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

Order No. 561-A

FERC Stats & Regs. [Regs. Preambles, 1991-1996] ¶ 31,000 (1994)

affirmed, Association of Oil Pipe Lines v. FERC, 83 F.3d 1424 (D.C. Cir. 1996)

Order No. 561-A makes the following changes to Order No. 561:

1. Section 341.4 of the regulations is modified to require the filing of suspension supplements within 30 days of the suspension order, instead of 15 as required in Order No. 561.

2. The "uncontrollable circumstances" test of § 342.4 of the regulations has been modified to provide that the pipeline may use the cost-of-service methodology for changing rates when it can demonstrate that its prudently incurred costs have increased to such an extent that there is a substantial divergence between such costs and the rate produced by application of the index.

3. Section 343.3 of the regulations has been modified to require that a protestant must file a verified statement which contains a detailed description of the nature and substance of the protestant's substantial interest in the pipeline's tariff filing.

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proposed in Docket No. RM94-1-000.[2] While I fully support settlements, I believe that settlements should be in the public interest and subject to Commission scrutiny. I believe the procedures established in this rule do not adequately safeguard against potential abuses of market power and, indeed, may invite the unlawful use of market power to obtain rate increases in excess of the indexed rate.

For these reasons, as well as those previously expressed in my November 2, 1993 statement, I respectfully concur in part and dissent in part to today's Order.

William L. Massey, Commissioner, *dissenting:*

I respectfully dissent for the same reasons set out in my statement, issued November 5, 1993, dissenting from Order No. 561.[3]

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were submitted in the comment phase of this rulemaking, by Chevron or anyone else.

The Commission orders:

The applications for rehearing and requests for clarification are granted to the extent reflected herein. In all other respects, such applications and requests are denied.

List of Subjects

18 CFR Part 341

Maritime carriers, Pipelines, Reporting and recordkeeping requirements.

18 CFR Parts 342 and 343

Pipelines, Reporting and recordkeeping requirements.

By the Commission. Commissioner Hoecker concurred in part and dissented in part with a separate statement attached. Commissioner Massey dissented with a separate statement attached.

Lois D. Cashell,

Secretary.

Appendix—List of Parties Seeking Rehearing and/or Clarification of Order No. 561

Alaska, State of (Alaska)

Alberta Petroleum Marketing Commission (Alberta)

All American Pipeline Company (AAPC)

Amoco Pipeline Company (Amoco)

ARCO Pipe Line Company, Four Corners Pipe Line Company and ARCO Transportation Alaska, Inc. (ARCO)

Association of Oil Pipelines (AOPL)

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

Chevron U.S.A. Products Company (Chevron)

Colonial Pipeline Company (Colonial)

Conoco Pipe Line Company (Conoco)

Exxon Pipeline Company (Exxon)

Holly Corporation (Holly)

Kerr-McGee Refining Corporation (Kerr-McGee)

Lakehead Pipe Line Company (Lakehead)

Marathon Pipe Line Company (MPL)

Petrochemical Energy Group (PEG)

Phillips Pipe Line Company (Phillips)

Plantation Pipe Line Company (Plantation)

SFPP, L.P. (SFPP)

Shell Pipe Line Corporation (Shell)

Sun Pipe Line Company (Sun)

Total Petroleum, Inc. (Total)

Unocal Pipeline Company (Unocal)

US Air, Inc. (USAir)

Williams Pipe Line Company (WPL)

James J. Hoecker, Commissioner, *concurring in part and dissenting in part:*

I largely concurred with the Final Rule adopted in this docket.[1] The regulatory regime that will become effective January 1, 1995, for oil pipelines is generally quite simple for companies whose rates tend to track legitimate cost incurrence. On rehearing, two serious flaws in the Final Rule persist. Consequently, I will dissent in part once again.

First, the rule continues to require that protests to indexed rates will be allowed only where "the *increment* of the rate change produced by application of the index is substantially in excess of the individual pipeline's *increase* in costs." As I explained in my prior dissent on this issue, I would have preferred a rule that allowed protests that can show a substantial divergence between the rate taken as a whole and the pipeline's total costs. Even with an index, costs and rates may occasionally become so unrelated that rates cease to be just and reasonable under the Interstate Commerce Act. We should provide for such exigencies.

Second, I continue to be concerned that the "settlement rate methodology," under which existing rates can be changed or initial rates can be established, may lead to unjust and unreasonable rates wherever negotiations are not constrained by demonstrable market forces. This aspect of the rule should only be adopted pursuant to the market-based rate procedures

[1] A full exposition of my views on Order No. 561 and on regulation of the oil pipeline industry are contained in my statement of November 2, 1993, which will be, belatedly, published at *FERC Statutes and Regulations* ¶ 30,985 (1993). Pending publication, a copy of the November statement may be obtained from the Commission's public reference room.

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Moreover, these items which are required to be included in tariffs not only affect the value to the shipper of the service offered by the carrier, but also can have a direct effect on access to transportation. Because different carriers implement different policies, a carrier's prorationing, carrier liability, quality bank, and connection policies may adversely affect shippers. As the Commission has stated in another context, "By requiring publication of such tariff provisions, section 6 [of the ICA] helps ensure rate certainty and uniformity between shippers and reduces the possibility of discriminatory treatment between shippers."[47]

All items contained in § 341.8 (except for prorationing policy, carrier liability, quality bank, and line connection policy) have been listed in § 341.10 of the Commission's regulations for a substantial number of years, as ARCO has observed.[48] In fact, § 341.10 required the publication of tariffs which contain all the rules governing the various items listed in that section, as well as all rules "which increase or decrease the value of service to the shipper."

The new items specifically added are rules "which increase or decrease the value of service to shippers," or are required to diminish the possibility of discrimination. Since they are of the same character as those contained in § 341.10, which was superseded by the new § 341.8, the Commission is not convinced that they will constitute the burden on carriers expressed by AOPL, ARCO, and Williams.

G. *TAPS*

ARCO, Unocal, and Alaska each request that the Commission clarify its intent regarding establishing rates for TAPS carriers and those delivering to TAPS. ARCO requests that the Commission confirm that TAPS and other excluded pipelines will continue to be regulated under the ratemaking standards that are currently in effect, and that nothing in the final rule should be construed to the contrary. Alaska similarly asks that the Commission clarify that three pipelines delivering oil to TAPS—Kuparuk, Endicott, and Milne Point—shall continue to justify their rates under their respective settlement agreements. Unocal requests clarification that the TAPS Settlement Methodology (TSM) is not the sole methodology applicable to TAPS carriers.

It was not the Commission's intent to change, in any way, the current ratemaking standards for TAPS and excluded carriers. Indeed, as stated in the final rule, the Act of 1992 specifically excluded TAPS and any pipeline delivering oil directly or indirectly to TAPS from the provisions of the Act for ratemaking purposes. As further explained, TAPS and those excluded pipelines will continue to be regulated under the ratemaking standards that are currently in effect.[49] That continues to be the Commission's intent.

H. *Miscellaneous Issues*

Chevron asserts that the Commission's procedures are not adequately defined, and that such lack of definition now generates protracted oil pipeline rate proceedings. Chevron states that "at a minimum the Commission should scrutinize its discovery and decision-making processes."[50] This would entail, according to Chevron, new regulations that would prevent a pipeline from delaying the rate review process and that would require issuance of orders and decisions in a timely manner.

In response to Chevron's arguments, the Commission believes that the regulations contained in the final rule will streamline and expedite the Commission's ratemaking and decision-making processes. Chevron has not identified any specific changes or additional reforms that would improve and expedite the implementation of the ICA by the Commission.

In particular, as Chevron notes, the discovery process can contribute to delay in the hearing of contested proceedings. The improved filing requirements that will result from the Commission's NOPR in Docket No. RM94-2-000 should ameliorate this problem as it existed in the past. In addition, no specific proposals to expedite and reform discovery procedures

[47] *KK Appliance Co.*, 47 FERC ¶ 61,076, at p. 61,217 (1989).

[48] ARCO, p. 28.

[49] *FERC Statutes and Regulations* ¶ 30,985 (1993), at p. 30,961.

[50] Chevron Rehearing, at p. 8.

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Commission has given no explanation for this requirement, and its imposition may hurt shippers who have a shorter period to find alternatives. Moreover, it argues, such a requirement would unnecessarily inhibit seasonal rate filings. The Commission does not agree. The Commission encourages carriers to keep their shippers informed of proposed changes in a timely fashion. At times, the carrier may determine that it should notify the shippers at a date sooner than 60 days of its proposal, and nothing in the regulations prohibits this. Also, nothing in the regulations prohibits seasonal filings, as long as there is only one effective date for the tariff. Moreover, since the deadline for filing a protest is proposed to be changed to 15 days after the filing date of the tariff publication and not 12 days before the effective date of the tariff, as has been the past requirement, shippers could be placed in the untenable situation wherein they would be judging the tariff filing under circumstances which could significantly change prior to the effective date of the tariff. This requirement should have no significant effect on the planning functions of the pipeline and its shippers; rather it will streamline the tracking of filings made at the Commission.

5. WPL claims that certain provisions are not properly included in the final rule, citing § 341.8, which requires that pipelines publish in their tariffs rules which in any way increase or decrease the value of service to a shipper. ARCO and AOPL object to including such items as prorationing of capacity, product specification, and connection policies. AOPL argues that the Commission cannot require publication of non-rate terms and conditions of service; ARCO argues that there is no statutory authority for this requirement; rather, the Commission's statutory authority is limited to rates or rate-related matters, not a "public interest" standard, as indicated by the Commission in the text of the final rule.[41]

Section 1(3) of the ICA[42] defines transportation to include ". . . all services in connection with the receipt, delivery, elevation, and transfer in transit. . . storage, and handling of property transported."

Section 1(6) of the ICA[43] requires all carriers to "establish, observe, and enforce. . . just and reasonable regulations and practices affecting classifications, rates, or tariffs,. . . the facilities for transportation,. . . and all other matters relating to or connected with the receiving, handling, transporting, storing, and delivery of property. . . ."

