking and that their DR&R collections are not prepayments and not subject to refund. Specifically, the cases cited by the TAPS Carriers in support of their arguments are distinguishable from the instant case for the same reasons indicated in the ID.[274] The Commission reiterates that accounting for the DR&R collections is not retroactive ratemaking since the remedy only concerns the 2005 rates forward, the money was collected in jurisdictional rates related to a jurisdictional service and the DR&R collections and earnings are prepayments. In addition, accounting for DR&R collections and earning is consistent with Commission precedent.[275]

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[274] ID at P 165-69.

[275] *See Kuparuk*, 55 FERC ¶ 61,122 at 61,382; *Sepulveda*, 117 FERC ¶ 61,285 at P 74-75.

Issue III.F: Return on Investment

Issue III.F.1: What is the appropriate capital structure?

I. ALJ's Findings

164. The ALJ rejected the TAPS Carriers' argument that the appropriate capital structure is that of the TAPS Carriers' parent companies. The ALJ found that the parent companies' capital structure, which has a weighted average equity ratio of 71.42 percent for the period of 1968-2005, falls well outside the range of capital structures approved by the Commission. The ALJ concluded that neither the evidence in the record nor the Commission precedent support using such a ratio. In reaching this conclusion, the ALJ specifically distinguished the two cases primarily relied upon by the TAPS Carriers, *Kuparuk* and *Colonial*.[276]

165. The ALJ also rejected the parent companies' capital structure because she found that the parents' business risks are not comparable with those of the TAPS Carriers. The ALJ stated that the parents are involved in highly risky and competitive exploration and production (E&P) activities, while, in contrast, the TAPS Carriers are solely engaged in the TAPS pipeline. The ALJ explained that the TAPS Carriers' sole involvement in the TAPS pipeline is less risky than the parents' ventures because the TAPS pipeline has no direct competition, as it is the only means of transporting ANS oil to market. The ALJ also rejected the TAPS Carriers' argument that the risks associated with the original construction of TAPS are relevant here, 35 years later, and stated the ID's inquiry would focus on the years 2005, 2006, and forward. The ALJ's finding that the TAPS Carriers' business risks are not as high as the risks of their parents, in combination with the finding that the equity ratio of the parents was too high, led the ALJ to determine that the capital structure of the parent companies is anomalous and, therefore, inappropriate.

166. The ALJ decided instead to use a hypothetical capital structure based on the average equity ratio of a group of comparable MLPs. The ALJ stated that it is consistent with Commission precedent to use a hypothetical pipeline where the equity structure of the parent is "anomalous," as it is here. The specific proxy group the ALJ chose is the proxy group sponsored by Anadarko/Tesoro's witness, Mr. Hanley,[277] and is also the

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[276] *Colonial Pipeline Co.*, 116 FERC ¶ 61,078 (2006) (*Colonial*).

[277] The ALJ noted that Mr. Hanley developed an alternate proxy group of four diversified gas companies, and found that equity ratio of this alternate gas proxy group of

(continued....)

same proxy group used by the parties that filed return on equity evidence.[278] The ALJ determined this proxy group is appropriate because it consists of a representative group of oil MLPs[279] that have been endorsed by the State and previously found acceptable by the Commission.[280] In addition, the ALJ determined that the risk profile of the proxy group is comparable to that of the TAPS Carriers.

167. The ALJ rejected the TAPS Carriers' concerns about using a proxy group consisting entirely of MLPs. The ALJ explained that *Sepulveda*[281] and *Kern River*,[282] two of the cases cited by the TAPS Carriers, do not preclude the use of MLPs if proper adjustments are made to account for the differences between MLPs and corporations. The ALJ noted that though the four MLPs in the oil proxy group have distributions exceeding income for a portion of the relevant time period, there is sufficient evidence in the record to make the necessary adjustments and that the effect would be minimal.

168. The oil proxy group the ALJ relied on yielded an equity ratio of 45 percent, which the ALJ found to be significantly lower than the 71 percent weighted average equity ratio of the TAPS Carriers' parent companies. Thus, the ALJ concluded that, notwithstanding the inclusion of the MLPs, the equity structure produced by the oil proxy group is reasonable and credible when compared to the other proposed equity structures.

169. In light of this, the ALJ adopted a capital structure comprised of 55 percent debt and 45 percent equity for 2005, and 58 percent debt and 42 percent equity for 2006, based

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55 percent is close to the equity ratio of the oil proxy group. The ALJ stated this further confirms that the equity ratio of the parent companies is anomalous. The ALJ relied on Mr. Hanley's testimony that the alternate gas proxy group is comparable to the oil proxy group from a financial and business risk point of view. ID at P 199.

[278] Staff's Brief Opposing Exceptions at 104.

[279] Mr. Hanley's proxy group consists of Buckeye Partners, L.P., Enbridge Energy Partners, L.P., Kinder Morgan Energy Partners, L.P., and TEPPCO Partners, L.P.

[280] *See SFPP, L.P.*, 96 FERC ¶ 61,281 (2001) (*SFPP*).

[281] *Sepulveda*, 117 FERC ¶ 61,285.

[282] *Kern River*, 117 FERC ¶ 61,077.

on the oil pipeline proxy group discussed above. The ALJ further found that because the business risks for all the TAPS Carriers are virtually identical, there should only be one rate of return, which necessarily means one capital structure.

II. Exceptions

170. The TAPS Carriers object to the ALJ's use of a proxy group to determine capital structure. The TAPS Carriers contend the Commission has never imposed a hypothetical capital structure on an oil pipeline and that the Commission only intended proxy groups to be used to determine cost of equity, and not capital structure. The TAPS Carriers further state that the business risks they face are significantly higher than the risks of the oil proxy group. The TAPS Carriers cite the risks associated with the harsh climate and terrain of Alaska, in addition to the risks they face being entirely dependent upon a declining oil supply in a single region. The TAPS Carriers state that in comparison, the members of the proxy group are diversified, publicly-traded companies that hold other companies as well as oil pipelines and encounter none of the risks of operating in Alaska.

171. The TAPS Carriers argue the Commission should instead adopt the capital structure of the TAPS Carriers' parent companies. The TAPS Carriers state that the Commission has consistently approved the use of actual pipeline or parent company capital structures in previous oil cases and cites *Kuparuk* and *Colonial* in support of this position. In addition, the TAPS Carriers argue that the risks they face are higher than the risks of their highly diversified parent companies. The TAPS Carriers further contend that if the Commission does not accept the parent companies' capital structures, it would be appropriate to use the 71 percent ownership-weighted equity ratio of the parents over the course of TAPS' life (1968-2005). The TAPS Carriers argue that doing so is consistent with Commission precedent[283] and reasonably reflects the unique risks TAPS has faced over the life of the system.

172. Flint Hills argues that the ALJ erred by not using the weighted average capital structure of the TAPS Carriers' parent companies. Flint Hills contends that the ALJ's acceptance of the oil proxy group's capital structure is inconsistent with the *Kern River* and *Sepulveda* cases, which cast doubt on the use of MLPs in oil proxy groups. Flint Hills further argues that the parents' weighted average equity ratio of 71 percent is reasonable given the D.C. Circuit's approval of equity ratios in the range of 65 percent

[283] The TAPS Carriers cite *Colonial* in support of this position.

for less risky gas pipelines.[284] Flint Hills states it recognizes there may be issues with using the parent companies' common equity ratios of 85 and 87 percent, but argues that the solution is not to use the too low common equity ratios of the oil proxy group. Flint Hills argues that the Commission should instead use the parents' weighted average equity ratio of 71 percent,[285] which Flint Hills argues is consistent with Commission precedent in *Kuparuk* and *Colonial*.

173. Both Flint Hills and the TAPS Carriers contend the ALJ's capital structure analysis is incomplete because it does not include capital structure determinations for the period of 1983-2004. Flint Hills and the TAPS Carriers argue such a determination is necessary to calculate deferred returns, and the TAPS Carriers argue this data is necessary to calculate AFUDC and the SRB write-up. Flint Hills and the TAPS Carriers contend the Commission should use the capital structures of the TAPS Carriers' parent companies in determining these amounts. They argue the hypothetical capital structure data cannot be used because the oil proxy group did not exist prior to 1992, amongst other reasons.

III. Commission Determination

174. As the ALJ stated in the ID, an integral part of any return calculation is the appropriate capital structure to which the cost of equity and cost of debt are to be applied.[286] In the past, the Commission used the capital structure of the regulated entity unless it does not provide its own financing.[287] If the entity does not provide its own financing, the Commission will generally use the capital structure of the parent company that does the financing.[288] However, if the parents' capital structure is anomalous relative to the capital structures of the publicly-traded proxy companies used in the discounted cash flow (DCF) analysis and capital structures approved for other regulated pipelines,

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[284] Flint Hills cites *Missouri Public Service Commission v. FERC*, 215 F.3d 1, 6 (D.C. Cir. 2001).

[285] Flint Hills also suggests setting a common equity ratio cap at 71 percent. Flint Hills' Brief on Exceptions at 59.

[286] ID at P 188.

[287] *Id*. *Entrega Gas Pipeline*, 113 FERC ¶ 61,327, at P 32 (2005) (*Entrega*).

[288] *Id*.

the Commission will use a hypothetical capital structure based on the average capital structure of a selected group of comparable firms.[289] The Commission will also reject the parents' capital structure if it is not representative of the risks of the pipeline.[290]

175. Here, since TAPS does not provide its own debt financing, the ALJ appropriately looked to an alternative capital structure. In doing so, the ALJ rejected the TAPS Carriers' request to use the capital structure of their parent companies. Though not expressly stated in the TAPS Carriers' Brief on Exceptions, the record demonstrates that the equity ratios of the TAPS Carriers' parents are 85 percent for 2004 and 87 percent for 2005. As an alternative to the parents' actual equity ratios, the TAPS Carriers and Flint Hills advocate a 71.42 percent equity ratio that represents the ownership weighted average equity ratio for the TAPS Carriers' parents from 1968 through 2005. We agree with the ALJ that the equity ratios of the TAPS Carriers' parent companies are anomalous and do not appropriately represent the Carrier's risk profile.

