Opinion No. 397

<u>Lakehead Pipe Line Company, Limited Partnership</u>
Opinion No. 397
71 FERC ¶ 61,338 (1995)

Opinion No. 397 addressed Lakehead's rates for the shipment of crude oil and natural gas liquids (NGLs) through its system, as well as issues concerning Lakehead's conduct of its NGL business.

Regarding rate base issues, Opinion No. 397 concluded that trended original cost (TOC), rather than depreciated original cost (DOC), is the appropriate form of rate base to use in determining Lakehead's rates. The Commission also concluded that the Canadian Association had not shown that Lakehead was not entitled to a starting rate base as adopted in Opinion No. 154-B.

Regarding cost of service issues, the Commission concluded that its gas and electric test year precedents were not controlling, choosing instead to adopt two test years for the fifteen month locked in period. The Commission also found that Lakehead is not entitled to an income tax allowance for income attributable to limited partnership interests held by individuals. Hydrostatic testing costs and rate case expenses were included to be amortized over three years, but they will not be considered for purposes of indexing in future years. Finally, the Commission adopted a three-year average period as representative of Lakehead's future oil loss expenses.

Regarding Lakehead's rate floor, the Commission concluded that Lakehead's rates in effect on October 24, 1991 were not deemed just and reasonable by the Energy Policy Act of 1992, because those rates were subject to a complaint of October 13, 1992, filed by the Canadian Association. However, the Commission also concluded that the Canadian Association had not sought reparations. Hence, Lakehead's rates were subject to refund down to the level of its effective rates on May 2, 1992.

Regarding natural gas liquids, the Commission concluded that Lakehead did not violate the ICA at this time by transporting NGLs only for shippers who provide their own breakout storage tank facilities at Superior, Wisconsin, because no potential shipper could make a reasonable request for NGL service, since there is no access for those shippers in Canada to the pipeline connecting with Lakehead. However, the Commission found that if shippers obtain access in Canada to Lakehead, it must ensure that their NGLs can move beyond Superior. Moreover, Lakehead may not require that NGL shippers provide buffers. If Lakehead is going to commingle shipments, it must publish rules regarding the quality of NGLs that may be batched together.

<u>Lakehead Pipe Line Company, Limited Partnership</u>
Opinion No. 397
Opinion and Order Affirming in Part
and Modifying in Part Initial Decision
71 FERC ¶ 61,338 (1995)

[¶ 61,338]

Lakehead Pipe Line Company, Limited Partnership, Docket Nos. IS92-27-000, IS93-4-000, and IS93-33-001

Opinion and Order Affirming in Part and Modifying in Part Initial Decision

(Issued June 15, 1995)

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

[The Initial Decision, Phase 1, issued December 7, 1993, appears at 65 FERC ¶ 63,021.]

Appearances

Steven H. Brose, Steven Reed, Kelly C. Maynard, and *Cynthia L. Quarterman*, on behalf of Lakehead Pipe Line Company, Limited Partnership

Roger A. Berliner, Peter Hirst, Robert M. Feick, and *Wendy Moreland*, on behalf of Canadian Association of Petroleum Producers and Alberta Petroleum Marketing Commission

Francis X. Berkemeier, William M. Lange, and *Robert M. Neustifter*, on behalf of Marysville Fractionation Partnership

Michele F. Joy, Roger D. Williams, Patrick H. Corcoran, Paul F. Forshay, Keith R. McCrea, and *Michael T. Mishkin*, on behalf of the Association of Oil Pipelines

Robert L. Woods, Donald Williams, William J. Froehlich, Dennis H. Melvin, and *Richard L. Miles*, on behalf of the Staff of the Federal Energy Regulatory Commission

[Opinion No. 397 Text]

On December 2, 1993, the administrative law judge (ALJ) issued his Initial Decision in Phase I of this proceeding.[1] He concluded that Lakehead Pipe Line Company, Limited Partnership's (Lakehead) rates for the shipment of crude oil and natural gas liquids (NGLs) through its pipeline system are not just and reasonable and that Lakehead further violated the Interstate Commerce Act (ICA)[2] in conducting its NGLs business. Lakehead, the Commission staff, the Association of Oil Pipe Lines (AOPL), and the Canadian Association of Petroleum Producers and Alberta Petroleum Marketing Commission (Canadian Association) filed briefs on exceptions to the Initial Decision. Those parties, Marysville Fractionation Partnership (Marysville), and Amoco Canada Petroleum Company, Ltd. (Amoco)[3] filed briefs opposing exceptions. As discussed below, the Commission affirms the Initial Decision in part and modifies the Initial Decision in part.

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[1] *Lakehead Pipe Line Co., L.P.*, 65 FERC ¶ 63,021 (1994). Phase I involves the locked-in period of from May 3, 1992 through July 5, 1993. On October 31, 1994, the administrative law judge issued his Initial Decision in Phase II of this proceeding. *Lakehead Pipe Line Co., L.P.*, 69 FERC ¶ 63,006 (1994). On November 29, 1994, the Commission's Oil Pipeline Board accepted and suspended Lakehead's October 28, 1994 filing, to be effective November 30, 1994, subject to refund. The Oil Pipeline Board instituted an investigation, which was stayed pending the outcome of the proceedings in Docket No. IS92-27-000, *et al.*, or further procedural orders. *Lakehead Pipe Line Co., L.P.*, 69 FERC ¶ 62,174 (1994). On March 23, 1995, Lakehead submitted an offer of settlement of Phase II of this proceeding and the October 28, 1994 filing.

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

[3] Amoco's unopposed motion to intervene out-of-time and to file a brief opposing exceptions is granted.

I. Rate Base Issues

A. *Trended Original Cost*

Prior to the issuance of Opinion Nos. 154-B[4] and 154-C,[5] oil pipelines were entitled to earn a return on capital determined by multiplying the allowed rate-of-return times a valuation rate base.[6] The valuation formula "weights original cost and reproduction cost according to their relative sizes and then averages them. The resulting weighted mean is then reduced for depreciation."[7] Opinion No. 154-B adopted net depreciated trended original cost (TOC) as the appropriate form of rate base to replace the valuation rate base.[8] The Commission adopted TOC over net depreciated original cost (DOC) because it will help newer pipelines with higher rate bases to compete with older pipelines with lower rate bases and will help them compete with other modes of oil transport and so will tend to foster competition generally. The Commission concluded that TOC does that because it mitigates the front-end load problem for new pipelines under DOC.[9] The Commission found that TOC and DOC are essentially the same except for their treatment of inflation and that this difference is in a different timing of the recovery of the cost of equity capital, when inflation exists, over the life of the property. The Commission further concluded that it was crucial that "[t]heoretically, TOC results in the same discounted value of the earning stream as does 'untrended' original cost."[10] Further, the Commission found that TOC has other advantages by (1) coming closer to duplicating pricing in unregulated enterprises and (2) providing for greater intergenerational equity by providing a relatively consistent cost of equity capital charge in real terms to ratepayers over the life of the regulated property. That is so because while the successive generations of ratepayers will be paying more in dollars, they will be paying in cheaper dollars because of inflation.

The ALJ here rejected the Canadian Association's arguments that TOC is inappropriate in Lakehead's circumstances, and he concluded that TOC rather than DOC is justified for Lakehead. The Canadian Association excepts. It maintains that because Lakehead possesses significant market power, the dominant rationale of TOC of promoting competition is not applicable to Lakehead. It further submits that TOC will unreasonably raise rather than lower Lakehead's rates as anticipated by Opinion No. 154-B. It asserts that this is so because Lakehead's rates were based on the valuation methodology, which front-end loads the recovery of return on equity. It maintains that TOC would result in Lakehead's ratepayers paying both the higher front-end load of DOC-based regulation[11] and the higher back-end load associated with TOC. It next

[4] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985).

[5] *Williams Pipe Line Co.*, 33 FERC ¶ 61,327 (1985).

[6] The valuation formula appears in *Williams Pipe Line Co.*, 21 FERC ¶ 61,260, at p. 61,696 n.295 and *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486 at p. 1495 n.28 (D.C. Cir. 1984), *cert. denied sub. nom., Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034.

[7] *Farmers Union*, 734 F.2d at p. 1495 n.28.

[8] The Commission has described TOC as follows:

> First, TOC, just like net depreciated original cost, requires the determination of a *nominal* (inflation-included) rate-of-return on equity that reflects the pipeline's risks and its corresponding cost of capital. Next, the inflation component of that rate-of-return is extracted. This leaves what economists call a "real" rate-of-return. The real rate-of-return times the equity share of the rate base yields the yearly allowed equity return in dollars. The inflation factor times the equity rate base yields the equity rate base write-up. That write-up, like depreciation, is written-off or amortized over the life of the property.

Williams Pipe Line Co., 31 FERC ¶ 61,377, at p. 61,834 (footnote omitted). See *Id.* for an illustration with numbers.

[9] See *id.* at pp. 61,834-85.

[10] *Id.* at p. 61,834.

[11] The Canadian Association states that Lakehead was regulated using a valuation rate base and its returns on equity were higher than if DOC regulation had been used.

contends that, contrary to Opinion No. 154-B's position, TOC does not produce intergenerational equity because Lakehead will overrecover its costs over its life owing to its past use of the valuation methodology and because TOC and DOC produce equal present value returns only under certain rarely justified assumptions.[12] It also avers that those faulty presumptions also underlie the assumption that TOC emulates free-market pricing. It finally maintains that TOC by resulting in higher rates than DOC in later years when production costs are rising will tend to promote the premature abandonment of Western Canadian production.

Lakehead responds that "the existing rule is that a pipeline that has market power receives *TOC* rather than the lighthanded regulation available if it lacks market power."[13] It cites *Kuparuk Transportation Co.*[14] in support of its view that TOC applies even when the pipeline has a transportation monopoly. It further replies that the Canadian Association argument regarding premature abandonment of Western Canadian oil reserves is speculative and discriminates against domestic production.