Section 6(1)[44] of the ICA provides that carriers' tariffs shall

> state the places between which property. . . will be carried, and shall also state separately all terminal charges, storage charges, icing charges, and all other charges which the Commission may require, all privileges or facilities granted or allowed, and any rules or regulations which in any wise change, affect, or determine any part or the aggregate of such aforesaid rates, fares, and charges, *or the value of the service rendered to the. . . shipper. . . .* (Emphasis added.)

The three items specifically mentioned by the applicants for rehearing—prorationing policy, line connection policy, and product specification—all constitute conditions of offering transportation service by the carrier, or constitute conditions of "receipt, delivery. . . , and transfer in transit. . . , and handling" by the carrier.[45] They certainly affect the value of services to the shipper. Thus, they are encompassed within the term "transportation" as defined in the ICA.

It is clearly within the Commission's authority under section 6(1) to require that such regulations and practices be contained in the company's tariffs on file with the Commission and open to public inspection. This is a primary purpose of a tariff—to set forth the terms and conditions under which the service of the carrier is offered so as to militate against discrimination and preferential treatment in favor of one shipper over another.[46]

[41] ARCO, p. 25. *See FERC Statutes and Regulations* ¶ 30,985, at p. 30,969 (1993).

[42] 49 U.S.C. app. § 1(3) (1988).

[43] 49 U.S.C. app. § 1(6) (1988).

[44] 49 U.S.C. app. § 6(1) (1988).

[45] Section 1(3)of the ICA.

[46] *See Atchison, Topeka & Santa Fe Ry.*, 607 F. 2d 1199 (7th Cir. 1979); *Central R.R. Co. v. Anchor Line, Ltd.*, 219 F. 716,718 (2d Cir. 1914); *Central & S. Motor Frtg. Tar. Assn. v. United States*, 273 F. Supp. 823 (D. Del. 1967).

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tion to this one supplement, there are five other types of technical or ministerial supplements which can be filed and are not included in the count. These are correction supplements (three allowed per tariff), suspension supplements, postponement supplements, cancellation supplements, and adoption supplements. The Commission believes this series of supplements is ample to meet the carriers' needs. Given the clarity and uniformity of the rule, the elimination of page restrictions for supplements, and the exception for certain types of supplements, the Commission believes the rule is a balanced one. The Commission denies rehearing on this issue.

2. WPL claims that certain regulations are inconsistent with the explanatory text. It cites § 341.0(a)(7), which requires that pipelines post tariffs at the carrier's principal office and other offices of the carrier where business is conducted with affected shippers, and the textual statement in the final rule that this section "requires such posting only at 'principal' pipeline offices."[38]

The Commission has determined that a carrier should maintain its tariff in places where it does business with its customers. The Commission used the term "principal pipeline offices" in the explanatory text of the final rule in this context. Confusion over the requirement in § 341.0(a)(7) was created by the use of the term "principal place of business" in its more legalistic sense; however, the sense of what the Commission sought to achieve is contained in the phrase "and other offices where business is conducted with affected shippers."

WPL argues that § 341.3(b)(6)(i) would require that all rules affecting the rates or services provided for in the tariff publication must be included in the tariff publication, whereas the text[39] of the final rule allows for incorporation by reference.

As the Commission explained in the explanatory text, incorporation by reference of rules affecting the rates or services will be allowed, so long as the document to which reference is made is readily available.

3. WPL claims that certain regulations, while clear, do not make sense when applied. It cites § 341.3(b)(6)(iii), which prohibits tariffs from including rules which provide that traffic of any nature will be transported only by special agreement, arguing that agreements such as volume incentive and throughput and deficiency agreements are common industry practice and have long been accepted under the ICA. It seeks clarification that the Commission is not banning such agreements.

The Commission did not intend to change the current practice respecting the prohibition of a tariff that provides that traffic of any nature "will be transported only by special agreement." Such a prohibition has always existed in the regulations.[40] The "special agreement" referred to in this context means that the carrier may not require a special agreement available only to one shipper, which would be discriminatory to another similarly situated shipper who sought to ship on the carrier's lines. The Commission did not attempt to bar the use of non-discriminatory throughput and deficiency agreements, or volume incentive agreements. Administration of such agreements will continue as before.

WPL cites § 341.4(f), which requires pipelines to publish suspension supplements within 15 days of suspension, whereas the pipeline does not often receive the suspension notice within sufficient time to do so. It asks that the Commission telecopy such suspension notices to the pipeline.

The Commission will modify § 341.4(f) so that suspension notices must be filed within 30 days of the suspension, thus obviating the need that suspension notices be telecopied to the pipeline.

4. WPL claims that certain regulations appear to serve no purpose, citing § 341.2(b) which prohibits pipelines from posting tariffs more than 60 days before the effective date. WPL argues that the

[38] *FERC Statutes and Regulations* ¶ 30,985, at p. 30,969.

[39] *Ibid.*

[40] Section 341.4(h)(3) of the regulations which existed prior to promulgation of the instant regulations provided, in part, "... nor shall any rule be provided to the effect that traffic of any nature will be 'taken only by special agreement' or other provision of like import."

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stated in enough detail to allow an informed decision on standing to be made in a timely fashion. It is obviously to the benefit of the Commission, in performing its review function, and to the interested public, that this be done. Moreover, this should not pose a burden for protestants who possess the requisite substantial economic interest in a tariff filing. Rehearing is granted on this issue, and § 343.3(b) will be revised accordingly.

2. Pipeline Response to a Complaint

Under § 343.4(a) a pipeline may file a response to a complaint no later than 30 days after the complaint is filed. AOPL requests this section be changed to allow a response to be filed no later than 30 days after service of the complaint, as opposed to filing.

This request will be denied. AOPL has stated no facts indicating that the procedure set forth in § 343.4(a), which is unchanged from current practice, provides insufficient time for a pipeline to file a response to a complaint.

F. *Revisions to Existing Procedures*

In its application for rehearing, WPL cites five areas of concern about the revisions to existing procedures contained in Part 341 which were adopted in the final rule. Each is discussed below.

1. WPL claims that certain regulations increase the burden on pipelines with no apparent benefit to shippers. It points to an alleged redundancy in § 341.2(c), which requires that transmittal letters describe the filing and explain changes to the carrier's rates, rules, terms, or conditions of service, and § 341.(b)(10)(i), which requires that tariff changes be indicated and described by specific symbols. It cites AOPL for the argument that the requirements of the new regulation would transform a ministerial document into a substantive summary of the filing, whereas the tariff publication itself must identify all such changes. It asserts that to have the letter of transmittal also identify those changes would be superfluous.

WPL reads too much in the Commission's requirements for the transmittal letter. Simply stated, the Commission desires an informative transmittal letter which will briefly state the essential facts—that the carrier is seeking to change its rates and the basis for its rate change—*i.e.*, it is based on the carrier's application of the index, or it is based on the carrier's cost of service, or it is a settlement rate. Moreover, a brief statement of any tariff language changes proposed will suffice. It is not intended that the carrier restate the terms and conditions of its tariff filing in the transmittal letter.

Further, the rule requiring a narrative explanation of tariff changes in a letter of transmittal is not duplicative of § 341.3(b)(10)(i) which refers to designating changes in the tariff by use of uniform symbols. Clearly, these are two separate requirements. A general explanation of the filing is warranted. The brief nature of the description required is not burdensome. Indeed, this requirement is common practice for several carriers which have been including an explanation of their filing in their letters of transmittal for some time, even prior to implementation of these regulations.

WPL also argues that limiting the number of supplements to one rather than five, which currently exists, will likewise burden the pipelines, since they must capsulize all their supplements into one large supplement even if the matter sought to be supplemented could be done in a single page. WPL suggests that if the intent is to consolidate all supplements, the result could be achieved by requiring that subsequent supplements clearly indicate all prior supplements currently in effect.

The Commission finds the rule allowing only one effective supplement is reasonable. The previous rules were written when all tariffs were individually printed by printing press. Now many carriers have computerized the publication of their tariffs, making it easier to merely bring forward all the changes into one complete supplement. In addition, the previous limitations relating to the number of supplements to be filed to an effective tariff, as well as the requirements for the length of the supplements themselves, were confusing and not useful. Since oil pipeline bound tariffs are rarely in excess of forty pages, the previous maximum supplement limitation of five supplements to be filed to a tariff in excess of 200 pages was never reached. Further, under the previous regulations, tariffs of four pages or less could not be supplemented. The rules as currently revised allow one effective supplement to a tariff to be filed. In addi-

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indexed rate. SFPP asserts that the Commission should allow cost-of-service treatment in the event of a divergence in actual costs and indexed rates so substantial that the existing rate level under indexing is not just and reasonable, regardless of the nature of the circumstances.

The Commission is persuaded that a modification such as that proposed by SFPP and Phillips should be made to the test. There indeed may be instances where prudently incurred costs have increased to such an extent that the rate produced by the index would not be just and reasonable. Such cost changes may be the result of planned expansions or of upgrading or replacement of facilities for safety or environmental considerations. Accordingly, where the pipeline can show that the costs are prudently incurred and that there is a substantial divergence in its costs and the rate that would be produced by application of the index, the pipeline will be allowed to charge rates based on a cost-of-service methodology. Section 342.4 will be modified to reflect this change.

2. Fully Allocated Costs

Amoco, AOPL, and WPL object to the Commission's characterization of its current methodology as contemplating use of fully allocated costs to determine proper rates for any movement. In the final rule at footnote 83, the Commission stated, in response to comments addressing the issue of whether the cost-of-service 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." The Commission cited Opinion No. 154-B as illustrative. In this regard, the Commission determines the justness and reasonableness of rates for other modes of transportation it regulates on a fully-allocated cost basis. However, as the commenters point out, this issue has not been determined in a fully litigated case by this Commission under the Interstate Commerce Act. The Commission does not intend by this rulemaking to decide the issue with finality, and proponents of "stand-alone" cost methodology or other costing methodologies will not be precluded from advocating such methodologies in individual cases.[37]

E. *Procedures for Streamlining Action on Rates*

1. Requirements for Standing

Section 343.3(b) provides that only persons with a substantial economic interest in a tariff filing have standing to file a protest against that filing. A protest must be accompanied by a verified statement as to the protestant's substantial economic interest.