176. The parent companies' equity ratios are anomalous in that they fall outside the range of capital structures normally approved by the Commission. The Commission has never approved an oil pipeline equity ratio close to 85 percent, and even the parents' lesser equity ratio of 71 percent is out of line with the 45 percent to 55 percent equity range typically found just and reasonable by the Commission for oil pipelines.[291] The TAPS Carriers and Flint Hills primarily rely on two cases to support the use of a 71 percent equity ratio – *Colonial* and *Kuparuk*. However, the ALJ properly explained that these cases do not support the TAPS Carriers' argument.[292] In *Colonial*, the Commission did not approve a 71 percent equity ratio, but stated it would review the proposal upon completion of the project. The pipeline in that case was embarking on a mainline expansion and faced substantial challenges, such as the length and scope of the project, the enormous investment involved, financing challenges, the challenges of constructing a

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[289] *Id. Transcontinental Gas Pipeline Corp.*, 90 FERC ¶ 61,279, at 61,928 (2000); *Michigan Gas Storage Co.*, 87 FERC ¶ 61,038, at 61,160 (1999); *Transcontinental Gas Pipeline Corp.*, 84 FERC ¶ 61,084, at 61,414-15 (1998) (Opinion No. 414-A).

[290] *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042, at P 86 (2004); *SFPP*, 96 FERC ¶ 61,281 at 62,068.

[291] *See SFPP*, 96 FERC ¶ 61,281 at 62,064-65.

[292] ID at P 189-91.

multi-state project, and the short time for completion of the project. This is distinguishable from the situation here because TAPS is a completed project and does not face similar challenges. In addition, the Commission noted in *Colonial* that a 71 percent equity ratio was "at the extreme" of the equity ratios approved by the Commission.[293] In *Kuparuk*, the Commission approved a 58 percent equity ratio, which is much lower than the 71 percent equity ratio advocated by the TAPS Carriers. In addition, there were risks present in *Kuparuk* that do not apply to the TAPS Carriers. These distinguishing risks include uncertainty over whether the drop in oil prices in the mid-1980's and early-1990's might shut in Kuparuk's wells and whether demand for Kuparuk's transportation services would continue in the market it was serving.[294] Thus, as the ALJ concluded, neither *Colonial* nor *Kuparuk* can be read to support the TAPS Carriers' position.

177. It is also not appropriate to use the capital structure of the TAPS Carriers' parents companies because their risk profiles are not comparable. The TAPS Carriers' parents' business risks are high because they are involved in several highly risky E&P undertakings. Even though the parents are diversified, their overall risk is still high because the projects they diversified into are risky E&P projects. The TAPS Carriers argue the risks they face are higher than the risks of their parents because of TAPS' location in the harsh Alaska climate and because their operations are not diversified, but reliant on declining production from a single oil field. We disagree. As Staff points out, most oil pipelines operate in harsh climates.[295] Whether in the Rocky Mountains, in desert terrain, or offshore in the Gulf of Mexico, pipelines are often located in hostile environments, each with its own set of challenges. TAPS' Alaska location does not make the operating, economic, and regulatory risks it faces any more substantial than those of other pipelines. In addition, while it may be appropriate to consider construction risks when establishing a capital structure for developing projects, such considerations are not highly probative for a pipeline completed over thirty years ago. Further, the TAPS Carriers' lack of diversity does not increase their risk. To the contrary, the record demonstrates that the TAPS Carriers are involved in a project with little remaining unrecovered investment, no direct competition, and that boasts a 30-year history of safe, successful operations. In addition, Anadarko/Tesoro's witness testified that the "likelihood that additional [oil] reserves would be found [for TAPS to draw from] was

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[293] *Colonial*, 116 FERC ¶ 61,078 at P 62.

[294] *See Kuparuk*, 55 FERC ¶ 61,122 at 61,376-77.

[295] Staff's Brief Opposing Exceptions at 95.

high and proved to be true."[296] Therefore, the ALJ appropriately concluded that based on the evidence in the record, the business risks of the TAPS Carriers and their parents are not comparable and that the parents' capital structure should not be used.

178. The Commission affirms the ALJ's determination that the appropriate capital structure is that of a hypothetical proxy group that mirrors a typical oil pipeline. The Commission has not yet adopted the use of a proxy group to determine hypothetical capital structures for an oil pipeline, but it has adopted proxy capital structures for other regulated entities.[297] In addition, the Commission's policy for determining whether to use the capital structure of the pipeline, as opposed to the parent or a hypothetical capital structure, is well-defined.[298] Since here it has been found that the TAPS Carriers' parent companies' capital structure is anomalous, it is both appropriate and consistent with Commission precedent to use a hypothetical capital structure.

179. The proxy group the ALJ relied on for determining TAPS' capital structure consists of a representative group of oil pipeline companies previously found acceptable by the Commission and endorsed by the State.[299] It is also the same proxy group the parties agreed to use to calculate return on equity, as discussed below in Issue III.F.2.[300] This matching of proxy groups makes sense because it ensures that the risks of the proxy groups are consistent for both capital structure and return on equity purposes. Anadarko/Tesoro's witness, Mr. Hanley, further demonstrated the appropriateness of the oil proxy group through an empirical study showing the risk profile of TAPS is comparable to that of the oil proxy group, as well as to an alternative gas proxy group.[301]

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[296] ID at P 192 (*citing* Ex. A/T-100 at 26).

[297] *See Louisiana Intrastate Gas Corp.*, 52 FERC ¶ 61,297, at 61,189 (1990); *Alabama-Tennessee Natural Gas Co.*, 40 FERC ¶ 61,244, at 61,814 (1987); *High Island Offshore Sys., L.L.C.*, 110 FERC ¶ 61,043, at P 143 (2005) (*HIOS*).

[298] *Transcontinental Gas Pipe Line Corp.*, 90 FERC ¶ 61,279 at 61,928.

[299] ID at P 197.

[300] Flint Hills argues that parties would not have agreed to this proxy group had the *Sepulveda* case been issued before testimony was filed. ID at P 175.

[301] ID at P 197.

180. The TAPS Carriers do not agree that the risks they face are comparable to the risks of the oil proxy group. The TAPS Carriers argue that because members of the proxy group are diversified, their risks are less then those of the TAPS Carriers. However, the TAPS Carriers failed to provide an analysis explaining how the diversification of the proxy group members decreases their risks. The mere fact of diversification is not enough to make the proxy group unrepresentative. In addition, the TAPS Carriers' argument that the proxy group's risks are not comparable to theirs because the proxy group members do not operate in Alaska is not persuasive. As explained above, many oil pipelines operate in harsh climates, and the TAPS Carriers have not provided any evidence that the locations of the proxy group members are exceptionally risk-free. Therefore, the Commission concludes that on balance, the evidence in the record demonstrates that the proxy group used by the ALJ to determine TAPS' capital structure is representative and risk-appropriate.

181. Flint Hills objects to the inclusion of MLPs in the proxy group used to determine TAPS' capital structure, to the extent that MLP distributions exceed earnings, and cites *Kern River* and *Sepulveda* in support of its position. However, Flint Hills' argument is misplaced. In *Kern River* and *Sepulveda*, the Commission expressed concern about including MLPs with distributions that exceed earnings in proxy groups because doing so could skew the return on equity calculation under the DCF analysis. However, the distinction between MLP distributions and corporate dividends is only relevant in the context of calculating return on equity, and is not a relevant consideration in the determination of an entity's capital structure. Therefore, Flint Hills' exception to the ALJ's capital structure determinations on these grounds is misplaced.

182. Flint Hills and the TAPS Carriers also argue the ALJ erred in not determining TAPS' capital structure for the period of 1983-2004 because this data is necessary to calculate deferred returns, AFUDC, and the SRB write-up. However, as discussed in Issues III.B.5 and III.B.2 of this order, the TAPS Carriers are not entitled to an SRB write-up or deferred returns for that time period. In addition, as discussed in Issues III.B.3 and III.B.4 of this order, the ALJ properly determined that the appropriate amounts of AFUDC to include in the rate base are listed in the relevant exhibits provided by Anadarko/Tesoro. Therefore, it was unnecessary for the ALJ to determine TAPS' capital structure for the period of 1983-2004.

183. The Commission finds that the exceptions raised by the TAPS Carriers' and Flint Hills to the ALJ's capital structure determinations hold no merit. The Commission, therefore, affirms the capital structure adopted by the ALJ in the ID of 55 percent debt and 45 percent equity for 2005, and 58 percent debt and 42 percent equity for 2006.

Issue III.F.2: What is the appropriate return on equity?

I. ALJ's Findings

184. The ALJ stated as an initial matter that the parties generally agree the DCF analysis is the appropriate methodology to employ in calculating the return on equity in this proceeding. However, the ALJ noted that there are small differences in the parties' application of the DCF analysis. Specifically, Anadarko/Tesoro's witness used an additional Social Security Administration (SSA) forecast in determining long term growth rates that the TAPS Carriers did not use. The ALJ stated the use of this additional SSA forecast, which has been approved for use in the DCF analysis by the Commission, rendered Anadarko/Tesoro's study more reliable than the study preformed by the TAPS Carriers. Thus, the ALJ chose to rely on Anadarko/Tesoro's DCF analysis over the TAPS Carriers, though the ALJ pointed out the differences in the two DCF calculations are *de minimis*.

185. The ALJ found that the appropriate return on equity for TAPS, calculated using the DCF methodology inputs of Anadarko/Tesoro, is 12.16 percent on a nominal basis (8.9 percent inflation adjusted or real ROE) for 2005, and 12.31 percent on a nominal basis (8.89 percent inflation adjusted or real ROE) for 2006.

186. The ALJ rejected the TAPS Carriers' claim that a risk premium of 2 percent (or 200 base points) should be added to their return on equity. The ALJ explained that "[a]bsent highly unusual circumstances that indicate exceptionally high or low risk as compared to other pipelines, the assumption is made that a pipeline faces average risks...."[302] Using this analysis, the ALJ concluded the TAPS Carriers failed to prove that operating TAPS is riskier than the operations of other pipelines. The ALJ also disagreed with the TAPS Carriers' assertion that the risks faced during the construction of TAPS merit a 2 percent risk premium and explained that the risk premium inquiry is forward-looking. Finding TAPS was not a risky enterprise in either its construction phase or operational phase, and more important prospectively, the ALJ concluded that the TAPS Carriers failed to rebut the presumption that they face average risks and are not entitled to a 2 percent risk premium.

[302] *Petal Gas Storage*, 106 FERC ¶ 61,325, at P 8 (2004).

II. Exceptions

187. Flint Hills objects to the ALJ's use of a proxy group consisting of MLPs to determine the appropriate return on equity. As an initial matter, Flint Hills argues the ALJ made no affirmative finding that this MLP proxy group was appropriate for use in determining the return on equity. Flint Hills next contends the MLPs contained in the oil proxy group do not pass the tests set forth in *Sepulveda* and *Kern River*, which require earnings to exceed distributions. Flint Hills also disagrees that the difference between earnings and distributions is minimal and can be handled through earnings-capped distributions. Flint Hills further argues that because the *Sepulveda* decision was not issued until after the parties had submitted pre-filed testimony, they did not have the opportunity to address the use of the MLPs in light of the Commission's decision and, therefore, due process requires that the capital structure and return on equity portions of the ratemaking be remanded for further proceedings.

