ALASKA LEGISLATURE COMMITTEE FILES 2007-2008 B072
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History of the State of Alaska's Pipeline Positions

- **Out Resourced**
  - Out litigated
  - Out negotiated
  - Out staffed
- **Limited Successes**
  - Never established a just and reasonable rate
- **Bad Settlements**
  - Negotiating away the basic right to ensure the settlement remains fair
  - TAPS Settlement
  - Feeder lines to TAPS (Depreciation/DR&R)
  - Murkowski Gas Line Agreement
  - CIPL
- **Restrictive Interpretation of Duty to Defend in the TAPS Settlement**
  - Forecloses the State from protesting TSM ceiling rates as unjust and unreasonable
  - Does not foreclose the State from clarifying that shippers have the right to request just and reasonable rates (TAPS Carriers' misrepresentations concerning the TAPS Settlement)
  - Does not foreclose the State from litigating issues not settled in the TAPS Settlement (DR&R)
  - Does not require the State to continue to litigate against shippers trying to get just and reasonable state rates (P-97-4, P-86-2)
- **No Clear and Consistent Policy or Client**
  - No clear policy concerning access
  - No clear policy concerning just and reasonable rates
  - No clear client. AS 42.06.140(a)(10) Attorney General—Attorney and Client

State of Alaska's Financial Stake

- 25 Percent of Refunds and Interest for 2005 and 2006.
- 25 Percent of Lower Refunds and/or Interest for 2007 Forward.
  - DOR Understates Benefit to State by Assuming Benefit Ends in 2008.
  - Example: $211.7 Million for 2007
    [($4.94 - $2.04) * 800,000 BPD] * 365 * 25%
- 25 Percent of DR&R Refunds

Lessons for the Gas Line

- Don't Leave Anything to the FERC
- Resource the Effort
- Get Gas for Alaskans
- Get Access Right
- Get Rates Right
- Have a Very Good Reason If You Decide to Give Control of the Line to a Few Major Producers (Alignment)
  - Impact on Access
  - Impact on Rates
  - Impact on State of Alaska's Power to Manage and Tax its Own Resources

Additional Materials

- **RCA's Order 151:**
  Order Rejecting 1997,1998,1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates; Requiring Refunds and Filings; and Outlining Phase II Issues (11/27/02)
  http://www.state.ak.us/rca/orders/pipeline/1997/p97004_151.pdf

- **Judge Suddock's Decision Affirming Order 151:**
  Decision and Order (01/19/06)
  http://rca.alaska.gov/data/docketDetail.html?docket=P-97-004A(1) at 012020060858327

- **Judge Cintron's Decision:**
  Initial Decision (05/17/07)
  http://elibrary.ferc.gov/idmws/file_list.asp?accession_num=20070522-0215
  Errata to Judge Cintron's Decision:
  Errata to Initial Decision (05/31/07)
  http://elibrary.FERC.gov/idmws/file_list.asp?accession_num=20070531-3066

From the desk of **Richard A. Fineberg**

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To: Members of the House Resources Committee Date: June 7, 2007

Re: Questions for Department of Law on TAPS Tariffs
(For Committee Members Only)

Here are 20 Questions for the Alaska Department of Law on TAPS Tariff and Tariff Management Issues. Additional information on each of these questions can be found in my prepared testimony for today's hearing (and on my web site).

I. Fiscal Impacts of TAPS Tariff Challenges on State Revenue

1. Fiscal Outcomes of Current Tariff Challenges.
   - A. Please identify the factors that account for the change in the Department of Revenue's latest refund estimates.
   - B. When did the Department of Law ask the Department of Revenue to quantify the impacts of the CY 2005 and CY 2006 tariff protests?
   - C. When tariffs for CY 2008 will not be filed until December 2007, how was the CY 2008 estimate derived?
   - D. When actual tariff data exists for CY 2005 through CY 2007 but future tariff data are not yet available, was it appropriate to include CY 2008 estimates with the three prior years?
   - E. Did the Department of Revenue estimate revenue lost, based on the difference between the RCA tariff and the FERC tariff, for CY 2003 and CY 2004, or the full amount of the difference between a timely filing of a TOC tariff and the actual filed TSM?
   - F. Why did estimates of future impacts terminate with CY 2008?

2. State CY 2004 TAPS Tariff Overcharge Protest at FERC.
   - A. Please indicate the status or disposition of each of the alleged TAPS tariff overcharges in the State's CY 2004 TAPS Tariff Protest.
   - B. Please indicate the estimated amount of the state revenue that was potentially at issue for 2004 and specify whether those amounts were included in the figures presented in response to Question 1, above.

3. State CY 2005 and CY 2006 TAPS Tariff Overcharge Protests at FERC.
   - A. Is the State still seeking recovery of revenue lost due to alleged CY 2005 and CY 2006 tariff overcharges by the TAPS Carriers?
   - B. If not, how were the State's protests resolved?
   - C. If so, please indicate the status of the challenge to each of those alleged TAPS tariff overcharges.

- D. Please indicate the estimated amount of the state revenue that was potentially at issue for 2005 and 2006 and specify whether those amounts were included the figures presented in response to Question 1, above.

4. <u>Fiscal Outcomes of Tariff Protests Since 1996.</u>
   - A. Please provide estimates of the annual amounts that might be obtained in refunds for tariff items the State has protested during this period as inconsistent with TSM terms.
   - B. Please provide comparable estimates of the annual amounts that might have been obtained in refunds for tariff overcharges such as those alleged by Anadarko and Tesoro under the statutory standard of a "just and reasonable" tariff under AS 42.06 or comparable federal statute.

5. <u>Tariffs below TAPS Settlement Agreement Ceiling (Re: 1997 Capacity Settlement Agreement)</u>
   - A. For oil shipped under FERC tariffs since Jan. 1, 1998, please provide, by year, the average amount per-barrel by which the annual TAPS Settlement Agreement ceiling has exceeded actual TAPS tariffs under FERC jurisdiction.
   - B. Have the Department of Law and/or its consultants analyzed the 1997 Capacity Settlement Agreement to determine whether excess capacity naturally occurring on TAPS due to reduced throughput would have resulted in (a) the filed below-ceiling tariffs on TAPS and/or (b) additional tariff reductions?
   - C. If so, can you provide those analyses?

<u>II. State Position in Current FERC Proceedings</u>

6. <u>Tariff Levels.</u>
   - A. How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed for nearly two decades, and as recently as 2004?
   - B. How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed as recently as 2004 with its previous assertions to FERC that the much higher tariffs filed under the 1985 TAPS Settlement Agreement were both "cost-based" and "fair and reasonable"?

7. <u>Depreciation.</u>
   - A. How did the Department of Law and its consultants arrive at the decision to reverse its long-held position that no element of the 1985 settlement can be viewed outside the context of the settlement because TSM is the product of a negotiated settlement involving many inter-related compromises and tradeoffs?
   - B. Could a better explanation for this switch in a long-held position have enhanced the State's credibility in this proceeding?
   - C. Why did it take the Department of Law and its consultants 20 years to recognize that the Carriers' tariff filings under TSM were double-counting depreciation expenses to overcharge independent shippers?

8. Per-Barrel Allowance.

- A. Have the Department of Law and its consultants compared the amounts the TAPS Carriers have gained through tariff collections realized through the inflation-adjusted per-barrel allowance in effect under TSM since 1990, plus other profit elements, to an allowable standard rate of return profits on a depreciated rate base under a standard cost-based ratemaking method?

9. May 17, 2007 FERC Administrative Law Judge Decision.

- A. Please identify the specific items in the ALJ decision in which the State believes it achieved significant victories.
- B. For each point on which the State believed it achieved significant gains, please provide a statement of the fiscal impact of each item and/or a brief summary of the policy implications of that item.

III. Independent Producers and Shippers

9. The State and Independent Producers/Shippers.

- A. How do the Department of Law and its consultants reconcile the State's prolonged opposition to independent shipper challenges to excessive TAPS tariffs with its assertions (e.g., in the Explanatory Statement accompanying the submission of the 1985 settlement agreement to FERC) that Alaska stands in the shoes of the shippers?
- B. Does the prolonged levy of excessive TAPS tariffs handicap independent producers, who must pay the excess tariffs out of pocket?
- C. Does the prolonged levy of excessive TAPS tariffs have a chilling effect on North Slope exploration and development by companies other than the TAPS owners?

10. Excess Tariff Handicaps to Independent Shippers.

- A. When a TAPS Owner ships its own oil, tariff charges in excess of actual costs represent internal transfer payments between the production and the transportation arms of the company. In contrast, the independent shipper must pay these costs out of pocket. Has the Department of Law asked its consultants or the Department of Revenue to quantify the handicap to independent shippers on TAPS of excess charges under the TAPS Settlement Methodology?
- B. If so, please provide that information on an aggregate and a per-barrel basis.
- C . Compared to TAPS tariffs filed under the 1985 settlement methodology , correction of these four specific tariff elements in the filed 2006 tariffs would reduce TAPS tariff revenue by approximately 60% (from more than $5.00 per barrel to approximately $2.00 per barrel). By comparison, if the State prevailed in its protest of specific elements of the 2006 tariff, what would the reduction to TAPS tariffs have been on an aggregate and a per-barrel basis?
- D. For CY 2003, 2004 and 2005, following the A/T methodology please provide the amounts of corrections to the four specific tariff elements discussed in this question on an aggregate and per-barrel basis.

- E. By comparison, For CY 2003, 2004 and 2005, if the State were successful in its protest of specific tariff elements, what would the reduction to TAPS tariffs have been on an aggregate and a per-barrel basis?

11. Antitrust Issues.

- A. When did the Department of Law become aware of Conoco CEO Archie Dunham's statement that he hated to give up the Milne Point field, but "all the value of that property was taken away in the pipeline tariffs;" what action did the department take to determine whether there was a relationship between pipeline tariffs and the departure from Alaska of the only independent operator on the North Slope?
- B. When did the Department of Law become aware of the Maritime Endeavor case and what action did the Department of Law take to determine whether the company's complaint had merit?
- C. Are the Department of Law and its consultants aware of any other state or region producing more than 500,000 bpd in which (1) the only link to market is dependent on largely producer-owned transportation links whose average cost exceeds $4.00 per barrel and/or (2) three or fewer producers own more than 95% of the only pipeline link to market and control a similar share of production?

IV. Duty to Cooperate in Defending 1985 TAPS Settlement Agreement

12. Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement.

- A. Since the State evidently did not deem itself contractually bound to join the TAPS Carriers in actively defending the 1985 TAPS Settlement Agreement after Feb. 28, 2006, what factors prompted the State oppose the challenges of independent TAPS shippers at the RCA between 1996 and February 28, 2006, despite the fact that reduced tariffs would augment State revenue and promote competition on the North Slope by independent developers?

13. Definition of Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement.

- A. Has the Department of Law attempted to determine the extent to which Sec. I-3 of the 1985 TAPS Settlement Agreement constrains the State's current challenges to TAPS tariffs?
- B. Has the Department of Law ever attempted to determine the legal extent to which Sec. I-3 of the 1985 settlement agreement constrained the State's challenges of possible or actual TAPS tariff overcharges between 1986 and the the present?
- C. If so, please (1) indicate the dates that written documents on this subject were prepared and (2) provide those documents.

V. TAPS Tariffs Under TSM v. *Explanatory Statement* Prognostications

14. Tariff Levels under TSM (1990-2011):

- A. What accounts for the radically differences between (a) the tariff outcomes calculated by the RCA and the FERC Trial Staff and Administrative Law Judge and (b) the prognostications of the 1985 *Explanatory Statement*?

- B. Please compare TAPS throughput from Jan. 1, 1986 through Dec. 31, 2006 to the forecast figures used in the Explanatory Statement prognostications?
- C. All other things being equal, in comparing actual results to 1985 projections, shouldn't increased production and reduced federal income tax rates have resulted in decreased tariffs, compared to 1985 projections?

15. Other Representations.

- A. In view of the facts that (a) tariffs under the 1985 settlement were significantly higher than a standard DOC tariff would have been and (b) the RCA, FERC Trial Staff and FERC Administrative Law Judge concur that actual tariffs filed in compliance with the settlement agreement have been excessive, what is the basis for the prognostications of the 1985 *Explanatory Statement* and the 2001 statements of the Department of Law's counsel, on behalf of the State, to the RCA that the 1985 TAPS Settlement Agreement "has performed better than expected"?

16. Dismantling, Removal & Restoration (DR&R).

- A. What specific settlement benefits did the State receive from granting, through the 1985 settlement, DR&R collection terms to the TAPS owners that, according to the 1986 calculations of the APUC Staff Expert Witness, increased the estimated settlement gains to the TAPS Owners by more than 50 percent?
- B. In the two decades since this defect in the 1985 Settlement terms was identified and the resulting after-tax, off-book gains to the TAPS Owners were quantified, what steps did the Department of Law and its consultants take to remedy this situation?
- C. In 2000, the Department of Law became aware that a 1988 ruling by the U.S. Internal Revenue Service increased the tariff gains to TAPS Owners by making the DR&R pre-collections (which had been "grossed up" under the settlement terms to pay federal income tax) tax-deductible. At that time, the attorney representing the Department of Law promised the Legislature the attorneys and accountants would get to the bottom of this issue and remedy it. What substantive actions (if any) have the Department of Law and its consultants taken in the intervening six years to remedy this problem and what is the status of these efforts?

(VI.) Natural Gas Pipeline Tariffs

17. Sensitivity to Pipeline Tariffs.

- A. Has the State prepared estimates of project tariffs for a proposed natural gas line? If so: (1) What is the range of the tariff estimate per mmBTU? (2) Does the variation in estimates reflect (a) differences in project costs, (b) uncertainty about FERC inputs, treatment of costs and other factors critical to tariff methodology, or (c) both?
- B. Does the EconOne estimate of approximately $1.50 per mmBTU, plus or minus 20%, incorporate uncertainty about FERC inputs, treatment of costs and other factors critical to tariff methodology?

- C. Does the State believe that natural gas trades at a discount to oil? If so, does that discount factor increase project sensitivity to tariffs?

18. Strategies to Reduce Sensitivity to Pipeline Tariffs.

- A. Have State tariff managers presented a strategy (with timelines for data submission and analysis, agency and court review procedures) that will ensure that just and reasonable gas pipeline tariffs are established in a timely manner?
- B. On May 12, 2006, a Department of Law consultant representing the Administration assured legislators that, at least in theory, producers could be expected to contain pipeline costs to a greater extent than independent pipeline builders because, as shippers, they would have to pay the tariff. (1) Has the Department of Law explained the apparent contradiction between the historical reality of TAPS tariff charges and his statement?

(VII.) Pipeline Tariff Management Issues

19. Payments to Department of Law Consultants.

- A.. It has been reported that between 1981 and June 30,1997, the Department of Law paid Morrison & Foerster and its associates more than $20 million for legal assistance associated with TAPS tariffs..Does this amount include payments to accountants working with Morrison & Foerster, including Dr. Thomas Horst?
- B. How much did the State of Alaska pay Morrison & Foerster and its associates, including Dr. Thomas Horst, for work on TAPS tariff issues between July 1, 1997 and June 30, 2003?
- C. According to the *Alaska Budget Report*, between July 2003 and the end of 2006 the State paid the law firm of Morrison & Foerster $12.3 million for legal services and negotiations. Does this payment include payments for work on TAPS, including payments to Dr. Thomas Horst, for work on TAPS tariff issues?
- D. Between July 2003 and the end of 2006, how much did the State of Alaska pay Morrison & Foerster and its associate accountants, including Dr. Thomas Horst, for work on TAPS tariff issues?

20. Responsibility for State Pipeline Tariff Policy. *The Alaska Pipeline Act lists ten general powers and duties of the RCA under which that agency regulates pipelines and pipeline carriers in the state. The final subsection states that the commission*

> *(10) shall provide all reasonable assistance to the Department of Law in intervening in, offering evidence in, and participating in proceedings involving a pipeline carrier or affiliated interest and affecting the interests of the state, before an officer, department, board, commission, or court of another state or the United States.*

- A. Apart from this statutory reference to the Department of Law, please identify any statutes that specifically assign responsibility for pipeline tariff policy to the Department of Law.

- B. The various sections of the Civil Division of the Department of Law handle legal matters and provide legal advice to the agencies of the executive branch. What state agency has statutory authority to set and review pipeline tariff policies?
- C. Please identify any functions of State government for which the Civil Division of the Department of Law not only handles legal matters associated with implementing policy, but also has (1) statutory and/or (2) *de facto* responsibility for setting and reviewing that policy.

Twenty Questions on Trans-Alaska Pipeline System Tariffs
And State Pipeline Tariff Management Issues

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Testimony before the Alaska State House of Representatives
Committee on Resources
June 7, 2007

Thank you for the opportunity to testify today on petroleum pipeline tariff issues. Pipeline transportation arrangements are critical to petroleum development. For this reason, I commend this committee for its initial effort to explore this important subject last March, and for your follow-up today. I am testifying today on my own behalf.

Mr. Chairman, it is no secret that I believe that responsibility for State petroleum tariff policy formulation rightly belongs with a line agency, such as the Department of Natural Resources. In most areas of State governance, the Department of Law serves a client agency by handling legal matters under the direction of that agency. But in the case of pipeline tariff management, that's not the way it works. I believe recent developments on TAPS and the proposed natural gas pipeline combine to confirm the importance of ensuring that clearly considered policy goals and directives are driving State actions in this important area.[1]

In broad terms, the importance of TAPS tariffs to the State Treasury is outlined in an analysis I prepared in February 2007 for the *Alaska Budget Report* on fiscal impacts of the TAPS tariff cases before FERC and the State Supreme Court. Mr. Chairman, that report was by no means perfect. But to the best of my knowledge, at the time I prepared these estimates, those were the only comprehensive numbers out there. Strange as it may seem, despite the important effects of TAPS tariffs on State revenue and the time and energy the Legislature spent in 2006 looking at the petroleum revenue picture, the State had not published (and, I suspect, may not have performed) a comprehensive, quantitative assessment of potential TAPS tariff litigation effects on State revenue. I estimate that since I completed that report earlier this year, the State treasury has lost another $55 million due to excess TAPS tariffs, based on the difference between FERC and RCA tariffs.[2]

I therefore commend you for your efforts today and encourage you to look very carefully at what has happened since you met in March to learn about a FERC document that excoriated the TAPS Owners' defense of their high filed TAPS tariffs.

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[1] My comments are based on three decades of observation of North Slope petroleum development as a reporter, as a public servant (including six years on the inside as a policy analyst in the Governor's Office – three years working on budget and revenue issues and three years as a senior advisor to the Governor on oil and gas policy) and as a consultant.

[2] For background information on the basis of this estimate, see: Richard A. Fineberg, *Historical and Current State Revenue Loss Quantified: Difference Between RCA's 2002 TAPS Tariff Order And State's 1985 Pipeline Tariff Agreement Costs State More Than $400 per Minute*, Feb. 28, 2007 (prepared for the Alaska Budget Report; on-line at http://www.finebergresearch.com)

At the March 5 hearing, Steve Brose, an attorney for the TAPS Owners, told you that the Feb. 16, 1007 FERC Trial Staff brief was just the view of one guy in Washington. That evidently wasn't the case. And Mr. Brose assured you that the TAPS Owners would be responding to the FERC Trial Staff brief "quite vigorously." Despite that defense, FERC Administrative Law Judge Carmen Citron's May 17 decision closely followed the arguments of the FERC Trial Staff and the TAPS Owners went down in flames. The judge recommended that the FERC reduce TAPS tariffs to levels near those ordered by the RCA. I'm not altogether surprised that the TAPS Owners declined to appear today.[3]

Since you last convened to consider this issue, attorneys for the TAPS Owners made another vigorous appearance in another venue: They appeared before the Alaska Supreme Court in Anchorage March 13 to appeal the challenge to the RCA's 2002 decision and order requiring the TAPS owners to reduce tariffs on in-state shipments to approximately $1.96 per barrel.[4] In my estimation, the TAPS Owners' appearance before the State Supreme Court was the latest example of their use of everything but the kitchen sink and meaningful ratemaking data to justify their unreasonably high tariffs. Here, too, their arguments were vigorous.

And no wonder: Whatever the TAPS Owners' odds of success before the State Supreme Court, a filed tariff in excess of just and reasonable rates enables the major TAPS Owners to retain hundreds of thousands of dollars per day that they would have to pay the State.[5] As a practical matter, it is often – if not always – more difficult to collect refunds after the fact than to collect the right amount in the first place.[6] Chalk up the lost refunds to another example of the price the State pays for its historical failure to respond with alacrity to the TAPS Carriers' high filed tariffs.

I believe the FERC decision is unusual in the remarkable degree to which Judge Cintron's decision lines up with the principal arguments of the FERC Trial Staff and the protesting shippers. For example, in setting out the methodology and in her findings and conclusions, the FERC judge adopted Anadarko and Tesoro's tariff numbers.[7] I can't

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[3] Presiding Administrative Law Judge Carmen A. Cintron, "Initial Decision," in *BP Pipelines (Alaska) Inc., et al.* (FERC Docket No. IS05-82-002, *etc.*), May 17, 2007, *passim*.

[4] See: Regulatory Commission of Alaska, *Order Rejecting 1997, 1998, 1999 and 2000 Filed TAPS Rates; Setting Just and Reasonable Rates; Requiring Refunds and Filings; and Outlining Phase II Issues* (Docket Nos. P-97-4 and P-97-7, Order P-97-4[151] / P-97-7[110]), Nov. 26, 2002. (I have discussed the significance of this order in various articles posted on my web site since I initiated that enterprise in September 2004.)

[5] Two simple facts explain this problem: (1) For every dollar paid in tariffs, the State loses approximately $0.25. (2) Three major oil companies own more than 95% of TAPS and control a roughly similar share of North Slope production. For a producer shipping its own oil, excess tariff payments are an internal transfer payment, not a cash outlay.