The Commission concludes that TOC, rather than DOC, is the appropriate form of rate base to use in determining the reasonableness of Lakehead's rates. The Canadian Association misapprehends both the rationale for TOC and the way that TOC will operate as compared to DOC. First, the Commission adopted TOC to stimulate future competition. It did not adopt TOC only for competitive markets. Rather, the Commission's policy for competitive markets is that pipelines that establish that they lack significant market power are entitled to market-based rates in the relevant markets.[15]

Second, the Canadian Association is incorrect in its premise that TOC will raise rather than lower Lakehead's rates because, under valuation, equity return was front-end loaded. This is so because the Commission adopted TOC as a modern, viable precedent to replace valuation. Hence, the appropriate comparison is between TOC and DOC as they affect Lakehead's rates under its present rate base without regard to the use of the valuation rate base in the past. In that light, TOC will produce lower rates than DOC in TOC's early years because under TOC the inflation component of the equity return is capitalized into rate base rather than recovered in the return allowance.

Third, the Commission adheres to its prior position that over time there is no essential difference between TOC and DOC and that the only difference is in the timing of the recovery of the cost of equity capital.[16] Further, the Commission continues to believe that a present value analysis is an appropriate way to compare future earnings under TOC and DOC and that it is crucial that the present value of future earnings under TOC and DOC are the same.[17] The Canadian Association's criticism of the assumptions underlying the production of equal discounted value earning streams (present value) under TOC and DOC is that the assumptions are rarely justified. It points to the assumptions of a static rate base (one with no additions or

[12] *See infra.* The present value of future earnings on an investment is determined by factoring in the time value of money through discounting at an appropriate rate of interest.

[13] Brief Opposing Exceptions at p. 15.

[14] 55 FERC ¶ 61,122 (1991).

[15] Revisions to Oil Pipeline Regulations pursuant to Energy Policy Act, Order No. 561, 58 Fed. Reg. 58785 (November 4, 1993), *FERC Statutes and Regulations* ¶ 30,985 (1993), order on reh'g and clarification, Order No. 561-A, 59 Fed. Reg. 40243 (August 8, 1994), *FERC Statutes and Regulations* ¶ 31,000 (1994), *Buckeye Pipe Line Co.*, 53 FERC ¶ 61,473 (1991) and *Williams Pipe Line Co.*, 68 FERC ¶ 61.136 (1994). There is thus no reason to address the issue of whether Lakehead is a natural monopoly or possesses and exercises significant market power.

[16] Ex. 131 at p. 8.

[17] *Id.* and Ex. 133.

retirements), constant straight line depreciation, constant sales volumes, and inflation rates and other expenses which are either constant or increase only by the annual rate of inflation over the life of the project. The Commission rejects the Canadian Association's criticism.

It is necessary to use assumptions in order to perform a present value analysis. Further, it is self-evident that it is difficult to predict the future with respect to the various assumptions underlying a present value analysis. Hence, it is typical and reasonable to use constant assumptions. It is true that, as with any comparison of investments, assumptions underlying the analysis may prove to be different from reality. However, a present value comparison is nonetheless an appropriate approach because whether future changes work to the advantage or disadvantage of a company under TOC or DOC is uncertain as that depends on the nature and timing of the changes.[18] Indeed, this is true for ratemaking in general because the test year method assumes a rate of inflation, volumes, and expenses which may or may not prove accurate. Last, the Canadian Association has not suggested other assumptions or an alternative method for comparing TOC and DOC. Nor did the Canadian Association present any argument (other than its invalid valuation argument discussed above) to suggest that TOC will result in a higher present value of earnings than DOC.

Fourth, the Commission continues to believe that TOC will provide for better intergenerational equity by providing a relatively consistent cost of equity capital charge in real terms to ratepayers over the life of the property.[19] Future ratepayers will pay more in dollars, but will be paying in cheaper dollars owing to inflation. As discussed above, the Canadian Association's arguments about past cost recoveries under valuation are irrelevant, and its arguments about the premises underlying the present value analysis are invalid. This also erodes its contention that TOC does not better emulate free-market pricing.[20]

Last, the Commission sees no reason to reject TOC for Lakehead on the ground that it will *tend* to promote the premature abandonment of Western Canadian production because of higher transportation rates and lower net-backs to producers in later years. The Canadian Association's allegation of a mere tendency is not adequate to support even a prediction that TOC will promote abandonment of Western Canadian production. As the ALJ found, the "Lakehead system . . . transports oil from a variety of fields, some newer than others."[21] It serves an entire supply basin rather than a limited number of production fields. In addition, assuming that in general oil production costs increase over time, there are other factors that affect producer net-backs, such as projected crude oil prices and projections of production costs and production profiles for Lakehead's shippers.[22] The Canadian Association has not provided any of those projections. Last, "in real economic terms, TOC tends to levelize [rates] over time, which means that current and future producers bear the same relative cost burdens."[23] To conclude, the Canadian Association has presented no more than a mere possibility of the curbing of production, which is not a sufficient reason for denying TOC. In any event, where the discouraging of oil production is of sufficient

[18] For example, if in the second year the inflation rate declined from the assumed rate, TOC would produce a lower present value than that predicted.

[19] Ex. 131 at p. 10.

[20] TOC better emulates free-market pricing by producing higher nominal returns and prices than DOC in a pipeline's later years and by adjusting rate base each year based on an appropriate inflation index. Ex. 131 at p. 9.

[21] 65 FERC ¶ 63,012, at p. 65,134.

[22] Ex. 131 at p. 10.

[23] *Id.*

concern, other approaches are available, such as the retention of TOC, coupled with a plant cost recovery method that front-end loads the recovery of plant cost.[24]

B. *Starting Rate Base*

In Opinion No. 154-B, the Commission adopted a starting or transition rate base in dollars for existing plant in order to "bridge the transition from valuation to TOC."[25] The starting rate base consists of the sum of a pipeline's debt ratio times book net depreciated original cost and the equity ratio times the reproduction cost portion of the valuation rate base depreciated by the same percentage as the book original cost rate base has been depreciated.[26] Opinion No. 154-B stated that the formula was "fair in view of pipeline investor reliance on a rate base which has been adjusted for inflation,"[27] and that it would "more closely approximate the TOC rate base that would have existed had the [Interstate Commerce Commission] not written-up debt [in the valuation formula] and will ensure that the equity holder does not benefit from the write-up of debt financed assets."[28] However, the Commission also stated that a participant in an oil pipeline rate case may attempt to prove that a particular pipeline is not entitled to the starting rate base. In Opinion No. 154-C, the Commission stated that "Opinion No. 154-B permitted participants challenging the starting rate base to prove that investors had not relied upon the previous rate base method."[29] The Commission added that evidence of earnings in past years higher than those allowed under valuation is "one avenue for participants to pursue in showing that a pipeline was not relying on future earnings under the valuation methodology."[30] Such a showing would "require the pipeline to come forward with evidence of its reliance."[31]

The ALJ rejected the Canadian Association's argument that Lakehead is not entitled to a starting rate base. He first found that the Canadian Association had proved that Lakehead's past year earnings were higher than those (eight percent) allowed under valuation. He then concluded that Lakehead had nonetheless successfully proved long-term investor reliance on valuation. He stated:

> In light of IPL's [Lakehead's parent, Interprovincial Pipe Line, Inc.] awareness of the regulatory standards applied to Lakehead, Lakehead's long-term use of valuation and the Commission's and ICC's examinations of Lakehead's rates without a finding that its use of valuation was unjust and unreasonable, Lakehead proved that IPL reasonably relied on Lakehead's use of valuation until 1983.[32]

Lakehead maintains that the ALJ erred in stating that the Canadian Association proved that Lakehead's actual returns for certain years between 1983 and 1990 exceeded eight percent on valuation because of several errors in the evidence supporting that conclusion. It further argues that, even if accurate, the evidence was irrelevant because the pertinent period is prior to the adoption of the starting rate base in June

[24] *E.g.*, *Kuparuk Transportation Co.*, 55 FERC ¶ 61,127, at pp. 61,380-81 (1991). (The Commission permitted, on agreement of the parties, the use of unit-of-throughput depreciation where there were a limited number of fields.

[25] *Id.* at p. 61,833.

[26] The formula is:

$SRB = O(1-e) + R(e)$.

Where:

SRB = starting rate base

O = book net depreciated original cost

R = net depreciated reproduction cost

e = ratio of equity to total capitalization

[27] 31 FERC ¶ 61,377, at p. 61,836.

[28] *Id.*

[29] 33 FERC ¶ 61,327, at p. 61,641.

[30] *Id.*

[31] *Id.*

[32] 65 FERC ¶ 63,021, at p. 65,136.

1985, not after. It adds that, even if the returns for 1983-1985 are accurate, they cannot be taken as proving lack of investor reliance on valuation because, at that time, its earnings were governed by Opinion No. 154. It further submits that the Canadian Association was unable to show excessive returns during the period prior to Opinion No. 154. It concludes that the Canadian Association's argument should be dismissed for a failure to carry its threshold burden of proof.

The Canadian Association maintains that the ALJ erred in his understanding of what Opinion No. 154-B meant by reliance and in finding that Lakehead's investors did rely on valuation. The Canadian Association submits that reliance "consists of a commitment of capital that is dependent on the future recovery of deferred earning,"[33] and not on the ALJ's factors quoted above. It adds that the reliance rationale as defined by the ALJ was specifically rejected in *Farmers Union* , which also prohibited investor reliance in any sense from justifying the starting rate base. Next, it asserts that Lakehead's investors have not relied on the valuation methodology's deferred earnings in the sense of a specific dependence on valuation for realization of an expected benefit rather than reliance in the sense of mere expectation created by the use of valuation. In support, it refers to Opinion No. 154-C, where the Commission stated that "evidence of such earnings [higher than allowed under valuation] . . . is clearly one avenue for participants to pursue in showing that a pipeline was not relying on future earnings under the valuation methodology."[34] It further maintains that the ALJ's standards are so universal that they render the reliance exceptions meaningless. It concludes here that "the 'reliance' that Lakehead must maintain in order to receive [a starting rate base] is a commitment of capital under circumstances in which realization of full return is dependent on the deferred earnings provided by [the] valuation rate base."[35]

The Canadian Association then asserts that Lakehead's excessive earnings show that there was no reliance. It refers to Lakehead's historic returns on invested equity of approximately 50 percent, to its earnings of approximately 25 percent on the inflated equity component of the valuation rate base, and to earnings of 7 to 10 percent on the valuation rate base as indicating no reliance on deferred future earnings. It emphasizes the historic returns in excess of 50 percent on equity as significantly exceeding the returns that Lakehead would have been entitled to under original cost and even those it was presumably entitled to under valuation. Last, it argues that Lakehead has allegedly had a transition in the seven years it has had to restructure its investments.

