

Revisions to Oil Pipeline Regulations Pursuant to
the Energy Policy Act of 1992

Order No. 561

FERC Stats & Regs. [Regs. Preambles, 1991-1996] ¶ 30,985 (1993)
affirmed, Association of Oil Pipe Lines v. FERC,
83 F.3d 1424 (D.C. Cir. 1996)

Order No. 561, along with Order Nos. 571 and 572, comprehensively revised the Federal Energy Regulatory Commission's regulation of the oil pipeline industry. Those orders responded to Congress' mandate in the Energy Policy Act of 1992 that the Commission adopt a "simplified, generally applicable ratemaking methodology" for oil pipelines.

Order No. 561 establishes a price cap for oil pipeline rates, to be adjusted annually based upon changes in the Producer Price Index, minus one percent. In cases where the price cap results in rates that may be either too low or too high to be just and reasonable, the Commission allows either pipelines or their customers to seek traditional cost-based rates in lieu of the rates set under the price cap. A cost-based showing is also required for some initial rates. In addition, the Commission allows pipelines to adopt market-based rates in those markets where they can demonstrate they lack market power.

Finally, Order No. 561 sets forth new procedures to streamline oil pipeline rate matters. These procedures address the treatment of protests and complaints, revise certain tariff filing and accounting requirements, and institute a requirement that all protested oil pipeline rate filings be sent to a settlement judge before formal hearing procedures commence.

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58 F.R. 58753 (November 4, 1993)

18 CFR Parts 341, 342, 343, 344, 345, 347, 360, 361, and 375

[Docket No. RM93-11-000; Order No. 561]

Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992

(Issued: October 22, 1993)

AGENCY: Federal Energy Regulatory Commission (Commission), DOE.

ACTION: Final Rule.

SUMMARY: The Commission is revising its regulations of oil pipelines in order to implement the requirements of Title XVIII of the Energy Policy Act of 1992. The revisions provide a simplified and generally applicable method for regulating oil pipeline rates by use of an index for setting rate ceilings for such rates. In certain circumstances, an oil pipeline would be permitted to establish rates using traditional cost of service or other methods of ratemaking. The final rule also revises certain procedural regulations as required by the Act of 1992; abolishes the Oil Pipeline Board; and provides for the institution of alternate dispute resolution procedures for oil pipeline rate matters. The final rule changes the Commission's existing regulations concerning the tariff filing requirements of oil pipelines.

EFFECTIVE DATES: As to the changes in Parts 341 and 344 and section 375.303 and as to the removal of old Parts 342, 343, 345, 347, 360 and 361, this final rule shall take effect December 6, 1993. As to the addition of new Parts 342 and 343 and changes to sections 375.306, 375.307, and 375.313, this final rule will be effective January 1, 1995.

FOR FURTHER INFORMATION CONTACT: Harris S. Wood, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426, Telephone: (202) 208-0696.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the *Federal Register*, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in Room 3104, 941 North Capitol Street, NE., Washington, DC 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 208-1397. To access CIPS, set your communications software to use 300, 1200, or 2400 bps, full duplex, no parity, 8 data bits, and 1 stop bit. CIPS can also be accessed at 9600 bps by dialing (202) 208-1781. The full text of this rule will be available on CIPS for 30 days from the date of issuance. The complete text on diskette in WordPerfect format may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, also located in Room 3104, 941 North Capitol Street, NE., Washington, DC 20426.

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- I. Introduction

The Federal Energy Regulatory Commission (Commission) hereby promulgates regulations pertaining to its jurisdiction over oil pipelines under the Interstate Commerce Act (ICA),¹ to fulfill the requirements of Title XVIII of the Energy Policy Act of 1992 (Act of 1992).²

The Act of 1992 requires the Commission to promulgate new regulations to provide a simplified and generally applicable ratemaking methodology for oil pipelines, and to streamline procedures in oil pipeline proceedings.³ The policy objective underlying these requirements is to simplify and expedite the Commission's regulation of oil pipeline rates. Congress made it explicit, however, that this simplification objective must be accomplished in a manner that ensures that rates are just and reasonable, for section 1801 of the Act of 1992 provides that the simplified and generally applicable ratemaking methodology must be "in accordance with section 1(5) of the Interstate Commerce Act." That section requires oil pipeline rates to be just and reasonable.

The Final Rule recognizes several ways of establishing just and reasonable rates. First, Congress, in section 1803 of the Act of 1992, has deemed many rates to be just and reasonable under the ICA, thereby forming a baseline for many future oil pipeline rates and obviating debate over the appropriateness of existing rates, many of which are based on valuation or trended original cost methodologies.

Recognizing the effect of this Congressional finding, the final rule first provides a simplified and generally applicable approach to changing just and reasonable oil pipeline rates. The simplified and generally applicable approach, adopted in this final rule, for changing oil pipeline rates

¹ 49 U.S.C. app. 1 (1988).

² 42 U.S.C.A. 7172 note (West Supp. 1993). References to the Energy Policy Act are to this note, indicating the section number of the statute.

³ The Act of 1992 contemplates two rulemakings—one on ratemaking methodology and another

on streamlined procedures—and establishes separate deadlines for their completion. These rulemakings are related, and so the Commission is addressing and completing both in this Final Rule.

is an indexing system which will establish ceiling levels for such rates.

Second, the final rule also permits cost-of-service proceedings to establish just and reasonable rates, with regard to initial rates for new service, and also with regard to changes to existing rates where appropriate. The Commission is issuing a notice of inquiry simultaneously with this final rule to explore ways to improve the collection of data on oil pipelines costs, and as the first step in establishing filing requirements for cost-of-service rate filings, to facilitate these cost-of-service proceedings.

Third, the final rule retains the Commission's current policy of encouraging settlements of rate issues at any stage in our proceedings.

Finally, the final rule does not disturb current Commission practice, which permits a pipeline to seek Commission authorization to charge market-based rates. However, until the Commission makes the finding that the pipeline does not exercise significant market power, the pipeline's rates cannot exceed the applicable index ceiling level or a level justified by the pipeline's cost of service. Also, the Commission is issuing a notice of inquiry on the subject of market-based rates for oil pipeline ratemaking.

Under the indexing methodology oil pipeline rates may be adjusted pursuant to the Commission's regulations, so long as they comply with ceiling levels under the indexing system adopted here. The final rule uses the annual change in the Producer Price Index for Finished Goods (PPI-FG), minus one percent, as the appropriate index to determine annual ceiling levels for oil pipeline rates. Individual rates will be subject to these ceiling levels, which may increase or decrease, according to the index. Rates will be permitted to increase (or decrease) within the range capped by the ceiling level established pursuant to this index.

Pipelines that find that they are underrecovering costs under existing rates may, upon a threshold showing, file for an increase above the indexed ceiling level. Further, under certain circumstances, customers may challenge existing rates, even if such rates are below the applica-

ble ceiling levels, if they reasonably believe such rates are excessive.

The Commission believes that indexing of oil pipeline rates will eliminate the need for much future cost-of-service litigation. As stated above, however, rates may be subject to cost-of-service review when an oil pipeline company claims it is significantly underrecovering its costs, or when its rates become excessive in relation to actual costs.

To ensure further that the operation of the index meets the Commission's responsibility under the ICA to ensure that rates are just and reasonable, the Commission will undertake an examination of the relationship between the annual change in the PPI-FG, minus one percent, index and the actual cost changes experienced by the oil pipeline industry every five years, beginning in the year 2000 upon the availability of the final index for calendar year 1999.

The monitoring process, combined with the continued availability of procedures to challenge proposed and existing rates, should "render the prospect of unreasonable filings sufficiently improbable. . ."⁴ to justify the legality under the ICA of the approach to ratemaking adopted by the Commission.

The Commission believes that the approach adopted in this final rule fulfills the objectives of the Act of 1992, while meeting the requirements of the ICA. The approach will accomplish these purposes by simplifying and expediting the process of establishing oil pipeline rates, which is the policy objective of the Act of 1992, while at the same time ensuring that the resulting rates are just and reasonable, which is the legal requirement of the ICA.

This final rule complies fully with the requirements contained in the Act of 1992. However, the Commission has determined that it is in the public interest to continue with the process of reforming and simplifying its regulatory processes under the ICA. The Commission is continuing that effort by initiating two notices of inquiry, published elsewhere in this issue of the *Federal Register*, that are companions to this order. Comments were filed on cost-of-service and market-rate methodologies in response to the Commis-

⁴ *National Rural Telephone Association v. FCC*, 988 F.2d 174, 185 (D. C. Cir. 1993).

sion's Staff Proposal and the Notice of Proposed Rulemaking. The two companion notices of inquiry on cost-of-service methodology and reporting requirements and market-power determinations will seek to build upon the record already compiled with a view toward promulgating final rules in time for implementation by January 1, 1995, the effective date of this final rule.

This final rule, following the directives contained in the Act of 1992, also adopts certain reforms to the Commission's procedures relating to oil pipeline proceedings. These reforms will help to streamline these proceedings. In addition, this final rule includes an updating of the regulations pertaining to oil pipeline tariffs.

The ratemaking approach and streamlined procedures portions of this final rule will take effect January 1, 1995. The revised tariff regulations will take effect 30 days after publication of this final rule in the *Federal Register*.

II. Reporting Requirements

The Commission estimates the public reporting burden for the collection of information under the final rule to average ten hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. The information will be collected under FERC-550, Oil Pipeline Rates: Tariff Filings. The current annual reporting burden associated with the FERC-550 information collection requirements is 6,500 hours based on an estimated 325 responses from approximately 150 respondents.

The final rule will reduce the existing reporting burden associated with FERC-550 by an estimated 1,150 hours annually—an average of ten hours per response based on an estimated 535 responses. The final rule does not change the burden estimates from those contained in the Commission's Notice of Proposed Rulemaking issued July 2, 1993 in the subject docket. These estimates have

been reported previously to the Office of Management and Budget (OMB). A copy of this rule is being provided to the OMB for informational purposes only.

Send comments regarding these burden estimates or any other aspect of this collection of information, including suggestions for further reductions of this burden, to the Federal Energy Regulatory Commission, 941 North Capitol Street, NE, Washington, D.C. 20426 (Attention: Michael Miller, Information Services Division, (202) 208-1415, FAX (202) 208-2425); and to the Office of Information and Regulatory Affairs, Office of Management and Budget (Attention: Desk Officer for Federal Energy Regulatory Commission), Washington, D.C. 20503.

III. Background

A. Historical Background of Oil Pipeline Rate Regulation

Before describing the specifics of the Commission's final rule, it would be useful to review briefly the history of Federal regulation of oil pipelines.

In 1906 Congress passed the Hepburn Act,⁵ which amended the ICA to include among the responsibilities of the Interstate Commerce Commission (ICC) the regulation of the rates and certain other activities of interstate oil pipelines. Specifically, oil pipelines were made common carriers,⁶ were required to file for, and charge, rates that were just and reasonable and not unduly preferential,⁷ and were required to file certain financial reports and follow certain accounting procedures.⁸

Many constraints commonly associated with utility-type regulation, such as review and approval of construction or acquisition, and abandonment or sale of facilities, were not imposed on oil pipelines. This has been interpreted as reflecting a Congressional intent to allow market forces freer play within the oil pipeline industry than was allowed for other common carrier industries.⁹

From enactment of the Hepburn Act until jurisdiction of oil pipelines was

⁵ 34 Stat. 584 (1906).

⁶ 49 App. U.S.C. 1(1), (4), and (7).

⁷ *Id.* at §§ 1(5), 2(1) and 6(1) and (3).

⁸ *Id.* at §§ 20(1), (2), (4), and (5).

⁹ See *Farmers Union Central Exchange v. FERC*, 584 F.2d 408, 413 (D. C. Cir., 1978), cert. denied, 439 U. S. 995 (1978) ("*Farmers Union I*"). "[We] may infer a congressional intent to allow a freer play of competitive forces

transferred from the ICC to the Commission in 1977, oil pipeline rates were fixed according to a cost-of-service methodology grounded upon use of a valuation rate base—a mixture of original and replacement costs.¹⁰ Valuation ratemaking was heavily criticized in *Farmers Union I*, the first Federal judicial review of an oil pipeline rate case.

During the pendency of the appeal that culminated in *Farmers Union I*, Congress enacted the Department of Energy Organization Act of 1977,¹¹ which transferred Federal regulatory jurisdiction over oil pipelines from the ICC to the newly created Federal Energy Regulatory Commission. The Commission was required by this act to regulate oil pipelines under the provisions of the ICA as they existed on October 1, 1977. Thus, though the ICA was later revised and recodified,¹² the Commission continues by law to regulate oil pipelines under the ICA as it read at the time jurisdiction was transferred from the ICC to this Commission.

Because of this transfer of regulatory authority, the Commission requested and the court agreed in *Farmers Union I* to remand the rate case to the Commission. The Commission's decision on remand¹³ was the first attempt to fashion a ratemaking methodology for oil pipelines that reconciled the modern day economic and competitive realities affecting oil pipelines with the regulatory directive contained in the governing statute. In Opinion No. 154, the Commission adopted a variation of the old ICC methodology, on the basis that the allowed rate levels would be so high they would rarely,

(Footnote Continued)

among oil pipeline companies than in other common carrier industries and, as such, we should be especially loath uncritically to import public utilities notions into this area without taking note of the degree of regulation and of the nature of the regulated business.”

¹⁰ The ICC also established generic rates of return for oil pipelines.

¹¹ 42 U.S.C. 7101.

¹² See Revised Interstate Commerce Act of 1978, 49 U.S.C. 10101.

¹³ Opinion No. 154, 21 FERC ¶ 61,260 (1982), *reh'g denied*, 22 FERC ¶ 61,086 (1983).

¹⁴ See *id.*, at p. 61,649: “Competition both actual and potential is a far more potent or price-constraining force in oil pipelining than it

if ever, be achieved in practice.¹⁴ Opinion No. 154 was reversed and remanded by the D.C. Circuit in *Farmers Union II*.¹⁵ The court found the Commission's opinion deficient in several respects, including the reasoning and factual documentation for its almost exclusive reliance on market forces to restrain rates. Summarizing the requirements of the ICA, the court stated:

Most fundamentally, FERC's statutory mandate under the Interstate Commerce Act requires oil pipeline rates to be set within the “zone of reasonableness”; presumed market forces may not comprise the principal regulatory restraint. Departure from cost-based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods ensure that the resulting rate levels are justified by those factors.

Id., at p. 1530.

Following *Farmers Union II*, the Commission issued Opinion No. 154-B,¹⁶ establishing a fairly traditional cost-of-service methodology for determining oil pipeline rates. This methodology used a trended original cost rate base, and a rate of return based upon the actual embedded debt cost and equity costs reflecting the pipeline's risks.

Adjudicated proceedings for oil pipelines, though few in number, have been long, complicated and costly, and required considerable expenditure of participants' time and resources, including that of the Commission.¹⁷ Even after the Commission's Opinion No. 154-B methodology was adopted, the next proceeding

is in the other areas in which we work [fn. omitted].”

¹⁵ *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486 (D. C. Cir., 1984), *cert. denied*, 469 U.S. 1034 (1984).

¹⁶ *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985) (the *Williams* case).

¹⁷ Other than cases involving rates for the Trans-Alaska Pipeline System, there have been eight oil pipeline rate cases which have gone to hearing. The longest case was the *Williams* case, which culminated in Opinion No. 154-B, and took fourteen years to resolve, although some of the time was attributable to the transfer of jurisdiction of oil pipelines to the Commission from the Interstate Commerce Commission and to intervening remands from the court.

attempting to apply this methodology took four years to conclude.¹⁸

More recently, the Commission has authorized market-based rates for Buckeye Pipe Line Company.¹⁹ *Buckeye* was an effort to determine if an alternative to the traditional cost-of-service ratemaking methodology could be utilized in cases where the pipeline does not exercise the power to control prices in all of its markets. The adjudication of the *Buckeye* case included an analysis of pipeline market power that was similar to that used in anti-trust cases.

A critical predicate to the utilization of a market oriented rate regulation scheme is the ability to identify and measure the competitiveness of relevant markets. The first step in this process is to define the scope of the market. In *Buckeye*, the Commission held that markets would be delineated by product and geography, and determined that this would be done on a case-by-case basis.²⁰ To determine whether the pipeline exercises market power in a given market, the Commission stated that it would analyze a number of considerations, including market share, market concentration, excess capacity, transportation alternatives, and potential entry.

Buckeye was also an effort to see if the Commission's ratemaking methodology could be simplified. It was determined that the market-based approach was useful in those markets where the pipeline did not possess market power. However, using an analysis similar to that used in anti-trust cases to determine whether the pipeline possessed market power is itself a costly time and resource consuming effort. Moreover, the market-based methodology is not appropriate where the pipeline possesses market power.

B. Energy Policy Act of 1992

Section 1803 of the Act of 1992 deems certain existing rates to be just and reasonable within the meaning of section 1(5) of the ICA. These are rates that were in effect for the 365-day period ending on

the date of enactment of the Act of 1992, or that were in effect on the 365th day preceding enactment, and which have not been subject to a protest, a complaint, or an investigation during this 365-day period.²¹ Complaints under section 13 of the ICA may be filed against these "grandfathered" rates only under one of two circumstances: first, a substantial change has occurred, since enactment, in the economic circumstances or in the nature of the services which were the basis for the rate; or, second, the complainant was under a contractual bar against filing a complaint, and the bar was in effect prior to January 1, 1991 and on the date of enactment. Further, the complainant must file its complaint within 30 days of the expiration of the contractual bar.²² These grandfathering provisions do not prohibit any "aggrieved person" from filing a complaint alleging that a pipeline tariff provision is unduly discriminatory or unduly preferential.²³

Sections 1801 and 1802 of the Act of 1992 require the Commission to promulgate regulations establishing a "simplified and generally applicable ratemaking methodology . . . in accordance with section 1(5) of the Interstate Commerce Act" for oil pipelines, and streamlining Commission procedures relating to oil pipeline rates "in order to avoid unnecessary costs and delays." A final rule on ratemaking methodology must be issued not later than one year after the date of enactment, or by October 24, 1993 (and the rule may not take effect before the 365th day after its issuance). A final rule on rate procedures must be issued within eighteen months of the date of enactment, or by April 24, 1994.

