Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

SFPP, L.P.
Order on Initial Decision
106 FERC ¶ 61,300 (2004)

This order addressed a Phase I initial decision (ID) on complaints against SFPP, L.P.'s (SFPP) interstate rates for the years 1996, 1997, 1998, and 2000, alleging that SFPP's rates or charges on its West, East, North, and Oregon Lines, and for its Watson Station Drain Dry facilities were unjust and unreasonable. The Initial Decision dealt primarily with the issue of whether the complainants had satisfied the "changed circumstances" standard established in Section 1803(b)(1) of the Energy Policy Act of 1992 (EPAct) and thus were eligible to seek a just and reasonable determination under Section 15(1) of the Interstate Commerce Act (ICA). This standard requires a showing of evidence that establishes that a substantial change has occurred in the pipeline's economic circumstances after the date of enactment of the EPAct. (at 62,139).

The Commission affirmed most of the Judge's conclusions on the interpretation of the statute (at 62,139), but modified the ALJ's method for making the calculations used in determining whether there were substantially changed circumstances, in the following manner.

- Any change that occurs between the EPAct effective date (B) and the date of the complaint (C) must be measured relative to economic basis of the rate (A). (C-B/A)

- Only if the information regarding A is not readily available, would it be appropriate to compare any B to C change relative to B. (C-B/B)

- If B is less than A in a situation where those factors would be expected to show an increase, the proper comparison is the change from A to C, relative to A. (C-A/A). The same would be true if B is greater than A in a situation where those factors would be expected to show a decrease. (at 62,142-43)

- The Commission concluded that the ALJ should not have relied so heavily on the changes in tax rates and tax allowances, which can lead to anomalous results. The Commission also concluded that the ALJ should have examined rate base when making his determinations. (at 62,143-44)

- While changes in regulatory policy may be considered in determining whether there are substantially changed circumstances, and the Commission's decision in Lakehead Pipe Line Company, L.P., 71 FERC ¶ 61,338 (1995), reh'g denied, 75 FERC ¶ 61,181 (1996) was not final until 1996, the Lakehead policy should not be used as a stand-alone factor in addressing substantially changed circumstances. It should only be used in the context of a full cost-of-service analysis. (at 62,144).

- While a complainant must show both prongs under the statute to show substantially changed circumstances, if a pipeline is unable to produce anything during discovery that bears on the economic basis of the rate at issue, it will not be permitted to defeat the

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

purpose of the statute on the absence of evidence absent offering an alternative theory on its own behalf. (at 62,149).

The Commission applied a two-step process in determining whether there had been a substantial economic change. First, the Commission determined what the economic basis was for the rate on each line and facility, which required finding when each rate became effective and what the economic factors underlying each rate were. Second, the Commission determined whether there had been a substantial change to that economic basis. (at 62,144-45). Utilizing this process, the Commission affirmed the ALJ's finding of changed circumstances on the West Line and reversed his finding of changed circumstances on the North and Oregon Lines. (at 62,145-50). It also affirmed that the East Line shippers are eligible for reparations. (at 62,152-53).

In setting the cost issues for further development in Phase II, the Commission reiterated that the general rule on the write-up of assets acquired by one company from another is that such assets must be included in the acquiring company's rate base for rate making purposes at no more than their depreciated original cost, unless it can be shown by clear and convincing evidence that the acquisition results in substantial benefits to the ratepayers. Since SFP had not made such a showing the parties were directed not to use the write-up in designing rates. (at 62,152).

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

COMM-OPINION-ORDER, 106 FERC ¶61,300, ARCO Products Co. a Division of Atlantic Richfield Company, Texaco Refining and Marketing Inc., and Mobil Oil Corporation v. SFPP, Docket Nos. OR96-2-000, OR96-10-000, OR98-1-000 and OR00-4-000, (March 26, 2004)

© 2005, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company

ARCO Products Co. a Division of Atlantic Richfield Company, Texaco Refining and Marketing Inc., and Mobil Oil Corporation v. SFPP, Docket Nos. OR96-2-000, OR96-10-000, OR98-1-000 and OR00-4-000

[62,139]

[¶61,300]

ARCO Products Co. a Division of Atlantic Richfield Company, Texaco Refining and Marketing Inc., and Mobil Oil Corporation v. SFPP, Docket Nos. OR96-2-000, OR96-10-000 , OR98-1-000 and OR00-4-000

Ultramar Diamond Shamrock Corporation, Ultramar, Inc. v. SFPP, OR92-2-002, OR96-15-000, OR96-17-000, OR97-2-000 , OR98-2-000 and OR00-9-000

Tosco Corporation v. SFPP, OR98-1-000 , OR98-13-000 and OR00-9-000

Navajo Refining Corporation v. SFPP, OR00-7-000

Refinery Holding Company v. SFPP, OR00-10-000

SFPP, L.P., OR96-2-002, OR96-10-002 and OR96-17-002

SFPP, L.P., IS98-1-000

Order on Initial Decision

(Issued March 26, 2004)

Before Commissioners: Pat Wood, III, Chairman; Nora Mead Brownell, Joseph T. Kelliher, and Suedeen G. Kelly.

I. Summary

1. This order addresses a June 24, 2003, Phase I Initial Decision (ID)[1] on complaints against SFPP, L.P.'s (SFPP) interstate rates for the years 1996, 1997, 1998, and 2000. Those complaints alleged that SFPP's rates or charges on its West, East, North, and Oregon Lines, and for its Watson Station Drain Dry facilities were unjust and unreasonable. The principal issue addressed by the ID is whether the complainants have satisfied the threshold "changed circumstances" standard in Section 1803(b)(1) of the Energy Policy Act of 1992[2] (EPAct) and thus may seek a just and reasonable determination under Section 15(1) of the Interstate Commerce Act (ICA).[3] This threshold standard requires a showing of evidence that establishes that a substantial change has occurred after the date of enactment of the EPAct in the economic circumstances of the pipeline which were a basis for the rate,[4] and is referred to here as the "substantially changed circumstances" standard.

2. The administrative law judge (ALJ) found that the substantially changed circumstances standard had been satisfied with regard to: SFPP's West Line rates for 1996, 1997, 1998, and 2000; the North Line for 1997, 1998, and 2000; the Oregon Line for 1997, 1998, and 2000; and in the case of the Watson Station Drain Dry facilities, for all years for which complaints were filed. After making those determinations, the ALJ further held that SFPP's

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

rates for the West, North, and Oregon Lines were not just and reasonable for any of the years at issue, nor were the Watson Station Drain Dry charges. The ALJ also held that SFPP's East Line rates were not just and reasonable in the years 1997, 1998, and 2000. The ALJ further concluded that it was necessary to resolve issues regarding SFPP's cost structure in a Phase II of this proceeding in order to establish just and reasonable rates.

3. SFFP, the Association of Oil Pipelines (AOPL), and Chevron Products Company (Chevron) filed exceptions to the ID. Briefs opposing SFPP's and the AOPL's exceptions were filed by all other participants,[5] while SFPP filed in opposition to Chevron's. On review, the Commission affirms most of the ALJ's conclusions on the interpretation of the statute, but modifies the ALJ's method for making the specific calculations used to determine whether there are substantially

[62,140]

changed c.rcumstances. The Commission affirms the ALJ's findings of changed circumstances on the West Line, and the Commission reverses the ALJ's findings of changed circumstances on the North and Oregon Lines. Issues regarding the Watson Station Drain Dry facilities are now pending before the D.C. Circuit Court of Appeals and will be addressed once the Court rules on those issues.

4. The Commission also affirms the ALJ's initial conclusion that rates and charges for the West Line were not just and reasonable for the years at issue. The Commission also affirms the ALJ's rulings on procedural and evidentiary points and his conclusion that SFPP's East Line complainant shippers are eligible for reparations. The ALJ thus is authorized to proceed with Phase II to resolve West Line cost-of-service issues. In authorizing this continuation into Phase II, the Commission expects the ALJ to bring the proceeding to an early conclusion.

5. On review here, the Commission determines a cost-of-service issue regarding the acquisition write-up of SFPP's rate base on December 31, 1998, rather than referring the issue to Phase II. The Commission concludes that the write-up is inconsistent with Commission policy.

6. Upon a final resolution of the outstanding cost-of-service issues by the Commission, SFPP will be required to make compliance filings establishing the specific rates and charges to be applied prospectively from an effective date to be established by the Commission. The Commission will set the procedures for any compliance filings and for calculating any reparations that may due.