ARCO requests that the Commission amend the regulation on standing to require the verified statement to explain in sufficient detail the nature of the substantial economic interest and its connection to the proposed rate, so that the Commission will be able to make a determination on the standing of the protestant expeditiously. ARCO proposes that the regulation be changed to read as follows:

> Along with the protest, the protestor shall file a verified statement which shall contain a reasonably detailed description of the nature and substance of the protestor's economic interest in the tariff filing in question.

In support of its request, ARCO notes that the Commission will have a relatively short period of time after the filing of the rate, the protest, and the response to the protest, in which to make a determination on what action to take. Requiring a protestant to explain in reasonable detail how it meets the standing requirement will, according to ARCO, assist the Commission in making a timely decision on standing.

ARCO's suggested amendment to the standing requirement appears to be reasonable. ARCO is not advocating a substantive change in the standing requirement contained in the regulation. Rather, it is requesting that the Commission require that the basis for standing be

[37] As AOPL correctly notes, the Commission's Notice of Inquiry (NOI) at Docket No. RM94-2-000, issued concurrently with the final rule in this proceeding, encompasses the data to be filed with a cost-of-service showing, including the issue of whether such data should be required on a stand-alone or fully allocated cost basis, or some other basis. Kerr-McGee's recommendation that the Commission establish a simplified cost-of-service method will also be considered in that NOI. *See* NOI at mimeo p. 8. *See also* the NOPR in Docket No. RM94-2-000 issued concurrently with this order.

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circumstances a market-based rate may be lawful. The regulation, however, provides that market-rates may only be charged after the Commission has determined that such ratemaking methodology is appropriate and lawful. Until such time, a pipeline must show some other basis for its rates, such as costs or compliance with the indexed ceiling.

Rehearing on this issue is denied.

2. Protests of Settlement-Based Initial Rates

Plantation and WPL also argue that the settlement option for establishing initial rates does not go far enough. They contend that the regulations should not prohibit the shipper agreeing to the rate from being an affiliate of the pipeline. Further, they maintain that a settlement initial rate should be immune from protests. Thus, under their view, the only mechanism for a party to challenge the justness and reasonableness of a settlement initial rate would be a complaint, with the burden of proof, in accordance with section 13(1) of the ICA, being upon the complainant. Plantation and WPL assert that allowing a protest of a negotiated rate defeats and renders superfluous the negotiation.

Unlike the case of changes of existing rates, the settlement option for initial rates only requires the agreement of one non-affiliated shipper. The purpose of requiring the one shipper who must agree to the initial rate to be unaffiliated with the pipeline is to ensure that the agreement is based upon arms-length negotiations. Allowing a protest to a settlement rate permits those shippers who were not party to that agreement to protect themselves and other shippers from an unjust and unreasonable initial rate. The arguments of Plantation and WPL do not show that these requirements are unreasonable or unfair. In particular, these requirements should not render initial rate settlements, or the negotiations preceding them, meaningless. A pipeline will still have an incentive, and derive a benefit, from seeking to gain the concurrence of its potential shippers to an initial rate for new service. To the extent concurrence is obtained, a protest is unlikely. If unanimous concurrence of potential shippers is not obtained, the regulation still allows the pipeline to file the initial rate based upon the agreement of at least one non-affiliated shipper. This one-shipper provision simply expands the options for a pipeline. The availability of the protest mechanism in such a case provides balance to the provision from the standpoint of the interests of shippers.

Rehearing on this issue is therefore denied.

D. *Other Rate Changing Methodologies*

1. Uncontrollable Circumstances Test

Several parties have asked for clarification or rehearing of the requirement contained in § 342.4 that there be cost increases incurred because of "uncontrollable circumstances" before carriers may change rates based on a cost-of-service methodology. AAPC suggests that the Commission clarify that what constitutes "uncontrollable circumstances" will be determined in individual cases. ARCO and Lakehead ask that the standard be relaxed to reflect only that a change in circumstances need occur before the pipeline is allowed to justify its rates on a cost-of-service basis. MPL argues that the rule is too restrictive and may prevent pipelines from recovering their costs associated with catastrophic losses due to accident, equipment failure, or third-party damage, any one of which might lead to extraordinary costs and liabilities.

The Commission's intent in the Final Rule was that there be a change in economic circumstances that justifies use of the cost-of-service methodology brought about by events or conditions outside the control of the pipeline. These circumstances would include, but not be limited to, events such as those alluded to by MPL. It was never the Commission's intent to provide an exhaustive list in the Final Rule of what might constitute "uncontrollable circumstances."[36]

SFPP and Phillips contend that the pipeline seeking to invoke a cost-of-service methodology should be governed by the same standard as those seeking to challenge an indexed rate—*i.e.*, a substantial divergence between costs and the

[36] Some of the items referred to on rehearing were clearly not within the contemplation of the Commission, such as the suggestion by ARCO that it might be allowed to raise its rates in the future to make up for past earnings lost due to competition. (ARCO, pp. 14-16.)

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rates under the indexing system will be subject to investigation through both the protest and the complaint procedures of the ICA. Second, under the final rule, every five years beginning in the year 2000, the Commission will examine the relationship between changes in the index (PPI-1) and actual cost changes experienced by the oil pipeline industry. The purpose of this review will be to ensure that the ceiling rates established under the indexing system fairly and reasonably track the actual cost changes to the oil pipeline industry, such that rates in compliance with the applicable indexed ceiling are just and reasonable within the meaning of the ICA.

The Commission therefore concludes that the requests of Holly and Total for a periodic review of pipeline rates should not be adopted.

Finally, Chevron makes several specific proposals for changing the filing requirements of the final rule. Chevron requests that the Commission extend the notice period for filing proposed rates to 60 days, and the period for filing a protest in response to such a filing beyond the 15 days contained in the regulation. Further, Chevron suggests that a pipeline be required to send notice of its rate increase filing by telefax or overnight mail.

Chevron's requested changes to the regulations will not be adopted. The proposal to extend the notice period to 60 days for filing rate changes is contrary to the ICA. Section 6(3) of the ICA provides that the notice period shall be 30 days, except that a shorter period may be provided for by rule or in a particular case. Given this statutory 30-day notice period, it is not advisable to adopt Chevron's suggestion that the period for filing a protest in response to a changed tariff filing be greater than 15 days. A longer period would leave an unduly short amount of time for the Commission to review the filing and any protests and make a determination whether to suspend and initiate an investigation of the filing. Finally, Chevron does not make a persuasive case for requiring pipelines to telefax or express mail rate filings, although pipelines are encouraged to voluntarily do so at the request of their shippers.

C. *Establishment of Initial Rates*

Section 342.2 of the final rule provides a pipeline with two ways of establishing an initial rate for new service. An initial rate may be established through a cost-of-service based filing. As an alternative to a cost-of-service filing, a pipeline may establish an initial rate through an agreement reached with at least one non-affiliated person who intends to use the service in question. Under this alternative, however, a protest filed against such a settlement initial rate would require the pipeline to justify the rate based upon costs.

1. Market-Based Initial Rates

Plantation and WPL seek rehearing of the lack of a provision for relying upon market forces to justify an initial rate. Plantation argues that a pipeline has a statutory right to file an initial rate of its choosing and to defend its lawfulness in accordance with the suspension and hearing procedures set forth in the ICA. In addition, Plantation states that the establishment of a rate for a service not previously offered is a particularly appropriate context for use of market competition as a justification for the rate because a pipeline cannot exercise market power in a market it is not already serving.

Based upon the comments and reply comments received in this proceeding the Commission concluded that an initial rate should be established either on a cost-of-service or a settlement basis. The Commission was concerned that a pipeline might be able to exercise market power to establish an initial rate that was unjust and unreasonable. In this regard, it is important to note that an initial rate for new service may, depending upon the circumstances, represent no more than an additional receipt or delivery point on an existing pipeline. Contrary to the impression given by Plantation's argument, a new service may not always, or even most of the time, involve additional service to a new market. The pipeline offering the new service, and seeking approval for an initial rate, may be the only or one of the few transporters in an existing market.

The regulations promulgated in the final rule do expressly provide a pipeline with an opportunity to use a market-based methodology to change existing rates, subject to proof that competitive pressures exist to a sufficient degree to restrain rate changes to just and reasonable levels. See § 342.4(b). Thus, the Commission has recognized that under some

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non-cost factors may not be taken into account. In *Farmers Union Central Exchange, Inc. v. FERC*, 734 F. 2d 1486 (D. C. Cir.), *cert. denied*, 469 U.S. 1034 (1984), the court stated that rates must be within a zone of reasonableness, and that factors other than costs may be taken into account. Further, Kerr-McGee's argument would, if accepted, negate the legality of any indexing system to implement the just and reasonable standard of the ICA. For the reasons explained at length in the final rule,[34] the Commission rejects this argument.

Holly and Total state that the Commission may not limit protests to challenging the increment of the rate increase. According to their view, the Commission's statutory duty is to examine the whole rate when a rate change is proposed. Holly argues that this is required by the principle that the lawfulness of a ratemaking process is dependent upon the end result. Chevron also takes the position on rehearing that the Commission may not lawfully limit protests to challenging the increase in the rate, as opposed to the whole rate.

