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Opinion No. 435*

SFPP, L.P.
Opinion and Order on Initial Decision
86 FERC ¶ 61,022 (1999)

This is the first oil pipeline rate case in which the "substantially changed circumstances" standard under the provisions of the Energy Policy Act of 1992 (the EPAct), was fully litigated before the Commission. This case also involved oil pipeline rate issues such as the starting rate base, its capitalization and amortization, the allocation of costs among different regions or zones, and cost-of-service issues such as the cost of capital, litigation expenses, and tax allowances.

Grandfathering

- The Commission held that West Line rates from SFPP's new East Hynes origin were grandfathered, even though East Hynes was not an origin listed in SFPP's tariff at the time the EPAct was enacted. (at 61,063).

- The Commission held that SFPP's rate for transportation of turbine fuel was not grandfathered because turbine fuel was not a product carried by SFPP at the time the EPAct was enacted. (Id.).

- Finally, the Commission held that the mere fact that the tariffs containing SFPP's West Line rates were suspended at the time the EPAct became effective is irrelevant for grandfathering purposes because the tariffs that were suspended did not contain any rate changes. (Id.).

Changed Circumstances

- With respect to the grandfathered West Line rates, the Commission held that the complainants had failed to make their threshold showing under the EPAct of a substantial change (i.e., more than a material change of 10%) in the economic circumstances that were a basis of the rate. (at 61,065-66).

- The Commission ruled that a substantial change could be established by "one or a number of rate elements," including volumes, asset base, operating, and capital costs. (at 61,067).

- The Commission determined that the "economic basis" is not the twelve-month period before enactment of the EPAct, but is instead "the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination." (at 61,068).

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- The Commission acknowledged that a change in regulatory policy, such as the Commission's decision in Lakehead Pipe Line Company, L.P., 71 FERC ¶ 61,338 (1995), reh'g denied, 75 FERC ¶ 61,181 (1996), (imposing limits on the right of oil pipelines organized as limited partnerships to include an income tax allowance in their costs of service), could cause "changed circumstances" within the meaning of the EPAct, but held that complainants had failed to specifically address how the Lakehead policy affected the economic basis of the rates at issue. (at 61,512).

Enhancement Facilities

- The Commission determined that the Watson Station facility was jurisdictional because it served to enable all shippers from Watson Station to meet SFPP's mandatory pressure requirements. (at 61,074-75). SFPP was directed to file a rate equal to the rate negotiated in the contracts, which was determined to be a legal rate. (at 61,075-76).

ARCO Reversal Agreement

- The Commission held that it did not have jurisdiction over SFPP's decision to reverse the flow of its six-inch line between Phoenix and Tucson, Arizona because construction, entry, and abandonment of service by an oil pipeline are not subject to the Commission's jurisdiction. (at 61,077).

Rate Design Issues

- The Commission reaffirmed that oil pipelines are not necessarily limited to the use of a fully allocated cost ceiling as a justification for their rates. However, SFPP's East and West Lines must be looked at separately for cost of service purposes because the cost of providing service over a given territory must be recovered only from the shippers who use that particular service. The allocation of indirect overhead costs among SFPP's jurisdictional and non-jurisdictional operations should be based on the KN method. (at 61,079-82).

Rate Base Issues

- For purposes of determining the debt and equity portions of the SRB as of December 31, 1983, the Commission held that since SFPP had no independent capital structure as of that date, SFPP should use the capital structure of its parent as of June 28, 1985. (at 61,087-90). The Commission also ruled that: 1) once the amount of the SRB is determined, the amount is not modified to reflect subsequent changes in the capital structure (at 61,089-90); 2) the SRB should be amortized based on the composite remaining life of the pipeline's assets as of December 31, 1983, with no adjustments for additions or retirements (at 61, 090); 3) after December 18, 1988 (when SFPP became a publicly traded limited partnership), SFPP's actual capital structure in any given year should be used to determine the portion of the equity component that is to be deferred in each year (at 61,091); and 4) the composite depreciation rate for the year in which the return is first deferred must be used to amortize that deferred return in all subsequent years until it is fully amortized (at 61,092).

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- With respect to ADIT, the Commission held that the South Georgia method must be used to amortize the excess or deficiency of ADIT for each category of property resulting from changes in income tax rates. (at 61,092-93).

- Regarding accumulated depreciation, the Commission concluded that SFPP improperly wrote-up certain elements of its rate base (by eliminating accumulated depreciation) when it created a limited partnership. It required SFPP to restate rate base to reflect the associated accumulated depreciation. (at 61,097).

Cost of Capital

- The Commission held that only oil partnership equities should be used in developing the equity cost of capital for an oil pipeline limited partnership because there was sufficient evidence of market pricing and trading patterns in those shares. The Commission also determined that the short-term growth forecast should be given a two-thirds weight, while the long-term component should be given only one-third weight. (at 61,098-100).

Income Taxes

- The Commission applied the Lakehead decision to SFPP and denied the pipeline an income tax allowance for income attributed to interests other than Subchapter C corporations. (at 61,102).

Litigation Expenses

- The Commission permitted SFPP to recover its test year litigation costs, but required that they be amortized over five years. It excluded the settlement payments to two parties, but allowed the litigation expenses associated with settlements. A reserve for anticipated litigation expenses was disallowed. Costs were allocated between the East and West lines on the basis of throughput. (at 61,106).

Other Costs

- The Commission denied the recovery of a reconditioning reserve and anticipated environmental remediation obligations as inconsistent with its test year practices, and disallowed much of SFPP's claimed allowance for post-retirement benefits other than pensions (PBOP) as inconsistent with its PBOP Policy Statement. (at 61,107-111).

Reparations

- The Commission allowed reparations to commence for each East Line complainant from the date of each complaint, and ordered SFPP to calculate reparations based on the difference between the per barrel rates charged to those shippers and the per barrel rates that would have been charged had SFPP charged cost-based rates using a 1994 test year, and indexed those rates annually going forward. (at 61,111-113).

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- The Commission allowed SFPP to offset the over-recovery of its costs in one reparation year with the under-recovery of costs in another reparation year. (at 61,113-14).

- The Commission allowed SFPP to recover certain post-test period litigation, environmental, and reconditioning costs through a five-year surcharge, but only to the extent those costs were actually incurred. (at 61,113).

Prorationing Policy

- The Commission held that SFPP need not include the details of its prorationing policy in its tariff. However, the Commission did require that SFPP's tariff be modified to: (1) state that a more detailed prorationing policy circular exists, (2) provide where the circular can be obtained, and (3) state the minimum notice period for any proposed changes to the circular. (at 61,115).

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* Much of this summary is derived from the Report of the Oil Pipeline Committee of the Energy Bar Association (2003).

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COMM-OPINION-ORDER, 86 FERC ¶61,022, SFPP, L.P., Docket Nos. OR92-8-000, OR93-5-000, OR94-3-000, and OR94-4-000, Mobil Oil Corporation v. SFPP, L.P., Docket No. OR95-5-000, Tosco Corporation v. SFPP, L.P., Docket No. OR95-34-000, (Jan. 13, 1999) PART 01 OF 02.

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SFPP, L.P., Docket Nos. OR92-8-000, OR93-5-000, OR94-3-000, and OR94-4-000, Mobil Oil Corporation v. SFPP, L.P., Docket No. OR95-5-000, Tosco Corporation v. SFPP, L.P., Docket No. OR95-34-000

[61,055]

[¶61,022]

SFPP, L.P., Docket Nos. OR92-8-000, OR93-5-000, OR94-3-000, and OR94-4-000

Mobil Oil Corporation v. SFPP, L.P., Docket No. OR95-5-000

Tosco Corporation v. SFPP, L.P., Docket No. OR95-34-000

Opinion No. 435; Opinion and Order on Initial Decision

(Issued January 13, 1999)

Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, William L. Massey, Linda Breathitt, and Curt Hébert, Jr.

Appearances

Stephen H. Brose, Timothy H. Walsh, Amy W. Lustig, R. Gregory Cunningham, J. Patrick Kennedy, Steven G. T. Reed and *Kelly C. Maynard* for SFPP, L.P.

Thomas B. Magee, Michael Lobue and *John B. Merritt* for Arco Products Company

R. Gordon Gooch, Mark R. Haskell, Glenn S. Benson and *Jonya Walker* for Arco Products Company, Texaco Refining and Marketing, Inc., Mobil Oil Corporation and Tosco Corporation

J. Wade Linsday and *Joel L. Greene* for Arizona Public Service Company, Salt River Project and Phelps Dodge Corporation

D. Jane Drennan, Andrew S. Katz, David L. Hunt and *Ruth A. Bosek* for Chevron USA Products Company

Patrick J. Keeley and *Franklin R. Bay* for El Paso Refinery, L.P.

Stephen L. Teichler, Charles M. Darling and *Jennifer S. Leete* for Navajo Refining Corporation

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Jeron L. Stevens, Charles M. Butler, III, Michael Hamric and *David Stevens* for Refinery Holding Company

Robert L. Woods, Arnold H. Meltz, Warren C. Wood, Dennis H. Melvin and *John P. Roddy* for the Staff of the Federal Energy Regulatory Commission

[Opinion No. 435 Text]

An initial decision issued in the captioned dockets that addressed the reasonableness of SFPP, L.P.'s (SFPP) rates for the transportation of various petroleum products from California and Texas to points in Arizona and New Mexico. [1] That decision concluded that the East Line rates between Texas and Arizona were not just and reasonable and ordered them to be modified and directed SFPP to make reparations accordingly. The initial decision also held that the complainants shipping on the West Line between California and Arizona had not met the jurisdictional standard for oil

[61,056]

pipeline rate cases contained in the Energy Policy Act of 1992 (the EPAct), [2] and that therefore SFPP's West Line rates would continue to be deemed just and reasonable.

The Commission affirms the bulk of the initial decision while modifying and clarifying a number of rulings related to jurisdictional and cost-of-service issues. SFPP is directed to recalculate and refile its East Line rates to comply with this order. Any revised East Line rates developed pursuant to this order will be effective March 1, 1999. SFPP is directed to calculate the potential reparations, but the Commission will defer its decision on whether reparations must be made pending review of the compliance filing.

I. Background

A. *Regulatory Framework*

This is the first oil pipeline rate case to be decided under the provisions of the EPAct, enacted on October 24, 1992. The more important provisions of the EPAct included the "grandfathering" of certain rates that were not subject to protest, investigation, or complaint during 365 days prior to the enactment of the EPAct, [3] a requirement that such rates may be modified only if a complainant establishes substantially changed circumstances [4] and modified provisions for reparations for complaints meeting the jurisdictional standards of the EPAct. [5]

After this proceeding began, the Commission initiated rulemaking proceedings to modify its regulations governing oil pipeline rate filings and complaints, including regulations governing the type of information required to justify such filings. This case also involves oil pipeline rate issues such as the starting rate base, its capitalization and amortization, the allocation of costs among different regions or zones, and cost-of-service issues such as the cost of capital, litigation, repair, and retirement expenses, and tax allowances.

B. *SFPP and its Operations*

SFPP owns a pipeline system that transports refined petroleum products in six Western and Southwestern states: Texas, New Mexico, Arizona, California, Nevada, and Oregon. [6] This proceeding involves SFPP's interstate rates, practices, and terms and conditions of service on its "South System," which consists of pipe and other facilities used to transport refined petroleum products into Arizona from El Paso, Texas (the "East Line") and

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from the Los Angeles, California area (the "West Line"). [7] A map of the South System is attached as Appendix A.

The West Line consists of a 24-inch pipeline from Watson Station to Norwalk, California, a combination 20-inch and 24-inch pipeline and a 16-inch pipeline from Norwalk to Colton, California, a 20-inch pipeline and a 12-inch pipeline from Colton to Phoenix, Arizona, and a 6-inch pipeline from Phoenix to Tucson, Arizona. The East Line consists of parallel 8-inch and 12-inch pipelines between El Paso and Tucson and one pipeline (at various points 8- or 12-inches) between Tucson and Phoenix. SFPP also operates an enhancement facility at its Watson Station, in California. The Watson Station enhancement system, installed in 1994 after negotiations with its shippers, consists of vapor collection piping connected to tanks and related vapor collection

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facilities that allow SFPP to operate its tanks at a higher pressure than that previously used on it systems. [8]

SFPP, whose rates are at issue in this proceeding, is a limited partnership that was organized on December 19, 1988, under Delaware law. [9] SFPP succeeded to the assets of its predecessor company, Southern Pacific Pipe Lines, Inc. ("SPPL"), which was the original owner and operator of the South System, and was owned by the Santa Fe Pacific Corp. [10] The tariff rates for movements over the East and West Lines into Phoenix were equal from the pipeline's inception in 1956 until 1985. [11] In 1985 SFPP's predecessor filed equalized tariff increases to reflect capital expenditures undertaken on the West Line to increase capacity into Phoenix. This filing was protested by certain East Line shippers, including Navajo Refining Company ("Navajo"), which objected to paying any rate increase attributable to capital improvements on the West Line. [12]

The Commission terminated the 1985 rate proceeding by approving two settlement agreements reached by the pipeline and the protesting shippers. The first settlement, filed on July 6, 1988, was approved on November 17, 1988, [13] and the second, dealing only with Navajo's issues, was filed on January 30, 1989, and was approved on October 19, 1989. [14] Both settlements rolled back the South System rate increases from those filed in 1985, effective November 24, 1988, provided for refunds based on those lower rates through the settlement dates, and for the first time established a rate differential for movements into Phoenix on the East and West Lines. The rates challenged in this proceeding are those established by the two settlements. [15]

Under these settlements, SFPP completed several expansion projects on both its East and West Lines during the late 1980s and early 1990s and increased its rates as permitted under the settlement agreements. [16] Two West Line expansion projects increased capacity to 173,000 barrels per day into Phoenix from Los Angeles at a cost of about $140 million. As part of those expansion projects SFPP reinstituted West Line service from Phoenix to Tucson over its 6-inch line. [17] The West Line expansion project was completed in January 1989, and the related rates were increased at that time. [18]

The East Line expansion project was undertaken in two phases. In Phase I, completed in February 1992, SFPP made facility modifications at Tucson and it increased pumping capacity at a cost of approximately $4 million. In Phase II, SFPP replaced forty miles of 8-inch pipe between Tucson and Phoenix with 12-inch pipe and constructed more breakout tanks at Tucson at a cost of approximately $20 million. The East Line expansion project increased capacity between El Paso and Tucson to 95,000 barrels per day, and between Tucson and Phoenix to 55,000 barrels per day. [19]

During Phase II of the East Line expansion project SFPP reversed and then re-reversed its 6-inch line between Tucson and Phoenix. The 6-inch line had been in West Line service from Phoenix to Tucson since completion of the West Line expansion in 1989, but was under-used during 1990 and early 1991. To serve its customers during

[61,058]

Phase II of the East Line expansion project, SFPP reversed the 6-inch line in August 1991 to operate in East Line service from Tucson to Phoenix. [20] SFPP returned the 6-inch pipeline to West Line service upon completion of Phase II of the East Line expansion at the end of August 1992. [21] At that time, SFPP began to carrying out the terms of an agreement it had made with ARCO Products Company ("ARCO"). The Reversal Agreement obligated SFPP to dedicate the 6-inch line to West Line service for five years, with possible renewals for three additional five-year periods. ARCO agreed to ship an annual volume of 1.825 million barrels of product from Phoenix to Tucson (based on a 5,000 barrels per day commitment) or to pay SFPP damages in the form of equivalent revenues. [22] ARCO did not renew the Reversal Agreement when it expired in 1997.

The litigation involved here was engendered by disputes between SFPP and its shippers, and among its shippers, regarding the allocation of costs among the various expansions and services, the overall level of SFPP's rates, the jurisdictional status of the Watson Station enhancement facilities, and whether the details of the ARCO Reversal Agreement and the obligation of SFPP's to publish its prorationing policy in its tariff.

C. *Procedural History*

This proceeding was initiated on September 4, 1992 when El Paso Refinery, L.P. ("EPR") filed a pleading styled "Protest or, Alternatively, Complaint" with the Commission. [23] EPR alleged, among other things, that SFPP's proration policy [24] and the re-reversal of the direction of flow of the 6-inch line between Phoenix and Tucson adversely affected its business, and that SFPP's existing East Line rates should be reduced. [25] On September 29, 1992, the Commission's Oil Pipeline Board ("Board") suspended SFPP's tariffs for one day and set them for investigation. [26]

On December 31, 1992, SFPP filed FERC Tariff No. 18 to provide its West Line shippers with the service of transporting turbine (or jet) fuel to Tucson. EPR and Chevron USA Products Co. ("Chevron") protested Tariff No. 18, arguing that it raised many of the same issues that were pending in proceeding begun on September 29, 1992, and that the rate for the turbine fuel contained in Tariff 18 [27] was unjust and unreasonable. On January 29, 1993, the Board suspended Tariff No. 18 for one day subject to refunds, instituted an investigation under Section 15(7) of the ICA, and consolidated the cases. [28]

SFPP filed exceptions to both of the Board's September 29. 1992, and January 29, 1993 orders. On April 2, 1993, the Commission vacated the original suspension orders and the refund obligations, [29] holding that the case should go forward as a complaint

[61,059]

proceeding limited to the issues raised by EPR, Chevron and the intervenors. The Commission concluded that allegations about the unlawfulness of SFPP's past and existing practices with respect to flow reversal, prorationing, and current rates, should be adjudicated under Section 13(1). The April 2, 1993 order also placed the burden of proof on the complainants to prove the challenged rates were not just and reasonable since SFPP had not proposed to modify those rates. [30]

Chevron and Navajo filed requests for rehearing. The Commission issued two Orders on Rehearing in response. In the first, issued June 18, 1993, the Commission reaffirmed its ruling vacating the Board's suspension order and imposition of refund obligations. The Commission reiterated its conclusion that the protests addressed in the Commission's September 29, 1992 and January 29, 1993 orders were in the nature of complaints, and that the burden of proof was on the complainants. The Commission terminated the suspension dockets and stated that the proceedings would proceed in the complaint docket, OR92-8-000. [31] On August 3, 1993, Chevron filed its complaint against the West Line rates.

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On October 5, 1993, the Commission issued a further rehearing order in response to the rehearing requests filed by EPR, Chevron, Navajo and SFPP. The Commission first reiterated its prior conclusion that none of the protests had challenged anything that *SFPP* had proposed to change in the filings addressed by the September 29, 1992 and January 29, 1993 orders. [32] With respect to grandfathering of SFPP's rates, the Commission agreed with SFPP that nothing in the initial protests filed by EPR and Chevron challenged SFPP's West Line rates, and therefore found those rates had been deemed just and reasonable under Section 1803(a) of the EPAct, pending resolution of the complaint. [33] The Commission therefore held that Chevron must establish substantially changed circumstances under Section 1803(b) of the EPAct as a condition for litigating whether SFPP's West Line rates are unlawful as it had challenged rates that had not previously been in effect. The order therefore affirmed the dismissal of Chevron's protest of Tariff No. 18, holding that the relevant protest could not apply to rates that were not modified when the tariff was filed. [34] The October 5 Order also affirmed SFPP's right to present market-based evidence while noting that at that point SFPP had no intention to do so.

Additional complaints were filed on December 22, 1993, by Navajo (challenging SFPP's East and West Line rates) and on January 14, 1994, jointly by ARCO Products Co. and Texaco Refining and Marketing Inc., both of whom challenged SFPP's West Line rates. In its answers SFPP acknowledged that Navajo need not meet the requirement of establishing a substantial change in the economic circumstances because Navajo was contractually barred from filing a compliant during the 365 day period proceeding the October 24, 1992 effective date of the EPAct. [35] SFPP asserted, however, that other parties could not "piggy-back" on Navajo's complaint and challenge the West Line rates without establishing substantially changed circumstances. On April 20,

[61,060]

1994, the Commission held that the filing of Navajo's complaint removed the grandfathering protection from SFPP's West Line rates and that ARCO, Texaco and Chevron therefore need not establish substantially changed circumstances. [36] However, in response to SFPP's request for rehearing of that ruling, the Commission reversed its April 20 Order concluding that the plain meaning of the language of Section 1803 required Chevron and ARCO/Texaco to meet the substantially changed circumstances standard. [37] Petitions for rehearing of that order were denied on September 16, 1994. [38]

Further complaints were filed against Tariff Nos. 15, 16, 17, and 18 by Mobil on August 3, 1995, and by Tosco on August 7, 1995, and were consolidated with the instant proceeding. [39] Since that date several additional complaints have been filed against SFPP. [40] In each case the Commission held the complaints in abeyance pending the outcome of the decision in this proceeding. Thus, the instant order only addresses the consolidated complaints that were filed through August 7, 1995.

The hearing began in 1993, and pursuant to an ALJ order, SFPP filed a Cost and Revenue Study in February 1994, setting forth unadjusted results for 1993. The complainants filed written direct testimony in June of 1994 and the Commission staff did so in August. SFPP's responsive testimony was filed in April 1995, and all rebuttal testimony in August 1995. SFPP moved to strike those portions of the Staff's and complainants' testimony that included updated test year information, or alternatively, for leave to file surrebuttal testimony responding to the parties' testimony. The ALJ granted SFPP's alternative motion and permitted SFPP to file surrebuttal testimony, and allowed the other parties sur-surrebuttal testimony. The hearing commenced on April 9, 1996, and lasted until July 19. Briefing was competed November 16, 1996.

During the hearing, SFPP and EPR reached an agreement to settle all issues raised in EPR's complaint, pleadings and testimony filed in this proceeding, provided that the agreement would not prejudice the rights of other parties. [41] After the conclusion of the hearing, Navajo withdrew its complaint against SFPP's West Line rates, subject to the condition that Navajo's withdrawal would not prejudice the rights of other parties. [42] Navajo remained as a complainant against SFPP's East Line rates. The initial decision issued on September 25, 1997. Six parties filed briefs on exceptions on December 5, and briefs opposing exceptions on January 23, 1998.

[61,061]

D. *The Initial Decision*

The 100 page initial decision addressed 38 major issues the ALJ consolidated into thirteen sections, each organized around several related issues. The details of the ALJ rulings and the related exceptions filed are discussed below.

II. Discussion

This discussion follows a somewhat different organizational structure than the initial decision. The first section addresses all basic jurisdictional issues establishing whether the Commission will entertain the parties' arguments, the second addresses the rate design issues that determine how costs are to be allocated among the different sections of SFPP's pipeline. the third section addresses various operating and capital issues, the fourth addresses the scope of reparations, and the fifth addresses the publication of prorationing policies. A sixth addresses the content of the compliance filing to this order and an overview of procedures pertinent to the remaining complaint proceedings involving SFPP.

A. *Jurisdictional and Related Procedural Issues*

The EPAct provides that, with one exception not relevant here, all rates in effect on the date of the Act are deemed just and reasonable, and are not subject to a maximum rate challenge unless the rate was subject to protest, investigation, or complaint in the 365 day period before the Act was effective. [43] Such rates may be challenged only if the complainant "presents evidence which establishes that there has been a substantial change after the enactment of [the Act] in the economic circumstances of the pipeline that are the basis for the rate" or a substantial change "in the nature of the services which were the basis for the rate." [44] Therefore, a threshold issue is what rates, if any, are grandfathered under the provisions of the Act, and if they are, whether the complainants have established substantially changed circumstances [45] as required by the statute.

1. *The "Grandfathering" of Rates.*

A number of the consolidated dockets at issue here raise the question of whether they are barred by the grandfathering provisions of the EPAct. In the initial phases of this proceeding, the Commission determined that Navajo did not have to establish substantially changed circumstances in order to challenge either the East or the West Line rates. [46] However, the Commission ultimately determined on rehearing of a series of complaints filed by ARCO, Chevron, and Texaco against SFPP's West Line rates, that those rates were generally subject to the grandfathering provisions of the EPAct, and that these parties were required to establish substantially changed circumstances in order to challenge the West Line rates at issue here. Addressing these complaints, the ALJ held that they failed to meet the statutory standards and that therefore ARCO's, Chevron's and Texaco's complaints were barred under the EPAct. No party argues here that SFPP's East Line rates are grandfathered, and that Navajo and Chevron, the remaining complainants complaints against the East Line rates, are required to establish substantially changed circumstances with regard to those rates. [47]

[61,062]

The West Line Shippers [48] filed exceptions to this determination on two grounds: first that the ALJ improperly held that all West Line Rates were grandfathered as to complainants other than Navajo; and second, that the ALJ had improperly ruled on the issue of substantially changed circumstances. [49] The West Line Shippers first assert that the rates from East Hynes, California, to Arizona, are not grandfathered because the East Hynes point did not exist prior to the passage of the EPAct, and SFPP has effectively admitted that rates from East Hynes are not grandfathered. West Line Shippers also assert that the balance of West Line rates are not grandfathered because (1) the rates were protested prior to the enactment of the EPAct, (2) SFPP admitted in its 1992 SEC Form 10-K

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that they were challenged, (3) the Oil Pipeline Board had suspended the West Line rates in an earlier order, and (4) Navajo's filing of a complaint under Section 1803(b)(2) of the EPAct removed the need of the West Line Shippers to establish substantially changed circumstances. They assert that since the Commission's reversal of the Oil Pipeline Board occurred after the rates had been suspended, they could not have reasonably been expected to know that an additional challenge was required and to have filed a complaint in a timely fashion. West Line Shippers also argue that the Commission has expressly held that two sets of SFPP's West lines rates are not grandfathered, SFPP's rates from East Hynes and SFPP's rates under its Tariff No. 18 for turbine fuel from California origins to Tucson, Arizona.