Lakehead responds that the Canadian Association has misapplied *Farmers Union* , which only told the Commission that it need not consider reliance, not that it could not consider reliance. It further responds that starting rate bases are appropriate as a general matter and not as a narrow exception available only under special circumstances. It next states that it disagrees with the Canadian Association's definition of reliance as dependence on deferred earnings rather than the expectation of continued benefits from valuation, which was what investors assumed. It adds that, under either definition, Lakehead's investors relied on and expected the continuation of valuation or some recognition of current value in rate base in making their well-informed investment decisions.

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[33] Brief on Exceptions at p. 51.

[34] *Id.* at p. 62, *quoting*, 33 FERC ¶ 61,327, at p. 61,641.

[35] *Id.* at p. 64.

Lakehead further submits that its investors were deferring earnings under valuation and, therefore, depended on recovering those earnings at a later date. It maintains that deferred earning are inherent under the valuation methodology because valuation automatically stores a portion of the company's earnings in rate base. Lakehead further responds that it did not earn excessive earnings as argued by the Canadian Association, whose numbers are irrelevant and do not pertain to the period prior to the issuance of Opinion No. 154-B on June 28, 1985. It adds that the Canadian Association is essentially arguing that the Commission should make up for allegedly inflated returns in the past by denying Lakehead the starting rate base today and that this action would constitute the purest form of impermissible retroactive ratemaking, since its sole purpose would be to affect the evaluation of rates for a subsequent period. It adds that the fact its rates were in effect without change from 1983 to 1992 virtually provides a finding that those rates did not generate excessive returns because they are presumptively fair and reasonable and, more important, were deemed just and reasonable by the Energy Policy Act of 1992.

Lakehead next attacks the Canadian Association's analysis of its returns—approximately 50 percent on invested equity, 25 percent on the "inflated" equity component of the valuation rate base, and 7 to 10 percent on the valuation rate base. Lakehead maintains that the 25 percent return on the equity component of the valuation rate base is not supported by the record but was obtained from withdrawn original exhibit 220.[36] It adds that the revised exhibit 220 contains many flaws but, in any event, returns between 7.05 and 9.8 percent on valuation do not prove rates far in excess of the eight percent valuation standard. It further submits, with respect to the 50 percent earnings on invested equity that any calculation of returns from an accounting standpoint is completely irrelevant.

This is the Commission's first opportunity to address the starting rate base issue since the issuance of Opinion Nos. 154-B and 154-C. First, Lakehead is presumptively entitled to the starting rate base adopted in Opinion No. 154-B for the reasons there given. Hence, the burden was on the Canadian Association to rebut that presumption and thus shift the burden of proof to Lakehead to justify its entitlement to a starting rate base. The Commission's approach will not result in retroactive ratemaking if a starting rate base as adopted in Opinion No. 154-B is denied, because there is no right to a particular rate base.[37] Nor does the fact that Lakehead's rates were in effect from 1983 to 1992 provide any sort of presumption with respect to its entitlement to a starting rate base because those rates were not adjudicated. In addition, the Energy Policy Act of 1992, in deeming rates just and reasonable, did not adopt starting just and reasonable rate bases for pipelines in connection with challenges to rates to be adjudicated under the guidelines of Opinion No. 154-B.

The Commission will now address the Canadian Association's challenge to Lakehead's starting rate base. Opinion No. 154-C set forth as one avenue for showing no reliance on future earnings under a valuation rate base, the existence of earnings in past years higher than those allowed under valuation. The Commission agrees with Lakehead that the Canadian Association has not met its burden under that avenue.[38] This is because Lakehead's actual earnings on valuation of 9.3 percent in 1983 and 9.8

[36] Lakehead's motion to strike designated portions of the Canadian Association's brief opposing exceptions is denied and its alternative for leave to reply is granted.

[37] Farmers Union II at p. 1517.

[38] The Canadian Association also maintains that Lakehead's rate filing was made because of the higher financial obligations assumed by Lakehead when it was restructured from a corporation to a limited partnership. The Canadian Association argues, therefore,

percent in 1984 are not so much higher than allowed earnings of eight percent so as to rebut the presumption of entitlement to a starting rate base.[39] In addition, the Commission does not find relevant the data about Lakehead's earnings on its equity capital. This is because that data is nothing more than the earnings on valuation adjusted to reflect earnings from an accounting standpoint as earnings on equity capital. This data thus provides no additional pertinent information beyond that provided by earnings on valuation. To conclude, the Canadian Association has not shown that Lakehead is not entitled to a starting rate base.

Lakehead also claims that, under the Agreement between the Government of the United States and the Government of Canada Concerning Transit Pipelines ("Transit Pipeline Treaty"),[40] it, as a transit pipeline, must be subject to the same Opinion No. 154-B methodology applied to all other United States oil pipelines. It refers to Article IV of the Transit Pipeline Treaty, which provides that a transit pipeline will be "subject to regulations by the appropriate governmental authorities having jurisdiction over such Transit Pipeline *in the same manner as for any other pipelines*... with respect to... rates, tolls, tariffs, and financial regulations relating to pipelines. . . ." and that: "All regulations imposed under Paragraph 1 [quoted above] shall be just and reasonable, *and shall always, under substantially similar circumstances with respect to all hydrocarbons transmitted in similar pipelines*, other than intra-provincial and intra-state pipelines, *be applied equally to all persons and in the same manner*."[41] Lakehead is correct that the Commission must apply its Opinion No. 154-B methodology in the same manner for all oil pipelines. However, the Opinion No. 154-B methodology includes the right to challenge the starting rate base of all oil pipelines. Hence, the Commission is applying it equally and in the same manner to all oil pipelines.[42]

II. Cost of Service Issues

A. *Test Year*

As stated above, the present case involves Lakehead's rates for the locked-in period from May 3, 1992 through July 5, 1993. The ALJ adopted two test year periods. The first is the year 1992 for Lakehead's rates from May 3, 1992 through December 31, 1992. The second is April 1, 1992 through March 31, 1993 for Lakehead's rates from January 1, 1993 through July 5, 1993. The ALJ concluded that the Canadian Association did not provide "any reason why Lakehead's proposed test period and throughput for the locked-in period January 1, 1993 through July 5, 1993 are not just and reasonable"[43] and added that:

> The April 1, 1992 through March 31, 1993 data "is representative of the most current period that the rates have been in effect when the stipulation was

(Footnote Continued)

that a return based on the Opinion No. 154-B method is, in effect, an improper acquisition adjustment. In short, Lakehead's motive for filing for a rate increase is of no moment to whether it is entitled to that increase under the just and reasonable standard, including its entitlement to a starting rate base which is not, in any way, an acquisition adjustment. Rather, it results from the shift from a valuation rate base to a TOC rate base. Last, Lakehead has not sought an acquisition adjustment in connection with its restructuring.

[39] There is thus no need to determine whether the Canadian Association's calculations are inaccurate as claimed by Lakehead. In addition, Lakehead's earnings on valuation from 1985 through 1990 were actually lower and range from 8.9 percent (1985) to 7.05 percent (1990). 65 FERC ¶ 63,021, at p. 65,135.

[40] TIAS No. 8720, 28 U.S.T. 7449.

[41] 28 U.S.T. at pp. 7454-55 (emphasis provided by Lakehead).

[42] Of course, the Transit Pipeline Treaty similarly does not prevent challenges to Lakehead's rates because of other issues, such as its income tax allowance, discussed *infra*.

[43] 65 FERC ¶ 63,021, at p. 65,131.

> developed. Since throughput was lower and operating expenses were higher during this period than during the year 1992, it is appropriate that the more recent rates reflect this more recent data."[44]

He further stated that "Lakehead's use of different data to evaluate rates for separate periods is not *per se* unjust and unreasonable."[45]

The Canadian Association excepts. It maintains that the ALJ has not justified the use of post test year data under Commission precedent[46] and that the ALJ's throughput and expense rationale provides no basis for using data after 1992.[47] It submits that the ALJ's reliance on *Kuparuk* is misplaced in that it involved a radical increase in throughput from 85 million bbl to over 100 million bbl and a choice of a base or test year; not use of data outside of the test year.[48]

Lakehead responds that the Canadian Association has relied on the erroneous premise that the Commission's gas and electric test year standards apply to oil pipelines and, that, rather than creating a moving target, the use of 1993 data ensured that the most accurate available data was used, and that this comports with the Commission *Kuparuk* decision.

The Commission concludes that it was appropriate in this case for the ALJ to use two test years. First, at the time of the Initial Decision, the Commission had no policy with respect to oil pipeline test years.[49] Second, the Commission's gas and public utility precedents were not controlling. In fact, they could produce different test years.[50] The ALJ's task was to fashion an appropriate test year approach for this proceeding. Third, the ALJ did not use data outside the test year. Rather, he used two test years. Fourth, the ALJ's use of April 1, 1992 through March 31, 1993 data was reasonable because that was the most accurate data available. The Canadian Association's complaint is that it does not like the result produced by that data. It does not question the data's accuracy. Hence, it has not been harmed in presenting its case.