This limitation is necessary in order to preserve the vitality of the protection for certain existing rates provided in subsection 1803(a) of the Act of 1992. That section deems rates in existence and unchallenged for the one-year period prior to enactment of the Act of 1992 to be just and reasonable and not subject to a complaint under section 13 of the ICA , unless evidence is presented to the Commission which establishes that a substantial change has occurred after the date of enactment of the Act of 1992 in the economic circumstances of the oil pipeline which were the basis of the rate; or in the nature of the services provided which were the basis for the rate; or unless the person filing the complaint was under a contractual prohibition against filing a complaint.[35]

This "grandfathering" provision of the Act of 1992 protects from most complaints the vast majority of rates in existence on the date of enactment. To allow a protestant of a proposed increase of a statutorily protected underlying rate to challenge the whole rate, and not just the proposed increase, would be to remove the protection of section 1803(a) solely on account of the filing of a proposal to effect a modification of that rate. There is no indication that Congress intended the protection of section 1803(a), for those rates that qualify, to be overridden by regulatory actions, or to be of limited duration. The statute clearly states two conditions under which the safe harbor afforded rates under section 1803(a) does not apply. Merely filing a protest against a proposed change to a grandfathered rate is not one of them.

In addition, limiting a protestant to challenging the increment of the rate increase is consistent with the ICA. Under section 15(7), a pipeline proposing a rate change bears the burden of proving the change will result in a rate that is just and reasonable. On the other hand, in an investigation of an existing rate pursuant to sections 13(1) and 15(1), the burden of proving the rate is unjust and unreasonable lies with the complainant (or the Commission, in investigations begun *sua sponte*). To allow a protestant in a section 15(7) proceeding, where the burden of proof lies with the pipeline, to challenge that part of a rate that was pre-existing would therefore be contrary to the statutory scheme.

It is relevant to note, moreover, that under the indexing system adopted in the final rule, existing rates to the extent not grandfathered under the Act of 1992 remain subject to investigation under the complaint process set forth in section 13(1) of the ICA.

3. Other Issues

Holly and Total argue for an automatic periodic Commission review of pipeline rates. Total suggests that this be done every five years, with the pipelines being required to file cost and revenue data to be used in this process. Total also favors insulating pipelines from protests during the five year intervals between the cost-based rate reviews.

The concern reflected in these requests—that under the indexing system pipeline rates will increasingly diverge from actual pipeline costs—has been addressed by the Commission in its structuring of the index system. First, pipeline

[34] *See FERC Statutes and Regulations* ¶ 30,895 (1993), at pp. 30,948-51.

[35] Subsection 1803(b) of the Act of 1992.

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do so would merely create a divergence between those costs and the allowable rate ceiling that could form the basis for a protest.

The position that the protest mechanism should not be available in cases where proposed rate increases comply with the applicable rate ceiling must be rejected. As explained in the final rule, under an indexing system some divergence between the actual costs of a pipeline and its rates is inevitable. An indexing system relies upon industry-wide average costs, not company-specific costs, to establish rates. Moreover, the Commission is requiring that there be a *substantial* divergence between actual costs and rates to allow for efficiency gains that may occur.

The indexing system has been adopted because it complies with Congress' mandate in the Act of 1992 for a simplified and generally applicable ratemaking methodology, in conformity with the just and reasonable standard of the ICA. A measure of the justness and reasonableness of rates is the cost of providing the service. Thus, the divergence between a pipeline's actual cost increases, and its rate increases, while to an extent inevitable under the indexing methodology, should not be allowed to grow so wide as to negate the cost basis of the rate increases. The provision in question allows a protest to be brought against a rate increase that strays too far from the actual cost increases of the pipeline in recognition of the just and reasonable standard that is still applicable under the ICA.

This provision should not, contrary to the contention of AOPL, MPL, Shell, and Explorer, undermine the simplification and efficiency benefits associated with an indexing system of changing rates. Prohibiting the hearing of protests that do not state reasonable grounds for alleging that the proposed rate increase is substantially in excess of cost increases will reduce the number of protests that might otherwise be filed in the absence of such a standard. It is true that prohibiting all protests against proposed rate increases in compliance with the applicable ceiling would further simplify the Commission's review of rates. However, as explained above, such a prohibition would be inconsistent with the just and reasonable standard of the ICA.

The necessity to comply with the just and reasonable standard is also part of the reason for rejecting the argument that a cost-based protest against a proposed rate increase must be rejected in order to ensure the efficiency benefits of indexing. Another reason for rejecting this argument is that the regulation in question does shield a pipeline from cost-based protests where rates are not substantially in excess of costs, thus allowing a pipeline to capture some efficiency gains.

Amoco, Sun, Lakehead, and Buckeye claim that the standard of "so substantially in excess" so as to render the proposed rate "unjust and unreasonable" is vague. This contention, while not entirely inaccurate as a matter of linguistics, is not persuasive as an argument on rehearing. The extent of the divergence between actual cost increases to a pipeline and its proposed rate increase that would justify a finding that the proposed rate is unjust and unreasonable is not susceptible to mathematically precise definition.

This determination is reinforced by these parties' proposal for an alternative standard—changed circumstances. Such a standard is not directly tied to cost changes that may be experienced by a pipeline. Thus, were this standard to be used, there would be the potential for wide divergences between a pipeline's costs and its rates that would nonetheless not be subject to challenge. Such a regulatory regime clearly would not serve as an effective check on rate increases, and would therefore be contrary to the Commission's continuing responsibility to ensure that oil pipeline rates are just and reasonable.

Reflecting a different perspective from that articulated by the pipeline petitioners, some shippers have requested rehearing on the basis that the threshold standard for filing a protest under the indexing system is too stringent.

Kerr-McGee contends that any rate increase that exceeds the actual cost increase experienced by a pipeline is unjust and unreasonable. It argues that protests premised on any divergence from actual costs in the proposed rate should be allowed.

As the cases demonstrate, the requirement that rates under the ICA be just and reasonable does not mean that such rates must perfectly reflect costs, or that

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rulemaking, the Commission is exercising its authority under section 15(1) of the ICA to require the pipeline to file a rate decrease.

ARCO specifically maintains that the Commission has no authority summarily to reject a rate filing without a hearing, except for technical formatting reasons. The ICA, ARCO argues, gives a pipeline a statutory right to a hearing to justify its rate proposal. This contention is also without merit. The hearing requirement contained in section 15(1) for existing rates and section 15(7) for proposed rates, has been satisfied by the notice and comment procedures of this rulemaking. All interested persons, including affected pipelines, have had an opportunity to be heard. If a pipeline desires to rebut the presumption that a rate above the ceiling is unjust and unreasonable, it will receive an individual hearing on that matter. However, a pipeline that makes a filing which fails to comply with those standards, without a showing as to why those standards should not apply, has no right to a hearing. There simply would be no disputed facts or issues to warrant a hearing.[32]

In short, the rate methodology provisions of the final rule, including the filing and other substantive requirements in the indexing system, reflect the Commission's exercise of its ICA authority through promulgation of rules of general applicability, as opposed to issuance of orders through case-by-case adjudication. An agency's discretion to exercise its statutory authority in this fashion through a rulemaking, rather than case-by-case, is well established.[33]

The simplification mandate of the Act of 1992 lends further support to the reasonableness of the Commission's decision to proceed through a rulemaking. Section 1801 of the Act of 1992 directs the Commission to implement a "simplified and generally applicable" ratemaking methodology. It is the Commission's judgment, based upon its experience under the ICA and similar statutes, and the evidence compiled in the record of this rulemaking, that an indexing methodology will fulfill this simplification and general applicability directive, while at the same time ensuring that the resultant rates are just and reasonable under the ICA. By its very nature, an indexing methodology is a generic approach to establishing rates. The requirements of the indexing methodology crafted in this final rule therefore are to be applied generically, through rules, subject, as explained above, to opportunities for pipelines and their customers to show in any particular case that the indexed-based ceiling should not apply.

The claims on rehearing against the validity of the filing requirements contained in Part 342 of the new regulations are therefore denied.

2. Challenges to Rates

Under § 343.2(c)(1) of the new regulations, a protest against a proposed rate increase under the indexing system must show that the "increase is so substantially in excess of the actual cost increases incurred" by the pipeline that the proposed rate would be unjust and unreasonable.

Amoco argues that this standard is too vague. It contends that a more appropriate standard would be a change in circumstances since the rate was last changed. Sun, Lakehead, and Buckeye make the same argument on rehearing, arguing for a standard for bringing protests that relates to changed circumstances.

Several other pipelines on rehearing challenge the notion of allowing any protests against a rate increase proposed that is within the applicable ceiling. Thus, Explorer, AOPL, MPL, and Shell argue that allowing challenges to rate increases within the ceiling would defeat the simplification and efficiency goals of the indexing methodology. They contend that the simplification goal would be defeated by the fact that protests, and thus contested rate proceedings, would proliferate. They further contend that the efficiency goal would be defeated because a pipeline would have no incentive to cut costs if to

[32] *See, e.g., United States v. Storer Broadcasting*, 351 U. S. 192 (1956); See also Davis & Pierce, Administrative Law Treatise, § 8.3, at p. 389 (1994):

Even when an agency is required by statute or by the Constitution to provide an oral evidentiary hearing, it need do so only if there exists a dispute concerning a material fact.

[33] *See, e.g., Heckler v. Campbell*, 461 U. S. 458 (1983); *United States v. Storer Broadcasting*, note 32, *supra*.

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The requirements of the final rule reflect, and are consistent with, the Commission's authority under these ICA provisions to investigate and establish just and reasonable rate levels. As explained in detail in the previous section of this order and in the order issuing the final rule, the Commission has conducted an on-the-record investigation in this proceeding and has determined that use of a generic, cost-based formula (PPI-1 index) for changing existing rates, the vast majority of which have been deemed just and reasonable by act of Congress, will streamline and expedite the ratemaking process in accordance with the mandate of the Act of 1992, while at the same time ensuring that the resulting rates are just and reasonable within the meaning of section 1(5) of the ICA.