SFPP and Navajo oppose these exceptions. They assert that the Commission has previously ruled on the arguments relating to the protests filed by ARCO, Texaco, and Chevron prior to the enactment of the EPAct, and that the Commission concluded that those protests did not challenge the overall level of SFPP's existing West Line rates. They also assert that the Commission has specifically ruled that the West Line Shippers may not "piggy-back" on Navajo's complaint. [50] SFPP argues that the prior Oil Pipeline Board action could not bind the Commission, that it did not admit that the West Line rates had been challenged, and that it alluded to this litigation in its 10-K only because the Commission had not ruled in its review of the Board's suspension action at the time SFPP's 1992 10-K was filed.

SFPP and Navajo argue that, under *Santee Distribution Company v. Dixie Pipeline Co.*, [51] changes to a tariff, as opposed to changes to rates, do not affect the grandfathering status of any rates already stated in the tariff that are not modified when the tariff is filed. SFPP further asserts that the filings it made in July of 1992 simply added East Hynes as a Los Angeles origin station to an existing rate cluster and that therefore there was no change in the rates from Los Angeles to Arizona. Navajo asserts that the same rationale applies to a new service, such as transportation of turbine fuel from Los Angeles to Arizona. However, SFPP concedes that the Commission has previously held in a September 1994 rehearing order that the Tariff No. 18 rate, which added the turbine fuel in 1993, was not subject to the grandfathering provisions of the EPAct. [52]

[61,063]

The Commission concludes that the only grandfathering issues that require further analysis at this point are those related to the revised Tariff No. 18 that SFPP filed on December 31, 1992. The Commission finds that the addition of the East Hynes station is subject to the grandfathering provisions of the EPAct because this filing did not involve a change to a rate or service SFPP was providing at the time the EPAct was enacted. As SFPP states, that tariff change only added another tap within an existing rate cluster for transportation services provided for a group of commodities from that rate cluster to points in Arizona. No rate from Los Angeles to Arizona was changed, and there was no change in the products transported or the services provided. Since neither the rates nor the services provided were changed, the Commission concludes that the East Hynes station is part of a rate that was not subject to protest, suspension, or investigation in the 365 days proceeding enactment of the EPAct.

However, the Commission affirms its earlier conclusion that Tariff No. 18, to the extent it added turbine fuel to SFPP services, is not subject to the grandfathering provisions of the EPAct. When it filed Tariff No. 18, SFPP began to transport a new commodity, and as such to provide a new service for a specific commodity that had not heretofore been listed in its tariff, *i.e.*, the transportation of turbine fuel. SFPP may have applied an existing rate to the new commodity, but adding that commodity instituted a new service, and was not a change in the nature of the service that was the basis for the rates. [53] Thus, even though at the time there were a number of services provided under in Tariff No. 18, the grandfathering provisions of the EPAct do not apply, and the complaining parties do not need to establish substantially changed circumstances to challenge the rate applicable to turbine fuel under Tariff No. 18.

Regarding the other rates complained against, the West Line shippers assert, that they could not have anticipated that the Commission would reverse an Oil Pipeline Board order that had suspended the tariffs with which they were concerned, and that therefore the Board's suspension of Tariff Nos. 15, 16, and 17 on September 29, 1992 should remove the statutory bar. As the Commission explained in its June 18 and October 5, 1993 orders, the matters the West Line Shippers protested did not involve any changes that *SFPP* made when it

filed Tariff Nos. 15, 16, and 17. The fact that the Oil Pipeline Board initially suspended certain tariffs does not change the basic fact that the Commission's power to investigate (and suspend) a pipeline filing, either under the ICA and the NGA, only attaches to those portions of a tariff that the *carrier* proposes to change. [54] This is true even though the custom in the oil pipeline industry is to file a new tariff rather than to file supplements or changes to existing pages.

Given that only carrier proposed rates are subject to suspension, the parties should have taken greater care to frame their pleadings accordingly. Thus, if the West Line Shippers were concerned about SFPP's West Line rates in September of 1992, they should have filed a complaint against those rates before the EPAct became effective. The remaining arguments on the protests and complaints filed before the enactment of the EPAct on October 24, 1992, were addressed in the Commission's prior orders and there is no need to address them further here.

2. *Substantially changed circumstances.*

[61,064]

The EPAct requires, among other things, that any party challenging a grandfathered rate must provide evidence to the Commission of a substantial change in the economic circumstances of the pipeline which were the basis for the rate [55] before the Commission may determine the reasonableness of the challenged rate. In the instant case, the issue applies only to the West Line rates that have been challenged by the West Line Shippers. The ALJ interpreted the substantially changed circumstances standard as requiring proof of change that exceeded a material change in the economic circumstances that were the basis for the existing rate(s). Applying this standard, the ALJ concluded that the West Line Shippers had failed to establish substantially changed circumstances and that, with the exception of Navajo's complaint and the new service included in Tariff No. 18, SFPP's West Line rates must be deemed to be just and reasonable.

He therefore rejected the arguments of Chevron and the West Line Shippers that changes in five factors warranted a finding of substantially changed circumstances. These factors were increased throughput on the West Line between California and Arizona, increased demand for turbine fuel reflected in SFPP's Tariff No. 18, changes in environmental regulations in California, the impact of the Commission's *Lakehead* decision [56] on SFPP tax allowances, and the filing of the complaints themselves. Chevron and the West Line Shippers assert that the ALJ erred in rejecting the factors. SFPP and Navajo state that none of these factors are appropriate and support that ALJ's ruling that there are no substantially changed circumstances. The Commission staff did not address in detail the arguments on whether "substantially changed circumstances" exist here, but suggested that the Commission provide some guidance on the matter. In affirming the ALJ, the Commission will address the statute, the arguments on each of the factors addressed by the ALJ, and some related procedural matters.

a. *The Statutory Standard*

Section 1803(b)(1) of the EPAct states that a grandfathered rate may be challenged only if the complainant presents evidence to the Commission which establishes that a substantial change has occurred after the date of the enactment of [the Act]:

(A) in the economic circumstances of the oil pipeline which were the basis for the rate; or

(B) in the nature of the services provided that were the basis for the rate; or

(C) the person filing the complaint was under a contractual prohibition against filing a complaint which was in effect on the date of the enactment of the EPAct, and had been in effect prior to January 1, 1991, provided the

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complaint is brought within 30 days after the contractual prohibition expires. [57]

The provision at issue here is Subsection (b)(1)(A) addressing "a substantial change in the economic circumstances of the oil pipeline which were the basis for the rate." [58]

As noted, the ALJ held that a substantial change exceeds the concept of a material change and should be considered a rigorous standard for filing a complaint. [59] On exceptions, the West Line Shippers argue that the ALJ erred in failing to conclude that

[61,065]

a "substantial change" is the same as a material change, and that therefore the standard he adopted was unduly rigorous. They assert that in other Federal legislation the word "substantial" has been construed to be equivalent to "material," [60] and that "material," "significant" and "substantial" are considered to be similar terms. They also assert that the ALJ erred in failing to find that evidence occurring after the complaint was filed to establish substantially changed circumstances.

In reply, Navajo asserts that the more stringent standard is appropriate and that the complainants have not established a substantial change in the economic circumstances that are the basis for the rates challenged here. Navajo argues that the rates at issue here are based on the assumptions contained in SFPP's 1988 and 1989 Settlements and it is changes in the basis to those rates that must be demonstrated. SFPP similarly asserts that "substantial" is a much stricter term than "material," and that the ALJ's decision was correct in that regard. SFPP also argues that it operates its South System as a whole and that the issue of whether there are substantially changed circumstances applies to that system, not the East and West Lines separately.

The Commission finds that the ALJ was correct in concluding that a "substantial" change is more rigorous test than a "material" change. An example based on the plain language of the statute illustrate the interpretation the Commission is adopting here. As a matter of common usage the words "material' and "substantial" usually have a different connotations, even when they appear to be used as synonyms. For example, if one group of voters delivers an election by a one half of one percent margin, their participation was clearly material, and in fact, decisive. But few would conclude as a matter of common usage that such a narrow election margin was substantial. This example suggests that the term "material" is qualitative and goes to the relative importance or weight of a matter, or indicates its relevance, not necessarily its quantity or size. [61] The dictionary definitions reviewed in footnote 61 indicate that a change that is "substantial" is likely to be "material" but that the obverse is not necessarily true. For example, a relatively small change in the rate of return the Commission allows a pipeline may have a material impact on the expectations of the pipeline's owners without the overall rate impact being substantial. The essential difference between the two terms is one of importance in the sense of logic or relevance (material), and importance in terms of relative degree or size (substantial). In the context of ratemaking "substantial" more appropriately reflects a considerable difference in amount or degree since ratemaking is essentially a quantitative discipline based on numerical formulas and relationships, for example, *the pipeline obtained a substantial return on equity*, or *the shippers received a substantial rate reduction from the settlement.*

This difference between importance or weight as a matter of logic or relevance (material) and importance as a matter of scope or degree (substantial) is also reflected in securities regulation. The SEC defines its disclosure requirements in terms of "materiality." The SEC defines such information as that which would influence a well informed, reasonable person whether or not to make an investment. The term "materiality" is not necessarily quantified by a given percentage or dollar amount; it need only

[61,066]

be enough to sway the investor's decision. [62] This could mean, for example, the fact that negotiations are underway even though they have not been completed, [63] or that a portion of the company's debt is held by one of the officers, factors which affect risk but which may not be directly quantifiable. [64] Moreover, where the definition

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of material is used in a quantified manner, it is often a relatively low threshold. For example, accountants certify audits on the basis of material facts, which normally implies a change of 10 percent, the definition of "material" used in the Commission's oil pipeline accounting regulations for determining whether a change must be disclosed. [65]

Moreover, the legislative history of the EPAct, while very limited, indicates that the word "substantial" was substituted for the word "material" during the drafting phase, and as such implies the two words reflect a different standard. [66] The substitution would not have been necessary if the two words were to be considered identical in import, the interpretation of other federal statutes, or other case law or dictionary definitions stating that they are synonymous notwithstanding. The Commission concludes that Congress would not have used the word "substantial" rather than the word "material" if the conventional accounting threshold of ten percent, or another relatively low quantity, was meant to be the test for establishing substantially changed circumstances in the economic basis of the pipeline.

For these reasons, the higher burden adopted by the ALJ is appropriate. Moreover, he was correct that the justness and reasonableness of the rate is not relevant to making a determination of whether the complainant has established that there are substantially changed circumstances. As the Commission recognized in *Santee*, [67] it is possible that a challenged rate might not be just and reasonable if the Commission were to examine it without the presence of the jurisdictional threshold, but that the statute would bar such an examination. Thus, even if the level of a challenged rate might be reduced if the statutory threshold were met, reasonableness may not be determined unless the complainant first establishes that there has been a substantial change in the economic circumstances that are the basis for the rate.

The parties also debate whether a complainant must establish that there has been a substantial change to every rate design element that may be the economic basis for the rate in order to meet the substantially changed circumstances standard. The Commission finds that this is not the case; the statute states that a complainant must present evidence and establish that there has been a substantial change in the economic circumstances of the pipeline that are the basis of the rate. [68] Such a change could be established by one or a number of rate elements, thereby justifying an evaluation of whether the rate is just and reasonable. However, as part of establishing that there has been a substantial change in the economic basis for the rate, a complainant should explain why the Commission should conclude that the challenged rate may reasonably be expected to be found to be unjust and unreasonable in any subsequent investigation

[61,067]

On exceptions, the complainants assert that even these modest requirements could result in an undue burden. However, the number of rate elements that significantly affect the economic basis for most rates is relatively small. The basic ones are volumes, asset base, operating, and perhaps, capital costs. These in turn are most likely to influence the company's revenue requirements and return. Thus, a complainant must establish substantial change to one of these more important elements that are the basis for the rate and explain why this change is likely to have rendered the existing rate unjust and unreasonable. Basic information on these elements is not beyond the reach of the most parties given the materials available in FERC Form No. 6 or SEC Reports, and as in this case, may be supplemented by discovery.

The Commission also concludes that Navajo is correct that the economic basis for the rates at issue here is not the twelve month period before the enactment of the EPAct, but the 1988 West Line settlement rates, as increased to reflect the increased capacity SFPP constructed pursuant to those settlements. The West Line expansion was completed in 1989 and, as the ALJ noted, it is the West Line rates that are challenged here. Thus, any changed circumstances must be measured against the economic assumptions embodied in the rates filed after the expansion was completed to determine whether the change is substantial.

For the same reason, SFPP's argument that the issue of substantially changed circumstances applies to the South System as a whole, not its West and East segments, fails. For whatever reason, SFPP designed its current

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South System rate structure using two different sets of rates that reflect the economic basis of two different services, which serve two competing groups of shippers for whom the rate differentials are significant. Even if shippers use both the East and West Lines at different times, or simultaneously, this does not change the fact that the economic characteristics of the services and the shipments involved are different. Moreover, the challenge must be to the economic circumstances that are the basis for the *rate* challenged. In this case these are the West Line rates, not a broader, geographically defined system utilizing an undifferentiated rate structure as SFPP argues here. Since there are no rates for the South System as a whole, the statutory standard can only be applied to the rates for SFPP's separate East and West Lines. The ALJ's analysis was correct.

b. *The Specific Allegations of Change Circumstances.*

(1) *Increased Throughput*

The ALJ determined that the West Line Shippers and Chevron did not establish that increases in volumes on the West Line System after October 1992 resulted in substantially changed circumstances. Both parties assert this was error.

The Commission affirms the ALJ. All the complainants measure the increase in volumes on the SFPP West Lines using a statistical base consisting of the 12 months prior to the effective date of the EPAct, October 24, 1992. They defined base volumes for that period, and then compare those to volumes for an approximately two and one-half year period thereafter. The estimated increases in volumes range of 27 to 36 percent depending on the base and the date of the last measurement. [69] However, as has been discussed, the base point for measuring whether a change is substantial is not the

[61,068]

twelve months proceeding the effective date of the EPAct, but the economic circumstances the are the basis for the rate. In this case, these are the economic bases for the rates to implement SFPP's West Line expansion, which became effective in 1989. [70] Thus, any changes must be measured from that point in time, and then only using evidence of changes in the economic basis for the rate that occurred after the effective date of the EPAct.

What complainants attempted to do here was to establish substantially changed circumstances utilizing a test period concept based on the twelve month period preceeding the enactment of the EPAct on October 24, 1992. This is an arbitrary date that has no necessary correlation to the economic circumstances that were the basis of the rate at the time it was designed. In context, it is relatively clear that economic basis for the rate is the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination. Otherwise, the economic basis for all oil rates would be the status of the principal design factors at the time the EPAct was enacted. Such a definition would be arbitrary because the actual economic performance of the company at any time (throughput, etc) in relation to the design of a particular rate can vary and performance may have no correlation to the factors that are the actual economic basis used to design the rate.

In contrast, SFPP's discussion of the history of its West Line improvements supports the conclusion here. SFPP asserts that the initial results of the expansion were disappointing, that its West Line volumes declined in 1990-1991 under the impact of base closings and a recession, and then recovered in 1992. [71] Moreover, SFPP's explanation is consistent with the complainants' perception that as late as 1992 the West Line was frequently operating well below capacity. [72] Given the interpretation of Section 1803(b)(1)(A) adopted here, SFPP has correctly argued that the increase in volumes in 1993 over 1992 could be attributed to an economic rebound, the execution of new contracts such as the ARCO Reversal Agreement, and other factors whose full impact came only after the first complaints were filed. In fact, on this record it is not possible to tell whether even the increased throughput through 1992 and 1993 had by that point raised throughput (and returns) to the level embodied in the rates utilized to implement the West Line expansions. For example, the West Line does not appear to have been

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subject to prorationing until early 1996. [73]

Under the EPAct, the complainant must establish that there has been a substantial change in the economic circumstances of the pipeline that are the basis for the rate at the time the complaint is filed. The Commission finds they failed to do so. The parties filing consolidated complaints before August 7, 1993, agreed to accept the record developed by the other complainants, and as such the later complaint suffers

[61,069]

from the same limitation as the earlier complaints in that they measure substantially changed circumstances against the wrong base period.

On a subsidiary point, on exceptions the West Line Shippers assert that the ALJ erred in not ruling that post-complaint evidence can be considered in determining whether there are substantially changed circumstances, in this case on the issue of volumes. For support, they cite the Commission's willingness in *Santee Distributing Company v. Dixie Pipeline Co.* [74] to look at events in 1995 to evaluate a complaint filed in October 1994. SFPP asserts on rebuttal that while the Commission did so, its action was beyond the literal words of the statute.

The Commission concludes that SFPP has the better argument on this point. While the statute does not literally address the matter, it states that the complainant must present evidence to the Commission which establishes that a substantial change *has occurred* after the date of enactment of the Act. [75] It is difficult to see how language that so explicitly uses the past tense could apply to evidence that would be developed at some indeterminate time after the complaint is filed, particularly since an initial determination on substantially changed circumstances is required if the complaint is to proceed to hearing on the issue of reasonableness. Otherwise, the date for determining whether substantial evidence exists becomes a moving target lacking in any certainty in the time frame to be addressed, even though, in contrast, reparations for a rate deemed to be just and reasonable are fixed as of the date of the complaint. If post-complaint evidence should eventually point to a different answer than any pre-compliant evidence, the answer is to file another complaint, which in fact several complainants have done. Thus, to the extent the parties rely on data that occurred after their complaints were filed to establish substantially changed circumstances, this was incorrect. [76] The Commission affirms the ALJ's conclusion to reject complainant's efforts to use the increases in West Line volumes that occurred after their complaints were filed to establish a substantial change in the economic circumstances of the pipeline that were the basis for the rates at issue here.

(2) *The Filing of Tariff No. 18*

On December 31, 1992, SFPP filed Tariff No. 18 providing for the transportation of turbine (jet) fuel to Phoenix. Chevron and the West Line Shippers argued that this new tariff constituted substantially changed circumstances. Chevron also asserted below that the ARCO Reversal Agreement, which provided guaranteed throughput for turbine fuel, constituted substantially changed circumstances. In both instances the theory was the increased volumes meant greater efficiencies. The ALJ held otherwise, concluding that Tariff No. 18 was a non-grandfathered rate and did not constitute substantially changed circumstances in any event. [77] The complainants renew their arguments on exceptions

The ALJ is affirmed. The filing of a new tariff in itself is of no import for the issue of substantially changed circumstances. While an increase in volumes might result in substantially changed circumstances in a different case, this did not even remotely

[61,070]

occur in this proceeding. The projected increase in volumes was 365,000 barrels per year on a line whose base

volumes for 1993 are estimated by complainants at 32,850,000 barrels per year, an increase of slightly more than 1 percent. [78] The complainants have clearly failed to show how the relatively low volumes shipped under Tariff No. 18 are a changed circumstance, and any such analysis suffers from the same infirmities as the complainants' other use of increased volumes.

(3) *Changes in Environmental Regulations.*

The West Line Shippers argued that changes in California environmental regulations would prohibit the sale of certain types of gasoline in California after 1996, and that these changes would lead to a substantial increase in volumes on the West Lines. The ALJ rejected this argument, concluding that it is conjectural. [79] He cited the statutory language providing that the complainant must establish that a substantial change has occurred, and correctly concluded that the language bars an argument based on an event that is so far removed from the date of the complaint. The West Line Shippers renew their arguments here. The ALJ is affirmed for the reasons stated in his order.

(4) *The Commission's Lakehead Decision*

In 1995 and 1996, the Commission issued two decisions in *Lakehead Pipe Line Company, L.P.* [80] that redefined Commission policy on the rights of oil pipelines organized as limited partnerships to include certain income tax allowances in their cost of service. The complaining parties assert that this represented a substantial change in economic circumstances since the inability to recover a significant cost allowance represents a substantial change in their economic circumstances. The ALJ held that a change in Commission policy that may subject a grandfathered rate to possible revision is not a substantial change in the economic basis for that rate. The complainants renew their argument on exceptions. The Staff asserts that the EPAct should not be construed to insulate pipelines against changes in Commission policy. SFPP supports the ALJ's interpretation.

The Commission will affirm the ALJ but on different grounds. The EPAct has no legislative history on whether a rate that is deemed to be just and reasonable under the EPAct may continue to be so deemed in perpetuity if a major component of that rate were to become inconsistent with Commission policy through subsequent Commission action. What is clear is that regulatory change is a well recognized risk of doing business and may significantly affect the economic basis of a pipeline's rate structure as much as its own commercial policies or the extrinsic economic environment. [81] In light of this established case law, the Commission concludes that Congress did not intend that a pipeline may maintain an element in its rate structure in perpetuity if that element clearly violates Commission policy.

However, the Commission also concludes that a change in Commission policy does not in and of itself establish substantially changed circumstances without a demonstration that the policy change caused a substantial change in the economic basis of the rate at issue. A mere allegation that a rate element violates Commission policy is inadequate. Here the complainants did not establish that such a change would result

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from the application of the *Lakehead* policy to SFPP. Rather, they simply asserted that the existence of the *Lakehead* policy constitutes substantially change circumstances without addressing how this affects the economic basis for the rates that are challenged here. The ALJ's ultimate conclusion is affirmed.

5. *The Initiation of the Instant Complaints.*

West Line Shippers argued below that the filing of the complaints in the instant case constituted substantially changed circumstances in and of themselves because the Commission in its orders approving the 1985 Settlement left the subject rates open to challenge at a later date. The ALJ concluded that a Commission order in

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effect before the provisions of the EPAct were effective could not supersede the statute. [82] The West Line Shippers renew this argument on exceptions. SFPP, Navajo, and the Staff support the ALJ. The Commission agrees that a routine reservation of jurisdiction in a Commission order cannot override a specific statutory provision enacted after the order issued and the ALJ is affirmed.

c. *Procedural Considerations*

The Staff asserts on exceptions that the Commission should clarify the purpose and intent of the substantially changed circumstances portion of the EPAct. In particular, the Staff suggests that there is considerable confusion regarding the degree of proof that is required to meet the jurisdictional threshold and the procedural framework in which a determination of substantially changed circumstances should be made. Staff suggests two possible alternatives for addressing the issue of substantially changed circumstances. One is that the complainant must satisfy the test before proceeding to hearing on the merits, even if this means limiting the complainant's access to discovery and additional materials. Another would be to make a preliminary determination to be followed by a final determination on the record. Staff also raises the issue of whether a complainant must address all the factors that determine whether a rate is just and reasonable or only those elements which the complainant believes reflect a substantial change.

The complainants also assert that the instant case provides an example of how evidentiary and procedural issues can present barriers to a party attempting to establish substantially changed circumstances. Chevron argues publicly available information would not have permitted it to establish substantially changed circumstances regarding the West Line rates in the instant case because only the volumes were readily available. It asserts that additional information on operating costs, and the supplemental information on volumes in the later years, became available only after discovery in the instant case, as did the segment specific information required in this case. Chevron concludes that it is impossible to determine substantially changed circumstances at the Commission level given the data that is available in the current version of the Commission's Form No. 6 and annual reports to the SEC. SFPP asserts that the issue of substantially changed circumstances should be decided at the outset of the case and that Staff's suggested clarifications should be denied.

The Commission concludes that the complainants' concerns regarding their opportunities to establish substantially changed circumstances are overdrawn. In the instant case, discovery was permitted before any determination was made. The complainants' efforts to establish substantially changed circumstances failed not from a want of

[61,072]

adequate information, but from failure to advance a sustainable theory or to address the proper economic basis for the rate. The Commission does recognize that in the instant case it would have been difficult for a complaining party to attack an existing rate based on a settlement without access to information about the costs, revenues, and volumes that underlie SFPP's settlement rates. For this and other reasons, it may be necessary to permit the issue of substantially changed circumstances to go to hearing in order to obtain a fair result. In fact, the Commission did so in this case, concluding that, the complainants had made a sufficient showing to warrant referring the matter for further consideration by an ALJ. [83]

By comparison, in its first *Santee* order the Commission concluded that much of the evidence of increased volumes and returns addressed the period before the enactment of the EPAct and therefore could not be utilized to establish substantially changed circumstances. The Commission also concluded that the volume increases after the effective date of the EPAct were minimal, in the range of 2.8 percent, and that Santee had not adequately explained the basis for its expense calculations. [84] On rehearing, the Commission performed its own analysis of changes that had occurred after the EPAct, and again found that there was no basis to proceed with the complaint. [85] In contrast, while in the instant case the Commission has found that the complainants have not met their burden after completion of a hearing, the relative increase in volumes alleged in the instant docket was several orders of magnitude greater than in *Santee*. [86] Since volumes are a major component in the rate design of

an industry having strong economies of scale, the Commission sent the issue of substantially changed circumstances to hearing in this proceeding, including the right to discovery given the limitations of available information. In any event, the record in the instant case indicates that it is not impossible to estimate the economic value of a settlement even if the details are not provided in the settlement document. For example, Staff reviewed the rates filed by SFPP pursuant to its 1990 settlement with Navajo and estimated the return, which SFPP disputed. [87]

Thus, in response to the concerns expressed by Staff and Chevron, a review of this case and other proceedings since the EPAct indicates that the Commission has been willing to refer a complaint, and therefore the issue of substantially changed circumstances, to hearing when the initial filings raise a colorable argument that there a substantial change has occurred in the economic circumstances that are the basis for the rate. This opportunity does not remove a complaining party's burden of establishing at the outset that there are substantially changed circumstances meriting further investigation of the rate itself. [88] Thus, where a complaint has been scheduled for hearing, substantially changed circumstances is a threshold issue that should be addressed and decided before proceeding to litigate the merits of whether the challenged rate is just and reasonable. This will permit the presiding ALJ to dismiss the complaint if it is determined there are no substantially changed circumstances, thereby saving considerable time and resources for all parties.