[6] If Judge Cintron's Initial Decision stands, it appears that future tariffs will be lowered to approximately $2.00 per barrel, but the State will not be able to collect full refunds on the difference between that level and higher filed past tariffs. Rather, the refunds she ordered for 2005 and 2006 will be based on the difference between the filed tariffs for CY 2004 and the filed CY 2005 and 2006 tariffs. ("Initial Decision," p. 106.)

Filed tariffs in CY 2004 averaged approximately $3.11 – more than $1.00 per barrel above what Judge Cintron's order sets as the just and reasonable tariff for TAPS shipments. (See: *Historical and Current State Revenue Loss Quantified: Difference Between RCA's 2002 TAPS Tariff Order And State's 1985 Pipeline Tariff Agreement Costs State More Than $400 per Minute*, Figure 1, note 5.)

[7] "Initial Decision," p. 40.

assess for you the odds that the FERC itself will uphold Judge Cintron's May 17 Initial Decision. But I can tell you this: Since Tesoro launched its protest of TAPS tariffs at the Alaska Public Utilities Commission (predecessor to the RCA) in 1996, the TAPS Owners have lost every major challenge to their high tariffs.[8] In view of the foregoing, my guess – and my hope for the State – is this: At the end of the day, the Courts are likely to find that the law and the public interest lie with the protesting shippers.

Near the end of her May 17 decision, Judge Cintron devoted a few brief paragraphs to the State's primary argument in this proceeding. The State had argued that "[t]he State's protests of the TAPS Carriers' proposed 2005 and 2006 tariffs raise a single, simple question – can the TAPS Carriers charge vastly different rates for transportation of oil solely on the basis of where shippers take their oil after it leaves TAPS?"[9] Judge Cintron's decision concluded that her findings on behalf of the shippers rendered the State's principal argument in this case moot.[10] Judge Cintron also ordered that the

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[8] A quick summary of these decisions follows:

In its 2002 decision and subsequent orders on TAPS tariffs, the RCA upheld the protests of independent shippers that tariffs charged by the TAPS Owners were excessive. In doing so, the Commission rejected arguments by the State of Alaska and the TAPS Owners. In that proceeding, the State, represented by the Department of Law and its consultants, argued to the effect that TAPS tariffs filed under the 1985 TAPS Settlement Agreement serve Alaska public policy interests well and should remain in place.

The State joined the TAPS Carriers in appealing the RCA's 2002 decision; in January 2006, the Alaska Superior Court upheld the RCA decision "in all respects," rejecting the arguments of the Carriers and the State. The State subsequently withdrew from the TAPS Carriers' appeal to the State Supreme Court.

In December 2004, the State and independent shippers Anadarko and Tesoro (A/T) protested TAPS tariffs filed by the Carriers at FERC. The Department of Law has emphasized that the State's protest at FERC is based on different grounds from the protests brought by the independent shippers.

On Feb. 16, 2007, the various parties to the FERC proceeding filed their initial briefs with the FERC Administrative Law Judge, who is charged with the task of determining facts and laying out the principal arguments for the commission itself. Unlike the independent shippers, who argued that the filed tariffs were excessive, the State's principal argument was that the tariffs should be reduced because the different tariffs would be discriminatory and would therefore violate the Interstate Commerce Act. In the estimation of many observers the most notable brief was filed by the FERC Trial Staff, which supported the A/T position and rejected the arguments of the Carriers. The FERC Trial Staff took no position on the State's principal argument, arguing that a just and reasonable tariff at FERC would bring the FERC and RCA tariffs into line, removing the tariff differential the State argued would be discriminatory. The FERC Trial Staff also supported a single tariff on TAPS.

(For citations and additional discussion see: Richard A. Fineberg, *Alaska Department of Law Imitates Wrong-Way Corrigan. Famous Aviator Left New York For L.A., Landed in Ireland – With increasing recognition focusing on Trans-Alaska Pipeline System (TAPS) shipping costs, does the peculiar history of TAPS tariff ratemaking hold lessons for the proposed natural gas pipeline?* [March 2, 2007 web site comment.])

[9] "Initial Post-Hearing Brief of the State of Alaska," in *BP Pipelines (Alaska) Inc., et al.* (FERC Docket No IS05-82-002, *etc.*), Feb. 16, 2007, p. 11.

[10] "Initial Decision," pp. 112-113. In her 277-paragraph decision, Judge Cintron dealt with the State's principal argument between paragraphs 258-263. In that section, she wrote:

> It has been found in this initial decision that the TAPS interstate rates for 2005 and 2006 are unjust and unreasonable. Thus, this decision contemplates new rate filings that will be substantially less than the Carriers 2005 and 2006 original filings. This new rate will be similar to the rates proposed by Anadarko/Tesoro. Anadarko/Tesoro's Opinion 154-B TOC interstate rate calculation for transport of a barrel from Pump Station No. 1 to the Valdez Marine terminal is $2.04 for 2006 and $1.83 for 2006. Anadarko/Tesoro's calculations shown in Illustration Number 1 above were adopted in this decision. The State's Opinion 154-B reference rate in this proceeding for the interstate rates, for transport of one barrel from Pump Station No. 1 to the Valdez Marine Terminal is $1.96 and $2.05 for 2005 and 2006, respectively. The intrastate rate set by the RCA is $1.96 to transport a barrel of oil from Pump Station

Carriers file a single, uniform tariff annually, rejecting what I think most observers consider to be the State's second most important argument in this case.[11]

I am also troubled by apparent inconsistencies in some of the State's positions. Here are two examples:

➔The State appears to have reversed itself on one of the fundamental premises of the 1985 TAPS Settlement Agreement between the TAPS Owners and the State, represented by the Department of Law and its consultants. As recently as its 2004 Court appeal of the RCA's 2002 order reducing TAPS tariffs, the State was attempting to argue – in concert with the TAPS Owners – that the 1985 settlement can only be understood as a package established by trade-offs, individual tariff elements spelled out in the settlement and in annual tariff filings have no meaning.[12] But in its Initial Post-Hearing Brief in the CY 2005-2006 FERC tariff proceedings, the State testified that "[t]here can be no genuine debate over the fact that TSM [TAPS Settlement Methodology] depreciation is actual depreciation for ratemaking purposes."[13]

➔ In its initial post-hearing brief, the State, through the Department of Law and its consultants, argued that "the State has demonstrated that the reduced intrastate rate ordered by the RCA contributes at least its 'fair share' of earnings required to meet the maintenance and operating costs on TAPS and to yield a fair return on the property."[14] How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed for nearly two decades, and as recently as 2004? And How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed as recently as 2004 with its previous assertions to FERC that the much higher tariffs filed under the 1985 TAPS Settlement Agreement were both "cost-based" and "fair and reasonable"?[15]

While both reversals are welcome, their inconsistency with prior stated and vehemently argued positions suggests to me that State tariff argumentation may be driven more by tactical legal maneuvering than by firmly grounded policy considerations. Coming at this

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No 1 to the Valdez Marine Terminal The difference between these rates and the RCA established intrastate rate are minimal Accordingly, the discrimination has been alleviated and the State's discrimination claims are rendered moot [Par 263; citations omitted.]

[11] "Initial Decision," p. 110.

[12] State of Alaska, "Appeal of the Regulatory Commission of Alaska's Order No P-97-4(151)," in Amerada Hess Pipeline Corporation, et al , vs Regulatory Commission of Alaska (State of Alaska Superior Court Case No. 3AN-02-135?12 CI), Mar 1, 2004, p 45 (Filed by Senior Assistant Attorney General Janice Gregg Levy , Robert H Loeffler and Bradley S Lui, Morrison & Foerster, LLP for Attorney General Gregg D Renkes.) The State's 2004 appeal referenced the representations of the *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* at p 33

[13] "Initial Post-Hearing Brief of the State of Alaska," p. 24 (This passage summarizes similar arguments at pp. 3 and 18-23.)

[14] "Initial Post-Hearing Brief of the State of Alaska," p 86

[15] See, for example, State of Alaska and United States Department of Justice. *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* (submitted to Federal Energy Regulatory Commission with settlement offer in Docket No OR 78-1, *etc.*), June 28, 1985, pp 2, 89 (Filed by Attorney General Norman C Gorsuch and Assistant Attorney General and Robert M Maynard, State of Alaska, Robert H Loeffler, Steven S Rosenthal and W Stephen Smith, Morrison & Foerster [State of Alaska] and Acting Assistant Attorney General [Antitrust Division] Charles F Rule, Energy Section Chief Melanie Stewart Cutler and Special Litigation Counsel to the Assistant Attorney General [Antitrust Division] Donald A Kaplan [U S Department of Justice.)

late date, I think it is important to ask how much money the State has lost and how much North Slope development has suffered due to the State's failure to understand and correct its long-held positions on tariff matters in a timely manner.[16]

In sum, a slew of important and long-delayed decisions and statements have borne out the long-held concerns of critics of the 1985 TAPS tariff settlement. Since 2002, a series of major legal decisions have fallen like dominoes against the TAPS Owners and against the positions the State argued vociferously until last year. But the fact remains: In the decade since Tesoro filed its first challenge to TAPS in-state tariffs, excessive TAPS tariffs have enabled the TAPS Owners to reduce their payments to the State by more than $1.1 billion (based on the RCA standard). And as careful examination of the FERC administrative law judge's decision demonstrates, the longer an excessive tariff is in place, the harder it becomes to collect full refunds.[17] In light of the fact (or apparent probability) that refunds will not fully attain that level, I believe the correct standard for State petroleum pipeline tariff policy analysis is to calculate what the State should have received if, instead of pressing its aggressive support of the TAPS Owners' position, the State had operated from its intent, clearly stated on the date of the 1985 settlement, to stand in the shoes of the Shippers.

In preparing for this hearing, I made a list of questions about State petroleum pipeline tariff policy that I wanted to see answered. Based on the difficulty this committee encountered obtaining information on the significance of the FERC Trial Staff's Feb. 16 brief in its March 5 hearing, I thought that a checklist covering background issues and recent developments in this complicated and important area might prove useful today. The twenty questions I came up with cover seven areas:

- Fiscal Impacts of TAPS Tariff Challenges on State Revenue;
- State Position in Current FERC Proceedings;
- Independent Producers and Shippers;
- Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement;
- TAPS Tariffs Under TSM v. *Explanatory Statement* Prognostications;
- Natural Gas Pipeline Tariffs; and
- Tariff Management Issues, including locus of responsibility for setting tariff policy and information about the Department of Law's consultants.

The intent of these questions is to help assess the current TAPS tariff situation, looking forward, and to discover what lessons the TAPS experiences holds for the proposed North Slope natural gas project. To the extent that many of these questions seek historical information, that is because TAPS tariff management issues demonstrate anew, in the Spring of 2007, the maxim of philosopher George Santayana that those who do not understand history are compelled to repeat it. If you find these questions worthy of your attention and you do not have substantive answers to them by the close of this hearing, I respectfully request that you forward them to the Attorney General for his consideration and written response.

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[16] During informal discussion, representatives of the Department of Law have told me that I am not giving the State's attorneys and their consultants sufficient credit for their efforts at FERC. One thing I hope to learn from the Department of Law today is exactly what the department believes it has accomplished in the FERC proceeding.

[17] See footnote 6, above.

I. Fiscal Impacts of TAPS Tariff Challenges on State Revenue

1. Fiscal Outcomes of Current Tariff Challenges. During the Mar. 5, 2007 State House Resources Committee hearing on TAPS tariff litigation at FERC, the Department of Revenue was unable to provide written information on its estimate of the fiscal impacts of the tariff case. The department provided a verbal estimate of potential gains to the State Treasure from a litigation victory for years 2005 through 2008 of $818 million. (Department of Revenue Tax Division Director Jon Iverson told the committee that its estimate was based on work that had just begun that morning; a one-page sheet containing that estimate was sent to legislators shortly after the hearing.) Recently, *Petroleum News* reported that the Department of Revenue now estimates the four-year sums at issue to be about $600 million.

- A. Please identify the factors that account for the change in the Department of Revenue's latest refund estimate.
- B. When did the Department of Law ask the Department of Revenue to quantify the impacts of the CY 2005 and CY 2006 tariff protests?
- C. When tariffs for CY 2008 will not be filed until December 2007, how was the CY 2008 estimate derived?
- D. When actual tariff data exists for CY 2005 through CY 2007 but future tariff data are not yet available, was it appropriate to include CY 2008 estimates with the three prior years?
- E. Did the Department of Revenue estimate revenue lost, based on the difference between the RCA tariff and the FERC tariff, for CY 2003 and CY 2004, or the full amount of the difference between a timely filing of a TOC tariff and the actual filed TSM?
- F. Why did estimates of future impacts terminate with CY 2008?

2. State CY 2004 TAPS Tariff Overcharge Protest at FERC. The State formally protested certain TAPS tariff charges in the CY 2004 tariff on Dec. 15, 2003. (This protest was not mentioned in the March 5, 2007 State House Resources Committee hearing.)

- A. Please indicate the status or disposition of each of those alleged TAPS tariff overcharges.
- B. Please indicate the estimated amount of the state revenue that was potentially at issue for 2004 and specify whether those amounts were included in the figures presented in response to Question 1, above.

3. State CY 2005 and CY 2006 TAPS Tariff Overcharge Protests at FERC. The State formally protested certain TAPS tariff charges in the CY 2005 and CY 2006 tariffs. (These protests were not discussed in the March 5, 2007 State House Resources Committee hearing.)

- A. Is the State still seeking recovery of revenue lost due to alleged CY 2005 and CY 2006 tariff overcharges by the TAPS Carriers?
- B. If not, how were the State's protests resolved?
- C. If so, please indicate the status of the challenge to each of those alleged TAPS tariff overcharges

- D. Please indicate the estimated amount of the state revenue that was potentially at issue for 2005 and 2006 and specify whether those amounts were included the figures presented in response to Question 1, above.

4. Fiscal Outcomes of Tariff Protests Since 1996. It is conservatively estimated that since Tesoro first protested TAPS tariff overcharges in 1996, the State Treasury has lost at least $1.1 billion in reduced royalty and tax payments due to TAPS tariff overcharges. Yet, through most of that period, the State, represented by the Department of Law and its consultants, has sided with the TAPS Carriers against challenges to their tariffs. During this period, the State tariff protests filed at FERC by the Department of Law and its consultants sought tariff reductions on specific tariff elements that, in the Department of Law's view, were inconsistent with the 1985 settlement terms (rather than overcharges compared to the statutory standard of a "just and reasonable" tariff under AS 42.06 or comparable federal statutes). The FERC trial staff and ALJ decision confirm that protests under the latter grounds result in much larger refund payments to the State Treasury than protests the State filed.

- A. Please provide estimates of the annual amounts that might be obtained in refunds for tariff items the State has protested during this period as inconsistent with TSM terms.
- B. Please provide comparable estimates of the annual amounts that might have been obtained in refunds for tariff overcharges such as those alleged by Anadarko and Tesoro under the statutory standard of a "just and reasonable" tariff under AS 42.06 or comparable federal statute.

5. Tariffs below TAPS Settlement Agreement Ceiling. In November 1997, the State, led by the Department of Law and its consultants, entered into an agreement with the TAPS Carriers known as the "Capacity Settlement Agreement" (CSA). The CSA was designed to induce rate competition on TAPS, bringing about reduced tariffs over the next decade. According to the Attorney General, "[t]his settlement is historic because it assures competition among pipeline carriers to lower their rates." From testimony in the RCA rate case, it appears that as of 2001 the CSA agreement had resulted in very little rate reduction on TAPS. Moreover, in the decade since the settlement, the TAPS Carriers have increased tariffs significantly.

- A. For oil shipped under FERC tariffs since Jan. 1, 1998, please provide, by year, the average amount per-barrel by which the annual TAPS Settlement Agreement ceiling has exceeded actual TAPS tariffs under FERC jurisdiction.
- B. Have the Department of Law and/or its consultants analyzed the CSA to determine whether excess capacity naturally occurring on TAPS due to reduced throughput would have resulted in (a) the filed below-ceiling tariffs on TAPS and/or (b) additional tariff reductions?
- C. If so, can you provide those analyses?

II. State Position in Current FERC Proceedings

6. Tariff Levels. In the CY 2005-2006 FERC tariff proceedings, the State, through the Department of Law and its consultants, testified that "the State has demonstrated that the reduced intrastate rate ordered by the RCA contributes at least its 'fair share' of

earnings required to meet the maintenance and operating costs on TAPS and to yield a fair return on the property."[18]

- A. How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed for nearly two decades, and as recently as 2004?
- B. How does the State reconcile its present support of the relatively low TAPS tariff levels it opposed as recently as 2004 with its previous assertions to FERC that the much higher tariffs filed under the 1985 TAPS Settlement Agreement were both "cost-based" and "fair and reasonable"?[19]

7. Depreciation. In its Initial Post-Hearing Brief in the CY 2005-2006 FERC tariff proceedings, the State, through the Department of Law and its consultants, testified that "[t]here can be no genuine debate over the fact that TSM depreciation is actual depreciation for ratemaking purposes."[20] But throughout But throughout RCA case and as recently as 2004, the State, through the Department of Law and its consultants, argued an apparently contradictory position. For example, in its March 1, 2004 opposition to the RCA decision that TAPS tariff filings were based on a clear statement of annual depreciation laid out in the 1985 settlement, the State argued that "the depreciation schedule in the TSM calculations does not represent a depreciation schedule for TAPS in any conventional sense" and warned that "a rule that a settlement depreciation schedule or any other depreciation schedule not approved for regulatory purposes constitutes 'actual depreciation' will lead to unreasonable results."[21] The 1985 Settlement Agreement's hyper-accelerated depreciation allowed the TAPS owners early recovery of their expenditures, enabling the TAPS owners to avoid paying refunds. But in 2001 the RCA found – as Tesoro had argued before the FERC – that the Carriers were seeking an unjustified double recovery of depreciation through tariff levels permitted under TSM.

- A. How did the Department of Law and its consultants arrive at the decision to reverse its long-held position that no element of the 1985 settlement can be viewed outside the context of the settlement because TSM is the product

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[18] "Initial Post-Hearing Brief of the State of Alaska," in *BP Pipelines (Alaska) Inc., et al.* (FERC Docket No IS05-82-002, *etc.*), Feb. 16, 2007, p. 86.

[19] See, for example, State of Alaska and United States Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* (submitted to Federal Energy Regulatory Commission with settlement offer in Docket No. OR 78-1, *etc.*), June 28, 1985, pp. 2, 89. (Filed by Attorney General Norman C. Gorsuch and Assistant Attorney General and Robert M. Maynard, State of Alaska, Robert H. Loeffler, Steven S. Rosenthal and W. Stephen Smith, Morrison & Foerster [State of Alaska] and Acting Assistant Attorney General [Antitrust Division] Charles F. Rule, Energy Section Chief Melanie Stewart Cutler and Special Litigation Counsel to the Assistant Attorney General [Antitrust Division] Donald A. Kaplan [U.S. Department of Justice.)

[20] "Initial Post-Hearing Brief of the State of Alaska," p. 24. (This passage summarizes similar arguments at pp. 3 and 18-23.)

[21] State of Alaska, "Appeal of the Regulatory Commission of Alaska's Order No. P-97-4(151)," in Amerada Hess Pipeline Corporation, et al., vs. Regulatory Commission of Alaska (State of Alaska Superior Court Case No. 3AN-02-135112 CI), Mar. 1, 2004, p. 45. (Filed by Senior Assistant Attorney General Janice Gregg Levy, Robert H. Loeffler and Bradley S. Lui, Morrison & Foerster, LLP for Attorney General Gregg D. Renkes.) The State's 2004 appeal referenced the representations of the *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* at p. 33.

of a negotiated settlement involving many inter-related compromises and tradeoffs?[22]

- B. Could a better explanation for this switch in a long-held position have enhanced the State's credibility in this proceeding?
- C. Why did it take the Department of Law and its consultants 20 years to recognize that the Carriers' tariff filings under TSM were double-counting depreciation expenses to overcharge independent shippers?

8. Per-Barrel Allowance. Some observers believe that the 1985 TAPS Settlement Agreement departed significantly from principles of cost-based ratemaking by replacing the return profit calculation applied through 1989 with a per-barrel allowance (inflation-adjusted annually from a CY 1983 starting point of $0.35 per barrel). Under the 1985 agreement, beginning in 1990 the major profit element on TAPS was no longer related to the costs incorporated in the rate base.

- A. Have the Department of Law and its consultants compared the amounts the TAPS Carriers have gained through tariff collections realized through the inflation-adjusted per-barrel allowance in effect under TSM since 1990, plus other profit elements, to an allowable standard rate of return profits on a depreciated rate base under a standard cost-based ratemaking method?

9. May 17, 2007 FERC Administrative Law Judge Decision. The FERC Administrative Law Judge supported the A/T arguments, and recommended that the commission order reduced tariffs filed by the TAPS Carriers from over $5.00 per barrel to a level approaching the $1.96 per barrel tariffs ordered by the RCA in 2002 for in-state shipments, thus rendering moot the Department of Law's petition for a lower tariff on grounds of discrimination under the Interstate Commerce Act.

- A. Please identify the specific items in the ALJ decision in which the State believes it achieved significant victories.
- B. For each point on which the State believed it achieved significant gains, please provide a statement of the fiscal impact of each item and/or a brief summary of the policy implications of that item.

III. Independent Producers and Shippers

9. The State and Independent Producers/Shippers. According to the Explanatory Statement on the 1985 settlement agreement, because there is no other practical means to ship oil from the North Slope, "Alaska stands in the shoes of both past and future shippers . . . . Alaska's interests are coextensive with shippers."[23]

- A. How do the Department of Law and its consultants reconcile the State's prolonged opposition to independent shipper challenges to excessive TAPS tariffs with its assertions (e.g., in the Explanatory Statement accompanying

[22] State of Alaska and United States Department of Justice, *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer* (Federal Energy Regulatory Commission, Docket No. OR 78-1, *etc.*, pp 3-4 (quoted in State Brief, Mar. 1, 2004, pp. 32-33)

[23] *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer*, p. 18

the submission of the 1985 settlement agreement to FERC) that Alaska stands in the shoes of the shippers?