The specific means by which this indexing system will ensure just and reasonable rates is by establishing, in the language of the ICA, rate maximums.[30] Section 342.3(a) of the regulations requires rate changes to produce rates that are no higher than the applicable ceilings. This regulatory requirement reflects the Commission's authority under section 15(7) of the ICA to require that proposed changes yield just and reasonable rates. Section 342.3(e) of the regulations provides that pipelines must reduce existing rates to comply with new ceilings which have been lowered because of the decline in the index. This regulation reflects the Commission's rebuttable finding that a rate above the ceiling is unjust and unreasonable, and under section 15(1) of the ICA, the Commission has the authority to require existing rates that are determined to be unjust and unreasonable to be adjusted to lawful levels.

However, the regulations also provide procedures for both pipelines and their customers to show that the applicable ceilings would not ensure just and reasonable rates. As explained in detail in the final rule, and elsewhere in this order, § 342.4 provides that the pipeline may rebut the presumption in the regulation that the above-ceiling rate is unjust and unreasonable and that rates above the ceiling are justified. The pipeline has the burden of proof to show that the applicable ceilings are too low to allow recoupment of prudently incurred costs, in respect to both proposed and existing rates, except for those rates deemed just and reasonable under section 1803 of the Act of 1992. Section 343.2(c)(1) provides similar protection for customers, by providing for challenges to proposed and existing rates that are within applicable indexed ceilings, but are nonetheless so substantially in excess of actual costs as to be unjust and unreasonable.

Contrary to petitioners' position, nothing in these regulations is inconsistent with section 15(1) of the ICA, which places the burden of proving the unlawfulness of an existing rate on the complainant or the Commission.

The rate decrease requirement of § 342.3(e) is based upon the Commission's finding, in this proceeding, that a rate level in excess of the ceiling established by the PPI-1 index is presumptively unjust and unreasonable.[31] The section simply applies this finding to an existing rate that is in excess of a new, lower ceiling, subject to an opportunity for the pipeline to rebut the presumption to show that its prudently incurred costs justify the above-ceiling rate. Thus, the statutory burden of proof has been fulfilled in this proceeding and is reflected in the regulations.

Kuparuk does not compel a different conclusion, for it involved a distinctly different kind of filing requirement than the rate decrease requirement of the indexing regulations. In *Kuparuk*, it was proposed that a pipeline should be required to make a rate change filing every year, under section 15(7) of the ICA, which would then be subject to review by the Commission. In this review, the burden of proof, as in every case under section 15(7), would be upon the pipeline. This procedure would have upset the statutory scheme for burden of proof because the existing rate to be superseded by the required annual filing, unlike the existing rates subject to § 342.3(e), would not necessarily have been determined to be unjust and unreasonable. In contrast, in this

[30] Section 1(5) of the ICA.

[31] The pipeline would not be required to lower rates below those deemed just and reasonable by the Act of 1992, since the Commission is not here making any of the findings required by § 1803(b) to allow it to prescribe rates below that level.

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a rate change proposal. Thus, they argue, the Commission is without authority to require a pipeline to abide by the requirements established in the final rule for filing for changes of rates under an indexing system. According to the petitioners, a pipeline has sole control over the substantive contents of a rate filing and, when one is made, the Commission's action in response is limited by section 15(7) of the ICA to acceptance of the filing, or acceptance combined with a suspension of the effective date (of no more than seven months), imposition of a refund obligation, and the convening of a hearing.

Petitioners' argument that these regulations are unlawful because the Commission has no authority to prescribe substantive requirements for rate filings is clearly mistaken. In the first instance, these requirements are grounded in specific authorities contained in the ICA. The end result of this rulemaking proceeding as it relates to the ICA is the same as if the Commission had proceeded in a case specific adjudication. That is, the Commission has identified rate levels that comply with the just and reasonable standard of section 1(5), and it has required that no rates above those levels can be charged to customers, unless the pipeline can show there are unusual circumstances justifying higher rates. Thus, contrary to the view that underlies petitioners' objections, requiring a pipeline to abide by these determinations, reflected in the final rule, is no different than requiring a pipeline to abide by the requirements of an order issued after an adjudication on its existing or proposed rates.

In regard to the rate decrease filing requirement contained in § 342.3(e), AOPL argues that this provision is inconsistent with the ICA's scheme on burden of proof. AOPL notes that the ICA places upon the Commission, or the complainant, the burden of proving that an existing rate is unjust and unreasonable. Contrary to this provision, argues AOPL, the final rule's requirement that a pipeline file for a rate decrease effectively shifts the burden of proof in respect to the lawfulness of an existing rate to the pipeline.

According to these petitioners, the Commission has acknowledged this principle in a prior decision. In *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122 (1991), the Commission declined to order the pipeline to make automatic annual filings to change rates based upon a formula-prescribed ceiling. AOPL argues that the Commission's decision in *Kuparuk* was premised upon the necessity of respecting the ICA's burden-of-proof scheme, in which a pipeline bears the burden of proof on proposed rates, but the challenger bears the burden of proof of showing that existing rates are unlawful.

These arguments of the petitioners are not persuasive.

In complying with the directive of the Act of 1992 to craft a simplified and generally applicable ratemaking methodology for oil pipelines, the Commission has exercised its substantive authorities under the ICA, which are intended to ensure that the rates charged by oil pipelines for transportation services are in accordance with the standard contained in section 1(5) of that statute:

> All charges made for any service rendered or to be rendered in the transportation of . . . property . . . shall be just and reasonable, and every unjust and unreasonable charge for such service or any part thereof is prohibited and declared unlawful.

Sections 13(1) and 15(1) grant to the Commission authority to enforce the just and reasonable standard with respect to existing rates. If after an investigation instigated by virtue of a complaint brought by any person under section 13(1), or upon the Commission's own initiative, the Commission finds that an existing rate is not just and reasonable, section 15(1) empowers the Commission "to determine and prescribe what will be the just and reasonable ... rate ... or the maximum or minimum ... to be charged ...," and to order that the pipeline "shall not thereafter publish, demand, or collect any rate ... in excess of the maximum ... so prescribed .... "

Section 15(7) provides the Commission with similar authority if the pipeline proposes changes to its rates. Thus, under that section the Commission is empowered to investigate proposed rate changes and, if it determines that the proposed change would not establish a lawful rate, issue an order "as would be proper" in the context of remedying an unlawful existing rate under section 15(1).

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method that falls short of the Act of 1992 goals of simplicity and streamlining.

Third, the extensive vertical integration of the oil industry raises questions concerning meaningfulness of the cost data supplied.[29] Although such companies may operate their pipeline divisions as independent profit centers, vertical integration does permit integrated companies considerable leeway in allocating common costs among their various divisions.

At one extreme, a pipeline could be allocated none of a company's joint or common costs, giving it low rates, and perhaps noticeably lowering the average of reported industry costs. At the other extreme, a company could allocate to its pipeline a share of the company's worldwide common costs, resulting in higher rates and raising the industry cost average significantly. In this latter case, if the integrated pipeline company transports primarily company crude, it would suffer little loss in volumes transported despite its higher rates, and could remain indifferent to the actual level of the rate being charged. Revenues not recovered by the pipeline could be recovered at the producing, refining, or marketing end of the company's operations. The Commission is not suggesting that such cost-shifting would occur, nor that it would necessarily be improper. But the possibility of it occurring undetected in reported data does exist. The net result in either case is that the data available to the Commission for constructing a proper index would be skewed. In any event, the need to improve data collection with regard to oil pipelines is specifically the subject of the separate rulemaking proceeding at Docket No. RM94-2-000.

4. Conclusion

Based upon the record evidence of this proceeding, publicly available data filed with the Commission by pipelines, and the nature and characteristics of the PPI and GDP indexes, the Commission reaffirms its decision to use the annual change in the PPI-1 index to establish rate ceilings under the indexing system. This decision, as stated in the final rule, will be reviewed every five years, beginning with the year 2000.

B. *Filing Requirements for the Indexing System*

1. Pipeline Filing Requirements

The final rule imposes certain new affirmative filing requirements on pipelines. These new requirements may be broken down into two categories. The first category contains those substantive requirements governing a pipeline's use of the ratemaking methodology established in the final rule. A pipeline is generally required to use the indexing system to change rates. In filing for a rate change under the indexing system, a pipeline must file a proposed rate that is no higher than the ceiling derived from application of the index. If a pipeline wishes to file for a higher rate, it must use a cost-of-service or negotiated-rate methodology and it must justify that use based upon certain factors that are enumerated in the regulations. These requirements are contained in §§ 342.3 and 342.4 of the regulations.

The second new affirmative pipeline filing requirement, contained in § 342.3(e) of the regulations, concerns rate decreases under the indexing system. In any year in which the index is negative, and has the effect of lowering the applicable rate ceiling, a pipeline with a rate above the new ceiling must file a new tariff to bring that rate into compliance with the new ceiling, subject to the provisions of the Act of 1992. This filing must be effective no later than July 1 of the applicable index year.

AOPL, ARCO, Exxon, MPL, and Phillips challenge the Commission's statutory authority to promulgate these requirements on filing rates. Their argument is that the ICA grants to a pipeline sole discretion as to the substantive content of

[29] Although the Commission collects no data on, and does not have up-to-date information about, the degree to which pipeline companies are shipping their own oil from one company division to another, historically the industry has been highly vertically integrated. According to a Treasury Department staff study, "Implications of Divestiture" (June 1976), the top 20 interstate oil pipeline firms (all major producers and refiners), owned 86.6% of the interstate trunkline capacity in 1972. A Department of Energy study, "United States Petroleum Pipelines" (December 1980), reports that in 1980 integrated pipelines owned by the major oil companies accounted for three out of the top four and 17 of the top 20 pipelines, 66% of total barrel-miles carried, 57% of total barrels delivered per day, and 67% of the undivided interest systems.

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Commission is concerned with tracking changes in pipeline costs, not in absolute levels of pipeline costs, of which gathering and delivery costs comprise a minor part. Omission of these costs therefore provides some consistency to the costs analyzed without jeopardizing the validity of the analysis.