II. Background

7. The instant proceedings are a sequel to the protracted litigation between SFPP and several of its oil pipeline *customers that began with the filing of a complaint against SFPP's East Line rates in* Docket No. OR92-8-000 *on* September 2, 1992.[6] A series of complaints filed through August 7, 1995, asserted that SFPP's rates for its West Line between Los Angeles and Arizona and those for its East Lines between El Paso and Arizona were unjust and unreasonable. These complaints were consolidated with Docket No.OR92-8-000, and were addressed by Opinion No. 435, issued January 13, 1999,[7] its rehearing orders in Opinion Nos. 435-A and 435-B,[8] and ending with the acceptance order of SFPP's compliance filings in Docket Nos. OR92-8-020 and -021 on June 5, 2003.[9]

8. In those orders the Commission addressed: (1) the "substantially changed circumstances" standard with regard to complaints against SFPP's West Line rates for the period before August 7, 1995; and (2) cost-of-service issues regarding the East Line. The Commission found that the complainants had based their case on a one year cost- of-service for the 12 months before the EPAct became effective, and not on the economic circumstances that underlay the challenged West Line rates in the year those rates were established, *i.e.*, 1989 in the case of the West Line rates, which were filed with the Commission in early 1989.[10] The Commission thus concluded that the complainants had failed to meet the substantially changed circumstances standard. Further, because SFPP's East Line rates were not grandfathered under the EPAct, the Commission addressed the justness and reasonableness of those rates, determined that they should be reduced prospectively for all shippers as of August 1, 2000, and ordered reparations for those shippers that had filed complaints against those rates.[11]

9. Additional complaints were filed against SFPP's rates in 1996, 1997, and 1998. When the Commission

issued Opinion No. 435 in January 1999, the Commission issued a contemporaneous order permitting complainants to amend their pending complaints in light of the rulings in that opinion.[12] The amended complaints, which were filed in January 2000, were consolidated with the pending complaints that had been filed after August 7, 1995, and set for hearing.[13] Additional complaints filed in August 2000 were likewise consolidated and were set for hearing.[14] As noted, the ID was issued on June 24, 2003. The time for filing briefs on exceptions and briefs opposing exceptions was extended, the latter being filed on September 5, 2003.

10. The complaints filed after 1995 differed from the earlier series in that most challenged all of SFPP's rates, not just those of SFPP's East and West Lines. Thus, the challenges in the consolidated dockets here are directed against the West Line rates from Los Angeles to Phoenix and Tucson, Arizona, the East Line rates from El Paso to Phoenix and Tucson, Arizona, the North Line rates from Oakland to Reno, Nevada, and the Oregon Line rates between Portland and Salem. Complaints were also filed against SFPP's charges for the operation of its Watson Station Drain Dry facilities and its Sepulveda Line, both located in SFPP's Los Angeles origin market. The Drain Dry

[62,141]

Facilities are used to assure that oil is inserted into SFPP's system at mainline operating pressures. The Sepulveda line connects certain refineries and storage facilities at Sepulveda Junction to SFPP's trunk system at Watson Station. The proceeding regarding the latter rates for service on Line 109 between Sepulveda Junction and Watson Station was held in abeyance until a recent Commission ruling that SFPP had not established that it lacked significant market power for transportation services over the Sepulveda line.[15]

11. The ID reviewed the various complaints filed in 1996, 1997, 1998, and 2000 in detail, including the dates that they were filed and the rates at which each filing was directed.[16] While all these dates need not be repeated here, the date that each of the complaints was filed is significant for at least two reasons. First, if a rate is grandfathered under the EPAct, any attempt to show substantially changed circumstances must be based on circumstances occurring after the date of the EPAct and before the filing of the complaint.[17] Second, if the complaint does satisfy the substantially changed circumstances standard, Section 1803(b) of the EPAct provides that reparations of grandfathered rates are due only from the date of the complaint forward to the date on which any new rate is set prospectively. The dates of the complaints against the East Line rates, which are not grandfathered, will also determine whether reparations will be due, since only those complaints filed before new rates were set for the line on August 1, 2000, are eligible for reparations.

12. The balance of this order reviews the ALJ's interpretation of Section 1803 of the EPAct and its application to the rates charged for service over SFPP's West, East, North, and Oregon Lines. While the issue of whether the Sepulveda Line (Line 109 between Sepulveda Junction and Watson Station) is grandfathered was not formally before the ALJ at the time the ID issued, he nevertheless ruled on the matter.[18] The parties have briefed that issue and the Commission at this time can resolve the issue. It is uncontested that the East Line rates are not grandfathered and those complainants need not meet the substantially changed circumstances standard for those rates. For the East Line rates the issue thus is whether they are just and reasonable under Section 15(1) of the ICA.

III. Discussion

13. The central issue in Phase I of this consolidated proceeding is the proper interpretation and application of Section 1803(b)(1) of the EPAct. That section provides that a rate deemed to be just and reasonable under the EPAct, *i.e.*, a grandfathered rate, may be challenged only if a complainant presents evidence to the Commission which establishes that a substantial change has occurred after the date of enactment of the Act:

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

(B) in the nature of the services provided that were a basis for the rate.

14. The issues addressed here center on Subparagraph A, a substantial change "in the economic

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

circumstances of the oil pipeline which were a basis for the rate..." and the procedures to be used in applying that standard. Whether some of the rates at issue are actually grandfathered under the EPAct is another issue that is addressed, since rates that are not grandfathered may be challenged without a complainant meeting the substantially changed circumstances threshold. Subparagraph (B) of Section 1803(b)(1) is not at issue.

15. In Opinion No. 435, the Commission concluded that a "substantial change" is more than a "material change," and that Congress would not have adopted the word "substantial" if the conventional accounting threshold of ten percent, or another relatively low quantity, were meant to be the test for establishing substantially changed circumstances. The Commission also addressed whether a complainant must establish that there has been a substantial change to every rate design element that may be the economic basis for a challenged grandfathered rate in order to meet the substantially changed circumstances standard. The Commission concluded that this is not the case, holding that a substantial change could be established by one or a number of rate elements, thereby triggering an investigation under Section 15(1) of the ICA as to whether the rate is just and reasonable.[19]

16. The Commission further held in Opinion No. 435 that the number of rate elements that significantly affect the economic basis for most rates is relatively small, and that the basic ones are volumes, asset base, operating costs, and, perhaps, capital costs. Since these elements in turn are most likely to influence the oil pipeline's revenue requirements and return, the Commission stated, complainant must establish substantial change to one or more of these important elements that are the basis for a grandfathered rate and explain why this change is likely to have rendered that rate unjust and unreasonable. The Commission also concluded that in assessing whether the substantially changed circumstances standard had been met, any change must have occurred after the date of enactment of the EPAct, and must be measured against the economic assumptions embodied in the grandfathered rate.[20]

[62,142]

A. *The ALJ's Determinations*

17. The ALJ addressed how the substantially changed circumstances standard of Section 1803(b) of the EPAct should be construed, developed a methodology for measuring whether there had been substantially changed circumstances, and applied that methodology to determine whether there were substantially changed circumstances for the West, North, and Oregon Lines and for the Watson Station Drain Dry Facilities. The ALJ also determined that the Watson Station Drain Dry Facilities and Sepulveda Lines were not grandfathered, and that reparations would be available to shippers on the East Line if the rates for that line were not found to be just and reasonable in the complaint years at issue.

18. In construing Section 1803(b) of the EPAct, the ALJ generally adopted the Commission's analysis in Opinion Nos. 435, 435-A, and 435-B. He concluded that Section 1803(b) requires that substantially changed circumstances must occur after the effective date of the EPAct but before the date of a complaint, and must be measured against the economic circumstances in the year in which a grandfathered rate was established (filed). He also concluded that the measurement of change could be based on one or more important cost factors, such as volumes, rate base, total allowed return, and changes in tax rates and income tax allowances.

19. To measure whether there were substantially changed circumstances, the ALJ identified three different points in time, denoted "A," "B," and "C": "A" to represent the year that includes the economic basis for a grandfathered rate, *i.e.*, the year when a grandfathered rate was filed and took effect; "B" to represent the 12-month period ending October 24, 1992, the date of enactment of the EPAct; and "C" to represent the year when a complaint was filed. The ALJ then concluded that a measurement to determine whether there were substantially changed circumstances required two comparisons. The first, to see if there was a substantial change in economic circumstances from the date the rate became effective, "A," to the date the complaint was filed, "C," compared the cost factors at "A" to the cost factors at "C" to obtain a percentage difference relative to "A," *i.e.*, (C-A)/A. If this comparison showed substantially changed circumstances, the ALJ then compared the cost factors at "B" to the cost factors at "C" relative to "B," *i.e.*, (C-B)/B, to see if the substantial changes occurred after "B," the date of enactment of the EPAct.

