Williams Pipe Line Company
75 FERC ¶ 63,016 (1996)

In Phase I of this case, Williams Pipe Line Company successfully proved that it lacked market power in certain of its markets. Williams now charges market-based rates in those markets, free of Commission rate review. The instant case, Phase II, involves the setting of base rates for Williams' remaining markets. These rates will serve as a basis for indexing pursuant to the Commission's oil pipeline indexing rules.

Williams relied on a Constrained Market Pricing (CMP) methodology to support its rates, whereby all rates are set by the marketplace, subject only to certain "floors" and "ceilings." The floors used were short run incremental costs and short run marginal costs, while the ceilings used were Williams' Opinion No. 154-B cost of service and the cost of a new stand alone pipeline. According to Williams, any rates between the floors and ceilings should be deemed just and reasonable. The Judge rejected the CPM methodology for several reasons.

First, Williams relied heavily on ICC railroad precedent, which has little or no application to the transportation of oil by pipeline.

Second, the Judge rejected the floors advocated by Williams as not meaningful and too unrealistic to be used in a rate-setting context. The proposed ceilings were also flawed. The Opinion No. 154-B total company cost of service was not limited to jurisdictional costs, nor did it serve to demonstrate the reasonableness of any of Williams' individual rates. The stand alone cost standard is an unprecedented ratemaking concept that was effectively rejected in Opinion No. 154-B (under the title of replacement cost). In addition, the Judge found it unreasonably speculative and difficult to administer.

Third, as suggested above, the Judge concluded that Williams' methodology failed to separate interstate and intrastate costs, or products costs from crude and propane costs. He found there was nothing in the record upon which to base a proper allocation of costs to Williams' interstate services.

Fourth, the Judge concluded that Williams' overly low floors and excessively high ceilings would result in de facto deregulation in markets acknowledged to be noncompetitive.

Although he rejected Williams' base rates, the Judge nevertheless addressed a number of cost of service (test year adjustment, rate of return, ADIT and deferred earnings) issues.

Williams Pipe Line Company
Initial Decision
75 FERC ¶ 63,016 (1996)

# [¶ 63,016]

**Williams Pipe Line Company, Docket Nos. IS90-21-000, IS90-31-000, IS90-32-000, IS90-40-000, IS91-1-000, SP91-3-000, SP91-5-000, IS91-21-000, IS91-28-000, IS91-33-000, IS92-19-000, and IS92-22-000**
**Enron Liquids Pipeline Company, Docket Nos. IS90-39-000, IS91-3-000, and IS91-32-000 (Phase II)**

**Initial Decision**

**(Issued May 29, 1996)**

**Jerome Nelson, Administrative Law Judge.**

*Appearances*

*Kevin M. Hawley* and *Lawrence A. Miller* for Williams Pipe Line Company

*Gordon R. Gooch, Dena Eve Wiggins* and *Glenn Benson* for Texaco Refining & Marketing, Inc.

*Kelly A. Daly* and *David D'Alessandro* for Total Petroleum, Inc.

*Russell B. Mamone* and *Irene E. Szopo* for the Staff of the Federal Energy Regulatory Commission

## I. Procedural Background

Williams filed a series of rate changes, culminating "in an increase of approximately 13 percent on an overall basis, . . ." (Br., p. 2). The company then chose a two-phase adjudication, an option made available by *Buckeye Pipe Line Co.*, 44 FERC ¶ 61,066 (1988), order on rehearing, 45 FERC ¶ 61,046 (1988). In Phase I, Williams successfully proved that it lacked market power in certain places. The Commission concluded that for this reason "no further rate review is required" in those markets. *Williams Pipe Line Co.*, 68 FERC ¶ 61,136, at p. 61,696 (1994); 71 FERC ¶ 61,291, at p. 62,149 (1995).

The instant Phase II involves rates in the remaining markets, where Williams was unable to make such a competitive showing.[1] For these captive "noncompetitive markets"[2] (*Id.* at p. 62,147), the Commission directed the setting of "base rates." These will "serve as the basis for indexing" under the Commission's new regulations, which place ceilings on oil pipeline price increases according to a particular price index. 18 C.F.R. Part 342. *Williams Pipe Line Co.*, 72 FERC ¶ 61,276, at p. 62,203 (1995).

Hearings as to the proposed base rates were held in December of 1995, and January and February of 1996. After receiving Briefs and Reply Briefs, oral argument was held on April 3 and 4 of this year.

## II. Williams' "Constrained Market Pricing" (Floors and Ceilings)

Williams rests its entire case on a methodology labeled "Constrained Market Pricing" (CMP), whereby all rates are set by the marketplace—subject only to certain "floors" and "ceilings." Rates between the floors and ceilings, are automatically deemed just and reasonable.

Williams thus announces the test, defines the floors and ceilings, and then blesses its own rates.

This approach does not focus on the development of individual rates—i.e., the specific

[1] Des Moines, Grand Forks, Duluth, Rochester, Sioux City, Topeka, Grand Island, Sioux Falls, Aberdeen, Cedar Rapids, Waterloo, and Ft. Dodge.

[2] The company calls these markets "less competitive."

price for transportation to or from any particular market, let alone those for the twelve non-competitive markets in issue here. Williams rested solely on this CMP; it did not allocate any costs in any way, and produced almost nothing about the details, bases, or particularized rationale for any specific jurisdictional rate between any two points. Williams used only its "floors" and "ceilings" to produce an asserted system-wide reasonableness.