[61,073]

d. *Allegations of Undue Discrimination and Prejudice.*

The West Line Shippers assert that the ALJ erred in not discussing whether a failure to adjust all of SFPP's rates prospectively, in the event some of the existing rates are changed, would be unduly discriminatory. They assert that Navajo was permitted to settle on the matter of West Line Rates provided that its withdrawal would not prejudice the rights of the other parties. The West Line Shippers argue that the Commission has jurisdiction over discrimination issues regardless of the EPAct, and that to adjust one rate on the West Lines without adjusting all rates would result in an unduly discriminatory result since there would be no cost justification for the result.

The Commission affirms the ALJ. First, while Navajo's Settlement was conditioned on it not prejudicing the other parties to this proceeding, this condition can only address the integrity of the record, not to the settlement terms. When it comes to the terms, settlements are intrinsically unique, and it is quite possible for different parties to obtain different settlements, all of which are just and reasonable based on the particular circumstances of the parties involved. Just as the other parties may not piggyback on Navajo's complaint, [89] they cannot piggyback on Navajo's settlement in order to achieve the substantive goals as long as the Navajo settlement is consistent with the public interest. Otherwise the requirement under the grandfathering provisions of the EPAct that each party prove the merits of its own complaint would be nullified by linking unrelated complaints and any resolution that may result.

Second, since the rate for turbine fuel is not grandfathered, the rate for this commodity may be adjusted as the result of an investigation even if other rates appearing on the face of the same tariff are unchanged. A resulting rate might well be lower than the rate for all other products and services now contained in the same tariff, but this result would not be unduly discriminatory if based on the just and reasonable standards the Commission normally applies in oil pipeline cases. While there would be no cost justification for the difference in the two rates, the difference would flow directly from the procedural provisions of the EPAct. If, as a result of the grandfathering provisions of the EPAct, different rate levels result because the differing rates became effective at different times, this is a function of the statute. To hold otherwise would nullify the grandfathering provisions of the EPAct.

3. *The Watson Enhancement Facilities.*

Watson Station is a major origin point for volumes moving on the West Line. In March 1989, SFPP notified its

shippers that it was increasing the minimum pumping rate and pressure at Watson Station and required its shippers to meet the higher standards in two phases, the final pressures to be effective April 1, 1992. SFPP's shippers were given the option of providing their own facilities to meet the increased pressure requirements or to pay SFPP a charge to provide the necessary services. At the time the instant complaints were filed all the relevant shippers had executed contracts to pay the charge rather than to construct their own facilities. SFPP constructed and now operates the Watson enhancement facilities, which serve to increase the capacity and efficiency of shipper storage facilities in the Watson Station area.

In reviewing the complaint by Chevron, the ALJ determined that the Watson enhancement facilities were jurisdictional, and that SFPP must publish a tariff for

[61,074]

providing the services and include the revenues and costs in its West Line cost of service. [90] The ALJ also concluded that no reparations or revenue crediting would be required for the period preceding SFPP's filing of an appropriate rate with the Commission. SFPP excepts to the conclusion that the facilities are jurisdictional, asserting that the enhancement services it provides at Watson Station are ancillary services provided for the convenience of the shippers. However, it supports the determination that no refunds should be made. The complainant parties and the Staff support the ALJ's determination on the jurisdictional issue but the West Line Shippers oppose his determination that no refunds need be made for the period that SFPP has no tariffs for the Watson enhancement services on file.

The Commission will uphold the ALJ's determination. The ALJ carefully detailed how all volumes tendered to SFPP by shippers tendering oil products at Watson Station must pass through the enhancement facility since the shippers do not possess facilities of their own. [91] It is undisputed that much of the volume moving through the enhancement facilities moves in interstate commerce and that shippers intend that much of the volumes tendered were to move in interstate commerce. Construction of the shippers' own facilities or the use of SFPP's facilities is a prerequisite of use of SFPP's system for interstate shippers tendering volumes to SFPP at Watson station in order to meet the minimum pumping requirements contained in SFPP's tariff, and has been since November 1, 1991. The fact that contracts were executed for provision of the service does not detract from the fact that SFPP imposed a mandatory choice on its shippers, and modified its FERC tariffs to assure compliance with its needs.

It is the mandatory nature of the pressure requirements that renders SFPP's argument that the service is ancillary unconvincing. For example, SFPP cites an earlier Interstate Commerce Commission case holding that a service charge for the compression of cotton was ancillary. [92] But in that case the shipper had the option of shipping either compressed or uncompressed cotton, and the failure to provide compressed cotton (whether or not the shipper or the carrier did the compression) did not bar access to the common carrier railroad system. To the extent such earlier ICC cases are relevant, the ALJ's citation of *Atlanta Pipe Line Company* [93] is more appropriate. In that case the ICC held that tank storage facilities necessary for the practical operation of the pipeline system were subject to its jurisdiction, and that the pipeline was required to provide them.

The ALJ's conclusion is well reasoned and consistent with the Commission's recent decisions involving SFPP's Sepulveda line [94] and *Lakehead Pipe Line Company*. [95] The Commission therefore affirms his conclusion that SFPP's Watson enhancement facilities are subject to the Commission's jurisdiction. The ALJ also held that SFPP would not have to credit the revenues received to date or to make reparations. Chevron asserts that this was error, stating that the latter ruling is inconsistent with the Commission's *Sepulveda* decision, and inconsistent with his own determination that the costs of the facility have been recovered several times over. Neither argument is

[61,075]

persuasive here. It is true that in *Sepulveda* the Commission required SFPP to publish a rate and held open the prospect of reparations once the related rate issues had been determined. However, in that case the underlying contracts had expired and the parties were disputing what the rate should be for continued service.

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For the period at issue here the contracts were still extant, the charge was established by negotiation, and the contracts were entered into voluntarily by the parties, mostly before the end of 1991. The typical Watson Station enhancement facilities contract contains detailed provisions on the charge, the term, the pressure to be maintained, and the minimum annual throughput required to support the construction of the Watson Station Line. [96] A contract of this sophistication requires a good deal of thought and negotiation on the part of parties. As such, this Commission can assume they were reasonably aware of their rights and obligations under the Interstate Commerce Act. In this regard, Chevron and others had approximately two years in which to make the decision to build their own facilities or to enter into a contract under which SFPP would construct the facilities and amortize them for a specific charge designed to recover the costs of the facilities over the life of the contract.

During that time no party chose to formally protest SFPP's tariff requirement calling for increased pressure for deliveries in the Watson Station area or to bring the jurisdictional issue to this Commission. Nothing would have prevented a sophisticated shipper like Chevron having filed with the Commission on the jurisdictional issue in a more timely fashion. Under these circumstances, the complaint against the Watsonville charge is arguably little more than an attempt to avoid a previously negotiated contract, agreements the Commission has held are lawful under the ICA. [97] While the Commission has little choice under controlling authority but to assert its jurisdiction over the movements at issue here, the exercise of that jurisdiction to alter that charge would be inequitable given the parties' intention to resolve the issue through a number of interlocking contracts allocating the costs of the facilities among several shippers. [98]

The issue of timeliness raises a second point that goes directly to the Commission's legal ability to exercise its jurisdiction. It appears on this record that all the relevant contracts were required to be, and had been, executed well before June 1, 1992. While the contract charge was not a rate filed with this Commission, the charge itself was clearly established before the effective date of the EPAct. The complaint here is against both the jurisdictional issue and the level of the charge. The clear purpose of the EPAct's grandfathering provisions is to insulate pipelines from challenges to the rates and charges that pipelines assess their shippers for common carrier services if those charges were in effect before October 24, 1992. If the Watson Station enhancement services are common carrier services, and the Commission has so held, then the full range of legal provisions applicable to those services should apply to assure consistency in the implementation of the statute.

[61,076]

Therefore, while the Commission will direct SFPP to file a rate equal to the historic charge in the shipper contracts, it will dismiss complaints against the charges under the Watson Station facilities contracts since those contacts were effective at the time the complaints were filed. Moreover, as long as the underlying contracts are in effect, the charges for the Watson Station facilities are part of enforceable contracts and are the equivalent of a lawful, effective rate. [99] Given the restrictive purpose of the statute and the lawful nature of the existing changes the Watson Station enhancement services, the Commission finds that any party challenging those charges while the contracts are in effect must establish substantially changed circumstances in order to do so. Chevron has not done so, and therefore its complaint against the level of the Watson Station facility charge fails. [100] The ALJ's conclusions are affirmed.

4. *The ARCO Reversal Agreement.*

As detailed in the background section, in mid-1992 SFPP entered into an agreement with ARCO to reverse the flow of its 6 inch-diameter line between Tucson and Phoenix, Arizona, from an eastbound to a westbound service. This engendered disputes about whether the Commission had jurisdiction over the reversal of the flows and whether the terms of the so-called ARCO Reversal Agreement must be published in SFPP's tariff. The ALJ held that the reversal of the six inch line was not subject to the Commission's jurisdiction because it constituted an abandonment of service. He also held that the essential terms of the Agreement must be published in SFPP's tariff because they are an integral part of the tariff and the rate to be paid. He also held that the Reversal Agreement is not unduly preferential or discriminatory and that ARCO was not entitled to a revenue credit for

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volumes that were not shipped under the Agreement.

On exceptions, ARCO asserts that the ALJ erred in refusing to require revenue crediting or return of ARCO's payments and in rejecting ARCO's interpretation of the Agreement. The West Line Shippers assert that the ARCO Reversal Agreement was unlawful because it provides for a minimum volume, that this results in an unlawfully high rate, and because SFPP violated a Commission order [101] when it temporarily used the 6-inch line in East Line service while SFPP was undertaking its East Line expansion work. The Staff asserts that the ALJ correctly held that the Commission had no jurisdiction over the decision to reverse the line, and that SFPP must publish the terms of the ARCO Agreement in its tariff. SFPP first asserts that the ARCO agreement has expired and therefore there is no need to address its merits. If the merits are to be addressed, SFPP agrees that the ALJ correctly held that the Commission was without jurisdiction over the decision to reverse the line and with his conclusion that the agreement is neither unlawful nor unduly discriminatory. It disagrees with his determination that the terms of the Agreement are integral to the rate and must be published in SFPP's tariff.

The Commission will address certain of the issues regarding the ARCO Agreement since the ARCO Agreement was in effect during in the time frame addressed in the complaints. The ARCO Agreement was executed in June 1992, and shortly thereafter

[61,077]

the 6-inch line between Phoenix and Tucson was restored to west to east service. Prior thereto, as noted, the line had been operated in west-to-east service before being shifted to east-to-west service. Thus, SFPP has twice reversed the flow of the 6- inch line between Tucson and Phoenix.

As noted, the West Line Shippers assert that the first reversal violated a Commission order approving rates for the flow of volumes between Phoenix and Tucson and that SFPP should not have reversed the line without canceling its tariff for west to east service. First, the Commission affirms the ALJ's decision that the Commission does not have jurisdiction over SFPP's decision to reverse the flow of the 6-inch line. [102] Each time the line was reversed, this constituted an abandonment of all west-to-east, or east-to-west, service over the 6-inch line. Abandonment of service by an oil pipeline is not subject to the Commission's jurisdiction. While it might have been better form for SFPP to have canceled the relevant tariffs, SFPP clearly provided notice to its shippers that it was not holding itself out to provide at that times it reversed the 6-inch line and operations ceased accordingly. Given the lack of jurisdiction over the reversal of the line, a protest to the tariff cancellation would have been dismissed, contrary to complainants' assertions. Moreover, as SFPP was under no obligation to establish or maintain the west-to-east flow in the first place, SFPP could not have violated a Commission order "establishing" the service. Construction, entry and abandonment of service by oil pipelines are not subject to the Commission's jurisdiction.

The Commission also concludes that the Agreement was not unlawful or unduly discriminatory. Agreements for minimum throughput, with annual volume and revenue guarantees, are common in the oil pipeline industry. [103] There is no indication on this record that the Agreement was for less than the maximum tariff rate, that the Agreement precluded other shippers from having access to capacity, [104] or that any form of rebate was involved. West Line Shippers do assert that since ARCO paid an average per barrel charge in some years that exceeded the maximum rate, the Agreement violated SFPP's maximum rates. This is a specious argument. The higher average per barrel rate occurred because ARCO did not ship the minimum volumes required under the Agreement, and therefore the dollars due under the contract were simply spread over fewer barrels than the minimum number required by the contract. The ALJ's conclusion on this point is affirmed.

The Commission also affirms the ALJ's determination that ARCO is not entitled to any revenue credits or refunds. He correctly stated that ARCO agreed to pay a fixed annual amount in exchange for capacity being made available to it on the 6-inch line between Phoenix and Tucson, that ARCO is liable, and that any other contractual interpretation is unreasonable. However, the Commission will reverse the ALJ's determination that the terms of the Agreement must be published in SFPP's tariff. Several of the parties assert that an agreement to reverse the flow of a line is unique, but this point is irrelevant since the Commission lacks jurisdiction over such a decision to reverse the line in the first instance. Once the decision was made, the Agreement provided for

transportation at the filed tariff rate.

[61,078]

Thus, contrary to Staff's and the ALJ's assertion, the Agreement was not an integral part of that rate because it was based solely on the tariff rate. The related volumes, the revenues, and the term of the contract would clearly be relevant to designing a rate in a maximum rate case; to that extent they would be integral to a rate at issue in such a proceeding. But SFPP was not attempting to design a rate through the use of the Agreement; it was simply applying the rate on file. The Commission has not heretofore required oil pipelines to publish the details of throughput agreements in their tariffs and it will not do so here. If the Agreement resulted in a discriminatory allocation of capacity, the Commission could exercise its jurisdiction, but there is no credible assertion here that this has occurred. A general concern that discrimination may occur in the allocation of capacity is insufficient to sustain the remedy sought here.

5. *Conclusions*

The Commission affirms that the West Line Shippers and Chevron must establish substantially changed circumstances for all of the West Line rates they have challenged except for that portion of Tariff No. 18 that addresses turbine fuel. The Commission has also concluded that the West Line Shippers and Chevron failed their burden in that regard. Moreover, since Navajo has settled its disputes with SFPP regarding the West Line rates, the only West Line rate that remains before the Commission at this point is the turbine fuel component of Tariff No. 18. [105] Therefore no further action will be taken on the complaints filed against SFPP's West Line rates through August 7, 1995, the date of the last consolidated complaint at issue here. The Commission also finds that the charges for the use of SFPP's Watson enhancement facility are barred in the absence of substantially changed circumstances and that issue will not be pursued further here.

Moreover, the Commission concludes that there is no reason for further review of the turbine fuel portion of the Tariff No. 18. As the complainants themselves have stated, there are no operating differences, or attendant cost differences, between providing this service and the other services provided under Tariff No. 18. Since the rates for all other services and products transported under Tariff No. 18 are deemed to be just and reasonable, there is no basis for providing a different rate level for turbine fuel at this time.

In light of this conclusion, the Commission will not review further the ALJ's determinations related solely to West Line rates, including: (1) allocation of overhead administrative costs between SFPP's jurisdictional and non-jurisdictional lines in the State of California, (2) the level of the charge for the Watson enhancement facilities, (3) the specific rate issues related to the ARCO Reversal Agreement, (4) the proper method for allocating revenues to the Cal/Nev lines, and (5) reparation issues related to the West Lines. The proper allocation of costs between the West and East Lines is discussed in the next section.

[61,079]

B. *Rate Design Issues.*

SFPP operates two distinct pipeline systems, the North System, which operates between the Los Angeles basin and the Pacific Northwest, and the South System between the Los Angeles Basin and El Paso. The South System has historically involved two different flows, one between Los Angeles and Tucson via Phoenix (the West Lines), and the other between El Paso and Phoenix via Tucson (the East Lines). As has been described, the shippers on the West and East Lines often compete to sell products in the Arizona market, and the two lines have different rate structures. The fact that SFPP has different rates on different parts of its system has raised a number of fundamental rate design issues.

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1. *The Use of a System Rate Ceiling.*

The ALJ held that SFPP must establish the reasonableness of each of the rates that were challenged in the instant proceeding and that the maximum rate that could be charged for each such rate was the fully allocated cost of that rate. He also held that SFPP must provide separate cost justifications for the East and West Lines. SFPP and the Association of Oil Pipe Lines (AOPL) excepted to this finding. [106] They argue that Commission precedent does not limit oil pipelines to the recovery of fully allocated costs, that Congress and the Commission have consistently contemplated that oil pipelines would be subject to more light-handed regulation than gas pipelines in determining rate design issues. SFPP also asserts that it has consistently operated the South System as a single entity and that therefore any rate ceiling should apply to the service of that system as a whole. Staff and the complainant parties support the ALJ's decision, asserting that the cases cited by SFPP in support of its position are inapposite, that fully allocated cost is the normal standard for determining a maximum rate, that SFPP's East and West Lines have substantially different cost structures, and that any use of system-wide cap will result in substantial allocation of West Line costs to East Line shippers.

The Commission will affirm the ALJ in part and modify his order in part. First, SFPP and AOPL are correct that oil pipelines are not necessarily limited to the use of a fully allocated cost ceiling as a justification for their rates, and they are equally correct that there are other theories available under the Interstate Commerce Act. [107] To the extent the initial decision is to be read as a categorical statement that fully allocated costs are the only methodology for evaluating an oil pipeline maximum rate, that portion of the initial decision is reversed.

However, the issue of a fully allocated cost cap is not the essence of the dispute between the pipeline interests, the complaining parties, and the Staff in this proceeding. The focus is on the costs to which any rate cap should be applied and the nature of the cap. On the first point, SFPP argues that any rate ceiling should be based on the costs of the South System as a whole and not the East and West Lines separately. This assertion is unreasonable both as a matter of law and the practical economics of rate design. On the matter of law, SFPP and AOPL assert that the Commission has never

[61,080]

required that the reasonableness of rates be determined on an individual rate basis and that the Commission has dismissed complaints where the revenues were less than the system-wide cost-of-service. However, as the complainant parties and the ALJ properly state, in *Farmers Union Central Exchange v. FERC*, the Court specifically stated:

> Because oil pipeline rates are charged on a point-to-point basis, such cost allocation [by shipment] ensures that the costs of providing service over a given *territory* will be recovered only from the companies that use that particular service. [108]

Farmers Union is still controlling law, and the Commission's subsequent decisions are consistent with this admonition, as is the ALJ's ruling that the maximum rates for the East and West Lines must be calculated separately. For example, as pointed out by Refinery Holding Company (RHC), in *ARCO* the parties stipulated which of the pipeline's services, *i.e.* which products, would be the subject of the proceeding, the cost-of-service for transporting those products, and for providing the services under those specific tariffs. Since the subject rates generated less revenue than the stipulated costs for the service at issue, the Commission dismissed the complaint. Similarly, the challenge to *Lakehead*'s rates was to those for transporting crude oil and natural gas liquids through the pipeline's entire system. SFPP's own rate structure in this proceeding indicates that its citation of *Lakehead* is inapposite. The issue here, as in *Williams*, *supra*, is how costs should be allocated to services with two distinctly different rate structures. The Commission stated in *Williams*, that regardless of what maximum rate methodology is adopted, the object is to assure that shippers pay for the costs of the services that they are using. [109]

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Applying the *Williams* analysis, SFPP's assertions that the South System is a single system for rate design purposes lacks a credible foundation. The rates at issue here serve different markets and different shippers, often competitors, and the rates themselves reflect differently sized pipelines and different patterns of investment. These are enumerated on pages 25 and 26 of RHC's Brief on Exceptions. For example, the West Line has about twice as many terminal and pump stations as the East; the West Line has 83 percent of the throughput and the East Line 17 percent of the South Lines' total; depreciation expense was allocated some 77 percent to West Line; and planned investment on the West Line in the late 1980's was $170 million, with actual investment amounting to $140 million, compared to $48 million on the East Line in the early 1990's. RHC correctly argues that there is no convincing evidence that most East Line shippers receive any benefit from the $140 million invested in the West Lines, and that a system-wide approach would require East Line shippers to pay for large amounts of capacity that many have no reasonable prospect of using. Together with other parties, it correctly asserts that utilizing a system-wide cost-of-service and a system-wide rate cap, would result in a large cost shift from the West Line to the East Line. To the extent there is excess capacity on the West Lines, as is indicated in this record, [110] the cost shift to the East Line shippers would be accentuated. This is reflected in the perception of one witness that the West Line was operating at less than 50 percent of capacity in 1994. [111]

Moreover, SFPP's arguments that the two lines have certain common facilities, services, and required coordinated operations means nothing more than the fact that

[61,081]

SFPP is multi-product firm with significant amounts of joint and common costs. The fact these costs exist, and that a number of shippers may use both lines at different times or simultaneously, is simply not relevant here. If SFPP's shippers shift volumes from the East Line to the West Line, or *vice versa*, they are still utilizing a different service between different markets, provided by means of different assets in order to reach their markets. Any such shifting of traffic does not warrant exposing customers that do not engage in large volume shifts to the cost shifting that would result under SFPP's proposal. SFPP's rate structure in its current format reflects the fact that the underlying transportation economics of the East and West Lines are different, particularly as regards their relative volumes and investment bases.

Under its 1988 settlement, SFPP's current South System rates were designed to accommodate the large difference in investment between the West and East Lines that SFPP planned to make following its 1985 settlement, and to avoid the very cross-subsidy that would likely result if a rate ceiling were now designed on a system-wide basis. Finally, to the extent SFPP asserts that it should be permitted to recover revenue shortfalls in some markets by recovering revenues in excess in other markets without a more definitive review, *i.e.*, to engage in unlimited differential pricing without regard to the costs actually incurred in each region, *Williams*, *supra*, clearly rejects this theory, as do the ICC and Surface Transportation Board decisions cited in the order. [112]

Finally, to the extent that AOPL and SFPP argue that Congress and the Commission have recognized that the oil pipeline industry faces a considerable degree of competition and that this should change the result here, this argument is simply not relevant. It is clear on this record that SFPP is the only product pipeline serving Arizona from points in Texas and California, and that railroads, barges or trucks do not provide competitive transportation of petroleum products to points in Arizona from El Paso or Los Angeles. [113] To the extent that the presence of competition might limit the application of cost-of-service regulation in the instant proceeding, the presence of competition has not been established here. The ALJ correctly determined the evaluation of SFPP's rates and charges must be done separately for the West and East Lines. The related allocation issues are discussed in the rest of this section. [114]

2. *Between Jurisdictional and Non-Jurisdictional Operations.*

Regardless of what maximum rate theory is adopted here, the parties agree that SFPP's jurisdictional revenues and costs should be separated from its non-jurisdictional revenues and costs. They disagree, however, over how this separation should be performed. Some of the matters raised in this regard are not before the Commission

given its earlier determination that the complainants have not established that there are substantially changed circumstances to the basis for SFPP's West Line rates. These latter issues include the allocation of costs between inter- and intra-state operations in California, [115] the allocation of overhead costs between carrier and non-carrier operations to the extent that operations involve non-carrier facilities serving only the West Line shippers, and any cost issues related to the CalNev service. However, to the extent that facilities serve only the East Line shippers or both East and West Line shippers, then an allocation must be performed. Among the overhead costs at issue here are those

[61,082]

of breakout tanks, the portions of terminals used for storing product for local delivery, and the related racks and other facilities that are used to transfer product from SFPP's system to a local pipeline, consumer, or transportation company, such as a trucking company. [116]

The ALJ concluded that the allocation of indirect overhead costs among SFPP's jurisdictional and non-jurisdictional South System operations should be based on the *KN* method. The *KN* method allocates indirect overhead costs based on the ratio of direct labor and capital investment of each of the pipeline's functions or services at issue to the total direct labor and capital investment of all of the divisions involved. [117] The ALJ found that an alternative method proposed by SFPP was not credible because it was based on the allocations used in SFPP's general ledger entries. These allocations were developed in an internal management study conducted in 1991 and used a strikingly uniform allocation factor for individuals with same or similar job descriptions without any variation by geographic location. As such, the ALJ concluded that by allocating some 83.5 percent of indirect costs to jurisdictional activities, SFPP's ledger based methodology did not adequately account for the fact that non-jurisdictional facilities on the South Lines accounted for some 25 percent of investment costs and 30 percent of direct labor. The ALJ also rejected a supporting study by Ernst & Young that reviewed SFPP's internal study, which concluded that 83 to 87 percent of joint costs were properly allocated to jurisdictional activities. Under the *KN* method 77 percent of the indirect overhead costs would be allocated to jurisdictional activities. The ALJ further concluded that the SFPP study was also inadequate because it was not introduced into evidence. [118]

On exceptions, the complainants and the Staff support the ALJ, asserting that SFPP's internal study was prepared in anticipation of litigation, and as such has little credibility. They also assert that it is unreasonable given some of the discrepancies that were uncovered and that the Ernst & Young study did not verify the internal SFPP effort by reviewing all the relevant workpapers. SFPP asserts that the ALJ erred in his ruling, and argues that the *KN* method has heretofore been used only in gas cases, and that in any event it is used only where more precise evidence of how indirect overhead costs should be allocated has been considered. SFPP again asserts that its ledger values were based on interviews of the staff involved at particular sites to determine the direct and indirect labor costs involved at those sites, and that the Ernst & Young analysis validated its integrity. Finally, it asserts that the actual workpapers were made available to all the complainant parties, and if reviewed, would support SFPP's conclusions.