20. As a final step before deciding whether there were substantially changed circumstances, the ALJ addressed what "A," the year grandfathered rates took effect, should be for each of the West, North, and Oregon Lines. For the West Line the ALJ determined that "A" was 1989 and that the economic basis for the rates filed in that year was a cost-of-service study submitted by SFPP. For the North Line the ALJ determined that "A" was also 1989 and that the economic basis for those rates was a cost-of-service study for the North Line submitted by SFPP. For the Oregon Line the ALJ determined that "A" was 1984, the year the rates were established. The ALJ concluded, however, that there was no evidence of record that would enable a determination of the economic basis for the Oregon Line rates. In the absence of such evidence, the ALJ examined the period after "B" to determine if there had been a substantial change in economic circumstances between "B" and "C," relying on cost-of-service information such as changes in volumes, rate base, allowed returns, income tax rates, and income tax allowances. The ALJ also addressed the Watson Station Drain Dry rates, focusing on the fact that the rate base of those facilities had been fully recovered after the date of enactment of the EPAct. The ALJ's methodology and conclusions and objections thereto are reviewed below.

B. *The Commission's Determinations*

21. This portion of the order addresses the ALJ's conclusions and methodology for analyzing substantially changed circumstances, the factors used in that analysis, and the findings for each of the lines and facilities at issue.

1. *The Methodology for Measuring Changed Circumstances*

22. As described earlier, the ALJ's methodology compared different points in time to determine whether there had been substantially changed circumstances. The ALJ held that change must have occurred after the date of enactment of the EPAct and should be measured by the percentage difference: (1) between C and A, compared to A; and (2) the percentage difference between C and B, compared to B. The ALJ properly concluded that any substantially changed circumstances must occur after the effective date of the EPAct. The ALJ erred, however, by concluding that any change that occurred between B, the EPAct effective date, and C, the complaint date, *i.e.*, C-B, should be evaluated relative to B. Rather, the change from B to C properly should be evaluated relative to A, since the EPAct requires a showing that there has been a change in the economic circumstances that were a basis for the rate, *i.e.*, a change compared to A. That formula, *i.e.*, (C-B)/A, was supported by the Commission's Trial Staff. The ALJ's use of a cumulative change from A to C is not needed to make this comparison.

23. As an example, assume the value for A is 100, B is 120, and C is 140. A comparison using the ALJ's approach of (C-B)/B would require comparing a change of 20 to B, or 120, and would result in a 16.7 percent change. The EPAct, however, requires that the change after the EPAct, C- B, or 20, be compared to the basis of the rate, A, or 100. This would result in a 20 percent change. If information regarding A is not readily available, however, only then would it be appropriate to compare any B to C change relative to B, as the ALJ did in addressing SFPP's Oregon Line.

[62,143]

24. When the value of B is less than A, however, the appropriate comparison is the change from A to C relative to A, *i.e.*, (C-A)/A. This would apply to those factors that would be expected to increase in a changed circumstances situation, such as volumes. As an example, assume A is 100, B is 80 and C is 100. The change from B to C is 20, or a change of 20 percent relative to A, while the change from A to C is 0. Since the EPAct provides that evidence of a substantial change in the circumstances that were the basis for a grandfathered rate is necessary to challenge the justness and reasonableness of that rate, it only makes sense to conclude that such a change must reflect an increase above the basis, *i.e.*, above A, in this example a value of 100. In this instance, using a comparison of C-B relative to A would reflect a change from some point that is less than the basis value of A, *i.e.*, from 80 to the basis value, 100, in the example. This comparison would reflect a change not in the basis for a grandfathered rate but rather in a value that is less than the basis for the rate.

25. Similarly, for factors expected to decrease, such as costs and rate base, the formula also would be (C-A)/A

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

when the value for B is greater than A. If A is 100, for example, B is 120, and C is 100, this formula would reflect no change above A, the basis for the rate, at C. Again, using a comparison of C-B relative to A instead, would reflect a change from a point greater than the value of A, and thus would not reflect a change in the basis for the rate.

26. The comparisons thus would be inconsistent with the EPAct. The ALJ acknowledged that a comparison of C-B relative to A could lead to illogical results in these situations, but he discarded it completely in favor of (C-B)/B rather than adopting an approach that would account for such situations. Congress may have assumed that on the effective date of the EPAct, it was likely that oil pipelines would have had grandfathered rates that had been in effect for long periods and thus would have values at B that differed from those that long before at A were the bases for those grandfathered rates. That, however, is not always the case. On SFPP's West Line, for example, the volumes declined from 60,480,000 in 1989, which is A, to 52,160,000 at the enactment of EPAct, which is B. Volumes on SFPP's North Line likewise declined. *See* Appendix A, Table 1. Similarly, the West Line rate base for 1992 is greater than that for the base period 1989. *See* Appendix B, Table 3.

2. *The Factors to Be Used for Measuring Change*

27. In making his determinations of whether there were substantially changed circumstances for the various rates at issue here, the ALJ reviewed the following major cost factors: total volumes, income tax rate, income tax allowance, and allowed total return in the case of the West Line, together with some composite evidence prepared by Ultramar;[21] volumes, income tax rate and income tax allowance in the case of the North Line;[22] and volumes, income tax and income allowance in the case of the Oregon Line.[23]

28. SFPP attacks this methodology on several grounds. First, it asserts that the ALJ relied in several cases on only one factor rather than several as is required by Opinion No. 435, that he failed to evaluate realized compared to projected returns, and that his decision places undue emphasis on the *Lakehead* tax allowance adjustment.[24] SFPP also asserts that the ALJ excessively relied on cost-of-service considerations.[25] The Complainant Parties and Staff reply that the ALJ did rely on more than one factor in most instances, that Opinion 435 specifically states the reliance on one or more factors is appropriate, and that the factors the ALJ used were consistent with the direction in Opinion No. 435.

29. The ALJ's reliance on a few important cost- of-service factors in making his determinations was consistent with Opinion No. 435 where the Commission identified the rate elements it considered would significantly affect the economic basis for most rates. However, the ALJ did not examine one factor, rate base, that is an important component of allowed return and a major factor that can affect a pipeline's return. He also relied too extensively on the changes in tax rates and tax allowances, which the Commission concludes below can lead to anomalous results. The ALJ's use of volume changes and allowed total return as major cost factors is affirmed. Volumes measure the growth or decline of the pipeline's business and are a good proxy for revenue growth. Allowed total return reflects the permitted return that would be permitted given its current rate base and the current weighted cost of capital. Changes in this cost factor therefore reflect changes in the rate base as well as changes in the cost of capital.

30. Changes to the rate base also reflect the increase and decrease in pipeline assets that may occur from additional investment, retirements, or the decline in rate base that occur as assets of different vintages are depreciated under the Commission's

[62,144]

Opinion No. 154-B cost methodology.[26] The size of the rate base directly influences the return because the allowed rate of return is applied to it, thus determining the dollar amount of the return. As such, it is likely to be a significant factor because of the large amount of fixed costs present in a capital-intensive industry like oil pipelines. It is a figure carried on the company's books and should be readily allocated to a specific service based on the capital line items and related accrued depreciation recorded in the pipeline's property accounts.

31. The ALJ also concluded that a change in regulatory policy could establish substantially changed circumstances. The ALJ therefore applied the so-called *Lakehead* tax allowance policy[27] in analyzing SFPP's

income tax allowance.[28] The Lakehead case held that a pipeline partnership could take an income allowance only for the portion of the partnership interests that would be subject to double taxation on income distributions, primarily by corporate owners.

32. SFPP objects to the ALJ's reliance on the *Lakehead* policy in determining substantially changed circumstances. It asserts that the Commission itself described *Lakehead* as a continuation of existing Commission policy, and that in Opinion No. 435 the Commission applied *Lakehead* to reparations for the calendar year 1992. SFPP further asserts that use of the *Lakehead* policy reflects a more fundamental error of including regulatory changes as a factor in the ALJ's determinations, if those changes occurred after the rate at issue was established. The Complainant Parties and Staff assert that SFPP's position has no merit because the *Lakehead* policy was announced in 1995 and became Commission policy only at that time. They further argue that the Commission expressly held in Opinion No. 435 that regulatory change was one factor to be addressed in evaluating whether there are substantially changed circumstances.

33. The Complainant Parties and Staff are correct that the Commission has previously determined in Opinion No. 435 that Congress did not reject changes in regulatory policy as a consideration in determining whether there are substantially changed circumstances. Moreover, SFPP's specific arguments regarding the *Lakehead* policy are without merit. The policy was not final until after rehearing in the Lakehead proceeding was decided in 1996, and until that date pipeline partnerships were free to take the full income tax allowance. In fact, SFPP did so in preparing the cost-of-service evidence it produced in 1989 to justify its West and North Line rates.