The Act of 1992 also directs the Commission to consider the following issues in streamlining its rate procedures:²⁴

- Type of information required to be filed with a tariff;
- Availability to the public of the Commission's or the staff's analysis of the tariff filing;

¹⁸ See *ARCO Pipe Line Company*, 52 FERC ¶ 61,055 (1990), order on reh'g, 53 FERC ¶ 61,398 (1990).

¹⁹ Opinion No. 360, 53 FERC ¶ 61,473 (1990).

²⁰ *Buckeye Pipe Line Co., L.P.*, Opinion No. 360-A, 55 FERC ¶ 61,084 at p. 61,260 (1991).

²¹ Sec. 1803(a).

²² Sec. 1803(b).

²³ Sec. 1803(c).

²⁴ Sec. 1802(b).

- Qualifications for standing of parties who would file protests or complaints;
- The level of specificity required for protests and complaints;
- Guidelines for Commission action on the portion of the tariff subject to a protest or complaint;
- An opportunity for the pipeline to respond to an initial protest or complaint; and
- Identification of circumstances under which Commission staff may initiate an investigation.

Further, the Commission is required by the Act of 1992 to establish, "to the maximum extent practicable," appropriate alternative dispute resolution procedures for use early in pipeline rate proceedings. These procedures must include required negotiations and voluntary arbitration. The Commission was directed to consider rates proposed by the parties through these procedures upon an expedited basis.²⁵

Finally, Congress explicitly excluded the Trans-Alaska Pipeline, or any pipeline delivering oil directly or indirectly to it, from the provisions of the oil pipeline regulatory reform title of the Act of 1992.²⁶

The Commission concludes that the Act of 1992 does not deregulate oil pipeline rates and that the Commission must continue to ensure that oil pipeline rates are just and reasonable. Moreover, the new Act requires regulation of oil pipeline rates to be accomplished in a manner that brings a degree of simplicity, expeditiousness, and economy to the process.

C. Staff Proposal and NOPR

On March 18, 1993, the Commission made available for public comment a proposal by its Staff which encompassed alternatives for regulation of oil pipeline rates in the future. This proposal emphasized three alternative ratemaking methodologies: indexing, market-based rates, and cost-of-service ratemaking. Some 24 sets of comments were received on the Staff's proposal.

Staff proposed that the Commission adopt as a primary means of regulating oil pipeline rates an indexing methodology based on the Producer Price Index for Finished Goods, with a productivity incentive adjustment of minus one percent. Staff further proposed, as an alternative, a market-based approach if a pipeline could demonstrate, under a new streamlined approach to market delineation, that it lacked market power in markets to which it would apply such a methodology. Finally, Staff proposed that a pipeline be allowed to utilize a cost-of-service methodology as a means of establishing new just and reasonable rates in certain extraordinary cases, such as natural disasters which would require replacement of systems, where the pipeline could clearly show that the indexing methodology would not provide it the opportunity of earning a just and reasonable rate.

Staff's other proposals were directed at the procedural reforms called for by the Act of 1992 and other reforms to existing regulations which were designed to modernize those regulations.

Based on the Staff proposal and the comments received thereon, on July 2, 1993, the Commission issued a notice of proposed rulemaking (NOPR).²⁷ In the NOPR, the Commission proposed to use, as its primary means of regulating oil pipeline rates, an indexing scheme similar to that proposed by Staff. The Commission intended to establish thereby a "simplified and generally applicable"²⁸ oil pipeline ratemaking methodology consistent with its statutory mandates under the ICA and the Act of 1992. The Commission's proposal contained the following elements:

1. The adoption of an indexing methodology as its general approach to regulating the level of oil pipeline rates, utilizing as the Gross Domestic Product, Implicit Price Deflator (GDP-IPD), to establish the maximum ceiling level for any given rate in a given year. The GDP-IPD is generally a higher index than the PPI-FG.

²⁵ Sec. 1802(e).

²⁶ Sec. 1804(2)(B). The Trans-Alaska Pipeline System (TAPS) will continue to be governed by the TAPS Settlement Methodology approved by the Commission by order issued October 23,

1985. *Trans-Alaska Pipeline System, et al.*, 33 FERC ¶ 61,064 (1985).

²⁷ 58 Fed. Reg. 37671 (July 13, 1993).

²⁸ *Id.*, Section 1801.

2. Under indexing, rate increase filings within the ceiling would be discretionary with the pipeline.

3. No cost of service or any other supporting information would be required to be filed with a rate increase that complied with the index.

4. A pipeline would not be precluded in an individual proceeding from demonstrating either (a) that the rate in question is to be charged in a market in which it lacks significant market power and therefore no price cap is required, or (b) that, due to extraordinary circumstances, application of the index methodology in a particular instance would not allow the pipeline to recoup its costs and therefore a cost-of-service methodology should be utilized.

5. Challenges to rate change proposals of oil pipelines that the Commission proposed to entertain would be those made through clearly defined protest and complaint procedures which would require specific showings by protestors/complainants of why a particular rate methodology is inappropriate or why particular rate changes should not be allowed.

6. The Commission proposed to revise all rate filing requirements and procedural regulations to reflect these proposals.

The Commission emphasized that it was interested not only in the comments that it would receive on this proposal but also any proposals that interested parties wished to put forth to achieve the purpose of establishing a ratemaking scheme that is "simplified and generally applicable," conforms to the requirements that the rates of oil pipelines be just and reasonable under the ICA, and otherwise comports with the Act of 1992 and the ICA.

Forty-two sets of comments were received from parties representing pipelines, shippers, State commissions, consumers and trade associations.²⁹ Based on these comments, the Staff paper and the NOPR, the Commission has formulated this final rule.

²⁹ Appendix A contains a list of all commentors and the designation by which they are referred in this document.

IV. Ratemaking Methods Adopted in the Final Rule

A. Overview

Section 1801(a) of Title XVIII reads as follows:

(a) Establishment.—Not later than 1 year after the date of enactment of this Act, the Federal Energy Regulatory Commission shall issue a final rule which establishes a simplified and generally applicable ratemaking methodology for oil pipelines in accordance with section 1(5) of part I of the Interstate Commerce Act.

It is apparent from section 1801(a) that it is the intent of the Congress that oil pipeline ratemaking must be simplified. By referencing section 1(5) of the ICA, however, Congress reaffirmed the Commission's obligation under the ICA to ensure just and reasonable rates. To accomplish these two objectives requires a rate-changing methodology that produces just and reasonable rates; that reduces the necessity and likelihood of prolonged litigation; that can be applied by pipelines and reviewed by shippers and by the Commission expeditiously; and that is usable without significant variation or modifications by most, if not all, pipelines.

The Commission believes that the approach of applying an industry-wide cap on rate changes derived by an appropriate index would achieve the above-described policy objectives, as well as meet the statutory criteria of simplicity and general applicability. This is because the indexing approach allows rates to be changed without a detailed and comprehensive presentation and examination of the individual pipeline's cost of service in each case.

The index—the change in the Producer Price Index for Finished Goods minus one percent (PPI-FG minus one percent)—will be utilized to establish a ceiling on annual rate changes. Rates may be charged up to the ceiling level. Further, there will be no limit on the number of times a rate may be changed, so long as the ceiling is not violated.

As a general rule, a pipeline must utilize the indexing system to change its

rates. As some commenters point out, there may be circumstances that dictate a different methodology be used for changing rates.³⁰ Therefore, an alternative method of changing rates will be permitted when certain defined circumstances are obtained.

First, a cost-of-service showing may be utilized to change a rate whenever a pipeline can show that it has experienced uncontrollable circumstances that preclude recoupment of its costs through the indexing system.³¹

Second, whenever a pipeline can secure the agreement of all existing customers, it may file a rate change based on such a settlement.

Finally, in accordance with existing Commission precedents, the Commission will permit a pipeline to make a showing that the pipeline lacks significant market power in the markets in question, and therefore some market-based form of rate regulation is warranted as a matter of policy and justifiable as a matter of law under the ICA. Until such time as the Commission has determined that the pipeline lacks market power, the pipeline will be constrained in the rate it may charge. Until the Commission makes that finding, the rates cannot exceed the ceiling level which would be applicable under the indexing methodology. However, if the pipeline files a cost-of-service justification for the rate, it may charge such cost-based rate until the Commission makes the market power determination. Any such rates are subject to the suspension and refund powers of the Commission under the ICA.

To repeat, the cost-of-service, settlement, and market-based rate methodologies are alternatives to the generally applicable and required indexing approach. They may only be utilized to change rates when certain defined circumstances, as explained above, are shown by the pipeline to exist. The Commission's action in the final rule ameliorates the concern of Alaska, which objects

to allowing the pipelines to "mix and match" rate methodologies.³² Rather than allowing total discretion by the pipelines to pick and choose among the alternative methodologies, the Commission's final rule prescribes strict limitations under which the alternative methodologies may be used. Moreover, in response to the concern of CAPP about the potential divergence between costs and rates,³³ it is expected that data will be available to the public and to the Commission which will allow determinations to be made as to the reasonableness of increases produced by application of the index.³⁴ Furthermore, the Commission will review the appropriateness of the index in relation to industry costs every five years, beginning July 1, 2000. In this way, the Commission can ensure that the index chosen by the Commission adequately correlates with changes in industry costs.

Finally, the indexing system is a methodology for changing rates. Generally, the initial rate will be established by a cost-of-service showing. However, a pipeline may file an initial rate based upon the agreement of at least one non-affiliated shipper. The Commission will not require a cost-of-service justification for such an agreed-upon rate. An initial rate established by agreement may be protested, in which case the pipeline will be required to justify the rate based on a cost-of-service showing.

To implement this approach, this final rule provides new regulations governing the establishment of initial rates and the changing of rates pursuant to the indexing system. Further, this rule provides a new regulation for changing rates through settlement. In addition, this final rule puts into place procedures to implement these new ratemaking methodologies, along with streamlined procedures for oil pipeline proceedings. By promulgating these new regulations, the Commission has fully complied with the directives contained in the Act of 1992 to implement a simplified and generally applicable ratemaking methodology, in

³⁰ See, e.g., ARCO comments, pp. 1-2.

³¹ Kaneb, in its comments at pp. 3-7 and 10-12, seeks assurance that pipelines have the ability to justify higher rates based on the pipeline's cost of service. In the instance of uncontrollable circumstances, the final rule provides that assurance.

³² Alaska comments, pp. 11-14.

³³ CAPP comments, pp. 11-15.

³⁴ The Commission is concurrently issuing a Notice of Inquiry in Docket No. RM94-2-000, Cost-of-Service Filing and Reporting Requirements for Oil Pipelines.

accordance with section 1(5) of the ICA, and to streamline its procedures relating to oil pipeline rates.

The Commission has concluded, however, that it would be in the public interest to go further in its reform of the regulation of oil pipeline rates. Thus, although the cost-of-service methodology, which will be available as an alternative to the generally applicable and required indexing system, is currently being employed by the Commission, it is clear from the Commission's experience—and from the many comments received in response to the NOPR—that reforms related to this methodology may be warranted. Further, reforms may also be required with respect to the market-based approach to setting rates.

Of necessity, however, in light of the statutory deadline for action in this rulemaking, these reforms must be undertaken in subsequent rulemakings. Therefore, the Commission is issuing notices of inquiry (NOIs) (i) to receive comments on how it can improve annual reporting; (ii) to determine whether a consensus can be formed on cost-of-service filing requirements; and (iii) to explore market-based rates for oil pipelines. It is the intent of the Commission to conclude these inquiries and subsequent rulemakings in time to allow new regulations on cost-of-service and market-based ratemaking to take effect simultaneously with the regulations promulgated in this rulemaking.³⁵ Thus, the end product of the Commission's efforts in this area will be an across-the-board reform and streamlining of its regulation of the ratemaking process for oil pipelines.

The Commission concurs with the commenters that a simplified cost-of-service methodology should be developed which would be available for use by pipelines in the event that uncontrollable circumstances occur which prevent the pipeline from recovering its prudently incurred costs under the indexing methodology. Further, in order for the Commission and all interested persons to have a clear un-

derstanding of pipeline costs, the Commission will consider modification of its Form No. 6 reporting requirements as a result of comments received on the concurrently issued NOI on cost of service. Cost data included in Form No. 6 can be used by an interested person to form the basis of a complaint or protest that the increase sought under any of the methodologies is not justified. The Commission believes that this use of such cost data in this manner—*i.e.*, to demonstrate that the increase in the rate proposed by the pipeline would result in an unjust and unreasonable rate—is entirely appropriate and justified. It will thus serve as a "reality check" on increases under the indexing methodology.³⁶

Finally, the Commission is allowing pipelines to depart from indexing only in limited circumstances. Pipelines will be afforded the opportunity to recover prudently incurred costs which are uncontrollable, as discussed below, in conforming with the ICA. It will also allow pipelines to charge market-based rates in markets where the pipeline can demonstrate that it does not possess significant market power and its rates are therefore constrained by competition. Pipelines may also establish rates based on the unanimous support of all affected shippers. This, too, is permissible under the ICA.

B. Indexing Methodology

1. Purpose, Benefits, and Legal Justification

An indexing scheme has a number of benefits. First, the hallmark of an indexing system is simplicity. Under indexing, pipelines adjust rates to just and reasonable levels for inflation-driven cost changes without the need of strict regulatory review of the pipeline's individual cost of service, thus saving regulatory manpower, time and expense. Second, an indexing scheme is a form of incentive regulation. As such, it gives greater emphasis to productive efficiency in noncompetitive markets than does traditional cost-of-service regulation.³⁷ Third, indexing provides shippers protection from rate

³⁵ Crysen and PEG recommend that the Commission adopt as a simplified approach to oil pipeline ratemaking the "ABC Pipeline" developed by Staff in April 1993. Crysen comments, pp. 8-10, PEG comments, pp. 8-9. In addition, Crysen recommends that the Commission discard the Buckeye market-based methodology.

These suggestions can be pursued in the NOIs that accompany this final rule.

³⁶ See, *National Rural Telecom Association v. FCC*, 988 F.2d at p. 178.

³⁷ Indexing fosters efficiency by severing the linkage under traditional cost-of-service

increases greater than the rate of inflation.

Under an indexing system, however, some divergence between the actual cost changes experienced by individual pipelines and the rate changes permitted by the index is inevitable. This is because the indexing system utilizes average, economy-wide costs rather than pipeline-specific costs to establish rate ceilings. It is this focus on economy-wide costs that makes the methodology of indexing simplified and streamlined, because there is no need to present and examine the costs of each individual pipeline each time a rate change in compliance with the ceiling rate is proposed.

The Commission concludes that the adoption of an indexing system is entirely within its power under the ICA and the Act of 1992, contrary to the assertions of several commenters.³⁸ The Commission does agree that some modifications in the methodology proposed in the NOPR are appropriate to achieve a better balance among competing interests, and the final rule has accommodated many of the comments of shippers to ensure that the rates produced by an index achieve that balance.³⁹

The Commission concludes that the indexing system it has adopted is in compliance with the ICA. The inevitable divergence between the cost changes reflected in the index and the cost changes to individual pipelines is not a bar to adopting the index approach. There are several reasons for this conclusion.

First, the indexing methodology selected by the Commission in this final rule is cost-based, as further discussed below. It thus meets the fundamental requirement applicable under section 1(5) of the ICA, as enunciated by the court in *Farmer's Union II*, that costs be used as

the basis for determining the justness and reasonableness of rates.

Second, the index establishes a ceiling on rates—it does not establish the rate itself. Some commenters are concerned about “automatic increases” in pipeline rates.⁴⁰ However, in competitive markets, pipeline rates will be constrained by competition, and in markets where the pipeline has market power, the cost basis of the index itself will provide the check required by the ICA. The courts have historically approved the approach of regulating prices, pursuant to a governing just and reasonable standard, through ceilings based on industry-wide costs. See, e.g., *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Mobil Exploration & Producing Southeast, Inc., et al. v. United Distribution Cos.*, 498 U.S. 211 (1991). In the *Mobil* case, the Commission had established just and reasonable ceiling rates for the sale of “old” gas, and allowed the ceiling to escalate by the amount of an economy-wide index—there, the GDP-IPD. The Court approved.

Another recent example of judicial approbation of this approach is provided in *Environmental Action v. FERC*, 996 F.2d 401 (D. C. Cir. 1993), where the court upheld the Commission’s adoption of a price ceiling approach to regulation of bulk power transactions between electric utilities in the face of a contention that the approach did not meet the just and reasonable standard of the Federal Power Act. In so doing, the court noted many factors that validated the price ceiling approach, including the monitoring of the individual transactions and the presence of a complaint mechanism to hear challenges against particular rates.⁴¹ Both of these factors are present in the instant proceeding as well. Individual rates must still be filed under the ICA, and the Commission will continue to hear challenges to

(Footnote Continued)

ratemaking between a pipeline's rate changes and changes in its current operating and investment costs. This provides the pipeline with the incentive to cut costs aggressively, since it is assured that it may retain a portion of the savings it generates.

³⁸ See, e.g., the comments of Alaska at pp. 10-14; CAPP at p. 9; NARO at p. 3; PEG at pp. 10-11; USAIR at pp. 1-2; Kerr-McGee at p. 2. Numerous commenters have argued that the Commission has authority to implement an in-

dexing system, among them being NCFC at p. 4; Phillips at pp. 5-9; ARCO at pp. 31-34, AOPL at pp. 13-19; Buckeye at pp. 11-13; Holly at pp. 4, 11-14.

³⁹ See, e.g., comments of SIGMA at p. 4; Holly at p. 4.

⁴⁰ E.g., APMC at pp. 2-6; PEG at pp. 10-11; SIGMA at p. 5.

⁴¹ *Id.* at pp. 410-11.

proposed and existing rates under the indexing system.

The court in *Environmental Action* also placed weight on the fact that the alternative approach of company-specific regulation of prices entailed extensive and expensive administrative burdens.⁴² Here, the Commission is specifically directed by the Congress to streamline and expedite its rate regulation to reduce such burdens.

The Federal Communications Commission adopted a price cap ratemaking approach for the telecommunications industry.⁴³ Importantly, the FCC found that a price cap approach that was not tied to individual company costs was legally sustainable under the "just and reasonable" standard governing ratemaking under the Federal Communications Act of 1934. The FCC reasoned that the just and reasonable standard did not require any particular ratemaking model, simply that the end result of the model employed produced rates that were within the zone of reasonableness.