This issue presented here is a difficult one since the allocation of indirect overhead costs by a more precise study is to be preferred over the use of a general regulatory formula. However, the party advancing a method that it believes is more precise has the obligation to establish that the method it proposes is preferable to the method normally applied under Commission policy. [119] The Commission concludes that SFPP has failed its burden in this regard. The uniformity in the overhead factors for each

[61,083]

category of employee involved in both jurisdictional and non-jurisdictional operations without regard to the location or size of the facility or the scope of the territory covered supports the ALJ's conclusion that SFPP's internal accounting system cannot be relied on to support the allocations it has made. In particular, the Commission is troubled that such a high percentage of indirect costs was allocated to jurisdictional activities when it is undisputed on this record that some 30 percent of direct labor costs and 25 percent of capital investment were attributable therefore to the non-jurisdictional activities. The Commission affirms the ALJ.

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3. *Among Various Portions of the South System.*

Since the Commission has previously rejected SFPP's assertions that the South System should be treated as a single entity for ratemaking purposes, it is necessary to allocate costs among the different geographic sections of SFPP's South System. Such an allocation involves both the costs of facilities that are used by both the East and the West Lines to deliver petroleum products to points in Arizona as well as the allocation of indirect overhead costs between the two different services. SFPP allocated the common costs for facilities operated in Arizona based on the relative volumes moving in each direction during each month of the test year. The ALJ adopted this approach and it is not challenged here.

However the ALJ rejected SFPP's proposed allocation of indirect overhead costs between the East and West Lines. SFPP proposed to use a modified *Massachusetts* formula using three factors: direct labor, capital investment, and barrel-miles, the latter being a substitute for the revenue component normally used in *Massachusetts* formula. [120] The Commission staff used a similar approach. In adopting the *KN* formula, the ALJ based his decision in part on an assertion that the *Massachusetts* formula is not used when the parent company has revenues. [121] The complainant parties supported the ALJ while SFPP opposed this conclusion, arguing the formula that incorporated revenue was more appropriate.

On review, the Commission affirms the ALJ's adoption of the *KN* methodology but will modify his ruling. The Commission notes first that the choice of the *KN* or the *Massachusetts* method does not turn on whether a parent company has revenues or no revenues, the basis for the ALJ's ruling here. Rather, it turns primarily on whether separate affiliated corporate entities are involved in the allocation of common overhead costs, or whether functions or services involve the same legal entity. This central distinction was explained in *Mojave Pipeline Company*, [122] in which the Commission distinguished the *Questar* decision cited by the ALJ. In the instant case, since affiliates are not involved, the proper allocation method is *KN*. In fact, in *Mojave*, the Commission explicitly recognized that different services could be involved in the use of this formula. The formula is for different operations within the same company because the Commission has concluded that the limited number of overhead costs that cannot be directly assigned are best allocated on the basis of direct labor and capital costs that reflect the operations of geographically distinct portions of a pipeline's system. Thus, in the instant case, the East and West Lines are subsets of the same functional classifications, whose costs are allocated primarily on the engineering (capital) and labor of the assets involved. As such, it is appropriate to apply the same allocation method to the

[61,084]

subset of a category as is applied to the category as a whole. The ALJ is affirmed on his conclusion but reversed on his reasoning.

4. *Military Costs and Revenue Crediting.*

In addition to serving its conventional commercial markets, SFPP provides services to military facilities under Section 22 of the ICA. Section 22 rates are negotiated rates between the United States and a private company for common carrier transportation services. Such rates are not subject to the Commission's maximum rate jurisdiction. In preparing its rate design for this case, SFPP excluded the costs of those facilities that were exclusively used to serve its military customers and the revenues that were generated exclusively by those facilities. It included in its cost-of-service that portion of military shipments that moved over its commercial trunkline system as part of its projected volumes, along with all costs attributed to those facilities. The ALJ accepted the exclusion of the costs of the spur that constitutes the military facilities but included all of the revenues generated by the military shipments, including the trunkline revenues, in the cost of service.

Several parties asserted that the ALJ's ruling raises both a cost allocation issue and a volumes issue. Staff proposed an alternative method which would simply credit military revenues against SFPP's total cost-of-service

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without excluding the costs that could be directly assigned to the military facilities. Chevron and Navajo requested that the Commission clarify that the *KN* method previously discussed will apply to the military facilities. In its reply, SFPP stated its methodology excluded all of the costs of the assets that served only the military facilities and the Section 22 rates used to serve those facilities. It asserts that, from the point of origin to the point of connection to the military facility, SFPP charges the standard commercial rate. Thus, it claims, the Section 22 rate is relevant only to those facilities that are used exclusively in military service. Finally, it supports the ALJ's conclusion that the indirect overhead costs associated with the military movements are removed at the same time the direct costs are under the *KN* method.

The Commission agrees with the parties that the ALJ mismatched trunkline revenues with the costs solely related to the military facilities SFPP was serving. SFPP correctly separated all the costs related solely to the military facilities and charged an incremental rate that was applicable solely to those facilities. Under these circumstances, the revenues derived from using the commercial rate to the point of interconnect with the military facilities have no relationship to the costs incurred only by the military facilities. Therefore there is no need to exclude the trunkline revenues paid by military customers as proposed by Staff, and the ALJ is reversed on this point. His conclusion regarding the allocation of the indirect overhead costs is affirmed on the grounds stated.

C. *Cost-of-Service Issues*

1. *The Test Year for this Proceeding.*

The ALJ held that 1994 should be the test year to be utilized in this proceeding. After initially reviewing 1993 as the test year, he determined that 1994 would be a more representative year, particularly for throughput, and permitted the parties to update the record with adjusted 1993 costs to develop 1994 operating expenses. [123] On exceptions, SFPP states that it does not object to use of 1993 as a base year but objects

[61,085]

to the selective use of 1994 figures as the basis for the alternative year. It states that whatever year is used, the result should be a consistent matching of cost and revenues for the same years. SFPP asserts that the initial decision erred in selectively updating certain expenses and accounts from 1993 to 1994 while not updating all of them, including the failure to update for fuel costs and to consistently use 1994 volumes as the basis for allocating costs. SFPP reserves the right to use actual 1994 right-of-way costs in making any compliance filing.

Two of the complainants assert that the use of a two-year test period is consistent with Commission practice, citing *Lakehead*. They also assert that use of an update is consistent with the Commission's current oil pipeline regulations and would result in a test year that is consistent with the December 31, 1994 date that is now used as the basis of the Commission's indexing methodology for evaluating rate filings after that date. They assert in general that there was little variation in SFPP's operating costs from 1993 through 1994 and that the ALJ's methodology was reasonable and should be affirmed. Chevron asserts that regarding SFPP expenses for leasing its right-of-way, SFPP admits that it did not use the 1994 right-of-way expense information that Chevron's witness found to be unreliable. Chevron claims that the 1994 property additions, retirements, transfers, and other adjustments were not a credible basis for adjusting SFPP's 1993 cost of service, and that in any event, the use of costs for the entire year 1994 would extend beyond the nine month known and measurable period contemplated by the Commission's regulations.

The Commission first affirms the ALJ's ruling to use 1994 as the base year in this proceeding. Since the Commission has determined that the West Line Shippers have not proven substantially changed circumstances, only the East Line rates are now at issue, and the ALJ correctly decided that 1994 is a more representative year than 1993 for volumes on that line. However, SFPP is correct that 1994 costs should have been used to the extent possible in developing SFPP's cost-of-service for that year. As argued by Chevron on exceptions, there may be some limitations in the quality of SFPP's accounting data for that particular year, for example, in the additions and retirements made to its plant in 1994. However, these fairly narrow technical issues can be addressed in a compliance filing through a review of the company's work papers and the final entries for SFPP's

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accounts for the calender year 1994.

2. *Rate Base Issues.*

Under Opinion No. 154-B oil pipelines use a rate base and depreciation method based on trended original cost (TOC). The method is similar in most regards to the net depreciated original cost method (DOC) used in gas pipeline regulation. However, inflation is accounted for in a different manner. Under the DOC method, an inflation factor is included in the equity cost of capital and is expected to be recovered from current earnings. Under the TOC method, the inflation component of the equity cost of capital is added to rate base, an addition called the *deferred equity component of the rate base. The deferred equity component is then amortized over the remaining* life of the current year's addition. The result is lower rates in earlier years of an investment, which makes it easier for new entrants, or new investment, to compete with older investment. Returns are lower in the initial years under this method but the present value of the total returns over the operating life of the pipeline are expected to be approximately the same under either method. [124]

[61,086]

Oil pipelines also have a different method for establishing the rate base. Gas pipelines utilize a original cost based method that reflects actual additions and retirements to the pipeline's plant accounts determined in accordance with the Commission's Uniform System of Accounts. Prior to June 28, 1985, oil pipeline rate bases were based on an Interstate Commerce Commission reproduction cost valuation method that significantly increased oil pipeline assets when compared to the book basis of the same assets. [125] Upon the adoption of the Opinion No. 154-B rate methodology on June 28, 1985, the issue of the relationship between original cost and the ICC's valuation method was revisited. The Commission decided to adopt an original cost methodology but tempered this conclusion with a device designed to mitigate the transition to the new method of determining a pipeline's rate base.

Recognizing that an abrupt change to an original cost-based method would reduce oil pipeline earnings and have a potentially sharp impact on oil pipeline investors, the Commission developed a transitional, middle ground method that is fair in light of investor expectations, but did not perpetuate the serious flaws of the previous method. The compromise method employs a starting rate base (SRB) that is the sum of a pipeline's debt ratio times net depreciated original cost and the equity ratio times the reproduction portion of the valuation rate base depreciated by the same percentage as the original cost rate base had been depreciated. [126] The size of the SRB is therefore strongly affected by the pipeline's debt/equity ratio. Calculation and amortization of the SRB and any deferred equity components of the rate base are among the issues raised here. In addition, oil pipelines are permitted to add Allowances for Funds Used During Construction (AFDUC) to new plant additions after December 31, 1983, and are required to consider related Accumulated Deferred Income Taxes (ADIT) in determining rate base. [127]

a. *The ALJ's Determinations.*

The ALJ first determined that SFPP's starting rate base should be determined in part by adopting SFPP's actual capital structure as of December 19, 1988, when it first became a publicly traded partnership pursuant to a corporate reorganization by its parent company, the Santa Fe Pacific Corporation, and that the deferred equity component of the rate base up to December 18, 1988 also should be determined using SFPP's December 19, 1988 capital structure. [128] He also determined that the SRB should be amortized based on the remaining useful life of SFPP's assets as of December 31, 1983, the point from which the Commission's trended original cost methodology was to be applied to a pipeline's existing asset base. [129] He further concluded that the equity component of the SRB after December 19, 1988, and the deferred equity component of the additions to the rate base after the same date should be governed by the capital structure applicable to the year of the addition, and that the actual inflation rate in the test year should be used for determining the increase in the deferred equity component. [130] The ALJ also held that SFPP had not used an appropriate method for

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amortizing its ADIT and had not justified its proposed AFUDC. [131] The ALJ therefore adopted an alternative method for determining AFUDC and modified SFPP's proposed method for recognizing these costs. The ALJ also rejected arguments that SFPP should be required to adjust the amount of accumulated depreciation on its books. [132] All of theses rulings are contested on exceptions.

b. *The Starting Rate Base.*

As discussed, the SRB of an oil pipeline reflects the compromise rate base methodology adopted by the Commission on June 29, 1985 when it issued Opinion No. 154-B . The issues involved here include determining the SRB, the equity and debt components of the capital structure, and the amortization of the SRB once it has been created.

The first issue is how to determine the SRB for the South Lines. As has been discussed, as of December 31, 1983 there were two different sets of numbers, using the pipeline's historical cost and the valuation base developed under the ICC methodology. In the instant case, Staff examined the historical cost of the South Lines and determined the ratio of net depreciated original cost of the South Lines to the net depreciated original cost for the system as a whole. Staff then applied this ratio to the total ICC valuation base to determine the valuation figure to be use to for the South Lines. [133] SFPP presented an alternative method that utilized 1993 volumes to determine how the 1983 SRB costs should be allocated to the South System.

The Commission finds that staff's approach was the more reasonable of the two approaches and should be adopted because consistent with the Opinion No. 154-B methodology, it factors in the net accumulated depreciation for determining the historical rate base, just as accumulated depreciation is used in adjusting the valuation base. The ALJ correctly relied on Staff's ratio method for determining the allocation of the SRB costs between the North and South Lines and properly rejected SFPP's methodology. [134]

c. *The Capital Structure to be Applied in Determining the SRB.*

As the ALJ correctly stated, the next step is to determine the debt and equity portions of the SRB. This is done by multiplying the debt ratio times net depreciated original cost of the pipeline's assets and multiplying the equity ratio times the reproduction portion of the valuation rate base after it is depreciated by the same percentage as the book original cost rate base has been depreciated. Opinion No. 154-B states in categorical terms that the pipeline will use its actual capital structure, or if the pipeline's capital structure is not representative, the capital structure of its parent. [135] In either case, for pipelines with a valuation rate base as of December 31, 1983, the capital structure to be used is that as of June 28, 1985, because that date is the date of transition to the trended original cost methodology. [136]

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In the instant case, SFPP had no independent capital structure as of that date; therefore, its parent company's capital structure would normally be used under the guidance contained in Opinion No. 154-B . However, on June 28, 1985, [137] SFPP's parent, Santa Fe Pacific, had an unusual equity-oriented capital structure, with equity comprising 78.29 percent of the capital structure and debt 21.71 percent of the capital structure. [138] Based in part on this weighting, the ALJ concluded that the risks facing SFPP's parent company were different from those of SFPP itself and that the use of the parent's capital structure would be inappropriate. [139] The ALJ therefore concluded that a more representative capital structure would be that adopted by SFPP when it became a publicly traded limited partnership on December 19, 1988. [140] At that time, SFPP's capital structure was changed, through the issuance of debt instruments, to approximately 60.74 percent debt and 39.26 percent equity. [141] He therefore

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adopted a hypothetical capital structure for the period between December 31, 1983, and December 19, 1988 using that ratio, and ruled that SFPP should use its actual book capital structure for the period after December 31, 1988.

The Staff and the complainants support the ALJ's decision, based on the ALJ's ruling in a 1987 initial decision [142] that SFPP's parent had different risks because most of its operations were unregulated and the parent was far more heavily involved in rail and trucking than in pipeline operations. [143] Staff also argues that in its previous rate case SFPP itself asserted that the parent's capital structure was inappropriate. SFPP argues that the ALJ's ruling would require it to change its capital structure retroactively at a time when the company had no time to respond by modifying its capital structure, and asserts that in any event that there is no evidence on this record that SFPP's risks for the period before December 18, 1988, were different from its parent's. [144]

In addition, SFPP asserts that the SRB should not be modified to reflect the change in capital structure that occurred on December 19, 1988, but that the SRB should reflect the capital structure used to create it until the SRB is fully amortized. Otherwise, it asserts that the SRB will not be "frozen." On this point the Staff and complainants also support the ALJ, asserting that there is no indication that Opinion No. 154-B intended the capital structure to be static and that later decisions specifically contemplated that the pipeline's capital structure would change. Under SFPP's theory, the initial amount of the SRB is fixed and would change only through the amortization of the SRB. Under the ALJ's approach, the debt-equity ratio of the SRB would vary depending on the debt-equity ratio adopted in subsequent rate cases as it does in gas proceedings.

Both the complainants and SFPP argue at length the circumstances under which the Commission has required a hypothetical capital structure, and whether it fails to create a middle ground result in creating the rate base called for by the SRB methodology. This concerns a dispute whether the Commission's description of the SRB

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in Opinion No. 154-B as a "middle ground" refers to a methodological middle ground or a statistical "middle ground" between the historical rate base and the ICC valuation method. [145] Without reaching this issue, the Commission concludes that capital structure in the instant case should be the capital structure of SFPP's parent as of June 28, 1985. It does so on the grounds that the issue of whether a hypothetical structure should apply to the period December 31, 1983 through December 19, 1988 is foreclosed by the 1988 settlement between SFPP and most of its principal customers. [146]

In the 1988 settlement, the parties agreed to modify, and substantially reduce, SFPP's rates and to provide for subsequent increases that would reflect additional capital expenditures that SFPP proposed to make to its system. Approval of a settlement establishes a legal just and reasonable rate that the carrier may utilize until the rate is changed by a subsequent filing or by action on a complaint. While the Commission did not address each element that lay behind the settlement rates, and as such did not make an explicit determination that capital structure of SFPP's parent was just and reasonable as of June 30, 1985, the issue was addressed by the ALJ's decision and was before the parties at the time the 1988 settlement was filed. Moreover, the nature of the Opinion No. 154-B methodology was known and the potential impact of SFPP's capital structure on its rates could be readily calculated by the parties. The parties clearly elected to reduce SFPP's rates at when the 1988 settlement became effective, but do not appear to have addressed the issue of SFPP's capital structure at that time, essentially leaving it in place. It was modified shortly thereafter. [147]

This case is a complaint, not a suspension proceeding, and it would be unreasonable to change retroactively SFPP's capital structure to ante-date the July 6, 1988 settlement that established SFPP's rates for the five years after November 23, 1988. This latter date was less than one month before SFPP recapitalized its system and modified its debt-equity ratio to approximately 60 percent debt and 40 percent equity on December 19, 1988. The issue of SFPP's capital structure was one that the parties could have disposed of in the context of the 1988 settlement if the issue was one of import to the settling parties. They declined to do so. Moreover, on December 31, 1983, SFPP's existing facilities had a composite remaining useful life of approximately 20.6 years. Since over

15 years wil have passed between the date of the SRB and the effective date of any East Line rates to be adopted in this proceeding, the amount of the SRB will have been sharply reduced, as well as its impact on the rates to be set here. [148]

It is also essential to distinguish between the capital structure to be applied to the SRB and that to be applied to later changes to the pipeline's investment base. First, SFPP is correct that the capital ratio applied to the SRB at the time it is created should apply to the SRB until it is fully amortized. The Commission intended that the SRB be a transitional method designed to mitigate the change to its current TOC methodology for holders of oil pipeline equities on December 31, 1983. To modify the SRB to reflect changes to a capital structure that occurred after the SRB was defined would modify the expectations of the equity holders and defeat that purpose. While the

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Commission stated that some oil pipelines may not be entitled to use the SRB method, this comment did not go to the makeup of the SRB if the method was otherwise available. Therefore, the structure the Commission has determined is appropriate for the SRB as of December 31, 1983, will apply to the SRB until it is fully amortized. [149]

d. *Amortization of the SRB.*

The next issue involves the amortization of the SRB after its calculation as of December 31, 1983. [150] The arguments of the parties on this point turn on whether the SRB should be amortized by varying the amortization period to reflect changes to the estimated useful life of the pipeline's assets that occur in years when additions or retirements are made to its property accounts. SFPP's proposed method, called the "variable method" by the ALJ, has the practical effect of extending the amortization of the SRB, because the remaining useful life of the pipeline is extended as additions to its rate base lengthen its composite depreciation rate. The ALJ rejected SFPP's method in favor of a constant rate of amortization based on the composite depreciation rate in effect on December 31, 1983. SFPP excepts to this ruling, which the other parties support it.

The ALJ is affirmed on this point. As the ALJ stated, the SRB is a one-time calculation that is designed to operate as a transitional mechanism that will gradually return the pipeline to a purely original cost-based rate base, as properly determined under the TOC method. Any additions to the SRB, or a method for calculating it that extend its amortization period beyond the composite useful life of the pipeline's assets as of December 31, 1983, are inconsistent with the concept of an adjustment mechanism. Therefore, the proper way to amortize the SRB is over the composite remaining useful life of the pipeline's assets as of December 31, 1983, which in this case was approximately 20.6 years.

e. *Calculation of the Deferred Equity Component.*

As has been noted, once the SRB is determined, all additions to the rate base are at original cost. Additionally, under TOC, the inflation component of the equity portion of the new investment is added to rate base as a deferred equity return. Thus, if the equity cost of capital is 12 percent, the inflation component is 10 percent, and the investment $100, then $10 of the return is deferred in the first year. Amortization of this deferred return begins in the first year of the investment and continues over the life of the additional property. The disputes here center on the capital structure to be used in determining the deferred equity component of rate base, the inflation rate to be used to determine the deferred equity return, and the proper method for amortizing the deferred equity return.

The ALJ first rejected in part SFPP's argument that the capital structure for calculating the deferred portion of the equity return should be the actual capital structure in any given year in which a deferred equity component is determined. For the years between January 1, 1984, and December 18, 1988, the ALJ used the same

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imputed capital structure based on SFPP's actual capital structure as of December 18, 1988. Thereafter, he stated that the actual debt equity structure should be used to determine the portion of the inflation component that should be deferred in each year. The complainants and the Staff support the ALJ.

The Commission reverses the ALJ on the capital structure to be used to calculate the deferred equity component between January 1, 1984 and December 18, 1988, for the same reasons supporting the ruling on the capital structure to be used to defend the SRB. Thus, the actual capital structure of SFPP's parent should be used for the period December 31, 1983 to December 18, 1988. As in the case of the SRB, this results in an unusually high equity component for those years. However, since the largest portion of the West Line and East Line construction was placed in service after December 18, 1988, this will mitigate the impact of the four years of a high equity component on SFPP's current rates.

After December 18, 1988, SFPP's actual capital structure in any given year should also be used in determining the portion of the equity component that is to be deferred in each year. In any such year, the equity component of the pipeline's capital structure reflects the cost of equity and the risk involved in the year that the investment is made, and as such is the appropriate basis for determining how much of the total return will be capitalized and amortized under the TOC methodology.

Since the deferred equity component accrues, this will, as the ALJ and the complainants assert, shift the capital structure toward the equity portion, at least until the deferred equity component begins to decline through its amortization. However, the debt/equity ratio used to define the portion of a deferred equity component of a given fiscal year's investment should not change in subsequent years, nor should the inflation component. SFPP appears to have adjusted the subsequent deferrals of the investment made in a given year to reflect changes in the capital structure and the inflation rate that occur in future years, a so-called layering approach. The ALJ correctly rejected this approach. The only debt/equity ratio and inflation rate that are relevant to a given stream of deferrals are those for the year in which the investments are made. Subsequent years are irrelevant to the risk evaluation the pipeline made when deciding to make an investment.

A second, more narrow point in calculating the deferred equity component is the inflation rate to be used to determine the portion of the equity cost of capital that should be capitalized. The ALJ correctly concluded that this should be the actual inflation rate in the year in which the investment is made. This calculation has been derived from an extrinsic historical source, the annual consumer inflation index, [151] and is used to determine the inflation component of the equity cost of capital. The ALJ is affirmed for the reasons stated in his order.

A third point is how the deferred equity return should be amortized. One method would be to have a separate amortization period for the deferred equity component of each increment to the pipeline's rate base, and to amortize that increment through a constant amortization rate based on the composite depreciation rate for the year any additions are made. This provides a clear time frame within which the deferred equity component caused by each year's investment will be amortized. An alternative method

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is to combine the equity deferrals from different years into a single pool, and to modify the amortization period to reflect changes in the pipeline's estimated useful life as that life varies based on the changes that occur to its investment base. This latter method is characterized as a "variable" approach of amortizing the deferred equity component of the rate base, and has the effect of extending the amortization period of any deferrals. The ALJ rejected the variable method, consistent with his ruling that the SRB should be amortized at a constant rate.

The Commission affirms the ALJ on the amortization issue with the following clarification. The amortization of the deferred equity return is to be done annually as follows. Amortization of the deferred component of the equity return begins in the year in which that inflation component is deferred. Consistent with the previous determination

on how the deferred equity return is calculated in subsequent years, the composite depreciation rate for the year in which the return is first deferred will be used to amortize that deferred return in all subsequent years until the amortization is completed. This will assure that the deferred return is amortized in a reasonable period of time and prevent its indefinite extension.

f. *Accumulated Deferred Income Taxes.*

SFPP calculates its income tax allowance using the normalization method *i.e.*, in essence income taxes are imputed on the allowed equity return. Under that method, temporary differences between the amount of taxes computed for ratemaking purposes and taxes on the amount of actual current federal income liability are accumulated as deferred income tax liabilities (ADIT). For example, SFPP initially accelerates its depreciation expense for tax purposes, but computes its tax expense for rate purposes as if it were paying the higher taxes reflected by its book depreciation method (such as straight-line). As a result, SFPP collects through current rates funds necessary to pay both its current and deferred tax liability. [152] Later, when the depreciation expense amounts reverse so that taxable income is higher than book (rate) income because depreciation as a tax expense is less than depreciation as a book (rate) expense, SFPP will use its ADIT to pay its higher tax liability. In the interim, the ADIT are deducted from the pipeline's rate base to ensure that shippers do not pay a return on cost-free deferred tax capital.