B. *Expenses*

1. *Tax Expense*

In determining a pipeline's cost-of-service, the Commission includes an allowance for state and federal income taxes based on corporate income tax rates. This ensures that the pipeline will have the opportunity to earn its allowed after tax return on equity. Lakehead, however, is a limited partnership, which does not pay income taxes. Rather, the taxes are paid by the partnership's partners. The ALJ concluded that, nonetheless, Lakehead is entitled to a tax allowance based on the corporate income tax rate. He relied on several Commission precedents to that effect,[51] and he rejected the Canadian Association's contention that those cases are distinguishable because Lakehead's unitholders (holders of limited partnership interests) include individual investors, as well as corporate partners.

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[44] *Id.*, quoting Ex. 125 at p. 4. The stipulation was between Lakehead and the Commission staff.

[45] *Id.*, *citing*, *Kuparuk Transportation Co.*, 55 FERC ¶ 61,122, at p. 61,383 (1991).

[46] *Citing*, *Pacific Gas & Electric Co.*, 53 FERC ¶ 61,146, at p. 61,520 (1990).

[47] *Citing*, *Arkansas Louisiana Gas Co.*, 22 FERC ¶ 61,125 (1983).

[48] 55 FERC ¶ 61,122, at p. 61,383 n.93.

[49] The Commission has now adopted a test period for oil pipelines effective January 1, 1995. 18 C.F.R. § 346.2(a).

[50] Compare 18 C.F.R. § 154.63(e)(2)(gas) and 18 C.F.R. § 35.13(d) (public utility).

[51] 65 FERC ¶ 63,021, at p. 65,138, *citing*, *e.g.*, *Pelican Interstate Gas System*, 29 FERC ¶ 61,062, at p. 61,135 (1984).

The Canadian Association excepts to the ALJ's decision. It maintains that because Lakehead is a widely held limited partnership, a tax allowance in effect increases its equity return in excess of the after-tax return that would be achieved if Lakehead were a corporation. It asserts that this is because Lakehead will never have to pay those corporate taxes which thus redound to the equity owner. It adds that Lakehead has eliminated one-tier of taxes, the corporate tier.

Lakehead responds that it is well-settled Commission policy to allow a non-taxpaying partnership a tax allowance in its cost-of-service. It submits that this policy should apply whether or not the partners are corporations. It adds that the Canadian Association has provided no reason for deviating from the long-standing stand-alone tax policy, which, if done, would adversely affect the value of limited partnerships. It further maintains that ratepayers are paying no more than if Lakehead had reorganized as a corporation. It criticizes the Canadian Association's contention that unitholders will receive more money on the ground that they did not look at the ultimate tax bill generated from Lakehead's operations as compared to the ultimate tax bill of any other pipeline throughout the ownership chain. It further avers that it is an incorrect premise to assume that partnerships and their owners will always pay less in overall taxes than comparable corporations and their shareholders. It also maintains the Canadian Association has ignored Lakehead's "curative allocation" whereby Lakehead's general corporate partner bears more than its partnership interest in taxes.[52] Lakehead also refers to the complications in determining actual taxes paid for its publicly traded units and the possible undesirable rate swings caused by this tax allowance treatment in lieu of the corporate tax rate.

Under cost-of-service ratemaking principles, a regulated company is entitled to rates that yield sufficient revenue to cover its appropriate costs, including state and federal income taxes and a specified return on capital. The income tax allowance is no different from the allowance for any other cost. When the regulated entity is organized as a corporation, its revenues are taxed at the corporate tax rate and the earnings of the owners (shareholders) of the corporation are then taxed on dividends at their particular rates. Because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the cost-of-service to ensure that the regulated entity has the opportunity to earn its allowed return on equity. However, there is no allowance for the taxes paid by the owners of the corporation. If the Commission were to allow excessive or deficient cost allowances, including the tax allowance, this would distort the regulated entity's opportunity to earn its return on equity either to its benefit or detriment with the opposite result to its ratepayers. That is, a regulated entity is entitled to an allowance to cover its costs, including taxes, which are actually incurred.[53]

The issue in this proceeding is whether a limited partnership should receive an income tax allowance in its cost-of-service. The Commission first concludes that Lakehead is entitled to an income tax allowance with respect to income attributable to its corporate partners. This accords with current Commission policy.[54] When partner-

[52] Lakehead states that, in 1992, $46 million out of its $71 million in taxable income was attributed to its general corporate partner with less than a 20 percent ownership interest.

[53] A regulated entity cannot collect through the tax component of its cost of service an amount greater than its actual tax liability. *See Generally*, Regulations Implementing Tax Normalization for Certain Items Reflecting Timing Differences in the Recognition of Expenses or Revenues for Ratemaking and Income Tax Purposes, Order No. 144, *FERC Statutes and Regulations, Regulations Preambles 1977-1981*, ¶ 30,254 (1981).

[54] *E.g.*, *Pelican Interstate Gas System*, 29 FERC ¶ 61,062, at p. 61,135 (1984) and *Riverside Pipeline*

ship interests are held by corporations, the partnership is entitled to a tax allowance in its cost-of-service for those corporate interests because the tax cost will be passed on to the corporate owners who must pay corporate income taxes on their allocated share of income directly on their tax returns. The partnership is in essence a division of each of its corporate partners because the partnership functions as a conduit for income tax purposes.

However, the Commission concludes that Lakehead should not receive an income tax allowance with respect to income attributable to the limited partnership interests held by individuals.[55] This is because those individuals do not pay a corporate income tax. Since there is no corporate income tax paid, there should be no corporate income tax allowance built into Lakehead's rates with respect to income attributable to individual limited partners. This comports with the principle that there should not be an element in the cost-of-service to cover costs that are not incurred.

The individual limited partners are entitled to an after tax return "commensurate with returns on investments in other enterprises having corresponding risks."[56] If Lakehead were to receive a corporate tax allowance with respect to individual limited partners, Lakehead and those investors would be earning an after tax return on equity in excess of that to which they are entitled for Lakehead's risks. For example, if Lakehead were entitled to a return on equity of 10 percent on a rate base of $1000, its return on equity would be $100.[57] If it received an income tax allowance of $54, its total return and taxes would be $154. If it paid a corporate tax of 35 percent, it would retain $100 and earn its 10 percent. However, if there were no corporate income tax on the $154, it would retain $154 and earn 15.40 percent on its investment.[58] This would overcompensate Lakehead for its risk. It is true that Lakehead's individual limited partners will pay income taxes on their share of partnership income. However, with respect to those partners, the corporate level of income tax has been avoided and no tax allowance is needed to ensure that the partnership has the opportunity to earn its allowed return on equity.

2. *Hydrostatic Testing Expense*

Lakehead's cost-of-service includes hydrostatic testing expenses,[59] which it seeks to amortize over a period of three years. It instituted testing as a result of an oil spill on Line 3 in 1991 and a Consent Decree with the Department of Transportation, Office of Pipeline Safety. It tested approximately 70 percent of Line 3 in 1991 and the remainder in 1992. It then started multiyear testing on Lines 2 and 5 to last through 1996. The ALJ concluded that Lakehead is entitled to recover those expenses, but he adopted an amortization period of five years. He found that Lakehead's hydrostatic testing was prudent in light of two past spills and the age of its system and that a relatively brief amortization period was warranted because near-term future customers

(Footnote Continued)

Company, L.P., 48 FERC ¶ 61,309, at p. 62,017 (1989).

[55] This is the first time that the Commission's policy about the income tax allowance for a limited partnership has been adjudicated with respect to limited partnership interests held by individuals.

[56] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1942).

[57] For convenience, the example assumes a 100 percent equity capital structure.

[58] For convenience, the example assumes that the partnership consists solely of individuals.

[59] As described by the ALJ, "[h]ydrostatic testing [to search for leaks] involves filling the line with water, which is then elevated to a test pressure higher than the intended operating pressure. If the line endures this higher pressure for the specified period of time without failing it has been successfully tested." 65 FERC ¶ 63,021, at p. 65,139 n.25.

benefit from hydrostatic testing and more distant future ratepayers may not have been using the Lakehead system when the two spills occurred.

The Canadian Association excepts to the inclusion of hydrostatic testing costs, which it argues are non-recurring owing to anomalous circumstances, as opposed to costs characterized as the result of normal practice. Both the Canadian Association and Lakehead except to the five-year amortization period.

The Canadian Association first maintains it is inappropriate for Lakehead to recover retroactively the hydrostatic testing costs incurred in 1991 with respect to the 1991 oil spill (Line 3) given the level of Lakehead's returns. It also submits that its costs associated with its testing (1991 and 1992) on Line 3 and its multi-year testing of Lines 2 and 5 are anomalous, non-recurring expenses. It maintains that a five-year amortization period is a windfall because the expense stays in rates unless it is removed at the end of the period, and recommends a 15-year period because it better reflects the frequency of testing in that it is not continually testing each line.

Lakehead argues that the ALJ correctly held that it can include in its rates its hydrostatic testing costs. It maintains that those costs will recur with predictable frequency and are not non-recurring as contended by the Canadian Association. Lakehead further submits that the costs will not become embedded in its rates because this phase of the case involves a past, locked-in period. With respect to the amortization period, it maintains that a three-year amortization period is appropriate because such testing is essentially a yearly event on some portion of its system and amortization over a long period of time improperly imposes those costs on customers that may not have been using the Lakehead system when the cost was incurred. Lakehead asserts that the Canadian Association, in its argument for a 15-year amortization period, erroneously assumes that the testing procedure is not on-going when in fact it is on-going on various portions of the system. It concludes that there is no justification for stretching its recovery of hydrostatic testing costs to near oblivion or to eliminate the amortization of all pre-1992 testing costs.

Lakehead's hydrostatic testing costs for Line 3 (1991) were incurred before the 1992 test year. However, the nature of these costs, testing to prevent oil spills, benefits ratepayers in the future, and hence the Commission concludes that Lakehead's Line 3 hydrostatic testing costs incurred in 1991 should be recovered from ratepayers via amortization. However, the costs associated with Line 3 in 1992 and with Lines 2 and 5 reflect the start of on-going program of testing and, as such, are of the type of normal recurring costs to be reflected as test year costs rather than collected by amortization.