- B. Does the prolonged levy of excessive TAPS tariffs handicap independent producers, who must pay the excess tariffs out of pocket?
- C. Does the prolonged levy of excessive TAPS tariffs have a chilling effect on North Slope exploration and development by companies other than the TAPS owners?

10. Excess Tariff Handicaps to Independent Shippers. The FERC Administrative Law Judge concluded, citing A/T's numbers for CY 2006, that adoption of TOC (Trended Original Cost) methodology for TAPS would produce a tariff very near that of the RCA's DOC (Depreciated Original Cost) tariff. Using A/T's comparison of that rate to the TAPS Carriers' rejected proxy tariff, it appears that the major differences between the A/T TOC tariff of $2.04 per barrel and the TAPS Carriers' rejected TOC tariff of $5.53 per barrel are: Return Allowance ("return on equity)", Depreciation, Deferred Earnings and Income Tax Allowance. The first two items are associated, respectively, with Items 7. and 8., above; the third item represents payments to the Carriers for trending (inflation-adjusting) the rate base; the final item represents collections from shippers to pay the income tax on pre-tax net revenue. These four items represent charges in excess of a "fair and reasonable" or "just and reasonable" tariff, both of which allow the Carriers a reasonable return on their property.

- A. When a TAPS Owner ships its own oil, tariff charges in excess of actual costs represent internal transfer payments between the production and the transportation arms of the company. In contrast, the independent shipper must pay these costs out of pocket. Has the Department of Law asked its consultants or the Department of Revenue to quantify the handicap to independent shippers on TAPS of excess charges under the TAPS Settlement Methodology?
- B. If so, please provide that information on an aggregate and a per-barrel basis.
- C . Compared to TAPS tariffs filed under the 1985 settlement methodology , correction of these four specific tariff elements in the filed 2006 tariffs would reduce TAPS tariff revenue by approximately 60% (from more than $5.00 per barrel to approximately $2.00 per barrel). By comparison, if the State prevailed in its protest of specific elements of the 2006 tariff, what would the reduction to TAPS tariffs have been on an aggregate and a per-barrel basis?
- D. For CY 2003, 2004 and 2005, following the A/T methodology please provide the amounts of corrections to the four specific tariff elements discussed in this question on an aggregate and per-barrel basis.
- E. By comparison, For CY 2003, 2004 and 2005, if the State were successful in its protest of specific tariff elements, what would the reduction to TAPS tariffs have been on an aggregate and a per-barrel basis?

11. Antitrust Issues. In a 1996 interview, Conoco CEO Archie Dunham discussed Conoco's 1993 trade of its Milne Point field to BP for a Gulf of Mexico property and its departure from Alaska with *Hart's Oil & Gas Investor*. At the time of its departure from Alaska in 1993, Conoco was the only independent (non-TAPS owner) field operator on the North Slope. In the 1996 interview, Dunham commented: "It broke my heart to trade

Milne Point but we had to do it. All the value of that property was taken away from us in the pipeline tariffs."[24] In 1997 Maritime Endeavor, an independent tanker company, filed an antitrust suit against the TAPS Owners and Alyeska Pipeline Service Co. in federal court in Juneau, alleging that the TAPS owners were violating antitrust law by using technical requirements to prevent an independent tanker from serving the Alyeska terminal.[25] In October 1997, I prepared a report on TAPS antitrust issues for Oilwatch Alaska, in which I recommended that the Department of Law look into the issues raised in that report to ensure competition on the North Slope.[26] The Department of Law declined to undertake that investigation.

- A. When did the Department of Law become aware of Mr. Dunham's statement and what action did it take to determine whether there was a relationship between pipeline tariffs and the departure from Alaska of the only independent operator on the North Slope?
- B. When did the Department of Law become aware of the Maritime Endeavor case and what action did the Department of Law take to determine whether the company's complaint had merit?
- C. Are the Department of Law and its consultants aware of any other state or region producing more than 500,000 bpd in which (1) the only link to market is dependent on largely producer-owned transportation links whose average cost exceeds $4.00 per barrel and/or (2) three or fewer producers own more than 95% of the only pipeline link to market and control a similar share of production?

IV. Duty to Cooperate in Defending 1985 TAPS Settlement Agreement

12. Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement. It has been suggested that the State, represented by the Department of Law and its consultants, actively opposed the protests of Tesoro and other independent shippers at the RCA (and its predecessor, the APUC) for the first 7-1/2 years of this case – and is currently limited in its grounds for protesting TAPS tariffs at FERC – because Section 1-3 of the 1985 TAPS Settlement Agreement between the State and the Carriers requires that each party "cooperate . . . at its own expense . . . in defending against any litigation affecting the validity and enforceability of this Agreement, or any provision thereof." After opposing the independent shippers at the APUC/.RCA for approximately eight years, on Feb. 28, 2006, the State, represented by the Department of Law and its consultants, served notice that the State was withdrawing from case and would not be appearing before the State Supreme Court in the final argument on that case.

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[24] "Getting to the Future First" (interview by Leslie Haines), *Hart's Oil and Gas Investor*, August 1996, p. 39

[25] This antitrust complaint (filed in U.S. District court, Juneau, by Maritime Endeavor Associates, LP against Alyeska Pipeline Service Company, Inc., and its owners [Case No. J97-010 CV (HRH)], May 27, 1997) was filed along with a companion breach of contract case filed in state court. The state case went first; in that case, the judge decided in favor of Maritime and awarded the plaintiffs a $10 million judgment (Judge Walter Carpineti, "Memorandum of Decision and Order," in Maritime Endeavor Associates, LP against Alyeska Pipeline Service Company [Case No. 1JU-95-1141 CI], Sept. 30, 1998). The decision was vacated and settled out of Court – reportedly for approximately $10 million. As part of the final settlement, Maritime dropped the federal antitrust charge.

[26] Richard A. Fineberg, *The Big Squeeze: TAPS and the Departure of Major Oil Companies Who Found Oil on Alaska's North Slope* (Oilwatch Alaska, Oct. 23, 1997).

- A. Since the State evidently did not deem itself contractually bound to join the TAPS Carriers in actively defending the 1985 TAPS Settlement Agreement after Feb. 28, 2006, what factors prompted the State oppose the challenges of independent TAPS shippers at the RCA between 1996 and February 28, 2006, despite the fact that reduced tariffs would augment State revenue and promote competition on the North Slope by independent developers?

<u>13. Definition of Duty to Cooperate in Defending the 1985 TAPS Settlement Agreement</u>. The 1985 agreement uses ten pages to describe the elements of the settlement methodology and contains an additional three page "Index of Defined Terms." Neither set of definitions makes reference to Sec. I-3 of the Settlement.

- A. Has the Department of Law attempted to determine the extent to which Sec. I-3 constrains the State's current challenges to TAPS tariffs?
- B. Has the Department of Law ever attempted to determine the legal extent to which Sec. I-3 of the 1985 settlement agreement constrained the State's challenges of possible or actual TAPS tariff overcharges between 1986 and the the present?
- C. If so, please (1) indicate the dates that written documents on this subject were prepared and (2) provide those documents.

<u>V. TAPS Tariffs Under TSM v. *Explanatory Statement* Prognostications</u>

<u>14. Tariff Levels under TSM (1990-2011)</u>: According to the 1985 Explanatory Statement, tariff levels between 1990 and 2011 would be comparable to a DOC tariff and far lower than tariff implementing a TOC methodology.[27] However, (1) the RCA has determined that TSM permitted overcharges of nearly $10 billion through 1996, compared to a DOC tariff, and (2) the standard TOC tariff recommended b by the FERC ALJ would reduce current TAPS tariffs by more than 60%. The FERC Trial Staff and Administrative Law Judge agree that a properly implemented TOC tariff would produce current TAPS tariffs to levels very near that of a DOC tariff.

- A. What accounts for the radically differences between (a) the tariff outcomes calculated by the RCA and the FERC Trial Staff and Administrative Law Judge and (b) the prognostications of the 1985 *Explanatory Statement*?
- B. Please compare TAPS throughput from Jan. 1, 1986 through Dec. 31, 2006 to the forecast figures used in the Explanatory Statement prognostications?
- C. All other things being equal, in comparing actual results to 1985 projections, shouldn't increased production and reduced federal income tax rates have resulted in decreased tariffs, compared to 1985 projections?

<u>15. Other Representations</u>. In the 1985 Explanatory Statement, the Department of Law and its consultants asserted that "[t]he TAPS Settlement Agreement resolves all outstanding issues of dispute in regard to the settling carriers' TAPS tariffs." Moreover,

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[27] *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer*, pp. 88-89 and Appendices 7, 8

the Explanatory Statement asserted, "[f]rom an administrative standpoint, the TSM will be practically as easy to administer as any other methodology."[28] In expressing the State's strong support for the maintaining the 1985 settlement at the start of the RCA hearing in April 2001, the State's consulting counsel told the RCA that the 1985 TAPS Settlement Agreement "has performed better than expected."

- A. In view of the facts that (a) tariffs under the 1985 settlement were significantly higher than a standard DOC tariff would have been and (b) the RCA, FERC Trial Staff and FERC Administrative Law Judge concur that actual tariffs filed in compliance with the settlement agreement have been excessive, what is the basis for the prognostications of the 1985 *Explanatory Statement* and the 2001 statements of the Department of Law's counsel, on behalf of the State, to the RCA?

16. Dismantling, Removal & Restoration (DR&R). This element of the 1985 TAPS Settlement, codified in Sec. II-4 and Exhibit E delivered a significant, off-book giveaway to the TAPS Carriers over and above the amounts indicated by the reckonings in Items 1 through 5 and 13, above. Although settlement presentations to the State Legislature (and the 1985 *Explanatory Statement*) misleadingly glossed over the gargantuan giveaway resulting from this settlement element, in 1986, the Alaska Public Utilities Commission Staff Expert Witness authoritatively explained that the accelerated over-collection and failure to escrow these sums would increase the off-book, after-tax gains to the TAPS owners by more than $7.0 billion.[29] A/T's current updating of that calculation indicates that the gains to the TAPS Owners will be more than twice that amount. Although more than 99 percent of those funds have already been collected from TAPS shippers through the accelerated terms in TAPS Settlement Exhibit E, the status and management of those funds is still at issue. In light of this background:

- A. What specific settlement benefits did the State receive from granting, through the 1985 settlement, DR&R collection terms to the TAPS owners that, according to the 1986 calculations of the APUC Staff Expert Witness, increased the estimated settlement gains to the TAPS Owners by more than 50 percent?
- B. In the two decades since this defect in the 1985 Settlement terms was identified and the resulting after-tax, off-book gains to the TAPS Owners were quantified, what steps did the Department of Law and its consultants take to remedy this situation?
- C. In 2000, the Department of Law became aware that a 1988 ruling by the U.S. Internal Revenue Service increased the tariff gains to TAPS Owners by making the DR&R pre-collections (which had been "grossed up" under the settlement terms to pay federal income tax) tax-deductible. At that time, the attorney representing the Department of Law promised the Legislature the attorneys and accountants would get to the bottom of this issue and remedy

[28] *Explanatory Statement of the State of Alaska and the United States Department of Justice in support of Settlement Offer*, pp. 17, 66.

[29] Prefiled Testimony of Rudolph L. Bertschi (Alaska Public Utilities Commission Docket No. P-86-2, Dec. 17, 1886), pp. 63-70 and Exhibits RLB-15, Schedules 1 and 2. (Reprinted in Appendix C of this writer's *Hidden Billions: The TAPS DR&R Provision* [report to Stan Stephens, August 21, 1992], pp. 47-57.)

it.[30] What substantive actions (if any) have the Department of Law and its consultants taken in the intervening six years to remedy this problem and what is the status of these efforts?

(VI.) Natural Gas Pipeline Tariffs

17. Sensitivity to Pipeline Tariffs. On a BTU equivalent basis, natural gas tariffs constitute a significantly greater percentage of the commodity price than oip pipeline tariffs. For example, Econ One places the gas tariff to Alberta (with conditioning plant costs) at approximately $1.50 per mmBTU.[31] By comparison, the average barrel of oil produces 5.8 mmBTU. Therefore, an oil tariff of $2.00 to $5.00 per barrel is transporting an equivalent commodity for somewhere between $0.34 to $0.90 per mmBTU, depending on the tariff. The figures above suggest that natural gas pipeline tariffs, as a percentage of the commodity price, would be somewhere between 66% and 340% greater than oil pipeline tariffs. It appears from this calculation, that both the viability of the project and State revenue are much more dependent on tariff decisions than the oil pipeline.

- A. Has the State prepared estimates of project tariffs for a proposed natural gas line? If so: (1) What is the range of the ta ff estimate per mmBTU? (2) Does the variation in estimates reflect (a) differences in project costs, (b) uncertainty about FERC inputs, treatment of costs and other factors critical to tariff methodology, or (c) both?
- B. Does the EconOne estimate of approximately $1.50 per mmBTU, plus or minus 20%, incorporate uncertainty about FERC inputs, treatment of costs and other factors critical to tariff methodology?
- C. Does the State believe that natural gas trades at a discount to oil? If so, does that discount factor increase project sensitivity to tariffs?

18. Strategies to Reduce Sensitivity to Pipeline Tariffs The history of the TAPS tariff implementation suggests that the State (a) rewarded bad behavior by the industry in1985 by caving in on cost over-runs, refunds and other major tariff issues when it entered into the TAPS Settlement Agreement and (b) after three decades of operation,has yet to secure just and reasonable tariffs on TAPS, to the detriment of State revenue and development.

- A. Have State tariff managers presented a strategy (with timelines for data submission and analysis, agency and court review procedures) that will ensure that just and reasonable gas pipeline tariffs are established in a timely manner?

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[30] See. Richard Fineberg, "New filings reveal oil pipeline owners' tax scam," *Anchorage Daily News* (Compass). Feb 8, 2000, p B-8; Richard A. Fineberg. "Federal Income Tax Payments on Dismantling Element of the Trans-Alaska Pipeline System (TAPS) Tariff" (corrected final testimony before the Alaska State House Oil & Gas Committee, April 13, 2000), and Letter from Attorney General Bruce M Botelho (signed by Assistant Attorney General Michael A. Barnhill), May 23, 2000

[31] Adapted from Anthony Finizza (consultant to Econ One), "Natural Gas Prices and Tariffs," presented to State Legislative Budget and Audit Committee, Aug 31, 2005, pp 16-17 (2005 estimates adjusted to reflect inflation and current prices; Dr Finizza estimated that this tariff estimate could be 20% high or low)

- B. On May 12, 2006, a Department of Law consultant representing the Administration assured legislators that, at least in theory, producers could be expected to contain pipeline costs to a greater extent than independent pipeline builders because, as shippers, they would have to pay the tariff. (1) Has the Department of Law explained the apparent contradiction between the historical reality of TAPS tariff charges and his statement?

(VII.) Pipeline Tariff Management Issues

19. Payments to Department of Law Consultants. Between 1981 and June 30,1997, the Department of Law paid Morrison & Foerster and its associates more than $20 million for legal assistance associated with TAPS tariffs. During the 1980s, payments averaged approximately $1.0 million per year, increasing to about $1.5 million per year during the 1990-93 period and $2.1 million per year between Jan. 1, 1994 and June 30, 1997.[32]

- A.. Does this amount include payments to accountants working with Morrison & Foerster, including Dr. Thomas Horst?
- B. How much did the State of Alaska pay Morrison & Foerster and its associates, including Dr. Thomas Horst, for work on TAPS tariff issues between July 1, 1997 and June 30, 2003?

According to the *Alaska Budget Report*, between July 2003 and the end of 2006 the State paid the law firm of Morrison & Foerst . $12,268,896 million for legal services and negotiations.

- C. Does the $12.3 million payments to Morrison & Foerster between July 2003 and the end of 2006 include payments for work on TAPS, including payments to Dr. Thomas Horst, for work on TAPS tariff issues?
- D. Between July 2003 and the end of 2006, how much did the State of Alaska pay Morrison & Foerster and its associate accountants, including Dr. Thomas Horst, for work on TAPS tariff issues?

20. Responsibility fo State Pipeline Tariff Policy. The Alaska Pipeline Act lists ten general powers and duties of the RCA under which that agency regulates pipelines and pipeline carriers in the state. The final subsection states that the commission

> (10) shall provide all reasonable assistance to the Department of Law in intervening in, offering evidence in, and participating in proceedings involving a pipeline carrier or affiliated interest and affecting the interests of the state, before an officer, department, board, commission, or court of another state or the United States.[33]

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[32] Alaska Dept. of Law, "Oil & Gas Contract Summary, 1977-February 15, 1994" [attachment to letter from Attorney General Bruce Botelho to House Finance Committee Co-Chair Ron Larson, Feb. 17, 1994], supplemented by personal communication from Alaska Department of Law, August 1997

[33] AS 42.06.140(a)(10)

- A. Apart from this statutory reference to the Department of Law, please identify any statutes that specifically assign responsibility for pipeline tariff policy to the Department of Law.
- B. The various sections of the Civil Division of the Department of Law handle legal matters and provide legal advice to the agencies of the executive branch. What state agency has statutory authority to set and review pipeline tariff policies?
- C. Please identify any functions of State government for which the Civil Division of the Department of Law not only handles legal matters associated with implementing policy, but also has (1) statutory and/or (2) *de facto* responsibility for setting and reviewing that policy.

Again I want to thank you for your efforts in this important area.

Secs. 42.06.010 — 42.06.120. Legislative policy; Alaska Pipeline Commission. [Repealed, § 20 ch 110 SLA 1981.]

Sec. 42.06.130. [Renumbered as AS 42.06.605.]

Article 1. Powers and Duties of Regulatory Commission of Alaska.

Section
55. Commission decision-making procedures
140. General powers and duties
150. Powers and duties with respect to federally regulated carriers

Section
210. Publication of reports, orders, decisions, and regulations
220. Annual report
230. Jurisdiction of commission

Sec. 42.06.055. Commission decision-making procedures. The commission shall comply with AS 42.04.080 for matters that come before the commission for decision. (§ 16 ch 25 SLA 1999)

Effective dates. — Section 31(c), ch. 25, SLA 1999 makes this section effective July 1, 1999

Sec. 42.06.140. General powers and duties. (a) The commission

(1) shall regulate pipelines and pipeline carriers in the state;

(2) may investigate upon complaint or its own motion, the rates, classifications, rules, regulations, prices, services, practices, and facilities of pipeline carriers, and the performance of obligations under and compliance with the terms of leases issued by the state;

(3) may make, prescribe, or require just, fair, and reasonable rates, classifications, regulations, practices, services, and facilities for pipeline carriers;

(4) may require pipeline carriers and affiliated interests to file with the commission reports and other information and data required or permitted to be required by other provisions of this chapter;

(5) may adopt regulations that are necessary and proper to the performance of its duties under this chapter, including regulations governing practices and procedures of the commission; the regulations may not be inconsistent with state law;

(6) shall during normal business hours have access to and may designate any of its employees, agents, or consultants to inspect and examine the accounts, financial and property records, books, maps, inventories, appraisals, valuations, and related reports kept by a pipeline carrier, or kept for it by others, that directly affect the interests of the state and directly relate to pipelines located in the state;

(7) may initiate, intervene in, and appear personally or by counsel and offer evidence in and participate in, any proceedings involving a pipeline carrier, and affecting the interests of the state, before any officer, department, board, commission, or court of this state;

(8) shall require permits for the construction, enlargement in size or operating capacity, extension, connection and interconnection, operation or abandonment of any oil or gas pipeline facility or facilities, subject to necessary and reasonable terms, conditions and limitations;

(9) may prescribe the system of accounts and regulate the service of an oil or gas pipeline facility;

(10) shall provide all reasonable assistance to the Department of Law in intervening in, offering evidence in, and participating in proceedings involving a pipeline carrier or affiliated interest and affecting the interests of the state, before an officer, department, board, commission, or court of another state or the United States.

DUTY TO DEFEND

The State is party to a Settlement Agreement with the TAPS Carriers that was executed by the parties <u>and approved by the FERC</u> in 1985. I'll refer to that settlement as the TSA. The TSA is a legally binding contract between its parties, and its term runs through at least the end of 2008.

The TSA provides a formula and criteria under which the Carriers annually calculate and file new TAPS rates.

The TSA expressly requires the parties to defend against any litigation that affects the validity and enforceability of the Agreement, or any provision thereof. [Section I-3]

This duty to defend is a contractual duty, and in essence it requires the State to support and defend TAPS rates filed in conformance with the TSA.

If the State were to protest TSA--conforming TAPS rates at the FERC, the TAPS Carriers would surely petition the FERC to dismiss the State Protest (as they have repeatedly done in the current FERC litigation), and in our judgment, the FERC would dismiss the State to keep it from breaching its FERC-approved contract.

STATE'S DISCRIMINATION PROTEST

In December 2004, the TAPS Carriers filed 2005 interstate rates for TAPS shipments from PS-1 to Valdez that averaged $3.71 / bl.

The RCA-regulated intrastate rates for shipments from PS-1 to Valdez have remained at $1.96 / bl since the RCA's decisions on Tesoro's protests in dockets P-97-4 and P-03-4.

Thus, the 2005 TAPS rates for identical shipping services varied by $1.75 / bl depending on whether the shipments were in interstate or intrastate commerce.

The final paragraph of the TSA rate methodology [II-11(e)] provides that 'notwithstanding any other provision of the TSA, rates charged for TAPS services are subject to legal prohibitions on unjust discrimination and undue preference.' [paraphrased]

In other words, rates that are unjustly discriminatory or unduly preferential are not TSA conforming rates.

The TSA duty to defend applies only to TSA conforming rates, and thus does not apply to unjustly discriminatory rates. The State therefore protested the TAPS 2005 interstate rates on the grounds of unjust discrimination and undue preference.

The legal prohibitions on unjust discrimination and undue preference are set out in sections 2 and 3 of the Interstate Commerce Act. The ICA was enacted in 1885, and there is a long history of rate discrimination caselaw to rely on in applying its terms.

The basic premise of the ICA discrimination caselaw is that rates charged for substantially identical services must be substantially identical. Thus the State's protest cites to the nearly double rates charged for interstate vs intrastate services on TAPS as proof of unjust discrimination.