188. The TAPS Carriers object to the ALJ's decision not to add a 2 percentage point risk premium on their return on equity. The TAPS Carriers argue that despite the ALJ's findings, risk premiums may compensate for past risks, as well as future risks. The TAPS Carriers state that as recognized in Order No. 31,[303] if there was no compensation for construction risks after they were overcome and the operation phase has begun, there could never be compensation for these risks. The TAPS Carriers argue that a 2 percent risk premium would help compensate them for the risks they faced in building TAPS.

III. Commission Determination

189. The Supreme Court has stated that "the return to the equity owner should be commensurate with the return on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[304] Since the 1980's, the Commission has used the DCF model to develop a range of returns earned on

[303] Order No. 31, 7 FERC ¶ 61,237 (1979).

[304] *FPC v. Hope Natural Gas*, 320 U.S. 591 (1944); *Bluefield Water Works & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1923).

investments in companies with corresponding risks for purposes of determining the ROE to be awarded natural gas and oil pipelines.[305]

190. The DCF model was originally developed as a method for investors to estimate the value of securities, including common stocks.[306] Unlike investors, the Commission uses the DCF model to determine the ROE, rather than to estimate the value of securities. However, some jurisdictional oil pipelines are wholly-owned subsidiaries and their common stocks are not publicly traded.[307] Therefore, the Commission must use a proxy group of publicly traded firms with corresponding risks to set a range of reasonable returns.[308]

191. Flint Hills expresses concerns regarding the ALJ's use of a proxy group consisting of MLPs to determine the appropriate return on equity. Flint Hills contends this was improper because the MLPs in the proxy group failed to meet the tests set forth in *Kern River* and *Sepulveda* because they made distributions that exceeded their earnings. The potential problem with including MLPs such as these in the DCF calculation is that doing so may overstate the estimated return on equity.

192. On April 17, 2008, the Commission issued a policy statement addressing the inclusion of MLPs in the proxy groups used to determine gas and oil pipelines' return on equity under the DCF analysis.[309] In the *Policy Statement*, the Commission noted that historically in determining proxy groups, the Commission required that pipeline operations constitute a high proportion of the business of any firm included in the proxy group. However, the Commission explained that because of the trend toward MLPs, there are no longer any purely oil corporations available for use in the oil pipeline proxy group and virtually all traded oil pipelines' equity interests are owned by MLPs. The Commission stated these MLPs are more likely to be representative of predominantly

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[305] *Policy Statement on the Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at P 3 (2008) (*Policy Statement*).

[306] *Id.* P 4.

[307] *Id.* P 7.

[308] *Id.*

[309] *Id.*

pipeline firms than the diversified oil corporations still available for inclusion in a proxy group. As a result, the Commission concluded that MLPs should be included in the ROE proxy group for both oil and gas pipelines.

193. In the *Policy Statement*, the Commission recognized that there are significant differences in the cash flows to investors and growth rates of MLPs and corporations. However, the Commission stated that those issues may be accounted for in a correctly performed DCF analysis and, therefore, do not preclude inclusion of MLPs in the proxy group.[310] The *Policy Statement* considered possible adjustments to the DCF methodology to account for the differences between MLPs and corporations. In doing so, the Commission decided not to impose an earnings cap on MLPs' distributions. The Commission instead found that the differences between MLPs and corporations, particularly MLPs' lower growth prospects due to their distributions in excess of earnings, are appropriately accounted for in the growth projection component of the DCF model. Historically, the Commission has required that projected long-term growth in Gross Domestic Product (GDP) be used as the corporate long-term growth component of the DCF calculation.[311] However, in the *Policy Statement* the Commission determined that for MLPs, the long-term growth projection should be 50 percent of projected growth in GDP.[312]

194. In the ID, the ALJ based TAPS' return on equity on a proxy group that is both risk-appropriate and representative, as discussed at length in the capital structure section

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[310] *Id.* P 52.

[311] *Id.* P 85.

[312] One of the inputs into the DCF formula is the expected constant growth in dividend income. Determining the constant growth of dividends is a two step analysis that involves averaging short-term and long-term growth estimates. Short-term growth is based on security analysts' five year forecast for each company in the proxy group. Long-term growth is based on forecasts of long-term growth of the economy as a whole, as reflected in the GDP which are drawn from three different sources. The three sources used by the Commission are Global Insight: *Long-Term Macro Forecast – Baseline (U.S. Economy 30-Year Focus)*; Energy Information Agency, *Annual Energy Outlook*; and the Social Security Administration. The short-term forecast receives a two-thirds weighting and the long-term forecast receives a one-third weighting in calculating the growth rate in the DCF model. *See Policy Statement* at P 4, 6.

of this order. However, the ALJ did not make any adjustments to the return on equity calculation to account for the differences for the lower growth prospects due to distributions in excess of earnings. As a result, the Commission generally affirms the return on equity amounts adopted by the ALJ, but requires that these amounts be modified to reflect the determination in the *Policy Statement* that the long-term growth projection for MLPs should be 50 percent of projected growth in GDP.

195. The Commission also affirms the ALJ's decision not to add a 2 percent risk premium to the TAPS Carriers' return on equity. As the ALJ explained, the Commission considers all pipelines to be of average risk and generally sets ROEs that reflect the median DCF range, absent unusual circumstances and a showing of anomalously high or low risk.[313] In the instances where the Commission has deviated from the median to allow a return on equity adjustment, it has done so based on perceived forward-looking risk factors unique to the regulated entity and/or shortcomings in available proxy companies.[314]

196. Here, the ALJ properly concluded that the TAPS Carriers failed to rebut the presumption that TAPS faces average risks. The TAPS Carriers' sole support for the 2 percent risk premium are the alleged challenges and risks TAPS endured during construction. As the ALJ stated, the risk premium inquiry is forward-looking.[315] While this does not mean the Commission cannot consider past risks when determining whether a pipeline is entitled to a risk premium, for the Commission to do so, the past risks must still be relevant in the present and prospectively. In this case, whatever risks the TAPS Carriers faced constructing TAPS over thirty years ago are not relevant today and will not likely influence how investors form their cash flow expectations for the future. In addition, as Anadarko/Tesoro's witness testified, TAPS current business and financial risks are average. Therefore, the ALJ correctly concluded that the TAPS Carriers are not entitled to a 2 percent risk premium since TAPS is essentially no riskier than other oil pipelines.

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[313] Opinion No. 414-A 84 FERC at 61,423-24.

[314] *See Kern River*, 117 FERC ¶ 61,077 at P 2,121-23, 148.

[315] ID at P 219.

Issue III.F.3. What is the appropriate cost of debt?

I. ALJ's Findings

197. The ALJ found that, for the sake of consistency, the cost of debt will be calculated in accordance with the findings concerning capital structure. The ALJ also found that as a result of all the findings on Issue III.F or the appropriate return on investment, the real weighted cost of capital in this case is 7.20 percent in 2005[316] and 7.16 percent in 2006. No party contested this finding.

II. Commission Determination

198. The Commission affirms the ALJ's ruling.

Issue III.J. Does the Designated Carriers' SAC presentation show that the filed 2005 and 2006 interstate rates are just and reasonable?

I. ALJ's Findings

199. The ALJ found that the SAC methodology runs afoul of the cost based ratemaking principles articulated in Opinion No. 154-B and *Farmers Union II*. The ALJ stated that SAC is based only on forward-looking costs and does not take the original cost of rate base into consideration. The ALJ also stated that the Designated Carriers' SAC presentation created a hypothetical pipeline out of thin air that was not similar to TAPS. The ALJ also found that SAC is a replacement methodology and is nothing more than an allocation method that has no place in the business of ratemaking or the inquiry here. Therefore, the ALJ rejected the SAC methodology as irrelevant since it does not, and cannot, support the Designated Carriers' assertion that their rates are just and reasonable. Moreover, the ALJ rejected the Designated Carriers' contention that SAC is a benchmark for their filed rates.

II. Exceptions

200. The TAPS Carriers argue that the ALJ's rejection of SAC as a benchmark is unsound as a matter of law and economics. The TAPS Carriers assert that the ID

[316] Ex. A/T-13, WP1; Ex. A/T-144, WP1.

misapprehends precedent from the Commission and the courts regarding SAC and there is nothing in either *Farmers Union II* or Opinion No. 154-B that mandates the use of historic or original costs.[317] The TAPS Carriers contend that in *Farmers Union II* and *Wisconsin v. FPC*, the D.C. Circuit held that the Commission "enjoys substantial discretion in its ratemaking determinations"[318] and "no single method need be followed" by the Commission "in arriving at a just and reasonable rate."[319] Moreover, the TAPS Carriers state that the court held, "strict original cost-based 'public utilities notions'" need not "be adhered to in deriving oil pipeline rates."[320] The TAPS Carriers also contend that in Opinion No. 154-B, the Commission stated that oil pipelines may advocate SAC principles in defending their rates.[321] The TAPS Carriers cite to Order No.

[317] *See* Ex. DTC-2 at 11-12; *Williams*, 84 FERC ¶ 61,022, at 61,103 (1998) (Opinion No. 391-B).

[318] *Farmers Union II*, 734 F.2d at 1501.

[319] *Wisconsin v. FPC*, 373 U.S. 294, 309 (1963).

[320] *Farmers Union II*, 734 F.2d at 1509 n.51; *see* Ex. DTC-36 at 19. The TAPS Carriers also indicate that the ID ignored other precedent endorsing forward-looking, non-historic cost based methodologies such as SAC, including the Supreme Court's decision in *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 498-501 (2002) (*Verizon*), where the Court approved the use of forward-looking costs for ratemaking and made clear that cost-based ratemaking is not restricted to the use of historic or embedded costs.

[321] *See* Ex. DTC-2 at 9-10. The TAPS Carriers contend that contrary to the ID's finding, Professor Baumol did not admit that "the SAC has been rejected by the courts and the FERC." ID at P 236 (*citing* Tr. 3588 (Dr. Baumol)), but simply agreed that he saw the statement read by Anadarko/Tesoro's counsel that the Commission "adopts net depreciable TOC as the model for calculating rate bases" in Opinion No. 154-B. Tr. 3588 (Dr. Baumol). The TAPS Carriers assert that in no way does this constitute an admission that the courts and Commission have rejected SAC.