The Commission concludes that Lakehead's proposal to amortize the 1991 Line 3 costs in 1991, 1992, and 1993 was appropriate. The amortization of one-third of the costs in 1991 would not be paid by ratepayers while the amortization of the remainder in 1992 and 1993 will balance the investor and ratepayer interest by returning the costs to the investors over a reasonable period of time. However, when the Commission acts on the stayed investigation with respect to Lakehead's October 28, 1994 filing, the Commission will direct Lakehead to remove any of these costs that are in those rates from its rates so that indexed rates under Order No. 561[60] do not include those costs.

[60] Revisions to Oil Pipeline Regulations pursuant to Energy Policy Act, Order No. 561, 58 Fed. Reg. 58785 (November 4, 1993), *FERC Statutes and Regulations* ¶ 30,985 (1993), order on reh'g and clarification, Order No. 561-A, 59 Fed. Reg. 40243 (August 8, 1994), *FERC Statutes and Regulations* ¶ 31,000 (1994).

3. *Rate Case Expense*

The ALJ concluded that Lakehead is entitled to amortize its regulatory expenses incurred in this rate case over a three-year period. He concluded that "[a] shorter payout would unnecessarily cause an artificial increase in Lakehead's rates."[61] He rejected the Canadian Association's position that Lakehead's regulatory expenses were excessive and concluded that "a period of considerably greater length [than three-years] would needlessly impose upon potential future customers the residual costs of a case in which they had no opportunity to participate."[62]

The Canadian Association excepts. It maintains that only one-quarter of the actual expenses incurred in 1992 and 1993 should be eligible for rate treatment because there were no substantive elements of this case that reflect initiatives undertaken for the benefit of ratepayers. It also submits that Lakehead should not be able to recover rate case expenses incurred in 1991. Further, it argues that those costs should be amortized for a six-year period because, if the Commission adopts a new method of regulation, Lakehead may not ever file a new rate case.

Lakehead seeks clarification. It maintains that it did not request amortization. Rather, it states that it seeks to use its actual test year regulatory expenses, which is consistent with the treatment of its other costs.

The Commission concludes that Lakehead is entitled to recover its actual rate case expenses. There is no requirement, nor should there be, that a rate case reflect initiatives for the benefit of ratepayers. However, Lakehead is not entitled to recover rate case expenses incurred in 1991 in anticipation of this proceeding because those costs were incurred before the 1992 test year.

In addition, it is Commission policy to spread rate case expense over a period of time rather than use a test year approach because a pipeline does not incur major rate case expenses each year. The period for gas pipelines has been three years because that was the time between major rate cases. However, here the Commission will adopt an amortization period ending November 29, 1994, as reasonable so that Lakehead's indexed rates do not include these costs. The Commission will direct Lakehead to remove those costs when it acts on Lakehead's October 28, 1994 filing.

4. *Oil Loss Expense*

The ALJ concluded that Lakehead's oil loss expense should be based on the average of such losses over a six year period. He so concluded because of Lakehead's recent operational risks and ongoing hydrostatic testing and systemwide inspection in progress, which make six years "more representative of average loss expenses." He adds that the price of oil itself is volatile and best measured over a long period.

Lakehead excepts and maintains that a three-year period should be used for calculating oil loss expenses. It argues that it offered unrebutted testimony that the period between 1986-1988 was not representative of prospective losses,[63] and that from an accounting prospective, a three-year average of oil loss expenses was most representative of future oil losses.[64] The Canadian Association opposes Lakehead's exception but without discussion.

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[61] 65 FERC ¶ 63,021, at p. 65,141.

[62] *Id.*

[63] Ex. 97 at p. 15, line 8 through 16, line 2.

[64] Ex. 134 (unrevised) at p. 4, line 8 through 5, line 24.

The Commission adopts a three-year period as representative of the experience on Lakehead's system. The ALJ's conclusions were based on matters which are unrelated to Lakehead's unrebutted testimony that the years 1986-1988 were not representative of prospective oil losses.[65]

III. Rate Floor

As stated above, at issue are Lakehead's rates for the locked-in period from May 3, 1992 through July 5, 1993. The instant issue is whether, under the Energy Policy Act of 1992,[66] Lakehead's rates in effect on October 24, 1991, created a floor under which ratepayers are not entitled to relief. Under that Act, as here pertinent, rates in effect on that date are deemed just and reasonable unless they were subject to protest, investigation, or complaint during the 365-day period thereafter.[67] The Canadian Association maintained that Lakehead's rates on that date were subject to its Amended Intervention and Protest (filed October 13, 1992) to its April 20, 1992 Intervention and Protest of Lakehead's proposed rates. In its amendment, the Canadian Association stated:

> Upon examination of the direct evidence and supporting material submitted by Lakehead, CAPP and APMC have concluded that both the rate increase requested in this proceeding and Lakehead's existing rates in effect prior to the filing of the new rates in this proceeding are and were unjust and unreasonable. For this reason, CAPP and APMC wish to clarify that they seek the full measure of relief provided for by sections 13 and 15 of the Interstate Commerce Act. Such relief includes full refund of the rate increase at issue here and, in addition, prospective reduction of Lakehead's rates to a just and reasonable level. . . .

The ALJ concluded that "Lakehead's tariffs in effect on October 24, 1991 were not properly subject to protest, investigation, or complaint during the 365-day period preceding the date of enactment of the EPA [Energy Policy Act]" and, therefore, those rates are "presumptively just and reasonable" and provide a refund floor so that "refunds cannot exceed the amount of Lakehead's rate increases."[68] He found that the Canadian Association's amended protest did not amount to a complaint under the Commission's regulations and observed that it was not noticed as such and no investigation was launched. He distinguished the Commission's orders in *SFPP, L.P.*, on the ground that the Commission was asked to consider the protest as a complaint and issued a notice of complaint.[69]

The Canadian Association excepts. It asserts that *SFPP, L.P.* does not require the formal designation of a pleading as a complaint to prevent the application of section 1803 of the Energy Policy Act's grandfathering protection. It argues that *SFPP, L.P.*, involved only preexisting rates as opposed to here where the existing rate has been superseded and the question is to what level it should be reduced. It further maintains that, in any event, if a rate no longer in effect is to be treated as an unchanged, existing rate, a pleading still need not be designated a complaint because section 13(1) requires a petition and not a complaint. Last, it concludes that the quoted language qualified as a petition requesting that Lakehead's new rates be just and reasonable, even if the

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[65] *ARCO Pipeline Co.*, 52 FERC ¶ 61,055, at p. 61,245 (six-year period found to be a "representative sample").

[66] 42 U.S.C.A. 7172 note (West Supp. 1993).

[67] Section 1803.

[68] 65 FERC ¶ 63,021, at p. 65,131.

[69] 63 FERC ¶ 61,275 (1993) and 63 FERC ¶ 61,014 (1993).

rates are below the level of the previously and no longer effective rates, and that form should not be exalted over substance.

Lakehead first responds that the Canadian Association's initial protest did not in any way purport to challenge the rates in effect prior to Lakehead's new rate filing or suggest that the new rates be reduced to a level below pre-existing lawful rates. It then maintains that the Canadian Association's Amended Intervention and Protest did not amount to a complaint and was, as its earlier protest, directed solely at the new rates filed in April 1992. Lakehead further submits that *SFPP, L.P.* is not controlling in that the protest was alternatively styled as a complaint and was directed expressly at its pre-existing tariff. Here, it submits, the Canadian Association's protests were not designated as complaints nor did they mention Lakehead's preexisting rates except for the second protest in the context of seeking relief from newly filed rates. It concludes that the Canadian Association did not meet the conditions of the Energy Policy Act and so no refunds can be ordered below the level of the pre-existing rates.

The issue is whether the Canadian Association's Amended Intervention and Protest of October 13, 1992 subjected Lakehead's rates in effect on October 24, 1991 to a complaint. If it did that, then those rates were not deemed just and reasonable under the Energy Policy Act and Lakehead's rates could be reduced to a just and reasonable level even if below the level of its rates in effect prior to the effective date of its increased rates in this filing.

The Canadian Association's amendment while styled as a protest was in fact a complaint against "Lakehead's existing rates in effect prior to the filing of the new rates in this proceeding . . . [as] unjust and unreasonable" under section 13 of the ICA. That is the only reasonable interpretation of the Canadian Association's amendment. Thus, Lakehead's prior rates were subject to a complaint and were not deemed just and reasonable under the Energy Policy Act. It is true that the Commission did not launch an investigation into the lawfulness of Lakehead's prior rates. Nonetheless, the rates were subject to complaint, which the Energy Policy Act differentiates from an investigation.

The Canadian Association, however, has sought only "full refund of the rate increase at issue here and, in addition, prospective reduction of Lakehead's rates to a just and reasonable level." It did not seek reparations under the Act in the event Lakehead's effective rates prior to May 3, 1992, were higher than the rates determined here to be just and reasonable. Accordingly, Lakehead is obligated to make Phase I refunds down only to the level of its effective rates on May 2, 1992, if such refunds are required as a result of this opinion. In addition, as concluded by the ALJ, Lakehead is not required to reduce its rates prospectively to the just and reasonable levels here established, because of its June 4, 1993 rate filing, which rates were effective July 6, 1993, and are the subject of Phase II of this proceeding.[70]

IV. Natural Gas Liquids (NGLs)

A. *Background*

Interprovincial Pipe Line, Inc. (IPL) transports NGLs from fields in Western Canada to Lakehead at the international border at Neche, North Dakota, Lakehead transports the NGLS from Neche, North Dakota to Superior, Wisconsin and from there

[70] 65 FERC ¶ 63,021, at p. 65,128, *citing*, Lakehead Pipe Line Co., 64 FERC ¶ 62,002 (1993).

eastward to the international border at Marysville, Michigan. At Superior, the NGLs must be broken out and stored in order to continue their eastward movement.[71] Lakehead requires the NGL shipper to provide the NGL receipt, intermediate break-out, and delivery facilities to the extent Lakehead does not do so. At present, the NGLs are broken out of Lakehead's traffic at Superior, Wisconsin using breakout storage tank (BOST) facilities owned by Amoco, Lakehead's single, existing NGL shipper. The ALJ concluded that the NGL issues were properly before him and that Lakehead has violated the ICA in several respects with regard to NGLs.[72] As discussed below, the Commission concludes that Lakehead is not in violation of the ICA at this time because shippers of NGLs other than Amoco have no access to IPL in Canada and hence cannot request service on Lakehead. However, the Commission finds that if such shippers obtain access onto IPL, Lakehead must ensure that their NGLs can move beyond Superior.