The remedy for unjust discrimination under ICA section 2, is to reduce the higher rate to a level comparable to the lower rate. The State is therefore seeking to have the interstate TAPS rate reduced to approximately the level of the $1.96 intrastate rate.

PROCESS THROUGH HEARING

The State initiated the current litigation by filing its discrimination protest of the 2005 TAPS rates. A day after the State filed its protest, Anadarko and Tesoro jointly filed a protest of the 2005 TAPS rate on separate grounds. The FERC consolidated the protests for hearing. The parties have since continued their protests on the TAPS 2006 and 2007 rates, on the same grounds

Anadarko / Tesoro are not parties to the TSA. They are not subject to the duty to defend and have taken no position in this litigation on whether the 2005, 2006 and 2007 TAPS rates are calculated and filed in conformance with the TSA.

A/T instead challenges the rates as not in conformance with the FERC **non-**settlement rate methodology -- the "Opinion 154-B" methodology.

In response to the A/T evidence regarding its TAPS 154-B calculation, the TAPS Carriers filed their own (much higher) 154-B calculation.

In response to the State's discrimination protest, the Carriers claimed that their 154-B calculation showed that the intrastate rate was too low, and that any discrimination should be alleviated by increasing the intrastate rate.

The State therefore responded by presenting its own 154-B reference rate calculation, and thereby established that the $1.96 intrastate rate did indeed cover its fair share of the costs of TAPS operations. The State's 154-B

evidence presents rates and rate components very close to those presented by A/T.

The focus of the litigation thus became an argument over the proper calculation of non-settlement 154-B rates for TAPS.

JUDGE CINTRON'S DECISION

Following a lengthy review of the filed testimony and arguments from all of the parties regarding the appropriate calculation of TAPS rates under the 154-B methodology, Judge Cintron ruled in favor of A/T's protest and found that the Carriers should be required to file new rates going forward (after 2006) at approximately $2 / bl.

She then moves on to address the State's discrimination claim, and in paragraph 263, at pages 112-113 she rules:

> "this decision contemplates new rate filings that will be substantially less than the Carriers 2005 and 2006 original filings . . . A/T's Opinion 154-B interstate rate calculation . . . is $2.04 for 2005 and $1.83 for 2006. The State's Opinion 154-B reference rate . . . for interstate rates . . . is $1.96 and $2.05 for 2005 and 2006, respectively. The intrastate rate set by the RCA is $1.96 . . . THE DIFFERENCE BETWEEN THESE RATES AND THE RCA ESTABLISHED RATE ARE MINIMAL. ACCORDINGLY, THE DISCRIMINATION HAS BEEN ALLEVIATED AND THE STATE'S DISCRIMINATION CLAIMS ARE RENDERED MOOT.

In summary, Judge Cintron found that by equalizing the TAPS interstate and intrastate rates going forward, her ruling for Anadarko/Tesoro alleviated the discrimination.

Now that sounds reasonable, as far as it goes, HOWEVER

the State's discrimination protest does not seek relief only from discrimination in rates charged after 2006, we also seek to cure the discrimination in rates already charged in 2005 and 2006.

And in ordering refunds for 2005 and 2006. Judge Cintron ignores our discrimination protest (which she found to be moot) and relies on a legal precedent that has applied only in a select few J&R -- that is, non-discrimination -- rate cases.

The precedent she relies on limits refunds to the difference between the rates actually charged and the last permanent (unprotested) rate that was in effect prior to the filing of the current protested rate. In this case she ruled that the 2004 TAPS rate was the "last legal rate" for calculation of refunds.

So, based on that narrow precedent, Judge Cintron has limited the refunds for 2005 and 2006 to the difference between the TAPS rates ...arged and the 2004 TAPS rate -- which averaged about $3.05 / bl.

Her decision to limit the refunds is subject to legal challenge even when applied in the context of a J&R rate protest, and the FERC staff has well presented <u>that</u> legal challenge in their Reply Brief.

The State has an alternative, perhaps stronger, argument to raise against the refund limitation ruling through its discrimination protest.

That's because, under ICA Sections 2 and 3, rates that are unjustly discriminatory and/or unduly prejudicial are illegal, and the remedy for such illegal rates is to remove <u>all</u> of the discrimination by resetting the interstate rates at a level comparable to the lower intrastate rate charged for comparable services.

Judge Cintron acknowledged this requirement for <u>equivalence</u> in the interstate and intrastate rates when she determined (as I quoted earlier)

that by setting interstate rates that are "minimally" different from the intrastate rates, she had "alleviated" the rate discrimination protested by the State.

However, the effect of her proposed refund decision is to allow the Carriers to retain tariff payments at a $3.05 / bl rate for 2005 and 2006.

This is still $1 more than the $1.96 intrastate rate or than the rate that she established as J&R for 2005 forward.

Her refund decision thus does not create the "minimal" difference between interstate and intrastate rates that she relied upon to support her finding that the State's discrimination claim is moot.

STATE'S RESPONSE

So, where do we o from here?

The State is considering possibly filing exceptions to Judge Cintron's decision along the following lines:

First that the State's discrimination claim is not moot since, as the judge's refund decision shows, different rules apply to the calculation of refunds in in J&R rate litigation, as opposed to in discrimination litigation, and

Second, that allowing the Carriers to retain a $3.05 / bl rate in calculation of the refunds for 2005 anu 2006, does not appropriately remedy the discrimination in rates for those years. In accordance with her ruling on the discrimination claim, the refunds must result in no more than minimal differences between the TAPS interstate and intrastate rates for 2005 and 2006, as well as going forward.

UNITED STATES OF AMERICA 119 FERC ¶ 63,007
FEDERAL ENERGY REGULATORY COMMISSION

BP Pipelines (Alaska) Inc.	Docket No. IS05-82-002
ConocoPhillips Transportation Alaska Inc.	Docket No. IS05-80-002
ExxonMobil Pipeline Company	Docket No. IS05-72-002
Koch Alaska Pipeline Company LLC	Docket No. IS05-96-002
Unocal Pipeline Company	Docket No. IS05-107-001

State of Alaska — Docket No. OR05-2-001
v.
BP Pipelines (Alaska) Inc
ExxonMobil Pipeline Company
ConocoPhillips Transportation Alaska, Inc.
Unocal Pipeline Company
Koch Alaska Pipeline Company

Anadarko Petroleum Corporation — Docket No. OR05-3-001
v.
TAPS Carriers

BP Pipelines (Alaska) Inc. — Docket No. OR05-10-000

BP Pipelines (Alaska) Inc.	Docket No. IS06-70-000
ExxonMobil Pipeline Company	Docket No. IS06-71-000
ConocoPhilips Transportation Alaska, Inc.	Docket No. IS06-63-000
Unocal Pipeline Company	Docket No. IS06-82-000
Koch Alaska Pipeline Company	Docket No. IS06-66-000

Anadarko Petroleum Corporation — Docket No. OR06-2-000
v.
TAPS Carriers

INITIAL DECISION

(Issued May 17, 2007)

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CARMEN ANA CINTRON, Presiding Administrative Law Judge

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I. INTRODUCTION

1. This case set for hearing the 2005 and 2006 interstate rate filings of the TAPS Carriers.[1] This decision finds that the proposed interstate rates for 2005 and 2006 are not just and reasonable.

II. PROCEDURAL HISTORY

2. The "labyrinthine regulatory process" leading to the Commission's approval of the TAPS Settlement Agreement (TSA) is set forth in *Arctic Slope Regional Corporation v. FERC*, 832 F.2d 158 (D.C. Cir. 1987), and is not repeated here. The stipulated procedural history of the case is described below.[2]

3. In December of 2004, the TAPS Carriers filed their interstate rates for 2005, which ranged from $3.52 to $3.97 per barrel, for the transportation of ANS crude oil from Pump Station No. 1 to the southern terminus of TAPS at the Valdez Marine Terminal (Valdez). On December 15, 2004, the State of Alaska (State) filed a protest of the TAPS Carriers' 2005 filed rates and a complaint with respect to the TAPS Carriers 2003 and 2004 filed rates (State's 2005 Protest and Complaint).[3]

4. In its 2005 Protest and Complaint, the State alleged that the TAPS Carriers' 2005 filed rates (1) violated the unjust discrimination and undue preference provisions of sections 2 and 3(1) of the Interstate Commerce Act (ICA), (2) were inconsistent with the terms of the Interstate Settlement Agreement, (3) impermissibly included dismantlement, removal, and restoration (DR&R) expenditures as Operating Expenses, and (4) unlawfully included non-jurisdictional intrastate litigation costs. The State also protested (5) ConocoPhillips' alleged failure to make the required section II-10 adjustment to its 2005 maximum allowable rate under the TAPS Settlement Methodology (TSM), and (6) ConocoPhillips', Unocal's, and KAPL's alleged inclusion in their 2005 interstate tariffs of the intrastate portion of the DR&R Allowance that they had waived before the Regulatory Commission of Alaska (RCA).

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

[2] The procedural history was submitted pursuant to an order of the Presiding Judge. Tr. at 6942-43 (January 11, 2007).

[3] "*Protest and Petition for Investigation into the Proposed 2005 TAPS Tariffs and Complaint and Petition for Investigation into the 2003 and 2004 TAPS Tariffs by the State of Alaska and Intervention in Any Subsequent Proceedings*," Docket No. OR05-2-000 (Dec. 15, 2004).

Further, the State complained that the TAPS Carriers' 2003 and 2004 interstate tariffs impermissibly included (7) non-jurisdictional intrastate litigation costs, and (8) DR&R expenses. The State subsequently reached a settlement with ConocoPhillips and withdrew the portions of its 2005 Protest and Complaint dealing with items (5) and (6) (as it pertained to ConocoPhillips).[4] The State also reached settlements with KAPL and Unocal, and withdrew the portions of its 2005 Protest and Complaint concerning item (6) (as it pertained to KAPL and Unocal).[5] On October 11, 2006, the State withdrew the portion of its 2005 Protest and Complaint concerning items (4) and (7).[6] On March 6, 2006, the Presiding Judge clarified that item (3) was to be considered along with the investigation of Strategic Reconfiguration Program costs in a later phase of the proceeding.[7] Items (1), (2) and (8), therefore, are the portions of the State's 2005 Protest and Complaint that remain at issue in this phase of the proceeding.

5. On December 16, 2004, Anadarko Petroleum Corporation (Anadarko) filed a protest and complaint (Anadarko's 2005 Protest and Complaint) alleging that the TAPS Carriers' 2005 filed rates were unjust, unreasonable and otherwise unlawful.[8]

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[4] "Notice of Partial Withdrawal of State's Protest and Complaint Against ConocoPhillips Transportation Alaska Inc.," Docket Nos. IS05-80 and OR05-2 (Sept. 7, 2005); "Notice of Partial Withdrawal of State's Protest and Complaint Against ConocoPhillips Transportation Alaska Inc.," Docket Nos. IS05-80 and OR05-2 (Nov. 2, 2005); "Order Granting Partial Withdrawals," Docket Nos. IS05-82-002, *et al.* (Nov. 4, 2005).

[5] "Notice of Partial Withdrawal of State's Protest and Complaint Against Koch Alaska Pipeline Company LLC," Docket Nos. IS05-82, *et al.* (Jan. 24, 2006); "Order Confirming Partial Withdrawal," Docket Nos. IS05-82-002, *et al.* (Feb. 9, 2006); "Notice of Partial Withdrawal of State's Protest and Complaint Against Unocal Pipeline Company," Docket Nos. IS05-82, *et al.* (April 20, 2006); "Order Confirming Partial Withdrawal," Docket Nos. IS05-82-002, *et al.* (May 18, 2006).

[6] "Notice of Partial Withdrawal of State's Protests and Complaints Against BP Pipelines (Alaska) Inc., ConocoPhillips Transportation Alaska, Inc., ExxonMobil Pipeline Company, Koch Alaska Pipeline Company LLC, and Unocal Pipeline Company," Docket Nos. IS05-82-002, *et al.* (Oct. 11, 2006) (State's October 11, 2006 Notice);

[7] "Order Establishing New Procedural Schedule, Granting Request for Clarification and Confirming Withdrawal of Motion to Amend Procedural Schedule," Docket Nos. IS05-82-000, *et al.* (March 6, 2006).

[8] "Protest, Complaint, Motion to Intervene, Motion to Consolidate, and Request for Hearing and Other Relief of Anadarko Petroleum Corporation," Docket No. OR05-3-000 (Dec. 16, 2004).

Tesoro Corporation (Tesoro) subsequently intervened in both Anadarko's 2005 Protest and Complaint proceeding and the State's 2005 Protest and Complaint proceeding.[9]

6. On July 20, 2005, the TAPS Carriers filed a petition pursuant to section 13(4) of the ICA requesting the Commission to (1) investigate the 2005 intrastate rates imposed by the RCA, (2) find such intrastate rates to be unduly preferential and unjustly discriminatory against and an undue burden on interstate commerce, and (3) raise the 2005 intrastate rates to the level of the 2005 filed interstate rates.[10]

7. In December of 2005, the TAPS Carriers filed their interstate rates for 2006, which ranged from $3.78 to $4.41 per barrel for the transportation of ANS crude oil from Pump Station No. 1 to Valdez. On December 14, 2005, Anadarko and Tesoro (along with its affiliate, Tesoro Alaska Company) (collectively, Anadarko/Tesoro) filed a joint protest and complaint of the TAPS Carriers' 2006 filed rates (Anadarko/Tesoro's 2006 Protest and Complaint), alleging that the 2006 rates were unjust, unreasonable, unduly discriminatory and otherwise unlawful.[11] On that same day, the State filed a protest of the TAPS Carriers' 2006 filed rates and a complaint with respect to the TAPS Carriers 2004 and 2005 filed rates (State's 2006 Protest and Complaint).

8. In its 2006 Protest and Complaint, the State alleged that the TAPS Carriers' 2006 filed rates (1) violated the unjust discrimination and undue preference provisions of sections 2 and 3(1) of the ICA, (2) were inconsistent with the terms of the Interstate Settlement Agreement, (3) improperly included intrastate litigation costs, and (4) impermissibly included imprudently incurred costs for the Strategic Reconfiguration Program. The State subsequently withdrew the portion of its 2006 Protest and Complaint dealing with item (3),[12] and on September 15, 2006, the Chief Judge severed the investigation of Strategic Reconfiguration Program costs (item (4)) from

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[9] "Motion to Intervene of Tesoro Petroleum Corporation," Docket Nos. IS05-82-000, *et al.* (Jan. 5, 2005).

[10] "Petition of the TAPS Carriers for the Commission to Investigate and Set Intrastate Rates and Motion to Consolidate Proceedings," Docket No. OR05-10-000 (July 20, 2005).

[11] "Protest, Complaint, Motion to Intervene, Motion to Consolidate, and Request for Hearing and Other Relief of Anadarko Petroleum Corporation, Tesoro Corporation, and Tesoro Alaska Company," Docket No. OR06-2-000 (Dec. 14, 2005).

[12] *See* State's October 11, 2006 Notice.

this proceeding.[13] Consequently, items (1) and (2) are the only portions of the State's 2006 Protest and Complaint that remain at issue in this phase of the proceeding.

9. Arctic Slope Regional Corporation, Flint Hills Resources Alaska, LLC (Flint Hills), Williams Alaska Petroleum, Inc. (Williams), Petro Star Inc. (Petro Star), ConocoPhillips Alaska, Inc., and the RCA each moved to intervene in one or more of the proceedings described above.[14]

10. Except to the extent that issues were withdrawn or severed, the foregoing protests and complaints and the TAPS Carriers' section 13(4) petition were consolidated and set for hearing.[15] The parties filed direct (December 7, 2005), supplemental direct (with respect to the TAPS Carriers 2006 filed rates) (April 4, 2006), answering (May 26, 2006) and reply (August 11, 2006) rounds of prepared testimony on those remaining issues. The hearing commenced on October 31, 2006 and ended on January 11, 2007. Initial and reply briefs were filed on February 16, 2007 and March 21, 2007, respectively, by the TAPS Carriers, Commission Trial Staff (Staff), Anadarko/Tesoro, the State, the RCA, Flint Hills, and Petro Star.

III. ISSUES

ISSUE I: WHICH PARTIES BEAR THE BURDEN OF PROOF ON WHICH ISSUES?

Burden of Proof - Carriers' Filed Rate Increases and Anadarko/Tesoro's Protests and Complaints

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[13] *BP Pipelines (Alaska) Inc.*, 116 FERC ¶ 63,056 (2006).

[14] *See State of Alaska*, 110 FERC ¶ 61,129 at P 5 (2005); *BP Pipelines (Alaska) Inc.*, 112 FERC ¶ 61,219 at P 3 (2005); "Notice of Intervention of the Regulatory Commission of Alaska," Docket No. OR05-10-000 (August 5, 2005); *State of Alaska*, 114 FERC ¶ 61,174 (2006) at P 4; *BP Pipelines (Alaska) Inc.*, 110 FERC ¶ 63,015 (2005); "Order of Chief Judge Granting Motion for Leave to Intervene," Docket Nos. IS05-82-000, *et al.* (Jan. 10, 2005); "Order of Chief Judge Granting Motions for Leave to Intervene," Docket Nos. IS05-82-000, *et al.* (Jan. 25, 2005); "Order Further Modifying Procedural Schedule and Granting Motions to Intervene," Docket Nos. IS05-82-000, *et al.* (Jan. 19, 2006).

[15] *See BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 (2004); *State of Alaska*, 110 FERC ¶ 61,129; *BP Pipelines (Alaska) Inc.*, 112 FERC ¶ 61,219; *State of Alaska*, 114 FERC ¶ 61,174.

11. The Carriers, Anadarko/Tesoro, and Staff all agree that the Carriers bear the burden of proof with regard to the Carriers' filed rate increases for 2005 and 2006 under ICA section 15(7), 49 U.S.C. app. 15(7) (1994). The Carriers claim that Anadarko/Tesoro's protests and complaints propose that the TSM should no longer be used and that the Carriers be required to file one rate. Thus, the Carriers assert that this is a third party challenge to an existing rate, and accordingly, Anadarko/Tesoro bear the burden of proving that the existing rate is unlawful. With respect to Anadarko/Tesoro's proposal to adopt a different methodology for establishing interstate rate ceilings, the Carriers state that Anadarko/Tesoro bear the burden of proving both that the TSM is unreasonable and that Anadarko/Tesoro's proposed new rates are reasonable.[16] In sum, the Carriers claim that Anadarko/Tesoro, as the parties proposing a new methodology for establishing interstate rates, bear the burden of proving: (1) that the TSM is unjust and unreasonable and (2) the proposed replacement methodology is just and reasonable.

12. Staff and Anadarko/Tesoro state that it is the Carriers, and not Anadarko/Tesoro, that bear the burden of proving the TSM produces just and reasonable rates. Staff claims that the Carriers' argument that the burden of proving the unlawfulness of the existing rate and the reasonableness of a replacement rate rests with Anadarko/Tesoro, is incorrect. This is evident, Staff and Anadarko/Tesoro contend, because the Commission, in accepting the settlement did not find, and has never found, the TSA or the TSM it established just and reasonable.

13. Anadarko/Tesoro and Staff also argue that the Carriers' suggestion that they have no burden of proof as to unchanged components of their rates is also incorrect. Both Anadarko/Tesoro and Staff cite *Northern Border Pipeline Co.*, 89 FERC ¶ 61,185 at 61,574 (1999) (*Northern Border*) and *Williston Basin Interstate Pipeline Co.*, 107 FERC ¶ 61,164 at P 21-26 (2004) (*Williston Basin*), for the proposition that the Carriers' bear the burden of proof with respect to each element of the TSM. Moreover, Anadarko/Tesoro and Staff state that since each item in the pipeline's proposed cost of service is part of the proposed rate increase, the Carriers' ICA section 15(7) burden includes the burden of supporting the dollar amount of each item in the cost of service, including any unchanged items. Staff further argues that to the extent the Carriers fail to show the justness and reasonableness of their rates, the Commission may order refunds of the overall increase in the cost of service. Last, Anadarko/Tesoro state that they, as the complainants, carry the burden of supporting their complaints which they claim they have fully satisfied.[17]

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[16] Carriers' IB at 14-15 (citing *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 186-87 (D.C. Cir. 1986) (*Sea Robin*) for the proposition that a third party proposing to change a methodology bears the burden of proof).

[17] Anadarko/Tesoro IB at 11 (citing *Tesoro Refining and Mktg. v. Frontier*

14. The Carriers response states that they disagree with Anadarko/Tesoro's and Staff's contention that the Carriers bear the burden of proving that the TSM is just and reasonable. In fact, the Carriers contend, their burden only requires the Carriers to justify their filed rates as just and reasonable.

Discussion/Findings

15. The Carriers 2005 and 2006 filings propose rate increases. Accordingly, as discussed more in depth below, the findings with respect to this issue are as follows: (1) the Carriers bear the burden of proving that the TSM produces just and reasonable rates, and effectively, that the Carriers' proposed rate increases for 2005 and 2006 are just and reasonable and (2) Anadarko/Tesoro, as the complainants bear the burden of proof with respect to their complaints.[18] Anadarko/Tesoro and Staff are in agreement, and the Carriers concede, that section 15(7) of the ICA and the Commission in *Trans Alaska Pipeline Sys.*, 35 FERC ¶ 61,425 at 61,983 n.17 (1986), placed the burden of showing the proposed increases in the 2005 and 2006 rates are just and reasonable upon the Carriers.[19]

16. The only point of contention with regard to this issue concerns the Carriers' claim that because they have not proposed to change the TSM, Anadarko/Tesoro bear the burden of proving that the TSM, as an existing methodology, is unjust and unreasonable. Carriers IB at 14. As discussed by Anadarko/Tesoro and Staff, *Williston Basin* and *Northern Border* stand for the proposition that a pipeline proposing a change in its overall cost of service must justify each element in the new cost of service including the unchanged elements. In *Williston Basin*, the Commission stated that "[s]ince each item in the pipeline's proposed cost of service is a part of the pipeline's proposed rate increase, the pipelines' [NGA] section 4 burden to support the proposed general rate increase includes the burden of supporting the dollar amount of each item in the cost of service, including unchanged items."[20]

Pipeline Co., 105 FERC ¶ 61,227 at P 24 (2003)).