Under the FCC price cap regime, the index reflects the general rate of inflation in the economy. The index adopted by the Commission for oil pipeline ratemaking in this final rule, however, is one which, according to the only pertinent analysis available in the record, serves as a reasonable surrogate for the actual cost changes experienced by the oil pipeline industry. The FCC's price cap methodology is bolder because it employs a general inflation index to cap not specific rates, as proposed by the Commission, but revenues from baskets of services.

The FCC analogy is particularly instructive in that it was based upon the just and reasonable standard of the FCC Act. According to the Senate report on the legislation that became the FCC Act, that standard was adapted from the just and reasonable provision in the ICA. S. Rep. No. 718, 73d Cong., 2d Sess. 4 (1934).

The FCC example is also instructive in that the FCC, similar to the Commission in this rulemaking, included "fail-safe"

procedures for both the regulated company and its customers to take into account unusual circumstances that required a departure from the generally applicable requirements of the price-cap scheme. For the regulated company, the procedure was an opportunity to request a waiver of the requirement that the price-cap methodology apply to the entire firm, including all of its affiliates. For customers, the procedure was a petition to challenge streamlined tariffs filed under the price cap that were believed to be "unreasonable." The reviewing court cited both these procedures as supporting the reasonableness, and thus the validity, of these aspects of the FCC's price-cap proposal.⁴⁴

Further, *Farmers Union* makes clear that the Commission is not tied to exclusive reliance upon company-specific costs in establishing just and reasonable rates. The Commission, stated the court, was permitted to take other factors into consideration, so long as they were clearly identified and their effect on restraining rates to just and reasonable levels was substantiated.

In regard to justifying the effects of indexing on rates, it should be understood that indexing, conceptually, merely preserves the value of just and reasonable rates in real economic terms. This is because it takes into account inflation, thus allowing the nominal level of rates to rise in order to preserve their real value in real terms.

The indexing system proposed is consistent with the just and reasonable standard contained in the ICA. It is a cost-based methodology, even though it tracks general economy-wide costs rather than specific company costs.⁴⁵

Third, the indexing system accommodates the need to change rates rapidly to respond to competitive forces in many markets served by pipelines. This pricing flexibility will result from the facts that pipelines will be able readily to propose rate changes within the indexed ceiling

⁴² *Id.* at p. 409.

⁴³ Report and Order and Second Further Notice of Proposed Rulemaking, FCC 89-91, FCC Docket No. 87-313, 4 F.C.C. Rcd. 3379 (1989); LEC Price Cap Order, 5 F.C.C. Rcd. 6786 (1990), *aff'd*, *National Rural Telecom Association v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

⁴⁴ *National Rural Telecom Association v. FCC*, 988 F.2d at pp. 181, 185

⁴⁵ See *National Rural Telecom Association, Permian Basin Area Rate Cases, and Mobil, supra*.

level, and that challenges to changes that comply with the index will be limited. In sum, the time and expense traditionally associated with filing rate cases should be greatly reduced. This pricing flexibility is another reason cited by the courts in support of a price-cap approach to regulating rates subject to a just and reasonable statutory standard.⁴⁶ Moreover, as suggested by Kaneb, the index will be applied to individual rates, not overall revenue requirements of the pipeline.⁴⁷

ARCO expressed concern that indexing alone could be a straight jacket which might prohibit pipelines in some cases from earning a just and reasonable return.⁴⁸ The Commission is mindful that an index method alone could have such an effect in particular circumstances. A comprehensive scheme which includes at least a cost-of-service and settlement alternatives would be superior to indexing alone. The Commission is adopting an indexing program coupled with cost-of-service and settlement rate options which will ameliorate those concerns by providing some measure of flexibility to pipelines in adjusting their rates. Thus, the Commission rejects the suggestion of Alaska⁴⁹ and Chevron,⁵⁰ to the effect that pipelines should be required to adhere to one methodology of changing rates.

However, in the interests of preserving the proper balance between pipelines and shippers under the just and reasonable standard of the ICA, the Commission is also providing shippers with a procedure to challenge rate changes that, while in compliance with applicable ceilings, are substantially in excess of actual cost changes incurred by the pipeline. In addition, shipper challenges will be permitted where rates are established under one of the other rate changing methodologies.

This concept of providing "fail-safe" exceptions or mechanisms within the context of a generally applicable rule has been cited by a reviewing court with approval. In *National Rural Telecom Association*, the court stated:

⁴⁶ *Environmental Action v. FERC*, *supra*.

⁴⁷ Kaneb at p. 15.

⁴⁸ ARCO at pp. 2-3, 5-6.

⁴⁹ Alaska comments, pp. 11-13.

⁵⁰ Chevron comments, p. 13.

⁵¹ 988 F.2d at p. 181 [citations omitted].

As this court has held, waiver processes are a permissible device for fine tuning regulations, particularly where, as here, the [FCC] must enact policies based on "informed prediction." So long as the underlying rules are rational... waiver is an appropriate method of curtailing the inevitable excesses of the agency's general rule.⁵¹

For the above reasons, the Commission has concluded that the indexing system it is adopting, complemented and buttressed by the exceptions and alternatives, comports with both the just and reasonable standard of the ICA and the simplification objectives of the Act of 1992, and is in the public interest.

2. Selection of an Index

The Commission has determined to utilize the change in the Producer Price Index for Finished Goods minus one percent as its index. The change in PPI-FG minus one percent, comes the closest of all the indices considered in this rulemaking to tracking the historical changes in the actual costs of the product pipeline industry.⁵² An index that holds reasonable assurance of tracking the actual costs of the industry is more likely than other broader-based inflation indices to ensure that individual pipeline rates remain close to a pipeline's costs. However, to ensure that the change in PPI-FG minus one percent continues to fulfill this objective in the future, the Commission will conduct a periodic review of this index every five years. If the change in PPI-FG minus one percent becomes ineffective as a mean of tracking industry costs, the Commission will not hesitate to modify its approach to select a more accurate index.

In making this decision the Commission has given due consideration to the notion of applying a broader-based index to only that part of the rate that is arguably subject to inflation, as suggested by numerous commenters.⁵³ Such an approach might mitigate the tendency of such an index to produce ceiling rates substantially in excess of actual pipeline costs.

⁵² See Kahn Testimony attached to the Crysen comments at pp. 10-20.

⁵³ See, e.g., CAPP at pp. 11-15; Chevron at pp. 5-10; NARO at p. 3; PEG at p. 13; NCFC at p. 4; Total at pp. 14-15; Holly at p. 4

However, an approach of applying the index to specific components of a rate could have perverse and unintended consequences. For example, applying the index only to operating and maintenance costs may give pipelines an incentive to direct a disproportionate amount of their spending to such costs, to the neglect of other necessary or advisable expenditures, such as investment in plant. Such a bifurcated approach would not provide an incentive to pipelines to improve the quality of service through capital improvements, since the change in rates brought about by the index would be designed to reflect increased operational and maintenance expenditures, not capital costs. Because new investment may be substantial and would not be covered by the index, many companies would have to file cost-of-service cases to recover significant increases in costs.

Significantly, this approach would be complex and difficult to administer. For example, it would likely require substantial revisions, and perhaps additions, to the Commission's regulations to identify and monitor those pipeline accounts that would be subject to the index, and those that would not. The additional administrative work this would cause, to both the Commission and the industry, would undercut the policy of the Act of 1992, which is to reduce, not increase, regulatory burdens.

Application of the index of the change in the PPI-FG minus one percent to the whole rate would, in addition to tracking economy-wide cost changes closely, obviate the need to incur the additional regulatory work and unintended consequences involved in breaking down rates to adjust some components and not adjust others.

The Commission considers the change in the PPI-FG less one per cent to be the most appropriate index of those consid-

ered in this proceeding. This index is the index which, according to the evidence, is more appropriate for tracking reported pipeline costs.⁵⁴ The evidence of record supports applying this index to the total rate of the pipeline.⁵⁵

Finally, the selection of the change in the PPI-FG minus one percent is not necessarily a choice for all time. To the contrary, the Commission believes that its responsibilities under the ICA, to both shippers and pipelines, requires monitoring of the relationship between the change in the PPI-FG minus one percent index and the actual cost changes experienced by the industry. The Commission will use the Form No. 6 information for this purpose, and will review the choice of index every 5 years.

3. Procedures Related to the Indexing Methodology

a. *Filing the Rates.* The index would be applied to any existing⁵⁶ individual rate to establish a ceiling level, as recommended by Kaneb.⁵⁷ If the existing rate used to establish the ceiling is later adjusted by Commission order, then the ceiling level must be likewise adjusted. Further, any changed rates derived from those rates that are in effect but under investigation and thus subject to refund would be made effective subject to refund.⁵⁸

Some commenters argue that the increased rates resulting from application of the index should not be considered just and reasonable rates.⁵⁹ Under the approach adopted in this final rule, increased rates that comply with the indexed ceiling levels will be subject to challenge through protests. However, such protests must show that the increment of the rate change produced by application of the index is substantially in excess of the individual pipeline's increase

⁵⁴ Some have argued that, by adopting this index, shippers/consumers are sharing in "productivity gains" of the pipeline. See comments of Holly at pp. 13-14; CAPP at pp. 11-15; NAFO at p. 3, SIGMA at p. 4; Total, p. 24.

⁵⁵ See Kahn, *id.* See also, *Railroad Cost Recovery Procedures*, 364 ICC 841, 847-8 (1981), *aff'd Western Coal Traffic League v. U.S.*, 677 F.2d 915 (D.C. Cir. 1982).

⁵⁶ An existing rate may be one which is deemed just and reasonable under section 1803 of the Act of 1992, or one which has not been

legislatively determined to be just and reasonable. The latter category of rates may therefore be challenged under the traditional standards of section 13(1) of the ICA. Under the adopted regulations, however, such rates are entitled to be indexed.

⁵⁷ Kaneb comments, p. 15

⁵⁸ See Phillips comments, pp. 5-9; ARCO comments, pp. 23-26.

⁵⁹ Total comments, pp. 4-5; USAIR comments, pp. 16-18.

in costs. The rates may also be subject to challenge at any time by the filing of complaints pursuant to section 13(1) of the ICA. The Commission believes that an adequate balance has been struck between competing interests in this matter.

Each pipeline will establish an annual ceiling level for each of its rates. Under the economic climate that exists today, with little change in the index from year to year, it appears to the Commission that allowing changes in the index to occur annually will balance the interests of the industry with its customers in assuring some measure of rate stability.⁶⁰ Of course, a company is not required to charge the ceiling rate, and if it does not, it may adjust its rates upwards to the ceiling at any time during the year upon filing of the requisite data, discussed below, and upon giving the appropriate notice. Since this is an annual *ceiling level*, it is not necessarily the rate which will actually be charged, contrary to the asser-

tions of PEG⁶¹ and SIGMA on this point.⁶²

The Commission will publish the final change in the PPI-FG minus one percent after the final PPI-FG is available in May of each calendar year. Pipelines then will be required to calculate the new ceiling level applicable to their rates which are subject to indexing. If the rate being charged by the pipeline exceeds the new ceiling level, the pipeline will be required to file a change of rates to reduce the rate to a level not exceeding the new ceiling level. If the new ceiling level is higher than the rate being charged, the pipeline may file to increase such rate at any time in the index year to which the new ceiling level is applicable.

The index to be applied under the indexing methodology shall be the change in the final PPI-FG, minus one percent. The annual ceiling level shall be calculated in accordance with the following example:

$$\text{New Ceiling Level} = \text{Old Ceiling Level} \left(\frac{PPI_n}{PPI_{n-1}} - 0.01 \right)$$

Where:

PPI_n = Final Producer Price Index for Finished Goods for the year previous to the year of adjustment

PPI_{n-1} = Final Producer Price Index for Finished Goods for the year prior to PPI_n

Thus, assuming the ceiling level for the index year July 1, 1992 through June 30, 1993 is \$0.50; that the PPI-FG for 1992 is 120; and that the PPI-FG for 1991 is 115, the New Ceiling Level for the index year July 1993 to June 1994 would be:

$$\text{New Ceiling Level}_{1993/94} = \text{Old Ceiling}_{1992/93} \left(\frac{PPI_{92}}{PPI_{91}} - 0.01 \right)$$

Then:

$$\text{New Ceiling Level} = \$0.50 (120/115 - 0.01)$$

$$\text{New Ceiling Level} = \$0.5167$$

For the first adjustment under the indexing methodology, commencing with the effective date of this rule, pipelines will apply the index which will be published by the Commission in May of 1994, to their rates on December 31, 1994.

⁶⁰ PPI-FG minus one percent changed by 3.9 percent between 1989 and 1990, and by only 1.1 percent from 1990 to 1991. See U.S. Department of Commerce, Survey of Current Business. If indexing under the Rule had begun in July of 1991, the index for 1989-1990 as applied to the national average revenue per barrel delivered in 1990 (44 cents/bbl) would have resulted in a ceiling price of 45.7 cents/bbl for 1991, permitting a maximum increase in rates for 1991 of 1.7 cents/bbl. Applying the procedure again in July of 1992, one would apply the index for 1990-1991 to the 1991 ceiling rate (rather than to the actual rate as in the base year). The

resulting indexed ceiling rate for 1992 would be 46.2 cents, permitting a maximum increase of 0.5 cents/bbl. By contrast, the largest year-to-year change in the PPI-FG minus one percent index was in 1973-74, reflecting largely the impact of the first oil shock. The index rose 14.4 percent in that year. If that increase had happened in 1990-91, the 1992 allowable ceiling price would have been 52.3 cents/bbl, an increase over the 1991 ceiling (45.7 cents/bbl) of 6.6 cents/bbl.

⁶¹ PEG comments, pp. 10-11.

⁶² SIGMA comments, pp. 6-8.

Thus, for example, pipelines shall calculate the rate ceiling applicable to their rates for the period after the effective date of this rule until July 1, 1995, using the index published by the Commission. The rate ceiling thus established may thereafter be changed as of July 1 of each year, using the published index for the previous year.

If the rate in effect is changed during the year through a method other than indexing, or if the rate in question is an initial rate established during the year, then the pipeline must defer any rate change pursuant to the indexing system to the next subsequent adjustment date—*i.e.*, the following July 1.⁶³ This limitation is to preserve the integrity of the annual indexing concept. The index is intended to limit the amount by which a rate may be increased on an annual basis. To allow a rate established, or changed by a method other than indexing, during the index year to be further increased by the full amount allowed by the index would be contrary to the policy that the ceiling level is established on an annual basis, to be applied during an index year. This limitation is responsive to the concern reflected in comments submitted by Alaska⁶⁴ and Chevron⁶⁵ that were critical of the notion of pipelines being able to move back and forth between indexing and an alternative ratemaking method.

ARCO and Kaneb suggest that the Commission should allow updating of the index quarterly rather than annually.⁶⁶ The Commission is not persuaded that quarterly filings by all pipelines which desire to change rates under the index system—with their attendant costs of filing, tracking, and review—is necessary to avoid the lag problem that concerns the commenters. For the time being, the Commission will allow updating of the index only on an annual basis. Should the economic climate change whereby it appears

reasonable to allow more frequent updating of the index, the Commission can consider a change in the methodology at that time.

At any time during the year, a pipeline may file for and change a rate that is less than or equal to the annual ceiling level.⁶⁷ Should a pipeline file a rate below the annual ceiling level, it could file at any time during the year to increase its rates to any level up to the ceiling.

As ARCO and AOPL have indicated, the index is cumulative from year to year.⁶⁸ Thus, the index applies to the applicable ceiling rate, which is required to be calculated each year, not to the actual rate charged. A rate that is not increased to the ceiling level in a given year may nonetheless be increased to the ceiling level in the following year.⁶⁹

If deflationary pressures push the ceiling level below the filed rate in any year, those filed rates that exceed the new, lower ceiling must be lowered to the new ceiling by a filing within 60 days of the date of publication by the Commission of the index.

When a pipeline files changed rates in accordance with the index, it must provide the following information:

- A cover letter describing the basis for the proposed change (*i.e.*, that it is to change rates according to the index);
- The revised tariff;
- Supporting information, including a showing of the revised rate compared with the previous rate for the same movement of product, the applicable annual ceiling level, and the calculation of the applicable ceiling level done in accordance with § 342.3(d); and
- A certificate of service.

Pipelines will be prohibited from filing rates under the indexing system that exceed the applicable ceiling level. If the

⁶³ This limitation is contained in the new regulation for making a rate change through a methodology other than indexing, or an initial rate. See § 342.3(d)(5).

⁶⁴ Alaska comments, pp. 11-13.

⁶⁵ Chevron comments, p. 13.

⁶⁶ ARCO comments, p. 31. Kaneb comments, pp. 13-14.

⁶⁷ The Commission will not require a rate to equal its annual ceiling level because, in some

cases, the rate may be constrained by competitive market forces.

⁶⁸ ARCO comments, pp. 29-31; AOPL comments, p. 33.

⁶⁹ The filed rate doctrine would, of course, still apply and preclude a pipeline from recouping the revenues foregone in the previous year in which the rate charged was not at the ceiling level.

pipeline believes that in a particular instance the index would not yield a just and reasonable rate, it may justify a higher rate if it satisfies the standards to utilize either the cost-of-service or market-rate methodologies, or negotiates and obtains the agreement of all of its existing customers to a rate.⁷⁰

Holly⁷¹ and Total⁷² recommend that pipelines be required to cost justify their rates every five years. The Commission believes that data available in Form No. 6 may form the basis for a complaint if the criteria of the new regulations or of the Act of 1992 are met. However, the Commission is adopting a five-year review of the index as discussed, *supra*.

CAPP argues that there should be a minimum waiting period between rate filings.⁷³ The Commission disagrees. Pipelines which are collecting rates below the ceiling established by the index are in effect collecting rates below the level to which they are entitled, assuming their actual costs are not substantially below that level. Before changing rates, those pipelines must nonetheless give 30 days notice, unless a shorter notice period is requested and granted pursuant to section 6(3) of the ICA. This should be sufficient time to allow customers to respond to the proposed change in rates. Furthermore, if a pipeline determines that it is faced with uncontrollable cost changes, it should be allowed to file a rate change based on its individual cost of service to attempt to collect compensatory rates. (See discussion below.)

b. Challenges to the Rates. i. Protests declining to consider most cost-of-service challenges to proposed rate changes that comply with the index is an essential feature of an index-based ratemaking methodology. As explained above, an indexing methodology tracks, and bases rate ceilings upon, changes in economy-wide, as

opposed to company-specific, costs. This obviates the need for detailed examination of company-specific costs each time a rate change is proposed, and thus simplifies and expedites the rate-changing process. This simplification effect is the reason why the methodology comports with Congress' intent under the Act of 1992.

