

B. Opinion No. 154-B's Cost Based Methodology

After remand from *Farmers II*, the Commission reevaluated both the reliance on competitive market forces as the principal check on oil pipeline rates and the Interstate Commerce Commission's valuation methodology to determine rate base. In Opinion No. 154-B, the Commission held that "[i]t is evident that oil pipeline rates as a general rule must be cost-based."¹²² The Commission concluded that the rate base methodology should be derived from the original cost of the investment as opposed to the cost to reproduce the investment at the time, and adopted a unique approach for oil pipelines.¹²³ A detailed description of the Commission's cost-based approach to oil pipeline ratemaking is provided in Opinion No. 154-B.¹²⁴

¹²² *Williams*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,833.

¹²³ *Id.*

¹²⁴ *Id.* Briefly, the opinion provided for a transition mechanism from the "fair valuation" methodology to determine rate base to the original cost less depreciation method. This transition mechanism (the "starting rate base") was made up in part from the pipeline's last Interstate Commerce Commission rate base valuation, and in part based on the pipeline's original cost of their capital investments less depreciation. *Id.* at 61,833-36. On a forward-looking basis, the pipeline's rate base is determined based on the original cost of the capital investment. *Id.* at 61,833. The original cost is determined by including inflation in the equity portion of the cost of the capital, but not in the debt portion, which is determined on a depreciated original cost basis. *Williams*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,833. With respect to rate of return, the equity portion of the rate base receives only a "real" equity rate of return, meaning one from which the inflation component has been extracted. *Id.* at 61,834. The debt portion of the rate base, on the other hand, is subject to a nominal debt return, reflecting the fact that the debt rate base does not include inflation. *Id.* at 61,835.