34. While *Lakehead* may have represented an evolution of Commission policy, this is only in the sense that the Commission has a long-standing policy that an income tax allowance should be permitted only for taxes that are actually incurred.[29] The argument that the policy was decided before 1992 because the Commission applied the policy in determining SFPP's 1992 reparations is equally specious. The Commission explicitly stated in Opinion No. 435 that it was following the standard procedure of applying current policy to the year at issue in the context of setting a reasonable rate.[30] This ruling applied as well to the reparations for 1993. The determination of rate reasonableness in either year did not address the relevance of Lakehead to determining whether there had been substantially changed circumstances to the economic basis of a rate.

35. The Commission also concludes, however, that the *Lakehead* policy should not be used as a stand-alone factor in addressing whether there have been substantially changed circumstances. The application of the policy in this case has already involved extensive discovery and litigation regarding its scope, which will vary from year to year as ownership ratios change. Because of these year to year variations, application of the policy involves the complexities associated with a full cost-of-service study[31] and should be utilized only in that context. Moreover, as the analysis of the North and Oregon Lines in the next part of this order indicates, there can be a very large reduction in income tax allowance in the years since 1992 even if many of the other principal cost factors, and in fact the total cost of service, increased after 1992.[32] For this reason the Commission reverses the ALJ to the extent that he relied on the use of the Lakehead factor outside the context of a full cost-of-service analysis in making his determinations.

3. *The Determinations for the Individual Facilities*

36. There are two major steps involved in determining whether there has been a substantial change in the economic circumstances of each of SFPP's lines and facilities. The first step is determining what is the economic basis for the rate on each line and facility, which goes to finding when the particular rates became effective and what were the economic factors underlying those rates.

[62,145]

The second step is determining whether there has been a substantial change to that economic basis. These steps are applied here to SFPP's West, North, and Oregon Lines. Since whether a rate is grandfathered determines if a changed circumstances finding must be made by the Commission, the issue of whether the Sepulveda Line are grandfathered is also reviewed here.

37. As has been discussed, the Commission concludes that the ALJ applied an incorrect formula when making determinations regarding substantially changed circumstances. However, much of the data the ALJ relied on in making those calculations was correct, including updated cost-of-service information provided by SFPP at his

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

direction and volume information provided by the Trial Staff and SFPP. Relying on this information, the Commission reevaluated whether there were substantially changed circumstances by applying the correct formula. This revised analysis is reflected in the tables and charts in the Appendices to this order. These tables and charts illustrate each of the changed circumstances calculations made here.

38. Appendix A displays the volumes for each of SFPP's lines and percentage changes in volumes for each line. Appendices B, C, and D display for the West, North, and Oregon Lines charts and graphs showing the change in absolute numbers of volume, rate base total allowed return, tax allowance, and cost-of-service trends for each of those lines. Certain charts also compare the import of the ALJ's two formulas [(C-A)/A and (C- B)/B] and that used by the Commission [(C-B)/A].[33] When the overall trends are consistent, as in the case of the West Line, the conclusions of the ALJ and the Commission are the same. This is not the case, however, for the North and Oregon Lines due to the fact that the costs of those lines increased after 1992.

a. *The West Line*

i. *The Economic Basis for the Rates*

39. The ALJ determined that for SFPP's West Line rates the economic circumstances that were the basis for those rates were the "TOP Sheets" SFPP submitted to the Commission in on January 4, 1989, to justify the 25 cent per barrel increase to Tucson that became effective in February 1989, and thereafter a reinstated rate to Phoenix that became effective in early April 1989.[34] He further concluded that the rates were established on the date that they became effective. He also concluded that any change in the economic circumstances that were the basis for the West Line rates must be measured against the cost-of-service factors contained in the "TOP Sheets" submitted to the staff, particularly the forecasted volumes that were used in those sheets.

40. SFPP argues on exceptions that the economic basis for the West Line rates is reflected in its settlement offer to the Airline-Intervenors in a February 26, 1988 letter from Mr. Abboud, an officer of SFPP, to Mr. John Cleary, counsel to the Airline-Intervenors. That letter, together with other correspondence, resulted in a settlement agreement between SFPP and the Airline-Intervenors in March of 1988.[35] SFPP further argues that the economic circumstance for the West Line rates should be determined by the volumes SFPP expected to flow over the West Line once those volumes reached the capacity upon which the 1998 expansion of that line was predicated (the mature volumes).

41. SFPP also asserts that the filing with the Commission in 1989 of the revised Phoenix and reinstated Tucson rates after the completion of the West Line expansion did not establish the rates, but that they were established by negotiation. SFPP also argues that the Commission rejected the use of test year data as the economic basis for a rate in Opinion No. 435, and thus the use of the 1989 "TOP Sheets" is incorrect. SFPP argues that the Commission should use its projected 1991 "mature" volumes of 74.7 million barrels per year as the volume component for comparing any subsequent changes to its 1989 West Line rates.[36]

42. The Complainant Parties and the Commission Trial Staff support the ALJ, arguing that there were no exact rate levels established by Mr. Abboud's letter to Mr. John Cleary, or by the 1988 Settlement itself. They argue that the 1988 Settlement only established a 25-cent cap for the increase of any rates to recover the increased investment in the West Line, together with a bar to challenging those rates for a five-year period after the filing of Tariff 88.[37] They further assert that neither the 1988 Settlement nor Mr. Abboud's letter to Mr. John Cleary establishes what volumes would be used to design the rates, and that the volumes submitted to the FERC Staff in the 1989 "TOP Sheets" should control.

43. The Complainant Parties and the Commission Trial Staff further argue that if SFPP had used its anticipated long term volumes, then the Commission staff would have required a lower rate based on those higher volumes. Finally, they argue that the Commission rejected the use of 1992 as a test year in Opinion No. 435 because it was the wrong year to use to determine the economic

[62,146]

basis for the rate, not because the use of a cost-of- service approach was inherently incorrect. They state that the ALJ correctly adopted the1989 top sheet volume of 60.4 million barrels per annum as the volume component of the economic basis for SFPP's West Line rates.

44. The Commission agrees with the arguments of the complainants and the Commission Trial Staff and thus affirms the ALJ. First, it is clear that the rates for the West became effective in early 1989, and as such were established once they became effective without suspension; the issue here is to determine the economic basis for those rates. The economic basis for those rates is the "TOP Sheets" that were submitted to the Commission's Oil Pipeline Board for its review in January 1989. As pointed out by Complainant parties, SFPP's own documentation indicates that SFPP expected a critical review by the Staff and the burden would be on SFPP to convince the Oil Pipeline Board, which had authority to suspend the rates, not to do so.[38] SFPP anticipated and planned for the submission of documentation to the Oil Pipeline Board to justify the modified West Line rates,[39] and recognized that any rates developed pursuant to the March 1988 Settlement were not in themselves justified by the 1988 Settlement.[40] In fact, SFPP therefore prepared a three- volume study to justify the rates and submitted the entire study to the Commission staff. SFPP asserts that this study included forecasts of the 1989 and 1991 volumes.[41] As SFPP anticipated, prior to SFPP's January 1989 submission to Staff, the Commission took no action to accept any specific rates under the terms of the 1988 Settlement.

45. In acting on the 1988 Settlement, the Commission-specifically declined to accept specific rates, holding that the rates actually filed pursuant to that Settlement would be reviewed to determine if they were just and reasonable, and that firms that were not party to the 1998 Settlement and the Commission Trial Staff could challenge those rates when filed.[42] Given its own expectation that the 25 cent increase would be embedded in rates that would have to pass Staff review, and the extensive justification SFPP prepared, the Commission concludes SFPP's argument that the detailed filing submitted to Staff has no relevance to its definition and justification of the West Line rates has no merit. The Commission therefore finds that the only effect of the 1988 Settlement was to permit SFPP to increase the rates on its West Line by up to 25 cents a barrel once the West Line expansion was completed.[43] Before the rates were actually filed in early 1989, there was no agreement on the specific size of the increase, which SFPP had indicated might be less than 25 cents,[44] and equally important, the volumes upon which the rates would be premised. The Abboud letter is inadequate to establish the economic circumstances for the basis of the West Line rates.