AOPL also takes issue with Kahn's use of changes in net plant investment (i.e., rate of change in depreciated original cost) as a proxy for oil pipeline capital cost experience. AOPL notes in this regard that reported historical book investment has nothing to do with current costs of capital; reported net investment does not reflect the practice of using parent company equity for investment; and oil pipelines use trended original cost for determining rate base, which cannot be calculated from reported data. In brief, AOPL argues that no generally available or applicable method exists for discerning and calculating a given pipeline's capital cost changes from reported data, for which reason an index of general inflation is required to permit these costs to be tracked. On these grounds AOPL rejects as inaccurate Means' calculation of the industry's rate of return.

Means acknowledges in his testimony that it is not possible to determine a trended original cost rate base from publicly available data. He explains, however, that the relevant question

> . . . does not concern the level of pipelines' aggregate rate base, but rather the rate at which that level is changing. Over the life of an asset, the average annual rate of change will be the same under original cost and trended-original cost methodologies. This follows from the fact that the starting point (original cost) and the end point (zero) is the same under both.[26]

The only capital cost data available for public analysis is in Form No. 6. Use of such a proxy may be imperfect, but AOPL offers no better solution. They prescribe use of a general price deflator to reflect capital costs, which the Commission has accommodated by choosing PPI-1. AOPL would simply have the Commission choose a different deflator, namely GDP or even GDP+2.5. As to Means' rate of return calculations, they are irrelevant to the choice of index.

AOPL's original analysis, in contrast to that of Kahn and Means, focussed only on operating expenses, which are more likely to be affected by inflation.[27] Capital costs, which AOPL did not specifically address, will reflect depreciation and other adjustments that tend to reduce overall pipeline costs.

3. Construction of Commission Index

USAir, Alberta, and Chevron have urged the Commission to devise its own index of pipeline costs, using data from Form 6.

Under the best of circumstances, construction, verification, and testing of such an index within the near future would be extremely difficult. The data available to the Commission, from Form No. 6, are currently insufficient for constructing an oil pipeline industry index. This is particularly true for capital costs, as discussed in more detail above. Oil pipelines do not file data in their Form No. 6 which permit calculation of their capital costs on a trended original cost basis; as noted earlier, this has in part dictated the need for using a general price inflation index. While the Commission is proposing to revise Form No. 6 in the NOPR issued concurrently, it is unlikely that the data will be sufficient to construct an oil pipeline industry index.[28]

Moreover, a FERC-constructed index would entail serious complications. First, to construct such an index would require the collection of data over some extended period of time in order to have a statistically meaningful set of data points.

Second, if the cost data submitted by individual pipelines were to be used to charge all shippers maximum rates, it may be argued that each submission would and should be subject to challenge by any shipper on any pipeline. While such oversight is not necessarily undesirable *per se*, it might result in an indexing

[26] Means, p. 15.

[27] As noted in the final rule, some commentors in fact suggested that only such operating expenses be indexed, which we rejected for reasons explained there.

[28] *See* Notice of Proposed Rulemaking, Cost of Service Filing and Reporting Requirements for Oil Pipelines, Docket No. RM94-2-000, issued concurrently with this order.

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sence of any question of erroneous data.[22]

The median is, in fact, often preferred statistically as a measure of central tendency in cases where the distribution is highly skewed.[23] An average may be substantially influenced by one or two extreme outliers, whereas the median, or the middle 50% will not.

There is some dispute among commentors on how to weight average costs. Some use barrel/miles; others advocate using barrels. The choice of weight will significantly affect the average.[24] Use of the median obviates the need to decide on appropriate weights, since the median is determined only by its position relative to the other components of the series.

As noted by Means, use of a median range of pipeline costs is also more appropriate than the use of an index that includes all changes in pipeline costs, no matter how extraordinary. AOPL, in its request for rehearing, provides considerable evidence that the index of PPI-1 will not cover all changes in pipeline costs. It asserts that PPI-1 would not permit pipelines with far-above-average costs to recover those costs within the index. It also shows that the GDP implicit price deflator index would be insufficient to cover all pipeline costs, and that GDP+2.5 percent would better cover the range of extraordinary costs incurred by individual pipelines in any given year.

The role of an index is to accommodate normal cost changes. Its purpose is not to guarantee recovery of all costs at any time and in full, regardless of other circumstances. Even competitive markets do not do this.

AOPL argues that the more generous index would better track, and hence permit more complete recovery of, all reported pipeline costs. If the Commission chose such an index, sufficiently high and generous to encompass even the most extraordinary costs, it would provide windfalls to many oil pipelines by allowing rate changes substantially above cost changes. This would effectively abdicate our responsibilities for rate regulation under the ICA.

The choice of PPI-1 is intended to permit pipelines to recover normal costs through normal operation of the index.[25] Extraordinary costs can be recovered through either of the alternate rate change means—cost of service or settlement rates—as provided in the final rule. In both cases, the pipeline will have an opportunity to recover its costs.

In the Commission's judgment, PPI-1 adequately tracks normal industry average costs. It does not track extraordinary costs. If it did, it would permit at least some pipelines to capture monopoly rents, and foster the inefficiencies inherent in the exercise of monopoly power. PPI-1 may not be the only index that could have been chosen, but it is adequate and reasonable for purposes of regulating oil pipeline rates.

There are also strong equity and administrative reasons for choosing PPI-1 over GDP as an index. The PPI is issued as a final figure once a year and is not subject to further adjustments. Its use thus provides a measure of certainty that does not exist with the GDP-IPD. The GDP-IPD is subject to revisions even five years after so-called final figures are first issued. Adjustments in the GDP-IPD several years after rates have been adjusted would mean that rates would be based on unreliable data, thereby undermining the confidence of the industry, the financial community, and pipeline customers in the rates charged.

AOPL takes issue with two lesser points regarding Kahn's analysis. AOPL alleges that Kahn erred in omitting gathering and delivery costs (10% of total industry costs) from his analysis. However, the

[22] Means at pp. 18-19.

[23] George Snedecor and William Cochran, Statistical Methods, Sixth Edition, Iowa State U. Press, 1978, at p. 123.

[24] *See, e.g.*, Answer of Buckeye Pipeline to Brief of US Air, Inc., dated January 24, 1994, at p. 5, fn 3.

[25] Kahn states in this original testimony, at page 9, footnote 2, that this is the fundamental purpose of an index:

> The mere fact that changes in a particular price or cost index, intended to be applied to all companies across-the-board, diverge substantially from changes in the costs of individual companies is not necessarily an infirmity: the same is true in competitive markets, just as the competitive market price at any given time will typically allow some companies to make very high profits and others to suffer losses.

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continue to do so in the future. Therefore, on a broad conceptual basis, the PPI-FG is a more appropriate choice than GDP for an oil pipeline industry-wide index.

2. Kahn's Analysis

Both Kahn and AOPL provide statistical analyses of pipeline costs as reported in Form No. 6, to discern whether PPI-1 or GDP+2.5 more closely tracks these reported changes in oil pipeline costs. These Form No. 6 data are imperfect and, as AOPL points out, do not necessarily reflect true valuation and/or bookkeeping costs. Moreover, Form No. 6 does not contain the information necessary to compute a trended original cost (TOC) rate base or a starting rate base as allowed for in Order No. 154-B. Thus, all agree that the measure of the capital cost component of the cost of service is highly unsatisfactory.

Kahn and AOPL draw conflicting conclusions from their analyses. Kahn concludes that PPI-1 better tracks costs for product pipelines, and is inconclusive about crude oil pipelines. AOPL alleges a number of statistical flaws in Kahn's analysis, arguing these constitute sufficient basis to discredit support for PPI-1 as an index.

Kahn constructed a sample of pipelines from Form No. 6 data. He dropped from his sample those reported pipeline costs in any given year which were in the upper and the lower 25% of the cost spectrum, primarily to correct for statistical outliers and for incomplete or questionable data; and he divided the pipeline universe into strictly crude carriers and strictly product carriers, eliminating from his sample all pipeline companies which carry both.

AOPL charges the remaining sample is too small to be statistically relevant or informative. It particularly objects to the use of only the middle 50% of reported pipeline costs for computing industry-wide weighted average costs. It notes the potential downward skewing of average industry costs by excluding the top 25% of reported pipeline costs, but neglects to address the potential upward skewing that might result from eliminating the lower 25%.

AOPL obtained from some of the reporting pipelines, corrections to the data originally found by Kahn to be incomplete or questionable. Using these corrected data as supplied by AOPL, Dr. Robert Means[21] subsequently expanded Kahn's analysis to all crude and all product pipelines in the middle 50% of the cost range as reported in any given year. For reasons explained below, his results would also support the choice of PPI-1 as an appropriate index to track the central tendency of reported changes in oil pipeline costs.

As Dr. Means points out in his testimony, the use of only the median 50% of pipeline costs does not in any way negate the value of Kahn's sample as an indicator of the way in which the PPI-1 index tracks normal pipeline costs:

> To be applied without exceptions, a price cap index must be applied to an industry in which the firm's cost changes fall—or, with efficient operation, can be made to fall—within a moderate range. Even with corrections, however, the annual rate of increase in unit operating expenses and net investment for product pipelines still range from 19.89 to -12.89 percent; for crude oil pipelines, the range was from 37.75 to -15.32 percent....
>
> No index can match pipelines' actual cost experience over such a range. However, the remedy for this problem cannot be a different index. A higher index would alleviate the problem of cost underrecovery at the upper end of the range. However, any realistic index would fall short of the requirements of the firms with the highest rates of cost increase, and it would at the same time aggravate the problem of cost overrecovery at the lower end. Precisely the reverse would occur if a lower index was selected.
>
> The composite measure based on the middle 50 percent that was used by Dr. Kahn therefore is a reasonable method for assessing an index even in the ab-

[21] Dr. Means' statement is attached to the filing of Sinclair Oil Corporation and the National Council of Farmer Cooperatives in response to the application for rehearing of AOPL, on December 9, 1993.