B. *Procedural Issues*

1. *Jurisdiction*

The ALJ rejected Lakehead's contention that the NGL matters were not properly before him inasmuch as Marysville had not filed a complaint concerning Lakehead's rules tariffs already in place.[73] The ALJ concluded that "the practices asserted by Marysville to be illegal relate directly to tariffs 3 and 4, and Lakehead Stipulated to their being heard and determined in this proceeding."[74]

Lakehead excepts. It asserts that because Marysville challenged unchanged practices the issues may only be raised by a complaint under section 13(1) of the ICA and may not be raised here because the proceeding was instituted under section 15(7) of the ICA.[75] It further maintains that the Oil Pipeline Board, which initiated the proceeding, does not have the authority to initiate a section 13(1) proceeding.[76] Last, it submits that it did not agree to having the instant issues decided in this proceeding by their inclusion in a joint stipulation of issues, which provided:

> This stipulation reflects all of the issues that have been suggested by each party without regard to whether all parties agree with, or themselves raised, any particular issue.

It maintains that its signing that stipulation did not mean it agreed to having the stipulated issues tried in this proceeding and that it challenged Marysville's right to raise the issues from the outset of this proceeding.

Marysville responds that Lakehead's cited decisions are distinguishable in that they did not involve the reasonableness of changed rates questioned at least in part because of a disparity in the nature of service provided to the only existing NGL

[71] At Superior, three Lakehead pipelines from Western Canada feed into two Lakehead pipelines moving eastward.

[72] The ALJ also concluded that the Commission has no jurisdiction to direct the sole NGL shipper to allow other shippers to use its BOST facilities and rejected certain contentions of Marysville. No exceptions were filed to those conclusions of the ALJ. He also ordered Lakehead to reinstall its delivery line to Marysville, if a prospective shipper were to commit to its use and ask for reinstallation. Lakehead excepted, but on March 14, 1994, filed an unopposed motion to declare the issue moot because it has reinstituted service to Marysville. The Commission grants Lakehead's motion.

[73] Marysville operates hydrocarbon fractionation facilities. It is not, has never been, and has no present intention of being a shipper on Lakehead. Stipulated fact number 46.

[74] 65 FERC ¶ 63,021, at p. 65,142.

[75] *Lakehead Pipe Line Company, Inc.*, 62 FERC ¶ 62,104 (1992).

[76] *Citing*, SFPP, L.P., 63 FERC ¶ 61,014, at p. 61,125 (1993).

shipper when compared to the nature of the service offered to potential NGL shippers, as well as the disparity in the service offered as between oil and NGL shippers. It further states that none of the cited decisions involved a stipulation that the issues in question be addressed as part of a section 15(7) proceeding.

The Commission staff responds that the investigation of NGL transportation issues in this proceeding does not relate solely to Lakehead's existing practices; rather, the NGL transportation issues are inextricably related to Maryville's claim under section 15(7) that Lakehead's rates are affected by the decreased throughput resulting from its failure to provide BOST facilities at Superior. Staff adds that Lakehead has not demonstrated any prejudice to it justifying a retrial in a separate section 13(1) proceeding. Last, staff submits that Lakehead waived its right to make its argument because it failed to seek rehearing of the Oil Pipeline Board order setting this case for hearing[77] and because it failed to appeal the ALJ's ruling rejecting its opposition to addressing Marysville's claims in this proceeding.

The matter has been fully litigated and, therefore, the Commission will issue a merits decision. The Commission could issue a complaint under section 13(2) of the ICA upon its own motion and consolidate the complaint with this docket. However, the Commission will not do so since at this time it is not finding Lakehead in violation of the ICA and is thus not requiring Lakehead to take any action.

2. *Burden of Proof*

Lakehead also maintains that Marysville failed to sustain its burden of proving that Lakehead's practices were unduly discriminatory, unduly preferential, or otherwise unjust and unreasonable and failed to sustain its burden of showing that alternative just and reasonable rules or practices exist to remedy the alleged violations. It refers to the ALJ's statement that the record contains no remedy (65 FERC ¶ 63,021, at p. 65,147) and objects to his directing Lakehead to survey potential shippers and, if warranted, to construct NGL breakout tankage even though that remedy was not explicitly raised by Marysville.

Marysville replies that there is a simple remedy at hand—delete the tariff requirement that a shipper provide facilities at intermediate breakout locations.

The Commission staff responds that the burden of coming forward with evidence showing that Lakehead violated the ICA by not providing essential BOST facilities was satisfied and that Lakehead failed to thereupon justify its practice. Staff further maintains there was no error when the ALJ ordered a remedy not specifically requested by Marysville.

While Lakehead is right that the burden was on Marysville to prove a violation of the ICA, there is no requirement under the ICA that Marysville must have proposed any specific remedy. It is the Commission that prescribes a remedy under section 15(1) of the Act, if there is a violation of the ICA.

C. *Provision of NGL BOST Facilities*

The ALJ concluded that Lakehead's current practice of transporting NGLs only for shippers who provide their own BOSTs is a violation of the ICA. He found that,

[77] Maryville's NGL allegations were described in the Oil Pipeline Board order establishing hearing procedures.

under sections 1(4)[78] and 1(6)[79] of the ICA, the Commission has the legal authority to require Lakehead to construct facilities necessary to accommodate its customers. With respect to section 1(4), which governs through routes, he concluded that Lakehead is a "through route" in that it provides a "through transmission service with its affiliate, IPL."[80] He directed Lakehead "to construct BOST facilities [at Superior, Wisconsin] for the use of NGL shippers to the degree that there is need for such facilities."[81] However, he also found that "the record fails to establish or even suggest any specific remedy for this violation [and] no information which could be used to judicially formulate such a remedy."[82] He thus directed Lakehead to file with the Commission a proposed course of remedial action, including a confidential list of preliminary nominations for NGL transport, which it shall solicit.

Lakehead and the AOPL except. Lakehead argues that it holds itself out as a common carrier of NGLs, to the extent it does not provide NGL breakout facilities, only when the shipper provides those facilities. It maintains that its ability to define its common carrier status is well recognized.[83] It further submits that the Commission has no authority to order it to provide a service against its will as shown by court, ICC, and FERC precedents and that the precedents cited by the ALJ do not support the proposition that the Commission can order Lakehead to construct facilities. The AOPL similarly maintains that the Commission had held that it has no authority to order the construction of facilities,[84] that the pipeline's obligation to furnish transportation under section 1(4) is defined by what it holds out to the public in its tariffs,[85] that the Commission has no authority to order a pipeline to initiate a new service,[86] such as providing breakout services to all shippers, and that the ALJ's precedents are not relevant.

Both Lakehead and the AOPL maintain that the ALJ misapplied ICA section 1(4) because Lakehead does not offer a joint rate, fare, or charge with any other carrier and that section 1(4) applies only to conduct between or among connecting carriers establishing through routes. Lakehead adds that it does not have a through route with IPL while the AOPL maintains that the record is inadequate for making that determination. Lakehead further submits that, even if it does have a through route, the breakout facilities at Superior, Wisconsin have nothing to do with that through route. The AOPL maintains that, assuming a through route, section 1(4) prohibits discrimination among carriers and so cannot afford relief to a non-carrier like Marysville.

Lakehead next argues that its obligation under section 1(4), if it exists, is limited to providing reasonable facilities, that the Commission should not second guess man-

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[78] Section 1(4) provides in pertinent part that:

It shall be the duty of every such common carrier establishing through routes to provide reasonable facilities for operating such routes and to make reasonable rules and regulations with respect to their operation . . . which shall not unduly prefer or prejudice any of such participating carriers.

[79] Section 1(6) provides in pertinent part that:

It is made the duty of all common carriers subject to the provisions of this chapter to establish, observe, and enforce just and reasonable classifications of property for transportation, with reference to which . . . regulations or practices are or may be made or prescribed, and just and reasonable regulations and practices affecting classifications . . . .

[80] 65 FERC ¶ 63,021, at p. 65,143.

[81] *Id.* at p. 65,144.

[82] *Id.*

[83] *Citing, United States v. Pennsylvania R.R.*, 242 U.S. 208, 236 (1916); *Chapin - Sacks Corp. v. Atlantic Coast Line R.R.*, 80 ICC 255, 257 (1923), and *Potomac Elec. Power Co., v. United States*, 584 F. 1058, 1061-63 (D.C. Cir. 1978).

[84] *Citing, Chevron Pipe Line Co.*, 64 FERC ¶ 61,213 (1993).

[85] *Citing, e.g., Potomac Electric Power Co. v. United States*, 584 F.2d 1058, 1063 (D.C. Cir. 1978).

[86] *Citing, ARCO Pipe Line Co.*, 65 FERC ¶ 61,159 (1994).

agement decisions absent a convincing showing of unlawful conduct, and that there is no evidence of sufficient utilization to justify the substantial costs, which would amount to an unlawful taking prohibited by the Fifth Amendment. It adds that the requirement that it conduct a survey does not provide adequate assurance that construction will be justified. It avers that the survey is unnecessary in that it already has available the information that such a survey would provide and that the information it would actually need is extensive and must amount to adequate assurance of sufficient use of any facilities. The AOPL maintains that the ALJ's directives (survey) and the assertion of authority constitute an unwarranted intrusion into Lakehead's management affairs.