561-A,[322] Order No. 571[323] and *Williams Pipeline Co.*[324] as examples of instances where pipelines used SAC evidence to justify their rates.

201. Thus, the TAPS Carriers argue that the ID is incorrect in concluding that "SAC is nothing more than an allocation method that has no place in the business of ratemaking or the inquiry here."[325] The TAPS Carriers assert that SAC's use is not limited to "allocate[ing] costs between captive and non-captive customers of coal hauling railroads,"[326] even though it was used to resolve cost allocation issues.[327] Accordingly, the TAPS Carriers argue that there is no reason why the group of shippers for which a SAC analysis is performed cannot include all shippers on the pipeline, particularly when, all of the interstate shippers ship from the same origin to the same destination.

202. The TAPS Carriers also argue that the Opinion No. 154-B and SAC methodologies are designed to achieve a "common goal" since they are designed to ensure just and reasonable rates.[328] The TAPS Carriers submit that as explained by Professor Baumol, SAC's use of forward-looking costs is a virtue, not a vice. The TAPS Carriers state that SAC analysis hypothesizes a competitor that can enter the market with no barriers to entry or exit and uses the most current technology and develops an efficient

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[322] Order No. 561-A, FERC Stats. and Regs. ¶ 31,000 at 31,107.

[323] Order No. 571, FERC Stats. and Regs. ¶ 31,006.

[324] Opinion No. 391-B, 84 FERC at 61,103 n.52, 61,107, 61,113.

[325] ID at P 238.

[326] *Id.* P 234; *see* Exs. DTC-36 at 14-15; DTC-35 at 13; *Ashley Creek Phosphate Co. v. Chevron Pipe Line Co et al.*, Nos. 40131 (Sub. No. 1), *et al.* (Surface Transportation Board served Oct. 30, 1996) (applying SAC principles to assess the reasonableness of rates on a phosphate slurry pipeline).

[327] Ex. DTC-36 at 14-15; Ex. DTC-35 at 12-13; *Coal Rate Guidelines*, 1 ICC 2d 520, 544 (1985)("[w]e do not see a need for any restrictions on the traffic that may potentially be included in a stand-alone group").

[328] Opinion No. 391-B, 84 FERC at 61,103 n.52; Ex. DTC-2 at 9.

system based on current and future demand.[329] Then, a rate is developed which reflects the maximum rate that an economically efficient new entrant could charge for the same services as those provided by the incumbent carrier.[330] Next, the SAC rate is compared to the filed rate. If the SAC rate is higher than the filed rate, the filed rate is deemed reasonable and since the SAC rates are just and reasonable by definition, any rate below SAC must also be just and reasonable.[331] The TAPS Carriers stress that the SAC rate constitutes a ceiling against which to access both the TAPS Carriers' filed rates and the calculated Opinion No. 154-B rates. The TAPS Carriers contend that Mr. Klick's SAC calculations indicate that the SAC rate for all barrels transported on TAPS is $5.34 in 2005 and $5.52 in 2006, which exceed the level of each of the TAPS Carriers' filed rates for 2005-2006.[332]

203. The TAPS Carriers further argue that the fact that SAC is based on a hypothetical pipeline that differs from TAPS is likewise no basis for rejecting it, and indeed, the Commission and the D.C. Circuit have endorsed SAC's hypothetical components.[333] The TAPS Carriers assert that there is no merit to the ALJ's finding that the Designated Carriers produced their SAC analysis "out of thin air."[334] Rather, argue the TAPS Carriers, the Designated Carriers' SAC study resulted from an extensive and in-depth analyses conducted by experts in the fields of economics, engineering, pipeline operations, and SAC – and no party submitted evidence to the contrary.[335]

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[329] *See* Ex. DTC-1 at 14-15; Ex. DTC-2 at 7, 15; Ex. DTC-5 at 17

[330] *See* Ex. DTC-1 at 4-12; Ex. DTC-2 at 4; Ex. DTC-5 at 4-8; Ex. DTC-35 at 2, 7.

[331] Ex. DTC-2 at 5; Ex. DTC-35 at 2.

[332] Ex. DTC-2 at 34; Ex. DTC-34 at 1, 3.

[333] *See* Opinion No. 391-B, 84 FERC at 61,104; *see also PEPCO*, 744 F.2d 185, 193-94 (D.C. Cir. 1984).

[334] ID at P 237.

[335] *See* TAPS Carriers' Brief on Exceptions at n. 127.

204. Finally, the TAPS Carriers argue that contrary to the ID,[336] the Commission and the courts did not reject replacement costs,[337] but rejected reproduction costs, a component of the ICC Valuation methodology.[338] The TAPS Carriers emphasize that replacement costs differ from reproduction costs since reproduction costs generally reflect a determination of the current cost or value of oil pipeline assets based on indices, showing changes in prices of such assets yearly, while SAC takes into account optimal or efficient size and configuration of those assets based on current or expected demand. The TAPS Carriers contend that the Commission recognized this fact and expressly distinguished reproduction costs from SAC in *Williams*, which the ID ignored.[339]

III. Commission Determination

205. The Commission finds that this Commission never used SAC to establish an overall revenue requirement, nor was it ever suggested that it be used in such a manner. Neither Order Nos. 561-A nor 571, invite SAC to be used for revenue requirement purposes, or approve of it for that purpose.[340] In Order No. 561-A, the Commission indicated that although rate calculations begin with the Commission's traditional cost of service approach, whether the costs thus determined are allocated to the various shipper groups on the basis of fully allocated costs, or on some other basis, is determined in individual cases. In Order No. 571, the Commission allowed a stand alone method to be

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[336] ID at P 236.

[337] The TAPS Carriers state that the ID's reliance on *Chicago District Elec. Generating Corp.*, 2 FPC 412 (1941), for the proposition that "replacement cost evidence 'is inherently fallacious'" is misplaced, since that case rejected the ICC's Valuation methodology, which was based on reproduction costs, stating that "[r]eproduction *cost* evidence is *inherently* fallacious." 2 FPC at 419.

[338] *See Farmers Union II*, 734 F.2d at 1495 (the valuation methodology was based on weighted average of "cost of reproduction new" and original cost).

[339] *See* Opinion No. 391-B, 84 FERC at 61,104 n.59.

[340] Order No. 561-A, FERC Stats. and Regs. ¶ 31,000 at 31,107; Order No. 571, FERC Stats. and Regs. ¶ 31,006.

proposed, in response to a request that a pipeline be able to justify its cost based rates in a manner other than the Opinion No. 154-B fully allocated method.[341]

206. In addition, the Designated Carriers' attempt to use SAC as a test of revenue adequacy by suggesting that the SAC rates are simply benchmarks, is without merit, since the Designated Carriers acknowledge the use of SAC as justification of the challenged rates and as a ceiling to assess both the TAPS Carriers' filed rates and the calculated Opinion No. 154-B rates. Therefore, the Commission finds that the ALJ properly concluded that the Designated Carriers inappropriately applied the SAC methodology to establish a purported new overall revenue requirement.[342] Furthermore, the Commission finds that the ALJ properly rejected the Designated Carriers' contention that SAC is a benchmark for their filed rates.

207. The Commission also finds that the Designated Carriers' SAC proxy does not serve as adequate, credible, acceptable evidence of the propriety of the Designated Carriers' actual rate filings or any component of the filed rates and therefore cannot, and does not, justify the filed rates. Thus, the Commission affirms the ALJ's finding that the Designated Carriers' SAC proposal is without merit and does not support a finding that the filed rates are just and reasonable for the reasons set forth below.

208. First, the Designated Carriers' SAC methodology is inconsistent with original cost ratemaking since it is based on hypothetical present costs not related to the TAPS Carriers' actual costs and accordingly, ignores the front-loaded depreciation and all the other costs that shippers paid to the TAPS Carriers since 1977.[343] In addition, the Designated Carriers' arguments that the principles in *Farmers Union II* and Opinion No. 154-B can be totally ignored, is without merit. The Commission emphasizes that the courts and the Commission gave specific guidance regarding how the just and reasonable

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[341] The Commission stated that in Order No. 561-A, the issues of fully allocated costs for oil pipelines have not been determined in a fully litigated case by the Commission under the ICA. The Commission also stated that proponents of costing methodologies other than fully-allocated costs will not be precluded from advocating such methodologies in individual cases. Order No. 571 at 31,165.

[342] ID at P 236.

[343] *See e.g.*, Ex. A/T-33; Ex. A/T-35 at 6, 34-35, and 83-84; Ex. A/T-62, Statement E at 1; *see also* Tr. 6272:21-24 (Dr. Overcast); Tr. 6376-77 (Dr. Overcast).

provisions of the ICA are interpreted, and with limited exception[344] those provisions require the use of historic costs when setting just and reasonable rates.[345] Therefore, the Commission finds that the ALJ properly found[346] that the SAC methodology is not in accordance with *Farmers Union II*, is outside of the purview of the Opinion No. 154-B methodology or any recognized original cost ratemaking approach, is based only on forward-looking costs and does not take the original cost of the rate base into consideration.[347]

209. Second, since SAC is based on a replacement cost valuation, it contravenes Commission policy and precedent. The Commission and the courts have repeatedly rejected replacement costs as the basis for setting just and reasonable rates in a regulatory framework.[348] In addition, SAC fails to distinguish between the justness and reasonableness of different rates that fall below the SAC ceiling, and is only a starting

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[344] *See e.g.*, *Buckeye Pipe Line Company*, 44 FERC ¶ 61,066, *reh'g denied*, 45 FERC ¶ 61,046 (1988), where the Commission determined that an oil pipeline will avoid traditional, cost-based regulatory scrutiny only if it can demonstrate with substantial evidence that it lacks significant market power in the relevant markets.

[345] *See Farmers Union II*, 734 F.2d at 1530.

[346] ID at P 235-36.

[347] The TAPS Carriers' reliance on *Verizon* to support forward-looking, non-historic cost-based methodologies such as SAC is misplaced. The Telecommunications Act of 1996, under which *Verizon* arose, is a different regulatory schematic than the ICA, specifically prohibited the FCC from using traditional cost of service regulation and as noted by the Supreme Court, is different from any historical practice. *See* Tr. 3473-77 (Mr. Klick); *see also Verizon*, 535 U.S. at 488.