However, the Commission is mindful of the need to avoid indexed rates that increase substantially above a pipeline's actual costs. Therefore, the Commission will implement a standard for considering protests to proposed rate changes, that comply with the index, that will ensure that individual pipeline rates do not diverge substantially from the pipeline's costs. Under the indexing system, the Commission will not entertain, on the merits, a protest filed pursuant to section 15(7) of the ICA alleging simply that the proposed rate change does not reflect a change in the pipeline's actual costs of rendering the service in question. Rather, a protest must allege reasonable grounds for believing that the discrepancy between the actual cost increase to the pipeline and the proposed change in rate is so substantial that the proposed rate change is not just and reasonable within the meaning of the ICA.⁷⁴

ii. Complaints. Complaints against rates that have been indexed will continue to be governed by the procedures set forth in section 13(1) of the ICA. The ICA currently places the burden of proof on the complainant to show that an existing rate is unjust and unreasonable. The complainant will continue to bear that burden with respect to indexed rates in a complaint proceeding.⁷⁵

This presumption will apply to existing rates that are the product of indexing. Further, the same standard that limits challenges under section 15(7) to pro-

⁷⁰ Subsequent changes to a rate established by the cost-of-service or negotiated-rate methods would be allowed to be made pursuant to the index.

⁷¹ Holly comments, pp. 14-18.

⁷² Total comments, pp. 24-26, 32.

⁷³ CAPP comments, p. 16.

⁷⁴ Some commenters maintain that this procedure shifts the burden of proof to protestants, in violation of section 15(7) of the ICA. To the contrary, the burden of proof on proposed rates

will remain with the pipeline. The regulation simply sets forth in advance and with general applicability what a protestant must show to trigger an investigation of a pipeline's proposed rate. See § 343.2(c).

⁷⁵ Under the ICA, the burden of proof is on the pipeline only with respect to proposed rate changes. 49 U.S.C. app. 15(7)(1988). Of course, the Act of 1992 provides additional protection for certain rates in existence during the one year period ending on October 24, 1992.

posed rates will apply to challenges under section 13(1) to existing rates. The Commission would not conduct an investigation upon a complaint that was premised upon the allegation that the existing rate level, established under indexing, is too high because the pipeline had increased its rates to a greater extent than its actual costs justified. Rather, to be heard on the merits, a complaint against an existing rate that has been indexed will be required to allege reasonable grounds for believing that the discrepancy between the actual cost experienced by the pipeline and the existing rate is so substantial that the existing rate level is not just and reasonable.

The Act of 1992 "grandfathers" the large majority of existing pipeline rates. This provision, however, applies only to certain existing rates. It cannot be read fairly to encompass rates not in existence during the statutorily specified grandfathered period. Thus, increases from those rates resulting in application of the index are only *prima facie* lawful, and may be challenged through the complaint or protest procedure, as appropriate.

A complainant will simply be required to state "reasonable grounds" for believing that the rate is unlawful. Further, in response to PEG and Crysen who complain about the specificity required and the time for filing protests,⁷⁶ Form No. 6 data are available to all parties to challenge a pipeline's rate increase.⁷⁷ Inasmuch as the Commission only has thirty days under the ICA to act on whether to suspend a rate increase filing, and the Act of 1992 indicates that the Commission should allow pipelines to respond to initial protests or complaints, the Commission is constrained in the time it may allow for challenges to these filings in order to act before the rate change goes into effect. Under the circumstances, the Commission will increase the time for protests from the 10 days proposed in the NOPR, but the Commission believes that 15 days from the date of filing the rate change to challenge the rate increase should be adequate.

Moreover, the rebuttable presumption provided in the regulation adopted by the Commission protests rates that have been indexed from challenges based upon a mere divergence between the pipeline's cost of service and the level of the existing rate. This is a measure of protection that comports with the policy behind the indexing system—to allow rates to be changed in accordance with an index which tracks changes in costs of the economy as a whole, rather than the changes in costs of the individual pipeline.

C. Other Rate Changing Methodologies

1. Cost of Service

As an alternative to changing a rate via indexing, a pipeline may, under certain circumstances, elect to make a cost of service showing to justify a rate higher than the applicable ceiling under the index system. Those are circumstances which are beyond the pipeline's control and which do not permit the pipeline to recover its prudently incurred costs through the indexing system.

The Commission has adopted in this final rule a modification of the standard that was proposed in the NOPR for determining when a cost-of-service showing may be utilized. In the NOPR, the Commission proposed an extremely stringent test. The Commission proposed to allow a pipeline to utilize a cost-of-service methodology only when it could demonstrate extraordinary circumstances that were both unforeseeable and uncontrollable, and which precluded the pipeline from recovering its costs under the index system.

Many pipeline commenters argued that the test proposed by the Commission was stringent to the point of unfairness.

Lakehead argues that the test set forth in the NOPR for use of the cost-of-service methodology—substantial, unforeseen, and uncontrollable extraordinary circumstances—is too restrictive and will prevent pipelines from recovering their costs in some cases.⁷⁸

Kaneb says the NOPR excludes from the definition of extraordinary costs many costs that are not controllable and have a

⁷⁶ PEG comments, p. 20; Crysen comments, p. 18.

⁷⁷ Commenters can address the adequacy of Form No. 6 data in the cost-of-service rulemaking instituted concurrently herewith.

⁷⁸ Lakehead comments, pp. 3-4.

substantial effect on the pipeline: fuel and power, insurance, and safety and environmental compliance.⁷⁹

ARCO asserts that pipelines should be allowed to employ a cost-of-service method upon a showing that their costs cannot be recouped by the index because of a substantial change in the circumstances or the nature of the services they provide. There should be no requirement that a substantial change be both uncontrollable and unforeseen. For example, states ARCO, a depletion in an oil field leading to declined throughput is foreseeable but not controllable by the pipeline. ARCO says that the failure to provide pipelines with an adequate safety valve to exceed the index ceiling when necessary would undermine the public interest in a safe and adequate pipeline network.⁸⁰

AOPL urges the Commission to recognize that a cost-based rate standard should apply when pipelines find that revenues provided under indexed rates are inadequate to sustain their operations due to changed circumstances; and when pipelines require greater ratemaking flexibility, such as when a pipeline must structure its rates to respond to competitive changes in its markets. The standard should be "substantially changed circumstances." Pipelines should be given the opportunity to show what constitutes the requisite circumstances.⁸¹

Portland urges the Commission to liberalize the application of the cost-based alternative to consider case-specific financial and economic circumstances of pipelines including significant changes in volumes and expenses.⁸²

The Commission has decided there is merit in these comments and will permit a pipeline to depart from indexing, and make a cost-of-service showing to justify a rate higher than the applicable ceiling, when it can demonstrate that it is affected by uncontrollable circumstances that preclude it from recovering all of its prudently incurred costs under the indexing system. Thus, under this standard

such circumstances as increased safety or environmental regulations may justify the use of a cost-of-service methodology. Another example would be a natural disaster that disables facilities to such an extent that replacement would be necessary at great cost to the pipeline. Such circumstances would be "uncontrollable."⁸³ A similar approach was adopted by the Commission in restricting gas producer ratemaking to a showing of cost of service only where "special circumstances" could be shown. This approach was affirmed by the Supreme Court in 1968. See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

In the NOPR, the Commission had proposed the use of a more generous index based on the GDP-IPD. Foreseeable environmental and safety costs would not have qualified the pipeline for use of the cost-of-service methodology. Therefore, the Commission believed that the more stringent standard was warranted. Since the Commission is adopting as the index the change in the PPI-FG minus one percent, it follows that a less stringent standard should be applied for using the cost-of-service methodology.

Finally, AAPC requests that the Commission promulgate a special provision that would allow an "interim" or "developmental" rate to be increased under a cost-of-service methodology, without the necessity of meeting the criteria set forth in the new regulations.⁸⁴ The Commission declines to do so. The policy of the indexing system is to limit resort to cost-of-service showings to those instances when a pipeline faces uncontrollable circumstances. A decision to charge an interim or developmental rate, as described by AAPC, is not the product of uncontrollable circumstances. It is a voluntary business decision.

2. Market Rates

Pipelines will continue to be allowed to make a *Buckeye*-type showing and justify charging market-based rates.

⁷⁹ Kaneb comments, pp. 8-10.

⁸⁰ ARCO comments, pp. 20-22.

⁸¹ AOPL comments, pp. 44-48.

⁸² Portland comments, p. 2.

⁸³ The Commission received several comments addressing the issue of whether the cost-of-ser-

vice methodology should be applied on a "stand-alone" or fully allocated basis. The Commission is proposing no change in its current practice of using fully allocated rates. See *Williams Pipe Line Company*, 31 FERC ¶ 61,377 (1985).

⁸⁴ AAPC comments, pp. 5-8.

The Commission stated in the NOPR that it would not be proposing procedures to streamline market power determinations that are a necessary part of a *Buckeye* showing. The Commission reasoned that such determinations were inherently fact-specific and that it would be difficult to promulgate justifiable thresholds for identifying competitive markets that would not be subject to frequent exceptions. The exceptions would eventually swallow up the rule, and the entire effort of attempting to streamline market power adjudications will have been to little or no beneficial effect.

Several commenters were critical of the Commission's failure to propose streamlined procedures for market-power adjudications.

AOPL,⁸⁵ ARCO,⁸⁶ Exxon,⁸⁷ Sun,⁸⁸ Plantation,⁸⁹ Explorer,⁹⁰ Buckeye,⁹¹ and Williams⁹² strongly urge the Commission to reconsider market power streamlining measures. They argue that some markets are clearly competitive, and that it would be a waste of time and resources for all concerned to conduct protracted adjudicatory proceedings to measure pipeline market power in such markets. These commenters believe the Commission can and should identify threshold standards to apply in such cases.

Some commenters, however, believe that streamlined procedures for market-power determinations are inadvisable.

Alaska states that the great variation in markets makes adjudication a more workable vehicle.⁹³

Chevron contends that the Commission has no authority to allow market rates to be charged without price caps. Market rates would only be sought if a pipeline wanted to charge rates above the price caps. But if there are market forces, the rates should be below the level of the price caps. Further, market power hearings are cumbersome and expensive. Therefore, it argues that the Commission

should do away with the market-rate option, and rely exclusively on indexing. If the Commission decides to allow pipelines to make market-rate showings, however, it should adopt some guidelines in the form of market-screens to avoid frivolous cases that waste time and discourage shipper challenges.⁹⁴

PEG,⁹⁵ APMC,⁹⁶ NCFC,⁹⁷ and Crysen⁹⁸ also voice concerns about attempting to streamline market power determinations. They support dropping the proposal for streamlined procedures for establishing market rates.

Taking into consideration all of these comments, the Commission has determined to allow pipelines to continue to attempt to demonstrate a lack of market power and thereafter charge rates that are market-based. Until such time as the Commission has determined that the pipeline lacks significant market power in the markets to which it seeks to charge market rates, the pipeline will be restricted to charging rates within the ceiling level which would be applicable under the indexing methodology. If the pipeline files a cost-of-service justification along with its market-power showing, it may charge whatever the cost-of-service showing would permit. The Commission retains the authority under the ICA to suspend the effectiveness of such rates to the maximum extent allowed by law and to require the pipeline to collect its increased rates subject to refund.

The Commission is initiating a notice of inquiry on market-based rates.

The Commission therefore disagrees with the position that streamlining market power determinations is not a matter that warrants further investigation. Implementation of a light-handed, market-based approach to regulating the rates of oil pipelines that face sufficient competitive pressures is clearly within the Commission's authority under the ICA, as the Commission held in *Buckeye*. *Buckeye*, however, was a long and difficult adjudi-

⁸⁵ AOPL comments, p. 60

⁸⁶ ARCO comments, pp. 3-20.

⁸⁷ Exxon comments, p. 1.

⁸⁸ Sun comments, p. 2.

⁸⁹ Plantation comments, pp. 1-2.

⁹⁰ Explorer comments, p. 2.

⁹¹ Buckeye comments, pp. 1-9

⁹² Williams comments, pp. 4-9.

⁹³ Alaska comments, p. 9.

⁹⁴ Chevron comments, pp. 10-13.

⁹⁵ PEG comments, pp. 6-7.

⁹⁶ APMC comments, p. 17.

⁹⁷ NCFC comments, p. 3.

⁹⁸ Crysen comments, pp. 16-17.

cation. A more streamlined way of implementing a light-handed form of regulation, when appropriate, is in the public interest if it is consistent with the policies underlying the Act of 1992.

The many comments going to the details of a streamlined approach to determining pipeline market power will be evaluated in the notice of inquiry.

3. Settlement Rate Methodology

In the NOPR, issued July 2, 1993, the Commission proposed to allow a rate agreed to between a pipeline and shippers to serve as the filed initial rate for new service.⁹⁹ Various commenters¹⁰⁰ suggested that the Commission also allow changes to existing rates that have been agreed upon by the pipeline and shippers to be filed and collected even though these rates may be above the ceiling level that would apply under the indexing methodology. The Commission has considered these suggestions and finds that allowing rate changes to reflect the agreement of shippers and the pipeline would further its policy of favoring settlements as a means for parties to avoid litigation and thereby lessen the regulatory burdens of all concerned.

Congress, in the Act of 1992, encouraged settlement of oil pipeline rate cases. That Act requires the Commission to consider reforms to streamline proceedings. It also directs the use of alternative dispute resolution procedures. Therefore, the existing Commission policy, of encouraging settlements, has been supplemented by Congressional policy mandate to expedite and streamline the ratemaking process for oil pipelines by lessening the need to rely on traditional adversarial processes. Accepting changes to rates which have been agreed to by all shippers furthers this policy.

Therefore, the Commission will permit changes of rates which are the product of unanimous agreement between the pipeline and all shippers using the service to which the rate applies.

When such an agreement is reached, the pipeline will file the rate according to the usual procedures under the ICA and

include a verified statement to the effect that the proposed rate has been agreed to by all current shippers.

Even though the rates in this instance are the product of unanimous agreement, the Commission is still concerned that a pipeline which has market power can establish a higher rate through "negotiation." Therefore, the Commission will allow a challenge to the change in rates through a protest or complaint. Because the rate will reflect the concurrence of all customers, the Commission will require such a challenge to show the same circumstances that a challenge to an indexed rate must show—reasonable grounds for believing that there is a discrepancy between the negotiated rate and the pipeline's cost of service that is so substantial as to render the rate unjust and unreasonable within the meaning of the ICA.

D. Establishment of Initial Rates

In the NOPR, issued in this proceeding on July 2, 1993, the Commission proposed to allow pipelines to establish initial rates for new service, either by an existing pipeline or a new pipeline through agreement between the pipeline and shippers. This proposal followed the suggestion of the National Council of Farmer Cooperatives contained in its comments to the Staff Proposal.

Many comments were received on the Commission's proposal in the NOPR to allow initial rates to be established by a process of negotiation between the pipeline and prospective customers. Several shipper commenters, as set forth below, expressed concern with the potential for pipelines to exercise market power in negotiating initial rates.

Alaska opposes allowing new rates to be set by negotiation. It says many pipelines and shippers are affiliated, and this fact undermines any chance that market forces will restrain the negotiated rate. Further, it argues there is no cost basis in negotiated initial rates, a problem which would be compounded by allowing the rate to be changed through an indexing methodology.¹⁰¹

⁹⁹ See 58 Fed. Reg. at p. 37676 (July 13, 1993).

¹⁰⁰ See, e.g., Lakehead comments, p. 3; ARCO comments, p. 27; and AOPL comments, pp. 63-64.

¹⁰¹ Alaska comments, pp. 14-15.

Chevron says this proposal overlooks the fact that some pipelines will have market power in establishing a new rate—the regulations should therefore allow a new rate to be subject to a protest.¹⁰²

PEG states that the Commission cannot allow monopoly pipelines to set new rates through negotiation. This abandons the consumer's interest.¹⁰³

Long Beach says the proposed rule makes no provision for the contingency of not all parties agreeing to the negotiated rate, or the shippers being affiliates of the pipeline, or the shippers being unknown. This can be corrected by allowing a party who has not agreed to the negotiated rate to file a protest or complaint and subject the rate to a cost-of-service determination.¹⁰⁴

Several commenters reflecting the pipeline point of view support the negotiated rate option, but argue that it should be discretionary.

Phillips opposes the implication in the NOPR that the only valid basis for a new rate is negotiation. It argues that, under the ICA, a pipeline has an unqualified right to file a tariff offering a service at a rate developed by the pipeline. This is because the Commission has no jurisdiction over entry and therefore cannot forbid the offering of service simply because the pipeline is unable to secure the advance agreement of shippers on the initial rate.¹⁰⁵

ARCO agrees with Phillips that the negotiated rate provision should be permissive, not mandatory. The pipeline, states ARCO, should have the option of setting a new rate based upon cost of service or the market rate if it can demonstrate lack of market power.¹⁰⁶

ARCO¹⁰⁷ and AOPL¹⁰⁸ state that a valid negotiated rate should reflect the agreement of current shippers, should be the result of arms-length negotiations between the pipeline and non-affiliated shippers, and should be applicable to all shippers receiving the same service.

In the regulations adopted in this final rule, the Commission has determined that initial rates can be established through a cost-of-service showing, or, in furtherance of the Commission's policy to encourage settlements, through agreement of the pipeline and potential shippers, at least one of which must not be affiliated with the pipeline. In the event there are no non-affiliated shippers, the pipeline must use a cost-of-service showing to justify its initial rate.

Upon consideration of the comments received, the Commission will allow agreed-upon rates to take effect. If there is a protest to the rate, the pipeline must justify its initial rate for service through a cost-of-service showing.