The staff maintains that the Commission could find certain alternative remedies to be acceptable. These are that (1) Lakehead could purchase or lease Amoco's BOST facilities at Superior, Wisconsin; (2) Amoco could file its own tariff for the common use of its BOST facilities; or (3) Lakehead could cease offering the NGL common carrier transportation service. Staff argues that the ALJ's decision should be modified to provide either that Amoco must participate in the nomination process and use of the Lakehead's common carrier BOST facilities or that the cost of those facilities be rolled into Lakehead's transportation rate to be paid by all NGL shippers.

Marysville responds that Lakehead has a through route with IPL and that the BOST facilities are an essential link in the through route from Lakehead's Line No. 1 to its Line No. 5. It further maintains that unless Lakehead is willing to discontinue service beyond Superior, it must furnish the BOST facilities. It submits that Lakehead's citations are distinguishable as they involved carriers providing facilities or services but not in the form or quantity desired by a complaining party while here Lakehead is refusing to provide the required facilities and services except for one shipper, Amoco. Marysville asserts that the argument that only Amoco falls within Lakehead's defined NGL service ignores: (1) the operational needs of its system (it is neither necessary or desirable for all NGL shippers to have their own BOST); (2) the fact that the necessity of BOST facilities for the shipment of NGLs should make them part of the system rather merely private; and (3) Lakehead's obligation under section 1(4) of the ICA to make reasonable rules and regulations with respect to the operation of any facilities (BOST in this instance) that enable it to establish a through route. It concludes that, in any event, Lakehead explicitly holds itself out as providing through service from the international border, North Dakota to the international border, Michigan, and that Lakehead's route passes through Superior.

The Commission staff responds that the BOST facilities are essential for Lakehead to provide its common carrier transportation of NGLs and that, therefore, the ICA requires that those facilities be jurisdictional.[87] Staff further maintains that the right of Lakehead to define its role as a common carrier so as to exclude providing BOST facilities does not pertain to an essential service subsumed within its NGL transportation service. Staff asserts that Lakehead's cases support only the proposition that a common carrier is under no obligation to provide unnecessary facilities. Next, staff submits that it is irrelevant that the Commission has no power to prevent an abandonment, because here Lakehead is offering an NGL transportation service. Last, staff maintains that the requirement that Lakehead conduct a survey of potential NGL shippers and then file a proposes course of action is reasonable. Staff submits that

[87] *Citing, Southern Pacific Terminal Co.*, 219 U.S. 498, 522 (1910) and *Kerr McGee Refining Corp.*, 63 FERC ¶ 61,349 (1993).

Lakehead's concerns about whether it will be economic to build BOST facilities is of no moment. Staff maintains that Lakehead has the options of discontinuing its NGL transportation service or arguing that it needs certain firm commitments as part of its plan. It argues that the Commission should alleviate this revenue concern by either (1) requiring all shippers, including Amoco, to participate in the nomination process and use of Lakehead's new BOST facilities, or (2) rolling-in the cost of Lakehead's new BOST facility into the transportation rate for NGLs to be paid by all NGL shippers, including Amoco.

The AOPL responds that, under the ICA, a pipeline is not required to provide all essential facilities and may require shippers to provide facilities that are beyond the Commission's jurisdiction, such as BOST facilities, injection facilities, or receipt and delivery tankage. It further maintains that Lakehead has been unable to purchase or lease Amoco's BOST facilities, that the Commission has no authority to order such a purchase or lease, that the Commission has no authority to require Amoco to file a tariff, that the Commission has no authority to order Lakehead to cease its NGL transportation service, and that the Commission has no authority to require Amoco to make nominations for the projected Lakehead BOST facilities. Amoco responds that the staff's first remedy of Amoco's forced participation in the nomination process and use of Lakehead's new BOST facilities is beyond the Commission's lawful authority and that the staff's second remedy of rolling-in the costs of those facilities is discriminatory because Amoco would be forced to pay for facilities it neither wants nor needs.

The Commission concludes that Lakehead is not violating the ICA at this time by transporting NGLs only for shippers who provide their own BOST facilities at Superior, Wisconsin. First, the Commission concludes that, even if the IPL and Lakehead route is a through route,[88] it is not subject to section 1(4) of the ICA and therefore Lakehead cannot be required to provide facilities under that section. This is because section 1(4) applies only to through routes of carriers subject to the ICA.[89] IPL is not subject to the ICA and so there is no through route subject to the Commission's jurisdiction.[90]

Nonetheless, under the ICA, Lakehead, as a common carrier,[91] must transport NGLs[92] "upon reasonable request therefor."[93] The ICA broadly defines transportation to include "all instrumentalities and facilities of shipment and carriage . . . and all service in connection with the receipt, delivery . . . transfer in transit, storage, and handling of property transported."[94]

As indicated by the ICA provisions referred to above, Lakehead, as a common carrier of NGLs, has the duty to transport NGLs, and to furnish services in connection therewith, on its system upon reasonable request. Marysville is not, has never been, and

[88] The Commission expresses no opinion about whether the IPL and Lakehead route is in fact a through route because they have held "themselves out as offering through transportation service." Thompson, Trustee, *Missouri Pacific Railroad Co. v. United States*, 343 U.S. 549, 556 (1952).

[89] Section 1(4) provides in pertinent that: "It shall be the duty of every common carrier subject to this chapter . . . to establish reasonable through routes with other such carriers." *See* section 15(3) which gives the Commission the power to establish through routes applicable to the transportation of property "by carriers subject to the ICA." The ICA "does not authorize or forbid the making of joint through international rates." *Lewis-Simas-Jones Co. v. Southern Pacific Co.*, 283 U.S. 654, 659 note (1931).

[90] The ICA applies "to international commerce only insofar as the transportation takes place in the United States." *Id.* at p. 659.

[91] Section 1(3) provides that: "(a) The term 'common carrier' as used in this chapter shall include all pipeline companies.

[92] Section 1(1) provides that: "The provisions of this chapter shall apply to common carriers engaged in (b) The transportation of oil or other commodity, except water and natural or artificial gas, by pipeline.

[93] Section 1(4).

[94] Section 1(3).

has no present intention of becoming a shipper of NGLs on Lakehead.[95] In addition, no potential shipper of NGLs has complained to this Commission about Lakehead's NGL service. Moreover, at present, no potential shipper could make a reasonable request to Lakehead for NGL service. This is because there is no access for those shippers to IPL in Canada. This Commission has no authority to order IPL to provide NGL service in Canada. Hence, it is not appropriate at this time to conclude that Lakehead has, in fact, violated its common carriage obligation by refusing to obtain BOST facilities.

However, if shippers of NGLs without access to BOST facilities receive service on IPL for delivery to Lakehead, Lakehead must provide or arrange for the provision of BOST facilities. Those facilities are part and parcel of Lakehead's transportation of NGLs on its system. The BOST facilities are necessary because of a break in Lakehead's system. Indeed, the NGLs that come into Superior always go into BOST facilities[96] without which the Lakehead system cannot operate.[97] As with crude oil, they are "an integral part of the overall transmission function."[98] In essence and effect, the BOST facilities are facilities in lieu of pipe connecting Lakehead's upstream and downstream systems[99] and are an integrated part of its system of common carriage from Western to Eastern Canada.

The Commission rejects Lakehead's claim that it is entitled to qualify its obligation to serve by requiring shippers to provide their own BOST facilities. The common carrier can make reasonable and appropriate rules respecting the acceptance and transportation of traffic. However, those rules cannot be such that they vitiate the common carrier's obligation to hold out service upon reasonable request. Here, Lakehead's tariff provision would be unreasonable because it would render its common carrier obligation a nullity and convert Lakehead into a private carrier for Amoco. This would violate its common carrier obligation under the ICA to provide transportation upon reasonable request.

The authorities referred to by Lakehead do not require a different result. In *United States v. Pennsylvania Railroad Co.*,[100] the railroad refused to increase its number of tank cars in order to transport refined oil produced by shippers. Rather, the railroad stated that it would transport the refined products when contained in barrels or other similar containers. The ICC directed the railroad to furnish tank cars in sufficient number to transport the shippers' normal shipments. The Supreme Court affirmed the district court's reversal of the ICC's order and stated that the ICC had no power to order the railroad to provide tank cars and that the railroad had not held itself out in its tariffs as furnishing tank cars so that a duty could be established. In *Potomac Electric Power Co. v. United States*,[101] the carrier provided trainload service in its cars, but provided unit-train service only in shipper-furnished cars and not in carrier-furnished cars. The court of appeals held that the carrier's "failure to hold out a complete unit-train service did not violate the Interstate Commence Act."[102] It added that "a railroad's obligation to furnish transportation is defined by what it holds out to the public in its tariff... and the furnishing of transportation under the unit-train tariff in question did not occur until PEPCO-furnished cars were placed in the possession of the railroad for line-haul movement."[103]

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[95] 65 FERC ¶ 63,021, at p. 65,123, stipulated fact number 46.

[96] Ex. 2 at p. 8; Tr. at p. 793.

[97] Tr. 627; Tr. 628 (crude oil).

[98] Ex. 41 at p. 11 (discussing crude oil); Tr. 848-49 (NGLs).

[99] Ex. 2 at p. 8.

[100] 242 U.S. 208 (1916).

[101] 584 F.2d 1058, 1063 (D.C. Cir. 1978).

[102] *Id.* at p. 1063.

[103] *Id.*

In *Chapin-Sacks Corp. v. Atlantic Coast Line Railroad Co.*,[104] the ICC held not unreasonable or unduly prejudicial the railroad's refusal to accord baggage car service on shipments of condensed skim milk when it transported whole milk, cream, and buttermilk because though condensed skimmed milk was somewhat similar in character to those products, the same compelling reason of perishability did not exist. Lakehead argues that this case indicates that a carrier need not provide specialized services if it chooses not to provide them.