[18] *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 107 FERC ¶ 61,175 at P 150 (2004) ("In any complaint filed before the Commission, the complainant carries the burden of proof regarding the facts and law asserted.").

[19] The Commission, in approving the TSA, held that the Carriers' annual TSM tariff filings (like the ones at issue here) would be treated as "any rate change filing under the ICA," with the "burden of proof…upon the carrier to show that the proposed changed rate…is just and reasonable….". 35 FERC at 61,983 n.17.

[20] 107 FERC at P 24. Staff, the Carriers, and Petro Star agree that Sections 4 and 5 of the NGA are equivalent to the Section 15(7) and 15(1) of the ICA. Carriers

Thus, for the Carriers, this means proving that both the changed and unchanged cost of service elements, and effectively, the TSM itself and its derived rates, result in just and reasonable rates. Accordingly, since the Carriers have proposed an increase in their rates, it is found that the Commission requires the Carriers to justify each element of the proposed rates. This is confirmed by the Commission's pronouncements in adopting the TSA. To wit, the Commission stated that "the burden of showing that the new rate is just and reasonable will be on the TAPS Carriers, pursuant to section 15(7) of the ICA which provides that in any 'hearing involving a change in rate… the burden of proof shall be upon the carrier to show that the proposed changed rate…is just and reasonable. The carriers cannot rely on the approved settlements to establish the justness of these filed rate changes, since the settlement rates were never adjudicated to be just and reasonable." 35 FERC at 61,977 n.17.

17. The burden of proof with respect to the Carriers' section 13(4) petition and the State's section 2 and 3(1) claims will be addressed in the appropriate sections below.

ISSUE II: SHOULD THE TAPS SETTLEMENT METHODOLOGY BE USED TO DETERMINE TAPS RATES?

Issue II. A. Scope of the Issue

18. The TAPS Carriers argue that the Commission limited the scope of the hearing to the issue of whether the TAPS Carriers' filed rates comply with the TSM and did not include the issue of whether the TSM should continue to be the governing methodology for TAPS. Determinations by the Commission that the TSM is binding on all parties to the TAPS rate proceedings, the Commission's decision not to apply a different ratemaking methodology to TAPS, and the narrow scope of the issues in this proceeding show that the Commission views TAPS rates that comply with the TSM as lawful, the Carriers claim. Since the Commission's orders approving the TSA in 1985 and 1986, the Carriers aver, the Commission has affirmed that TSM is the ratemaking methodology that governs TAPS rates on several occasions. Specifically, the Carriers state that the Commission's original orders approving the TSM in *Trans Alaska Pipeline Sys.*, 33 FERC ¶ 61,064 (1985); 35 FERC ¶ 61,425 (1986), state that the TSM would not be binding on non-settling parties. However, the Carriers assert that the Commission's position on the TSM evolved following the enactment of the

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IB at 106; Staff RB at 4; PS RB at 4 n.3. Section 5 of the NGA is equivalent to Section 15(1) of the ICA and Section 4 of the NGA is the equivalent of 15(7) of the ICA. Carriers' IB at 106; PS RB at 4 n.3; *Texaco Refining and Marketing Inc. v. SFPP, L.P.*, 117 FERC ¶61,285 at 61,367 (2006) (*Sepulveda*).

Energy Policy Act of 1992 (EPAct of 1992). Evidence of this evolution, the Carriers contend, can be found in *Amerada Hess* where the Commission found that "[t]he TSM is now binding on the TAPS Carriers, all parties to TAPS rate proceedings, as well as the Commission" and "[t]he TAPS Carriers may not establish rates on any other basis." Carriers RB at 12 (citing *Amerada Hess Pipeline Corp.*, 79 FERC ¶ 61,300, 62,358 (1997) (emphasis omitted) (*Amerada Hess*).

19. In addition, the Carriers claim that in Order No. 561 the Commission followed the directive of Congress to exclude TAPS from the methodological reforms implemented in Title 18 of the EPAct.[21] In Order No. 561, the TAPS Carriers assert, the Commission required TAPS rates to be justified in accordance with the TSM and stated that the TSM would control if a conflict were to arise between the TSM and the revisions in Order No. 561. The Carriers further claim that Commission Order No. 588 states that the Carriers could continue to file rates based on the TSM and would only need to file rates pursuant to *Williams Pipe Line Co.*, 21 FERC ¶ 61,260 (1982) (Opinion 154) if their filings sought to charge rates under the Opinion 154-B methodology.[22] The positions taken by Anadarko/Tesoro and Staff are groundless, the Carriers claim. In conclusion, the Carriers state that the sole issue to be resolved is whether the TAPS Carriers' 2005 and 2006 filed rates comply with the TSM.

20. In contrast, Anadarko/Tesoro assert that the scope of this issue is defined by the protests and complaints that the Commission set for hearing. Anadarko/Tesoro state that their protests and complaints raised issues regarding whether the TSM and TSM derived rates are just and reasonable, and if such rates are not, how to develop just and reasonable cost-based rates for TAPS. The complaints and protests did not raise TSM compliance issues, Anadarko/Tesoro contend. Moreover, Anadarko/Tesoro argue, the scope is not limited to compliance with the TSM since the Commission in, *Trans Alaska Pipeline Sys.*, 35 FERC at 61,983 n.17, and the United States Court of Appeals for the District of Columbia (D.C. Circuit) in, *Arctic Slope Reg'l Corp. v. FERC*, 832 F.2d 158, 163 (D.C. Cir. 1987), held that the Carriers cannot rely on the TSM to establish the justness and reasonableness of their rates. Anadarko/Tesoro also state that when the Carriers submitted the TSA for approval they requested a ruling that it was in the public interest, not just and reasonable. Staff agrees with Anadarko/Tesoro's claims that the scope of the issue is not limited to whether the Carriers properly followed the TSM formula and that the scope of the issue is defined in the protests and complaints. According to Staff, the Commission

[21] Carriers IB at 16 (citing Order No. 561, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, FERC Stats & Regs. ¶ 30,985 at 30,961(1993) (Order No. 561)).

[22] Carriers IB at 16 (citing Order No. 588, *Oil Pipeline Cost-of Service Filing Requirements*, FERC Stats & Regs. ¶ 31,037 at 30,053 (1996) (Order No. 588)).

was clear, when it accepted the TSA, that challenges to the annual TSM rate filings would be allowed by non-signatories such as Anadarko/Tesoro and such rates would be judged under the just and reasonable standard.

21. Next, Anadarko/Tesoro and Staff aver that the TSM has not "evolved" as the Carriers contend, into a just and reasonable rate methodology that cannot be challenged by non-signatory parties. Specifically, Anadarko/Tesoro and Staff argue that the Carriers' claims that the Commission later reversed the holdings concerning the rights of non-signatory parties to challenge future rates and that the TSM has been adjudicated as just and reasonable rely primarily on *Amerada Hess*. Anadarko/Tesoro and Staff assert that *Amerada Hess*, is distinguishable because the issue in that case was limited to TSM compliance and, consequently, neither the justness and reasonableness of the TSM nor the shipper's rights to challenge the TSM were before the Commission.[23]

22. Moreover, Anadarko/Tesoro and Staff contend, the Carriers use of the statement that the TSM is "binding on…all parties" is taken out of context. Anadarko/Tesoro claim that the Commission was simply stating that for compliance purposes it could not order a change in the TSM retroactively and issues related to refunds had to be decided in accordance with the TSM. Thus, Anadarko/Tesoro and Staff conclude, nothing in *Amerada Hess* limited the statutory right of shippers to challenge future TSM filings under the ICA or suggested that the Commission intended to change its prior orders and deem the TSM just and reasonable.

Discussion/Findings

23. The scope of this proceeding is defined by the Commission's orders setting the issues in Anadarko/Tesoro's and the State's protests and complaints for hearing.[24] The Commission's language in each of the orders is virtually identical. In each order, the Commission described Anadarko/Tesoro's protests and complaints as arguing that

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[23] Anadarko/Tesoro and Staff state that the issue in *Amerada Hess* was strictly an accounting question. Staff states that the Commission examined whether certain oil spill costs were properly recorded in Account No. 610 or 680 of the Commission's Uniform System of Accounts for Oil Pipelines. The Commission also examined whether the TSM excludes amounts recorded in Account 680 from the definition of operating expenses to be recovered.

[24] *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 (2004) (protests to 2005 rates); *State of Alaska v. BP Pipelines (Alaska) Inc.*, 110 FERC 61,129 (2005) (complaints to 2005 rates); *BP Pipelines (Alaska) Inc.*, 113 FERC 61,332 (2005) (protests to 2006 rates); *State of Alaska v. BP Pipelines (Alaska) Inc.*, 114 FERC 61,174 (2006) (complaints to 2006 rates).

"the TSM does not produce rates that are just and reasonable under" the ICA. Then, the Commission, again in each order, established hearing procedures to examine the issues raised in the protests and complaints.[25] The Commission was clear that the issues raised by Anadarko/Tesoro, as well as the State, were to be the subject of the consolidated hearings. Thus, it is found that the scope of this proceeding, *inter alia*, includes the TSM calculated 2005 and 2006 rates as well as the TSM itself.

24. The Carriers claim that the Commission's orders defined the scope of the hearing as follows: "the issues of this case pertain to application of the TSM to the TAPS 2005 Tariffs. The parties have different understandings of how the terms of the TSM apply when there is an order from the RCA that may be inconsistent with the TSM." [26] This language does not indicate that the Commission intended to narrow the scope of the hearing. The Commission described the issues contained in Anadarko/Tesoro's protests and complaints, but never stated that it would not allow Anadarko/Tesoro's TSM arguments to be addressed, in their entirety, at the hearing. Consequently, it is found that the scope of the issues in the protests and complaints are significantly broader than those listed in the sentences cited by the Carriers. Limiting the scope as suggested by the Carriers would mean removing the main contention from Anadarko/Tesoro's protests and complaints – that the TSM itself results in rates that are not just and reasonable. It would be remiss to ignore the main arguments in Anadarko/Tesoro's protests and complaints especially in light of the fact that the Commission ordered that such arguments be considered.

25. The Carriers also contend that the Commission's perspective that the TSM would not be binding on non-settling parties has evolved, the TSM governs TAPS rates and the Carriers may not establish rates on any other basis, and the TSM is now binding on all parties. Carriers' IB at 16, RB at 11. As articulated by Anadarko/Tesoro, the gist of the Carriers' argument is that the "TSM has 'evolved' such that it now binds even non-settling parties and is thus immune to challenge under

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[25] *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 at P 10; *State of Alaska v. BP Pipelines (Alaska) Inc.*, 110 FERC ¶ 61,129 at P 3; *BP Pipelines (Alaska) Inc.*, 113 FERC ¶ 61,332 at P 20-21; *State of Alaska v. BP Pipelines (Alaska) Inc.*, 114 FERC ¶ 61,174 at P 16-17.

[26] Carriers' IB at 17 (citing *BP Pipelines (Alaska) Inc.* 109 FERC ¶ 61,376 at P 10; *see also State of Alaska v. BP Pipelines (Alaska) Inc.*, 110 FERC ¶ 61,129 at P 3; *BP Pipelines (Alaska) Inc.*, 113 FERC ¶ 61,332; *State of Alaska v. BP Pipelines (Alaska) Inc.*, 114 FERC ¶ 61,174. In addition, the Carriers argue that the Commission also limited the scope by stating that the suspension order "benefits customers by ensuring that the rates for transporting petroleum on TAPS are consistent with the settlement." Carriers' IB at 17 (citing *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 at P 2).

the 'just and reasonable' standard." A/T RB at 11. Anadarko/Tesoro and Staff focus their rebuttal on the Carriers use of *Amerada Hess* to support the Carriers' position that the TSM is "now binding on... all parties." Carriers IB at 16, RB at 11-12, 16 (citing *Amerada Hess*, 79 FERC at 62,538).

26. Not even a cursory review of *Amerada Hess* would support the Carriers' contentions. *See Amerada Hess*, 79 FERC ¶ 61,300. This is because the Carriers' arguments rely on two sentences in the *Amerada Hess* order without placing them in the proper context. *Id.* Anadarko/Tesoro's and Staff's assertions that the issue in *Amerada Hess* was an accounting question limited to TSM compliance and that issues concerning the justness and reasonableness of the TSM were not before the Commission, however, are clearly supported by the text of the order. *Id.*; A/T RB at 12; Staff RB at 8-9. Moreover, Anadarko/Tesoro's and Staff's arguments that the Commission's statement that the TSM is now binding on all parties only referred to: (1) TSM compliance and (2) the Commission's decision that the Carriers were obligated to determine the refunds and address accounting issues consistent with the TSM are persuasive. A/T RB at 12; Staff RB at 8-9.

27. Contrary to the Carriers' assertions, the EPAct of 1992, Order Nos. 561, 561-A and 588, do not indicate an evolution in the Commission's previous determinations. Carriers' IB at 16 n.15. In fact, those pronouncements are congruent with previous orders concerning the TSA. The language in the Commission's orders approving the TSA indicate that the Commission intended the TSM to govern TAPS unless or until a challenge was filed by a non-signatory. The Carriers fail to cite any language in these EPAct of 1992 pronouncements that limits the rights of non-signatory parties. In conclusion, as discussed above, nothing cited by the Carriers indicates that the Commission changed its position with respect to the legal status of the TSM as articulated in *Trans Alaska Pipeline, Sys.*, 35 FERC ¶ 61,425[27] and *Arctic Slope Reg'l Corp. v. FERC*, 832 F.2d 158[28]. Importantly, it is found that the statement that "the

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[27] *Trans Alaska Pipeline System*, 35 FERC ¶ 61,425 at 61,977 n.17 ("The [C]arriers cannot rely on the approved settlements to establish the justness of these filed rate changes, since the settlement rates were never adjudicated to be just and reasonable.") *Id.* at 61,981 ("we categorically state that our approval of this settlement is not a precedent as to future TAPs' rates"). *Id.* at 61,980 ("We affirm the conclusion of the ALJ that the settlement may not be imposed on any objecting party, including Arctic."). *Id.* at 61,982 ("Arctic, as well as any entity which is not a party to the settlement, may file at any time in the future for an adjudicated rate, which does not exceed the settlement rate...)

[28] *Arctic Slope Reg'l Corp. v. FERC*, 832 F.2d 158 at 161 ("Under the TSM,... rates are set on an annual basis, and are regarded under the regulatory schemes as any other rate filings by a common carrier. Thus, any such rates are subject to challenge

Carriers cannot rely on the approved settlements to establish the justness of... filed rate changes" remains intact and has not been reversed by the Commission. *See Trans Alaska Pipeline System*, 35 FERC ¶ 61,425 at 61,978 n.17.

Issue II. B. What Legal/Regulatory Principles Apply?

Just and Reasonable Rate Standards

28. Anadarko/Tesoro's assertion that the TSM cannot be used to determine the justness and reasonableness of the 2005 and 2006 rates since the TSM includes elements that are not cost-based is incorrect, the Carriers claim. The Carriers state that the TSM, although non-traditional, is a cost-based methodology. In addition, the Carriers claim that if it is determined that the TSM elements are not cost-based, the TSM could still be found to be in compliance with *Farmers Union Central Exchange, Inc., v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984) ("*Farmers Union II*"), which stated that departures from a cost-based approach may be legitimate if each deviation is found to be not unreasonable and consistent with the public interest. Accordingly, the TAPS Carriers conclude, the Commission would be justified in utilizing the TSM to determine the lawfulness of the TAPS interstate rates.

29. Next, Carriers again argue that the Commission's determination in *Amerada Hess* that the TSM is "now binding... on all parties" does not conflict with previous Commission orders approving the TSA which stated that non-settling parties would not be bound by TSM at that time. Carriers IB at 19; *Amerada Hess*, 79 FERC ¶ 61,300. In fact, the Carriers argue that the principle that future rate challenges must be brought pursuant to Opinion 154-B without relying on components of the TSM supports the Commission's findings in *Amerada Hess* that the TSM is "now binding... on all parties." *Amerada Hess*, 79 FERC ¶ 61,300. By the mid-1990's, the Carriers claim, rates calculated under the Opinion 154-B methodology (without use of TSM elements) would be greater than the TSM ceiling rates, and for that reason, the Commission was justified in concluding that the TSM was the only meaningful constraint on the TAPS Carriers' rates and that TSM is binding on all parties. The Carriers again claim that the legal status of TSM evolved after the enactment of EPAct of 1992.

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by non-settling parties, such as Arctic, as well as any other non-signatory." *Id.* at 166 n.16 ("FERC has explicitly stated... that its settlement approval in no way establishes the justness or reasonableness of any rates" and that "the agency was not even considering, much less near the point of decision on, the reasonableness of the TSM and the rates established under it".)

30. Anadarko/Tesoro and Staff state that the applicable standards for determining just and reasonable rates are set forth in *Farmers Union II* and Opinion 154-B.[29] Anadarko/Tesoro and Staff further assert that a just and reasonable rate is one that is cost-based with any departures specifically identified and justified as articulated in *Farmers Union II*, 734 F.2d at 1530, and Opinion 154-B.[30] The Commission adopted trended original cost (TOC) for determining rate bases and revenue requirements for oil pipelines in Opinion 154-B, Anadarko/Tesoro also state.

31. Staff similarly argues that although the TSM may contain some elements of a cost-based methodology, it is clear that the TSM also contains elements that are not appropriate for a cost-based rate.[31] In addition, Staff and Anadarko/Tesoro assert that the Carriers did not submit any evidence to support their TSM rates on a cost basis and even failed to discuss the justness and reasonableness of the TSM by eliminating section II.D from their briefs. Staff's reply brief also argues that the Carriers cite *Farmers Union II* to support the contention that non-cost factors can be considered, but fail to note that its application is limited. Specifically, Staff claims that *Farmer's Union II* states that deviations from cost-based pricing must be found not unreasonable and the resulting rate must be justified by those factors.

32. Anadarko/Tesoro and Staff claim that the Carriers concede that the TSM does not comply with just and reasonable rate standards. Specifically, Anadarko/Tesoro assert that: (1) the Carriers and their expert, Dr. Toof concede that the TSM is inconsistent with just and reasonable rate standards and cannot be approved outside the context of an uncontested settlement; (2) Dr. Toof acknowledged that ABP is not tied to the Carriers' costs; and (3) Dr. Toof agreed that neither the TSM true-up

[29] In addition, Anadarko/Tesoro contend that the applicable regulatory principles are those for setting the just and reasonable rates under the ICA, which include Sections 1(5) and 15(1) of the ICA. Section 1(5), Anadarko/Tesoro claim, requires all interstate rates charged for oil transportation to be just and reasonable and Section 15(1) requires the FERC to prescribe a just and reasonable rate if it finds a rate unjust or unreasonable or unjustly discriminatory.

[30] Anadarko/Tesoro claim that in *Williams Pipe Line Co.*, 21 FERC ¶ 61,260 (1982) (Opinion 154), the Commission issued a decision attempting to justify the retention of the ICC's "valuation" approach to ratemaking for oil pipelines. The Carriers state that Opinion 154 was rejected in *Farmers Union II* and in response, the Commission issued 154-B adopting an original cost rate method for oil pipelines.

[31] Staff states that the cost-based elements of the TSM include depreciation, DR&R, amortization of the $450 million rate base write-off, and deferred earnings. Some of the non-cost-based elements included in the TSM, Staff contends, are the inflation-adjusted, non-cost based APB, a 100% equity structure assumption, and a depreciable life known to be too short.

provision nor the method of allocating costs between federal and state jurisdictions is acceptable for use in making just-and-reasonable rate determinations. Thus, Anadarko/Tesoro contend, the Carriers agree that the TSM is incompatible with just and reasonable ratemaking standards.

Equitable Estoppel

33. The Carriers also argue that under the doctrine of equitable estoppel, Anadarko/Tesoro after waiting 20 years to challenge the justness and reasonableness of TSM interstate rates and reaping the benefits of the TSA, should not be allowed to invalidate the TSM. This late challenge regarding purported overcollections, the Carriers claim, also raises serious concerns about retroactive ratemaking. Anadarko/Tesoro's failure to challenge the rates over the years further supports the Commission's conclusion in *Amerada Hess* that the TSM is now binding on all parties, the Carriers contend. In addition, the Carriers state that the Commission should reaffirm its earlier finding that the TSM is binding on all parties and that rates that do not exceed the TSM rate ceilings are lawful. A ruling to that effect, the Carriers claim, would avoid many intergenerational equity issues, enhance prospects for building future infrastructure investments in Alaska and elsewhere, and would be appropriate since the TSA could be terminated in less than two years.[32]

34. Anadarko/Tesoro respond by arguing that they are not equitably estopped from challenging the filed rates because their right to challenge those rates is guaranteed by the Commission, the court orders approving the Interstate Settlement, and the ICA itself. In addition, Anadarko/Tesoro assert that they timely filed protests and complaints to the Carriers' 2005 and 2006 rates and the Commission recognized their standing to do so in setting the protests and complaints for hearing. Nothing cited by the Carriers alters these rights, Anadarko/Tesoro contend. Specifically, Anadarko/Tesoro assert, the case law on equitable estoppel requires, *inter alia*, false representation, reliance, and unjust enrichment involving a party to the agreement. None of those elements are present here, Anadarko/Tesoro claim.

35. Anadarko/Tesoro also aver that the Carriers' equitable estoppel argument fails because contrary to the Carriers' assertion that Anadarko/Tesoro have benefited from the TSA for more than 20 years without challenging the rates, Anadarko/Tesoro have only began producing oil on the North Slope in 2000 and have actually been paying excessive rates on TAPS since then. Staff's reply also states that the Carrier's

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[32] The Carriers state that "[O]n January 1, 2007, the State exercised its right under Section I-8 of the TSA to commence negotiations regarding the replacement of TSM. If such negotiations are not successful the State can terminate the TSA as early as January 1, 2009." Carriers IB at 24 n.25 (citing Ex. ATC-14 at 11; FHR-55).

equitable estoppel and retroactive ratemaking arguments are without merit. With regard to equitable estoppel, Staff similarly argues that the Commission's orders approving the TSA guaranteed the shippers the right to seek just and reasonable rates under the ICA and that right was never waived. Staff claims that the retroactive ratemaking argument is moot because Anadarko/Tesoro have not requested any remedies prior to the date the rates in this proceeding were suspended, subject to refund.