According to Williams, ". . . a pipeline is permitted to recover its cost-of-service on a system-wide basis, and its rates are allowed to vary between a minimum of some measure of marginal or incremental cost and a maximum of the stand-alone cost ("SAC") of the most efficient hypothetical substitute, with market forces determining the exact level of rates within those bounds." (Br., pp. 30-31). The CMP methodology sets up a "four-legged stool" by which the reasonableness of its rates can be tested (Tr. 11209).

Williams defined the "floors" (two legs of the stool) as short run incremental costs and short run marginal costs. The two ceilings consist of Williams' cost of service, calculated in accordance with FERC Opinion 154-B, *Williams Pipeline Co.*, 31 FERC ¶ 61,377 (1985), and the cost of a SAC pipeline. Applying this self-announced test, the pipeline argues that all of its rates are just and reasonable, because they are above the floors, and because the total earned by its system-wide rates does not exceed the lower of the ceilings.

A. *Misplaced Reliance on ICC Rail Precedent*

Williams relies heavily on ICC railroad precedents (Br., pp. 30-33). But this oil pipeline case is being conducted "[p]ursuant to 49 U.S.C. § 15(7),"[3] a statute which governs oil pipeline rates, not railroad rates. Its title reads: "Commission to determine lawfulness of new rates . . .; suspension; refunds; *nonapplicability to common carriers by railroad subject to chapter*" (emphasis added), and its last sentence states: "[t]his paragraph shall not apply to common carrier railroads subject to this chapter."

Section 15(7) has long been inapplicable as to railroads; it remains in effect only as to the transportation of oil by pipeline (See Revised Interstate Commerce Act, P.L. 95-473, 92 Stat. 1470 (1978). As the ICC itself explained in *Ashley Creek Phosphate Company v. Chevron Pipe Line Company*, 1992 ICC LEXIS 58 at p. 17 (1992), recognizing that FERC oil pipeline orders were not binding on it, "oil pipeline rates continue to be the subject of the 'just and reasonable' standard of the old, pre-codified" Interstate Commerce Act.

The ICC's "constrained market pricing" precedents rest on two statutes: the Railroad Revitalization and Regulatory Reform Act (4R Act) (45 U.S.C. § 801 *et. seq.*) and the Staggers Rail Act of 1980 (former 49 U.S.C. § 10101, *et seq.*). *See Consolidated Rail Corp. v. United States*, 812 F.2d 1444, 1448 (3rd Cir. 1987), sustaining *Coal Rate Guidelines*, 1 ICC.2d 520 (1985). These statutes reflect findings, policies and purposes which were tied to particular railroad problems, and do not apply to pipelines.

Among the express purposes of the 4R Act, for example, were the following:

> to improve the operations and structure, and restore the financial stability of the railway system of the United States, and to promote the revitalization of such railway system . . . through ratemaking and regulatory reform. (45 U.S.C.801(a)).

The Staggers Act had similar promotional purposes (P.L. 96-448, Sec. 3):

> to provide for the restoration, maintenance, and improvement . . . and financial stability of the rail system . . . to assist the railroads of the nation in rehabilitating the rail system . . . to assist the rail system to remain viable . . . .

These statutes were written in the context of serious railroad financial problems. At the time of the 4R Act, "[e]ight major carriers in the Northeast and Midwest are bankrupt; several elsewhere in the country are in precarious financial condition and one is bankrupt" (S. Rept. No. 94-499, p. 3). Similarly, in recommending the Staggers Act, the relevant House Committee recognized that Congress "has had to address both the Milwaukee and Rock Island bankruptcies through special legislation", and that "[n]early 30 percent of the railroad business is today carried whole or in part by financially weak railroad carriers" (H. Rept. No. 96-1035, pp. 36-37).

There is no corresponding Congressional intent to "improve", "promote", or "assist" oil pipelines. Nor are such carriers "bankrupt" or in "precarious financial condition." Williams' attempt to import railroad doctrine into oil pipeline regulation lacks an analogous basis. Rescue tools drawn from the statutory railroad "restoration" scheme have no particular applicability to oil pipelines.[4]

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[3] *Williams Pipeline Co.*, 50 FERC ¶ 61,179, at p. 61,523 (1990).

[4] Moreover, even the *Coal Rate Guidelines* anticipated only a limited use of CMP, and not a formula

B. *Defects in Williams' Method*

1. Floors

As noted, Williams' chosen floors are the "short run marginal cost" (SRMC) and the "short run incremental cost" (SRIC). The SRMC test tries to identify the costs that would be incurred (or saved) in the short-run by adding (or subtracting) a marginal volume of traffic. Williams defined "short-run" as a year, which the company says corresponds to its rate review cycle (Exs. 28, p. 45; 80, p. 7).

Williams' SRMC study of all possible physical routes on Williams' system (Ex. 1, pp. 38-50, RGvH II-6) reflects some operating and maintenance costs, as well as some general expenses, which the company then converted into individual variable unit numbers. All of Williams' existing rates exceeded these numbers. (*Id.*).

Another Williams' witness performed a short run incremental cost study of the thirty-seven terminals on Williams' system (Ex. 79). The study combined the net liquidation value and the short run avoidable costs associated with each terminal[5] to determine the SRIC floor (*Id.*). The actual revenues pertaining to each terminal exceed these floors, and therefore, according to Williams, the terminal should remain in business (*Id.*).