46. At bottom, SFPP's position is essentially grounded in its financial expectations in expanding its West Line. SFPP argues that when corporations make investments of the magnitude of the West Line, the expected returns will be realized (the realized returns) only when anticipated utilization is achieved. Thus, the improvements are expected to under-perform in the early years with full returns being achieved in later years. Under this theory, the conditions described in the Abboud letter reflect its corporate expectations from the expansion of the West Line, that the forecasted volumes of 74.7 million barrels per annum embody the fulfillment of those expectations, and that these expectations were embedded in the 1988 Settlement. SFPP therefore argues that changed circumstances should be measured against those volumes and the economic returns that it expected to obtain when the expansion matured.

47. The difficulty in SFPP's position is that its initial internal corporate analysis for the West Line rates was specifically designed in the context of the regulatory framework that existed at that time and in expectation of the Commission's review, or at least that of the Oil Pipeline Board.[45] SFPP anticipated that the rate level it deemed adequate to obtain a 14.1 percent incremental annual return would have to be justified in the context of a probable Oil Pipeline Board review. Exhibit JMA-3 is a project analysis for the West Line expansion prepared in October 1987. After discussing recent changes in tax law, the document evaluates possible system-wide returns after the completion of the project based on 74.5 percent equity capital structure, a 25 cent per barrel increase, and a 10 to 11 percent system-wide regulatory return. The assumptions include a 50 percent roll back of pending rate increases on the West Line and a 100 percent roll back on the East Line.[46]

[62,147]

48. Once the settlement was reached incorporating many of these features, Ex. JMA 14 indicates that an 18-cent per barrel incremental rate (on top of the rollbacks) would have been sufficient to give SFPP a projected return on its incremental investment in the West Line of 14.8 percent per year.[47] SFPP submitted the justification for proposed rates to the Commission in January 1989 based on the 60.4 million barrels in the "TOP Sheets." Clearly SFPP concluded that this level of volumes would be adequate to meet its corporate goals.[48] SFPP's internal documents thus disclose that the economic basis for the rate was embedded in the information eventually

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

included in the January 1989 "TOP Sheets." This is true even though, as SFPP asserts, the 1988 Settlement negotiations and the Settlement occurred in early 1988 and the rates themselves were not filed until 1989. There is no merit to SFPP's argument that there is no connection between the time frame in which the 1988 Settlement was negotiated and the preparation of the Top Sheets. The 1989 "TOP Sheets" reflect a well thought through plan to design and justify the new West Line rates.

49. Complainant parties also correctly argue, if SFPP had actually used the theory it advances here to design the rates, it would have had to use both the anticipated mature volumes, which SPFF projected to occur in 1991, and the mature costs, in order to obtain a determination at the Commission staff level that the proposed West Line rates were just and reasonable. But this is not what SFPP did. It justified the rates based on the projected volumes of the first year of operation (1989) and based its cost estimates on the same year. If it had used the mature volumes (reflecting "realized returns") to justify the rates in the first year of the analysis provided to the Oil Pipeline Board, the result would most likely have been a lower rate, which would have meant lower revenues in the initial years. The practical result would have been a greater probability of losses during the first two years of operations pending the achievement of mature volumes in 1991.

50. Thus, in order to maximize the probability that it would achieve its corporate return for its increased investment in the West Line, and to minimize its regulatory risk, SFPP's best tactic under the circumstances was to include in its "TOP Sheets" the minimum initial volume it believed would be acceptable to Staff, and then rely on the related growth assumptions to support obtain the return contained in its internal corporate analyses. In 1989, the test year approach SFPP attacks here worked to its advantage given the growth SFPP believed would occur in later years. The Commission therefore concludes, contrary to SFPP's assertions, that the West Line rates were designed from the outset based on a strategy of using the lowest forecast of volumes SFPP believed would be acceptable to the Commission staff based on the 25 cent increase. Given the indefinite nature of the Abboud letter and SFPP's carefully thought-out regulatory strategy to justify the 25 cent rate increase, the ALJ correctly found that the 1989 "TOP Sheets" were the best evidence of the circumstances that were the economic basis for the West Line rates.

51. Finally, there is no merit to SFPP's argument that the ALJ's approach violates the Commission's rejection in Opinion No. 435 of a test year as the economic basis for the rate. The Commission rejected the use of SFPP's 1992 cost-of- service as the economic basis for the West Line rates because the year 1992 had nothing to do with the time at which the rates were established. The West Line rates were established early in 1989 and were tied to SFPP's completion of the West Line expansion in the same time frame. Under this rationale, the use of the calendar years 1990 or 1993 as the base year would have been equally arbitrary. In contrast, the "Top Sheets" submitted to the Staff in January 1989 were specifically intended as a justification for the very rates to be adopted in 1989. While the "Top Sheets" used a cost-of-service format, they are as relevant as any detailed set of corporate *pro forma* s that might be used to justify a pricing decision that the corporation is about to make.

ii. *Analysis of Changed Circumstances*

52. The ALJ found that there were substantially changed circumstances for the West Line rates based on an increase in volumes by 1996, changes in income tax rates and income tax allowance by 1996, and allowed total return by 1996. The ALJ further found there were substantially changed circumstances based on Ultramar's estimate of SFPP's over-recovery when compared to SFPP's allowed total return.[49] The ALJ also found substantially changed circumstances for the years 1997, 1998, and 2000.[50] SFPP excepts on the grounds that the ALJ's analysis used the wrong volumes for the base year 1989, relied incorrectly on individual cost-of-service elements, and relied incorrectly on tax rate and tax allowance factors. The Complainant Parties and Staff support the ALJ's rationale, asserting that in fact he used more than one factor, that the factors were also combined based on a composite analysis by Ultramar, and that his reliance on volumes, tax rate changes, and tax allowance factors is consistent with Opinion No. 435.

[62,148]

53. The Commission concludes that on the West Line there were substantial changes in the circumstances that were the basis for the Yuma, Calnev and West Tucson rates beginning in 1995, and for the West Phoenix rates beginning in 1997, based on cost decreases for the West Line and increases in volumes for those specific points. Since SFPP justified its West Line rates utilizing a projected 1989 cost of service that did not allocate costs

among those different delivery points, the Commission agrees with the ALJ that it is appropriate to examine cost-of-service factors for all points on the West Line in the aggregate. Appendix B reveals that, compared to 1989, the allowed total return had declined by 17.77 percent between 1992 and 1995 and by 25.31 percent between 1992 and 1996 (Table 4). Table 6 of Appendix B reveals that total cost of service had declined by some 16.61 percent between 1992 and 1995 and by 19.11 percent between 1992 and 1996.

54. Thus, as long as the volumes projected for each of the delivery points on the West Line at least equaled those contained in the 1989 forecast, in general the yield for each unit of throughput had increased by at least 16.61 percent between 1992 and 1995 based on the aggregate West Line cost of service that SFPP used to justify its rates in 1989. In fact, total volumes on the West Line increased some 16.4 percent in 1995 over 1989, suggesting a total increase in return of over 30 percent in 1995 compared to 1989 when the volume increase is combined with the cost-of-service decrease.[51] With a overall decline in expenses of 16.61 percent, based on SFPP's cost of service, combined with an increase of overall volume of 16.40 percent, it is not surprising that Staff calculated a cost over-recovery for the West Line as a whole of some 35.68 percent in 1995. When viewed as an aggregate, there were clearly substantially changed circumstances for the West Line as a whole beginning in complaint year 1995 and in each complaint year thereafter.

55. Section 1803(b) of the EPAct provides that evidence shall be submitted that establishes that there are "substantially changed circumstances has occurred in the to the economic circumstances of the oil pipeline that were a basis for the *rate*" to the extent such evidence can be elicited. While this level of detail is not available for a cost- of-service analysis, the Trial Staff included point- to-point flows for each origin and delivery point on the West Line (and the other lines) in the record. Thus it is appropriate to look at volumes for individual points on the West Line, rather than in the aggregate, to analyze whether there were substantial changes in the economic circumstances that were the basis for the rate at each of those individual points. Accordingly, the Commission will review the four West Line points with deliveries in 1995 to determine if there are substantially changed circumstances for the rates at Yuma, CalNev, Phoenix, and Tucson.

56. As shown by Table 2 of Appendix B, volumes to Yuma were 9.44 percent higher in 1995 compared to the 1989 volumes at a time when overall costs-of-service were had declined by 16.61 percent in the same time frame. The 9.44 percent increase in volume, when combined with a 16.61 percent decline in the cost-of-service between 1992 and 1995, compared to 1989, establishes there were substantially changed circumstances given a likely impact on return in excess of 20 percent. The fact that volumes declined thereafter does not change the result, although this may suggest the Yuma rates were not compensatory after 1995.