[348] The Designated Carriers' attempt to distinguish between reproduction costs and replacement cost, to argue that the courts rejected reproduction costs, is unavailing. The Commission, in *Farmers Union II*, rejected the valuation approach because the reproduction cost was essentially a replacement cost. *See Farmers Union II*, 734 F.2d at 1495, 1511. In addition, the Commission, on a number of occasions rejected replacement costs. *See e.g., Viking Gas Transmission Co.*, 57 FERC ¶ 61,417, at 62,356 (1991); *Bayou Interstate Pipeline Sys.*, 41 FERC ¶ 61,086, at 61,223 (1987); *Panhandle Eastern Pipe Line Co.*, 23 FPC 352-53 (1960).

point for additional assumptions and further studies,[349] to reconcile the difference between the SAC ceiling and an original cost rate.[350] Therefore, the Commission finds that since the Designated Carriers conceded that their SAC proposal is premised on replacement cost valuation, the ALJ appropriately rejected the proposal.[351]

210. Third, the Designated Carriers' SAC proposal is inconsistent with any approved use of SAC at this Commission. The Commission specifically rejected use of SAC to set an overall revenue requirement.[352] In *Williams*, the Commission's suggested use of SAC, as a means of allocating a proper revenue requirement among competitive and noncompetitive services, was consistent with SAC's use in other settings.[353] In *Coal Rate Guidelines, Nationwide*,[354] SAC was used to allocate costs, but only those costs already determined adequate to meet the railroad's costs.[355] The Designated Carriers' contention that this case does not rule out other purposes for SAC is without merit. The Designated Carriers point to the phrase "We see no need for any restrictions on the traffic that may potentially be included in the stand-alone group", but disregard the preceding

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[349] The Designated Carriers object to the ALJ's characterization of their SAC study as being produced out of thin air. ID at P 237. The ALJ was referring to the fact that the SAC study represents a New Alaska Pipeline System (NAPS) that does not now nor ever will exist. The Commission does not intend to involve itself in the details of pipeline engineering, construction and other costs for a hypothetical pipeline that will never be built, potentially every time its sets an oil pipeline rate case for hearing.

[350] Tr. 3611-12 (Dr. Baumol); Tr. 3618-29 (Dr. Baumol).

[351] ID at P 238.

[352] Opinion No. 391-B, 84 FERC at 61,098-100.

[353] *See Ass'n of American Railroads v. STB*, 146 F.3d 942, 943-44 (D.C. Cir. 1998); *Burlington Northern RR v. ICC*, 985 F.2d 589, 596 (D.C. Cir. 1993); *Coal Rate Guidelines Nationwide*, 1 ICC 2d 520; *Public Service Co. of Colorado v. Burlington Northern and Santa Fe Railway Co.*, 2005 STB Lexis 23 (2005).

[354] *Coal Rate Guidelines, Nationwide*, 1 ICC 2d 520, aff'd sub nom. *Consolidated Rail Corp v. U.S.*, 812 F.2d 1444 (3rd Cir. 1987).

[355] *Id.* 523.

statement where the ICC noted that "The ability to group traffic to different shippers is essential to the theory of contestability…Without grouping, SAC would not be a very useful test, since the captive shippers would be deprived of the benefits of any inherent production economies."[356] This does not suggest that all shippers may be grouped into one overall group nor does it suggest that SAC may be used to develop an overall revenue requirement. Accordingly, this case fails to support the Designated Carriers' argument.

Issue III.K: What Refunds Should Be Ordered?

I. ALJ's Findings

211. The ALJ held that the new just and reasonable rates ordered here would be effective for 2005 and 2006 and prospectively thereafter. However, refunds would be limited to the difference between the pre-existing rates prior to January 1, 2005 and the filed rate since the applicable rule is that refunds are limited to the amount of the increase from the preexisting rate, citing *Distrigas of Massachusetts Corp. v. FERC*, 737 F.2d 1208 (1st Cir., 1984) (*Distrigas*). The ALJ held that to order refunds for the difference between the just and reasonable rate and the filed rate, as proposed by Staff, would constitute a policy change beyond the ALJ's jurisdiction.

II. Exceptions

212. Petro Star excepts to the ruling, asserting that the ALJ erred by ordering retroactive refunds to all TAPS shippers pursuant to section 15(7) of the ICA, instead of awarding damages to complainants pursuant to section 13(1) of the ICA. It argues that Commission policy favors a narrower remedy that will not unnecessarily abrogate the long-established TSA. Petro Star contends that Anadarko and Tesoro can obtain relief under ICA section 13(1) and 15(1) and be made whole for unjust and unreasonable rates under the 2005 and 2006 TAPS Tariff. Awarding relief in this manner, it argues, will not have the consequence as the ALJ ordered, namely of effectively abrogating the TSA and TSM effective January 1, 2005. This unnecessary remedy will impair the public interest in settlements as well as inflict collateral impacts on Alaska refiners that depend on stable TAPS rates in determining their crude oil costs. Finally, Petro Star argues that the

[356] *Id.* 544; *see e.g., Potomac Electric Power Co. v. ICC*, 744 F.2d 185, 193 (D.C. Cir. 1984).

Commission has discretion to deny all refunds, which it asserts is consistent with Commission practice and the Commission orders that established these hearings.

213. Staff argues that the Commission has the discretion to order refunds to the just and reasonable rates for the years 2005 and 2006 that is provided for in this order. This, Staff contends, would be consistent with the Commission's orders approving the TSM over twenty years ago.

214. Staff asserts that while the ALJ ruling citing *Distrigas* is the general rule, in a later case, the court stated that "We need not decide whether, or what, circumstances might ever justify a departure from this principle, for the Commission has not justified any departure on the record here before us."[357]

215. Staff urges that in this case there are circumstances which justify the Commission's departure from its usual policy. The circumstances Staff refers to are that in approving the TSA the Commission, and the subsequent court approval, stated that in the future, a non-settling party would be afforded a meaningful remedy upon a successful challenge to the TSM. In this case, Staff contends, if a non-settling shipper such as Tesoro, were denied the ability to receive refunds in the entire amount of the difference between the challenged 2005 and 2006 interstate rates and a Commission-determined just and reasonable rate, it would be denied the "meaningful remedy" that was promised to non-settling shippers on TAPS.

216. The TAPS Carriers assert that the ID erred in rejecting the TAPS Carriers' contention that if the Commission determines that a change is required in the methodology used to set TAPS rates, such change may be imposed only prospectively from the date of the Commission's order in this proceeding, as directed by the clear language in ICA section 15(1). In support, the TAPS Carriers cite to *Sea Robin*, 795 F.2d 182. The TAPS Carriers contend that while that case was under the Natural Gas Act (NGA), the ICA has an equivalent provision in section 15(1). Under that section, the TAPS Carriers argue any relief is prospective from the date of the Commission's decision. The TAPS Carriers emphasize that they did not seek to change the TSM, but rather they merely sought to increase the rates calculated under it. The TAPS Carriers assert that it was the protesters that asked the Commission to reject the TSM and impose

[357] *Distrigas of Massachusetts Corp. v. FERC*, 751 F.2d 20 (1st Cir. 1984) (*Distrigas II*).

a new methodology on the TAPS Carriers – a hybrid of TSM and the Commission's Opinion No. 154-B methodology that calculates maximum rates lower than those imposed by TSM. Under *Sea Robin*, the TAPS Carriers argue, since protesters are invoking the Commission's power to alter a methodology that the pipelines are not seeking to change, any order under section 15(1) may take effect only prospectively. Thus, there is no basis for ordering refunds for any period prior to the date on which the new rates are prescribed, and the ALJ erred in establishing a retroactive effective date.

217. The TAPS Carriers argue that the D.C. Circuit's decision in *East Tennessee Natural Gas Company v. FERC*, 863 F.2d 932 (D.C. Cir. 1988) (*E. Tennessee*) similarly makes clear that the Commission's power to change rate components that a pipeline has not proposed to change is limited. Here, protesters propose that the TSM be rejected and a new rate methodology – the Anadarko/Tesoro methodology – be adopted. Accordingly, the TAPS Carriers contend that to the extent the Commission rejects the TSM and prescribes a new methodology for calculating maximum rates on TAPS, ICA section 15(1) and the decisions in *Sea Robin* and *E. Tennessee* require that any change in methodology be made only prospectively.

218. The State does not take issue with the ID's ruling concerning application of the rate determined in this proceeding going forward. However, the State excepts to the limitation of refunds for the 2005 and 2006 filings to the "difference between the 2004 rate and the rates set forth in the 2005 and 2006 rate filings." The State argues that depending on the particular carrier, this would still leave between a $1.04 and $1.75 per barrel difference between the interstate and intrastate rates for the tariff years 2005 and 2006. The State asserts that while the ALJ's ruling may be correct for remedies for rates determined to not be "just and reasonable," this policy need not apply to the State's discrimination claims under ICA sections 2 and 3(1). Nor, the State argues, can the TAPS Carriers claim reliance on the existing rates because when the TAPS Carriers proposed their interstate rates for 2005 and 2006, they had to understand that their proposed rate changes would interact with the existing intrastate rates to create results that would violate ICA sections 2 and 3(1). By their actions, the State maintains, the TAPS Carriers "forego [any] reliance interest and invite retroactive changes to existing rates."[358]

[358] *E. Tennessee*, 863 F.2d at 943.

219. Under these circumstances, the State argues, the TAPS Carriers' unjust discrimination or undue preference in their proposed 2005 and 2006 rates violates ICA sections 2 and 3(1) and must be remedied by ordering refunds in the amount of difference between the TAPS Carriers' proposed 2005 and 2006 rates and the level of the intrastate rates.

220. Flint Hills argues that the ALJ erred in not allowing the TSA and TSM to run their full course. Flint Hills notes that the early termination provision in the TSA has been triggered so there is an "all but guaranteed termination [of the TSA] at the end of 2008." Thus, Flint Hills claims, the overriding public interest is to allow the TSM ratemaking to run its full course so that the parties thereto, and the shippers, all realize the full benefits of the desired levelized rates over the full term of TSA. This, Flint Hills argues, avoids any non-signatories from being rewarded for clearly opportunistic actions at the very end of TSA's life, after reaping the economic benefits during the two decades before.

221. Flint Hills suggests that consistent with allowing the TSA to run its full course, the Commission should sever non-signatories Anadarko and Tesoro from having the TSM-based rates apply to them starting in 2007. Instead, the lower non-TSM rates would apply to Anadarko and Tesoro in 2007 and 2008. Thereafter, the termination provision of the TSA having been triggered, presumably all parties would again be under the same interstate rates because the TAPS Carriers would have to file rates under an Opinion No. 154-B methodology starting in 2009.