These methods do not produce meaningful floors for base rates involving the twelve markets in issue. Williams' principal witness conceded that oil pipelines had never before used marginal or incremental costs as a basis for setting rates, and that no oil pipeline could expect to stay in business if it set rates in accordance with Williams' floors: "I would dare say it is only a matter of time before you would be driven out of business." (Tr. 11024-25).

Williams' one-year "short-run" approach, of course, creates low floors. Because they are "short run," the floors fail to include fixed and common costs; nor do they encompass depreciation, return on equity or other such costs (Tr. 11024-25). Actual rates must recover a reasonable amount of the fixed and common costs; otherwise Williams would cease to remain a viable business. Finally, this "short term" notion is incongruous in any event. All of the rates proposed by Williams have long-run implications; indeed, the rates at issue in this proceeding were first filed in 1990 (See Ex. 90).

2. Ceilings

(a) *Cost of Service Ceiling*

It is undisputed that Williams' system-wide revenues are substantially less than its system-wide Opinion 154-B cost of service. Therefore, says Williams, all of its rates are just and reasonable (Br., pp. 44-45).

The conclusion does not follow. This total cost of service includes all costs of everything—intrastate, interstate, crude, LPG, as well as the "products" in issue here (Tr. 12735-36). There was no effort even to match relevant costs with relevant revenues. In any event, the fact that total revenues produced by all of the rates may be lower than total costs sheds no light on the propriety of any particular rate—and thus proves nothing in assessing the reasonableness of the rates for the twelve noncompetitive markets. Such rates could well be unreasonably high—while company-wide revenues nevertheless remained below company-wide Opinion 154-B costs. There is no authority for the proposition that this cost of service somehow blesses all individual rates, and I am not convinced that it does.

(b) *Stand-Alone Cost Ceiling*

Williams constructs a hypothetical "stand-alone cost" (SAC) pipeline as another form of a ceiling (Ex. 81): an imaginary pipeline that would serve the 12 captive markets at the same level of service as Williams' existing system (Br., p. 45). Williams estimates the annual revenue requirement of this SAC pipeline to be $176.8 million, (Ex. 81, p. 15; Tr. 12108), and argues that because the revenues generated by Williams in the 12 captive markets ($49.2 million, Ex. 81, p. 15) are less than that $176.8 million, its rates for the markets are just and reasonable (*Id.*; Tr. 12109).

There are significant weaknesses in Williams' SAC test. First, it bears an uncanny resemblance to "replacement cost," a concept squarely rejected by this Commission in Opinion 154-B, as a basis for justifying oil pipeline rates. *Williams Pipeline Co.*, 31 FERC ¶ 61,377, at pp. 61,833-835 (1985).

A SAC test for oil pipelines is wholly unprecedented. With the exception of the ICC in railroad coal rates, neither FERC, nor any other regulatory agency, has apparently ever adopted the SAC test. Indeed, when asked if any regulatory agency other than ICC had

(Footnote Continued)

for all railroad ratemaking. The ICC there stated "[w]hile we are adopting the CMP methodology for determining coal rate reasonableness, we fully expect the number of instances in which the guidelines need be applied are relatively few" and ". . . the need for CMP guidelines is expected to decline even further." *Coal Rate Guidelines*, 1985 ICC LEXIS 254 at p. 4.

[5] The short run avoidable costs consist of specific costs that would have been avoided if the terminal was shut down (Ex. 79 at TRG3.D203; Tr. 12,066). These costs include operation and maintenance costs, employees salaries and benefits, as well as marketing and division office costs (*Id.*; Tr. 12,067).

"ever appl[ied] the stand alone cost methodology to any rate case," Williams' expert could say only (Tr. 11290):

> It has come up in a number of state rate cases. I don't know whether or not—I can't tell you for certain whether or not—I have seen it proposed or heard it discussed. I'm not sure. I have not reviewed the state regulatory cases to see to what extent it has gone anywhere. It certainly has been proposed.

In addition, hypothesizing the construction of a stand-alone cost pipeline in every oil rate case could be an administrative nightmare. Oil pipeline companies and shippers would have to construct hypothetical pipelines each time new rates were in issue. Every detail concerning the construction of the pipeline, from the type of pipe utilized, to the amount of an employee's salary, could become a time-consuming issue. Even the ICC recognized that the cost of developing the SAC evidence could be prohibitive and outweigh whatever benefits that might be achieved. *See McCarty Farms v. Burlington Northern*, 3 ICC 2d 822 (1987) (Ex. 34, pp. 41-42).

The SAC concept is also speculative. There was no evidence that anyone was even thinking of, let alone planning to, actually build a SAC pipeline serving these markets (Staff Br., p. 27). A staff witness testified that there were no possible entrants into the captive marketplace, hypothetical or otherwise (Ex. 120, pp. 20-21). Evidence of the actual rates of the competitors which Williams claims to have in the twelve markets would have been superior to the problem-ridden, hypothetical SAC pipeline analysis.

Williams offers the SAC as "the most efficient hypothetical substitute" (Br., p. 30), relying on *Coal Rate Guidelines, supra*, which describe the hypothesis in "least cost" terms.[6] But Williams' SAC pipeline cannot be the "most efficient" or "least cost" alternative, when its costs are such as to require $176 million annually from markets which now produce only $49 million. To recover its costs, such a SAC ceiling would justify rates 300% higher than those presently being charged by Williams in markets already found to be noncompetitive.