The ALJ addressed several issues related to SFPP's calculations of its ADIT. The first is the proper method for amortizing the excess or deficiency of ADIT for each category of property resulting from changes in income tax rates. SFPP proposes a method that aggregates all the ADIT balances for all categories and for all vintage years into a single pool, and amortizes the pool using a variable remaining life method. The ALJ concluded that this results in an extension of the amortization period long after the time when the assets on which the balance accrued have been depreciated and retired from service. In contrast, the complainants used a method that conforms to the Commission's *South Georgia* method. [153] Complainants propose to amortize the overfunded or underfunded ADIT balances for each category and vintage of property over the remaining life of that category and vintage. The Commission has long accepted the use of the *South Georgia* method as a reasonable way of dealing with the problem of over or under-funded deferred taxes. SFPP's proposed method has not been

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shown to be preferable. Therefore, the Commission affirms the ALJ's decision to adopt the conventional *South Georgia* method

The second issue concerns the amount of "unfunded" tax liability that SFPP should recover. This issue has its genesis in 1974, when SFPP's predecessor, SPPL, adopted the normalization method of accounting and established ADIT. Because the ICC had required SPPL to use "flow through" prior to 1974, SPPL had not recovered this ADIT from its shippers, *i.e.*, it was "unfunded." There is no dispute that SFPP is entitled to recover that unfunded balance. The dispute centers around when to begin amortizing this unfunded ADIT: in 1974, when SPPL adopted normalization, or in 1984, the effective date of Opinion No. 154-B . SFPP argues that the Commission adopted normalization as the standard for oil pipeline ratemaking in Opinion No. 154-B . Choosing 1974, as complainants urge, would result in a lower rate base and income tax allowance, whereas choosing 1984, as SFPP advocates, would increase SFPP's rate base and income tax allowance. The ALJ rejected SFPP's approach, finding it inconsistent with SFPP's adoption of normalization for accounting purposes in 1974.

The Commission affirms the ALJ's ruling on this issue but on a different basis. Although no party contests SFPP's right to recover the unfunded ADIT, the Commission concludes that SFPP has failed to show that it has not already recovered the portion of the unfunded ADIT that should have been amortized since 1974. It is reasonable to assume that SFPP would not have adopted normalization for accounting purposes absent corresponding rate recovery of a normalized tax allowance. To do otherwise would expose SFPP to under-recovery of its normalized tax expense after 1974. But SFPP seeks only to recover unfunded ADIT that existed prior to 1974. This implies that its rates after 1974 were normalized. However, it is impossible to determine from the record whether SFPP's post-1974 rates included amortization of the unfunded ADIT, but it is logical to assume

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that the rates were sufficiently high to amortize the deferred cost; otherwise SFPP would have acted against its own interest. [154] Therefore the Commission rejects SFPP's proposal to begin amortization (*i.e.*, rate recovery) of its unfunded ADIT in 1984, and requires SFPP to begin amortizing its unfunded ADIT beginning in 1974.

Finally, there are two ADIT issues related to SFPP's partnership status. First, under the Commission's *Lakehead* decision, [155] partnership pipelines are permitted to include an income tax allowance in their rates only for that portion of enterprise that is owned by interests that incur a corporate income tax liability on their share of the partnership income. In the instant case, the ALJ ruled that to the extent SFPP had taken an income tax allowance in past years in violation of the *Lakehead* doctrine, that it must include such payments in its total ADIT. SFPP excepts to this and the other parties support the ALJ.

The Commission will resolve this issue on narrow grounds. As is explained below, the Commission is affirming that SFPP must apply the *Lakehead* doctrine in designing its rates, which will be based on a cost-of-service for the calender year 1994, and for all years thereafter. This is because Commission practice is to base its decision on the policy in effect in the year a regulatory decision is made, and then apply that decision

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to the time frame to which the case applies. For example, in *Lakehead*, the Commission applied the *Lakehead* policy, decided in June 1995, to the locked in period May 3, 1992 to July 5, 1993, in the context of a suspension proceeding. [156] The earliest complaints filed here were September 4, 1992. Given the similarity in the time frames and the issue, the Commission concludes that SFPP's rates should be determined in a similar fashion, and will apply *Lakehead* to this proceeding as of the date of complaints that are sustained in this proceeding. SFPP will not be required to apply *Lakehead* to periods before the actual date of any complaint investigated herein. Since the rate itself is to be adjusted, together with reparations as appropriate, there is no need for SFPP to create the additional ADIT required by the initial decision since the necessary adjustment will be reflected in any reparations awarded. The ALJ is reversed to that extent.

The second issue is whether the ADIT balance that existed on December 18, 1988, when the pipeline was transformed from a corporation into a limited partnership, should be retained or eliminated. At the time the partnership was formed, SFPP, Inc., as a new limited and general partner, contributed assets to the partnership with a fair market value in excess of the tax basis of those assets. The difference between the assets' fair market value and its tax basis, *i.e.*, the gain, would normally result in an immediately payable tax liability. However, when a partner contributes property to a partnership, the contributing partner is able to defer paying the tax on the gain to future years. [157] In Opinion No. 397-A, the Commission recognized that the tax on the gain that would be eventually be paid by the contributing partner is not includable in a pipeline's cost of service. [158] SFPP argues that the Commission should treat its ADIT in the same manner as it treats the tax on the gain (*i.e.*, exclude the ADIT from the cost of service) because the ADIT is related to the gain on the sale. [159]

The Commission agrees with the ALJ's conclusion that the ADIT balance existing at the formation of the partnership should be retained. As the ALJ recognized, if no tax was payable by the partner at the time it contributed property to the partnership, there is no justification for eliminating SFPP's 1988 ADIT balance. The deferred taxes accumulated by the pipeline prior to its reorganization remain available to pay future income taxes, and, consistent with Commission policy, ratepayers are entitled to the full benefit of the ADIT deduction from rate base until those taxes are paid. Therefore, SFPP's ADIT balance existing at the time of the formation of SFPP in 1988 should be adjusted for changes in ADIT from 1989 through 1994, and deducted from the rate base in 1994.

g. *AFUDC.*

The Commission permits oil pipelines to add an allowance for funds used during construction (AFUDC) to the cost of plant additions for ratemaking purposes. [160] In essence, the allowance compensates the pipeline for the return that would otherwise be earned on funds that have been committed for utility purposes but have not yet

been included in rate base. The determination of the amount of allowable AFUDC is a matter of import in this proceeding because of the large additions made by SFPP to its rate base in the late 1980's and early 1990's. It is uncontested that SFPP did not keep

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appropriate records on the monthly cash expenditures for each construction project for the years 1984 through the 1994 test year, or exclude from the AFUDC calculation interest on those portions of gross property additions that represent suspended or failed projects. [161]

To provide SFPP with at least some AFUDC, the ALJ accepted an AFUDC allowance based on the percentage that actual interest capitalized on SFPP's books (during 1989-1993) bore to the total interest that would have been capitalized using SFPP's cost of debt. He rejected an estimate developed by SFPP equal to one half of the interest that would have derived by applying SFPP's overall weighted cost of capital to its total capital expenditures for a three-year period, 1991 through 1993. He did so even though the amount permitted under the method he accepted was not adjusted for deferrals or incompletions, and did not, reflect only eligible construction expenditures. The ALJ concluded that SFPP's estimate was not based on any formal record of interest that had actually been incurred, while the alternative he accepted was at least based on the actual interest amounts recorded on SFPP's books for a five year period. [162]

On exceptions the complainants and the Staff assert that SFPP should obtain no AFUDC or that its recovery should be limited to the lower figure adopted by the ALJ. SFPP asserts that its methodology was appropriate, claiming in part that the methodology it used to develop its estimate understates the actual IDC (interest during construction) that SFPP reported to the IRS in some years. SFPP argues in the alternative that it should obtain some AFUDC, and that the Commission should affirm the ALJ's ruling if the Commission's rejects SFPP's primary argument.

Determination of a reasonable AFUDC amount in this proceeding is difficult given SFPP's failure to maintain construction records in a manner reasonably consistent with FERC practice. AFUDC is a basic regulatory accounting concept, and is important here, considering the amount of money involved. While in Opinion No. 154-B the Commission did not require oil pipelines to use any particular method for calculating AFUDC, the regulatory concept and the principles to be applied were well established in numerous Commission cases and were later followed in major oil cases. [163] By failing to keep the proper records SFPP effectively undercut its own interests. However, the ALJ was correct in concluding that a complete denial of AFUDC would be an inordinately harsh result.

The AFUDC methodology adopted by the ALJ, based on that used by Navajo's witness Zaegel, [164] results in a AFUDC allowance of 29.3 percent of the interest that would have been earned if SFPP's cost of debt were applied to 100 percent of gross plant additions. Thus, on $100 of gross plant additions, the AFDUC would be approximately 30 percent of a full year's interest on those capital expenditures. Thus, at a debt cost rate of 10 percent, the AFUDC allowable on those gross plant additions would be $3.00. He then applied this methodology to the capital expenditures for the East and West lines to arrive at an estimated AFUDC that should be used in designing those rates.

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In contrast, SFPP's witness Ganz performed a calculation based on 50 percent of its "South System" capital additions. His calculation looked at total system-wide capital expenditures for the year, divided that number by half, [165] applied SFPP's overall weighted cost of capital to the result, and developed an estimated AFUDC. Thus, following the prior example, and assuming debt and overall cost of capital is the same, *i.e.*, 10 percent, the cost of capital figure would be applied to one half of $100, or $50, resulting in a capitalized AFUDC of $5. SFPP then compared the interest that resulted from this calculation to the interest actually capitalized for income tax purposes as a test of its reasonableness.

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The problem with SFPP's calculations is SFPP failed to take any steps to tie them directly to actual expenditures on the South Lines or to derive the imputed AFUDC directly from the interest recorded on its books. The record suggests that Navajo's method may very well understate the AFUDC that SFPP would be entitled to if its records were maintained adequately. However, in the absence of any evidence much beyond assertions by the parties that their proffered method is correct, the Commission is left with the choice of affirming the ALJ and accepting Navajo's better supported, if understated, AFUDC calculation, or allowing none. The ALJ is affirmed.

h. *The Amount of Accumulated Depreciation.*

A final issue is the determination of the proper amount of accumulated depreciation that should be used in determining the net plant balance includable in rate base and in the determination of the proper equity balance to be used in determining the capital structure. At hearing one complainant, Navajo, asserted that SFPP improperly removed all the accumulated depreciation from its accounts when it reorganized into a partnership, a total of some $115 million, thereby increasing rate base and partner's capital. Navajo asserted during the hearing, and on exceptions, that since the equity component of SFPP's capital structure was increased, the equity return allowance is higher than would otherwise be the case if the accrued depreciation had not been eliminated. Navajo further asserts that another practical effect of this action is to require the rate payers to pay for the same assets twice. It therefore requests that SFPP be required to restate its accounts to include the accrued depreciation that it removed when the partnership was organized.

The ALJ concluded that there was insufficient evidence to warrant restoration of the accrued depreciation that SFPP eliminated from its balance sheet when the partnership was created on December 19, 1998. On exceptions, SFPP supports the ALJ's conclusion that the evidence is insufficient to require restoration of the accrued depreciation, that Navajo is the only party that raised the issue, that it did so only on cross-examination of one witness, and that in any event SFPP did not increase the value of its rate base to reflect the increased value of the assets contributed from the predecessor corporation to the limited partnership.

The issue raised by Navajo is a serious one. When SFPP succeeded to the ownership and operation of the pipeline on December 18, 1988, it closed its corporate books and later filed a Form No. 6 reflecting that fact. It also filed a separate Form No. 6 for the period December 19 to December 31, 1988. [166] A review of SFPP's Form No. 6 for the period December 19 to December 31, 1988, discloses a sharp increase (approximately

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$222.5 million) in the reported value of SFPP's net carrier property compared to that reported on December 18, 1988. The increase in SFPP's assets reflects not only the elimination of accumulated depreciation, but also a re-valuation of the book basis of carrier properties. [167] Re-valuations of SFPP's liabilities and/or adjustments of SFPP's equity balances necessarily would result from the re-valuations of SFPP's assets.

Although under the Commission's regulations the adjustment of assets at issue here may be permissible for accounting purposes, [168] the issue here is whether the adjustment was correct for ratemaking purposes. SFPP states that it did not attempt to write-up its rate base to reflect the sale of the corporate SFPP assets to the partnership. The Commission agrees that this statement is correct as far as it goes. In this proceeding, the Commission has determined the starting rate base as of the end of 1983, which was prior to the reorganization. Additions to rate base since 1983 were based on original cost (plus AFUDC and the deferred equity return). Therefore, the book amounts of re-valued assets did not enter into rate base determinations. However, equity balances used in determinations of capital structure and equity return in this proceeding would have reflected the effect of the asset re-valuations, *i.e.*, they could have been increased.

Writing up an asset to reflect a purchase price for ratemaking purposes is normally disallowed, although it has been allowed under certain limited circumstances. [169] The increased equity component of the capital structure at

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issue here most likely results in a higher weighted cost of capital, and a higher return allowance (and rates) than would otherwise be the case. It also increases the deferred equity component of any improvements made after the formation of the partnership. This in turn accelerates the growth of the equity component of the capital structure and produces a higher equity component for the capital structure in subsequent rate cases.

The situation presented is a difficult one because the Commission's rate regulation of oil pipelines is generally more light-handed than that of gas pipelines. Nevertheless, under *Longhorn* and other Commission precedent, it is impermissible to revalue pipeline property and re-state equity balances for ratemaking purposes. Therefore SFPP is directed to exclude the effect of any revaluations of carrier property (including the elimination of accrued depreciation) that resulted from the formation of the SFPP partnership for ratemaking purposes, and to recalculate the cost-of-service used in this proceeding accordingly.

3. *Projected Volumes.*

The ALJ made several findings regarding the volumes to be used for rate design purposes on the West and East Lines. Only the findings related in whole or in part to the projection of East Line volumes are relevant here. The ALJ's determination to use calender year 1994 as the test year for the East Line volumes is generally not questioned here. However, several parties excepted to the ALJ's determination of how

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military volumes should be projected and one, Navajo, excepted to his conclusion that volumes projected to flow over the East Line after 1994 should not be included in the East Line projections.

With regard to military volumes, the ALJ held that since SFPP excluded costs of military facilities from its cost of service, that volumes should also be excluded from the South System cost of service. Numerous parties argued that this was incorrect. The Commission concludes that, as SFPP only excluded costs of the military laterals from its cost of service, the ALJ incorrectly excluded military volumes from the trunkline volumes to be used in designing the South System cost of service. Rather, only the revenues attributed to the Section 22 rates should have been excluded from SFPP's cost-of-service and the volumes to the interconnect with the military facilities should have been included in SFPP's cost-of-service.

The ALJ also decided that possible volumes to be delivered to the El Paso area by a new Diamond Shamrock pipeline, arguably beginning in December 1995 and reaching full operations in 1996, should not be included in determining the projected throughput of the East Line. RHC reiterates that much of the throughput Diamond Shamrock will deliver to El Paso would necessarily flow over the East Line since the El Paso market cannot absorb all the product delivered. SFPP replies that El Paso is a growing market, that the product could move over Chevron's pipeline to another market, and that any additional volumes moving on the East Lines displace existing products. SFPP therefore supports the ALJ's determination that the potential impact of the Diamond Shamrock pipeline on SFPP's East Line is speculative at best.

The Commission affirms the ALJ. First, since the East Line is frequently constrained, it is difficult to determine on this record what the likely the impact of the Diamond Shamrock pipeline would be on the East Line other than displacement of existing volumes. The record does not contain the detailed volume forecasts for the period after December 31, 1994, that would permit this type of calculation. More importantly, the Diamond Shamrock pipeline was projected on this record to reach full operation only in late calender year 1996, a point that falls far outside the nine month known and measurable period for a 1994 test year. If the Diamond Shamrock pipeline is material to the total volumes transported on the East Line, this can be determined only in a subsequent rate case.

4. *Cost of Capital.*

The ALJ made several findings in determining SFPP's cost of capital. First, he determined the debt to equity ratio for SFPP's capital structure using the actual capital structure in 1994, 55.21 percent debt and 44.79 percent equity. This determination was challenged by Navajo to the extent that it did not reflect the removal of the accrued depreciation on SFPP's books as of December 18, 1988. This issue was decided earlier in the order. Thus, while the ALJ was correct in using the actual capital structure, its composition must be adjusted to exclude the effect of any revaluations of carrier property (including the elimination of accrued depreciation) that resulted from the formation of the SFPP partnership. The ALJ also used SFPP's actual 1994 cost of debt as the cost-of-debt component of the capital structure, which is unchallenged. The ALJ also used the actual inflation rate in 1994 for determining the inflation portion of the equity cost of capital, which was correct.

The disputes here turn on the proper method for determining the nominal cost of the equity component, with particular emphasis on the risk factor to be applied. In

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general, the ALJ adopted Staff's method, which involved developing a range of equity costs for six oil limited partnerships and a similar number of gas pipelines. Using a discounted cashflow methodology, the Staff selected the mid-point for the range of each mode, and then averaged the two. Asserting that SFPP has average risk, Staff concluded that the average mid-point of 12.87 percent was a reasonable nominal equity return for SFPP. Adopting this nominal return after discounting a number of risks raised by SFPP, the ALJ then deducted the actual 1994 inflation factor of 2.97 percent to get the allowed real return. All of these conclusions are challenged on exceptions.

The ALJ's adoption of the inflation factor is clearly correct under the Commission's test period methodology and is affirmed. However the other issues are more complicated. SFPP asserts that the ALJ improperly adopted the use of a combined average of gas and oil pipelines on the grounds that oil pipelines are more risky than gas pipelines, and conversely, that there is no evidence that they are equal in risk. SFPP also asserts that the ALJ improperly found that SFPP has low risks compared to other oil pipelines. SFPP further argues that the ALJ improperly rejected SFPP's proposed rate of return for SFPP, which was located at the lower end of range of equity returns for oil and gas pipelines. The Staff and the complainants support the ALJ, asserting among other things, that the use of the gas pipeline proxy was consistent with Commission precedent [170] and that SFPP faces extraordinarily low risk. In addition the Commission has recently modified its methodology for determining the equity cost of capital, [171] an issue the ALJ recognized was in flux, [172] although this was not raised by the parties on exceptions.

As noted, Staff used an average of the mid-points of the estimated nominal equity cost of capital for six oil pipeline partnerships and seven gas pipelines. Staff selected this approach because there was no Commission guidance on how the nominal equity cost-of-capital should be decided for an oil pipeline partnership, although acknowledging that it was now possible to develop cost-of-capital determinations for such pipelines. The ALJ relied on this method, correctly stating that all parties used gas pipelines as a check on the reasonableness of the oil pipeline estimates. [173] On exceptions, SFPP asserts that the record discloses that the gas pipeline equity returns were consistently below those for oil pipelines. It concludes that averaging the gas and oil pipeline equity returns is improper since the two businesses have different returns, implying significantly different investor expectations.

Upon review, the Commission concludes that there is now sufficient evidence of market prices and trading patterns in oil partnership limited shares that only oil partnership equities should be used in developing the equity cost of capital for that industry. This is reflected in the exhibits which show two to three years of information for publicly traded oil pipeline partnership interests. [174] Thus, prior cases such as *ARCO*, *supra*, in which gas pipelines were a proxy for data that was not readily available, need no longer control. SFPP is correct that on this record, the DCF method indicates that in 1994, equity markets consistently imputed a higher equity cost of capital to oil than to gas pipelines. Under these circumstances, as SFPP asserts, averaging the two returns has the practical effect of stating that oil pipeline equities have unrealistically high returns compared to gas pipelines and lowering their allowable

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return below that would otherwise result from a DCF method. [175] Given the growing ability to measure publicly traded oil pipeline partnerships, it was not necessary to average the estimated nominal equity cost of capital of oil and gas pipelines. [176]

All parties did encounter some difficulties in relying solely on a universe based on oil pipeline financial data. Specifically, there was disagreement on the use of the IBES or other data for determining the five year, short term growth component of the equity cost of capital. Staff correctly relied on the IBES as the standard Commission methodology and SFPP's reliance on another forecasting source, Zacks, was incorrect. [177] Moreover, all parties encountered some difficulty in dealing with the long-term component. SFPP argued initially that only the short-term component should be relied on, but also developed a long-term forecast based on the expected long-term growth in gas pipeline volumes. Staff initially relied on the anticipated long-term growth in the economy using the DRI forecast, but provided an alternative using the anticipated growth for long-term forecasts as well. The parties also disagreed about the relative weight of the short term and long term components, with Staff averaging the two and SFPP arguing that the shorter term component should have greater weight. [178]

These questions have been substantially answered by the Commission's recent decision in *Transco, supra*. In that decision the Commission affirmed use of the two-part method for determining a gas pipeline's equity cost of capital. It also affirmed the use of the IBES information for the five year short term period and the use of the anticipated growth in the domestic economy for the long term period. Thus, in both regards, Staff's initial proposal was the most appropriate method. [179] However, in *Transco*, the Commission also determined that the short term component should be given greater weight than its long term component, in that case two/thirds, a position similar to that urged by SFPP. SFPP's cost of equity capital should be calculated in a manner consistent with *Transco*.

The final issue is the degree of SFPP's risk. First, as regards the ALJ's decision, the Commission concludes that the ALJ did not determine that SFPP faces low risks compared to other pipelines. In fact, he accepted Staff's determination that SFPP faces slightly higher financial risks and lower commercial risks and better growth prospects than most oil pipelines, and therefore should be considered to have average risk. A more appropriate reading of the ALJ's decision is that he rejected SFPP's arguments that SFPP faces high risks. In doing so, the ALJ rejected SFPP's arguments that it faces unique regulatory risks, environmental risks, risks due to possible earthquakes and floods, the impact of the Commission's *Lakehead* decision, and potential competition

The ALJ's conclusions are supported by the record. For example, SFPP's risk under *Lakehead* and other aspects of regulation is theoretically the same as other oil pipeline's, and in fact one investment house thought that the *Lakehead* decision would

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not materially affect SFPP's long-term prospects. [180] The ALJ reasonably found that the earthquake and flood risks were not significant, and in any event, they are clearly less likely to happen in the portions of Arizona and New Mexico in which the East Line operations than in California. As to the prospects of additional competition, SFPP's own 1988 Form S-1 Registration statement clearly states that the prospects of a competing oil refinery in Arizona and a new East Line competitor are unlikely, [181] which directly contradicts SFPP's assertions on brief. As the ALJ states, SFPP effectively conceded that the truck and rail modes are not effective transportation options.

The ALJ's implicit finding that SFPP does not face extraordinarily high risk is affirmed. Moreover, in this case the Commission is setting rates only for the East Line, which has consistently been faced with curtailment problems and has evidenced consistently high demand during the period at issue here. Given SFPP's transportation monopoly and evidence of continued growth, Staff correctly concluded that SFPP may face somewhat higher financial risk while also facing lower commercial risks. [182] SFPP's lower commercial risk is borne out by additional Staff testimony demonstrating that SFPP had the lowest variation in volumes of any publicly traded oil pipeline between 1998 and 1993, [183] and that its revenue has grown steadily except for a

modest dip (less than one percent) in 1991. [184] Given Commission precedent at the time, Staff reasonably selected the mid-point of the equity range in developing SFPP's equity cost of capital. In any event, even with the difference in risk assumptions, the equity cost of capital estimates by Staff and SFPP's witness were remarkably close by the end of the hearing. [185] This consistency supports the result here.

However, in *Transco* the Commission modified this relatively mechanical approach of using the average of the range rather than the midpoint, and to then determine whether, based on the facts of the case, the equity cost of capital should be set at the average, the low end, or the high end of the range. In doing so, the Commission noted that if a pipeline faced relatively low risk, this could be the result of its own efficiencies and that to place its return at the lower end of the range would penalize the pipeline for its successes. Similar considerations apply here. While the current risks of operating the East Line, and therefore the risks to the attendant capital, appear relatively low, this does not detract from SFPP's efforts before 1994 to materially increase the capacity of its line. SFPP assumed the risk of the project in doing so and has met with success. Moreover, the Commission has no desire to discourage SFPP from pursuing similar risks in the future by lowering its equity return significantly below the average of its peers. Therefore, accepting Staff's conservative conclusion that SFPP faces average risks the Commission will adopt the average cost of capital for the oil pipeline sample used here. [186]

The calculations presently in record do not reflect the Commission's decision to weight the short term and long *term components of the equity cost of capital* by two

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thirds and one third respectively. However, the cost of equity capital that most accurately reflects the finding here is contained in Staff's Rebuttal testimony, Exhibits 281, 282 and 283. In this testimony, Staff witness Manganello developed a range of equity for oil pipelines. The upper end of the range was 14.85 percent and the lower end of the range was 12.74 percent with a median of 14.39 percent using the average of the long term and short term *growth factors. SFFP is listed at 14.27 percent, or just below the median,* a conclusion consistent with the Commission's prior finding that SFPP's risk is about that of an average pipeline. The Commission therefore concludes that SFPP's equity cost of capital should be calculated using Staff's rebuttal methodology adjusted for the new weighting that of the short and long term components required by Commission policy.