57. The increase in the CalNev volumes of 25.62 percent between 1992 and 1995 compared to 1989, and the 16.61 percent decrease in SFPP's cost-of-service from 1992 by 1995, results in substantially changed circumstances to the economic basis for those rates in 1995. The same conclusion applies to the rates to Tucson. While volumes consistently decreased from 1995 through 1999, in absolute and percentage terms, the increase in volumes by 1995 compared to 1989 amounted to 188 percent, due to a delay in substitution of West Line volumes for East Line volumes at Tucson.[52] The Commission concludes that there were substantially changed circumstances in the economic basis for both the CalNev and Tucson rates as of 1995.

58. The analysis of the Phoenix deliveries is similar. It appears that the volumes to Phoenix did not grow as fast as SFPP had anticipated in its 1989 cost-of-service filing and in fact had declined by 1992 compared to 1989, and had increased by 1996 by only .68 percent over 1989 volumes. However, the increase in volumes between 1989 and 1997 was 7.56 percent compared to the 1989 base while cost-reductions between 1992 and 1997 were 19.09 percent compared to the 1989 base. The combined impact of the volume increase and cost decrease between 1992 and 1997, compared to 1989, is similar to that of the Yuma Line in 1995.[53] Thus, given the volume increase of 7.56 percent in 1997, when combined with the 19.09 percent decrease in costs by 1997, the Commission finds substantially changed circumstances as of 1997.

[62,149]

b. *The North Line*

i. *The Economic Basis for the Rates*

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

59. With regard to the North Line, the ALJ based his determination of substantially changed circumstances on a 1989 cost-of-service study submitted to the Commission staff to justify the rate increase.[54] The Commission finds that to be appropriate for the same reasons involving the West Line rates. SFPP did present an alternative theory, asserting that rates for the North Line were constrained by truck competition at the time they were established. The Commission need not address that argument here because it finds below that there were no substantially changed circumstances to the economic basis of the North Line rates based on its analysis of the major cost-of- service factors.

ii. *Analysis of Changed Circumstances*

60. The ALJ concluded that changes in volumes after 1992 did not justify a finding of changed circumstances. The ALJ also found that there were substantially changed circumstances for the North Line rates for the complaint years 1997, 1998, and 2000 based on changes in the income tax rate and income tax allowances. SFPP excepted to this latter finding on the grounds that the ALJ failed to recognize cost increases that occurred after 1992, including additional investments in the North Line. SFPP also asserts that the cost evidence reviewed incorrectly blends inter-and intrastate cost factors.

61. Since earlier in this order the Commission has rejected the use of changes in tax rate and income tax allowances as stand-alone factors, as a result the ALJ's determinations that rely on those factors are reversed. However, his conclusions on the volume issue are correct. Appendix C, Table 2, indicates that the increase in volumes at Reno, the point on the North Line with the highest increase, after 1992, ranged from 11 percent to 12.53 percent for the years 1995 through 1999 when compared to 1989 with the exception of the year 1998, where the difference between 1992 and 1998 was 16.63 percent when compared to 1989. For the North Line as a whole the percentage increase in volumes after 1992 compared to 1989 was consistently less than 15 percent. Moreover, the percentage increase in total costs between 1992 and 1999 ranged for 4.66 to 17.34 percent and mitigated the percentage increase in volumes between 1992 and 1999.

62. Ex. S-51 demonstrates that there were three years (1995, 1996, and 1999) in which SFPP had large over-recoveries of its North Line rates, as much as 23 or 24 percent in 1995 and 1996. Ex. UIT-42 at 41 likewise asserts that a restated rate for 1996 and 1999 would be approximately 17 percent below the rate developed in the 1989 cost- of-service study, and that most of this change occurred after 1992. However, the tables in Appendix C establish the contrary, suggesting that any significant gains in profits and return occurred before 1992 because cost-of-service factors increased in an amount sufficient to mitigate the effect of any gains in volumes. A 23 percent over- recovery is quite large, but the issue is not the level of the return but whether it has substantially changed since the enactment of the EPAct. A review of the cost and revenue factors for the North Line after 1992 in relationship to the 1989 base year suggests that as much as 50 percent of that return may be attributable to the years before 1992. Therefore Complainants have not established that there were substantially changed circumstances for the North Line.

c. *The Oregon Line*

i. *Economic Basis for the Rates*

63. Because no cost-of-service evidence was available for the Oregon Line for the calendar year 1985, the last time the rates were increased and filed with the Commission, the ALJ relied on changes to the 1992 volumes, tax rates, and income tax allowance to determine if there had been a substantial change in the economic circumstances that were the basis for the rate.[55] SFPP asserts first that this was wrong because the ALJ's analysis assumes a cost-of-service approach where none may have been involved. It asserts that his analysis also ignores the critical fact that SFPP greatly expanded the Oregon Line in 1984, and that the increases in volume in the late 1998 and 1999 reflect the first time that SFPP began to transport volumes sufficient to recover its costs. SFPP asserts that no pipeline would expand its system in the expectation of losing money.

64. The Commission concludes that the ALJ erred in part in his analysis of the Oregon Line. First, in the absence of other evidence that addresses the year in which the rates were established, it might be reasonable to use 1992 as the base year for measuring whether there was a change in the economic basis for the rate. As previously explained, one must examine whether there has been a substantial change in the economic circumstances that were the basis for the rate at the time it was established, and whether such change occurred after the enactment of the EPAct. While a complainant must show both prongs under the statute to show substantially changed circumstances that would trigger an investigation under Section 15(1) of the ICA, if a

pipeline is unable to produce anything during discovery that bears on the economic basis of the rate at issue, it will not be permitted to defeat the purpose of the statute on the absence of evidence absent offering an alternative theory on its own behalf.

[62,150]

65. SFPP, however, is correct that it should be permitted to argue, as it did here, that, in the absence of evidence showing the basis for its 1985 rates, the increase in volumes on the Oregon Line in 1998 and 1999 only began to fill the expanded capacity after many years in which SFPP failed to recover its cost of service. By focusing only on the volumes and tax factors, the ALJ unduly constrained his analysis and failed to properly determine whether the Oregon Line was recovering its cost of service. Therefore the Commission will review the cost-of-service information available here to determine whether there was likely to have been a substantial change in the economic circumstances that were the basis of the Oregon Line rates.

ii. *Analysis of Changed Circumstances*

66. The ALJ found that there were no substantially changed circumstances for the Oregon Line rates for the complaint years 1996 and 1997 with respect to volumes, but that there were substantially changed circumstances based on volumes for the complaint year 1999. The ALJ also found that there was a substantial change in the income tax rate and income tax allowance for the complaint years 1997, 1998, and 2000. SFPP asserts that the 1999 finding does not allow for the fact that the line was oversized in 1984, the fact that the line may not have recovered its cost of service, or for offsetting cost increases that occurred in the years 1997, 1998, and 2000. The Complainant Parties support the ALJ's rationale as consistent with Opinion No. 435.

67. The Commission finds that the ALJ erred in using the percentage change in income tax rates and income tax allowances as a stand-alone factor to support his findings. As demonstrated by Tables 1, 2, and 7 of Appendix C, even if 1992 is used as the base and volume changes are measured against it, the percentage change in rate base in the same period works to offset those changes, and the increase in overall costs offsets it completely. In fact, the large increase in costs parallels the increase in volumes, suggesting that much of the increase may have been variable costs, and inferentially, that there were large amounts of excess capacity in the line. This is consistent with SFPP's argument that the line was performing below capacity for many years. In fact, Trial Staff Exhibit 51 suggests that in most years any over-recovery was marginal or negative. The record as a whole thus supports SFPP's contention that the Oregon Line underperformed for many years and has only recently begun to achieve design capacity and the likely volumes and revenues that were the economic basis for the rates. The Commission therefore concludes that there were no substantially changed circumstances to the Oregon rates for any of the years at issue here.

d. *Sepulveda Line*

68. The ALJ held that the Sepulveda Line was not grandfathered because the 5-cent rate established by SFPP in 1993 was a new rate for an existing service with different contract terms and conditions than those of certain contracts for the transportation of petroleum products over the line that had existed prior to their expiration in late 1992 and 1993. SFPP argues that, as in the case of the Watson Station Drain Dry Facilities, the rates were established by contract before the effective date of the EPAct. The Complainant Parties and the Commission Trial Staff support the ALJ.