Public Interest

36. Third, the TAPS Carriers argue that they have shown that the public interest supports a holding that the 2005 and 2006 rates are in compliance with the TSM. The public interest, the Carriers state, must be considered by the Commission in adjudicating the lawfulness of the Carriers filed rates and has been found, by the Supreme Court and other courts, to be a key factor in judging the lawfulness of rates under the ICA.[33] The public need for investors in energy infrastructure projects to make necessary investments and the public need for efficient investment in and long-term development of energy resources support upholding the TSM, the Carriers claim. In their reply brief, the Carriers further assert that a Commission decision rejecting the TSM would have a chilling effect on future investment.

37. In response, Anadarko/Tesoro aver that their initial brief shows that the Carriers have misused the public interest standard. It is the just and reasonable standard that is applicable here, Anadarko/Tesoro contend. Moreover, Anadarko/Tesoro claim that the Carriers incorrectly stated that Anadarko/Tesoro's position is that public interest considerations are irrelevant to a determination of whether the TSM-based filed rates are just and reasonable. Anadarko/Tesoro state that this is contrary to their position and what Anadarko/Tesoro actually assert is that the public interest is met by setting just and reasonable rates and providing adequate incentives for investment while protecting shippers from excessive rates. Thus, Anadarko/Tesoro claim, their position is consistent with the case law concerning the public interest cited by the Carriers. Staff also states that setting just and reasonable

[33] In support of the proposition that the public interest should be considered in determining just and reasonable rates, the Carriers cite the Supreme Court in *Midstate Horticultural Co, Inc., v. Pennsylvania R.R.*, 320 U.S. 356 (1943) and *ICC v. Cincinnati, N.O. & T.P Ry.*, 167 U.S. 479 (1897). Carriers IB at 23 n.22. The Carriers' reply brief also cites *Farmers Union II* in arguing that the D.C. Circuit recognized that the Commission could and should take the public interest into consideration and did not foreclose departing from a "rigid cost-based approach to ratemaking."

rates is in the public interest and should give investors comfort since it allows the recovery of costs and a fair rate of return.

38. Flint Hills argues that the TSA should be allowed to continue until it terminates under its own terms because the TSA will likely terminate at the end of 2008, and both the Commission and public policy require that the settlement be allowed to run its full course. First, Flint Hills states that the TSA has two mechanisms for termination: (1) section III-12 of the TSA, where the TSA would run its course and terminate at the end of 2011 and (2) section I-8, whereby a party can seek to renegotiate the agreement beginning January 1, 2007, and if the parties fail to renegotiate within two years of that date the State or any of the TAPS owners can give written notice terminating the TSA as early as December 31, 2008. The State sent a notice of renegotiation on January 1, 2007, Flint Hills claims. The benefit of allowing the TSA to run its course, Flint Hills contends, is that the controversy with respect to what has been collected under the TSM (for example, DR&R) would be eliminated.

39. Second, Flint Hills argues that the United States Supreme Court recognizes the importance of upholding settlements. FH IB (citing *United Gas Co. v. Mobile Gas Corp.*, 350 U.S. 332, 344 (1956). The D.C. Circuit, Flint Hills asserts, has held that rate contracts should not be unilaterally modified unless required by the public interest and that the fact that a contractual rate may be higher than rates calculated under a different methodology does not necessarily trigger a public interest finding that the contract should be abrogated. Similarly, Flint Hills asserts that the federal courts do not favor allowing a party to undo a settlement that applies to others. Flint Hills also contends that the D.C. Circuit has also stated that the Commission has a preference to preserve the benefits of the parties' bargain in the contract. Moreover, Flint Hills adds, the State and Anadarko are not shippers on TAPS. Tesoro which does ship on TAPS, ships ANS petroleum which is not preferred by Tesoro at its Kenai Refinery in Alaska. In contrast, Flint Hills states that it and Petro Star fully support the continued use of the TSM and that significantly, they are refiners that can only run ANS petroleum and must ship all their refineries' crude on TAPS.

40. Third, Flint Hills claims that that the Commission's policy is to allow settlements to run their full course since it provides the benefit of certainty. Flint Hills also argues that the Commission's decision in *Kern River Gas Transmission Corp.*, 117 FERC ¶ 61,077 (*Kern River*) (2006), upheld a long-term levelized rate structure which was the product of settlement to allow shippers to realize the benefits bargained for in the settlement. The Interstate TSA and TSM are producing levelized rates and lower rates in outer years just as the parties intended, Flint Hills contends. For these reasons, Flint Hills concludes that the TSA and TSM have achieved the public policy goals and should be found just and reasonable.

41. Flint Hills also argues that the settlement principles in *Kern River* should also apply to the TSA since the rate design is analogous to the levelized rate design used by Kern River. Flint Hills claims that the rate designs share a common thread which is a key to the Commission's holding in *Kern River*. According to Flint Hills, in both cases, the pipeline carrier assumes some risk with respect to an element in the rate design. For Kern River, the risk was any depreciation not recovered within the first 15 years and the Carriers' assumed risk is tied to the APB since the dollar amount collected depends on throughput volume, Flint Hills contends.[34] In conclusion, Flint Hills asserts that the Commission's statement in *Kern River* that it is inherent in any levelization plan that the levelized rate will remain in effect for the entire agreed upon period should also apply to the TSA due to the trade-offs that occurred during the TSA's formation. In response, Staff states that Flint Hills's argument that the APB represents deferred return and must be retained so that the Carriers receive the benefit of their bargain is without merit. The TSM contains a separate element for deferred return and it is not the APB, Staff contends. Moreover, Staff avers, the only bargain struck was between the State and the Carriers and it only prohibited the State from protesting rates under the TSM ceiling.

42. Flint Hills further claims that the State and Staff have not rebutted the Commission's policy of ensuring that settlements, particularly those with levelized rates, run their full term. The Commission's recent pronouncements in *Sepulveda*[35] and *Kern River* support allowing the TSA and TSM to run their full term, Flint Hills asserts. Moreover, Flint Hills claims that when the TSA was approved, it was known that the rates of return under the TSM, including the APB, could be higher than otherwise allowed.

Discussion/Findings

43. As discussed further, *infra*, *Farmers Union II* and Opinion 154-B are the applicable ratemaking standards. First, the Commission has already held that the TSM cannot be used to establish just and reasonable rates. Second, Anadarko/Tesoro are not equitably estopped from challenging the TSM or the filed rates. Third, the Carriers public interest arguments are rejected since the applicable ratemaking standards perform a balancing act that protect investors' rate of return expectations. Flint Hills' assertions that the TSA should be allowed to run its course are rejected.

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[34] Flint Hills goes on to explain since the ABP was substituted for the original Rate of Return beginning in 1990, if actual throughput volumes prior to 1990 exceed projections, the Carriers would earn less than they would have earned had the switchover began before 1990.

[35] Flint Hills' arguments concerning *Sepulveda* are more appropriately discussed in Section III below.

44. As discussed above, section 15(7) requires the Carriers to prove that their 2005 and 2006 filed rates are just and reasonable. Anadarko/Tesoro, Staff, the Carriers, and Flint Hills agree that Opinion 154-B should be used to determine whether the rates filed by the Carriers are just and reasonable.[36] Thus, the applicable regulatory principles are stated in *Farmers Union II*, which provided guidance to the Commission on the factors to consider in formulating a rate making methodology, and the Commission's adoption of those guidelines in Opinion 154-B.[37] It is found that just and reasonable rates should be cost-based. *See Farmers Union II*, 734 F.2d 1486; Opinion 154-B, 31 FERC ¶ 61,377.

45. In seeking to define what the "just and reasonable" statutory requirement for ratemaking entails, the D.C. Circuit, in *Farmers Union II*, stated that "the statutory standard is, of course, not very precise." 734 F.2d at 1501. However, the Court went on to explain that as determined by "decades of judicial review of agency determinations of 'just and reasonable' rates: an agency may issue, and courts are without authority to invalidate, rate orders that fall within a 'zone of reasonableness,' where rates are neither 'less than compensatory' nor 'excessive.'" *Id.* at 1502. *Farmers Union II* also noted that the "zone of reasonableness" strikes a fair balance between the financial interests of the regulated company and the relevant public interests, both existing and foreseeable. *Id.* Finally, the court offered, "[b]ecause the relevant costs, including the cost of capital, often offer the principal points of reference for whether the resulting rate is 'less than compensatory' or 'excessive,' the most useful and reliable starting point for rate regulation is an inquiry into costs." *Id.* The court also stated that "non-cost factors may legitimate a departure from a rigid cost-based approach" and may "play a legitimate role in the setting of just and reasonable rates," but such deviations must be justified. *Id.* at 1502-03.

46. In closing, the D.C. Circuit provided "important and basic guideposts" to assist the Commission in establishing an appropriate ratemaking methodology. Specifically, *Farmers Union II* stated the following: (1) oil pipeline rates must be set within the "zone of reasonableness" as required by the ICC (and presumed market forces may not comprise the principle regulatory constraint); (2) departures from cost-

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[36] The Carriers' claim that the filed rates should be found just and reasonable if they comply with the TSM has been rejected as discussed in Section II.A, *supra*. In addition, the Commission has already made clear that the Carriers' cannot rely on the TSM to justify their rates. The Carriers and Flint Hills state that if TSM is not used to measure TAPS rates, then the appropriate methodology is set forth in Opinion 154-B. Carriers' IB at 19, FH RB at 18.

[37] Staff has provided a helpful summary of the history of *Farmers Union II* and Opinion 154-B in their brief. Staff IB at 11-14.

based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods ensure that the resulting rate levels are justified by those factors; (3) the rate of return methodology should account for the risks associated with the regulated enterprise; and (4) the choice of a proper rate of return is only part of an integrated ratemaking method, thus, the FERC must scrutinize the rate base and the rate of return methodologies to see that they will operate together to produce a just and reasonable rate. 734 F.2d at 1530.

47. Opinion 154-B was issued in response to *Farmers Union II*. Opinion 154-B rejected the valuation methodology as the model for calculating rate base, and revenue requirements, and replaced it with the TOC methodology. 31 FERC at 61,833. Opinion 154-B acknowledged the guidelines set forth in *Farmers Union II*, including the "guideposts" stating that oil pipeline's rates must be set within the "zone of reasonableness" and that departures from cost-based rates must be clearly identified. *Id.* at 61,832 (citing *Farmers Union II*, 734 F.2d at 1530). It also announced that "[i]t is evident that oil pipeline rates as a general rule must be cost-based." *Id.* at 61,833. The methods for determining, *inter alia*, the rate of return, rate base, and a starting rate base were also established in Opinion 154-B. Accordingly, it will be the "guideposts" set forth in *Farmers Union II* and Opinion 154-B, and not the TSM, that shall be used as the regulatory framework for determining whether the TSM and the 2005 and 2006 rates it produced are just and reasonable.

48. The Commission and the D.C. Circuit have already stated that the Carriers cannot rely on the TSA, and accordingly, the TSM to establish the justness and reasonableness of its filed rates.[38] As articulated by the D.C. Circuit, "FERC has explicitly stated… that its settlement approval in no way establishes the justness or reasonableness of any rates." *Arctic Slope*, 832 F.2d at 166; *see Sohio Pipe Line Co.*, 35 FERC at 61,982. The Carriers correctly note that *Farmers Union II* allows departures from a "rigid cost-based approach," but "each deviation… must be found not to be unreasonable and to be consistent with the Commission's statutory responsibility" to serve the public interest. Carriers' IB at 19 (citing 734 F.2d at 1502). Thus, the elements of the TSM that depart from cost-based standards must be justified and only then can it be determined whether the TSM as a whole is just and reasonable.[39] It would be remiss not to perform a "reasoned inquiry" into such deviations and rely only upon a Commission approved settlement which the Commission itself stated is of no precedential value. *See Farmers Union II*, 734 F.2d

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[38] The Carriers argument that they properly applied the TSM in calculating their filed rates is also rejected on the same grounds.

[39] This argument will be addressed in the following section where it will be determined whether the TSM comports with Opinion 154-B.

1502. Thus, it is *Farmers Union II* and Opinion 154-B that will serve as the standards for this inquiry and the Carriers' argument that the TSM should be used to determine just and reasonable TAPS rates is rejected.

49. Second, with regard to the Carriers' equitable estoppel arguments, Anadarko/Tesoro and Staff aptly note that the Commission's order approving the TSA preserved the rights of "Arctic, as well as any entity which is not a party to the settlement," to file "at any time in the future for an adjudicated rate, which does not exceed the settlement rate." *Trans Alaska Pipeline Sys.*, 35 FERC ¶ 61,425 at 61,982. In addition, the D.C. Circuit recognized that under the TSM, "rates are set on an annual basis, and are regarded under the regulatory scheme as any other rate filings by a common carrier… [t]hus, any such rates are subject to challenge by non-settling parties." *Arctic Slope Regional Corp.*, 832 F.2d 158 at 1[illegible]. The time to challenge the Carriers' rates did not begin to toll from the moment the TSA was approved more than 20 years ago as the Carriers seemingly contend. Each yearly filing brings a new opportunity for a non-signatory, such as Anadarko/Tesoro, to challenge the justness and reasonableness of the rates. This was the Commission's intent when it approved that TSA and that intent was confirmed when Anadarko/Tesoro's and the State's protests and complaints were set for hearing. Finally, the Carriers' contentions concerning retroactive ratemaking are rejected, as Staff recognizes, since Anadarko/Tesoro's requested remedies only concern the 2005 and 2006 rate filings which the Commission accepted, subject to refund.[40]

50. Third, the public interest standard is not the standard that is applied in establishing just and reasonable rates; however, it is a key factor in such a determination. The Carriers contention that upholding the TSA is in the public interest is primarily based on financial factors. Specifically, the Carriers argue that the TSA should be upheld to preserve the sanctity of long term settlements and commitments regarding future rates and returns. Carriers RB at 14-15. Otherwise, the Carriers claim, investors in energy infrastructure projects will not make the necessary investments and there will be a "chilling effect on future investment." *Id.*

51. *Farmers Union II* states that the public interest should be taken into consideration, and to that end, the D.C. Circuit contemplated setting rates within the "zone of reasonableness." 734 F.2d at 1502. The D.C. Circuit stated that this zone would strike a fair balance between the financial interests of the regulated company

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[40] *BP Pipelines (Alaska) Inc.*, 109 FERC ¶ 61,376 at P 2; 113 FERC ¶ 61,332 at P 3. *See Oxy USA, Inc. v. FERC*, 64 F.3d 679 at 699 (D.C. Cir 1995) (the rule against retroactive ratemaking in Section 15(7) procedures is not violated where all parties are placed on notice that the agency has the authority to order a refund of any part of the increase that it finds to be unjustified).

(in this case the Carriers) and the relevant public interests, both existing and foreseeable. *Id.* (citations omitted). The "zone of reasonableness" also requires rates that are neither "less than compensatory" nor "excessive." *Id.* Again, the D.C. Circuit has taken the relevant financial interests of investors into consideration and established, in its guideposts to the Commission, a ratemaking framework that will compensate investors and ensure that such investors still receive a reasonable return on their investment.[41] Anadarko/Tesoro witness John F. Brown stated that "the Commission allows pipelines an opportunity to recover… a return of, and reasonable return on, the remaining investment in the pipeline. Thus, just and reasonable rates appropriately balance the pipeline's interest in maintaining service and attracting capital with the shipper's interest in paying rates that are not excessive." AT-78 at 6, 13 (citing *Farmers Union II*, 734 F.2d at 1502); A/T IB at 17 n.9.

52. More succinctly stated, "just and reasonable rates consider both pipeline and shipper interests." AT-78 at 13 (John Brown). The Carriers rely on Professor Joseph P. Kalt's testimony for the proposition that maintaining TSM will serve the public interest and investors will not make necessary investments if regulators do not preserve commitments regarding future rates and returns, and allow opportunistic conduct once the investment is made. Carriers IB at 22-23, RB at 14-15. However, the Carriers omit the portion of Professor Kalt's testimony that states that such concerns can be alleviated "through the consistent, proper application of an integrated ratemaking methodology, such as Opinion 154-B." ATC-4 at 38-40.[42] Establishing just and reasonable rates does not undermine the spirit of the TSA or the expectations of investors since the relevant regulatory principles ensure that the Carriers will still recover a fair return on their investment. Any expectation to receive more than that is contrary to Commission precedent.

53. In addition, the orders approving the settlement left the door open for non-signatories to challenge the rates established by the settlement, even if such rates are below the ceiling rate. *Arctic Slope*, 832 F.2d at 161; A/T-78 at 15. Signatories and investors were placed on notice that the TSM requires rates to be set on an annual basis and such rates, and the TSM itself, are subject to challenge by non-signatories.

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[41] *Farmers Union II* at 1502 (quoting *City of Chicago v. FPC*, 458 F.2d at 731, 750-51 (D.C. Cir. 1971) ("When the inquiry is on whether the rate is reasonable to a producer, the underlying focus of concern is on the question of whether it is *high* enough to both maintain the producer's credit and attract capital. To do this, it must, *inter alia*, yield to equity owners a return 'commensurate with returns on investments in other enterprises having corresponding risks.'").

[42] ATC-4 at 38-39. It is noted that Professor Kalt also states that "the more efficient outcome is to continue to abide by and support settlements, like the TAPS Settlement Agreement and TSM." ATC-4 at 39.

See Arctic Slope, 265 U.S. at 161. Moreover, setting rates within the "zone of reasonableness" as required by Opinion 154-B will establish just and reasonable rates for non-signatory shippers while allowing investors to continue to recover a reasonable return on their investment in TAPS. The sanctity of a long term settlement must be weighed against the risk of allowing unjust and unreasonable rates to continue.[43] Similarly, the Carriers' argument that by the mid-1990s rates calculated under Opinion 154-B exceeded TSM rates and that the TSM has kept rates below just and reasonable Opinion 154-B calculated rates does not automatically render the TSM or the TSM calculated rates just and reasonable. This will be further discussed in section III below.

54. Flint Hills fails to recognize that the Commission approved the TSA with a caveat – non-signatories are free to challenge the TSA and the rates it establishes using the TSM. *See Trans Alaska Pipeline Sys.*, 35 FERC ¶ 61,425 at 61,980-982. The fact that the remaining life of the TSA is now less than two years is not sufficient to (1) strip the rights of non-signatories to challenge filed rates as granted by the Commission and (2) allow the TSA to continue, in the face of such a challenge, when the Commission itself has stated that the TSA has not been shown to produce just and reasonable rates. Moreover, Flint Hills' arguments that the TSM has produced lower rates than projected, the State and Staff previously supported the approval of the TSM without a time limitation, and it was known that there was a possibility that TSM rates would be higher in the future fail with respect to Anadarko/Tesoro's challenge to the rates for the same reasons. FH RB 6-14, 17-18. Flint Hills cites *Kern River Gas Transmission Company*, 117 FERC ¶ 61,077 (2006) (*Kern River*), for the proposition that the TSM must run its course to achieve the agreed upon levelized rates. The Commission allowed non-signatories to step forward and challenge the TSA, and accordingly, the TSA derived rates can only be allowed to run its course if the Carriers prove that the TSM results in just and reasonable rates. *See Arctic Slope*, 832 F.2d at 166 (the FERC had not considered the reasonableness of TSM and the rates established under it). Flint Hills is now requesting that the Commission impose the TSA on a non-signatory such as Anadarko/Tesoro, which is something the Commission has already declined to do. FH IB at 11; *See Trans Alaska Pipeline Sys.*, 35 FERC at 61,980-982.

55. In conclusion, the applicable ratemaking standards are set forth in *Farmers Union II* and Opinion 154-B. The Carriers arguments concerning equitable estoppel,

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[43] As noted by the D.C. Circuit, FERC "was not even considering, much less near the point of decision on, the reasonableness of the TSM and the rates established under it." The Commission has also stated that the "Carriers cannot rely on the approved settlements to establish the justness of these filed rates changes, since the settlement rates were never adjudicated to be just and reasonable."

retroactive ratemaking, and the public interest are rejected. Flint Hills' arguments are also rejected. It is noted that the Commission does favor upholding the sanctity of settlements. However, with respect to the TSA, the Commission has explicitly stated that it did not enforce the terms of the TSA on non-signatories such as Anadarko/Tesoro.[44] For that reason, the arguments that the TSA should be allowed to terminate under its own terms and be upheld, solely on public interest grounds, are rejected.

Issue II. C. Have the Applicable Standards been Satisfied?

56. The Carriers aver that because the TSM is binding on all parties and the Carriers 2005 and 2006 rates comply with the TSM, the rates are lawful The Carriers state that they have shown that they properly applied the TSM in calculating their filed rates by presenting the testimony of Dr. Toof, who concluded that the filed rates were equal or less than the TSM ceiling rates. The State did not present evidence directly responding to Dr. Toof's showing and Anadarko/Tesoro failed to dispute this showing as well, the Carriers contend.

57. The Carriers claim that by showing their filed rates are lower than rates calculated using the 154-B methodology, the Carriers have meet their burden.[45] The Carriers also claim that the Commission's regulations in 18 C.F.R. part 342, allow an oil pipeline to defend its rates on an Opinion 154-B basis even if the rates were negotiated or settlement rates. In addition, the Carriers cite *Magellan Pipeline Co.*, 105 FERC ¶ 61,390 (2003), for the proposition that a pipeline can submit a cost-of-service defense of the rate once it has been challenged in a valid protest. The Carriers claim that the rates can be defended by showing that the challenged rate is lower than the rate the pipeline could otherwise lawfully charge. Carriers' IB at 27 (citing *Sithe/Independence Power Partner, L.P. v. FERC*, 165 F.3d 944, 951 (D.C. Cir. 1999); *ARCO Pipe Line Co.*, 41 FERC ¶ 63,015 at 65,081, *aff'd*, 41 FERC ¶ 61,397 (1987).