Williams' SAC has further flaws. It reflects costs of moving some intrastate, as well as interstate goods (Tr. 12987). In addition, it deals with the generalized cumulative cost of a hypothetical new pipeline serving all of the captive markets (Ex. 81, p. 5). The ceiling tells us nothing about the reasonableness of any particular rate to or from any of the captive markets.

Williams responds that the burden is on the shipper to request a SAC analysis for any particular movement on Williams' system (Tr. 12845-12846). The statutory burden of proof is on Williams to prove that its rates are "just and reasonable". 49 U.S.C. 15(7). A rate "ceiling" which forces shippers to envision and quantify hypothetical new pipelines in order to challenge rates is an evasion of that burden. Indeed, Williams' approach could create a substantial deterrent to shippers ever attacking oil pipeline rates. Such a result has no basis in the statute, the regulations, or any FERC precedent.

3. Failure to Allocate Any Costs in Any Way

The rates in issue pertain to interstate movements of refined petroleum products. Williams also carries intrastate shipments, and its loads include presently irrelevant shipments of crude oil and propane. Despite these boundaries on the case, Williams made no effort to separate its interstate costs from the intrastate, or the "products" costs from the crude and propane.

Once again, the company argues that the rates are just and reasonable so long as its floors-and-ceilings tests are satisfied, and there is no need for any kind of allocation. For the reasons shown above, these tests do not prove the lawfulness of the rates. Moreover, the floors and ceilings are especially useless for the purposes of sorting out what counts from what does not. Williams' cost of service "ceiling" reflects costs from all sources, unallocated as to interstate, intrastate or product, and its "floor" similarly lumps together interstate and intrastate costs (Tr. 12735-36; 12982).

Williams says that all cost allocation is merely "accounting manipulation" and "inherently arbitrary" (Br., p. 49). But these alleged weaknesses do not justify regulation in a vacuum, whereby the Commission knows nothing about the relevant universe of costs involving particular oil pipeline rate increases. Why should rates for particular captive interstate markets, for example, be set under numbers which include unknown amounts linked in unknown degrees to nonjurisdictional or irrelevant traffic? Shippers in these particular noncompetitive interstate product markets—the very payers of the base rates to be set here—should not have to pay more than their share of costs.

Without trying to clear away the irrelevant costs, so as to focus on what is really in issue, there is no place to start. Williams should have made some attempt, under some method, to separate the chaff from the wheat for regula-

[6] 1985 ICC LEXIS 254 at p. 54.

tory purposes; it failed completely to do so here.

In contrast to Williams, Staff and Texaco saw the need to allocate costs, but did so on a volumetric basis, treating every barrel as costing the same, no matter how far it may have travelled. See Ex. 120, p. 17 (Staff) and Ex. 86, p. 19 (Texaco). But distance cannot be so ignored. Williams transports "petroleum products from various origins to numerous destinations in an extensive service area in Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota and Wisconsin" (Ex. 1, p. 4). "The largest part of Williams' business is the *transportation* of petroleum products . . . from several major refining centers to destinations scattered throughout its service area" (*Id.*, emphasis added). It is undisputed that Williams operates more than 8,000 miles of pipeline (Br., p. 1).

Williams' principal witness recognized that the company's rates almost invariably increase with distance (Ex. 3, p. 42) and its rate structure has long been generally distance-related (Br., p. 57). The Staff's evidence recognized the impact of distance on costs. Mr. Penix's conclusions, while resting on the pure volumetric approach, nevertheless acknowledged that approximately 80% of Williams' cost of service is distance-sensitive (Ex. 122, col. 1, rows 7-8; Ex. 82, p. 20).[7] The Staff's Ms. Pride later did particular allocations involving barrel-miles for most of the transportation costs; but she started with Mr. Penix's universe which, as noted, was itself produced by using the defective volumetric method.

This record—reflecting Williams' failure to allocate anything, coupled with Staff and Texaco's decision to use pure volumetric methods—provides no meaningful basis for even a "first cut," where Williams' interstate product costs could be separated from non-germane costs. Because there is no way to take this first step, there is certainly no way to construct a "rate design," which would address subsidiary questions about how much of the relevant whole should be borne by whom.

4. De Facto Deregulation

As noted, Williams' short-run floors are so unrealistically low that they would concededly drive a pipeline out of business. The $176 million hypothetical new pipeline (which no one wants to build) is so high as to authorize a 300% price increase in markets which are already noncompetitive.

These overly low floors, together with the excessively high ceilings, produce a range so wide as to practically deregulate the prices. The Commission has already authorized market based rates in areas where Williams lacks market power (68 FERC ¶ 61,136; 71 FERC ¶ 61,291), specifically approving "light handed regulation in markets found competitive" (Opinion 391, 68 FERC at p. 61,695). To do the same thing here—for the noncompetitive markets—stands FERC's policies on end. The Commission directed this proceeding "for the purpose of establishing base rates for the [twelve] markets where Williams has failed to establish that it lacks market power" (Opinion 391-A, 71 FERC at p. 62,149). The agency cannot have meant by this language to turn Williams' pricing over to a range so broad that it establishes no rates and creates almost no regulation.