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sures of general inflation. However, the GDP-IPD has flaws, both as a measure of general inflation and as a contractual price escalator, despite its common use. The flaws are sufficiently serious for the Bureau of Economic Analysis of the Department of Commerce (BEA), the organization responsible for constructing and publishing this index, to have issued a fact sheet recommending against its use as an escalator:

> The Bureau of Economic Analysis does not recommend specific measures for escalation in contractual or other agreements. However, we do recommend that the implicit price deflators (for GDP, GNP, and other components) *not* be used as measures of price change.[16]

The two most important flaws of the GDP-IPD are (1) it is *not* simply a measure of price change, but it also reflects changes in the composition of GDP, and (2) it is subject to revision for up to five years after its publication.

The first problem can be illustrated by health care costs. Health care expenditures and prices have been rising at a much faster rate than other components of GDP and non-health care prices, respectively.[17] Because the GDP-IPD reflects both the increased "weight" given to health care and the increase in its price, it is an upwardly biased measure of health care price inflation. For categories whose shares of GDP fall as prices rise, GDP is a downwardly-biased measure of price change.[18]

BEA ordinarily revises the GDP-IPD each July and covers the months and quarters of the most recent calendar year and the preceding two years. Thus, the July 1994 revision will cover the years 1991, 1992, and 1993. Comprehensive revisions are carried out at five-year intervals, the most recent of which was released in December 1991.[19]

In contrast to the GDP-IPD, the PPI-FG is a fixed-weight index of the prices of finished goods taken at the producer level. It does *not* directly include the prices of services, such as those provided by medical doctors and hospitals, by teachers, lawyers, and others. It does reflect indirectly the increased cost of medical care, education, and legal service, since product costs will rise if the wage-benefit package that producers must pay reflects the higher prices of medical, educational, and legal services. Unless offset by productivity gains, producer prices will rise to reflect these higher costs. The PPI will reflect the higher costs of services to the extent that they represent higher costs to producers, but not to the extent that employees rather than employers absorb these higher service costs. For example, the benefits portion of the employment cost index rose by over 84% between 1980 and 1990, but the wages and salaries portion grew only by 58%. The medical care component of the Consumer Price Index rose by 118% during this period. Yet the total compensation index rose by only 65%.[20] Since employers pay the total compensation bill, it is only the latter that reflects the actual inflationary increase in their total wage bill. The GDP-IPD reflects both the increase in producer prices that reflect increases in total worker compensation and the effect of the increase in medical care prices as seen by consumers, as well as any increase in the price of housing and education.

The cost increases experienced by oil pipelines, which essentially do business at the wholesale level, has more closely resembled the cost increase experience of goods producers in the past than that of the economy as a whole, and it will likely

[16] BEA's Fact Sheet on the Implicit Price Deflator, attached to the comments of USAir, Inc., to the notice of proposed rulemaking in this proceeding, filed August 12, 1993, in Docket No. RM93-11-000.

[17] *See, e.g.*, Health Care Financing Review, Winter 1992, Vol. 14, No. 2, at pp. 1, 18.

[18] For a thorough discussion of alternative measures of deflating GDP see Young, Alan, "Alternative Measures of Change in Real Output and Prices," pp. 32-48, and Triplett, Jack, "Economic Theory and BEA's Alternative Quantity and Price Indexes," pp. 49-52, *Survey of Current Business*, vol. 72, number 4, April, 1992.

[19] For a more detailed account of BEA's release schedule, see "A Look at How BEA Presents the NIPA's", *Survey of Current Business*, pp. 30-32, vol. 73, number 2, February 1993. For the latest revision, see "Annual Revision of the U.S. National Income and Product Accounts", *Survey of Current Business*, pp. 9-51, vol. 73, number 8, August 1993.

[20] *Economic Report of the President*, January 1993, Table B-43, 397.

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fred Kahn, while voluminous evidence by AOPL (and its members) in favor of using the GDP-IPD, adjusted upward by 2.5 percent (GDP+2.5), has been ignored.

Before addressing this criticism directly, it would be useful to describe briefly how the Commission came to adopt the PPI-1 index for use in this rule.

The final rule in this proceeding is the result of a notice of proposed rulemaking (NOPR) initiated by the Commission on July 23, 1993,[12] in response to the mandate of Congress that the Commission issue a final order revising oil pipeline ratemaking, contained in the Act of 1992. On March 18, 1993, the Commission made available for comment a Proposal for Revisions to Oil Pipeline Regulation Pursuant to the Energy Policy Act of 1992, prepared by the Commission staff (Staff Proposal). Staff proposed, among other things, that the Commission adopt as a primary means of regulating oil pipeline rates an indexing methodology based on PPI-1. Twenty-four sets of comments were received on the Staff Proposal.

In the NOPR, the Commission proposed to use, as its primary means of regulating oil pipeline rates, an indexing system similar to that contained in the Staff Proposal. However, rather than the PPI-1, the Commission proposed to use the GDP-IPD as the index. Forty-two sets of comments were received from parties representing pipelines, shippers, State commissions, consumers, and trade associations.

Included in the comments on the NOPR were the sworn statement of Dr. Alfred Kahn, attached to the comments of Crysen Refining Company, *et al.* Dr. Kahn generally supported the use of PPI-1 as best reflecting the cost changes experienced by product pipelines and reported to the Commission in the pipelines' annual report to the Commission, Form No. 6. AOPL and the pipelines generally supported the use of the GDP-IPD as the index, adjusted upward by 2.5 percent, arguing that this index better reflected pipeline cost changes. Based on these comments, the Staff paper, and the NOPR, the Commission formulated the final rule, adopting as the index for pipeline rates the change in the PPI-1.

Numerous applications for rehearing were filed, and on December 9, 1993, Sinclair Oil Corporation and NCFC filed a response to the application for rehearing of AOPL. This response included the sworn statement of Dr. Robert Means, supporting the Commission's use of PPI-1 and the Kahn statement generally. Thereafter, on December 22, 1993, the Commission requested further comments on the issue of the appropriate index to use for changes to oil pipeline rates.[13] Six statements and comments were received. The supplemental comments of AOPL generally criticized the Kahn and Means studies.

Based on consideration of the foregoing items, the Commission reaffirms its decision to use the PPI-1 as the appropriate index for oil pipeline rate regulation. The choice of PPI-1 was not exclusively dependent on the evidence submitted by Dr. Kahn. The proposal for using PPI-1 was first introduced into the record in this proceeding in the Staff Proposal, before any testimony was submitted. The Staff Proposal argued that PPI-1 would track industry costs better than the Consumer Price Index (CPI) and the GDP-IPD because, for example, the latter were significantly influenced by "rapidly escalating health care costs,"[14] the full extent of which would not be borne by employers. The Commission ultimately chose PPI-1 in the final rule, but this choice did not hinge exclusively on Dr. Kahn's testimony nor solely on his statistical presentation of pipeline costs.

AOPL does not dispute that some general measure of inflation should be used as the index for pipeline rate changes. As AOPL points out, "The only practical and economically sensible method for addressing the oil pipeline industry's capital costs under indexation is to rely upon a general measure of inflation, which by its design captures the underlying changes in capital costs reflected in the cost of goods sold."[15]

Both the GDP-IPD and the PPI-FG are commonly considered and used as mea-

[12] 58 Fed. Reg. 37671 (July 13, 1993).

[13] 65 FERC ¶ 61,377 (1993).

[14] Staff Proposal, at p. 21.

[15] Request of AOPL for Rehearing and Clarification of *Final Rule*, at p. 15.

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that its prudently incurred costs are substantially in excess of the cost changes reflected in the index.

In this fashion, the regulatory scheme adopted by the Commission will provide constant monitoring of the relationship of the index to the costs of both the pipeline industry as a whole and of individual pipelines. To the extent this monitoring indicates a discrepancy between the index and changes in pipeline costs such that the indexed ceilings do not constrain rates to just and reasonable levels, the necessary adjustments to the index, or to its application to a particular rate, will be made.

Although certain petitioners on rehearing have challenged the Commission's authority to do so, judicial precedents make clear that an agency may lawfully enforce a "just and reasonable" standard through the imposition of rate caps derived from a broad-based index.[9] The indexed rate-cap methodology adopted in this proceeding has firm legal grounding in these precedents and is, with one exception, no different in substance from the methodologies affirmed in these cases.

The exception is the index that is to be used. In the *Mobil*, *Northern Telecom*, and other cases, the index in question was the Gross Domestic Product - Implicit Price Deflator (GDP-IPD), which is a measure of general inflation in the economy. In this proceeding, the Commission has selected the PPI-1 as the index to compute rate caps. This decision is based upon the conclusion that the PPI-1, which reflects changes in prices of finished goods, will more closely track the cost changes experienced by a typical pipeline than will the GDP-IPD. To ensure over time that this nexus between the changes in the index and the cost changes experienced by the typical pipeline will be maintained, the Commission will conduct a review of the PPI-1 index every five years, beginning in the year 2000.

An agency may lawfully rely upon the rate caps established by the index to constrain individual rates to just and reasonable levels. There is, in other words, generally no need, under the indexed rate-cap methodology, to examine the relationship between changes in costs and changes in rates on a rate-specific basis. *See, e.g., Permian Basin Area Rate Cases, supra.*

Nonetheless, since there may be cases presenting exceptional circumstances, the methodology includes procedures for both pipelines and shippers to show the need for overriding the presumptive validity of the rate cap. These procedures reinforce the appropriateness of using an indexed rate-cap methodology. *See Permian Basin Area Rate Cases* (special relief provision);[10] *National Telecom* (waiver provisions). It should be emphasized that these procedures will be invoked only in truly exceptional cases, in order to achieve the simplification objective of the indexed rate-cap methodology.[11]

It bears emphasizing that the choice of the PPI-1 index for use in the methodology adopted in this rule is not a choice for all time. The operation of this index will be monitored to ensure that actual rates charged customers comply with the just and reasonable standard of the ICA.