Initial rates for new service may be established by filing a rate that reflects the agreement of at least one non-affiliated shipper, as suggested by AOPL. In establishing initial rates through negotiation, the Commission is requiring the concurrence of only one non-affiliated shipper for the reason that, unlike the situation involving a change in existing rates, the pipeline would be unable to know who *all* potential shippers would be. Initial rates would of course be subject to challenge, through a protest or complaint under the ICA.

The comments reflect a concern, which the Commission believes is well taken, with allowing a pipeline that may possess market power to control prices in a market to establish an initial rate through negotiations. However, the regulation adopted adds the requirement that at least one non-affiliated prospective shipper must agree to the initial rate. This should provide some measure of protection against a pipeline exercising market power to dictate the rate it will charge. When a pipeline attempts to exercise market power to coerce an agreement, a concern expressed by Chevron and PEG, the Commission believes that adequate remedies are available through the protest and complaint procedures. In this regard, the Commission rejects the suggestion by AOPL that a negotiated initial rate should be entitled to a presumption

¹⁰² Chevron comments, p. 16.

¹⁰³ PEG comments, p. 17.

¹⁰⁴ Long Beach comments, pp. 7-8.

¹⁰⁵ Phillips comments, p. 11.

¹⁰⁶ ARCO comments, pp. 27-29.

¹⁰⁷ ARCO comments, p. 27.

¹⁰⁸ AOPL comments, pp. 63-64.

of lawfulness. An initial rate will not be entitled to any presumption of lawfulness. This should help to ensure that the remedies of protest or complaint are adequate to ensure that an initial rate is not established through the exercise of market power.

Finally, ARCO makes two other specific suggestions regarding establishing initial rates. ARCO says the Commission should clarify that a new rate includes a rate for service to a new point, even if no construction is involved. In addition, ARCO states that the Commission should uphold any escalator clauses in rate agreements, even if the clauses provide for increases larger than the index.¹⁰⁹ AAPC suggests that contract escalators in initial contracts should be allowed to effect rate increases within the ceiling set by the Commission's index, and that upon expiration of these contracts, the pipeline should be allowed to bring its rates up to that ceiling.¹¹⁰

As to ARCO's request that the Commission clarify that an agreed rate for initial service need not involve construction, nothing in the new regulations precludes a rate for new service where there is no new construction. As to ARCO's suggestion that escalator clauses in such agreements should be allowed, even if the rates would exceed the indexed ceiling, the Commission believes that it is consistent with the theory behind allowing a negotiated rate to uphold escalator clauses that reflect the unanimous agreement of the current customers. It should be pointed out, however, that the remedies of protest and complaint would remain available in respect to an escalation of rates that goes beyond just and reasonable levels. The Commission will not at this time provide in its regulations a blanket approval of escalator clauses in initial rate contracts. The contract escalator provision mentioned by AAPC would not violate the indexing system so long as the rates established thereunder comply with applicable ceilings.

E. Trans-Alaska Pipeline System

In the Act of 1992, Congress excluded TAPS and any pipeline delivering oil directly or indirectly to TAPS from the provision of this Act for ratemaking

purposes. Thus, for ratemaking purposes, TAPS and those excluded pipelines will continue to be regulated under the ratemaking standards that are currently in effect. However, it is the Commission's judgment that such exclusion was intended to apply only to the simplified and generally applicable rate methodology, not to the procedural rules that the Act of 1992 required the Commission to consider. Otherwise, the Commission would be required to enforce one set of procedural rules for TAPS and the excluded pipelines and another for all other pipelines under its jurisdiction under the ICA. This would not be consistent with Congress' intent for the Commission to streamline its procedures for oil pipelines. In other words, Part 342 of the regulations as adopted by this final rule will not apply to these pipelines.

Thus, all excluded pipelines, including TAPS, will be subject to the new rules established under Parts 341 and 343. TAPS must justify its rates in accordance with the TAPS Settlement Methodology.¹¹¹ To the extent there is a conflict between Parts 341 and 343 and the TAPS Settlement, the TAPS Settlement will control. All other excluded pipelines must justify their rates under the Opinion No. 154-B methodology.

V. Procedures for Streamlining Commission Action on Rates

Section 1802 of the Act of 1992 requires the Commission to consider certain specific procedural issues in a rule to streamline its procedures relating to oil pipeline rates. Accordingly, certain new procedures are being promulgated for the treatment of protests and complaints that will expedite consideration of rates by reducing the frequency and the scope of adjudicatory proceedings. These new procedures are discussed in section A below.

The new procedures will be incorporated into the Commission's existing practices and procedures for administering oil pipeline tariffs and resolving challenges to those tariffs. The existing practices are codified in Part 385 (Rules of Practice and Procedure) of the Commission's regulations, and govern the filing of tariffs, protests, and complaints; service upon parties; time periods for responding to

¹⁰⁹ ARCO comments, pp. 27-29.

¹¹⁰ AAPC comments, pp. 5-8.

¹¹¹ See *Trans-Alaska Pipeline Company*, 33 FERC ¶ 61,064 (1985).

pleadings; and other details of uncontested and contested proceedings.

The Commission is also making substantial revisions to the existing regulations on tariffs, which were inherited from the ICC, in order to eliminate archaic and unnecessary language.

A. New Procedures

Congress clearly intends for the Commission to expedite its handling of oil pipeline rate filings. Section 1802(b) of the Act of 1992 specifies the procedural issues set forth below for consideration in promulgating new regulations to streamline its process. The Commission has carefully evaluated two rounds of comments on these new procedures and, in compliance with the explicit direction of section 1802(a) to consider certain specific procedural reforms, the Commission has determined to adopt certain reforms.

These reforms are explained in detail below. In sum, procedures for filing rate changes under the generally applicable indexing system will require pipelines to file only that information which is necessary to show compliance with the applicable rate ceiling. The likelihood of investigations being conducted on non-meritorious challenges will be reduced and the scope of investigations that are justified will be confined to the allegations raised.

1. Identification of Information to Accompany a Tariff Filing

As stated above, pipelines will be required to file minimal information with rate filings under the new indexing and negotiated rates methodologies. In regard to rates filed under the cost-of-service and market-rate methodologies, the filing requirements will for now remain the same as under current practice. However, as stated above, the Commission intends to promulgate new regulations pertaining to the cost-of-service filings and perhaps to market rate filings.

The Commission received many comments that were critical of the notion of a minimal information requirement for filings under the indexing system.

Alaska wants the Commission to require a pipeline to file basic cost-of-service data with new rates, or shortly after the new rates are filed. It argues that without this requirement challenges cannot be fully developed and specific and filed within 10 days of the tariff filing, as required by the NOPR. It supports PEG's proposal to require pipelines to supply simplified cost of service information and an allocation justification. This would avoid unnecessary discovery, and eliminate unnecessary litigation. Alaska states that the Commission should adopt a procedure similar to that used under the TAPS Settlement Agreement, which includes annual filings of rates, and advance filing of supporting data, followed by an informal negotiation process.¹¹²

Chevron advocates requiring a pipeline to provide the supporting data when it files for a rate increase under indexing, much like the top sheets submitted by gas pipelines. Also, the pipeline should be required to give 60 days notice, and shippers should be allowed 30 days to file protests.¹¹³

PEG asserts that outside parties that wish to be heard will be severely handicapped by having less than 10 days to file a detailed answer to a filing that is neither noticed nor public, and which contains no information on which to make specific, detailed answers.¹¹⁴ PEG states that there should be advance notice by the Commission and the pipeline to the public of a proposed rate increase and sufficient information filed by the pipeline in advance so that all affected, including staff, can be heard.¹¹⁵

Crysen says pipelines are not currently required to file any information with a changed tariff, but merely to announce it. As a result, shippers are "flying blind". Pipelines should be required to file with the Commission and serve on shippers a detailed explanation of a rate increase, 60 days before the proposed effective date. Pipelines should thus be required to file the same type of information that natural gas pipelines must file.¹¹⁶

CA argues that the Commission should require all pipelines to submit annual in-

¹¹² Alaska comments, pp 16-20.

¹¹⁵ *Id.*, p. 14.

¹¹³ Chevron comments, pp. 14-15.

¹¹⁴ PEG comments, pp. 20-21

¹¹⁶ Crysen comments, pp. 17-18.

formation that conforms to information provided to the Commission by natural gas pipelines.¹¹⁷

Detailed cost data are unnecessary with respect to rate changes proposed under the indexing system. Rate changes under indexing are not required to be justified by the actual cost changes experienced by the individual pipeline filing the rate. The indexing system is predicated upon cost changes in the economy as a whole, not to individual pipelines.

However, the Commission discerns merit in the observations of Chevron, Crysen, PEG, and NCFC that it would be unfair to require the filing of a fact-specific protest to a rate filing under the indexing system, particularly in view of the limited information required to be contained in the filing, even though Form No. 6 data are available to protestants. Thus, as explained further in the section below on specificity of protests and complaints, the Commission has revised the NOPR proposal, and adopted a regulation that simply requires that a protestant state "reasonable grounds" for believing that a proposed rate change under indexing substantially exceeds the pipeline's actual cost increases. This is a much more lenient threshold for a protest than was proposed in the NOPR.

The Commission does not agree, however, with the comments of Chevron and Crysen that a longer than 30-day notice period should be required for rate changes. Such a notice period would substantially undercut the rate-changing flexibility that is one of the goals of the indexing approach.

In *National Rural Telecom Association v. FCC*, the court upheld the adoption of similar streamlined rate filing procedures under a rate cap regulatory regime, ruling that the rate cap could be relied upon to provide the primary means of protection against excessive rates.¹¹⁸

Finally, AOPL recommends that the Commission provide additional guidance with respect to tariff filings seeking cost-of-service or market-based regulation, or

containing negotiated rates. AOPL's call for additional guidance on the informational requirements for cost-of-service and market-rate filings is also well taken, and will be addressed in the companion rulemakings.

2. Availability to the Public of Staff Analysis of Tariff Filings

The NOPR did not propose any new regulation on public access to staff analysis of tariff filings. First, in those instances when no protest or complaint is lodged against a tariff there would be no need for making staff analysis available. Second, in those instances when a protest or complaint is lodged but an investigation is not initiated by the Commission based upon the pipeline's response the reasons for such action would be set forth in the Commission's order. The Commission believes this would be sufficient to meet any public need or right to know of the basis for the Commission action. Finally, when an oil pipeline tariff is subject to investigatory proceedings or has been set for hearing, the usual rules of discovery found in § § 385.401, *et seq.*, of the Commission's regulations would apply.

No comments were filed which opposed the above-described reasoning. Therefore, the Commission has determined to adopt no new regulations on this point.

3. Standing of Parties to File Protests

In the NOPR the Commission proposed a general rule to restrict standing to shippers. In addition, the Commission proposed to grant standing to customers of customers, if their economic interest in the proposed rate was substantial. Finally, the NOPR's proposal would limit standing to competitors to those cases in which the allegation being raised concerned alleged anti-competitive behavior.

Many comments were received urging the Commission to craft a standing requirement that includes a particular category of persons. Standing was urged for producers (IPAA,¹¹⁹ Long Beach,¹²⁰ CAPP¹²¹), trade associations (CAPP,¹²² NARO,¹²³ NCFC,¹²⁴ IPAA¹²⁵), agencies

¹¹⁷ CA comments, p. 5.

¹¹⁸ 988 F.2d at p. 185.

¹¹⁹ IPAA comments, p. 3.

¹²⁰ Long Beach comments, pp. 5-6.

¹²¹ CAPP comments, p. 21.

¹²² CAPP comments, p. 21.

¹²³ NARO comments, p. 3.

¹²⁴ NCFC comments, p. 6.

¹²⁵ IPAA comments, p. 3.

(Long Beach¹²⁶), and consumers and consumer groups (PEG¹²⁷).

The Commission has decided to continue to use its permissive rule for interventions found in § 385.214, but to adopt a "substantial economic interest" test for determining the standing of parties to file protests against proposed rates. This will ensure that all persons will have the opportunity to be heard in regard to a proposed rate increase, but only those who have a substantial economic stake in the rates can protest and trigger an investigation. This is analogous to the procedure used in federal courts in which only persons that are aggrieved may bring an action but others may be heard as *amicus curiae*.

The Commission has determined that application of a generic test based upon economic interest is preferable to the approach indicated in the NOPR of basing standing upon classifications, such as customer, customer of customer, and competitor. The key factor in determining standing should be the magnitude of the economic stake of the person seeking standing to challenge a proposed rate.

The Commission is not adopting language explicitly granting trade associations and other groups standing to file protests. The Commission believes that the policy of the Act of 1992 would be furthered by restricting the ability to initiate investigations of proposed rates to those who have a substantial economic interest in those rates. Organizations such as trade associations, consumer groups, and government agencies, will have standing to bring protests if they can meet the substantial economic interest test. Otherwise, they will continue to have the right to participate in proceedings by filing for intervention.

It should be noted that the requirement for standing promulgated herein applies only to the filing of protests. The ICA provides that "any person" may bring a complaint against an existing rate or practice under section 13(1) of the ICA. The Commission will not attempt to define a class of persons eligible to file complaints.

4. Level of Specificity for Protests and Complaints

The Commission had proposed in the NOPR to require parties challenging rates under indexing to set forth specific facts for alleging the rates were unlawful.

Some commenters criticized this requirement. NCFC states that a protester should be given at least 30 days to file a challenge, given the fact that it must allege specific facts.¹²⁸

Alaska maintains that the requirements that protests be supported by specific facts and filed within 10 days of the tariff are "onerous and impractical." The practical effect of this, and other obstacles such as the cursory information the pipeline is allowed to file with its tariff and the presumption of lawfulness of a rate increase within the index, is to shift the burden of proof to justify a rate change to the challenger in violation of section 15(7) of the ICA.¹²⁹

Long Beach claims that it is unfair to require those who would challenge a rate under the cost-of-service, initial rate, or market-based rate methodologies to aver "specific facts." The challengers may not have access to the cost and throughput information necessary to meet this requirement. This requirement shifts the burden to challengers and may preclude meritorious claims against rates whose basis is known only to the pipeline. More stringent pleading requirements for challengers are appropriate once the rate has been determined to be just and reasonable and is subject to indexing, where all parties have access to the relevant calculations.¹³⁰

On the other hand, AOPL strongly supports and cites to its comments on Staff proposal at pp. 79-81 for the legal basis for specificity requirements.¹³¹

The Commission has concluded that a requirement that a protestant or complainant allege specific facts is, in light of the lack of data provided by the pipeline under indexing, inappropriate. Thus, the regulations state that a challenge, under either section 15(7) or section 13(1) of the ICA, must allege "reasonable grounds" for believing that the rate is outside the

¹²⁶ Long Beach comments, pp. 5-6.

¹²⁷ PEG comments, p. 18.

¹²⁸ NCFC comments, p. 5.

¹²⁹ Alaska comments, pp. 16-20.

¹³⁰ Long Beach comments, pp. 6-7.

¹³¹ AOPL comments, p. 69.

zone of reasonableness. This requirement is fair. It must be presumed that one who files a challenge to a rate has some reasonable basis for believing it is unlawful. The new regulation simply requires an articulation of that basis. In addition, challengers of rates have at their disposal the data on pipelines contained in Form No. 6. Moreover, a rulemaking process is being initiated to examine improvements of this Form. In addition, the Commission is increasing the time for filing protests of rate changes from 10 days to 15 days.

Contrary to the comments filed by Alaska, the Commission's adopted procedures will not shift the burden of proof to protestants. These procedures merely specify, in advance and with general applicability, what showing pipelines must make to put forth a *prima facie* case justifying a rate change under the indexing system, and what showing a protestant must make to rebut that case. There is no shifting of the ultimate burden on the pipeline to justify a rate change.

5. Guidelines for Commission Action on the Portion of the Tariff or Rate Filing Subject to Protest or Complaint

In the NOPR, the Commission proposed to confine its investigations and remedial actions (if any) to the disputed rate or practice, and no others. Thus, protests and complaints raising certain specific issues would not be the basis for triggering a system-wide inquiry or going into issues not raised. Limiting the scope of investigatory proceedings in this manner, reasoned the NOPR, was important in achieving Congress' objectives of increasing the efficiency and economy of the Commission's regulation of oil pipelines.

Two commenters argued that this requirement was not appropriate. Alaska claims that this requirement, if applied strictly, could actually have the opposite of its intended effect because challengers would raise every conceivable claim to protect their rights.¹³² Chevron opposes restricting the inquiry to those issues raised in the protest or complaint, saying it is the Commission's duty to investigate

wrongdoing and that many times such wrongdoing is not discovered until after the investigation commences.¹³³

The Commission has concluded that it is reasonable and appropriate to request that one challenging a rate specify the grounds for that challenge. A protest or complaint should not, in other words, be a device for triggering a "fishing expedition." The Act of 1992 evinces an intent to limit the scope of proceedings to the issues raised.

As the Commission stated in the NOPR, there will be room for interpretation of this restraint on the scope of proceedings. Relevancy is often subject to debate. Under this new regulation, it will be the task of the Commission in the suspension order, or the presiding judge to make the proper rulings to ensure that proceedings remain focused on the issues raised. Similarly, if a proceeding is initiated to investigate matters raised in a protest and the protest is subsequently withdrawn, then the proceeding should be terminated. Section 343.3(d) of the new regulation provides for this result.¹³⁴

6. Opportunity for Pipeline to Respond to Protest or Complaint

In the NOPR the Commission proposed the following procedures:

Protests to a rate filing must be filed no later than ten days after such filing; the pipeline would be permitted to respond to any protest within five days of the date of filing of the protest, and to any complaint within 30 days (as currently provided in § 385.213 of the Commission's rules). This proposal contemplates that the Commission would examine the pipeline's response to a protest or complaint to make a determination as to whether to commence a formal investigation of the tariff. If the Commission were to determine that formal investigation is not warranted, the protest or complaint would be dismissed. If the Commission were to determine that a formal investigation is warranted, then the matter would proceed to the next stage. . . . The determi-

¹³² Alaska comments, p. 19.

¹³³ Chevron comments, pp. 18-19.

¹³⁴ The termination of a proceeding by the withdrawal of a protest will not preclude the Commission from initiating an investigation on

its own based on the record developed as a result of the protest, if the Commission determines an independent investigation is warranted. (See below in section 8.)

nation of whether to initiate a formal investigation of a tariff filing will be made within the 30-day statutory notice period.