The burden is upon the company to prove the justness and reasonableness of its rates. 49 U.S.C. 15(7). Nothing in this record allows for examination of the reasonableness of any individual rate proposed by Williams. The company's reliance on the broad range created by the low floors and high ceilings fails to carry the burden. The floors and ceilings do not establish just and reasonable base rates for the noncompetitive markets.

Williams points to certain language in Opinion 391-A as supposedly supporting its floors and ceilings: "[t]hese issues can also be considered, for example, by examining the cost and revenue contributions of relevant services or markets." 71 FERC ¶ 61,291, at p. 62,146 (1995). This sentence appears in the context of price discrimination questions, and in any event does not set out some magic formula for just and reasonable rates. Neither the language nor its paragraph says anything about floors and ceilings, constrained market pricing, or minimum and maximum levels.

The Commission did say that it had not prejudged Williams' method, and that the pipeline could "present any method it chooses for arriving at just and reasonable rates for the markets we have determined to be noncompetitive" (71 FERC at p. 62,148). Williams has now "presented" that method; it has been tried and

[7] Texaco argues for volumetric allocation because Williams is an "open stock" pipeline, some barrels do not travel the full tariff or "book" distance, and the exact distance travelled by molecules in any particular barrel is unknown. Notwithstanding this "open stock" operation, the products do generally travel about 94 percent of the distance shown on the tariff (Ex. 3, p. 24). Williams' "open stock" service differs from physical transportation "only by a relatively modest proportion" (*Id.*) Texaco did not dispute the fact that the average barrel travels 369 miles on Williams (Tr. 12962-63), and for interstate movements to the twelve captive markets in issue, the average length of haul is 445 miles (Ex. 3, p. 17).

found wanting. Perhaps all of the details of traditional cost allocation may not be required; but something beyond these general floors and ceilings is necessary in order to find that particular rates in the particular twelve noncompetitive markets are just and reasonable.

### III. Failure of Showing as to Cross Subsidies

The Commission directed "particular attention" be given "to the allocation of costs between the competitive and noncompetitive markets to ensure that the customers in the noncompetitive markets do not subsidize customers in the competitive market" (Opinion 391, 68 FERC at p. 61,695). The agency later explained that there was no "single sanctioned method" for resolving the question; the task could involve cost-of-service or point-to-point cost allocations, or, alternatively, "examining the cost and revenue contributions of relevant services or markets" (Opinion 391-A, 71 FERC at p. 62,146).

Williams argues that because "the rates for each movement on Williams . . . make some contribution to overhead, [fixed costs] the shippers to the less competitive markets are, by definition, not subsidizing those to the 20 workably competitive markets" (Br., p. 68). The pipeline cites no FERC case for this self-announced "definition." That discounts have been "recognized as benefitting captive customers, so long as the non-competitive customers contribute something to carrier costs" (Opinion 391-A; 71 FERC at p. 62,146) does not decide the issue. That discussion was not in the context of cross subsidy allegations (*Id.*). Moreover, the statement simply acknowledges that any contribution constitutes a benefit. That "something" is better than nothing does not mean that "some" contribution, no matter how small, automatically eliminates any question of cross subsidization.

If the captive customers contributed 99% of the overhead, while the competitive customers contributed 1%, the captives would be bearing an apparently disproportionate share of the costs, and seemingly cross subsidizing the others. Of course, competition lawfully enters into the design of the rates, and on an appropriate showing, that consideration might even justify a 99/1 assignment. The issue is one of degree; but that is for case-by-case development, as a particular pipeline shoulders its burden. If there is a simple automatic test for cross subsidization on oil pipelines, the Commission has yet to announce it.

Williams' case as to the non-existence of cross subsidies consisted almost entirely of repeated conclusory and unparticularized assertions: that its rates were just and reasonable because they were set by competitive considerations, because everyone contributed something to overhead, and because they were within the allegedly decisive floors and ceilings. None of Williams' rates "are below the appropriate measure of the associated marginal costs. Hence, . . . there are no 'cross subsidies' " (Ex. 1, p. 33). Differences were not cost-based, and some "are justified solely by competition" (*Id.*). Captive markets were not being "held responsible" for any revenue shortfall; "[i]t is Williams' position that rates to all of its markets should make as much of a contribution to Williams' overall revenue requirement as competition will permit" within the floors and ceilings (*Id.*, p. 32-33).

Williams' economist spoke in similar generalities: Williams "set rates that take into account the competition it faces in all 32 markets that it serves" (Ex. 30, p. 13). He mentioned the "level of competitiveness" and relative shipper influence as among the relevant factors (Tr. 11327-28). He did not explain how the company took "account" of competition in any particular market, what the level was; nor did he describe what constituted "significant" competition in any market, or what rates were "somewhat higher."

Williams' witnesses never came to grips with particular prices, particular places or particular competition. If competition justifies differentials, there must be at least some details. What competition? How was it accounted for? What calculations and judgments were made in setting particular prices? The company never addressed these or other details, but was instead content simply to reiterate general principles: everything was all right because of competition, because of "some" contribution to overhead, and because of the floors/ceilings.