58. Anadarko/Tesoro and Staff claim that the Carriers fail to address this central issue in the initial and reply briefs. Anadarko/ Tesoro argue that the Carriers have failed to satisfy the applicable legal standards in *Farmers Union II* and Opinion 154-B in two respects. First, Anadarko/Tesoro state that the Carriers incorrectly apply the less rigorous "public interest" standard which governs uncontested settlements,

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[44] This addresses Flint Hills' arguments concerning its assertion that the Commission's policy is to allow settlements to run their full course. FH IB 12-21; RB 9-12.

[45] The Carriers discuss this in Section III of their reply brief; however, this discussion is more appropriately addressed here. Carriers RB at 27-28.

instead of the "just and reasonable" standard which governs rate proceedings and is applicable here. Anadarko/Tesoro also argue that when the Commission approves a settlement as being in "the public interest," the Commission does not make an independent finding that the settlement rates are "just and reasonable."

59. Second, Anadarko/Tesoro assert that the Carriers also failed to satisfy the legal standards because the Carriers did not provide any evidence that the TSM rate formula or the filed TSM rates reflect the Carriers' actual cost of providing service. Anadarko/Tesoro argue that the Commission has held that, with respect to formula rates, the formula is the rate and the formula itself must meet the just and reasonable standard. As a result, Anadarko/Tesoro claim that the Carriers must justify the TSM formula and its components and not just a specific rate level to satisfy the just and reasonable standard. Instead, Anadarko/Tesoro contend, the Carriers present two proxy cases that have nothing to do with the Carriers' cost of providing service. The Carriers present a SAC proxy based on hypothetical costs and an Opinion 154-B proxy based on a different methodology with different inputs, and consequently, Anadarko/Tesoro argue, both proxies fail to show the cost of providing service on TAPS and should be rejected.

60. Next, Anadarko/Tesoro argue that the "end result" test is incorrectly used by the Carriers. Anadarko/Tesoro contend that the Commission has held that the test is employed after the Commission has approved the specific elements of the rate and the Carriers are not relieved of the burden of proving the specific rate elements. Anadarko/Tesoro also claim that the Carriers use the "end result" test for the proposition that the Carriers do not have to consider the TSM rate elements, but only the final rate. Finally, Anadarko/Tesoro argue that the Commission in *Olympic Pipeline Co.*, 101 FERC ¶ 61,245 at P 17 (2002), held that in a rate hearing, a pipeline must support the rate case it originally filed and not a different case later developed at the hearing which created a "moving target."

61. Staff posits arguments similar to Anadarko/Tesoro's. Specifically, Staff states that the Carriers failed to submit cost information to support the elements of the TSM formula that make up their filed rates. The Carriers cannot simply rely on their argument that mechanical compliance with the TSM formula or public interest concerns establish the justness and reasonableness of their rates, Staff claims. Staff also states that the Carriers argument that demonstrating that the filed rates were all equal to or less than the TSM ceiling rates does not satisfy the standard. The Carriers' 154-B proxy, Staff avers, uses "costs" that fail to recognize the large amounts of depreciation, DR&R, deferred earnings, and amoritization already collected through rates. In fact, Staff contends, only Anadarko/Tesoro and the State provide Opinion 154-B presentations that accurately calculate the TAPS cost of service. Staff claims that the Carriers' application of the SAC presentation is unprecedented at the

Commission and is irrelevant. Accordingly, Staff concludes, the Carriers have not satisfied the applicable standards and the rates should be rejected.

Discussion/Findings

62. It has already been determined that the applicable ratemaking standards in *Farmers Union II* and Opinion 154-B require rates generally to be cost-based. More importantly, the relevant precedent mandates that each component of the cost of service be supported. *See Williston Basin*, 107 FERC at P 24. The Carriers bear the burden of proving that the TSM and the rates it produces are just and reasonable. As discussed above, this necessarily requires the Carriers to provide cost justification for each element of the TSM. This burden is not met by the Carriers' showing via Dr. Toof's testimony, or otherwise, that the 2005 and 2006 rates comply with the TSM. Nor can the burden be met by the Carriers use of hypothetical Opinion 154-B and SAC proxies to assert that the TSM ceiling rates produce lower, and therefore, just and reasonable rates.

63. The TSM cost elements and supporting justification must stand on their own. The Carriers have failed to provide cost data to support the elements of the TSM, and accordingly, the Carriers have not met their burden of proving that the TSM is just and reasonable. The Carriers' argument that Anadarko/Tesoro and the State failed to respond to Dr. Toof's testimony showing that the Carriers filed rates were equal or less than the TSM ceiling rates is irrelevant. It is the Carriers that have the burden of proving the TSM is just and reasonable and Dr. Toof's presentation did not satisfy this burden. Moreover, to the extent that the TSM contains elements that depart from a cost-based approach, such deviations must be shown not to be "unreasonable and …consistent with the Commission's statutory responsibility." *See Farmers Union II*, 734 F.2d at 1502. Since the Carriers have not provided any supporting cost data to support their filed rates, they failed to meet their burden of proof.

64. The case law cited by the Carriers does not support the proposition that an Opinion 154-B proxy can be used to meet their burden of proof concerning the costs of providing service under the TSM. Carriers' IB at 27 (citing *Sithe/Independence Power Partner, L.P.*, 165 F.3d at 951).[46] Staff correctly states that such use of an

[46] For instance, *City of Holyoke v. FERC*, involved a comparison of a transmission rate *vis-a-vis* the integrated transmission rate, which is not the issue in the case at bar. *City of Holyoke Gas & Elec. Dep't v. FERC*, 954 F.2d 740 (D.C. Cir 1992). *Magellan Pipeline Company, L.L.C.*, involved a rate filing set for hearing. 105 FERC ¶ 61,390 (2003). *Sithe/Independence Power Partners, L.P., v. FERC*, in dicta talks about "end results" and comparing the rate charged to the rate that could legally be charged (citing the *City of Holyoke, supra*) in the discussion about rolled-in or incremental methodologies. 165 F.3d 944 (1999). These cases clearly do not

Opinion 154-B proxy "must be used in conjunction with the inputs that made up the filed rate. Otherwise, you have proven nothing, and certainly not the justness and reasonableness of the filed rate." *Id.* As discussed in more detail below, the inputs used by the Carriers' in their 154-B proxy, would allow an enormous double recovery of costs and do not reflect the actual balances. Moreover, Anadarko/Tesoro appropriately point out that the Carriers use the "end result" test incorrectly. A/T IB at 19 n.10 (citing *So. Co. Svcs., Inc.*, 80 FERC P 61,318 at 62,089 n.64 (1997)). "[T]he 'end result' test does not relieve Southern of the burden of supporting the specific elements of its rate, but is, instead, an additional test to which the rate is subject after the Commission has approved those specific elements." *So. Co. Svcs., Inc.*, 80 FERC at 62,089 n.64 (citing *Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1177-78 (D.C. Cir. 1987)*). Thus, the Carriers cannot just rely on the "end result" test – they must still prove each element of the TSM to meet their burden.

65. Anadarko/Tesoro's arguments addressing the Carriers' public interest arguments have been discussed above.

Issue II. D. Are the rates determined by the TSM just and reasonable?

66. The Carriers claim that the TSM methodology taken as a whole is cost-based.[47] According to the Carriers, Anadarko/Tesoro and Staff argue that the Carriers' failure to provide cost justification for specific elements of TSM means that the Carriers' filed rates are not just and reasonable. The Carriers claim that this argument is not sustainable since the TSM was not designed to be evaluated on an element-by-element basis. This is evidenced by statements made by the State and the U.S. Department of Justice (DOJ) in the Explanatory Statement submitted as part of the TSA, the Carriers assert. In sum, the Carriers contend that the statements provide that the elements of the TSM were drawn from general ratemaking principles and should not be evaluated independently since the elements were negotiated as a package tailored for TAPS to meet the objectives of the parties.

67. The Carriers also argue that the fact that the individual elements of TSM may not be justified on a cost basis does not mean that TSM or the ceilings it calculates are not cost-based. It is noteworthy, the Carriers assert, that the State and the DOJ compared TSM generated rates to rates generated by the ICC valuation methodology, a DOC methodology, and a TOC methodology and found that the TSM ceiling rates were at or below the other traditional methodologies. The Carriers contend that this

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parallel the facts in this case.

[47] This argument also includes the Carriers' contentions that the TSM is cost-based in Section II.B above.

confirms the TSM's reasonableness. In addition, the Carriers claim that there is also no merit to Anadarko/Tesoro's contention that the Carriers must justify the TSM formula itself as just and reasonable. According to the Carriers, this is because the TSM is not part of the Carriers' filed tariffs.

68. Anadarko/Tesoro and Staff posit extensive arguments that the Carriers have not shown that the TSM or the 2005 and 2006 rates are just and reasonable. The TSM includes non-cost based elements and the Carriers have failed to provide any direct evidence that shows the elements that comprise the TSM are just and reasonable, Anadarko/Tesoro and Staff contend. Specifically, Anadarko/Tesoro and Staff point to the following items and allege that the elements are not cost based or are inappropriate for cost-based ratemaking:

(1) The inflation-adjusted, non-cost-based allowance per barrel (ABP).
(2) The one hundred percent (100%) equity capital structure assumption.
(3) The subjective projections of costs and throughput.
(4) The depreciable useful life of the line that is known to be too short.[48]
(5) The true-up mechanism that guarantees cost recovery.
(6) The cost allocation/rate design mechanism that allows costs properly allocated to intrastate rates, but disallowed by the RCA, to be reallocated to the interstate rates.
(7) The DR&R collections premised on incorrect assumptions

Staff IB at 18-27, RB at 16; Anadarko/Tesoro IB at 20-34, RB at 22-26. Additionally, Anadarko/Tesoro claim that these elements are not cost-based and as a result of being included in the TSM: (1) produce excessive returns, (2) include excessive deferred returns, (3) include an excessive income tax allowance, and (4) include an unjustified DR&R allowance.

69. Staff again claims that the Carriers' have offered no cost evidence to support the TSM rates or any of the elements within the TSM. According to Staff, the closest the Carriers come to addressing whether the TSM produces just and reasonable rates is the Carriers' discussion of mechanical compliance, the public interest, equitable estoppel, and retroactive ratemaking. However, Staff contends, the Carriers fail to discuss just and reasonable or cost-based ratemaking standards. Similarly, Anadarko/Tesoro argue that the TSM produces rates that are inherently unjust and unreasonable and inconsistent with cost-based ratemaking standards. Anadarko/Tesoro also claim that the Carriers and Flint Hills failed to address issue II.D. Thus, Anadarko/Tesoro and Staff state, because there is no record evidence to

[48] Anadarko/Tesoro argue that this causes depreciation expense to be overstated.

demonstrate that that "costs" included in the filed rates represent the costs of service for TAPS and because the TSM violates just and reasonable ratemaking standards, the TSM cannot be used to determine just and reasonable rates.

Discussion/Findings

70. A discussion of the specific elements that Staff and Anadarko/Tesoro state are not cost-based is better left to section III where each of the items will be examined in detail *seriatim*. Although the Carriers have chosen not to follow the prescribed issues list format, it seems that the Carriers did include a discussion of whether rates determined by TSM are just and reasonable. In short, the Carriers argue that: (1) the TSM is a cost-based methodology and even if individual elements are not found to be cost-based, *Farmer's Union II* allows certain cost deviations; (2) the Commission found, in *Amerada Hess*, 79 FERC ¶ 61,300, that the TSM is binding on all parties; (3) Anadarko/Tesoro are equitably estopped from challenging the TSM; (4) Anadarko/Tesoro's challenge of the 2005 and 2006 filed rates raises concerns regarding retroactive ratemaking; (5) it is in the public interest to find the Carriers rates and the TSM just and reasonable; and (6) the Carriers have shown that they properly applied TSM in calculating their filed rates. All of these arguments have been rejected in the preceding sections of this decision.[49] One of the most important of these findings with respect to this issue is that the Carriers must submit evidence to support a finding that each element of the TSM is either cost-based or that the deviation from costs is justified. Staff and Anadarko/Tesoro aptly note that the Carriers' failed to place cost data to support the elements in the TSM in the record of this proceeding. As discussed above, without such evidence, the Carriers fail to meet their burden of proving the TSM and the rates it produces are just and reasonable. Accordingly, the rates determined by the TSM cannot be found just and reasonable.

Issue II. E. Do the TAPS Carriers' 2005 and 2006 TAPS Interstate Rates Comply with the TAPS Settlement Agreement?

71. Staff and Anadarko/Tesoro take no position on this issue. To the extent that the Carriers and Flint Hills assert a position, such arguments have been addressed above. As stated above, the mechanical compliance with the TSA does not, by itself, prove anything in this case, so this is a moot point.

[49] Anadarko/Tesoro's and Staff's arguments have already been considered with respect to these arguments.

ISSUE III: IF TSM SHOULD NOT BE USED, WHAT METHODOLOGY SHOULD BE USED AND HOW SHOULD THAT METHODOLOGY BE APPLIED?

Issue III. A. What is the Appropriate Methodology?

72. The Carriers state that if the TSM is not accepted as the governing methodology for determining the lawfulness of the Carriers' 2005 and 2006 rates, then Opinion 154-B and the Commission's cost of service regulations in, 18 C.F.R., part 346 (2006) apply. Since the parties agree that 154-B is the appropriate methodology, the large difference in the rates advocated by the parties, the Carriers contend, is due to the differences in the inputs each party uses in the formula. The Carriers state that their Opinion 154-B presentation uses the actual costs as recorded in their FERC Form 6 (Form 6) annual reports. Anadarko/Tesoro cannot "cherry pick" the most favorable terms of the TSM to use as inputs in their Opinion 154-B presentation, the Carriers claim. The Carriers also argue that no element of the TSA was to have any effect on the rights of non-settling parties and the non-setting parties have an all or nothing choice in litigating their rate challenge.

73. The Carriers argue that Anadarko/Tesoro's and Staff's attempt to apply *SFPP-Sepulveda*, 117 FERC ¶ 61,285 (2006) (*Sepulveda*), to this proceeding is unavailing because none of the fundamental underpinnings of the *Sepulveda* decision apply here. The Carriers assert that *Sepulveda* differs from the facts of this case because the contracts were between SFPP and the complaining shippers, the contract provisions did not limit the rights of third parties to rely on the contracts, and the Commission found that the contracts were fully performed on both sides.

74. Anadarko/Tesoro also state that although the parties agree that Opinion 154-B results in just and reasonable rates, there is a dispute concerning how to properly apply Opinion 154-B. Anadarko/Tesoro assert that just and reasonable rates should be established under either the TOC or DOC original cost rate methods. The Carriers' Opinion 154-B case is flawed because the Carriers do not use their actual costs as inputs, Anadarko/Tesoro contend. Anadarko/Tesoro claim that the Carriers have dramatically increased their total revenue requirement (TRR) by "restating and double counting their accumulated depreciation and deferred earnings, and by including a starting rate base adjustment." A/T IB at 40. Finally, Anadarko/Tesoro assert that the proxy cases presented by the Carriers have nothing to do with the Carriers' filed rates and fail to recognize 30 years of accelerated recovery of investment, deferred earnings, and DR&R.

75. Staff states that the appropriate methodology to use in setting TAPS rates is the TOC which is consistent with Opinion 154-B and *Farmers Union II*. Staff also claims that using either an Opinion 154-B TOC approach or the traditional DOC

approach as calculated by the State and Anadarko/Tesoro uses the proper inputs and are also similar to the DOC rate calculated by the RCA it its extensive proceeding. Staff concludes by stating that neither of the Carriers' proxies (SAC or Opinion 154-B) can be used to set rates or prove the justness and reasonableness of the Carriers' rates.

76. Proper application of the DOC and TOC methodologies, Anadarko/Tesoro and Staff claim, requires the inputs to reflect amounts actually collected by the Carriers. Staff contends that only the interstate rates calculated by the State and Anadarko/Tesoro are consistent with the Carriers' previous rate filings and the revenues already collected by the Carriers. The Carriers' Opinion 154-B proxy has nothing to do with the costs reflected in the Carriers' rate filings, Staff avers. In addition, Staff contends that in using an Opinion 154-B methodology to determine an oil pipeline rate, the inputs that made up the filed rate must be used.

77. The Carriers' argument that Anadarko/Tesoro are "cherry picking" elements of the TSM is incorrect, Anadarko/Tesoro claim. Anadarko/Tesoro state that their reliance on the annual rate filings has nothing to do with attempting to enforce rights under the TSA since Anadarko/Tesoro are simply including the current property balances from the Carriers' rate filings. Contrary to the Carriers' assertions, Staff also claims, using the actual recoveries does not constitute "cherry picking" from the TSA by Anadarko/Tesoro. Staff states that this argument fails for two reasons. First, Staff claims that the issue is not about enforcing the TSA, but the right of shippers to have just and reasonable rates in accordance with Commission policy and practice. Anadarko/Tesoro are simply accepting the balances as they find them and, Staff states, are not proposing to restate or alter these balances. Second, Staff claims that Anadarko/Tesoro are not selectively enforcing portions of the TSA because the bargain was only between the State and the Carriers and simply provided that the State would not protest or object to a maximum rate that complied with the TSM.

78. Staff claims that the numerous arguments forwarded by the Carriers to attempt to justify double recovery are without merit. Staff states that Commission precedent does not permit double recovery of investment. Staff also points to several reasons why *Sepulveda*, 117 FERC 61,285, applies to this proceeding and stands for the proposition that the Carriers' previous recoveries must be recognized for ratemaking purposes. Anadarko/Tesoro also assert that the Commission's decision in *Sepulveda*, which required SFPP to recognize prior recovery of investment in future rates is applicable here. *Id.* In addition, Staff avers that the Commission's decision in *Sepulveda* is consistent with its other rulings. Staff states that in *Kern River Gas Transmission Company*, 117 FERC ¶ 61,077 (2006), which involved the continued use of a levelized rate, the Commission required Kern River to create a regulatory asset to reflect the difference between what is reflected in its accounting books and what it collected in rates. The Commission confirmed that the regulatory asset is

recognized as an adjustment to the rate base, Staff contends. In addition, Staff claims that *Entergy Services, Inc.*, also stands for the proposition that allowing an investment to be recovered a second time is not just and reasonable.[50]

79 The Carriers' reliance on accounting regulations to justify the use of Form 6 information is misplaced since ratemaking books must be used when there are differences between the ratemaking books and regulatory accounting books, Anadarko/Tesoro and Staff argue. Moreover, Anadarko/Tesoro and Staff state, Commission and court precedent are clear that when this difference occurs, ratemaking standards control and ratemaking balances must be used.

80. Flint Hills claims that the Carriers, and not the State and Anadarko/Tesoro have submitted proper Opinion 154-B presentations. According to Flint Hills, the rate methodologies submitted by Anadarko/Tesoro and the State are skewed and result in unreasonable rates because they omit the return elements deferred under the TSM. Anadarko/Tesoro's inclusion of the accelerated recovery items and the omission of the back-end deferred return items is the only way Anadarko/Tesoro was able to calculate a $2 per barrel rate range. In conclusion, Flint Hills claims that the TSM rates are lower than the Carriers' properly calculated 154-B methodology rates and are therefore just and reasonable. If either Anadarko/Tesoro's or the State's Opinion 154-B presentations are used, significant corrections need to be made, Flint Hills claims.

Discussion/Findings

81. Although the parties agree that Opinion 154-B is the appropriate methodology to employ in this proceeding, the consensus ends there. It is the discussion concerning which amounts are the proper inputs where the parties' opinions sharply diverge. The Carriers and Flint Hills are advocating the use of the Form 6 balances, while Anadarko/Tesoro and Staff fervently contend that the appropriate balances are in the Carriers' annual filings. Anadarko/Tesoro and Staff have proven that it is their arguments that should prevail.

82. First, the Carriers must recognize the amounts they have previously collected in rates. The cases cited by Staff and Anadarko/Tesoro are applicable. The Carriers' attempt to distinguish *Entergy Services* fails. Carriers' RB at 41 n.40. Contrary to the Carriers' assertions, Staff cited *Entergy Services* for the basic proposition that allowing costs to be recovered twice is not just and reasonable and that assertion is clearly supported by the text of the initial decision which was later approved by the

[50] *Entergy Services, Inc.*, 102 FERC ¶ 63,016 (2003); 105 FERC ¶ 61,319 (2003) (*Entergy Services*).

Commission.[51] Anadarko/Tesoro and Staff cite *Sepulveda*, with respect to this issue, to assert that the Carriers must recognize the amount of investment previously recovered: (1) even if the amounts recovered are different from the amounts reflected in the Carriers' accounting books and records and (2) even if such records comply with the Commission's Uniform System of Accounts. A/T RB at 41-42; Staff RB at 33-34, IB at 35-39. Anadarko/Tesoro and Staff effectively refuted the Carriers' arguments in opposition on this point. *Id.*; Carriers IB at 53-55, RB at 40-42.

83. To wit, Anadarko/Tesoro and Staff specifically acknowledge the "fundamental underpinnings" that the Carriers use to contrast *Sepulveda* with this proceeding. Staff and Anadarko/Tesoro rebut the Carriers' arguments by stating that: (1) the fact that the contract was between the complaining parties is immaterial since what matters is that the money was already collected from the shippers, Staff RB at 34; (2) regardless of whether the settlement contracts have run their course, the Carriers cannot recover their investment twice;[52] and (3) it is irrelevant whether the SFPP contracts denied third-party beneficiary rights since parties to a settlement cannot restrict a third party's rights when determining a just and reasonable rate, Staff RB at 34. Importantly, Staff also notes that in *Sepulveda* "the contract's intentions regarding the recovery of investment were not explicitly stated and had to be presumed," but that is not the case here "where the recovery pattern for plant investment was explicitly described in the TSM." Staff IB at 38-39. Finally, *Kern River* also stands for the proposition that the Commission's objective is to ensure that entities do not double recover their investment.[53] The Carriers' arguments are without merit on this point and are therefore rejected. Carriers RB at 41 n.41.