222. Flint Hills also asserts that the ALJ erred in rejecting a "public interest" basis for permitting the TSM to govern. The "public interest" Flint Hills refers to is the importance of upholding settlements. Flint Hills states that the Commission described the TSA as "a comprehensive cost-based methodology that provides a rational and predictable tariff profile over time which is economically efficient," and the Commission approved the TSA "because it is fair and reasonable and in the public interest."[359]

223. Flint Hills asserts that two recent decisions, *Sepulveda* and *Kern River*,[360] support allowing the TSA and TSM to continue through the end of 2008. Flint Hills argues that *Kern River* is analogous to this proceeding since it involved levelized rates, and the

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[359] *Trans Alaska Pipeline System*, 33 FERC ¶ 61,064 at 61,140.

[360] *Sepulveda*, 117 FERC ¶ 61,285 and *Kern River*, 117 FERC ¶ 61,077.

purpose of TSM was to establish levelized rates over the life of the TSA, which was also the assumed life of TAPS when it was executed and approved by the Commission.

224. Flint Hills states that in *Kern River* the Commission stated that to achieve the agreed levelized rates, "at the heart of any levelization plan it is inherent in any such plan that the levelized rate will remain in effect for the entire agreed upon period."[361] Flint Hills argues that the same principle fully applies to the TSM, and the Commission must continue to allow its use in setting the resulting levelized rates over the life of the TSA previously approved by the Commission.

225. Flint Hills contends that the ALJ erroneously ignored Flint Hills' proposal that the TSM continue to apply to all except the one shipper, Tesoro, and the one producer which is not a shipper on TAPS, Anadarko, the only non-signatories to the TSA who challenged the continued use of the TSA and TSM to set interstate rates on TAPS. Under this proposal the lower Opinion No. 154-B methodology-based interstate rates would apply to Tesoro's interstate shipment of Anadarko's produced barrels. This alternative, Flint Hills asserts, would further the public policy interest of favoring settlements while, at the same time, honoring the Commission's prior pronouncement that non-signatories could challenge the TSM, and would give Anadarko and Tesoro the benefit of that successful challenge. Flint Hills cites Commission precedent which authorized both a settlement and litigated rate, as support for its proposal herein.[362]

III. Commission Determination

226. We affirm the ID's ruling that the rate determined here will be effective January 1, 2005, but the refund will be limited to the amount of the increase in the filed 2005 and 2006 rates over the existing rate in the 2004 filing, which filing was not protested.

227. The Commission finds no merit in the TAPS Carriers' exception urging that no refunds should be required and that any change in rates must be prospective only. The TAPS Carriers contend *Sea Robin*, and other similar cases established that since they have not proposed to change the existing methodology, any relief must be prospective only. This argument was addressed previously, when we stated that the filing of an

[361] *Kern River*, 117 FERC ¶ 61,077 at 61,326.

[362] Flint Hills cites *New England Power Co.*, 71 FERC ¶ 61,222; *Cove Point LNG Ltd. Partnership*, 98 FERC ¶ 61,270; *Tennessee Gas Pipeline Co.*, 81 FERC ¶ 61,090.

overall rate increase under section 15(7) subjects the entirety of the filed rate, including the unchanged elements, to scrutiny. Once this filing is made, the burden is upon the pipeline to show the justness and reasonableness of its rates, and "to the extent the pipeline fails to sustain that burden, the Commission may order refunds of the overall increase in the cost of service."[363]

228. Further, there is no merit in the TAPS Carriers' contention that since protesters challenged the entire TSM, cases such as *Northern Border* do not apply since in those cases specific components of the filing were challenged. That claim is baseless because in the 2005 and 2006 tariff filings, the TAPS Carriers filed for an overall rate increase under section 15(1), and the statute clearly sets forth the consequences if that filing is not found to be just and reasonable, which is that the Commission will prescribe the just and reasonable rate.

229. We also find no merit in Flint Hills[364] and Petro Star's exceptions that remedies herein should be "limited" or "tailored" such that refunds of the collections over and above just and reasonable rates should flow to Anadarko and Tesoro, the parties who specifically complained, but not to any other shippers. Flint Hills also suggests that the TSM should continue to be used to set rates for all shippers other than the protesters.

230. The simple answer is that the ICA provides the relief to be ordered after a finding that the proposed rates are not just and reasonable. ICA section 15(7) states that in the "case of a proposed increased rate or charge," the Commission may require the carrier to keep account of "all amounts received *by reason of such increase*," and may after hearing require a refund of "*such portion of such increased rates* . . . as by its decision shall be found not justified." (emphasis added) The Commission regulations implementing the statutory directive require oil pipelines whose rates are suspended to keep track for refund purposes of the difference in revenues from each shipper at the "rates in effect immediately prior to the date the proposed change became effective" and at the "proposed rates."[365] Further, the TSA was a settlement strictly between the State and the TAPS Carriers. No shippers ever agreed to the terms of the settlement or were

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[363] *Northern Border Pipeline Co.*, 89 FERC ¶ 61,185 at 61,575-76; *see also Williston Basin Interstate Pipeline Co.*, 107 FERC ¶ 61,164 at P 21-26.

[364] Flint Hills' exception was described, *supra*, in Issues I and II.

[365] *See* 18 C.F.R. § 340.1(b)(1)-(4) (2006).

signatories of the TSA. In fact, cases cited by Flint Hills lead to the opposite conclusion, namely, that settlements apply to settling parties and not to non-settling parties.[366]

231. We deny Staff's exception that the ID erred by not creating an exception to the "general rule that refunds are limited to the increase from the pre-existing rate," which Staff characterizes as a "policy" that the Commission has the discretion to disregard.

232. The ruling by the ALJ is required by the express terms of the applicable statute. Staff argues that while the ID's finding reflects the general rule, there might be circumstances that warrant a departure from the general rule. Staff refers to language in *Distrigas II*, quoted *supra*, suggesting that possibility. However, in *Distrigas II*, the court only stated that it need not decide whether such an exception might ever be warranted; it did not hold that such an exception existed, even in the context of the NGA. Moreover, Staff had not cited a single instance in which such an exception has been made. Given the explicit terms of that statute, as reflected in the Commission's oil pipeline refund regulations, there is no basis for an exception in the ICA context.

233. The State, in its exceptions, takes another route, challenging the refund floor rule. We find no merit in this contention. The State contends that its discrimination claim is not moot, as the ID found it,[367] because a successful discrimination claim authorizes the

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[366] Another proposal advocated by Flint Hills is to adjust the otherwise just and reasonable rate by adding certain "transition" costs as a surcharge. The surcharge reflects the TSM costs from the prior year that, under the net carryover provision of the TSM, would have been trued-up or recovered in the next year had TSM been used to set rates in 2005 and 2006. There was no testimony or evidence offered at the hearing to support this claim, nor was it suggested by the TAPS Carriers. The only exception to cost-based rates that Opinion No. 154-B allows is the one which it defines as the starting rate base, and even that may not be permitted if a particular pipeline is not entitled to it, and the TAPS Carriers are not entitled to it here. The transition cost proposed by Flint Hills would improperly allow the TAPS Carriers to bring forward a portion of the unjust and unreasonable, non-cost-based TSM revenue requirement by simply tacking it onto the otherwise just and reasonable rates. Allowing the net carryover to be collected in otherwise just and reasonable rates for 2005 and 2006 is tantamount to going back and correcting those estimates, i.e., the essence of retroactive ratemaking. Accordingly, we reject this proposal.

[367] ID at P 263.

Commission to order refunds below the level of the pre-existing rate in this case, down to the RCA-prescribed intrastate rates. The State has not shown discrimination, but only that there would be different interstate and intrastate rates for a certain period. Simply having different interstate and intrastate rates is not *de facto* discriminatory. The State suggests that the Commission clearly has the power under ICA section 15(1) to prescribe rates which will substitute lawful for discriminatory rate structures, quoting *New York v. United States*, 331 U.S. 284, 346 (1947), and in this case, this allows the Commission to order refunds below the refund floor.

234. We find no such authority in that case. There the Court stated that "the power granted to the Commission under section 15(1) includes the power to prescribe rates which will substitute lawful for discriminatory rate structures."[368] Once the Commission has found rates to be "unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial," it is empowered under section 15(1) of the ICA to prescribe rates which are "just and reasonable" or "the maximum or minimum, or maximum and minimum, to be charged.[369] In short, the issue of discrimination is separate and distinct from the issue of the justness and reasonableness of rates, and as stated in *New York v. United States*, that "[b]oth rates may lie within the zone of reasonableness and yet result in undue prejudice."

235. However, section 15(1) rate prescription power is prospective only since it authorizes the Commission to establish rates "to be thereafter observed." With respect to backward-looking relief, the Commission's authority to remedy past discrimination resides in ICA section 13, which empowers the Commission to award reparations going back for up to two years prior to the date of a proper complaint. A complainant has the burden under section 13 to prove that it has suffered damages and to quantify the amount of its damages, and here no party undertook to do either, and indeed no party sought reparations either before the ALJ or on exceptions. The State has not cited a single example under the ICA in which refunds below the pre-existing rate were awarded as a remedy for claimed discrimination. The proper remedy in such a case is for an injured party with proper standing to allege and prove damages under ICA section 13.

236. Accordingly, we affirm that the refund will be limited to the amount of the increase in the filed rates over the existing rates.

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[368] *New York v. United States*, 331 U.S. 284, 346.

[369] *Id.* at 345 (*quoting* section 15(1) of the ICA).

Issue III.L: Should the TAPS rates be set on an individual TAPS Carrier basis or should a uniform rate for all TAPS Carriers be determined?

I. ALJ's Findings

237. At the hearing no one contested that all the TAPS Carriers provide an identical interstate transportation service to the shippers regardless of which Carrier's space was used. However, in the past, the TAPS Carriers have charged individual rates that vary significantly within the same year and from year to year. The ALJ found that (1) these variations are not caused by differences in the cost of service, because all of the TAPS Carriers basically have the same cost of service; and (2) the TAPS Carriers did not provide a reasonable explanation as to why their rates should vary significantly when their costs are virtually identical. The evidence showed that the direct expenses for all the TAPS Carriers together totaled approximately $24 million in 2004, which should have had virtually no effect on the individual rates given that test year throughput was 326.7 million barrels.[370] Nevertheless, the TAPS Carriers' rates vary substantially from year to year. The ALJ determined that this occurred because the TSM allowed the TAPS Carriers "free reign to set rates largely as they choose,"[371] and this practice was unduly discriminatory and unjust and unreasonable.

238. The ALJ concluded that a uniform rate would be required since its use would result in several advantages. Rates would require adjustment when total throughput on TAPS changes. Further, the ALJ found employing a uniform rate is reasonable since among other things, it results in a rate that is more representative of the cost to ship a barrel of oil on TAPS and the use of a uniform rate would likely result in less filings due to individual carrier changes in throughput.