In 1991, the noncompetitive markets accounted for 38% of the relevant interstate product volumes, while contributing 46% of the relevant revenue (Tr. 12928-30). Williams contends that this surface disparity can be explained by "differential pricing," whereby rates were "driven down" in the competitive markets, where there are more alternatives for shippers (Tr. 12931-32). But despite Williams' burden, the details of that ratemaking are not here. To find no cross subsidization in these circumstances would endorse Williams' rates solely because the company says they are valid. That is the antithesis of "particular attention,"

which the FERC ordered here (Opinion 391, 68 FERC at p. 61,695).[8]

## IV. Other Issues

### A. *Introduction*

As explained, Williams rested entirely on its "floors" and "ceilings" theory as justifying the rates in issue. Because that case failed, various other issues need not be decided here. But remand is always possible, especially where, as here, the questions are ones of first impression. Moreover, Williams could start a new case with a new filing, where some of the present questions might well recur. In the interest of possible future efficiency, I add this "Other Issues" section.

### B. *Cost of Service Issues*

#### 1. Test Year Adjustment

Williams and Staff stipulated to a cost of service of $239.3 million, utilizing 1991 as the test year (Ex. 113). Texaco urges 1990 as the appropriate test year, arguing that for every year between 1990 and 1994, with the exception of 1991, the volumes leaving Williams' system, exceeded the volumes received by the company (Ex. 9; Br., p. 16). Williams could not effectively explain this situation (Tr. 10830, 12720). Texaco sees this overage as reflecting significant revenue to Williams, and seeks as a minimum an adjustment to the 1991 cost of service to account for it: the difference between volumes in and volumes out between 1990 and 1992 should be averaged and credited to the stipulated cost of service at $.53 a gallon (Br., p. 16; Reply Br., pp. 6-7). This calculation would reduce the stipulated cost of service by $13,875,400.

A proper "test year" fairly reflects typical activity on a company's pipeline. The discrepancy between the excess volumes in 1990, 1992, 1993 and 1994, as compared to 1991, demands a correction. For the five year period (1990-1994), the overage is typical, not atypical.

It is permissible to make adjustments to the cost of service calculation, if a particular estimate reflects a substantial deviation from actual numbers that would result in unreasonable rates. *Southwestern Public Service Co. v. FERC*, 952 F.2d 555, 558 (D.C. Cir. 1992). It is also consistent with Commission policy to use data outside the test year in cases where there are "known and measurable changes of a substantial nature". *National Fuel Gas Supply Corp.*, 51 FERC ¶ 61,122 (1990). The burden is on Williams to demonstrate why an adjustment should not be made; in essence, to explain why these overages occurred. *Public Service Co. of Indiana v. FERC*, 575 F.2d 1204, 1216 (5th Cir. 1978). As noted, the company has no such explanation.

If it is later necessary to use the stipulated $239.3 million cost of service, that figure should be adjusted to reflect the average of excess volumes released from Williams' system between 1990 and 1992 at $.53 a gallon. The appropriate cost of service would then be reduced from the stipulated $239.3 million to approximately $226 million.

#### 2. The Settlement

Originally Williams and Staff submitted conflicting evidence concerning various cost of service issues, as calculated under the Opinion 154-B methodology (31 FERC ¶ 61,377 (1985)). As explained, the Staff and Williams later stipulated to a cost of service (Ex. 113). The stipulation reflects compromise on basic elements embodied in the cost of service, including depreciation, accumulated deferred income tax (ADIT), deferred earnings, rate of return, rate base, allowance for funds used during construction and amortization (Ex. 113, pp. 1-2; Williams' Br., pp. 36-37; Staff Br., p. 17).

Texaco argued that under its "filed rate doctrine" theory (*see infra*), cost of service was irrelevant and immaterial (Tr. 10568, Br., p. 22). But if this theory was rejected, Texaco took the position that it could then revive the Staff's original claims and argue all elements of cost of service (Tr. 12509). Because Williams failed to prove its rates to the noncompetitive markets to be just and reasonable, there is certainly no requirement for further analysis of Texaco's attempt to embrace the Staff's case for back-up defensive use.

The stipulation, as adjusted *supra*, seems to be a just and reasonable settlement of cost of service issues. The Staff and the pipeline were adversaries, who bargained at arms' length. The stipulation details a "give and take" between the parties and compromise on all relevant components. Each item is listed and the specific areas of compromise are fleshed out (See Ex. 113). Nothing in Texaco's remaining challenges would be sufficient to justify scuttling the settlement, if it were necessary to reach the question.

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[8] Williams' rates have collapsed due to the failure of its floors/ceilings. Since the rates themselves are defective, there is less significance to questions of cross-subsidization allegedly embraced by them, and thus no need for discussion of Williams' evidence of "averages" and "regression analysis," supposedly showing some harmonious relationship between the competitive and noncompetitive markets.

3. Rate of Return

The stipulated real rate of return on equity is 9.9 % (Ex. 113, p. 2). Originally, staff recommended a 9.55% real equity return, whereas Williams' witness Dr. Kolbe recommended 10.5% (Williams' Br., p. 37; Ex. 116). The rate settled on reflects a number close to the midpoint of the above range. The Commission has endorsed this approach in dealing with rate of return and other cost estimates. *See e.g., Tennessee Gas v. FERC*, 926 F.2d 1206, 1209 (D.C. Cir. 1991); *Northwest Pipeline*, 71 FERC ¶ 61,253, at p. 61,992 (1995); *Vermont Yankee Atomic Electric Co.*, 40 FERC ¶ 61,372, at p. 62,192 (1987).