Two comments suggested that the five-day period for filing answers to protests needed modification. Phillips notes that five days is a very short time to respond to a protest, but recognizes that the Commission needs to examine both pleadings and decide whether to initiate an investigation within 30 days of the rate filing. This time crunch, suggests Phillips, would be lessened for the pipeline and the Commission by requiring protests to be upon the pipeline by telefax, thus giving the pipeline five full days (not reduced by mail time).¹³⁵

AOPL suggests that delivery of the protest be by overnight mail or by hand delivery.¹³⁶

Taking into account these comments, the regulation adopted by the Commission adds the following procedure. If a pipeline requests in a separate letter accompanying its rate filing a telefax transmittal of any protest, then a copy of the protest must be telefaxed to the pipeline at the same time it is filed with the Commission. The letter requesting this procedure must include the telefax number and a contact person. If no such request is made by the pipeline, the protest would simply be served in the customary manner.

7. Complaints Against "Grandfathered" Rates

The Act of 1992 provides that complaints against otherwise grandfathered rates may be filed under certain circumstances: a substantial change has occurred since enactment in either the economic circumstances or the nature of the services which were a basis for the rate; the complainant was contractually barred from challenging the rate prior to enactment; or the rate was unduly discriminatory or preferential.¹³⁷

Because of the difficulty, if not impossibility of adequately enumerating in ad-

vance the specific factual allegations that would cause the Commission to entertain a complaint against rates statutorily deemed to be just and reasonable, the Commission did not propose to do so in the NOPR. This is the position of the Commission in this final rule. Thus, no regulations are promulgated on this issue.

The Commission received two comments pertinent to this area.

CAPP says the Commission should provide for a reasonable period (one year from enactment of the rule) to challenge grandfathered rates.¹³⁸

Chevron requests that the Commission clarify that the restriction under section 1803(b) of the Act of 1992 on refunds only applies to grandfathered rates under that section.¹³⁹

CAPP's suggestion is contrary to the statute. Grandfathered rates may only be challenged under the circumstances under section 1803 of the Act of 1992. If those circumstances are met, the rates may be challenged at any time. If those circumstances are not met, the rates may not be challenged.

In regard to Chevron's comment, the Commission believes the statute is clear on this point and that no new regulation is necessary to supplement it.

8. Staff-Initiated Investigations

Section 1802(b) of the Act of 1992 requires the Commission to consider adopting a regulation defining the specific circumstances under which staff may initiate a "protest" (i.e., an investigation).

The Commission has not adopted the NOPR's proposal to prohibit all investigations initiated by the Commission. PEG asserts that the NOPR would silence Commission staff, who cannot raise issues as to illegal actions of pipelines.¹⁴⁰ NCFC says staff should be allowed to initiate and participate in investigations because shippers often need this assistance.¹⁴¹ Similar comments were also filed by Chevron.

¹³⁵ Phillips comments, p. 23.

¹³⁶ AOPL comments, p. 70.

¹³⁷ Sec. 1803(b) and (c) of the Act of 1992, 42 U.S.C.A. § 7172 note. Procedurally, such a complaint would be filed under § 385.206 of the Commission's existing regulations.

¹³⁸ CAPP comments, pp. 9-10.

¹³⁹ Chevron comments, pp. 17-18.

¹⁴⁰ PEG comments, p. 21.

¹⁴¹ NCFC comments, pp. 6-7.

The opposing point of view was articulated by Phillips¹⁴² and AOPL.¹⁴³ They both assert it was the intent of Congress in the Act of 1992 to prohibit staff-initiated investigations of rates.

Upon consideration of this issue, and the comments received, the Commission has determined that it will not promulgate an explicit bar to Commission-initiated rate investigations. As explained in the next section, the Commission is eliminating the Oil Pipeline Board. The Board has exercised delegated authority to suspend oil pipeline tariff filings. With the Board's elimination, that authority will now reside exclusively with the Commission. It will not be delegated at this time.

The decision not to adopt an absolute bar is premised primarily upon the Commission's responsibilities under the ICA, in particular, its obligation to ensure that pipeline rates are just and reasonable. The Commission believes that it would be inconsistent with these responsibilities to rule out in all cases the possibility of an agency-initiated rate investigation.

Nonetheless, while the Commission believes it is advisable to retain the authority to investigate a rate on its own motion, it should make clear that it does not contemplate invoking such authority except in the most unusual circumstances. The policy of streamlining and expediting the regulation of oil pipelines, as reflected in the Act of 1992, supports the notion of relying primarily upon the affected parties to bring challenges to rates.

9. Elimination of Oil Pipeline Board and Delegation of Authority to Office Directors

Section 375.306(a) of the current regulations authorizes the Oil Pipeline Board (Board) to exercise the Commission's power under section 15(7) of the ICA to institute investigations of proposed tariff changes. This authority includes suspending a tariff filing on the Board's own motion.

The Commission will adopt the proposal contained in the NOPR to eliminate the Board and instead reserve to itself the authority to suspend tariffs, while delegating to Staff Office Directors certain of

the other duties currently delegated to the Board.

The Chief Accountant or the Chief Accountant's designee will be authorized to pass upon applications to increase the size, add to or combine property units of oil pipeline companies, and sign all correspondence on behalf of the Commission relating to Form No. 6. In addition, the Chief Accountant will be delegated authority to issue interpretations and pass upon matters arising under the Uniform System of Accounts and related issues. These are authorities which the Chief Accountant has historically exercised over natural gas and electric utility companies subject to the Commission's jurisdiction. Since these delegations essentially conform the authority of the Chief Accountant to the authority already exercised over natural gas and electric utility companies, these delegations will be made effective thirty days from publication of this final rule in the *Federal Register*.

The Director of the Office of Pipeline and Producer Regulation or the Director's designee will be delegated authority to accept any uncontested item which has been filed consistent with Commission regulations and policy; reject any filing which patently fails to comply with applicable statutory requirements and with all applicable Commission rules, regulations and orders for which a waiver has not been granted; authorize, prescribe or revise the rates for depreciation of carrier property; and refer any matter to the Commission which the Director believes should be acted upon by the Commission. These delegations are similar to those which have been granted the Director with respect to the Commission's jurisdiction over natural gas companies.

The Commission has been performing depreciation studies to establish revised depreciation rates for oil pipelines. The Commission has determined that this task unnecessarily burdens the Commission's resources. Under the Commission's regulations, performing depreciation studies is the responsibility of the pipelines. (See, 18 CFR Part 352, General Instruction 1-8). In the future, pipelines will be required to perform such studies.

The specific requirements for such studies will be addressed in the accompa-

¹⁴² Phillips comments, p. 18.

¹⁴³ AOPL comments, p. 71.

nying investigation into cost-of-service filing and reporting requirements.

The Executive Director will be delegated authority to grant or deny petitions for waiver of annual charges. This delegation is consistent with the other authority the Executive Director now has.

Some duties currently delegated to the Board will not need to be re-delegated. For example, the granting of special permission to place tariffs in effect on less than 30 days' notice and "Fourth Section" waivers—i.e., from the provisions of section 4 of the ICA which would allow a pipeline to charge a greater amount for a shorter distance over the same line or route in the same direction, or to charge any greater compensation as a through rate than the aggregate of the intermediate rates—would be granted automatically under revised § 341.14 and § 341.15.

The Board was initially established at the Commission pursuant to section 17(2) of the ICA. Under section 17(2) the Commission has the authority to rescind its delegation to the Board at any time. While section 17(2) does not specifically provide for delegation to Office Directors, it does not bar such delegation, particularly in light of the specific language of sections 401(g) and 402(b) of the DOE Organization Act, which gives the Commission the power to delegate and which transferred the functions and authority related to oil pipeline regulation from the ICC to the Commission.

The termination of the Board and the transfer of the additional delegated authorities to the Director of the Office of Pipeline and Producer Regulation and the Executive Director will take effect on January 1, 1995. These actions are part of the Commission's streamlining of its oil pipeline procedures under the Act of 1992.

B. Revisions to Existing Procedures

1. Tariff Filing Requirements

¹⁴⁴ The ICC's regulations were transferred from 49 CFR (containing ICC regulations) to 18 CFR (containing FERC regulations) by a 1984 rulemaking. See *FERC Statutes and Regulations, Regulations Preambles 1982-1985* § 30.552 (1984).

¹⁴⁵ In 1928, the ICC issued "Tariff Circular No. 20," which contained many of the filing

The Commission has never significantly altered the tariff regulations it inherited from the ICC.¹⁴⁴ Some of these regulations have remained essentially unchanged for over 60 years.¹⁴⁵ The Commission will revise the regulations contained in Parts 341 through 345, 347, 360, 361 and § 375.303 of Title 18 of the Code of Federal Regulations. The Commission will make these revised regulations effective 30 days after issuance and publication of the final rule in the *Federal Register*.¹⁴⁶ The changes to the existing filing requirements should significantly reduce the burden of the preparation and filing of oil pipeline tariffs. In particular:

- Separate special permission applications would no longer be filed; rather, the request would be made concurrently with the tariff filing. The special permission would be deemed to be granted unless specifically denied within 30 days of the date of the tariff filing.

- Current regulations prohibit the withdrawal of pending tariffs. The revised regulations would permit pending tariff filings to be withdrawn prior to their proposed effective date.

- Format requirements would be revised and simplified to account for technological advances.

- The requirements to file concurrences and powers of attorney with the Commission would be eliminated.

- Requirements related to oil pipeline valuations would be eliminated in their entirety.

Finally, the Commission will require a full 30 days' notice for newly-constructed-pipeline rate filings.

The Commission received some specific suggestions regarding the proposed revision of the tariff regulations from AOPL and ARCO.

AOPL's comments contain a section-by-section analysis of the proposed regulations contained in Part 341, and a marked-up version to reflect its propos-

provisions still extant in the regulations adopted by the FERC.

¹⁴⁶ Other changes would be incorporated into the revised filing requirements effective with the implementation of the revised rate methodologies.

als.¹⁴⁷ Many of the comments of AOPL were also reflected in the comments of ARCO. The final rule reflects those AOPL suggested modifications that clarified the intent of the regulations, such as AOPL's suggested modifications in § 341(b)(10), concerning loose leaf tariffs.

Other suggested changes, which would limit the meaning of the regulations or would be redundant, were not adopted.

ARCO says proposed § 341.8 adds a number of items to the list that must be included in tariffs. These items were not previously required and would require amendment to all existing tariffs, and increase the volume of future filings. For example, the new rule would require a change in the tariff each time the pipeline changed its specification for the chemical composition of crude oil. The Commission, contends ARCO, has neither the time nor the expertise to review the amount of tariff filings this change would require. Further, many of the items, including prorationing policy, are arguably not within the authority of the Commission to require to be included in the tariff. The statute only requires publication of matters affecting the rate, charge or fare, not extraneous matters.¹⁴⁸

ARCO is critical of several other specific aspects of the tariff regulations proposed in the NOPR. It indicates that proposed § 341.0(a)(1) should be restricted, and that tariff justifications should be sent only to current shippers. It states that proposed § 341.0(b)(6) can be read to require tariff postings in all pipeline offices. According to ARCO, § 341.3(b)(7) should be clarified to allow the charging of volume rates. ARCO also criticizes § 341.3(b)(8), saying that a pipeline should not be required to show the specific route for a service, only the origin and destination points. The 30-day period provided under § 341.6(d)(5) should be subject to extension, according to ARCO. Finally, ARCO states that § 341.10 is confusing and should be deleted.¹⁴⁹

As to the comments of ARCO about the additional requirements specified in Part 341, the Commission believes that it is in the public interest for the Commission,

and the interested public, to have ready access to information concerning pipeline operations. This policy is reflected in the ICA. This policy has not been reversed in the Act of 1992. However, these informational requirements are subject to a rule of reason. Thus, for example, it is not true that a revised tariff would necessarily be filed each time the chemical make-up of a product transported was altered even slightly.

ARCO's comment that some voluminous documents should be allowed to be referenced rather than included with the posted tariff is not inconsistent with the language of the regulation, so long as the referenced document is readily available. The Commission will not, however, restrict the list of subscribers. This would be contrary to the spirit of the notice requirements of the ICA. The Commission responds to the other comments of ARCO as follows:

The comment that § 341.0(b)(6) would require the posting of tariffs at all offices is incorrect. The section requires such posting only at "principal" pipeline offices.

The Commission discerns no need to clarify that § 341.3(b)(7) does not preclude volume rates—this section merely states the requirements for clearly describing the rates.

The proposed requirement for showing the actual route for the service in question is modified. As an alternative to exact designation of routing, carriers may state that the rates apply via all routes utilized by the carrier except as otherwise specifically provided in the tariff.

A good-cause exception to the 30-day notice period in § 341.6(d)(5) is adopted.

The Commission has clarified § 341.10. It will therefore be retained.

2. Revised Accounting Requirements

In the NOPR in this proceeding, the Commission did not propose to modify the regulations relating to the Uniform System of Accounts except for a minor technical change to Instruction 3-2 which specifies the minimum amount for capitalization of property acquisitions.¹⁵⁰ The

¹⁴⁷ AOPL comments, pp. 71-88 and appendix A.

¹⁴⁸ ARCO comments, pp. 39-42.

¹⁴⁹ ARCO comments, pp. 39-42.

¹⁵⁰ 18 C.F.R. Part 352, Instruction 3-2 (1993).

Commission proposed that the minimum amount be raised from \$500 to \$2,500.

No comments were received on the proposed change. Subsequent to the issuance of the NOPR, the Commission has received applications from pipelines for waiver of the minimum amount that are less than and greater than the proposed \$2,500. Under the circumstances, the Commission is not satisfied that the proposed revision to the minimum amount is appropriate at this time. Rather, a more appropriate course of action will be to consider the minimum amount specified in Instruction 3-2 as part of an overall examination of the requirements of the Uniform System of Accounts following the issuance of the final rule, when the need for any changes can be better evaluated.

C. Alternative Dispute Resolution

Further evidencing Congress' goal to reduce the time and expense associated with the regulation of oil pipeline rates, section 1802(e) of the Act of 1992 requires that the Commission, to the maximum extent practicable, establish alternative dispute resolution (ADR) procedures, including "required negotiations and voluntary arbitration," for use early in a contested rate proceeding.¹⁵¹ Any rates derived from implementation of ADR must be considered on an "expedited basis."¹⁵²

The Administrative Dispute Resolution Act of 1990 ("ADRA")¹⁵³ amends the Administrative Procedure Act¹⁵⁴ by adding a new subchapter to provide explicit statutory authorization allowing federal agencies to use ADR techniques in lieu of litigation to resolve a dispute in the agency's administrative programs when all the participants to the dispute voluntarily agree to its use. ADR methods include the use of a neutral, an individual who functions to aid the participants in resolving the controversy. The ADRA provides that ADR methods may include, but are not limited to, settlement negotiations, conciliation, facilitation, mediation,

factfinding, minitrials, and arbitration, or any combination of these, as described below:

Conciliation is an informal process in which the third party tries to bring the parties to agreement by lowering tensions, improving communications, interpreting issues, providing technical assistance, exploring potential solutions and bringing about a negotiated settlement, either informally or, in a subsequent step, through formal mediation. Conciliation is frequently used in volatile conflicts and in disputes where the parties are unable, unwilling or unprepared to come to the table to negotiate their differences.¹⁵⁵

Facilitation is a collaborative process used to help a group of individuals or parties with divergent views reach a goal or complete a task to the mutual satisfaction of the participants. The facilitator functions as a neutral process expert and avoids making substantive contributions. The facilitator's task is to help bring the parties to consensus on a number of complex issues.¹⁵⁶

Mediation is a structured process in which the mediator assists the disputants to reach a negotiated settlement of their differences. Mediation is usually a voluntary process that results in a signed agreement which defines the future behavior of the parties. The mediator uses a variety of skills and techniques to help the parties reach a settlement but is not empowered to render a decision.¹⁵⁷

Factfinding is a process used from time to time primarily in public sector collective bargaining. The Fact Finder, drawing on both information provided by the parties and additional research, recommends a resolution of each outstanding issue. It is typically nonbinding and paves the way for further negotiations and mediation.¹⁵⁸

¹⁵¹ Section 1802(e)

¹⁵² *Id.*

¹⁵³ 5 U.S.C. 571-83, as amended by P. L. 102-354, 106 Stat. 944 (August 26, 1992).

¹⁵⁴ 5 U.S.C. 551-557 (1988)

¹⁵⁵ Administrative Conference of the U.S., *Sourcebook: Federal Agency Use of Alternative*

Means of Dispute Resolution (Office of the Chairman, 1987) (Sourcebook) at p. 44.

¹⁵⁶ *Id.* at p. 45.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

The *minitrial* is a privately-developed method of helping to bring about a negotiated settlement in lieu of corporate litigation. A typical minitrial might entail a period of limited discovery after which attorneys present their best case before managers with the authority to settle and a neutral advisor who may be a retired judge or other lawyer. The managers then enter settlement negotiations. They may call on the neutral advisor if they wish to obtain an opinion on how a court might decide the matter.¹⁵⁹ The neutral may also be called upon to mediate the dispute.

Arbitration is a relatively formal process in which parties jointly select the decisionmaker to whom they turn over the decisionmaking. The arbitrator, after hearing each side, issues a decision following the procedures agreed to in advance. The ADRA provides for a binding arbitration with limitations that protect the agency's statutory authority. The ADRA's arbitration provision is separately described and fully discussed below.

It is the policy of the Commission to conclude its administrative proceedings as fairly, effectively, efficiently, and expeditiously as possible. To that end, the Commission has long had in place flexible settlement regulations that encourage and promote the use of settlement negotiations and other means to resolve disputes. The Commission now has the opportunity to further develop and refine its policies to achieve less costly, less contentious, and more timely decisions in its oil pipeline rate proceedings. Under the existing framework for the review and determination of its proceedings, the Commission intends to foster the effective and sound use of innovative ADR procedures pursuant to the guidelines established in the ADRA.

Consistent with the Congressional mandate contained in both the Act of 1992 and the ADRA, the Commission encourages participants in its oil pipeline proceedings to consider the use of ADR procedures to assist them in resolving any

differences among them. ADR techniques are informal procedures based on the informed consent of all the participants. Flexibility is the mainstay of ADR.