239. The ALJ noted that all parties agreed that the rates must be established on a system-wide basis and that a uniform rate would also be consistent with the RCA's requirements for TAPS intrastate rates. Moreover, all of the other jurisdictional rates of Alaskan pipelines, involving many of these same owners (*e.g.*, Kuparuk Transportation Company, Endicott Pipeline Company), use a uniform rate regardless of ownership structure. The ALJ recognized that under either the uniform or individual rate approach, there will be an over or under collection of costs to the extent the amount shipped by a

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[370] Ex. A/T-20, Sch. II-B at 21; Ex. A/T-140 at 45.

[371] ID at P 252.

particular carrier is greater or less than the volume level assumed for that carrier for ratemaking purposes. This can be addressed, the ALJ held, by adopting the "pooling mechanism" already existing under section II-2(F)(ii) of the TSA, which annually adjusts for under and over recoveries of costs due to variances in throughput.

II. Exceptions

240. The TAPS Carriers except to the requirement that there be a uniform rate and request that they be permitted to maintain individual rate structures. They contend that by law each Carrier is required to file an individual tariff and assert that the Commission does not have the authority to impose a uniform rate on TAPS. Next, the TAPS Carriers argue that the adoption of uniform rates could upset existing financing, settlement, and shipper agreements, although they do not indicate which or how.

241. The TAPS Carriers also argue that to move to a uniform rate, the Commission must find the filing of individual rates unjust and unreasonable. They assert that the ALJ ignored the differences among the TAPS Carriers in their use of their individual capacity and erroneously found that their costs are "basically" the same. Finally, the TAPS Carriers claim that a uniform rate structure is unworkable and could possibly violate the Sherman Anti-Trust Act through the exchange of price information.

III. Commission Determination

242. No one disputed that the TAPS Carriers use the same operator to provide the same service through the same pipeline facilities. Moreover, since virtually all of the costs of operation are allocated to the TAPS Carriers in proportion to their ownership, the TAPS Carriers would have essentially the same cost of service. Thus, it seems to follow that there should be a uniform rate. We agree with the ALJ that there should be a uniform interstate rate, consistent with a uniform rate for intrastate transportation set by the RCA.

243. The TAPS Carriers nevertheless argue that until now carriers filed individual rates, and except to the ALJ's ruling on a number of grounds. We find no merit in the TAPS Carriers' contentions.

244. Contrary to the TAPS Carriers' arguments, the ALJ properly concluded that nothing in the ICA prevents the Commission from setting a uniform rate for the identical service, as long as, the uniform rate is just and reasonable.

245. The TAPS Carriers ignore the fact that the Commission regulates other oil pipelines in Alaska and none of these oil pipelines establishes separate rates for each owner.[372] While the TAPS Carriers cite to other undivided joint interest (UJI) oil pipelines or interstate natural gas pipelines where the owners calculate and file their rates individually, the TAPS Carriers do not address the differences between the four pipelines they identify as having individualized rates, let alone discuss in detail the individual characteristics of these pipelines.

246. In *Amoco Pipeline Company*,[373] the Big Horn pipeline constituted one segment of a UJI pipeline system owned by Amoco Pipeline Co. and Conoco Pipeline Co. whereby the companies provided different services to different locations.[374] Thus, it is not unusual to have individual tariffs for those services. Similarly, in *Kern River*,[375] and *ANR Pipeline Co.*[376] pipeline facilities were jointly owned by pipelines which constituted only a portion of each pipeline's interstate transmission facilities. The costs of those facilities are embedded in each pipeline's system cost to develop transportation rates for completely different service areas. In contrast to the UJI pipelines, the TAPS Carriers provide identical interstate transportation service over the same service area by shipping ANS crude from Pump Station No. 1 to Valdez. Lastly, in *Navajo Pipeline Co.*,[377] Navajo Pipeline Co. and Midland-Lea jointly owned a segment of pipe. However, Navajo sought to use it to provide service, whereas Midland-Lea did not. Under those circumstances it was appropriate for Navajo to file a separate tariff.

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[372] *See Alpine Transportation Co.*, 97 FERC ¶ 63,001, at 65,001 (2001) (*Alpine*); *BP Transportation (Alaska) Inc.*, 84 FERC ¶ 61,237, at 62,204 (1998); *BP Transportation (Alaska) Inc.*, 97 FERC ¶ 61,016 (2001); *Endicott Pipeline Co.*, 63 FERC ¶ 61,076 (1993); *Milne Point Pipe Line Co.*, 77 FERC ¶ 61,240 (1996); *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122 (1991).

[373] *Amoco Pipeline Company*, 83 FERC ¶ 61,156 (1998).

[374] *Id.* at 61,670.

[375] *Kern River*, 99 FERC ¶ 61,085 (2002).

[376] *ANR Pipeline Co.*, 86 FERC ¶ 61,316 (1999).

[377] *Navajo Pipeline Co.*, 33 FERC ¶ 62,032 (1985).

247. As to the burden of proof contention, in this case the ALJ found that the TAPS Carriers' filing of individual rates results in unjust and unreasonable rates.[378] We uphold the ALJ and find that a uniform rate is appropriate.

248. The TAPS Carriers contend that the Commission cannot rely on the pooling mechanism to address under-recovery concerns because it is the result of a voluntary agreement among the TAPS Carriers. However, the pooling mechanism was specifically approved by the Commission in its first order approving the TSA, and it will remain in effect for as long as the TSA continues. Further, there is nothing that precludes the Commission from requiring that, as part of the process of establishing just and reasonable rates, the TAPS Carriers continue to make revenue adjustments based on actual usage.

249. In fact, at least one of the TAPS Carriers, BP Pipelines (Alaska) Inc., one of the larger interest owners in TAPS, would not oppose a uniform rate if an acceptable Commission-approved pooling arrangement was put in place to address over and under-revenue.[379]

250. Finally, we fail to see how setting a uniform rate might violate the Sherman Anti-Trust Act. The TAPS Carriers contend that a uniform rate would compel the TAPS Carriers to share non-public information and agree on a common rate. However, the information is only that which is needed to calculate the "just and reasonable" rate, which is the permissible maximum rate. The TAPS Carriers' concern of how the rates could be changed is specious. The filed rate establishes the maximum rate, and for TAPS there is a required annual filing. The rate can be changed in the subsequent annual filing, while any TAPS Carrier is free to charge less than the maximum rate.

251. Accordingly, we affirm the ruling requiring use of a uniform rate.

Issue IV: Whether to grant the State's request for refunds?

I. ALJ's Findings

252. The ID stated that in the State's protest and complaints to the 2005 and 2006 tariff filings, the State asserted that the TAPS Carriers' 2005 and 2006 interstate rates exceed their intrastate rates by approximately $1.56 to $2.02 per barrel (approximately 100

[378] ID at P 257.

[379] *See* TAPS Carriers' Brief on Exceptions at 105 n.37.

percent) in 2005, and in 2006 by $1.82 to $2.45. This substantial disparity between the interstate and intrastate rate, the State asserted are unduly discriminatory and preferential in violation of sections 2 and 3(1) of the ICA and were inconsistent with section II-11(e) of the TSA.[380] The State contended that under sections 2 and 3(1) of the ICA, the lowering of an interstate rate is the appropriate remedy for a discrimination caused by different interstate and intrastate rates for the same service.

253. The ID found that the TAPS Carriers' rates for 2005 and 2006 were unjust and unreasonable and ordered that the TAPS Carriers file prospective just and reasonable rates for TAPS based upon the inputs and methodology specified in the order.[381] Those rates will be effectively the same as the TAPS Carriers' prevailing intrastate rates.[382]

254. In addition the ID ordered the TAPS Carriers to pay refunds for 2005 and 2006. Refunds were limited to the difference between the TAPS Carriers' 2004 filed interstate rates and the TAPS Carriers' 2005 and 2006 filed rates.[383]

255. The ID did not address the merits of the State's claims alleging that the TAPS Carriers violated ICA sections 2 and 3(1). Instead, the ID found that as a result of the order directing the TAPS Carriers to file new rates "the difference between [the 2005 and 2006 TAPS interstate rates prescribed by the ID] and the RCA established intrastate rate[s] are minimal. Accordingly, the discrimination has been alleviated, and the State's discrimination claims are rendered moot."[384]

II. Exceptions

256. The State excepts to the limitation on the refunds ordered. The State asserts that it is not disputed that the services provided on TAPS to interstate and intrastate shippers are

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[380] Section II-11(e) states: Notwithstanding any other provision of this Agreement, all tariffs rates or surcharges charged by a TAPS Carrier shall be subject to the legal prohibition upon unjust discrimination against and undue preference to shippers.

[381] ID at P 243, 276.

[382] *Id.* P 263, 271.

[383] *Id.* P 244.

[384] *Id.* P 263.

"essentially identical," yet the differences between the absolute levels of the TAPS interstate and intrastate rates are dramatic. The limitation on refunds to only the increase over the TAPS Carriers' 2004 rate does not fully remedy the discrimination in the TAPS Carriers' rates for 2005 and 2006. The State argues that under the ID's ruling, significant unjust discrimination and undue preference against interstate shippers remains untouched for these periods, despite the fact that when these rates were put into effect, they were made subject to refund.

257. The State argues that the only applicable remedy here is for the Commission to reduce the interstate rates to eliminate the unjust discrimination and undue preference, and to order refunds of the full amount of the difference between the TAPS Carriers' proposed 2005 and 2006 interstate rates and the actual 2005 and 2006 intrastate rates.

258. The State asserts that since there is no difference in the service provided to interstate or intrastate shippers, the State established a violation of section 2 because the TAPS Carriers' charging disparate rates under substantially similar circumstances establishes unjust discrimination.[385]

259. The State also argues that the disparate rates violate section II-11(e) of the TSA which prohibits "unjust discrimination against and undue preference to shippers."

260. The State argues that the ICA empowers and requires the Commission to direct the TAPS Carriers to lower the interstate rate to eliminate the unjust discrimination and undue preference. Thus, the State contends, it was error for the ID to not award refunds for the 2005 and 2006 interstate rates that would completely remedy the unlawful discrimination.

261. The State also asserts that the remedy for violating sections 2 and 3(1) of the ICA and the TSA in 2005 and 2006 is the difference between the intrastate and interstate rates, regardless of the lawfulness of the TAPS Carriers' 2004 interstate rates.