69. The Commission affirms the ALJ's conclusion that the 5-cent rate established by SFPP in 1993 was premised on an entirely new rate structure. The prior rate for transportation over the Sepulveda line was 15 cents a barrel with an annual revenue cap. Once the revenue cap was reached, there were no additional charges, and further volumes served to reduce the effective per barrel charge in any one calendar year. In contrast, the 5-cent rate did not provide for a reduction in the total revenues generated once a guaranteed revenue level was reached and total annual revenues could exceed those generated by the prior rate. As such, the 5-cent rate was premised on entirely different business assumptions, including the risk involved.[36] The 5-cent per barrel rate was contained in new contracts, was not effective more than 365 days prior to the effective date of the EPAct, and therefore is not grandfathered.

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

F. *Other Exceptions and Issues*

1. *The Substantially Changed Circumstances Standard*

70. The previous part of this order reviewed the ALJ's determinations of whether there were substantially changed circumstances for particular facilities. On exceptions, SFPP and AOPL assert the ALJ's analysis relied too heavily on cost-of- service considerations that worked to undercut certain broader policy goals they claim are contained in the EPAct. They argue that the ALJ adopted a relatively low level for the jurisdictional threshold, often approaching single digit percentage changes for individual cost factors, in determining whether there had been a substantial change in the economic circumstances that were the basis for a rate. They conclude that a series of modest gains in operating efficiency or growth could quickly result in cumulative changes in volumes, costs, tax factors, or returns that exceed the relatively low numerical threshold adopted by the ALJ. They claim that this would subject more grandfathered rates to a reasonableness review than is contemplated by the statute.

71. SFPP and AOPL further argue that the methodology adopted by the ALJ is inconsistent with the statement in Opinion No. 561 that one

[62,151]

advantage of the Commission's indexing methodology is that it permits a pipeline to keep a percentage of any efficiency gains.[57] They also assert that the ALJ's determinations will encourage wasteful and complex litigation between pipeline and shippers and undermine a Congressional desire to maintain rate stability and encourage investment in the oil pipeline industry. AOPL asserts that a more appropriate approach is to define the total economic circumstances of the firm, including exogenous factors, and to determine how changes in such broader economic factors impact the economic basis of a rate.[58]

72. The parties opposed to SFPP argue that the approach adopted by the ALJ is consistent with the guidance provided by Opinion No. 435 and that his analysis relies on the cost factors the Commission stated would be appropriate. They further argue that reliance on a cost-oriented approach to the substantially changed circumstances standard has not discouraged investment in the oil pipeline industry. They cite as an example SFPP's current proposal to quintuple its investment in its East line. They also argue that the efficiency argument is not the focus of this statute and that SFPP's and AOPL's rate stability arguments are without merit given the administrative orientation of the EPAct. They argue that adopting SFPP's and AOPL's broader policy assertions would create an impossibly high barrier for the review of grandfathered oil pipeline rates.

73. The Commission concludes that the central issue to be decided here is not whether the use of cost-of-service factors is appropriate or inappropriate in and of itself, but the level of the threshold that results. The Commission has concluded that changes in tax rates and tax allowance should not be considered as a stand-alone cost factor is making such determinations because this could lead to anomalous results and result a threshold that does not adequately discourage challenges to grandfathered oil pipeline rates. Second, the Commission's analysis here has used a reasonable threshold for substantially changed circumstances. Third, the threat of ongoing litigation has not discouraged SFPP from proposing to at least quintuple its investment base in its East Line even though those rates are not grandfathered and are now subject to review in this proceeding. In a related proceeding SFPP acknowledged that the resulting rates would be subject to conventional cost-based regulation when they were filed.[59]

74. Regarding the argument for rate stability on floor, the legislative history of the EPA does indicate that rate stability is one goal of the EPAct.[60] However, this language does not mean that a challenge to existing rates based on a cost- of-service approach is inappropriate. Rather, the mandate is to structure a threshold that restricts challenges to grandfathered rates that makes rate levels more predictable by limiting the disruptive influence of too frequent challenges. Thus, while providing rate stability against ready challenge may be a concern under the statute, this does not suggest that a cost-oriented approach to substantially changed circumstances is inappropriate.[61] Moreover, the efficiency gains to be achieved under the Commission's Opinion No. 561 indexing methodologies apply to all pipeline rates, whether or not those rates are grandfathered under Section 1803(a). There is no indication in the legislation that grandfathered rates are entitled to a higher standard of protection on such broad policy grounds.

75. Finally, the Commission concludes that AOPL's argument that broader measures of economic change should be used, including exogenous factors, falls outside the scope of the statute. AOPL provides no definition of its broader factors and thus the Commission rejects this argument.[62]

2. *Basis for the Rate*

76. The substantially changed circumstances standard of the EPAct requires evidence of a substantial change in the economic circumstances "which are the basis for the rate." SFPP asserts that the evidence submitted by the complainants and Staff on substantially changed circumstances is invalid because it addresses the economic characteristics

[62,152]

of rate groups, not individual rates. SPFF asserts that since their analysis is directed to aggregate volumes, operating revenues, and costs of, for example, the Los Angeles to Phoenix rates, and not to the individual rates to specific destinations between those points, it does not meet the statutory requirement. The Complainant Parties and Staff respond that the SFPP has always justified its individual rates based on the total revenues required to cover the West Line costs without distinguishing between the individual commodities that were moving between individual points. They further argue that the argument is untimely because it was not raised before the ALJ, thus depriving Staff and complainants an opportunity to respond to the argument.

77. SFPP should have raised its argument before the ALJ. Failing to do so denies the Commission a complete record on which to base a decision on the record.[63] Here, however, the issue can be addressed without prejudice. The complainant parties and Staff are correct that SFPP prepared the cost justifications for its rates on the West and North Lines by developing costs for the entire line, and not applying those costs to specific delivery points on the lines, the specific rates, or the individual commodities. To the extent that SFPP itself designed and justified the rates at issue by reference to the aggregated costs of all the rates in the year that the rates were established, then that portion of economic basis for each individual rate can be evaluated on the same basis. In any event, Staff provided volume data for each point on each line for every year at issue[64] and the Commission's review utilized that volume data. The Commission rejects SFPP's argument that complainant's order of proof is inadequate.

3. *Cost-of-Service and Accounting Issues*

78. ALJ concluded that there are a number of cost-of service issues that need further refinement in the second phase of this proceeding in order to determine the just and reasonable rate for some of the years at issue. The Commission agrees that the cost issues should be addressed in Phase II. After resolving the cost issues the ALJ previously identified, as well as any that may be raised by this order, the ALJ may make an initial determination of the appropriate level for a just and reasonable rate for each rate and year remaining at issue.

79. There is, however, one issue that the Commission will address here due to its central role in determining just and reasonable rates for the calendar year 1999 and later. On December 31, 1998 SFPP wrote up its rate base to reflect a purchase price adjustment for the premium over the regulatory return that Kinder Morgan Energy Partners (Kinder Morgan) paid to acquire SFPP in that year. As is shown on page 213, line 44, of SFPP's 1998 Form 6, net rate base, as reflected in carrier property, was increased from $642,740,093 to $1,232,374,000. The increase in the equity component of SFPP's balance sheet (Page 113, Line 65) increased from $274,278,274 to $1,062,269,257. The practical effect of these two balance sheet increases is to greatly increase the allowed depreciation rate and the equity component of the cost of capital. The former serves to increase the total cost of service and the latter increases the cash return permitted by the allowed total return on the increased rate base. This in turn would support significantly higher rates that would have been the case prior to these changes in SFPP's 1998 Form 6.

80. Line 34 of Column F on page 213 shows that only $13,916,548 of the huge increase in SFPP's rate base and equity component at the end of 1998 was for net physical improvements to its system. Thus the balance is the result of the write up of assets. The general rule on the write-up of assets acquired by one company from another is that such assets must be included in the acquiring company's rate base for rate making purposes at no more than their depreciated original cost, unless it can be shown by clear and convincing evidence that the acquisition results in substantial benefits to the ratepayers. This is to prevent rate payers from paying for the same assets twice. It was well established by the date of the hearing in this proceeding that it was SFPP's

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

obligation to address this issue, but it provided no evidence of record that would meet the governing standard.[65] Therefore the parties are directed not to use the acquisition write-up in designing rates for the calendar year 1998 and years thereafter. Moreover, SFPP was required to obtain Commission approval before making this accounting adjustment to its Form 6 and it failed to do so.[66] During this review the Commission found no evidence in its files that suggests that SFPP sought or obtained the required approvals. Therefore SFPP is directed to file within 30 days after this order issues for permission to include the acquisition write-up in its1998 Form 6, and its Form 6 for all subsequent years.

4. Whether the East Line Shippers Are Eligible for Reparations

81. All agree that SFPP's East Line rates are not grandfathered. On exceptions, however, SFPP argues that the challenged rate must be so substantially in excess of the level of the indexed East Line rate established by Opinion No. 435 before the Commission will entertain a complaint. It asserts that unless this standard is met, SFPP's East Line shippers will not be eligible for reparations.