5. *Income Taxes.*

In this case the issue of income taxes centers on whether the *Lakehead* decision, Opinion Nos. 397 and 397-A, should be applied to SFPP, and if so, its scope. Opinion Nos. 397 and 397-A held that an oil pipeline limited partnership may not include in its cost-of-service a corporate income tax allowance for the partnership units that are held by individuals. The ALJ held that the *Lakehead* decision would apply to SFPP, but rejected arguments by several of the parties that SFPP should not be permitted to have any income tax allowance. [187] Having held that *Lakehead* applied, the ALJ held that SFPP may not obtain an income tax allowance on income attributable to limited partners that are individuals, but may obtain an income tax allowance with respect to its corporate holders of limited partner interests. The ALJ also rejected SFPP's assertions that it should obtain an income tax allowance for unit holders that are not individuals, such as IRA's and trusts. The ALJ concluded that there was inadequate evidence whether these unit owners would actually pay taxes on the income received in the same manner as a corporation. [188]

SFPP excepts to the ALJ's determinations, arguing that application of the *Lakehead* doctrine would have a severe impact on the value of its partnership interests, that the policy should not be applied on the facts of this case, and that in any event, the policy should be applied only as of the effective date of the *Lakehead* decision, not retroactively to the date of the complaint. It also argues that the ALJ overlooked evidence on the income paying status of various unit holders, and that it is difficult to determine the status of such unit holders since many of the units are held in street name. Complainants assert that *Lakehead* should be applied and that it should be applied to all of the limited partnership interests, not simply those owned by corporate interests.

The Commission partially affirms the ALJ's determinations on the *Lakehead* issue. SFPP's position is no different from that of any other oil pipeline limited partnership, and there is no reason on this record to exempt it from *Lakehead* To the extent *Lakehead* affects the value of SFPP's limited partnership interests, SFPP is in the same situation as all other oil pipeline limited partnerships. The ALJ reiterated the Commission's rationale for the *Lakehead* policy in detail and no further elaboration is required here. [189] The Commission also affirms his conclusion that SFPP should not obtain an income tax allowance for income attributed to interests other than Subchapter C corporations. While there are other forms of ownership, many are intended to

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avoid the double taxation that the owners of Subchapter C corporations incur, such as: street accounts, IRA's, Keogh, and other individual retirement plans (where the tax is deferred until distribution to the individual owner), trusts where the income is distributed to the beneficiary, and Subchapter S corporations. Absent better evidence of the tax paying attributes of these other ownership patterns, many of which are adopted to avoid double taxation, the ALJ was right to deny the allowance. As in *Lakehead*, a yearly listing of partners would be sufficient to determine whether a change in the mix of corporate and individual partners merits a change in rates under the cost-of-service method.

The ALJ also held that SFPP could not obtain an income tax allowance on the limited partner interests held by SFPP, Inc., a holding company that controls a 1 percent general partnership interest and 42.7 limited partnership interest in SFPP. [190] On September 6, 1990, SFP Pipeline Holdings, Inc., which controls SFPP, Inc., issued some $218,981,000 in debentures with an interest obligation equal all of the dividend payouts made on the 42.7 percent of the limited partnership interests owned by SFPP, Inc. After noting that SFPP, Inc. is a corporate owner, and that as such an income tax allowance would normally be available for income attributed to the limited partnership interests SFPP. Inc. owns, the ALJ concluded that the sole purpose of the debentures was to assure that no Santa Fe Pacific unit would ever pay corporate income taxes on the income attributable to SFPP Inc.'s limited partnership interest. [191]

The ALJ therefore denied the income tax allowance on the grounds that such an allowance is available only for taxes actually paid. In doing so, he concluded that the Commission's stand-alone policy does not apply here. Under its stand-alone policy, the Commission provides a tax allowance on the actual corporate income tax liability associated with the pipeline's allowed return. This tax allowance is available to that entity even if offsetting deductions or losses at the consolidated level are used to offset the taxable income associated with the pipeline's allowed return. On exceptions, the Staff and the complainants support the ALJ, asserting that since no taxes will ever be paid on SFPP's partnership income, no income tax allowance should be permitted. Complainants therefore assert that SFPP has included phantom taxes in its cost of service. SFPP asserts that the stand-alone doctrine is valid here, that SFPP has paid taxes on its income on behalf of its parents, and that there should be no penalty for the issuance of the debentures for general corporate purposes.

The Commission will reverse the ALJ and permit SFPP to have an income tax allowance on 42.7 percent of the limited partnership interests that are held by SFPP, Inc. The ALJ has misunderstood the Commission's stand-alone method by incorrectly considering the tax deductions of an affiliate in determining the stand-alone income tax allowance. The stand-alone method is one in which a utility is considered as nearly as possible on its own merits and not on those of its affiliates. It takes into account the revenues and costs entering into the regulated cost-of-service without increase or decrease for tax gains or losses related to other activities. The stand-alone method results in the tax allowance being equal to the tax the utility would pay on the basis of its projected revenues less deductions for all operating, maintenance, and interest expenses included in the cost of service. In short, it results in a tax allowance equal to

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the tax on the allowed return on equity. [192] Thus, only the income and deductions generated by SFPP are relevant. Because the interest expense generated by SFPP Inc.'s debentures is not included in SFPP's cost-of-service (because the company did not incur that expense in providing service), the deduction created by that

expense is not considered in determining the stand-alone tax allowance. To do otherwise would result in subsidization of one entity by another. The tax allowance would then be lower or higher than is warranted by the profit (allowed return) provided by each. Under these circumstances, SFPP is correct that the stand-alone doctrine should apply and that it should obtain an income tax allowance on the income attributed to the limited partnership interests owned by its corporate parent.

SFPP also asserts that if the Commission applies its *Lakehead* policy to this proceeding, that the policy should be applied on prospectively, not retroactively to the date of the complaint. The Commission has previously concluded that the *Lakehead* policy should be applied as of the date of the complaints in these proceedings.

Finally, the ALJ used the same capital structure to compute the interest, *i.e*, the debt, component of the allowed return and to determine the interest expense to be used in computing the tax allowance. SFPP opposed Navajo's exception to this ruling on the grounds that Opinion No. 351-A supports the ALJ's ruling. [193] As SFPP properly states, the same capital structure is to be used for "both the interest expense deduction and the allowed interest return," [194] and, as discussed earlier in this order, under *ARCO* the capital structure is clearly to be adjusted to reflect the continued capitalization of the deferred equity component of any additional rate base investments. [195] The ALJ is affirmed.

6. *Litigation Expenses*

A major dispute among the parties in this proceeding is SFPP's proposed recovery of various types of litigation expenses. These include costs related to this proceeding, costs incurred in litigation with the El Paso Refinery Company, and a settlement with Navajo and the related litigation costs in that proceeding. The ALJ concluded that SFPP would be allowed its actual Commission-related litigation costs incurred in 1994, or $2,631,815, to be amortized over five years. The ALJ rejected SFPP's attempts to establish a $15 million litigation expense base in 1994, to be amortized over 3 years. SFPP's $15 million figure included $3.1 million in actual litigation expenses and $12 million in a litigation reserve. The $3.1 million reflected the cost of all litigation in 1994, not simply Commission litigation in that year. The ALJ further ruled that if separate costs of service were to be allocated between the East and West Lines, one half of the expense should be allocated to each. The ALJ also held that any settlement payments to Navajo were non-recurring and that both the payments and the related litigation costs could not be included in the SFPP's cost of service. He also held that the litigation expenses should be recovered through a surcharge that would be removed from SFPP's rates once the expenses were recovered, and would not be part of its indexed costs.

Complainants and the Staff support the ALJ. Some assert that SFPP should not be permitted to recover any litigation expenses since it is entitled to those expenses only if

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it successfully defends the rates. They argue that the litigation reserve that SFPP established in 1994 does not reflect actual costs or those that would be known and measurable, and in any event SFPP has exercised no restraint and that its total legal fees are unreasonable. [196] They further state that allowing a reserve will serve to eliminate any restraint on a pipeline's legal expenditures expenses since the pipeline knows it can recover its legal fees from the ratepayers, and as such would simply be free to spend up to the amount of the reserve. At the same time, they assert, creating the reserve and amortizing it over a short period simply justifies a higher rate. They note that the instant complaints were filed in 1992, that all subsequent complaints have been held in abeyance, and that none of them are likely to go to trial before 1998, a period of at least 5 years. The complainants also support the exclusion of non-Commission litigation costs, including the cost of settlements between Navajo and SFPP, and a settlement of some $16 million between SFPP and El Paso. Navajo and RHC note that the non-Commission litigation benefited only Navajo and El Paso, and that much of the benefit involved attempts by East Line shippers to offset the disadvantage or damages that would result from increased capacity and benefits to West Line Shippers when SFPP decided to reverse the flow of the 6 inch line between Phoenix and Tucson. They conclude that none of the litigation or settlement costs should be included in SFPP's cost of service, and recommend that any litigation expenses actually allowed be allocated between the East and the

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West Lines on the basis of throughput, not the 50-50 allocation suggested by Staff.

On exceptions SFPP asserts that it is entitled to the full recovery of all its litigation expenses and the settlement costs of its disputes with Navajo and El Paso. It asserts that the recovery of expenses for rate litigation is never limited simply to those cases where the pipeline wins, nor should the recovery of such expenses be based on judgements about whether the pipeline's litigating theories were correct. It further argues that most parties have not seriously challenged the level of expenditures, and states that for its part, the high level of legal fees comes from continuous challenges to its rates by its shippers, and the novelty of the issues involved. Moreover, it asserts that much of the litigation was engendered by disputes between shippers on the East and West lines over the addition of capacity to the SFPP system, the impact of such changes on their respective commercial positions, and their relative rate levels.

Specifically, SFPP asserts that the litigation about the collapse of El Paso, the ARCO Reversal Agreement, and the timeliness of the expansion relate directly to disputes about the allocation and pricing of pipeline capacity and market access by its shippers. SFPP also argues that settlement of the civil litigation reduced the potential cost, and exposure, of an expensive jury trial. It also asserts that the level of allowed legal expenses for 1994, to be amortized over 5 years, does not reflect anywhere near the costs that were actually incurred in 1993, 1994, and 1995, which exceeded the $15.1 million reserve created in 1994. It concludes that to limit the recovery of litigation expenses to those actually incurred in 1994 deprives it of any reasonable opportunity to recover its costs. SFPP has no objection to using a surcharge, and asserts that if litigation costs are to be allocated among the East and West Lines, the 50 percent allocation suggested by Staff is the only one supported by the record.

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The Commission will affirm the ALJ in part and reverse the ALJ in part. The Commission agrees that settlement costs involving El Paso and Navajo are non-recurring costs that arose out of litigation unique to the conditions of those two parties. However, the litigation expenses related to these settlements are part of SFPP's normal, and ongoing, disputes with its shippers regarding the costs and capacity allocations of its South Lines. Therefore the Commission will allow SFPP its full 1994 test period litigation costs. [197] The Commission will affirm the ALJ's determination that the costs should be amortized over 5 years, the period for which the 1994 rates have remained in effect. The first year in which the charge will be amortized is 1994, meaning that the amortization will be completed in 1998, coterminous with the conclusion on the bulk of the litigation connected with the complaints.

The Commission also agrees with RHC that litigation expenses should be divided among the East and West Lines on the basis of relative volumes, and not the 50-50 basis suggested by Staff. Many of the issues involved in this proceeding, including substantially changed circumstances, allocation of costs in California, and the ARCO Reversal Agreement have been raised primarily by West Line shippers. To the extent there are common issues, allocation of one half of the expenses to the East Line shippers does not reflect their relative use of the South Line system or, as has been previously discussed, SFPP's relative investment, or revenues, in the different portions of the South Lines Those litigation costs are to be allocated accordingly.

The Commission will deny SFPP's efforts to create a reserve in calender year 1994 based on its anticipated litigation expenses. While subsequent years established that SFPP's estimate of the costs to be incurred was accurate, the protesting parties are right that those costs could not have been known and measurable in 1994 since they were only anticipated. If anything, the use of the reserve creates the incentive for a self-fulfilling prophecy to the extent the reserve becomes the basis for including costs in a rate base. However, in its compliance filing SFPP may seek to recover additional litigation costs in excess of the 5-year amortization amount if those are incurred in the years between 1994 and 1998. Moreover, the Commission will not necessarily preclude the recovery of litigation costs incurred in the years after 1994 in determining whether reparations should be awarded in this proceeding.

7. *Power Costs*

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The ALJ ruled that any rate design of SFPP's East Line rates should be based on 1994 actual volumes. [198] As a secondary point, the ALJ held that, to the extent that 1993 volumes are adjusted upward, an "exponential factor" of 2.0 should be used to develop the related fuel costs. RHC excepted to this finding. As SFPP points out in reply, this only becomes an issue if 1994 throughput volumes are not used to design the East Line rates. Since the Commission has affirmed the ALJ in this regard and directed that actual 1994 costs be used in the related compliance filing, there is no need to consider this exception further.

8. *Reconditioning Costs*

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The ALJ reviewed, and rejected, a large reserve that SFPP created in 1994 for the purpose of funding the reconditioning of a substantial portion of the South System over 15 years. The reserve would have increased SFPP's operating expenses by at least $3 million in 1994. The ALJ rejected the expense on the grounds that almost no such expense was incurred in 1994, and that in fact of some $320,000 initially claimed, only $20,000 was properly expensed and the rest should have been capitalized. [199] He also concluded that the projected $3 million did not meet the nine-month known and measurable criteria used in Commission rate making proceedings and must be rejected for that reason. He considered SFPP's engineering assumptions about the rate of deterioration, the need for repair, and the expense likely to be incurred as too speculative to warrant inclusion of the projected costs in SFPP's rates. As an example, he noted that of the total reconditioning costs projected in 1995, one-half were eventually capitalized as replacement costs, not repairs. [200]

On exceptions the complainants and the Staff support the ALJ. They assert that SFPP had not committed to a firm reconditioning program by the end of 1995, that the Board of Directors had been told that the projected program would be less than the $3.5 million claimed in this litigation, [201] that SFPP had not followed standard industry practice in developing the estimate, and that SFPP's own principal witness had conceded that the program could vary significantly from year to year. They further assert that only 25 percent of SFPP's actual expenditures in 1995 to stabilize the integrity of the pipe had actually been expensed, and that the rest was capitalized, that between 1993 and 1995 SFPP capitalized 95 percent of its line reconditioning costs, that there were no contractual provisions to support the proposed expenditures, [202] and that SFPP stubbornly clung to its estimated expenses for 1993 and 1994 long after discovery established that they had in fact been capitalized. Staff submits that the Commission accepts adjustments to the projected test-period costs if there are significant actual changes during the nine-month adjustment period which are pertinent to the issue, and which justify making the adjustment. [203]

In reply, SFPP asserts that its consultants and engineers developed an appropriate reconditioning program, that it was properly approved by Board of Directors in 1994, and that the expense projection is appropriate. It asserts that it has monitored the pipe at issue for 40 years, that federal safety programs require the reconditioning of the pipe, and that its witnesses establish that the pipeline's coating is bad and has disbonded in locations too numerous to consider making spot repairs. It addresses the scheduling issues by stating that its witnesses acknowledged that the area in which the work was actually performed might vary from the original projections, but that this did not detract from its intention to recoat 30 miles of pipe a year on its South Lines.

SFPP further argues that reconditioning is a labor-intensive program requiring the unearthing, testing, and coating of some 500 miles of 8-inch and 6-inch pipe, the maximum possible for a labor intensive program. It asserts that the record establishes that this work is being performed on a regular basis and to preclude any recovery is too harsh. In this regard, it says that, work performed in 1996 totaled 30 miles and involved recoating and that 14 miles of the pipe replaced in 1995 was to repair damage

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caused by a contractor. In the alternative, SFPP suggests that ALJ should have permitted it to have formula rate that would allow SFPP to adjust its cost-of-service to reflect expenditures that were actually made, and notes that the West L ne shippers proposed a surcharge for this purpose and to recover environmental costs as well.

The record here strongly supports the ALJ's conclusion that SFPP should not be permitted to include a reconditioning expense in its cost of service. No such costs were incurred in 1993 or 1994, and the amount in 1995 was minimal, even assuming that the accounting basis for the actual expenditures was changed. The engineering basis for the reconditioning program was strongly contested, although the need for the program is supported to the extent that SFPP actually replaced a substantial amount of pipe (and capitalized the cost) rather than reconditioning, and expensing, the costs. As the complainants assert, since the replacements are capitalized and not expensed, allowing the $3 million expense in 1995 would have overstated both the total outlay and allowed recovery of the program costs both as repair expense and a depreciation expense in subsequent years.

The test period concept, with the nine month known and measurable adjustment period, is a relatively rigid concept simply because there must be some point at which the record closes and there is a known, factual basis for the conclusions. Given Commission practice in this regard, SFPP has failed to establish the validity of the proposed expenditures. However, to the extent that SFPP actually incurred reconditioning expenses after 1995, it may use those expenses as a basis for supplementing its compliance filing by simultaneously filing new rates to reflect those costs. In light of this ruling, it is not necessary to address SFPP's argument that it should be permitted to utilize a formula rate to recover its reconditioning expenses. The action here is not intended to prejudge the possible use of such a mechanism. Moreover, the Commission will consider any reconditioning costs that SFPP may have actually incurred between calender year 1994 and December 31, 1998, in determining whether reparations are due.

9. *Environmental Costs*

As with its reconditioning expenses, SFPP included in its 1994 cost-of-service a large expense item to cover the costs of an environmental reserve it created to cover anticipated remedial obligations and awards. SFPP first created the reserve in late 1992 after the instant cases were filed and proposed to amortize the reserve over five years. The ALJ denied most of this expense on grounds similar to his denial of SFPP's proposed reconditioning expenses. Notir g the environmental reserve was based primarily on SFPP's management's estimates, he did permit the inclusion in the 1994 cost-of-service of $553,942 that SFPP actually incurred in that year. The complainants support the ALJ's conclusion that the reserves are speculative and are not adequately supported by the record. SFPP asserts that the environmental reserves are justified by the liability exposure that became known to it between 1992 and 1994. It further states that it created and reported the reserves consistent with the requirements of generally accepted accounting principles and SEC reporting. [204] The amortization in the test year under SFPP's theory would be $764,500. [205]

The Commission will affirm the ALJ. SFPP's reserve for environmental costs is based on estimated expenses, and initially included large amounts that were more

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appropriately allocated to southern California operations and to non-jurisdictional operations (particularly terminals) in Arizona. At hearing the estimates were adjusted to reflect a more precise allocation to the South Line system for the 1994 test year.[3] However, as the ALJ states, while SFPP's environmental reserves may reflect its management's best estimate of costs it may incur because of complex environmental litigation, there is no basis for determining whether the costs actually paid will be within the five-year amortization period, or longer.[4] As with reconditioning expenses, SFPP has failed to establish the validity of the proposed expenditures. SFPP may have created the reserve in compliance with generally accepted accounting principles and SEC disclosure requirements, but somewhat different rate regulation considerations are involved.

Specifically, if the environmental remediation estimates are not actually expended but are collected from

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shippers, it is unlikely that SFPP's future rates (which may be based on an index rather than SFPP's cost of service) would reflect refunds of unexpended amounts. If that were to occur, undeserved profits would accrue to SFPP's investors. However, as with SFPP's proposed costs for pipeline reconditioning, the East Line rates at issue here are to be adjusted prospectively, and SFPP may file to recover any increase in its environmental costs that may be justified by actual experience from January 1, 1995, to the date of its filing to comply with this order. Moreover, as with the litigation costs, SFPP may utilize its actual environmental costs for the years 1995 through 1998 in calculating the amount of reparations that may be due under this order.

In contrast, if SFPP creates a reserve by taking a deduction against income and part of the reserve is not eventually spent as contemplated, the reserve can be liquidated, the amounts previously deducted declared as income, and any surplus cash becomes available for general corporate purposes. Thus, unlike the case of the ratepayer, the shareholder may recoup any funds that are not actually expended for the purpose for which the reserve was created. However, as with SFPP's proposed costs for pipeline reconditioning, the East Line rates at issue here are to be adjusted prospectively, and SFPP may file to recover any increase in its environmental costs that may be justified by actual experience from January 1, 1995, to the date of its filing to comply with this order. Moreover, as with the litigation costs, SFPP may utilize its actual environmental costs for the years 1995 through 1998 in calculating the amount of reparations that may be due under this order.

10. *Post-Retirement Benefits other than Pensions.*

SFPP included in its proposed cost-of-service an allowance for post-retirement benefits other than pensions (PBOP). Under SFPP's accrual method, the allowance includes future benefits for employees who were actually employed during the year used for the cost-of-service in this proceeding. As the ALJ stated, accrual accounting for PBOP expenses is mandatory under SFAS 106 [206] However, as the ALJ also stated, because the accrual basis for recognizing expenses for rate purposes can provide

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regulated companies with collections of ratepayer funds years in advance of the period when the funds will be expended, the Commission established policies to ensure the payment of benefits to employees and to provide that post-retirement benefits are accounted for properly in establishing rates. [207] Among these was the requirement that all regulated companies wishing to obtain an allowance for the accrual of PBOP expenses must establish an external trust fund to hold the funds generated by that PBOP allowance contained in its rates. It is undisputed that SFPP did not establish an external fund.

The Commission's PBOP Policy Statement applies to oil pipelines on a case-by-case basis. [208] In this case, the ALJ denied the accrued PBOP expense that SFPP had included in its cost of service. He did so in part based on SFPP's history of managing its PBOP accruals. The ALJ noted that under the accrual method, SFPP booked an annual expense for PBOPs in an amount of $2.231 million in 1992, $1.555 million in 1993 and $1.5 million in 1994. [209] Having thereby increased its cost-of-service by those amounts in each of those years, SFPP then amended its plan in 1994, reducing the plan benefits. The result was that SFPP recorded a gain in the amount of $3.1 million on its 1994 financial statements. [210] Moreover, by that plan amendment, SFPP also was able to reduce plan expenses to only $770,000 in 1995. [211] He concluded that, although SFPP increased its cost-of-service in 1992, 1993 and 1994 by plan expenses on an accrual basis, it made no correcting or crediting entry to the benefit of the ratepayers when it modified the plan in 1994 and thereby captured a $3.1 million gain, and that requirement of the external fund was intended to prevent this type of behavior. [212] The ALJ therefore limited SFPP to its 1994 actual cash expenditures for pension and other retirement benefits.

On exceptions, the Staff and most complainants support the ALJ. SFPP excepts, arguing first that the Commission can make exceptions to requirement of an external trust fund on a case by case basis, and that in any event it restructured its former plan in the 1994 test year. It argues that restructuring the plan in 1994 established a new amount for the annual PBOP accrual, and that this is the amount properly included in the 1994 cost-of-service to be collected prospectively through its rates. SFPP states that under these circumstances there

is no reason to deny SFPP an allowance based on its 1994 accruals.

The Commission will affirm the ALJ because he correctly applied the Commission's PBOP Policy Statement to the circumstances of this case. In the instant case, SFPP chose not to comply with the PBOP Policy Statement's requirement to establish an irrevocable trust for the benefit of its employees, and within two years of implementation of SFAS 106, amended the plan and reduced benefits, recognizing a gain for its investors . SFPP's actions conflicted with the express purpose of the Commission's PBOP Policy Statement:

> FASB statements permit in certain instances gains realized on settlements and curtailments of post-retirement plans to be taken to income. Recognition of income by the regulated company without a concurrent reduction in rates would not be fair to ratepayers, particularly if any shortfalls in fund assets are to be made up through increased future rates. That would be the effect of adopting the
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> **[61,111]**
>
> accounting principles of SFAS 106 for ratemaking purposes. A mandatory requirement to establish an irrevocable trust will prevent the company from realizing income not intended to be earned when the rates were originally established by the Commission. [213]

Given this, SFPP should not be allowed to reflect the accrued amount of its PBOP costs in its cost-of-service. SFPP will only be allowed to include amounts that were actually paid in 1994 with respect to retired plan participants for benefits earned in prior periods, *i.e.*, amounts determined using the pay-as-you-go method. [214] However, if between December 31, 1993 and the date of its compliance filing, SFPP has created an irrevocable external trust in which to place any net PBOP expense accruals (including any gains realized on plan amendments, settlements and curtailments) it may adjust its proposed compliance filing to retain a PBOP accrual component. Moreover, if SFPP has created this external trust, it may credit any PBOP expenses accrued between December 31, 1993 and December 31, 1998 in excess of pay-as-you-go amounts, to any reparations that might otherwise be required by this order.