Texaco advocates staff's original 9.55% real return on equity, instead of the stipulated 9.9% (Br., p. 22; Ex. 116). Rate of return is far from an exact science. *National Fuel Gas Supply Corp.*, 51 FERC ¶ 61,122, at p. 61,342 (1990). Texaco's unfocused urging of a different percentage, without any reference to its strengths or weaknesses—and without any evidence of its own—would not warrant a refusal to accept the bargained-for rate. Texaco has done nothing more here than to refer to the Staff's earlier position—now abandoned by its own sponsor. *See Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 553 (1997): ". . . it is still incumbent upon intervenors who wish to participate to structure their participation so that it is meaningful, so that it alerts the agency to the intervenors' position and contentions." Texaco has offered no meaningful support for a 9.55% real return on equity (Br., pp. 10-13, 22).

4. ADIT and Deferred Earnings

Texaco quarrels with Dr. Kolbe, a Williams' witness (Br., pp. 22-23), who made certain recommendations concerning the treatment of ADIT, and additions to rate base to account for "deferred earnings" (Tr. 11577-78). The stipulation makes no use of Kolbe's views on these issues; it does not increase rate base by any "perceived shortfall" relative to Williams' cost of equity (Ex. 113, p. 2).[9] Williams' brief (p. 38) acknowledges:

> Nor are Dr. Kolbe's recommendations reflected in the Stipulation between Williams and Staff. Hence, although Williams believes that Dr. Kolbe's recommendations are economically sound, Williams has not asked that they be implemented in defense of the rates at issue in this proceeding. Accordingly, there is no reason whatsoever why these recommendations should be addressed by Williams, by Texaco (unless Texaco believes they should be implemented in this case) or by the Presiding Judge.

In any event, the Commission mandates the trended original cost methodology, which encompasses some deferred earnings in the calculation of rates. (Opinion No. 154-B). The stipulation handles deferred earnings in a manner consistent with Commission precedent (Ex. 113, p. 2), and does not live up to Texaco's fears.

Texaco's concern that using Dr. Kolbe's ADIT recommendation will increase the rate base (Br., p. 23) is especially ill-founded. ADIT is normally used to reduce a company's rate base. Kolbe would have eliminated this reduction. The stipulation flatly rejects Kolbe's view, and on its face, employs large sums of ADIT to reduce rate base (approximately 81 million dollars) (*See*, Ex. 113, at Schedule 2, Ln.28 and Schedule 3, pp. 1-2, Ln.13).

C. *Other Texaco Issues*

1. The Filed Rate Doctrine-Revenue Methodology

Throughout the case Texaco urged the "filed rate" doctrine, as somehow directing that Williams' revenue projections created a cap for ratemaking. Because Williams failed to prove its rates to be just and reasonable, there would ordinarily be no need for adjudication of this "filed rate" defense. However, Texaco's persistent belief in this theory suggests its likely reappearance. For that reason, I discuss its merits.

Texaco says that a "public utility is limited to the lower of its cost of service or the revenues generated by the rate it files" (Br., p. 23). Because Williams' rates were projected to produce revenues below its cost of service, the "filed rate" doctrine supposedly converts those revenue projections into the equivalent of a cost of service ceiling (Br., pp. 23-24; Reply Br., pp. 7-8; Tr. 12734-35).

Under this theory, Williams could not charge rates that would yield more than its projected revenues. Here, the adjusted cost of service is $226 million, whereas the revenues Williams projected for the year 1990 were estimated at $145 million (Ex. 6). Texaco thus argues that the cost of service should be treated as though it were $145 million, as opposed to the $226 million (Br., pp. 23-24).

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[9] Dr. Kolbe first recommended that the amount of any test year "shortfall" relative to Williams' cost of equity should be added to the Opinion No. 154-B "deferred earnings" account, so that "investors have a fair opportunity to earn their cost of capital in the long run." Ex. 68, pp. 6-7, 67. Dr. Kolbe's second recommendation was that ADIT should be deducted from Williams' rate base only if, and to the extent that, they have been funded by shippers. *Id.*, pp. 7, 68-69.

There has been a long tradition at FERC of cost-based ratemaking[10]. Although the terms "revenue requirement" and "cost of service" are sometimes used interchangeably, there is no authority in that long history for ever using a company's "revenue projection" as a ratemaking ceiling. Indeed, Texaco's own witness testified that in a typical gas pipeline case, one would look at cost of service in order to determine a pipeline's revenue requirement (Tr. 12214).

Shortly after filing the rates in issue, Williams submitted a volume of "top sheets" (detailed settlement papers) to the Staff (See Ex. 92). Those documents included a revenue forecast (*Id.* at WII 12329), where "Williams projected what it thought it would earn on these new rates" (Tr. 11108). Later in Phase I, Williams' testimony reflected a similar prediction (Ex. 6). Texaco relies on these projections as triggering a "filed rate doctrine" cap (Br., p. 24).

The "filed rate" doctrine prohibits a regulated entity from charging rates for its service other than those on file with the appropriate regulatory agency. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981). The rule prohibiting retroactive ratemaking is derived from the filed rate doctrine. The rule "bars. . .the Commission's retroactive substitution of an [already filed] unreasonably high or low rate with a just and reasonable rate." *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979); see *Arkansas Gas Co.*, 453 U.S. at p. 578. Every rate at issue in this proceeding has been filed by Williams with the Federal Energy Regulatory Commission. (see *e.g.*, Ex. 90; Ex. 91). No party in this case is requesting that the Commission set rates retroactively. The filed rate doctrine in no way supports Texaco's use of Williams' revenue projections as a rate cap.