84. The Carriers claim that Anadarko/Tesoro's use of the TSM balances constitutes "cherry picking" from the TSA and should not be permitted. Carriers' IB at 34-45. As discussed above, the Commission will not allow an investment to be

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[51] *See* 105 FERC at P4; 102 FERC at 98-100 (the Commission affirmed the ALJ's decision "(I) requiring Entergy to develop its rates using the net non-levelized methodology" where the ALJ did not allow Entergy to switch to the gross plant levelized method because of the concern that it would allow Entergy to "recover some of the depreciation expense attributable to this equipment a second time, and the customers as a class will have to pay twice for use of these facilities. Clearly, this result would be unjust and unreasonable").

[52] The Carriers' argument that it is improper to recognize the accelerated recovery of any investment until it has been recovered in its entirety under the TSA also fails. *See Sepulveda*, 117 FERC 61,285; Staff RB at 34; IB at 39 n.103; (the Commission disallowed any over-recovery in *Sepulveda* and there was no indication that it was contingent on the amount of the investment recovered); A/T RB at 42-43.

[53] Staff IB at 40; *Kern River*, 117 FERC at P 48.

recovered twice. To that end, the mission here is to ensure that the inputs used in the Opinion 154-B methodology reflect amounts already recovered. Therefore, Anadarko/Tesoro and Staff are correct. The use of the amounts in the Carriers' filings has nothing to do with Anadarko/Tesoro or Staff attempting to enforce rights or provisions of the TSA.[54] Nor are Anadarko/Tesoro combining approaches by using the balances contained in the Carriers' filings. The Carriers collected rates pursuant to the TSA/TSM and, therefore, it is the filings made pursuant to the TSA that provide the most accurate picture of the Carriers' current property balances. Witness Sullivan's testimony provides a persuasive and an accurate explanation on this point.

> For the past, you look at what has been recovered in rates, and we know what has been recovered in rates, because [the Carriers'] made annual ICA filings under the interstate settlement agreement....
>
> ....
>
> [The filings] were made based on the TAPS settlement methodology... but it clearly shows the rate recovery, the past period rate of recovery that [the Carriers have] been able to recover, and going forward, you have to take those plant balances into account in establishing just and reasonable original-cost ratemaking standards.

Tr. at 5282:1-16 (Sullivan). Finally, where accounting regulations or balances do not match ratemaking standards or balances, it is the ratemaking balances that control.[55] Mr. Sullivan's testimony on this point is given significant weight.[56]

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[54] With that said, the Carriers' arguments that the TSA is an inseparable package and the independent items were not intended to be relied upon by third parties, are rejected.

[55] Staff IB at 44-46; 46 n.127 (citing (*Virginia State Corp. Comm'n v. FERC*, 468 F.3d 845, 847 (D.C. Cir. 2006) ("Petitioners' claim of a rate effect is belied by the proposition that '[a]ccounting practices are not controlling for ratemaking purposes'" (citation omitted)); *Consolidated Gas Supply Corp.*, 14 FERC P 61,029, 61,053-54 (1981) ("Accounting practices are not controlling for ratemaking purposes and deviations from normal accounting practices must be made where necessary to insure that rates established by the Commission are just and reasonable"); *Williston Basin Interstate Pipeline Co.*, 55 FERC at 62,008 ("the Commission has stated that accounting does not dictate ratemaking"); *Williston Basin*, 56 FERC at 61,104, 61,370 ("The Commission is not bound by accounting principles in determining whether proposed rates are just and reasonable")); A/T IB at 46 n.33 (citing *id.*); Tr. 1659-62 (Wetmore concedes at one point that ratemaking treatment should be used for just and reasonable rates).

[56] Conversely, the Carriers' witnesses' testimony concerning the Opinion 154-B analysis is not credible.

85. The crux of the matter is that the Carriers must recognize the previous recoveries of their investment, otherwise there will be an unjust and unreasonable double recovery. The Carriers have presented no fact in the case that calls for an opposite conclusion. The Carriers' theory that Opinion 154-B analysis has to start from the beginning of TAPS as if the TSA/TSM had never occurred, or that the revenues recovered until now cannot be considered is not given any weight. Furthermore, Staff's commonsensical argument that just and reasonable rates cannot result where *any* double recovery is allowed simply cannot be ignored. Staff IB at 39. Accordingly, it is found that the inputs into the Opinion 154-B presentation must reflect the actual amounts collected by the Carriers even if that means using amounts other than those found in Form 6. This is consistent with the Commission precedent which disallows the double recovery of investment. Moreover, this is not a small matter since the differences between Anadarko/Tesoro's and the Carriers' total revenue requirement is significant. Anadarko/Tesoro's revenue requirement is $647.32 million while the Carriers' is $1,751.18 million.[57] See Illustration No. 1 below. Anadarko/Tesoro's amounts from Illustration No. 1 below are the basis for the conclusions reached in this decision although the final numbers used by Anadarko/Tesoro may vary slightly based on findings elsewhere in this initial decision (i.e., ROE and income tax).

[57] The main differences are attributable to deferred earnings, SRB, and depreciation and various rate base items.

Illustration 1

Comparison of Anadarko/Tesoro's Revised 154-B And TAPS Carriers' 154-B Proxy

Total 2006 Revenue Requirements and Rates ($Millions)

Line No.	Description	Revised A/T 154-B	TAPS Carriers 154-B
1	Operating Expenses*	$559.65	$559.65
2	Depreciation Expense	$13.48	$335.43
3	Amortization of Deferred Earnings	$7.13	$223.84
4	Amortization of AFUDC	$0.86	$11.63
5	DR&R Allowance	$0.00	$0.00
6	Return Allowance		
7	Return on Equity	$30.58	$281.62
8	Interest	$13.77	$9.59
9	Total Return Allowance	$44.34	$291.21
10	Income Tax Allowance	$22.13	$329.04
11	Non-Transportation Revenues	($0.27)	$0.38
12	Total Revenue Requirement	$647.32	$1,751.18
13	Composite System Barrels (Millions)	326.795	326.795
14	Composite Rate ($/Bbl)	$1.98	$5.36
15	Valdez Interstate Rate ($/Bbl)	$2.04	$5.53

* Includes amortization of FERC rate case litigation costs and RCA rate case litigation costs

86. The parties' general arguments with respect to the proper Opinion 154-B inputs are better addressed in the individual sections where the parties contentions are more tailored.

Issue III. B. What is the Appropriate Rate Base?

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

87. The Carriers assert that the balances shown in Form 6 represent the Carriers' actual investment in TAPS. The Carriers contend that Mr. Van Hocke rejected Anadarko/Tesoro's exclusion of the $450 million in carrier property as of 1976 and further stated that as non-settling parties, Anadarko/Tesoro have no basis to claim the benefit of the $450 million exclusion. In addition, the Carriers contend that the $450 million should be included in the rate base because the amortization was a component of the settlement package that "assuredly [did] *not* set any rates." Carriers' IB at 50 (citing *Arctic*, 832 F.2d at 164 n.12). The Carriers also claim that the "amortization" of the $450 million was a product of the settlement negotiations and reflected an assumed recovery in early years. The Carriers assert that the reduction in refunds arguments forwarded by Anadarko/Tesoro and the State should be rejected because the TSA states that there would be no refunds from 1977 through 1981 and for the period 1982-1985. Nothing in the TSA or Commission's orders suggests that any amoritization or exclusion of the $450 million for that period is appropriate, the Carriers contend.

88. Anadarko/Tesoro and Staff state that the appropriate property balances for original investment, additions, and retirements are the balances reported in the Carriers' annual filings. In addition, Anadarko/Tesoro state that the amounts reported in the Form 6 original property balances advocated by the Carriers and the original property balances in the annual rate filings are virtually identical. The main difference, Anadarko/Tesoro claim, is $450 million excluded from the TAPS rate base that was separately amortized and recovered in rates from 1978-1984 pursuant to the TSA. The property balances reflected in the TSM filings are consistent with the rates charges and the revenues actually collected, Staff contends. Staff also states that, contrary to the Carriers' assertions, if the Commission would have intended to ignore costs already recovered when it established just and reasonable rates, it would have explicitly said so and provided legal justification. In addition, Staff states that contrary to the Carriers' assertions, *Boston Edison Company*, 61 FERC ¶ 61,026 (1992), actually supports Anadarko/Tesoro's position because unlike the Carriers the company voluntarily gave up the right to collect certain expenses and the Commission held the company to that decision and would not allow recovery later.

89. With regard to accumulated depreciation, the Carriers claim that they have followed Opinion 154-B and the Commission's order approving the 1982 Depreciation Stipulation (Stipulation) by using the actual investment costs and actual straight-line depreciation recorded in their Form 6 annual reports. The Carriers claim that Form 6 represents the actual depreciation expense incurred in past years and the sum of those amounts is the proper accumulated depreciation balance. Until changed by further order of the Commission, the Carriers contend, the Stipulation is binding in any proceeding involving the TAPS Carriers' interstate tariff rates.

90. The Carriers present several reasons in support of rejecting Anadarko/Tesoro's use of the TSM balances. First, the Carriers assert that Anadarko/Tesoro, as third party non-signatories, have no legal rights under and cannot enforce the TSA. Second, the Carriers argue that the Commission's order in, *Arctic*, 832 F.2d 158, approving the TSM clearly supports the assertion that the TSA was meant neither to burden nor benefit non-settling parties. Third, the Carriers claim that contrary to Anadarko/Tesoro's claims, the TSA did not supercede the Stipulation. Fourth, the Carriers claim that Anadarko/Tesoro have no basis to rely on TSM for depreciation or other rate base elements because the depreciation factors differ from traditional FERC approved depreciation.

91. The appropriate balances for accumulated depreciation are reported in the Carriers' annual filings, Anadarko/Tesoro aver. According to Anadarko/Tesoro, the Carriers Opinion 154-B utilizes an accumulated depreciation figure that completely ignores the accelerated depreciation: (1) used to calculate refunds for 1977 through 1985 and (2) reported by the Carriers in rate filings from 1986 to present. Anadarko/Tesoro assert that the Carriers' failure to recognize this prior recovery artificially inflates the rate base in the Carriers' Opinion 154-B presentation by over $481 million and will lead to the double recovery of investment. Anadarko/Tesoro state that the regulatory history of TAPS shows that the Carriers' recovery of investment was based on accelerated depreciation.[58]

92. Anadarko/Tesoro state that the Carriers' claim that all parties are bound to the 1982 Depreciation Stipulation fails because several witnesses have confirmed that the 1982 Depreciation Stipulation was not used for setting rates on TAPS. Furthermore, Anadarko/Tesoro claim that the Stipulation was superceded by the TSM.

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[58] Anadarko/Tesoro state seven major aspects of that regulatory history that demonstrate that the Carriers' recovery of investment was based on accelerated depreciation. A/T IB at 49-59. To wit, representations to FERC and the Alaska Public Utilities Commission (APUC); the Carriers reduced their refund obligation; rates included accelerated depreciation; Carrier internal communications; expert testimony; other motives, and the 1982 Stipulation was never used to set rates. A/T IB 49-58.

Anadarko/Tesoro further assert that the Carriers' argument that the TSA and the Stipulation were expected to remain in effect simultaneously (the TSA would apply to signatories and the 1982 Stipulation would apply to shippers) is impossible because no party to the TSA is a shipper and only shippers paid the TSA rates. Thus, Anadarko/Tesoro conclude, the Stipulation and the TSA could not remain in effect at the same time. In conclusion, Anadarko/Tesoro assert that the book balances of accumulated depreciation reported in Form 6 were not used to set rates and the use of those balances will result in double recovery by the Carriers.

93. Staff also states that the TSM rates filed and collected from the shippers reflected an accelerated depreciation factor. This is clear, Staff contends, because the Carriers' annual rate filings, the supporting data and sections of the TSA itself show the depreciation expense, accumulated depreciation, and unrecovered property balances underlying the rate calculations.[59] Staff claims that the Carriers argument that without an explicit order from the Commission, the Stipulation remains in effect is incorrect. Contrary to the Carriers' assertions, Staff states, the Commission's orders were clear that it was approving TSM depreciation and even the Carriers Reply Comments (on the offer of settlement for the TSA) acknowledge that was what they were seeking from the Commission's approval of the TSA. Staff also states that the TSA provided that the only stipulations that were to remain in effect were those consistent with the TSA.

94. The shippers on TAPS pay rates based on the accelerated depreciation factors in the TSM and not the straight-line factors in the Stipulation, Staff claims. Thus, Staff contends, the Carriers' assertion that the TSM factors are only relevant to the settling parties is clearly incorrect since it is the non-signatory shippers and not the settling parties who have paid TAPS rates. Staff also claims that the Stipulation was replaced by the TSA. According to Staff, the language in the Stipulation gave the Commission and the parties the authority to terminate the provisions and the Carriers recognized and advocated the adoption of the TSM depreciation schedule in place of the Stipulation. Staff also claims that the Commission's orders accepting the TSA approved of the new TSM depreciation methodology in place of the Stipulation.

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[59] Staff states that Section II-5 and Exhibit F of the TSA show the annual depreciation expenses to be recovered in the TSM rates. Exhibit G to the TSA also shows accelerated depreciation. In addition, Staff states that the Commission's Order Approving Settlement, dated October 23, 1985 also acknowledged that accelerated depreciation is included in the TSM.

Discussion/Findings

95. The appropriate rate base is one derived following the Commission's Opinion 154-B analysis and conforms to original costs ratemaking standards. In this case, the rate base should reflect net depreciated original costs as reflected over the years in the Carriers' rate filings before this Commission for almost three decades.

96. The Carriers, Anadarko/Tesoro and the State filed testimony using the 154-B analysis used by the Commission in setting rates for oil pipelines. However, the Carriers position is that the inputs to an Opinion 154-B analysis should be based on Form 6 as opposed to what they filed to justify their rate filings. It is found that the appropriate property balances for original investment, additions, and retirements are contained in the Carriers' annual rate filings.[60] Anadarko/Tesoro's cost of service presentations use the property balances reported by the Carriers in their annual rate filings. Anadarko/Tesoro use the amounts collected from ratepayers by the Carriers. These figures are found in the Carriers' annual rate filings and supporting documents. Accordingly, Anadarko/Tesoro's witnesses testimony is given significant weight.[61]

97. The only major difference between the property balances in the Carriers' annual filings and Form 6 is $450 million which was excluded from the total TAPS rate base and separately amortized from 1978 through 1984 through TSM. A/T IB at 44; RB at 45 n.32; Staff RB at 21. The $450 million has already been fully recovered by the Carriers via amortization from 1978 through1984 under the TSM.[62] This

[60] The amounts for 2005 are as follows (in millions): Carrier Plant in Service - $10,294.12, Additions - $14.855, Net Retirements - $0.796, Non-Depreciable Plant - 68.161, Ineligible Plant - 97.24. A/T IB at 44; Ex. A/T-144, WP-2 at 5, ln. 1, 2, 3, 11, and 17 ("Col. 2004"). The amounts for 2006 are as follows (in millions): Carrier Plant in Service - $10,308.96, Additions - $19.991, Net Retirements - $0.000, Non-Depreciable Plant - 68.161, Ineligible Plant – 120.14. A/T IB at 44; Ex. A/T-146, WP-2 at 4, ln. 1, 2, 3, 11, and 17 ("Col. 2005").

[61] The Carriers' testimony is not credible. As a matter of fact Mr. Van Hoecke previously testified in RCA docket P-97-4 explaining the difference between Form 6 and the annual rate filings. Exs. A/T-143 at 27-28, A/T 234 at 1-2. This testimony is inconsistent with his testimony in this hearing. In the cited proceeding he testified that the primary differences are: (1) $450 million removed from TSM balances and amortized; (2) $17 million in land treated separately by TSM-6 and (3) $56 million of timing differences between property records and TSM-6. Ex. A/T-143 at 27-28.

[62] Ex. A/T-33 at 10 (Section II-2(c)) (the TSA states that the TAPS investment base is reduced by $450 million and that amount is amortized from the period 1978 through 1984); Ex. A/T-140 at 28-30; Ex. A/T-140 at 28 (Brown); Ex. A/T-196 at

amount was clearly excluded from rate base as stated in the TSA. Thus, since this amount was excluded and amortized by virtue of the TSA and the TSM and the rates were charged based on the TSM, it is found that this is the correct way to treat the rate base in a 154-B analysis, as Staff and Anadarko/Tesoro point out. If the $450 million is added back into rate base this would result in double recovery of investment which is not allowed by the Commission. Carrier witness Van Hoecke and Ganz advanced similar arguments in a previous proceeding which were rejected by the Commission. To wit, in *Sepulveda*[63] the Commission did not allow a carry over of 1983 construction costs since it would result in over-recovery of investment and is inconsistent with the depreciation method SFPP used in previous contracts. The same reasoning is applicable here where the Carriers have invested $11 billion since TAPS was placed in service and have collected $58 billion in revenues while expending $15 billion in operation and maintenance. Ex. A/T 233 at 1. The amounts actually recovered by the Carriers must be recognized to avoid double recovery. Commission principles and policy do not allow costs to be included in rates twice.[64] Thus, it is found that the $450 million of original investment has been properly excluded from the Carriers' rate base.

98. The appropriate balances for accumulated depreciation are reflected in the net plant balance in the Carriers' annual rate filings.[65] Anadarko/Tesoro cost of service presentation uses these correct balances. The Carriers' varied arguments contesting the use of the amounts in their annual filings are without merit. Again, the point of this exercise is to determine what the Carriers' actually collected. Anadarko/Tesoro have shown that the Carriers never used the Stipulation to set rates on TAPS via several witnesses in this proceeding.[66] In fact, the witnesses have verified that it has been the TSM and not the Stipulation that has been used to set rates on TAPS. *Id.*

237-8; A/T RB at 45 n.32. The State gave up refunds and the Carriers reduced their refund liability by this settlement. *See* A/T Ex -181 at 28; 116-125.

[63] 117 FERC ¶ 61,285 at P 18 (2006).

[64] *See, Town of Norwood v. FPC*, 546 F. 2d 1036 (D. C. Cir 1976); *Entergy Services, Inc.*, 109 FERC ¶ 61095 at P 55 (2004); *Kern River Gas Transmission Co.*, 117 FERC ¶ 61,077 at PP 47-48 (2006).

[65] The amounts of accumulated depreciation are as follows (in millions): (1) for 2005 - $59.777 as shown in Ex. A/T-144, WP2 at 5, ln.7 ("Col 2004") and (2) for 2006 - $58.228 as shown in Ex. A/T-146, WP2 at 4, ln.7 ("Col 2005").

[66] Staff RB at 29. Tr. 2979-80 (Van Hoecke); Ex. A/T-196 at 234-26 (Dr. Horst), Tr. at 867 (Confidential) (Dr. Toof stated that rates were not calculated using the Stipulation); Tr. at 1666 (Wetmore, the Carriers' witness, also stated that he was not aware of the Stipulation being used to establish rates on TAPS); A/T IB at 55 (citing Ex. A/T-175 at 73 (witness Folmer who prepares the financial package that the

99. Additionally, further proof of the fact that the Carriers have recovered accelerated depreciation is the representations they made to the Commission recommending approval of the TSA. In the Explanatory statement the parties stated that if the TSA is approved accelerated depreciation will be recovered in rates. Ex. A/T-35 at 6, 33-32. Previously, in an APUC proceeding State witness Horst testified that the parties to the TSA used a unit of throughput depreciation schedule accelerated through multiplying throughput factors. Ex. A/T-180 at 7. Furthermore, in approving the TSA the Commission recognized that the depreciation schedule, based on an accelerated unit-of-production method, is fixed and heavily weighted towards the earlier years.[67]

100. The evidence in this case also establishes that from 1977-1985 the revenue requirements and rates were calculated in the TSM-6. Ex. A/T-44 and A/T- 155, line 163.[68] In the hearing proceeding in Docket No. P-86-2 Mr. Baden testified he reconciled actual property data with Form 6 reports and confirmed that the TSM had real numbers behind them. Ex A/T-178 at 19-20. Dr. Horst's deposition indicates that TSM-6 was split in half with the first half showing the historic pre-1983 numbers which became TSM-6. The ending balances from TSM-6 are identical to the beginning balances in Ex. G of the TSA. Ex. A/T-196 at 222-223. The historic balances in TSM-6, including operating expenses were used to determine refunds for the years 1982-1985 and for the determination that no refunds would be allocated prior to 1982. Ex. A/T 196 at 231, ln 1-6 and 236, ln. 7-16. The rates in TSM-6 for 1982-1985 match Ex. D-1 to the TSA. Ex. A/T -33.[69] The accelerated depreciation used for ratemaking purposes from 1977-1983 is specified in Ex. ATC-84 through ATC-88, Sheet E (2006) (Highly Confidential) in each of the Carriers past 100 annual rate filings.[70]

Carriers rely on in setting their rates stated that TSM depreciation was used to set rates)). *See also*, Ex. A/T-174 at 87-90 (Van Hoecke); Carrier witnesses Toof, Washington, Wetmore and Ganz (Tr. 867, 1542, 1666, 2040).

[67] *Trans Alaska*, 33 FERC ¶ 61, 064 at 61,139 (1985). The record reflects that the Carriers reduced their refund obligations through the accelerated depreciation. Exs. A/T-75 at 14; A/T-183.

[68] The deposition of Dr. Horst states that the TSM-6 applied back to 1969 (the first year of construction expenses attributable to TAPS. Ex. A/T-196 at 222 line 4-6.

[69] Other experts have testified in various proceedings. *See* Ex. A/T-238 (Williams) (he would expect depreciation in rates to be used for ratemaking purposes); Ex. A/T-212(Folmar) (TSM depreciation was used to set rates.)

[70] The Carriers' rate filings use the amounts of accelerated depreciation. However, ATC-84 through ATC-88, Sheet N refers to the accelerated depreciation as