All commenters on this subject favored use of ADR and the proposed regulations. Phillips¹⁶⁰ and ARCO¹⁶¹, however, expressed concern with the provision that allows imposition of a judgment against a party determined to have refused to negotiate in good faith. The Commission does not believe that this concern is well founded. Whether a refusal to negotiate is based upon good faith will, of course, depend upon the circumstances of the particular case. The standard does not require parties to reach an agreement; it simply requires that they negotiate, unless they have valid reasons not to. This is not an onerous requirement.

1. Required Negotiation

The Act of 1992 provides that the Commission shall include "required negotiations" in its ADR procedures. In this connection, with respect to all pipeline rates which are suspended, the Commission will send all protested oil pipeline rate filings to a settlement judge for consideration of appropriate disposition of the protest and final action to be taken on the rate filing at the time the Commission issues a suspension order. The settlement judge would be required to convene a conference of all interested parties within a short period of time. Parties to the proceeding would be required to participate in the resolution of these issues. The settlement judge would, as necessary and appropriate, and as may be guided by Commission requirements in the individual proceedings, submit status reports on whether settlement efforts should continue or whether formal hearing procedures should commence. The Commission would, in appropriate cases, provide time limits on the settlement judge.

PEG¹⁶², NCFC¹⁶³, CA¹⁶⁴, SIGMA,¹⁶⁵ and Holly¹⁶⁶ request that the Commission allow or even compel the pipelines to submit to ADR procedures prior to the filing of a rate change. These suggestions have not been explicitly included in the regula-

¹⁵⁹ *Id.*

¹⁶⁰ Phillips comments, pp. 23-24.

¹⁶¹ ARCO comments, p. 39.

¹⁶² PEG comments, pp. 14-15.

¹⁶³ NCFC comments, p. 6.

¹⁶⁴ CA comments, p. 12.

¹⁶⁵ SIGMA comments, pp. 5-6.

¹⁶⁶ Holly comments, pp. 22-23.

tions. The pre-filing negotiation process is allowable under both the current and the new regulations, and therefore no explicit regulation is necessary.¹⁶⁷

Alaska¹⁶⁸ and Holly¹⁶⁹ stress the necessity of having access to cost information at the beginning of the ADR procedure. The Commission agrees that sharing of information is useful in settling disputes. The Commission encourages this result.

2. Arbitration

The ADRA establishes procedures for binding arbitration proceedings. To the extent participants wish to use a different arbitration procedure, they should feel free to propose one.

a. *Applicability to Commission Proceedings.* Section 1802(e) of the Act of 1992 requires the Commission to provide voluntary arbitration procedures for rate matters involving oil pipelines. The Commission believes that the form of binding arbitration provided in the ADRA should be among those ADR techniques available to participants.

b. *Authorization.* Participants may at any time submit a proposal to use binding arbitration to resolve all or part of any oil pipeline rate matter in controversy before the Commission. A proposal to use binding arbitration would follow the procedures to be developed consistent with the ADRA and the Commission's responsibilities under the Act of 1992. The proposal would be submitted in writing. To ensure that the use of arbitration is truly voluntary on all sides, the Commission would not require any person to consent to an arbitration proposal as a condition of receiving a contract or benefit. Similarly, no company regulated by the Commission may impose such a condition. Further, an arbitration proposal would be required to have the express consent of all interested parties.

Any agreement to arbitrate would be enforceable under the Arbitration Act.¹⁷⁰ The Senate Report accompanying the ADRA states that the purpose of section 589 of the ADRA is to coordinate and clarify the relationship between the ADRA and the existing Arbitration Act, and stresses that the existing Arbitration Act applies to enforcement of arbitration agreements reached pursuant to the ADRA.¹⁷¹

c. *Arbitrator.* Participants in an arbitration proceeding would be entitled to select the arbitrator or arbitrators. The particular procedure to be used in selecting an arbitrator is not provided; however, the arbitrator is required to meet the requirements of a neutral. An arbitrator, like a neutral as described in proposed § 342.9(e), may be a permanent or temporary officer or employee of the Federal Government (including an administrative law judge), or any other individual acceptable to the participants. The arbitrator must have no official, financial or personal conflict of interest with respect to the issues in controversy, unless the participants waive this restriction. The arbitrator's duties would include conducting hearings, administering oaths, issuing subpoenas to compel attendance of witnesses and production of evidence at hearing. The arbitrator would be expressly authorized to make decisions on rate matters subject to arbitration. As the Senate Report to the ADRA explains:

This section is intended to provide arbitrators with the appropriate authority and flexibility to conduct arbitral proceedings in an informal and efficient manner and to keep the arbitral proceedings from becoming, in essence, full-blown litigation proceedings. An arbitrator should not use the authority granted in this section to indulge in or permit excessive discovery. Instead, the arbitrator should make ap-

¹⁶⁷ If advanced negotiations result in an agreement on rates, that agreement may be filed as a negotiated rate under the new regulations.

¹⁶⁸ Alaska comments, pp. 23-24.

¹⁶⁹ Holly comments, pp. 22-23.

¹⁷⁰ 9 U.S.C. § 1 (1982). Section 4 of the Arbitration Act provides that:

[A] party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under

a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.

¹⁷¹ S. Rep. No. 543, 101st Cong., 2d Sess. at p. 13 (1990).

propriate use of the authority provided in this section to gather the necessary materials and information to conduct a fair, effective and expeditious inquiry.

The section also limits arbitrators to the subpoena authority granted by the Arbitration Act and to the agency sponsoring the arbitral proceeding. This language is intended to ensure that the same practices and body of law apply to all arbitrations of disputes with federal agencies, whether initiated under the ADR subchapter in Title 5 or the Arbitration Act in Title 9. It is also intended to ensure that federal agencies do not gain, as a consequence of this Act, any subpoena powers that they do not already possess.¹⁷²

d. Rules of Conduct. The Commission will incorporate into its rules the provisions in section 589 of the ADRA that establish basic rules for the conduct of binding arbitration proceedings, including hearing. The arbitrator would set the time and place for the hearing and notify the participants. A record would be prepared, if desired, and evidence presented. The hearing would be conducted expeditiously and informally. The arbitrator could exclude evidence that is irrelevant, immaterial, unduly repetitious or privileged. According to the Senate Report to the ADRA, this common arbitral standard ensures informal and expeditious proceedings.¹⁷³ *Ex parte* communications would be prohibited, allowing the arbitrator to impose sanctions for a violation of this prohibition. The arbitrator would be required to issue an award within 30 days of the close of the hearing, unless the participants and arbitrator agree otherwise.

e. Arbitration Awards. The ADRA provides standards for the issuance and appeal of arbitral awards. The Commission proposes to adopt those standards. The award should be in writing and include a brief, informal discussion of the factual and legal basis for the award. The prevailing participants should file the award with the Commission and serve all participants. The award would become final 30 days after it is served on all participants; however, the Commission, upon motion or otherwise, could extend this pe-

riod for one additional 30-day period upon notice of the extension to all participants.

A final award would be binding on the participants and may be enforced under the provisions of the Arbitration Act, as amended by the ADRA. Under the ADRA, a non-party will be able to seek to have an award vacated by courts. The ADRA amended section 10 of the Arbitration Act to provide that a person who was not a party to an arbitration proceeding may obtain judicial review of the award upon a showing that the appealing person has been adversely affected or aggrieved. In addition, that person must demonstrate, pursuant to the amended Arbitration Act, that the use of arbitration or the award is clearly inconsistent with the six factors in the ADRA that govern the determination to use ADR in a proceeding.

f. Vacating an Award. As provided in the ADRA, the Commission would establish procedures for the Commission to vacate an award. Any person could request, within 10 days of the filing of an award, that the Commission vacate the award and require that person to provide notice of the request to all participants. Responses to such a request must be filed within 10 days after the request is filed. The Commission, upon request or otherwise, would be able to vacate an arbitration award before the award becomes final. To do so, it must issue a written order to that effect.

The Commission's review of an arbitration award would be based on the statutory standard that applies to the issues resolved, and depends, therefore, on the type of issues involved. The Commission would adopt the ADRA's provision that the award need only discuss informally the factual and legal bases for the award. If the participants wish to require that an award include formal findings of fact and conclusions of law, they may do so by adopting a different standard.

If the Commission vacates an arbitration award, a party to the arbitration proceeding would be able to petition the Commission for an award of the attorney fees and expenses incurred in connection with the arbitration proceeding. The Commission could award the petitioning party those fees and expenses that would not have been incurred in the absence of

¹⁷² *Id.*

¹⁷³ *Id.*

the arbitration proceeding, unless the Commission finds that special circumstances make the award unjust.

A decision by the Commission to vacate an arbitration award would not be subject to judicial review. Moreover, such a decision would not be subject to rehearing. In this case, rehearing would not be provided because the Commission itself would be acting on the request to vacate so there is no occasion to be reviewing staff action.

VI. Environmental Analysis

Commission regulations require that an environmental assessment or an environmental impact statement be prepared for Commission action that may have a significant adverse effect on the human environment.¹⁷⁴ The Commission categorically excludes certain actions from this requirement as not having a significant effect on the human environment.¹⁷⁵ No environmental consideration is necessary for the promulgation of a rule that does not substantially change the effect of the regulation being amended, or that involves the gathering, analysis, and dissemination of information, or the review of oil pipeline rate filings.¹⁷⁶ Because this final rule involves only these matters, no environmental consideration is necessary.

VII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act¹⁷⁷ generally requires the Commission to describe the impact that a rule would have on small entities or to certify that the rule will not have a significant economic impact on a substantial number of small entities. An analysis is not required if a rule will not have such an impact.¹⁷⁸

Pursuant to section 605(b), the Commission certifies that the rules and amendments will not have a significant impact on a substantial number of small entities.

VIII. Information Collection Requirements

Office of Management and Budget (OMB) regulations require OMB to ap-

prove certain information collection requirements imposed by agency rules.¹⁷⁹ These rules and amendments contain no new information collection requirements, rather the rule revises and reduces the reporting requirements under existing FERC-550, Oil Pipeline Rates: Tariff Filings (1902-0089).

The information collection requirements in this rule have not changed from those proposed in the NOPR issued in this docket on July 2, 1993. Therefore, this rule does not have to be submitted to OMB for review. A copy will be sent to OMB for informational purposes only.

The Commission uses the data collected under FERC-550 to investigate the rates charged by oil pipeline companies subject to its jurisdiction, determine the reasonableness of rates, and prescribe just and reasonable rates.

Because of the proposed revisions and expected reduction in public reporting burden under FERC-550, the Commission is submitting a copy of the rule to OMB for its information. Interested persons may obtain information on these reporting requirements by contacting the Federal Energy Regulatory Commission, 941 North Capitol Street NE., Washington, D.C. 20426 (Attention: Michael Miller, Information Services Divisions, (202) 208-1415, FAX (202) 208-2425); and to the Office of Information and Regulatory Affairs, Office of Management and Budget (Attention: Desk Officer for Federal Energy Regulatory Commission), Washington, D.C. 20503.

IX. Effective Dates

As to changes in Parts 341 and 344 and § 375.303 and as to the removal of old Parts 342, 343, 345, 347, 360, and 361, the final rule shall take effect December 6, 1993. As to the addition of new Parts 342 and 343 and the changes to §§ 375.306, 375.307, and 375.313, the final rule will be effective January 1, 1995.

¹⁷⁴ Regulations Implementing the National Environmental Policy Act, 52 FR 47897 (Dec. 17, 1987). *FERC Statutes and Regulations, Regulations Preambles 1986-1990* ¶ 30.783 (1987).

¹⁷⁵ 18 CFR § 380.4

¹⁷⁶ 18 CFR § 380.4(a)

¹⁷⁷ 5 U.S.C. 601-612.

¹⁷⁸ 5 U.S.C. 605(b).

¹⁷⁹ 5 CFR § 1320.13

321 8-31-94

Regulations Preambles

30,975

List of Subjects**18 CFR Part 341**

Maritime carriers, Pipelines, Reporting and recordkeeping requirements.

18 CFR Parts 342, 343, 344, 345, 347, 360 and 361

Pipelines, Reporting and recordkeeping requirements.

18 CFR Part 375

Authority delegations (Government agencies), Seals and insignia, Sunshine Act.

By the Commission.

Commissioner Hoecker concurred in part and dissented in part with a separate statement to be issued later.

Commissioner Massey dissented with a separate statement attached.

Lois D. Cashell,
Secretary.

Note: This Appendix will not appear in the Code of Federal Regulations.

Appendix A—Comments Received on Docket No. RM93-11-000*Commenter*

Air Transport Association (ATA)

Alaska, State of (Alaska)

Alberta Petroleum Marketing Commission (APMC)

All American Pipeline Company (AAPC)

Amoco Corporation (Amoco)

ARCO Pipe Line Company, *et al.* (ARCO)

Association of Oil Pipelines (AOPL)

Badger Pipeline Company, *et al.* (Badger)

Buckeye Pipe Line Co., L.P. (Buckeye)

Canadian Association of Petroleum Marketers (CAPP)

Chevron USA Products Company (Chevron)

Citizen Action (CA)

Colonial Pipeline Company (Colonial)

Conoco Pipeline Company (Conoco)

Consumers Power Company (Consumers Power)

Crysen Refining Company, *et al.* (Crysen)

Explorer Pipeline Company (Explorer)

Federal Energy Regulatory Commission

EXXON Pipeline Company (EXXON)

Holly Corporation (Holly)

Independent Gasoline Marketers of America, Society of (SIGMA)

Independent Petroleum Association of America (IPAA)

Kaneb Pipe Line Operating Partnership, L.P. (Kaneb)

Kerr-McGee Refining Corporation (Kerr-McGee)

Lakehead Pipe Line Company, L.P. (Lakehead)

Long Beach, City of (Long Beach)

MAPCO Natural Gas Liquids Inc. (MAPCO)

Marathon Pipeline Company (Marathon)

National Association of Manufacturers (NAM)

National Association of Royalty Owners, Inc. (NARO)

National Council of Farmer Cooperatives (NCFC)

Petrochemical Energy Group (PEG)

Phillips Pipe Line Company (Phillips)

Plantation Pipe Line Company (Plantation)

Portland Pipe Line Corporation (Portland)

Santa Fe Pacific Pipeline Partners, L.P. (SFPP)

Shell Pipe Line Corporation (Shell)

Sun Pipe Line Company (Sun)

TE Products Pipeline Company, L.P. (TE)

Total Petroleum, Inc. (Total)

Transok, Inc., *et al.* (Transok)

USAir, Inc. (USAIR)

Williams Pipe Line Company (Williams)

William L. MASSEY, Commissioner, dissenting:

I do not believe that the Congressional mandate for the Commission to adopt a simplified and generally applicable ratemaking methodology requires the use of an indexing system. Nor do I believe that an indexing system will ensure just and reasonable rates. I would have preferred the centerpiece of this rule to be a simplified and generally applicable cost of

¶ **30,985**

service methodology. For these reasons, which will be amplified in a more detailed statement I will issue within the next few days, I must respectfully dissent.

James J. HOECKER, Commissioner,
concurring in part and dissenting in part:

In 1985, one commentator questioned whether, in adopting Opinion No. 154-B, the Commission had finally found its way through the labyrinth of oil pipeline rate regulation and had slain the Minotaur of protracted litigation.¹ He concluded the Commission had not. And indeed, the Commission continues to wander the labyrinth, this time with the Congress, rather than the courts, playing Ariadne to our Theseus.

I.

I largely concur with the Final Rule we have adopted in this docket. The rule's approach—to employ a well-circumscribed price cap or indexing mechanism to adjust rates already found to be just and reasonable on a cost-of-service basis (or deemed so by the Congress)—is a fundamentally sound way to implement Sections 1801-1803 of the Energy Policy Act (EPAAct). I believe this rule, in spite of my disagreement with portions of it, is defensible and represents better policy than

some past attempts to regulate under the Interstate Commerce Act (ICA).²

The Commission is supplanting what the Final Rule calls "long, complicated, and costly"³ oil pipeline cases with the "simplified and generally applicable" ratemaking methodology required by the EPAAct. The yen for reform in this area may seem paradoxical, coming as it does after nearly 90 years of permissive if not negligible cost-of-service regulation at the Interstate Commerce Commission (ICC)⁴ and then at this agency.⁵ As the Final Rule acknowledges, oil pipeline adjudications have been very few.⁶ Clearly, the veneer of regulation of the oil pipelines stands in historic contrast to a more direct and detailed form of government oversight of other energy enterprises (e.g., natural gas and electric transmission services) where, as here, rates must be just and reasonable.

I attribute the reticence of past oil pipeline regulators to regulate oil pipelines to the unique circumstances of this industry. First, rates for crude oil and petroleum products transportation by pipelines comprise a small fraction of the total cost of the delivered commodities. It is highly likely that even activist rate

¹ Coburn, "Oil Pipeline Regulation: Has the FERC Finally Slain The Minotaur?" 6 Energy L.J. 207 (1985). Opinion No. 154-B, 31 FERC ¶ 61,377 (1985).

² In Opinion No. 154, the Commission made the imminently reversible decision that "specialized utility notions" were peripheral if not irrelevant to oil pipelines, which are best left to the exclusive discipline of market forces. Judged on the basis of the Commission's use of ideas and quotations from Shakespeare, Ida Tarbell, and the Scriptures, Opinion No. 154 was probably the high water mark of FERC literature. It also reflected the still-pervasive lack of a working knowledge of oil pipeline costs, operations, and markets. 21 FERC ¶ 61,260 (1982).

³ Final Rule, slip op. at 11.

⁴ See Opinion No. 154, 21 FERC at 61,583.

⁵ The Commission's recent disposition of oil pipeline filings, except those involving the Trans-Alaska Pipeline System, demonstrates how infrequent pipeline rate adjudication has been:

OIL PIPELINE FILINGS Not including TAPS Companies/Compiled October 19, 1993		
Fiscal Number	Number of Suspended Items	Hearings

¶ 30,985

Year	of Filings	Protested	Underlying *	Other	Com-menced
1985	229	6	3	0	N/A
1986	248	4	0	1	1
1987	282	4	25	1	1
1988	181	4	18	0	1
1989	204	1	10	0	2
1990	267	8	15	2	0
1991	276	9	11	0	1
1992	305	5	13	0	0
1993	284	5	17	0	1

* This category also includes items which were suspended due to underlying filings already under investigation even though they may have also been protested.