Williams' revenue projections do not constitute "filed rates." The top sheets do not go to the Secretary's office and are "never officially filed with the Commission" (Tr. 11113). They set out positions which are taken by the pipeline "for discussion/settlement purposes only" (Ex. 92, p. WII 12177). Nor were the top sheets required; they came into existence only because the Staff requested them (Tr. 11111-13). Williams states that its revenue projections were offered to Staff in Phase I of this proceeding, only to show that its revenues were estimated to be below its cost of service (Ex. 92; Tr. 12212).

Nor do the revenue totals constitute "rates." See, *e.g.*, section 6(1) of the Interstate Commerce Act, requiring public posting of schedules showing "rates, fares, and charges *for transportation*" (emphasis added). See 18 C.F.R. § 341.3(b)(7), requiring that for oil pipelines, "[r]ates must be stated explicitly in cents, or in dollars and cents per barrel or other specified unit." A company's total estimated gross from transportation is not a price "for transportation" and is certainly not set out in dollars per specified unit.

The only documents which qualify as "filed rates" in this proceeding are Williams' tariffs (Ex. 90; Ex. 91). These tariffs do not contain revenue projections.

Texaco's reliance on *FPC v. Tennessee Gas Co.*, 371 U.S. 145 (1962), is unfounded. *Tennessee* made no mention of revenue projections, requirements and/or their use as rate ceilings in replacement of a company's cost of service. The Court's reference to a company's responsibility for losses, when its "filed rate" was inadequate, does not apply to revenue forecasts. Williams is not attempting to make up for any past shortfall by requesting a retroactive rate (Br., p. 23). As shown, *supra*, the revenue projection is not a "filed rate." The rates filed with the Commission by Williams in its tariff sheets, like the gas pipeline's in *Tennessee*, are the "filed rates" at issue here. It is these rates that Williams must prove to be just and reasonable.

2. Joint Tariff Rates

Williams and other pipelines move certain volumes between particular points on each others' lines under "joint rates." As here relevant, the shipper pays Williams the total joint rate set out in published tariffs. Williams keeps its portion and remits the balance to the connecting carriers. The respective shares are called "divisions."

Texaco argues that these total joint tariff collections (said to be $18.9 million) should be deducted from Williams' cost of service (Br., pp. 25, 36-37), apparently on the theory that they exceed Williams' revenue projection, which Texaco sees as a "filed rate" cap on collections. As shown, the revenue projection cannot be so transformed, and this aspect of the joint rate challenge fails.

Texaco also challenged the respective "divisions" paid out of the jointly earned proceeds, as not sufficiently detailed or justified on this record. There is a dispute about whether this divisions challenge is cognizable in a section 15(7) rate case. Sections 15(3) and 15(6) of the Act do envision particularized adjudication of disputes about joint rates and divisions. Tex-

[10] See, *e.g.*, *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984) *cert. denied sub nom, Williams Pipe Line Co. v. Farmers Union Central Exchange*, 469 U.S. 1034 (1984).

aco's protest in the instant case concededly did not embrace issues involving the joint rates (Tr. 12790). Moreover, at least one order of the former Pipeline Board made clear that "only Williams' portion" of a proposed new joint rate was in issue here. *Williams Pipe Line Co.*, 57 FERC ¶ 62,026, at p. 63,034 (1991). In these circumstances, a proceeding under sections 15(3) and 15(6), triggered by a Texaco complaint, might be more appropriate for specific challenges to the joint rates and divisions.

3. Just and Reasonable Rates (El Dorado, discrimination, *etc.*)

Texaco argues that because El Dorado is grouped with several other Kansas and Oklahoma origins, Texaco barrels moving from its El Dorado refinery to certain destinations are unfairly charged the same rate as other lengthier and more costly routings (Texaco Br., p. 46). To cure this alleged impropriety, Texaco seeks a rate reduction.

The grouping issue raises questions on its face. As discussed *supra*, distance impacts costs; Williams itself has often acknowledged (*e.g.*, Tr. 12940-42). Indeed, the pipeline refers to its "existing and historic mileage-sensitive rate structure" (Br., p. 57). Yet Williams (again resting on its floors/ceilings defense) concededly introduced no cost evidence to justify the grouping (Tr. 13055). Why should Texaco pay the same as other more distant, and presumably more costly shippers, whose good fortune happened to land them in the same origin group?

Should the Commission agree that the floors/ceilings are not a simple mechanical determinator of all that is right in pricing, then the next step will be up to Williams. If the pipeline wants increases, it would have to make a detailed showing as to the justness and reasonableness of such a proposal. On appropriate challenge, Williams would have to develop the rationale for and particularized evidence supporting any such group pricing.

## IV. Conclusion

As to the twelve noncompetitive markets, Williams failed to prove that its increased rates, first filed on January 16, 1990, are just and reasonable. Those rates, are therefore, cancelled. The pipeline shall make appropriate refunds for amounts collected over and above the rates which were in effect on January 15, 1990. Pending any new rate filing, Williams' base rates for indexing purposes shall be those latter rates.