262. The State contends that the "refund floor" policy does not apply to the discrimination claim, particularly in the circumstances of this case where the Commission previously entered the TSA as an order of the Commission, thus converting the agreement of the TAPS Carriers not to file and charge unjustly discriminatory or unduly

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[385] The State cites to *Cook Inlet Pipelines Co.*, 47 FERC ¶ 61,017 (1989) (*Cook Inlet*) to support its proposition.

preferential rates into an enforceable duty subject to the full remedial authority of the Commission.

263. The State argues that the ICA conveys on the Commission the "ancillary power to award refunds" in furtherance of the Act's "mandates" even if such refunds do not fall squarely within the statutory test. This, the State asserts, is because Congress did not intend ICA section 15(7)'s reference to refunds of "such increased rates" to limit the Commission's authority to award refunds to only to the amount of the rate increase.

264. The State asserts that the issue of discrimination is separate and distinct from the issue of the justness and reasonableness of rates citing the Supreme Court's statement that "[b]oth rates may lie within the zone of reasonableness and yet result in undue prejudice,"[386] and that "once a forbidden discrimination is found, the Commission may remove it even though the rates are in the zone of reasonableness."[387] Accordingly, the State argues that the TAPS Carriers' unjust and unreasonable discrimination or undue preference in their proposed 2005 and 2006 rates, violate sections 2 and 3(1) of the ICA and the TSA must be eliminated by ordering refunds in the amount of the difference between the TAPS Carriers' proposed 2005 and 2006 rates and the level of the intrastate rate.

III. Commission Determination

265. The State urges the Commission to modify the ID and issue "an equitable order eliminating the unlawful discrimination by reducing the interstate rates that they charge to the level of the intrastate rate. Therefore, because the State is seeking an order requiring the TAPS Carriers to reduce their interstate rates, it does not need to make a showing of a specific injury resulting from the TAPS Carriers' actions."[388]

266. We find no such right and affirm the ID. Nothing in the ICA or decisions there under support the State's contention that because it is seeking equitable relief against discriminatory rates, it need not prove actual damages on its complaint under ICA section

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[386] *New York v. United States*, 331 U.S. at 345.

[387] *Ayrshire Colleries Corp. v. United States*, 335 U.S. 573, 594 (1949) (*citing New York v. United States*, 331 U.S. at 344).

[388] State's Brief on Exceptions at 21.

13(1). A prospective remedy reforming rates is provided under ICA section 15(1) which authorizes the Commission to prescribe rates, but only prospectively, by prescribing the rates "to be thereafter observed." Because the State chose not to prove actual damages, however, its sole retroactive remedy lies in ICA section 15(7) which authorizes the Commission to suspend rate increases (or initial rates) to allow such suspended increases to become effective subject to refund, to prescribe rates for the future, and to order refunds on of the portion of such increases found not to be justified.

267. Under the ICA refunds are not automatic when rates are found to be unduly discriminatory; rather damages for discriminations must be specifically proved by the complainant. As the court stated in *Council of Forest Industries v. Interstate Commerce Com.*, 570 F.2d 1056, 1059-1060 (D.C. Cir. 1978):

> [I]f the ICC in a section 15(1) proceeding finds a rate discriminatory, the successful claimant is not automatically entitled to a refund of "overpayments" but may recover only the actual damages it has suffered in the marketplace as a result of the discriminatory rate.

268. Sections 8, 9, 13(1), 15(1) and 16 of the ICA require that any party claiming reparations or damages must prove them. This requirement cannot be evaded simply because, as the State contends, its discrimination complaint was filed with the Commission under section 13(1), rather than in a court under sections 8 and 9, or because the State's complaint does not mention sections 8 and 9.

269. Moreover, contrary to the State's claim, it appears that the Intrastate Settlement Agreement (ISA)[389] provides in section II-2(e) that in the event unjust discrimination or undue preference occurs, "a TAPS Carrier shall adjust its maximum intrastate tariff for each type of Intrastate Transportation so that it equals the maximum interstate tariff for each equivalent type of Interstate Transportation offered by the TAPS Carriers."[390] Thus, even if the State's discrimination claim were upheld the net result would be the increase of intrastate rates to match the applicable TAPS interstate rate.

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[389] In April 7, 1986, the same parties to the TSA entered into the ISA to resolve the intrastate TAPS proceedings pending before the RCA concerning the TAPS intrastate rates.

[390] Ex. ATC-166 at 16.

270. Finally, the State's reliance on *Cook Inlet* as an authority that disparate rates constitute discrimination is misplaced. In the order on rehearing in that case the Commission stated that "under the ICA and applicable case law, the Commission's authority with respect to intrastate rates as they affect interstate carriers derives from section 13 of the ICA" and not from section 2.[391] Moreover, in *Cook Inlet*, the Commission did not ultimately resolve the disparity between Cook Inlet's interstate and intrastate rates in the manner advocated by the State (i.e., by lowering Cook Inlet's interstate rates).

271. Indeed, interpreting section 2 as the State proposes would fatally undermine the Commission's regulation of interstate rates, contrary to the ICA and the federal Supremacy Clause. Where it applies, section 2 generally requires identical rates for similarly situated shippers receiving the same service. If that principle were applied to differences between interstate and intrastate rates as the State proposes, the state regulators could determine what rates this Commission could set, which clearly cannot be the rule.

272. Accordingly, we affirm the ID that the State's claim is mooted by the law and interstate rates ordered by the ID.

Issue V: Do the TAPS intrastate rates established by the RCA violate section 13(4) of the ICA?

I. ALJ's Findings

273. The ALJ determined that once the new rates are filed using the methodology and inputs contemplated in the ID, the difference between TAPS' interstate and intrastate rates will be minimal. The ALJ concluded that with such a minimal difference between the RCA established rate and the rates required by the ID, the TAPS Carriers' ICA section 13(4) claim has been rendered moot.

II. Exceptions

274. The TAPS Carriers argue the ALJ erroneously dismissed their ICA section 13(4) petition. The TAPS Carriers argue that when the Commission corrects the errors in the ID with respect to TAPS' interstate rates, there will be a substantial disparity between the Commission-approved interstate rates and the RCA-set intrastate rates. As such, the

[391] *Cook Inlet*, 47 FERC ¶ 61,393 at 62,306.

TAPS Carriers argue the Commission should address the merits of the TAPS Carriers' section 13(4) claim and declare that the intrastate rates set by the RCA constitute an undue preference and are unjustly discriminatory against and an undue burden on interstate commerce, and should raise those rates to the level of the interstate rates, adjusted for the length of haul.

275. Staff and Anadarko/Tesoro support the ALJ's decision regarding the TAPS Carriers' section 13(4) petition. However, Staff and Anadarko/Tesoro except to the ID with respect to the section 13(4) issue for the purpose of preserving all rights, arguments, and future challenges regarding that issue in the event that the ALJ's mootness ruling is altered on review.

276. The State asserts that it does not take exception to the prospective rate relief the ALJ ordered with regard to the TAPS Carriers' section 13(4) claim. The State explains that even though the ALJ did not directly or expressly direct the TAPS Carriers to change their interstate rates going forward so that they equal their intrastate rates, the State does not oppose the ALJ's remedy because the ALJ correctly found that the interstate rates calculated using the inputs and methodology of the ID will be effectively the same and the intrastate rates currently charged by the TAPS Carriers. For this reason, the State does not expect that, going forward, there will be actionable discrimination or preference between the prospective interstate rates and the intrastate rates.

277. The RCA states that as the prevailing party on the section 13(4) issue, it does not believe it is obliged to preserve in a brief on exceptions alternative grounds for denying the TAPS Carriers' 13(4) claim. However, the RCA states that if they do not file a brief on exceptions explaining the non-mootness grounds requiring the rejection of the TAPS Carriers' 13(4) petition, the TAPS Carriers could contend that the RCA waived those grounds. Thus, the RCA presents in its brief alternate grounds for denying the TAPS Carriers' 13(4) petition. The RCA first states that the TAPS Carriers failed to submit evidence of their actual cost of providing service. Second, the RCA asserts the TAPS Carriers failed to show non-compensatory intrastate rates and that there was any deficiency in the RCA's Order No. 151 ratemaking process. Third, the RCA argues that the TSA is a distinguishing condition justifying a disparity between the intrastate and interstate rates. Finally, the RCA contends the TAPS Carriers failed to demonstrate harm to interstate commerce or interstate shippers. In light of this, the RCA argues the TAPS Carriers failed to prove the elements required for a *prima facie* section 13(4) case.

278. In addition to highlighting the deficiencies in the TAPS Carriers' case, the RCA reaffirms its position that section 13(4) of the ICA did not confer jurisdiction on the ICC to establish intrastate rates for oil pipelines, nor does it authorize the Commission to do so. The RCA states that any section 13(4) authority the Commission has over the intrastate transportation of oil is limited. The RCA further argues that the ICA assigns the primary authority for establishing intrastate rates to the states, and in accordance with

the doctrine of judicial comity, the Commission avoid taking action that would nullify the state regulatory orders, such as the RCA's Order No. 151. The RCA also argues that the doctrine of collateral estoppel precludes any challenge to the determination in Order No. 151 that the intrastate rates adopted in that order are just and reasonable.

III. Commission Determination

279. As discussed above, we affirm the methodology and inputs contemplated by the ALJ for determining TAPS' interstate rates. Once these new just and reasonable rates are implemented, the difference between the interstate and intrastate rates will be minimal. Therefore, we affirm the ALJ's decision that with such a minimal difference between the RCA established intrastate rates and the interstate rates required by this decision, the TAPS Carriers' ICA section 13(4) claim has been effectively rendered moot.

The Commission orders:

(A) The Initial Decision is hereby affirmed except as modified with respect to the return on equity amount.

(B) The TAPS Carriers are hereby directed to make a compliance filing establishing rates in conformance with the Initial Decision and this order within thirty days of this order.

(C) The TAPS Carriers are hereby directed to prepare and file a refund report and refund shippers in accordance with the Initial Decision and this order within thirty days of the Commission's order establishing the rates in this proceeding.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

EXHIBIT A

Witnesses

On behalf of the TAPS Carriers

Dr. Toof
Mr. Williamson
Mr. Browning
Mr. Mitchell
Ms. Taylor
Mr. Ganz
Mr. Tudor
Mr. Wells
Mr. Van Hoecke
Dr. Baumol
Mr. Washington

On behalf of the Designated TAPS Carriers

Mr. McDougall
Mr. Shakley
Mr. Klick

On behalf of the SOA

Dr. Rapp
Mr. Ives
Mr. Makholm

On behalf of Anadarko/Tesoro

Mr. Brown
Mr. Sullivan
Mr. Grasso
Dr. Overcast
Mr. Hanley

On behalf of Flint Hills

Dr. Olson

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