D. *Reparations*

The initial decision contains an extensive discussion of whether and when reparations may be available in the instant proceeding. [215] The ALJ first held that since the West Line Shippers had not shown substantially changed circumstances, they were not entitled to reparations for shipments on the West Line. The Commission has affirmed the ALJ's conclusion on substantially changed circumstances and affirms this conclusion as well. He also held that Navajo's prior settlement with SFPP barred Navajo from recovering reparations for the two year period prior to the date of its complaint. While Navajo asserts otherwise, the ALJ pointed out that the only reasonable interpretation of Navajo's 1989 settlement with SFPP is that Navajo is barred from seeking reparations for the time frame that its settlement was in effect. The Commission agrees, and on this point the ALJ's ruling is affirmed for the reasons stated in his ruling. [216]

The ALJ also held that the East Line Shippers were entitled to reparations for the two year period before the date of their complaints, except, as noted, for Navajo. The ALJ also held that the West Line shippers were not entitled to obtain reparations for shipments they made on the East Line if those rates should be determined to be unjust and unreasonable. The ALJ also ruled that shippers who had not requested reparations in their initial complaints could obtain reparations from the date of their original complaint upon filing an amended complaint. [217] The ALJ then used a test-period concept in determining the level of reparations. He concluded that once a just and reasonable rate is established to be applied prospectively, the same rate should be used to determine the level of reparations in the previous years. [218]

SFPP excepts to the conclusion that reparations may be obtained two years before the complaint if the existing

rate is not grandfathered, arguing that equitable considerations are such that reparations should not be awarded for any of the rates at issue here if they should be found unjust and unreasonable. SFPP also argues that reparations cannot be obtained through an amended complaint that relates back to the date of the original complaint. Both SFPP and Chevron object to the determination that reparations

[61,112]

should be awarded on a test year basis. They argue that the reparations for any year other than the test year should be determined based on the actual costs and revenues incurred in that year.

SFPP further argues that if reparations cover a period of several years, reparations should be made only if total revenues exceeded the total cost-of-service in the years to which the reparations would apply. SFPP claims that otherwise it would be required to absorb the losses from underrecoveries while surrendering the surpluses for the years for which there was an over-recovery. The West Line Shippers object to any determination that they may not obtain reparations for shipments that they may have made over SFPP's East Lines. The complainants also assert that reparations should be available from the date of an initial complaint, not from the date of an amended complaint first raising the reparations issue. They argue that this is consistent with federal court practice and the Commission's regulations.

There is no dispute that reparations are available to some degree for shipments over the East Lines if those rates are determined to be unjust and unreasonable. The debate turns rather on which parties may be eligible for reparations and the period for which they are to awarded. Reparations have traditionally been considered an equitable remedy, and whether they are granted is a matter of Commission's discretion. [219]

Upon consideration of the relevant precedent, the Commission is affirming the ALJ's determination that reparations are available on a "relation-back" basis. The complainants assert that requiring a request for reparations to be included in the initial complaint is an anachronistic practice, while SFPP asserts that the weight of Interstate Commerce Commission (ICC) and related court authority supports this conclusion. The Commission concludes that the ICC and Surface Transportation Board have become more liberal in recent years, for example, permitting a request for reparations to relate back to the date of an informal complaint. [220] While SFPP cites to federal cases to the contrary, [221] these cases dealt with contract matters in federal court and not rate cases before a regulatory agency vested with authority under the ICA. However, as the ALJ stated, the Commission normally follows the Federal Rules of Procedure in deciding procedural issues. [222] Given the relaxation of strict forms of pleading since the Federal Rules of Procedure were adopted, the Commission will permit reparations to be awarded back to the date of the original complaint.

The Commission also concludes that in this proceeding reparations should not be awarded for any period before the filing date of the East Line complaints. All of these complaints were filed while SFPP's 1988 settlement rates were in effect, rates that had been agreed to by the majority of the shippers using the system at the time the settlements were made. While the Commission only approved, and did not adjudicate, the settlement rates, SFPP undertook a substantial expansion of its system in reliance on those settlement rates. Until such time as the rates were called into question by the filing of the complaints, there was no reason for SFPP, or the Commission, to have grounds to believe that the settlement rates entered into with most of its shippers were not just and reasonable, or that the shippers themselves may have thought otherwise.

[61,113]

Therefore, the Commission will not award reparations for the period proceeding any of the complaints involved in these proceedings.

For the period after the complaints were filed to the date of this decision, SFPP was on notice that its rates were the source of some considerable dissatisfaction, that they would be subject to review, and that there was a risk that the rates could be found unjust and unreasonable and reparations awarded. SFPP had the choice of

litigating the rates, or attempting to reach a settlement with its shippers to resolve their disagreements. The Commission agrees with the complainants that holding that no reparations would be due in this proceeding removes much of the incentive for the pipeline to settle or to act with restraint in the litigation. The Commission also agrees with SFPP that to award reparations automatically lessens the restraint that shippers may feel in filing complaints against that pipeline, which several shippers have done repetitively. The number of unique issues involved in this proceeding and the fact that it has been protracted may also influence how reparations should be determined. However, since the Commission does not have before it the means to estimate reparations at this time, it will take no further action then to say in general terms for what time frames reparations may be available and how the reparations that may be due in this proceeding are to be calculated.

Thus, the period for reparations will commence from the date of each complaint until March 31, 1999, the effective date of any revised East Line rates required by this order. To calculate the potential reparations, SFPP shall develop an East Line cost-of-service for the test year 1994, design a rate that reflects that cost-of-service and conforms to this order, and index the rate so designed to December 31, 1998. Utilizing the indexed rates thus developed, SFPP will apply those rates to the design volumes adopted by this order for each calender year for which an indexed rate has been developed, thus establishing a new cost-of-service for each of the subsequent years. Thereafter, for each of the five years 1994 to 1998, and the partial year 1999 through February 28, 1999, SFPP shall determine whether the revenues for each subsequent period resulted in over- or underecovery of its cost-of-service for each of those years. For any reparations that may be due for the years prior to 1994, SFPP shall develop a separate cost-of-service applying the rulings stated in this order and shall determine whether it over- or underrecovered its cost-of-service in those years. As stated earlier, no reparations will be due for periods prior to the filing date of a complaint.

SFPP may also develop, as supplementary cost items for each such year, additional costs or cost factors that the Commission concluded were not to be included in the 1994 test year cost of service, but which were actually incurred in the years 1995 through 1998. Such costs may include litigation, settlement, reconditioning, and environmental expenses as actually incurred, not as estimated or accrued. Any such costs must be reflected as a separate line item for the year involved and be supported by SFPP's regulatory reports and work papers. SFPP may also include a PBOP allowance for time periods for which there was an external trust fund conforming to the Commission's policies. SFPP shall show a separate revised net income figure for each of the five years 1994-1998 to reflect any such additional costs. Any of the additional cost claims shall be fully supported by work papers and accounting records that should be available to all parties and the Commission.

The Commission concludes that the final amount of reparations due should be calculated on a total cost-of-service basis for the period for which the reparations are due. Since the proper cost-of-service has been at issue for several years and SFPP was

[61,114]

entitled to defend its existing rates, the Commission does not believe that it is equitable to require SFPP to make reparations for the years in which it may have overrecovered its cost of service, and to absorb the losses in which it underrecovered its cost of service. Prospectively, as a matter of normal rate design practice, SFPP is at risk for the underrecoveries and may keep any overrecoveries pending action in another rate case; moreover, if the underrecoveries are protracted, SFPP may file for a rate increase. This symmetry is maintained if SFPP is permitted to net out the fat and lean years that may occur during the time frame for which reparations may be due. Therefore, SFPP's final calculation will be to net out its over- and underrecoveries for each year and determine that net amount, if any, that is due its East Line shippers.

E. *The Publication of Prorationing Policies*

One of the issues consolidated with this proceeding was a proposal made by SFPP on July 31, 1992, to change its prorationing policies. The proposed change was not filed with the Commission but was distributed by letter to SFPP's shippers. Under the new policy, new shipper volumes, or increased volumes by an existing shipper, would be awarded only to those shippers who could show demonstrated need. The proposed change was protested by El Paso in the context of SFPP's filing Tariff Nos. 15, 16, and 17, which was made to cancel

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certain existing SFPP tariffs. El Paso asserted that the modified prorationing policy should have been included in SFPP's tariff, and that the "demonstrated need" policy was so vague as to be unjustly and unduly discriminatory and inimical to El Paso's interests. Chevron filed a similar protest on September 23, 1992, also stating that the proposed policy left too much discretion in the hands of the pipeline. On September 29, 1992, the Oil Pipeline Board suspended the proposed tariff changes and set the issue for hearing. [223]

The ALJ concluded that SFPP was required to publish the details of its prorationing policy in its FERC tariff. He based this conclusion on the language of the ICAct and Section 341.8 of the Commission's regulations. [224] He further concluded that SFPP had not justified the use of the so-called demonstrated need test and that test afforded SFPP too much discretion and opportunities for discrimination. He therefore ruled that SFPP should adopt a good faith nomination test as an alternative policy, stating that the good faith test reflected general industry practice. He also ruled that, when investigating the practicality of shipper nominations, SFPP should refrain from contacting any parties with whom SFPP's shippers have business dealings, and that SFPP should respond to requests regarding capacity within 30 days after it receives an inquiry. [225] On exceptions, all the intervening shippers and the Staff supported the ALJ's determination for the reasons stated in his order.

SFPP excepts to the ALJ's determinations on several grounds. It asserts that the ALJ's ruling is inconsistent with the Commission's decision in *Total Petroleum, Inc. v. Citgo Prods. Pipeline,* [226] and a recent Court of Appeals ruling in *ARCO Alaska, Inc. v. FERC,* [227] both of which SFPP claims limited the inclusion of detailed prorationing provisions in an oil pipeline's tariff. SFPP further asserts that the issue here is improperly framed as whether there should be a modification to SFPP's current prorationing policy, and that no party has proved that the demonstrated need policy has resulted in any preferential treatment among shippers. SFPP states that its

[61,115]

prorationing policy allocates capacity among shippers in times of constraint in proportion to their prior twelve-month average, and that the "demonstrated need" standard is intended to assure that new shippers do not displace existing shippers without adequately justifying their need for the capacity. It further claims that the "good faith" standard provides incentives for over-nominations and double counting, as demonstrated by its own experience. [228] Finally, it argues that on this record there is no basis for concluding that SFPP's allowable response time should be reduced from 90 to 30 days.

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COMM-OPINION-ORDER, 86 FERC ¶61,022, SFPP, L.P., Docket Nos. OR92-8-000, OR93-5-000, OR94-3-000, and OR94-4-000, Mobil Oil Corporation v. SFPP, L.P., Docket No. OR95-5-000, Tosco Corporation v. SFPP, L.P., Docket No. OR95-34-000, (Jan. 13, 1999) PART 02 OF 02.

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The Commission finds that SFPP is not required to include the details of its current prorationing policy in its tariff. Upon review, the complaining parties are correct that SFPP incorrectly cited *ARCO, supra*, for the proposition that the Commission has no authority to require oil pipelines to include prorationing rules in their tariffs. *ARCO* only held that the Commission could not require pipelines to include in their tariffs contracts or guidelines for allocating capacity among themselves since the requirement to publish tariffs attached to the pipeline's relationship with the shipper. However, SFPP is correct that the Commission's prior decision in *Total, supra*, is on point here. Under *Total* the Commission has construed Section 341.8 of its regulations as only requiring a summary of the proration policy and information on where to obtain the more detailed policy statement. The ALJ is reversed in this regard.

In *Total*, the pipeline provided its shippers with 45-days notice of the proposed changes and noted that the policy would be changed in a tariff filing. In the instant case, the hearing record discloses that SFPP mailed its revised policy on July 31, 1992, to be effective October 1, 1992. [229] To the extent that shippers thought that they had received less than 30 days notice before their next nomination deadline, they were mistaken. [230] SFPP's action in providing notice was consistent with *Total*, but, as *Total* requires, SFPP should have filed a tariff identifying its modified prorationing policies.

Based on the forgoing, the Commission concludes that SFPP's existing tariff on prorationing does not comply with the Commission's standards. While the tariff states that in case of prorationing, capacity will be allocated on a nondiscriminatory basis, the tariff does not clearly state that a more detailed prorationing circular exists, and where it can be obtained. Nor does SFPP's tariff state the minimum notice period for any proposed changes to the detailed policy circular. SFPP must modify its tariffs accordingly. The Commission also has some concerns regarding the more detailed circular itself. First, the outside reply date for SFPP to respond to a request for capacity is 90 days. The Commission concludes that this lengthy time frame is inconsistent with SFPP's obligation to provide transportation service upon reasonable request. Given the competitive nature of the petroleum industry and the need to determine whether capacity will be available to support an executory contract, the Commission concludes that responses should be made within 30 days. The Commission is also concerned that SFPP's contacting of a shipper's customers could discourage the customer from contracting for a sale, either inadvertently or due to some unanticipated favoritism at the operating level. Given that SFPP has not in the past found it necessary to contact a shipper's customers, the Commission concludes that it should delete the right to do so from its detailed policy statement.

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Beyond the matters just discussed, the Commission concludes that the complaining parties have not established that SFPP's "demonstrated need" policy is unjust and unreasonable, the burden they have in a complaint case, [231] or that the so-called "good faith" test is necessarily the only just and reasonable provision that should be used. The complaining parties assert that the "demonstrated need" standard provides the pipeline undue discretion and an undue opportunity to discriminate. Yet they fail to show actual harm by SFPP's use of the standard to allocate capacity. Moreover, Staff's citation to an ARCO tariff [232] as a model of the "good faith' standard is unconvincing. The ARCO tariff expressly provides that a new shipper must provide a realistic 12 month forecast of the volumes to be shipped and nominate in good faith. In the event of a capacity shortage, ARCO reserves the right to "accept and transport, during such period, only that portion of each good-faith offer to ship which Carrier shall determine to be equitable among all Shippers." [233] Under this standard, ARCO has as much discretion to deny capacity as SFPP does under its tariff as the standards for the review are not stated, and may do so after the nominations are made. In SFPP's case, the determination should be normally made before

nominations are submitted and shippers will know were they stand at that time.

SFPP's procedures are also very similar to that used by another petroleum pipeline, Colonial. [234] It is noteworthy that SFPP changed its prorationing policy because a number of smaller shippers believed that they were being unjustly denied access to capacity and that much of the opposition came from large existing shippers who feared that they would lose their existing capacity. [235] Thus, if Staff's concern is that SFPP's revised policy would discriminate against small shippers, the record indicates that this was the very concern that the policy change was intended to address. Existing shippers are concerned that if a new shipper over-nominated during times of constraint and then failed to ship, the existing shipper would lose an opportunity for a sale which would not be compensated for by penalties imposed by the pipeline. [236] In this regard, SFPP also established that it is possible for a new shipper to over nominate when the system is constrained and still not appear to have done so. [237] Therefore no further action will be taken on this issue.

IV. Remaining Procedural Issues and Conclusions

The Commission has determined that the West Line Shippers, Mobil, TOSCO, and ARCO have not proven substantially changed circumstances as of the dates of their complaints against SFPP's West Line rates in these consolidated proceedings. Therefore those complaints are dismissed and the proceedings are closed. Since the last of the

[61,117]

consolidated complaints was filed on August 7, 1995, the issues of substantially changed circumstances on SFPP's West Line and the reasonableness of the West Line rates are closed through the date of the last complaint. Thus, with the exception of a further complaint by Navajo, any complaint filed against SFPP's West Line rates filed after August 7, 1995 must establish substantially changed circumstances as of the date of that complaint in a manner that is consistent with this order. The Commission will elaborate in a separate order the procedures to be followed in evaluating the series of complaints filed against SFPP's rates subsequent to August 7, 1995.

The Commission has also found that some of the theories with which SFPP has sought to defend its East Line rates were not justified on this record. Thus, to the extent that the current level of SFPP's East Line rates depends on those theories or arguments, they may not be just and reasonable, and to that extent modifications to the related cost elements are required. This in turn may reduce SFPP's cost-of-service for 1994 below the rates that were in effect during that year. SFPP is therefore directed to recalculate its East Line rates for the year 1994 in a manner consistent with this order. In its compliance filing SFPP must state the recalculated rate, how the rate was devised, and must provide supporting memorandum work papers, and estimate reparations, if any, in the manner discussed earlier in the order. Both the compliance filing and any comments must be supported by specific citations to this order and to the portions of the record upon which any party relies in its filing.

Finally, if SFPP believes that any revisions to its East Line rates that may result from this order are too low to recover its costs as of the effective date of the revised rates, it may make a filing to raise the rates to a higher level at the time it makes its compliance filing to this order. SFPP will have the burden of establishing that any such new or refiled rate is just and reasonable under the ICAct and that its proposal is consistent with the findings of this order.

The Commission orders:

(A) The complaints against SFPP's West Line in this consolidated proceeding are dismissed. The dismissal of those complaints is without prejudice to complaints that may have been filed against SFPP's West Line rates after August 7, 1995.

(B) SFPP's East Line rates may not be just and reasonable for the year ended December 31, 1994 for the reasons stated in this order. Within 30 days after this order issues SFPP shall file revised tariffs reflecting the changes to the calculation of its East Line rates required by this order for the years 1994, 1995, 1996, 1997, and 1998, as indexed to a current level pursuant to the Commission's indexing regulations published at 18 C.F.R. §342.3, with any prospective East Line rates to be effective March 1, 1999. SFPP shall estimate any reparations that may be due as required in the body of this order.

(C) If, based on the compliance filing required by paragraph B, SFPP's East Line rates are determined to be just and reasonable, the complaints against the East Line rates will be dismissed for all complaints filed before August 7, 1995. If the East Line rates are determined not to be just and reasonable pursuant to paragraph B, the Commission will determine at a later date whether reparations should be made based on the compliance filing required by paragraph B.

(D) SFPP's base rates for the indexing of its West Line rates shall be those in effect on October 24, 1992, and for the indexing of its East Line rates, those established as of the effective date of this order if the compliance filing discloses that the rates on

[61,118]

the East Line must be modified. Otherwise, the base rates for the indexing of its East Line rates shall be those in effect as of October 24, 1992.

(E) SFPP must file a tariff reflecting the current charges for its Watson Station drain dry facilities within 30 days after this order issues.

-- Footnotes --

[61,055]

[1] *SFPP, L.P., 80 FERC ¶63,014 (1997).*

[61,056]

[2] Public Law 102-486 (1992), enacted October 24, 1992, codified as 42 U.S.C. §7172 (1994)).

[3] Section 1803(a) of the EPAct.

[4] Section 1803(b) of the EPAct.

[5] *Id.*

[6] Exh. 142 at p. 9.

[7] Exh. 144 at p. 3.

[61,057]

[8] *Id.* at pp. 12, 14.

[9] *See* 80 FERC at p. 65,118 and Exh. 142 at p. 5 for the details of SFPP's relation to its parent and affiliated companies.

[10] Exh. 142 at p. 8; Tr. 8125.

[11] Exh. 142 at p. 11; *see also* Tr. 8128-29.

[12] Exh. 142 at p. 12; Tr. 8129.

[13] *See Southern Pacific Pipe Lines, Inc.*, 45 FERC ¶61,242 (1988).

[14] *See Southern Pacific Pipe Lines Partnership, L.P.*, 49 FERC ¶61,081 (1989).

[15] Exh. 142 at pp. 13-14.

[16] *Id.*; Tr. 8131 *see* Exh. 147 at pp. 6-14.

[17] Exh. 147 at pp. 7-9; *See also* Exh. 863 at 45.

[18] *See* 49 FERC ¶61,081 (1989).

[19] Exh. 147 at p. 10.

[61,058]

[20] Exh. 147 at pp. 9-10.

[21] *Id.* at p. 11.

[22] *Id.* at pp. 15-17; *see also* Exh. 119 (ARCO Reversal Agreement).

[23] No shipper protested SFPP's FERC Tariff Nos. 15, 16 and 17, filed on July 31, 1992, which added a new West Line origin point at East Hynes, California.

[24] The term "proration" refers to the allocation of pipeline capacity among shippers during periods when the aggregate volume of petroleum products which shippers nominate for transportation exceed the capacity of the pipeline.

[25] This complaint was filed before October 24, 1992, and therefore is not subject to the grandfathering provisions of the EPAct. The Commission granted Refinery Holding Company, L.P. ("RHC") party status as the successor in interest to EPR following EPR's bankruptcy. *SFPP, L.P.*, 65 FERC ¶61,028 (1993), *reh'g denied*, 66 FERC ¶61,210 (1994).

[26] *SFPP, L.P.*, 60 FERC ¶62,252 (1992).

[27] The rate for the turbine fuel was the same rate previously filed in the predecessor Tariff Nos. 15, 16, and 17.

[28] *SFPP, L.P.*, 62 FERC ¶62,060 (1993).

[29] *SFPP, L.P.*, 63 FERC ¶61,014 (1993).

[61,059]

[30] *Id.* at pp. 61,124-25. On June 14, 1993, EPR sought to amend its complaint by adding claims for reparations. Over SFPP's objection, on September 10, 1993, the presiding administrative law judge ruled that EPR's complaint would be amended back to September 4, 1992, and that EPR could seek reparations for the period beginning two years prior to that date. This point is now moot as to EPR.

[31] *SFPP, L.P.*, 63 FERC ¶61,275, at p. 62,789 (1993).

[32] *SFPP, L.P.*, 65 FERC ¶61,028, at p. 61,376 (1993).

[33] *Id.* at p. 61,378.

[34] *Id.* On November 4, 1993, Chevron filed a third petition for rehearing, this time challenging the Commission's October 5 Order. The Commission denied that request on February 17, 1994. *SFPP, L.P.*, 66 FERC ¶61,210 (1994).

[35] *See* Section 1803(b)(2) of the EPAct.

[61,060]

[36] *SFPP, L.P.*, 67 FERC ¶61,089, at p. 61,255 (1994). The Commission further held that any reparations with respect to SFPP's West Line rates could be prospective only, starting from the date of the filing of each complaint. *Id.*

[37] *SFPP, L.P.*, 68 FERC ¶61,105, at p. 61,581 (1994).

[38] *SFPP, L.P.*, 68 FERC ¶61,306 (1994).

[39] These complaints were filed after SFPP filed its responsive testimony, and therefore Mobil and Tosco were required to accept the record as it stood when they filed their complaints. *Mobil Oil Corp. v. SFPP, L.P.*, 73 FERC ¶61,032 (1995); *Tosco Corp. v. SFPP, L.P.*, 74 FERC ¶61,056 (1996).

[40] The complaints that have not been consolidated with the instant proceedings are: Docket Nos. OR96-2-000, OR96-10-000 (75 FERC ¶61,292 (1996)), and OR96-17-000 (77 FERC ¶61,033 (1996)), as consolidated; Docket Nos. OR96-15-000 (77 FERC ¶61,191 (1996)) and OR97-2-000 (78 FERC ¶61,047 (1997)) held in abeyance pending the decision in OR92-8-000, *et al.*; and Docket Nos. OR98-1-000, OR98-2-000 (82 FERC ¶61,043 (1998), and OR98-13-000 (84 FERC ¶61,139 (1998)), as consolidated, and held in abeyance pending the decision in OR92-8-000, *et al.* Any party that made a timely filing to intervene and was not formally listed in the Commission's orders in these proceeding will be admitted in the separate order addressing the future of these proceedings.

[41] *SFPP, L.P.*, 76 FERC ¶63,018 (1996).

[42] *See SFPP, L.P.*, 80 FERC ¶63,014 (1997) and *SFPP, L.P.*, 80 FERC ¶61,088 (1997).

[61,061]

[43] Section 1803(a)(1) of the EPAct.

[44] Sections 1803(b)(1)(a) and (b) of the EPAct.

[45] The phrase "substantially changed circumstances" is used in this order as an abbreviation of the statutory threshold.

[46] *SFPP, L.P.*, 68 FERC ¶61,105, at p. 61,581 (1994), *order on reh'g, SFPP, L.P.*, 68 FERC ¶61,306 (1994).

[47] Navajo was party to a settlement that barred challenges to the East and West Line rates during the

[61,062]

one year period proceeding the enactment of the EPAct. As such it was not barred from pursuing a complaint once the applicable settlement expired. Navajo subsequently withdrew its complaint against the West Line rates.

[48] The "West Line Shippers" refers to ARCO Products Company, Mobil Oil Company, Texaco Refining and Marketing, Inc., and Tosco Refining Company.

[49] The substantially changed circumstances issue is discussed in the next section of this order.

[50] *SFPP, L.P.*, 68 FERC ¶61,105, at pp. 61,581-82 (1994).

[51] 71 FERC ¶61,205, at p. 61,753 (1995), *aff'd on reh'g*, 75 FERC ¶61,254 (1996).

[52] *See* 68 FERC ¶61,306, at p. 62,263 n.12.

[61,063]

[53] *See* Section 1803(b)(1)(B) of the EPAct.

[54] *See Western Resources v. FERC*, 9 F.3rd 1568, 1574, 1578 (D.C. Cir.) (1993); *East Tennessee Natural Gas Company*, 863 F.2d 932, 937 (D.C. Cir. 1988); *Sea Robin v. FERC*, 795 F.2d 182, 183 (D.C. Cir. 1986). *See also, Iroquois Gas Transmission Company*, 84 FERC ¶61,086, at p. 61,458 (1998) (*Iroquois*).