II. Issues Raised and Commission Response

A. *Choice of Index*

1. PPI-1 vs. GDP-IPD

AOPL and its members support the use of a general inflation index, but claim that the choice of PPI-1 is not supported by record evidence and is based on flawed statistical analysis presented by Dr. Al-

[9] *See, e.g., Mobil Exploration & Producing Southeast, Inc., et al. v. United Distribution Cos.*, 498 U.S. 211 (1991); *National Rural Telecom Association V. FCC*, 988 F.2d 174 (D. C. Cir. 1993). *See also Permian Basin Area Rate Cases*, 390 U.S. 747 (1968). In *Permian*, the area rates for producers were established with reference to an examination of area costs. Appellants argued on appeal that the Commission was required to make a rate-specific cost inquiry. The Court held to the contrary.

[10] In *Permian Basin Area Rate Cases*, the Court did not reach the question whether providing for exceptions was legally necessary, because the Commission's rule contained procedures for exceptions.

[11] In *Permian Basin Area Rate Cases*, the Court noted with approval the Commission's stated intention to grant exceptions to the area rate ceilings only rarely, lest the administrative benefits of regulating through area rates be undermined. The Court also found no infirmity with the Commission's decision not to set forth in advance specific criteria to govern applications for exceptions. 390 U.S. at p. 772.

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modified to provide that the pipeline may use the cost-of-service methodology for changing rates when it can demonstrate that its prudently incurred costs have increased to such an extent that there is a substantial divergence between such costs and the rate produced by application of the index. This change will more closely track the standard for shipper protests to an indexed rate as reflected in § 343.2.

3. Section 343.3 of the regulations has been modified to require that a protestant must file a verified statement which contains a detailed description of the nature and substance of the protestant's substantial interest in the pipeline's tariff filing.

In all other respects, Order No. 561 is affirmed as issued.

The Commission re-affirms that the index approach to oil pipeline ratemaking should be instituted on January 1, 1995. The indexing methodology adopted in the final rule is designed to fulfill both the simplification directive of the Act of 1992 and the just and reasonable standard of the ICA. It will simplify, and thereby expedite, the process of changing rates by allowing, as a general rule, such changes to be made in accordance with a generally applicable index. It will ensure compliance with the just and reasonable standard by subjecting the PPI-1 index to periodic monitoring and, if necessary, adjustment, and, in addition, by providing both pipelines and their customers with an opportunity to show in individual cases that the indexed ceiling level does not comport with the just and reasonable requirement of the ICA.

The Act of 1992 directed the Commission to establish a ratemaking methodology that is "simplified and generally applicable,"[8] and comports with the just and reasonable standard of section 1(5) of the ICA. At the outset of undertaking compliance with the Act of 1992, the Commission was confronted by a significant fact: Congress, in section 1803 of the Act of 1992, deemed the vast majority of existing rates to be just and reasonable, and subject to challenge only under narrowly defined circumstances. Thus, with a few exceptions, the oil pipeline industry's existing rates have been established as a just and reasonable baseline. Moreover, this is a baseline that has resulted not from an examination and confirmation of underlying costs, but from a statutory edict.

This statutory just and reasonable baseline of existing rates, combined with the mandate to simplify and expedite, has focused the Commission's task in this proceeding upon formulating a streamlined way of regulating rate changes. Thus, the indexed rate-cap methodology set forth in the final rule, and re-affirmed in this order, constitutes a simplified and generally applicable methodology of changing rates.

Simplification results from the elimination, with rare exceptions, of rate-specific examinations of costs. Under the indexed rate-cap approach, rates are allowed to change so long as the resulting rate is at or below a ceiling level established by the index. This approach is also generally applicable because a rate cap methodology serves to constrain rates in the pipeline's markets.

The indexing methodology adopted in the final rule and affirmed here is fundamentally based upon costs. The index selected, PPI-1, is that which the evidence in the record indicates most closely approximates the actual cost changes experienced by the oil pipeline industry. Thus, changes in rate ceilings should reflect changes in costs to the pipeline industry. To ensure this nexus is maintained, the Commission will periodically examine the relationship between the selected index and the actual cost changes experienced by the oil pipeline industry. Appropriate adjustments to the index will be made as warranted by the results of this periodic review.

The indexing methodology also provides a mechanism for ensuring in individual cases that the actual rates charged are within the zone of reasonableness required by the just and reasonable standard of the ICA. A protest may be filed against a rate increase that is within the applicable ceiling, if the increase is substantially in excess of the actual increase in costs experienced by the pipeline. The complaint procedure of section 13(1) of the ICA also remains available to challenge existing rates that are arguably unjust and unreasonable. Conversely, a pipeline may file a rate increase that exceeds the applicable ceiling, if it can show

[8] Section 1801, Act of 1992.

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Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

I. Introduction

A. *Order No. 561*

On October 22, 1993, the Federal Energy Regulatory Commission (Commission) issued Order No. 561 in this proceeding.[1] Order No. 561 promulgated regulations pertaining to the Commission's jurisdiction over oil pipelines under the Interstate Commerce Act (ICA),[2] to fulfill the requirements of the Energy Policy Act of 1992 (Act of 1992).[3]

The final rule reflects the Commission's compliance with the mandate of Congress in enacting the Act of 1992. In the final rule, the Commission recognized that Congress deemed certain rates to be just and reasonable, thereby forming a baseline for many future oil pipeline rate changes and obviating future debate over the appropriateness of existing rates, many of which are based on valuation or trended original cost methodologies. The final rule, in accordance with the directive of section 1801 of the Act of 1992, provided a "simplified and generally applicable" approach to changing just and reasonable rates through use of an index system to establish ceiling levels for such rates. The final rule adopted the annual change in the Producer Price Index for Finished Goods, minus one percent (PPI-1), as the appropriate index to determine annual ceiling levels of rates to be charged by oil pipelines.[4]

As alternatives to the indexing approach, the final rule permits, in certain defined circumstances, other rate-setting or rate-changing methodologies. The final rule 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.[5] The final rule retained the Commission's policy of encouraging settlements of rate issues at any stage in the proceedings. Finally, the final rule continued to allow pipelines to seek Commission authorization to charge market-based rates.[6]

In addition to establishing the ratemaking methodologies to be followed by oil pipelines, the final rule, pursuant to the directives of the Act of 1992, adopted certain reforms to the Commission's procedures relating to oil pipeline proceedings. The final rule also included an updating of Commission regulations pertaining to oil pipeline tariffs.

B. *Order on Rehearing*

This order on rehearing grants, in certain respects, the applications for rehearing that were filed, and clarifies in part the final rule.[7] The changes made in the rule on rehearing are:

1. Section 341.4 of the regulations is modified to require the filing of suspension supplements within 30 days of the suspension order, instead of 15 as required in the final rule.

2. The "uncontrollable circumstances" test of § 342.4 of the regulations has been

[1] Revisions to Oil Pipeline Regulations Pursuant to Energy Policy Act, Order No. 561, *FERC Statutes and Regulations* ¶ 30,985 (1993), which will be referred to herein as the "final rule."

[2] 49 U.S.C. app. 1 (1988).

[3] 42 U.S.C.A. 7172 note (West Supp. 1993).

[4] The Commission stated in the final rule that it would undertake an examination of the relationship between the annual change in the index and the actual cost changes experienced by the oil pipeline industry every five years, beginning in the year 2000.

[5] The Commission, concurrently with the issuance of the final rule, issued a notice of inquiry to explore ways to improve the collection of data on oil pipeline costs, and as a first step in establishing filing requirements for cost-of-service rate filings, to facilitate these cost-of-service proceedings. *See* Cost-of-Service Filing and Reporting Requirements for Oil Pipelines, Notice of Inquiry, *FERC Statutes and Regulations* ¶ 35,528 (October 22, 1993); Notice of Proposed Rulemaking, Cost of Service Filing and Reporting Requirements for Oil Pipelines, Docket No. RM94-2-000, issued concurrently with this order.

[6] The matter of market-based rates is also the subject of a notice of inquiry issued concurrently with the final rule. *See* Market-Based Ratemaking for Oil Pipelines, Notice of Inquiry, *FERC Statutes and Regulations* ¶ 35,527 (October 22, 1993); Notice of Proposed Rulemaking, Market-Based Ratemaking for Oil Pipelines, Docket No. RM94-1-000, issued concurrently with this order.

[7] A list of those parties filing applications for rehearing or requests for clarification is attached as Appendix A to this order, and the names by which they are referred herein.

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the circumstances under which oil pipelines may use the cost-of-service methodology for changing rates in order to more closely track the standard for shipper protests to an indexed rate; and to modify the requirements for protests to oil pipeline tariff filings in order to require that a protestant file a verified statement to support its claim of a substantial interest in the proceeding. The effect of these actions will be to provide a more accurate, timely, and balanced approach to oil pipeline ratemaking under the Energy Policy Act of 1992 and the Interstate Commerce Act.

EFFECTIVE DATE: The amendments to Part 341 are effective September 7, 1994, and the amendments to Parts 342 and 343 are 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, (202) 208-0224.

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 proposed 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.

[¶ 31,000]

59 F.R. 40243 (August 8, 1994)

18 C.F.R. Parts 341, 342 and 343

[Docket No. RM93-11-001; Order No. 561-A]

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

Issued July 28, 1994

AGENCY: Federal Energy Regulatory Commission, Energy.

ACTION: Order on rehearing.

SUMMARY: The Federal Energy Regulatory Commission is amending its regulations to revise the requirements for filing suspension supplements of oil pipeline tariffs in order to provide additional time to file suspension supplements; to modify

[13] 5 U.S.C. § 533(b)(1988).

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

Order No. 561-A

Order on Rehearing

FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 31,000 (1994)

affirmed, Association of Oil Pipe Lines v. FERC, 83 F.3d 1424 (D.C. Cir. 1996)