Source: Oil pipeline filing data at the FERC.

⁶ The extraordinary length of some of these cases is, in my estimation, largely attributable to the Commission's delay in acting on Initial Decisions, the first-impression nature of the cases (trended original cost-based rates and market-based rates are difficult to establish), the transition from ICC to FERC regulation, and the resistance of regulated carriers to any discovery of their costs-of-service. I should note that, if we ever again set a case for hearing, little in the Final Rule will correct these difficulties.

regulation "would have a negligible impact on the prices that consumers pay."⁷

Second, the industry performs a kind of wholesale long-haul transportation service among industrial sectors—from wellhead to refineries, from refineries to tank farms or ultimately to large commercial, industrial, and military markets. A high degree of vertical integration is common; large oil companies often transport oil and products for themselves. The players—transporters and shippers alike—are oil producers, cooperatives, refiners, and large users that constitute an essential but little-known part of the American infrastructure.⁸

Third, oil pipeline tariffs frequently contain a number of different rates, each for a different service or movement of crude oil or petroleum product. Because pipelines tend to provide only highly specialized point-to-point services, they can have hundreds of separate rates on file. On many systems, rates may apply in practice to only one or a few shippers. When tariffs and rates are applicable to such particular services and movements, it becomes less evident whether or to what extent stated rates are designed according to a system-wide allocation of a pipeline's total costs pursuant to acceptable principles of cost responsibility. Thus, without protracted discovery, there is no basis upon which the Commission can ascertain the relationship of any tariff or rate to the recovery of system costs under a pipeline's other rates. Such considerations, a staple of just and reasonable ratemaking in other areas, are usually inexplicable in oil pipeline rates.

⁷ In this regard, the reader should examine closely the potential per unit price impact of the index we are adopting. Slip op. at n.60. Clearly, even though today's index may be relatively low, there is potential for substantial rate increases should the rate of inflation rise to levels experienced in the not-so-distant past.

⁸ In Opinion No. 154, the Commission observed that "[o]il pipeline rate regulation is not a consumer-protection measure. It probably was never intended to be. It is and was a producer-protection measure." 21 FERC at 61,584.

⁹ See, e.g., the allegations raised by shippers in the following cases: 55 FERC ¶ 61,420 (1991) and 64 FERC ¶ 61,281 (1993).

¹⁰ Further circumstantial evidence of equilibrium in the oil pipeline marketplace is the relatively low number of protests to rate filings at

Most oil pipeline rates are never explicitly approved by the Commission, in any event. Instead, rates are generally approved by virtue of Commission inaction. Typically, after the statutory 30 days, proposed rates simply become effective by operation of law. Thus, even though cost-of-service regulation has been the avowed regulatory paradigm, the actual cost basis of oil pipeline rates has been shrouded from view.

Fourth, Congress did not provide for the regulation of entry or exit of oil pipelines from the transportation business, in contrast to its regulation of natural gas pipelines. The common carrier status of oil pipelines may militate against discrimination and the abuse of monopoly power. However, since the Commission does not regulate the entry or exit of oil pipelines, they are free to exercise strong control of their systems, especially when deciding whether to provide a new service, establish an initial one, or terminate an existing one.⁹

Finally, the market's effectiveness at disciplining the price or availability of transportation services is not apparent. The debate between the acolytes of light-handed regulation and those who would exorcise monopoly power through stronger regulation is endless and somewhat mysterious. At bottom, all I can conclude is that an apparent lack of severe economic dislocations in the industry shows that meaningful competition exists to some degree in some markets and that transportation prices are probably rational overall.¹⁰ However, whether the goal is to regulate or deregulate or do something in

the Commission. See n.5, *supra*. In that connection, I agree completely with remarks by Congressman Synar in this proceeding when he expressed exasperation about "listening to complaints about the 'unreasonableness' of pipeline rates from parties who have never taken the time or effort to exercise their rights to file protests or complaints against those rates" [either at the FERC or when Congress invited such objections to existing rates during EPA's enactment]. Letter to Honorable Elizabeth Anne Moler, September 29, 1993. It is nevertheless unclear to me the extent to which the lack of objections to rate filings can be attributed to the relative positions of pipelines and shippers, namely that many rates apply to only one or a few shippers and that transporters arguably have the ability to abandon service without this agency's approval.

between, I believe there is little else I can categorically know or assume about this industry under current circumstances.

In sum, I believe that my colleagues and I are being responsive to Congress' clear directive to this Commission that it must make its modest and essentially post hoc oversight of the industry even more efficient.¹¹ To implement a simplified and generally applicable methodology, we are adopting an approach that creates advantages and disadvantages for oil pipelines, shippers, and consumers or other interested persons. The operation of the index we adopt is therefore bounded on both sides. On one hand, the Final Rule makes it more difficult to raise a justiciable protest or complaint to a change in rates that conforms to the index. On the other hand, the index raises the threshold for Commission consideration of any cost-of-service rate increases that pipelines might wish to file in excess of indexed rates. In light of EAct, the Commission must adopt a new mode of investigating pipeline transportation rates. Simplicity and expedition permit the Commission to respond with its own resources only when an extreme case is presented. I believe that Congress' mandate in EAct, taken in light of the Commission's already minimal regulation, dictates such rough justice.

Whether shipper protection or adequate compensation for service is at issue, the fundamental ratemaking methodology that applies to oil pipelines under the just and reasonable standard of the ICA, when changes in rates within the price cap prove unsatisfactory to either transporters or shippers, is nevertheless cost-

based ratemaking.¹² It is this emphasis on the traditional standard that I prefer to the Final Rule's focus on indexing as the primary ratemaking methodology, especially given Congress' retention of the just and reasonable standard of Section 1(5) of the ICA. In the final analysis, however, my colleagues and I end up in fundamentally the same place, choosing automatic changes in rates instead of some simplified form of traditional cost-of-service ratemaking. Unfortunately, the record that has been developed in this proceeding does not strongly argue for or support this approach. This is arguably due to this Commission's reluctance to propose any simplified cost-of-service method as a viable alternative.¹³

II.

Notwithstanding my concurrence above, I believe the Final Rule is flawed in two respects. With respect to these specific issues, I dissent.

First, I find the protest mechanism ineffectual and unclear as adopted. Protests to indexed rates are limited by operation of the Final Rule to a showing that "the increment of the rate change produced by application of the index is substantially in excess of the individual pipeline's increase in costs."¹⁴ By limiting the protest to only an evaluation of the pipeline's costs at the margin (*i.e.*, only the filed change in rates), the Commission has turned an opportunity to assure itself that the index is yielding a just and reasonable rate into an event that is impossible for either shippers or the Commission to scrutinize.¹⁵ To require only a comparison of the change in rates to the change in costs is to make

¹¹ The separate inquiries into cost-of-service ratemaking (Docket No. RM94-2-000) and market-based ratemaking (Docket No. RM94-1-000) indicate that we plan to streamline this oversight even further, if administratively feasible.

¹² Neither the final rule nor the accompanying inquiries attempt to undo trended original cost ratemaking under Opinion No. 154-B. This may partly reflect an assumption that rate litigation will occur less frequently than in the past (if ever), obviating the need to simplify what I would term the "default" ratemaking methodology. I will be interested to read the prognostications of the rehearing applicants on this issue.

¹³ In this regard, it is hard not to sympathize with the concerns expressed by Commissioner Massey in his October 22, 1993 preliminary dissent to the Final Rule.

¹⁴ Slip op. at pp. 37-38 (emphasis added). See also § 343.2(c)(1) of the Commission's revised regulations. This regulation appears to treat protests and complaints the same, contrary to the discussion of the preamble.

¹⁵ I agree with the order (slip op. at p. 27) that no index can work if the mere divergence of pipeline costs and the costs represented in the index is grounds to challenge the indexed rate. However, the latent flaw in an index is that the costs that underlie the "base" rate may be subject to dramatic changes, or may not have accurately reflected the pipeline's actual costs in the first instance. It is important that revised Form No. 6 should reveal such circumstances.

terribly complex (if not impossible) a potential protestor's evaluation of the reasonableness of the rate change; presumably, a protestor must be able to discern where and how much pipeline costs have changed, rather than simply evaluating whether the resulting indexed rate is, as a whole, cost-justified. I know of no instance under any statute that prescribes just and reasonable rates where the base rate enjoys this kind of immunity. The complaint procedure, which is more burdensome, will not be helpful to vulnerable shippers.

Second, I believe the provision allowing negotiated rates is inadequate and premature. The Commission's revised regulations provide for them in terms of a "settlement rate methodology" which can change existing rates or establish initial rates.¹⁶ I want to emphasize that I fully endorse and support the settlement process; if settlements are the product of arm's length negotiation in an atmosphere free of coercion and are otherwise within the bounds of reasonableness and equity, the Commission should approve them. Likewise, I have no problem with negotiated rates that are constrained either by actual costs or by demonstrable market forces.¹⁷ The Final Rule, however, blesses negotiated rates that are not effectively constrained.

Section 342.4(c) invites the unlawful use of monopoly power to obtain rate increases in excess of the indexed rate. It requires all shippers to agree to the rate. However, as I noted above, oil pipeline rates may in practice apply to just one or a few shippers. The requirement for unanimous agreement to the rate offers little real protection because the pipeline may not be constrained by regulation from withdrawing service and the one or two shippers that alone pay for, and rely upon, a highly specialized service may be feeling the heat of market power.

¹⁶ The term "settlement rate methodology" is misleading in this context. It really does not involve settlement procedures as otherwise provided for under the Commission's Regulations. See 18 C.F.R. § 385.602.

¹⁷ For example, I generally support negotiated rates in the context of natural gas proceedings where the prices negotiated are constrained by the maximum reservation and/or usage charges that would apply in the absence of negotiation.

Similarly, the Final Rule indicates the Commission will accept without review any initial rates based simply upon the agreement of one non-affiliated shipper. The "one non-affiliated shipper rule" is not an effective check upon the use and abuse of market power and the Commission has no basis upon which to conclude otherwise. It is instead an invitation to find phantom shippers that will, regardless of their future intentions to actually use the service, agree to a rate that then binds future shippers. Those future shippers will have available only the complaint procedure with which to seek reduction of potentially excessive rates. The resulting proceedings may generate greater administrative costs than if the initial rates had been cost-based in the first instance.

In my estimation, it is wishful thinking to argue that protests or complaints will prevent the perverse or uneconomic effects of negotiations among parties with potential inequalities in bargaining power. Generally, the only persons with standing (see new § 343.2(b)) at the time the initial or existing rates are negotiated are the parties to that agreement. Protests or complaints from persons not under a specific tariff at that moment are (and will continue to be) virtually a null set.¹⁸ In other words, I find no workable constraints on negotiated rates where market power exists and the order provides no means of measuring or limiting such market power.

This aspect of the rule stands in peculiar contradiction to the Commission's cautious-inquiry into other kinds of marketbased rates for oil pipelines. The negotiated rate provisions require further refinement. They should have been included as part of the proposal subject to comment in the Notice of Inquiry in Docket No. RM94-1-000, rather than here in the Final Rule.

¹⁸ In addition, the rule virtually eliminates possibility that oil pipeline cases will be adjudicated before the Commission without a private complainant or protestor. (See, e.g., new § 343.3(d)). However, footnote 134 theoretically provides for an "independent investigation" even where protests or complaints are withdrawn. Compare staff's role in *Southern Pacific Pipe Lines, Inc.*, 35 FERC ¶ 61,242 (1986); 39 FERC ¶ 63,018 (1987).

III.

This Commission like its predecessors, is about to try to exit the labyrinth of oil pipeline regulation. At this juncture, the Commission resembles Sisyphus more than Theseus. As it rolls this rock up the hill one more time, the history of oil pipeline regulation counsels against optimism about any ultimate success in this perplexing area. I believe the Final Rule largely satisfies both the Commission's responsibility to ensure just and reasonable rates and the demands made upon it for expedition. However, the unique posture of this proceeding, together with the specific defects identified above, require that I concur in part and dissent in part.

William L. MASSEY, Commissioner,
dissenting:

The Energy Policy Act of 1992 required the Commission to issue a final rule that establishes a simplified and generally applicable ratemaking methodology for oil pipelines in accordance with the just and reasonable standard in section 1(5) of the Interstate Commerce Act. The final rule adopts indexing as the primary method for changing oil pipeline rates. Pipeline rates may increase automatically on an annual basis if the index increases.

I am highly sympathetic with the need for dramatic reform in this area of regulation, and voted for the Notice of Proposed Rulemaking that was issued on July 2, 1993. Moreover, the final rule is superior in many respects to the NOPR. In particular, the use of the Producer Price Index for Finished Goods (PPI-FG), minus one percent, as the appropriate indexing standard, the Commission's review of the index every five years, and the adoption of a more generous standing provision are all more rational and defensible policy choices than initially proposed.

Nevertheless, after reviewing the record compiled in this proceeding, I am not convinced that the Congressional man-

date for the Commission to adopt a simplified and generally applicable ratemaking methodology requires the use of an indexing system.¹ Nor do I believe that the indexing methodology in the final rule will ensure just and reasonable rates.

Although the final rule finds its indexing system to be consistent with the just and reasonable standard contained in the Interstate Commerce Act, I do not agree. In *Farmers Union II*, the Court of Appeals stated that:

Most fundamentally, FERC's statutory mandate under the Interstate Commerce Act requires the oil pipeline rates to be set within the "zone of reasonableness"; presumed market forces may not comprise the principal regulatory constraint. Departures from cost-based rates must be made, if at all, when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods ensure that the resulting rate levels are justified by these factors.²

There is no indication that Congress had any intention of undercutting the rationale of *Farmers Union II*. Recognizing this, the final rule argues that the indexing system is indeed cost-based. The problem lies, however, in the relationship between the index and the actual costs of the pipelines. I am not persuaded that automatic rate changes under the index will necessarily track the actual costs of the pipelines. Many of the costs underlying pipeline rates, such as the pipeline's rate base, depreciation expense, return and taxes, do not necessarily change with inflation.

Some actual pipeline costs, not represented by the index, may in fact decrease while the index increases. Accordingly, there may be pipelines that are able to increase rates in a given year, or over a several-year period, while experiencing an

¹ Although Congress provided no report language or joint explanatory statement directing a particular ratemaking approach, the Commission received letters from members of the House Subcommittee on Energy and Power that contained conflicting views on Congress' intent. While Representative Mike Synar stated that indexation is fully consistent with Congress' mandate and with the just and reasonable requirements of Section 1(5) of the Interstate Commerce Act, Representative Philip Sharp,

Chairman of the Subcommittee voiced strong objections to the NOPR because he felt that indexation constitutes "de facto deregulation" and would benefit only one party, the pipeline.

² *Farmers Union Central Exchange, Inc. v. Federal Energy Regulatory Commission*, 734 F.2d 1486, 1530 (D.C. Cir. 1984), cert. denied sub nom., *Williams Pipe Line Company v. Farmers, Union Central Exchange, Inc.*, 105 S. Ct. 507 (1984), 469 U.S. 1034 (1984).

overall decline in costs. In my judgment, such an occurrence would fail to meet the standard of justness and reasonableness.

The final rule also argues that the index establishes a ceiling and that, in some markets, competitive forces will constrain pipelines from charging these rates. This may prove to be true, and I welcome such competitive forces, but I am unable on the record before us to reasonably predict how often such constraint will occur, if at all. I fear that this weak justification is similar to why the Court in *Farmers Union II* remanded that case back to the Commission.

In addition, although the rule relies heavily upon the right of a customer to protest an unjust and unreasonable yet automatic rate increase, this provides little real comfort. The standard for such a protest is that the rate increase is so substantially in excess of the actual cost increases by the pipeline that the rate is unjust and unreasonable. I agree entirely with Commissioner Hoecker's thoughtful analysis that the protest mechanism adopted in the final rule is ineffectual and unclear. Moreover, even assuming that such a flawed mechanism is capable of acting as a reasonable restraint against an unjustified rate increase, its effective use assures that the customer has sufficient information on which to base such a protest. In sum, I believe this will prove to be an insufficient check on an automatic yet unjust and unreasonable rate increase.

I would have preferred the centerpiece of this rule to be a simplified and generally applicable cost-of-service methodology. Several comments in response to the NOPR have argued that there are cost-of-service methodologies the Commission could have adopted that would meet the standard imposed by Congress. Yet, as Commissioner Hoecker points out, the Commission was unwilling even to propose a simplified cost-of-service methodology as a viable alternative. Although formulating such a methodology would have posed a considerable challenge, I am

³ I also share Commissioner Hoecker's particular concerns regarding the negotiated rates allowed by the final rule. I can support market-based rates that result from effective competition or where market power has been mitigated. I can also support rates that are the result of negotiation when market forces are at work, or

convinced that the Commission should have pursued this alternative more vigorously. Because of our failure to do so, we have missed a critical opportunity to rationalize and simplify the regulation of oil pipelines.

In the Notice of Inquiry on Cost-of-Service Filing and Reporting Requirements issued with this rule, the Commission is asking for comments from the industry on cost-of-service issues. I will be interested in the responses we receive. We can clearly develop new requirements for oil pipeline initial rate filings and rate change filings. While such filing requirements may not provide the detail that we require of gas pipeline rate changes, they could nonetheless provide the foundation for a simplified and generally applicable methodology. Even with the indexing methodology in the final rule, there is still a need to develop cost-of-service filing requirements and a related methodology that is workable for initial rates and rate changes.

And finally, I question the wisdom of the unstated assumption implicit in this order that future increases in the index will be reasonable and in the low range. Although PPI-FG minus one percent increased by only 1.1 percent between 1990 and 1991, from 1973 to 1974 the same index rose a whopping 14.4 percent. While that year may represent an extreme, the Commission would be hard pressed to approve an indexing methodology in a time of high inflation. Projections by economists may provide some level of confidence that inflation is under control for now, yet none can predict with any certainty when an unexpected spike in inflation will occur. I fear that the low annual increases in the PPI index in recent years have lulled the Commission into a false sense of security that future rates under the index will be reasonable.

For all of these reasons,³ I must respectfully dissent.

rates that are agreed to in an arm's length settlement process. However, I am not convinced that the requirements in the final rule for negotiated rates will give all potential shippers the means necessary to ensure that the rates they will be charged are just and reasonable.