[61,064]

[55] Section 1803(b)(1)(A).

[56] *Lakehead Pipe Line Company, L.P.*, 71 FERC ¶61,338 (1995), *reh'g denied*, 75 FERC ¶61,181 (1996). (*Lakehead*).

[57] Section 1803(b)(1) of the EPAct.

[58] Section 1803(b)(1)(A).

[59] 80 FERC at p. 65,193 .

[61,065]

[60] West Line Shippers Brief on Exceptions at 39, *citing Rhode Island Higher Educational Association v. U.S. Department of Energy*, 929 F.2d 844 (1st. Cir. 1991).

[61] *See* the New Shorter Oxford Dictionary (Clarendon Press -Oxford 1998 Ed.), defining "material" at 1714 and "substantial" at 3124.

See also The American Heritage Dictionary (Houghton Mifflin Company (1976) defining "material" at 806 and at 1284.

[61,066]

[62] *See* Loss, Louis, *Securities Regulation*, Little Brown and Company, 1991, at 305-06 and 719-21.

[63] *Id.* at 720, n.88.

[64] Rappaport, Louis H., *SEC Accounting Practice and Procedure*, The Ronald Press, 3rd. Ed. 1972 at 16-14.

[65] *See* 18 C.F.R. Part 282 , Section 1-6(f).

[66] 80 FERC at p. 65,193 , n.763, *citing* Exh. 192 at 3.

[67] *Santee Distrib. Co., v. Dixie Pipeline Co.*, 75 FERC ¶61,254 (1996) (*Santee*).

[68] Section 1803(b)(1)(A) of the EPAct.

[61,067]

69

Period	Volumes (In Barrels)	Increase
Nov. 1991 - Oct. 1992	28,245,011	N/A
Nov. 1992 - Oct. 1993	36,142,011	27.96%
Nov. 1993 - Oct. 1994	37,020,946	31.07%
Nov. 1994 - April 1995	38,531,907	36.42%

See Chevron's Brief on Exceptions, at corrected page 24. Other parties make different calculations but the results are in the same range. SFPP's 1996 10-K showed increases in West Line volumes over 1992 of 28.21% in 1993, 33.33% in 1994, and 43.20% in 1995. *Id.*

[61,068]

[70] 49 FERC ¶61,081 (1989).

[71] Exh. 147 at 5-6, 10.

[72] *Prepared Direct Testimony of Andrew W. Battese*, Exh. 34 at 16.

[73] Tr. At 5472. While the Commission does not have before it an analysis of what economic assumptions may have been involved in designing the current West Line rates, the Commission assumes that the shippers would not have agreed to a settlement rate that was not based on a reasonable projection of the volumes and the costs that would result from the expansions they were contesting. To have done so they would have had basic rate design information available to them to determine whether the 1988 Settlement suited their interests.

[61,069]

[74] 71 FERC ¶61,205 (1995), *reh'g denied*, 75 FERC ¶61,254 (1996).

[75] Section 1803(b)(1) of the EPAct.

[76] In *Santee, supra*, the Commission did look at Form 6 data that was compiled after the date of the complaint, this was for the narrow purpose of validating the Commission's decision, on rehearing, to dismiss the complaint without further action. This was done solely because of the summary nature of the action to be taken by the Commission and to avoid injustice. In the instant case the complainants had a full opportunity for discovery after the case was set for hearing.

[77] 80 FERC at p. 65,195 .

[61,070]

[78] *See* 80 FERC at p. 65,814.

[79] *Id.*

[80] 71 FERC ¶61,338 (1995), *reh'g denied*, 75 FERC ¶61,181 (1996).

[81] *See Texaco Inc. and Texaco Gas Marketing, Inc. v. FERC*, 148 F.3rd 1091, 1098, (D.C. Cir. 1998); *See also*, Exh. 866, SFPP 1996 SEC Form-10 at 5-6.

[61,071]

[82] 80 FERC at p. 65,196 .

[61,072]

[83] *SFPP, L.P.*, 65 FERC ¶61,028 (1993).

[84] *See* 71 FERC ¶61,205, at p. 61,754 (1995).

[85] *See* 75 FERC ¶61,254, at p. 61,621 (1996).

[86] *See* footnote 89.

[87] See Exh. 864, dated December 20, 1990.

[88] For example, the throughput, revenue, and returns on the West Line in 1994 may not have substantially exceeded the economic assumptions embodied in the basis of the rates placed in effect in 1989. However, in later proceedings based on subsequent complaints the complainant might establish that the assumptions that underlie the economic basis for the rate have been substantially exceeded, and there has been a substantial change in the circumstances that are the basis for the rate.

[61,073]

[89] *SFPP, L.P.*, 68 FERC ¶61,105, at pp. 61,581 -82 (1994).

[61,074]

[90] *See* 80 FERC at pp. 65,154 -55.

[91] *See* 80 FERC at pp. 65,156 -57.

[92] See SFPP's Brief on Exceptions at 67, *citing New Orleans Cotton Exchange v. Louisville and Nashville R.R. Co.*, 46 I.C.C. 712, 725 (1915), *modified* 49 I.C.C. 271 (1918).

[93] 47 I.C.C. Val. Rep. 541 (1937), discussed at 80 FERC ¶65,157 .

[94] *Texaco Refining and Marketing v. SFPP*, 80 FERC ¶61,200 (1997) (*Sepulveda*).

[95] 71 FERC ¶61,338, at pp. 62,324 -26 (1995), *order on reh'g*, 75 FERC ¶61,181, at pp. 61,660 -01 (1996). See Staff's Brief Opposing Exceptions at pp. 29-36 for a particularly concise and appropriate discussion of this issue.

[61,075]

[96] *See* Exh. No. 124.

[97] See *Express Pipeline Company*, 76 FERC ¶61,145, at p. 62,254 (1996), *citing* at n.4, *Sea-Land Services, Inc. v. ICC*, 738 F.2d 1311, 1316 (D.C. cir. 1984), *order denying reh'g*, 77 FERC ¶61,145 (1996). The result here is consistent with the holding in that proceeding. The Commission notes that there is no current obligation to file an oil pipeline transportation contract with the Commission.

[98] The facilities appear to have been designed to reflect the total needs of all the shippers that agreed to use the facilities. The contract terms would normally reflect the most efficient terms for facilities of that size and scale and would allocate the risk among the various parties. Modifying the terms for one party by reducing its rate gives that party an unbargained for, and unwarranted, advantage.

[61,076]

[99] As in *Sepulveda*, *supra*, once the contracts expire SFPP must maintain a tariff on file with the Commission if it continues to assess a charge for use of the Watson Station facilities.

[100] The charge at issue is a special charge designed to amortize the costs of the facilities at issue. If the amortization was complete and there was no further basis for the charge, then the complaint would probably lie. But this has not been alleged or established for the period at issue here.

[101] 45 FERC ¶61,242, at pp. 61,714 -15 (1988), which approved the 1988 settlement containing the stated rates to apply to the West Line after the 1988-1989 expansions were completed.

[61,077]

[102] *See ARCO Pipe Line Company*, 55 FERC ¶61,240, at p. 62,263 (1991), *order on reh'g*, 66 FERC ¶61,159 (1994).

[103] As noted, the contracts supporting the construction and operation of the Watson Station dry drain facilities typically contain a minimum volume provision. *See* Exh. 124.

[104] In fact, the parties agree that the West Line was underutilized at most times relevant here. *See* n.86, *supra*, and n.120, *infra*.

[61,078]

[105] The daily incremental volumes for this service are estimated at 1,000 barrels per day on a West Line Capacity in 1995 of 173,000 barrels a day (Colton to Phoenix). *See* Exh. No. 413 and 75 FERC at 80 FERC at p. 65,818. As noted, Chevron estimates the incremental return at .322 percent. *See* Exh. No. 413. Other than complainant's efforts to establish substantially changed circumstances, there was no substantive basis upon which to challenge this rate.

[61,079]

[106] AOPL requested permission to file an amicus brief on exceptions with the Commission in this proceeding. The request was opposed on the grounds that AOPL had not participated in the proceeding and had no familiarity with the record. The Commission concludes that AOPL's proposed brief goes to issues of general law and policy and that any discussion of by AOPL of those issues is adequately supported by facts that are stated in the initial decision. Since all parties have had an opportunity to respond, they are not prejudiced and the Commission will accept AOPL's brief.

[107] *See Williams Pipe Line Company*, 84 FERC ¶61,022 (Opinion No. 391-B) (1998) (*Williams*).

[61,080]

[108] 734 F.2d at 1528-29.

[109] 84 FERC at pp. 61,099 -100, 61,104, 61,110-11, 61,113.

[110] *See* Exh. 34 at 16.

[111] *See* Prepared Direct Testimony of Andrew W. Battese, Exh. 34 at 16. The statement on utilization is as of June 1994 and is uncontroverted.

[61,081]

[112] *Williams*, 84 FERC at pp. 61,103 -104.

[113] This point is discussed by the ALJ in evaluating SFPP's business risk, but is equally applicable to the matter of competition. *See* 80 FERC at pp. 65,145 -46.

[114] SFPP does not assert that costs associated with those lines operating between southern California and the Pacific northwest should be included in the instant cost-of-service.

[115] *See* 80 FERC at pp. 65,149 -50.

[61,082]

[116] *See* 80 FERC at p. 65,118 .

[117] *Kansas-Nebraska Natural Gas Company*, 53 FPC 1691 (1975), aff'd 534 F.2d 227 (10th Cir. 1976); *Mojave Pipeline Company*, 83 FERC ¶61,257 (1998). The method is applied only to costs that can be identified as direct overhead costs and that are allocated to the relevant division or function.

[118] 80 FERC at p. 65,148 .

[119] *See Exxon Corporation, et al. v. FERC*, 114 F.3rd 1252 D.C. Cir. 1997).

[61,083]

[120] 80 FERC at p. 65,147 .

[121] *Citing Questar Pipeline Company*, 74 FERC ¶61,126, at p. 61,455 (1996).

[122] 81 FERC ¶61,150 (1997), *reh'g denied*, 83 FERC ¶61,276 (1998).

[61,084]

[123] 84 FERC at p. 65,123 .

[61,085]

[124] *Williams Pipe Line Company*, Opinion No. 154-B , 31 FERC ¶61,377, at pp. 61,834 -35 (1985).

[61,086]

[125] The ICC valuation formula appears in *Williams Pipe Line Company*, 21 FERC ¶61,260, at p. 61,696 , footnote 295 (1982), and *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 14886, at 1495 footnote 28 (D.C. Cir. 1984), *cert denied sub no. Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (Farmers Union). *See also Kuparuk Transportation Company*, 55 FERC ¶61,122, at p. 61,364 (1991).

[126] Opinion No. 154-B at p. 61,836.

[127] *Id.* at pp. 61,234-36.

[128] 80 FERC at pp. 65,130 -31.

[129] 80 FERC at p. 65,134 , *citing* Opinion No. 154-B , 31 FERC ¶62,377, at p. 61,839, n.40 (1985). December 31, 1983, was the end of an annual valuation under the Commission's regulations.

[130] 80 FERC at p. 65,135 .

[61,087]

[131] 80 FERC at p. 61,140 .

[132] 80 FERC at p. 65,141 .

[133] *See* 80 FERC at p. 65,129 , footnotes 132 and 133.

[134] Since only the East Line rates are at issue here, it will be necessary to divide the South Line rate base between the East and West Lines, reflecting the fact that one line between Phoenix and Tucson is used for east

bound service and one for west bound service. The ALJ did not address this issue in his order and therefore the parties will be required to do so when SFPP makes its compliance filing.

[135] Opinion No. 154-B, 31 FERC at p. 61,836. The Commission noted in *Kuparuk, supra*, "the strong preference for the use of the parent company's capital structure if the parent guarantees the oil pipeline's debt." 55 FERC at p. 61,377. While no debt is involved here, the principle is the same.

[136] Opinion No. 351-A at p. 62,384, footnote 8.

[61,088]

[137] Opinion No. 154-C provides that the capital structure for the SRB shall be determined as of the date of that opinion. 33 FERC at p. 61,640.

[138] 80 FERC at p. 61,126.

[139] 80 FERC at pp. 65,128-29.

[140] *Id.*

[141] 80 FERC at p. 65,130.

[142] *Southern Pacific Pipe Lines, Inc.*, 39 FERC ¶63,018 (1987).

[143] 80 FERC at p. 65,128.

[144] On the latter point SFPP is correct. The only material cited is the holding by the ALJ in SFPP's prior rate proceeding that the risks of SFPP and its parent between 1985 and 1988 were not similar. Staff also asserts that in the same period, SFPP itself asserted that its parent's capital structure should not be used. However, SFPP was arguing for a 100 percent equity capital structure.

[61,089]

[145] *See* 80 FERC at p. 65,129 for the ALJ's discussion.

[146] *See* 45 FERC ¶61,242 (1988).

[147] *See* the text of the January 30, 1989 Stipulation and Agreement between SFPP, Inc. and Navajo included in Exh. 895.

[148] The Commission notes that the decision here does not condone a capital structure with an equity component of 79 percent; only that the procedural framework is such that no further discussion or action is warranted.

[61,090]

[149] The Commission is making other rulings, *infra*, that will lessen the impact of this decision, for example, those regarding SFPP's capital structure after December 18, 1988, and the method for amortizing the deferred equity component of any additions to the rate base after December 31, 1983.

[150] Opinion No. 351 concluded that pipelines are not entitled to amortize the write-up in starting rate base as a cost-of-service expense. The shift from a valuation to a TOC methodology does not transform the write-up of SRB into deferred earnings or any other expense. The starting rate base was adopted for the purpose of determining return on and not return of capital. The write-up is a transitional measure which should be decreased over time. *See ARCO Pipe Line Company*, 53 FERC ¶61,398, at p. 62,386.

[61,091]

[151] For example, *see* Economic Indicators Prepared for the Joint Economic Committee by the Council of Economic Advisers, December 1995 (GPO 1995), page 24, Changes in Consumer Prices, All Urban Consumers,

far right column showing ten years of annual price changes 1985 through 1994.

[61,092]

[152] At any point in time, the ADIT balance reflects the amount by which the cumulative income tax allowance included in the pipeline's cost-of-service exceeds the cumulative income tax liability of the pipeline. Ex. 365 at p. 20.

[153] *See Natural Gas Pipeline Company of America*, 13 FERC ¶61,266, at pp. 61,587 -88 (1980); *see also Natural Gas Pipeline Co. of America*, 26 FERC ¶61,047, at p. 61,149 n.3 (1984). Exh. 365 at p. 22; Tr. 3618-19.

[61,093]

[154] The rate proceedings subsequent to SFPP's adoption of normalization concluded in settlements, which cannot be relied upon as support for the ratemaking treatment of any item.

[155] *Lakehead Pipe Line Company, Limited Partnership*, 71 FERC ¶61,338 (1995), *order on reh'g*, 75 FERC ¶61,181 (1996).

[61,094]

[156] 71 FERC at p. 62,305 , footnote 1.

[157] No gain or loss is recognized upon a contribution of property to a partnership in exchange for a partnership interest. I.R.C. Section 721(a).

[158] 75 FERC ¶61,181, at pp. 61,598 -99 (1996).

[159] On December 18, 1988, SFPP's ADIT balance reflected, at last in part, the difference between the book basis and the tax basis of its properties.

[160] *See Kuparuk Transportation Company*, 55 FERC ¶61,122, at p. 61,372 (1991).

[61,095]

[161] 80 FERC at p. 65,139 .

[162] 80 FERC at pp. 65,139 -40.

[163] *ARCO Pipe Line Company*, 52 FERC ¶61,055 (Opinion No. 351) at pp. 61,231-35 (1990), *order on reh'g*, 53 FERC ¶61,398 (Opinion No. 351-B) (1990).

[164] *See* Exhs. 137 and 157.

[61,096]

[165] This calculation assumes that the average period for a project, including all allowable costs, is approximately one year and that the expenditures are distributed over the year on a roughly equal basis.

[166] A search of the Commission's public records discloses that SFPP did obtain permission from the Office of the Chief Accountant to file two different Form No. 6's for the calendar year 1988.

[61,097]

[167] According to a March 6, 1989 letter to the Commission's Chief Accountant, SFPP stepped-up the basis of its properties by approximately $125 million.

[168] *See* 18 C.F.R. Part 353 Instruction No. 3-11 of the Instructions for Carrier Property Accounts (1998).

[169] *See Rio Grande Pipeline Company*, 78 FERC ¶61,020 (1997) and *Longhorn Partners Pipeline*, 82 FERC ¶61,146 (1998) and 82 FERC ¶61,147 (1998), in which the write-up the oil pipeline's rate base was denied. The *Longhorn* case, however, also contains a two prong test stating the limited circumstances under which the write-up of an acquisition rate base might be permitted. *See also Northern Border Pipeline Company v. FERC*, 129 F.3rd 1315 (D.C. Cir. 1997), *citing* 18 C.F.R. Pt. 201 at 526-27, holding that express permission is required and the company must justify the change under the so-called *United* criteria.

[61,099]

[170] Staff Brief Opposing Exceptions at 24, *citing Kuparuk Transportation Company*, 55 FERC ¶61,122 at p. 61,380 (1991).

[171] *See Transcontinental Gas Pipe Line Corporation*, (Opinion No. 414-A), 84 FERC ¶61,084 (1998).

[172] 80 FERC at p. 61,142 , n.226.

[173] *Id.* at p. 61,141.

[174] Exh. 101, 3 of 4 and 4 of 4; Exh. 908 at 6-7.

[61,100]

[175] Even in *ARCO*, the Commission noted that the six gas pipelines used as the control group evidenced consistently less risk than was appropriate for ARCO. *See* 52 FERC at pp. 61,243 -44.

[176] Staff acted on the basis of a lack of Commission precedent and its testimony was thorough and candid in evaluating the strengths and weaknesses of relying only on an oil pipeline universe in evaluating SFPP's equity cost of capital.

[177] 80 FERC at p. 65,142 .

[178] *Id.*

[179] *See Transco*, 84 FERC at p. 61,423 . To the extent additional long term forecasts are required under the *Transco* method, those in use in 1994 are a matter of public record and may be used in preparing a compliance filing. The sources should be included in the filing made a part of the record for comment by the other parties in their review of the compliance filing. *Transco*, 84 FERC at p. 61,246 ; *see also Iroquois*, 84 FERC at p. 61,453 .

[61,101]

[180] *See* Exh. 826 at 5, 29.

[181] Exh. 863 at 48. This is an example of the contradictions that did little to enhance the credibility of SFPP's case.

[182] *See*. Exh. 281 at 8-13. For a similar result, *see Iroquois*, 84 FERC at pp. 61,453 -56.

[183] Exh. 288 at 1.

[184] *Id.* at 3.

[185] *See* Exh. 908 at 5, columns 1 and 6.

[186] The Commission earlier required SFPP to exclude the effect of any revaluations of carrier property (including the elimination of accrued depreciation) that resulted from the formation of the SFPP partnership. This may reduce the equity component in that year with adjustments in the later years to reflect the Opinion 154-B methodology. *While this may indicate an increase in SFFP's financial risk*, Staff's conclusion that it has average risk is conservative and this change need not affect the result here.

[61,102]

[187] 80 FERC at p. 65,181 .

[188] 80 FERC at p. 65,179 .

[189] 80 FERC at p. 65,177 .

[61,103]

[190] SFPP, Inc. manages all of the Santa Fe Pacific Corp. holdings in the SFPP oil pipeline limited partnership. However, SFPP, Inc., is controlled 100 percent by SFP Pipeline Holdings, Inc., which is controlled by SFP Properties Inc., which is in turn owned by Santa Fe Pacific Corporation. *See* Exh. 870 for a diagram of full corporate structure.

[191] 80 FERC at p. 65,179 .

[61,104]

[192] *See Columbia Gulf Transmission Company*, 23 FERC ¶61,396 (1983).

[193] *Citing ARCO Pipe Line Company*, 53 FERC ¶61,398, at p. 62,389 (1990).

[194] *Williams Pipe Line Company*, Opinion No. 154-C , 33 FERC ¶61,327, at p. 61,640 (1985).

[195] 53 FERC at p. 62,389 .

[61,105]

[196] Navajo suggests that SFPP claimed its total legal expenses by the end of 1995 were $14.7 million, while further remarking that SFPP's total annual cost-of-service for the East Lines was $14 million. It further asserts that these costs were inflated by spending to advance positions that are contrary to well-established policy and to hire experts to file extensive testimony on marginal issues. Navajo Brief Opposing Exceptions at 66.

[61,106]

[197] *Williston Basin Interstate Pipeline Co.*, 84 FERC ¶61,081, at pp. 61,365 -66. In this case the Commission adopted the traditional three-year average for regulatory costs. However, consistent with the instant case, the Commission rejected Staff's efforts to reduce the average based on anticipated lower costs in later years.

[198] 80 FERC at p. 65,185 .

[61,107]

[199] 80 FERC at p. 65,168 .

[200] 80 FERC at p. 65,169 .

[201] *Citing* Exh. 816.

[202] *Distinguishing Kuparuk Transportation Company*, 45 FERC ¶63,006, at pp. 65,079 -080 (1988).

[203] *Citing Williston Basin Interstate Pipeline Company*, 56 FERC ¶61,104, at p. 61,371 (1991).

[61,108]

[204] *See* SFPP's Brief on Exceptions at 95, footnote 89.

[205] *Id.*, 97.

[61,109]

[206] The Financial Accounting Standards Board ("FASB") issued SFAS 106 in December 1990. SFAS 106 requires that, for fiscal years beginning after December 15, 1992, employers reflect in current expense an accrual for post-retirement benefits other than pensions during the working lives of covered employees. SFAS 106 essentially finds that PBOP plans are "deferred compensation arrangements whereby an employer promises to exchange future benefits for employees' current service and that their cost should be recognized over the employees' service periods for financial accounting and reporting services." *Post-Employment Benefits Other Than Pensions, Docket No. PL93-1-000, Statement on Policy* ("*Policy Statement*"), 61 FERC ¶61,330, at p. 62,199 (1992), *reh'g denied*, 65 FERC ¶61,035 (1993).

[61,110]

[207] *Policy Statement*, 61 FERC ¶61,330, at p. 62,200.

[208] 61 FERC at pp. 62,202-03.

[209] *See* Ex. 719.

[210] Ex. 337 at pp. 12-13.

[211] Ex. 719.

[212] 80 FERC at pp. 65,172-73.

[61,111]

[213] *Policy Statement*, 61 FERC ¶61,330, at p. 62,202.

[214] 80 FERC at p. 65,173.

[215] 80 FERC at pp. 65,201-208.

[216] 80 FERC at pp. 65,207-08.

[217] 80 FERC at pp. 65,205-06.

[218] 80 FERC at pp. 65,202-203.

[61,112]

[219] Refunds under the Natural Gas Act are also at the Commission's discretion. Reparations are not available under the NGA since rate changes in complaint cases are only effective prospectively under Section 5 of the NGA.

[220] *See* 80 FERC at pp. 65,204-05, *citing Thompson Phosphate Co. v. Atlanta Coast Line*, 282 F. Supp. 698 (S.D.N.Y. 1968).

[221] *See* 80 FERC at p. 65,204, n.851.

[222] 80 FERC at p. 65,205, *citing Revere Petroleum Corp.*, 60 FERC ¶63,023, at p. 65,192 (1992).

[61,114]

[223] *SFPP., L.P.*, 60 FERC 62,252 (1992).

[224] 18 C.F.R. §341.8 (1998).

[225] 80 FERC at pp. 65,196 -201.

[226] 76 FERC ¶61,164 (1996).

[227] 89 F.2d 878 (D.C. Cir. 1996).

[61,115]

[228] *Citing* Exh. 147 at 24-28.

[229] Tr. 5471.

[230] *Id.*; *see also* Exhs. 903 and 904.

[61,116]

[231] The instant case is a complaint case because SFPP did not change the tariff provisions related to its prorationing policy when it filed Tariff No. 17. Rather, the Oil Pipeline Board used the filing of that tariff, which contained SFPP's existing tariff language, to set the issue of whether the tariff, and the underlying detailed circular, were just and reasonable for hearing. 60 FERC at p. 63,508 . While suspension of the entire tariff was customary under Section 15(7), for those provisions of the tariff that were not a modification from SFPP's previous tariffs, the protesting parties have the burden of proof under Section 13(1) of the IC Act.

[232] Exh. 117.

[233] *Id.*

[234] *See* Exh. 151.

[235] *See* Exhs. 98-104.

[236] *See* Tr. at 5463-4, 5465, 5472.

[237] *See* Tr. At 8009-11. For example, if the system is constrained, the curtailment factor is 50 percent, and the new shipper intends to only ship 10,000 barrels while nominating 20,000, the abuse would not be detected because the amount available under prorationing would just be 10,000 barrels. However, the amount of capacity available to other shippers is reduced by 5000 barrels since this is the amount the new shipper would be limited to if SFPP were able to verify that the amount that was likely to be shipped was only 10,000 barrels rather than the 20,000 nominated.

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