None of the above cases require a different result here. The essential difference between them and the present case is that the above cases dealt with the duty of a railroad to provide a particular service (tank car service, unit-train service, baggage car service) on its system as opposed to the duty to provide physical facilities essential to a complete system. The BOST facilities are essential to completing Lakehead's system by filling a gap in the pipeline system at Superior. The BOST facilities are thus an integrated physical part of Lakehead's pipeline and not some specialized vehicle or service.

As discussed above, Lakehead is on notice that if a shipper of NGLs other than Amoco gains access to IPL and thus to Lakehead, Lakehead will be required to take appropriate action to ensure that the NGLs can move beyond Superior. In that vein, the Commission agrees with Lakehead and the AOPL that it cannot order Lakehead to initiate a service or prevent it from abandoning a service. However, once Lakehead has a reasonable request for service, it must do so in conformity with the ICA and must provide that service, upon reasonable terms and conditions, and without undue discrimination. That is Lakehead's statutory duty which it cannot render nugatory.[105]

The Commission, however, will not require Amoco to participate in any use of future BOST capacity or roll-in the costs of new facilities into Amoco's rates. Under the ICA, Lakehead may allow Amoco to furnish its own facilities for its own use in addition to providing a full service.[106]

D. *Buffer Materials*

Lakehead's tariff permits it to require an NGL shipper to supply material to serve as a buffer between NGL and crude oil batches.[107] The ALJ concluded that this provision is unreasonable because there is no similar obligation to provide buffer material on the part of a crude oil shipper. He ordered the provision deleted from Lakehead's tariff and found that: "If buffers are required they should be provided and paid for by all who benefit from them, not exclusively one class of shipper."[108]

Lakehead excepts. It maintains that its provision is reasonable for several reasons. It submits that buffers are needed to keep crude oil and NGLs separate and that its use of compatible buffer material such as syncrude permits the NGL shipper to take the

[104] 80 ICC 255 (1927).

[105] How it makes this decision is for Lakehead to decide. The Commission will not, as did the ALJ, require Lakehead to take specific action such as surveying potential shippers. However, Lakehead must act to ensure it can provide common carrier service once a shipper other than Amoco can access its system.

[106] *E.g., Potomac Electric Power Co.*, 584 F.2d 1058, 1063 (D.C. Cir. 1978).

[107] The current tariff rule 5(a) provides as follows:

A shipper shall, if requested by the Carrier, supply Petroleum as buffer material of a type and amount that is satisfactory to the Carrier. The Shipper shall, unless otherwise agreed to with the Carrier, accept at the *Intermediate Break-out Locations* and at the designated Regular Delivery Point for its NGL the volume of buffer material determined by the Carrier to be applicable to the transportation of such NGL.

[108] 65 FERC ¶ 63,021, at p. 65,145.

interface material without harmful consequences. It further maintains that it does not, at present, have the facilities to handle the buffer interface and does not desire to undertake this service, which, if required, would be an unwarranted intrusion into its management discretion. It also claims that it has no available means of apportioning the cost of material and facilities supplied by the existing NGL shipper. Lakehead also believes the ALJ's decision can be interpreted as suggesting only that it cannot require the NGL shipper to provide the buffer material. It states it is prepared to revise its tariff rule 5(a) as follows:

> If a Shipper requests the use of buffer material with the transportation of its NGL, then the Shipper shall (i) supply such buffer material of a type that is satisfactory to the carrier and (ii) unless otherwise agreed to with the Carrier, accept all such buffer material at the Intermediate Break-Out Locations and at the designated Regular Delivery Point for its NGL.

It adds that, if the revision satisfies the Commission's concerns, it will withdraw its objections to the ALJ's decision.

Marysville responds that Lakehead missed the point because the buffers benefit both NGL and crude oil shippers in that crude oil tanks cannot accept NGL-tainted material. It submits that the allocation of buffer costs would be no harder than other cost allocations and that there are market prices for syncrude. Marysville opposes Lakehead's proposal to amend its tariff because it ignores that both NGL and crude oil shippers benefit from the buffers and it does not permit a crude oil shipper to volunteer to provide a buffer. It further maintains that Lakehead's current rule assumed that there is only one NGL shipper.

At present, this issue is not ripe in that Lakehead's only shipper voiced no argument against Lakehead's current buffer practice. However, if Lakehead provides NGL service for additional shippers, it is its duty under the ICA to ensure such transportation and, therefore, to provide for buffer. Nonetheless, an NGL shipper may be permitted to provide NGL buffers and to take delivery thereof. Only if Lakehead provides the buffers must it apportion the cost between its crude oil and NGL shippers. The Commission will allow Lakehead to propose its revised buffer rules when it undertakes NGL service for additional shippers, at which time the Commission will consider the reasonableness of Lakehead's buffer rules.

E. *Commingling*

Lakehead's present tariff rule 6(b) provides that it will segregate NGL shipments, if they are not of a "kind or quality" currently being shipped on its system.[109] Lakehead allows an NGL shipper to request that its shipment not be commingled with the NGL shipment of another shipper and has no kind or quality standards in its tariff. The ALJ concluded that Lakehead's refusal to make necessary rules contravenes section 1(6) of the ICA and that it, as a common carrier, cannot abrogate its responsibilities by allowing the shipper to make the rules. He ordered Lakehead to make appropriate rules, if kind or quality definitions are relevant to its or its existing shippers' operations.

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[109] The current tariff rule 6(b) provides:

> If NGL tendered to the Carrier is of a kind or quality that is not currently being transported by the Carrier, then the Carrier shall, at the request of the Shipper of such NGL and subject to the operating conditions of the facilities of the Carrier, endeavor to segregate such NGL during transportation by the Carrier. In such circumstances, the Shipper shall, at the request of the Carrier make such NGL available in such quantities and at such times as may be necessary to permit such segregated movements.

Lakehead excepts to the extent the ALJ's decision could be interpreted to require forced commingling. It proposes the following new tariff rule 6(b):

> If a Shipper requests that its NGL be segregated from other specified NGL or other specified Petroleum transported by the carrier, then, subject to the existing facilities and operating conditions of the Carrier, the Carrier shall make reasonable efforts to segregate such NGL.

It further maintains that its decision to operate its pipeline on a batched basis is an exercise of its legitimate business judgment and comports with *Coastal States Marketing, Inc. v. Texas - New Mexico Pipeline Co.*, where the Commission dismissed a complaint that a shipper changed its practice of commingling to a practice of batching.[110] It submits that, at present, commingling is a moot issue because the existing breakout tankage owner will not let Lakehead use its tankage for third-party NGLs. It further maintains that, if new BOST facilities are built, there may be no need for commingling because of separate breakout spheres or tubes for distinct NGL streams. It also states that it wants to avoid use of a quality bank ("component balancing") type arrangement for compensating shippers whose NGLs would be devalued in commingling. It clarifies that by commingling it means mixing batches of different shippers and not one shipper's various products.

Marysville responds that Lakehead has missed the ALJ's point and has offered to amend its tariff to match its non-conforming behavior. It maintains that there is no harm in mixing NGLs of similar kind and quality and that component balancing is not particularly unusual or burdensome. It adds that since BOST facilities cannot be fully emptied of previous batches, it is no solution to build separate BOST facilities. It submits that *Coastal States Marketing* is inapposite because the pipeline was allowed to enforce its "kind or quality" requirements to stop the commingling of distinctly inferior product with higher grades of crude while here Lakehead is seeking to ignore its "kind or quality" requirements.

At present, this issue is not ripe in that Lakehead has only one shipper of NGLs. However, if Lakehead provides NGL service for additional shippers, it must publish in its tariff its kind or quality rules about what quality of NGLs will be batched together on behalf of different shippers.[111] However, the Commission concludes it would be appropriate for Lakehead to allow a shipper to request segregation of its own NGLs so long as it does not in effect vitiate its common carrier duty. The Commission will allow Lakehead to file those rules when it undertakes service for additional shippers, at which time the Commission will consider the reasonableness of the rules.

V. Conclusion

In conclusion, with respect to rate base, the Commission has concluded that TOC is the appropriate form of rate base to use in determining the reasonableness of Lakehead's rates, and that the Canadian Association has not shown that Lakehead is not entitled to a starting rate base.

With respect to the major cost-of-service issues, the Commission has concluded it was appropriate in this case for the ALJ to use two test years and that Lakehead is not

[110] 25 FERC ¶ 61,164 (1983).

[111] *See Denver Oil Co. v. Platte Pipe Line Co.*, 316 ICC 599, 604-05 (1962). (Tariff should contain *rules governing pipeline's segregation of crude oil into* streams "so that shippers are fully aware of the conditions under which a certain grade or quality will not be accepted").

entitled to recover a tax allowance with respect to individual limited partnership interests.

The Commission also has concluded that Lakehead's rate in effect on October 24, 1991, were subject to a complaint and so were not deemed just and reasonable by the Energy Policy Act of 1992, but that if Lakehead must make refunds under this opinion, it is obligated to do so only down to the level of its rates on May 2, 1992.

Last, the Commission has concluded with respect to NGL's that Lakehead has not violated its common carrier obligation by refusing to obtain BOST facilities, but that if it receives a reasonable request for service, it must take appropriate action to ensure that the NGLs can move on its system and file revised buffer and kind or quality rules.

The Commission orders:

(A) The Initial Decision of the administrative law judge is affirmed in part and modified in part as discussed in the body of this order.

(B) Within 45 days after issuance of this order (or 30 days after issuance of a final order on rehearing if there are requests for rehearing pending at the close of the 45-day period), Lakehead shall file detailed supporting workpapers for the locked-in period of May 3, 1992 through July 5, 1993, in accordance with the findings and conclusions of this order, along with a proposed plan of refunds showing the detailed calculation of proposed refunds to particular shippers that will be necessary as a result of the actions taken in this order.

(C) Within 30 days after Commission acceptance of Lakehead's revised workpapers and proposed refund plan filed pursuant to Ordering Paragraph (B), Lakehead shall make refunds to its customers and file a refund report with the Commission showing the calculation and payment of any refund that become necessary as a result of the actions taken in this order.

[1] 68 FERC ¶ 61,134 (1994).