[62,153]

The Complainant Parties and Staff respond that the substantial divergence threshold applies only to the increase taken under the Commission's indexing regulations, and does not apply to the level of the underlying rate. They assert that since the underlying East Line rates are not grandfathered, the base rate remains open to challenge even if the increase under the indexing regulations does not substantially exceed the cost increases actually experienced by the pipeline.

82. SFPP's argument is without merit. Section 343.2(c) of the Commission's regulations provides that a complaint filed against an indexed rate must allege reasonable grounds for asserting that the rate increase is so substantially in excess of the pipeline's actual cost increases that the rate is unjust and unreasonable. Such a challenge must rest solely on a comparison of the changes in rates and costs from one year to the next. The complaints against SFPP's East Line, however, challenge SFPP's underlying rates rather than the rate increases establishec through indexing. As these underlying rates are not grandfathered, complainants can proceed under Section 13(1) of the ICA to try and show under Section 15(1) of the ICA that the East Line rates are not just and reasonable. If the rates are found to be unjust and unreasonable, the Commission will prescribe new just and reasonable rate. The fact that a rate has been indexed does not preclude reparations if the underlying base rate has been determined to be unjust and unreasonable.

The Commission Finds

83. There were substantial changes in the economic circumstances that were a basis for SFPP's Yuma, Tucson, and CalNev rates as of 1995 and for SFPP's Phoenix rates as of 1997. These rates thus are no longer deemed to be just and reasonable as of 1995 and 1997, respectively. The ALJ shall address in Phase II of this proceeding the issue of just and reasonable rates for the Yuma, Tucson, and CalNev rates for the complaint year 1996 and the West Phoenix rates for the complaint year 1998, and for each succeeding year for which complaints were filed against those rates, consistent with the discussion in this order.

84. The were no substantial changes in the economic circumstances that were a basis for SFPP's North Line and Oregon Line rates as of any of the years at issue in this proceeding. These rates thus continue to be deemed just and reasonable.

85. The rate for SFPP's Sepulveda Line was not grandfathered at the time the complaints at issue here were filed. The ALJ shall address in Phase II of this proceeding the issue of just and reasonable rates for the Sepulveda for each of the years for which complaints were filed, consistent with the discussion in this order.

The Commission orders:

(A) The Initial Decision is affirmed in part and reversed in part as described in the body of this order.

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

(B) This proceeding is remanded to the ALJ to consider in Phase II the issues as described above.

(C) SFPP is directed to file within 30 days for permission to include the purchase price adjustment now reflected in its Form 6 for the calendar year 1998 in that report and in each of the reports filed in any of the years thereafter.

(D) The motion for oral argument before the Commission by BP West Coast Products LLC and ExxonMobil Corporation is denied.

Table of Contents

Appendix A --Comparison of West, North, and Oregon Lines

Appendix B --Comparative Figures for the West Line

Appendix C --Comparative Figures for the North Line

Appendix D --Comparative Figures for the Oregon Line

Appendix A --Comparison of West, North, and Oregon Lines

Table 1. SFPP Volume for Each Line

	(a)	*(b)*	*(c)*				
Line	V_{1989}*(bbls)*	V_{1992}*(bbls)*	V_{1995}*(bbls)*	V_{1996}*(bbls)*	V_{1997}*(bbls)*	V_{1998} *(bbls)*	V_{1999}*(bbls)*
West	60,480,000	52,160,000	70,398,491	73,688,461	76,391,251	76,600,714	77,7
North	12,465,000	12,059,000	13,951,489	13,801,898	13,822,380	14,330,911	13,
Oregon	N/A	12,812,000	13,631,189	13,715,688	13,044,932	14,563,780	15,50

Source: West, North, and Oregon Interstate Volumes. *See* Exhibit No. ___(S-4, S-6, S-8) Protected. June 18, 2001.

[62,154]

Table 2. Percentage Volume Change for Each Line

(a) *(b)* *(c)*

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

Line	V_{1989}*(bbls)*	V_{1992}*(bbls)*	*1995*	*1996*	*1997*	*1998*	*1999*
West	60,480,000	52,160,000	16.40%	21.84%	26.31%	26.65%	28.47%
North	12,465,000	12,059,000	11.93%	10.73%	10.89%	14.97%	11.53%
Oregon	N/A	12,812,000	6.39%	7.05%	1.82%	13.67%	21.00%

Source: If b ≥ a, then (c-b)/a; Else if b < a, then (c-a)/a; for West and North Initial decision methodology (c-b)/b. OR96-2-000, June 24, 2003, for Oregon

[62,155]

[62,156]

[62,157]

[62,158]

[62,159]

Table 1. SFPP West Line Volume Per Point

	(a)	*(b)*	*(c)*				
WestPoints	V_{1989}*(bbls)*	$V_{1992EPAct}$*(bbls)*	V_{1995}*(bbls)*	V_{1996}*(bbls)*	V_{1997}*(bbls)*	V_{1998}*(bbls)*	V_{1999}*(bbls)*

h b e cch c e c b h gh e

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

Yuma	603,000	531,000	659,934	425,675	485,283	347,231	368,275
Calnev	21,957,000	23,341,000	28,965,880	31,518,562	32,534,730	33,497,773	
Phoenix W	36,450,000	26,870,000	35,615,075	36,697,244	39,204,536	39,602,716	
Tucson W	1,470,000	1,418,000	4,234,239	3,870,184	3,004,226	2,860,684	2,370
Luke W	0	0	923,363	1,176,796	1,162,476	292,310	557,240
William AFB	0	0	0	0	0	0	0
Total	60,480,000	52,160,000	70,398,491	73,688,461	76,391,251	76,600,714	

Source: West Line Interstate Volumes. See Exhibit No. ___(S-4) Protected. June 18, 2001.

[62,160]

Table 2. West Line: Percentage Volume Change Per Point

	(a)	*(b)*	*(c)*				
WestPoints	*V_{1989}(bbls)*	*V_{1992}(bbls)*	*1995*	*1996*	*1997*	*1998*	*1999*
Yuma	603,000	531,000	9.44%	-29.41%	-19.52%	-42.42%	-38.93%
Calnev	21,957,000	23,341,000	25.62%	37.24%	41.87%	46.26%	50.45%
Phoenix W	36,450,000	26,870,000	-2.29%	0.68%	7.56%	8.65%	9.71%
Tucson W	1,470,000	1,418,000	188.04%	163.28%	104.37%	94.60%	61.25%
Luke W	0	0	N/A	N/A	N/A	N/A	N/A
William AFB	0	0	N/A	N/A	N/A	N/A	N/A
Total	60,480,000	52,160,000	16.40%	21.84%	26.31%	26.65%	28.47%

Source: If b ≥ a, then (c-b)/a; Else if b < a, then (c-a)/a

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

Table 3. West Line: Percentage Rate Base Change

	Base Period 1989 (a)($ mil)	162.439	*Rate Base Percentage Change*		
	EP Act 1992 ($ (b)mil)	163.043	(c-a)/a	(c-b)/b	(c-b)/a
	1995	140.291	-13.63%	-13.95%	-14.01%
	1996	138.434	-14.78%	-15.09%	-15.15%
(c)	1997	135.967	-16.30%	-16.61%	-16.67%
	1998	130.403	-19.72%	-20.02%	-20.09%
	1999	137.241	-15.51%	-15.83%	-15.88%

Source: If b ≥ a, then (c-b)/a; Else if b > a, then (c-a)/a

[62,162]

[62,163]

Table 4. West Line: Percentage Allowed Total Return Change

	Base Period 1989 (a)($ mil)	19,534	*Allowed Total Return Percentage Change*		
	EP Act 1992 ($ (b)mil)	18,975	(c-a)/a	(c-b)/b	(c-b)/a
	1995	15,504	-20.63%	-18.29%	-17.77%
	1996	14,030	-28.18%	-26.06%	-25.31%
(c)	1997	14,023	-28.21%	-26.10%	-25.35%
	1998	13,352	-31.65%	-29.63%	-28.79%

1999	15,003	-23.20%	-20.93%	**-20.33%**

Source: If b ≥ a, then (c-b)/a; Else if b > a, then (c-a)/a

[62,164]

[62,165]

Table 5. West Line: Percentage Income Tax Allowance Change

Base Period 1989 (a)($ mil)	10,754	*Income Tax Allowance Percentage Change*		
EP Act 1992 ($ (b)mil)	9,124	(c-a)/a	(c-b)/b	**(c-b)/a**
1995	1,941	-81.95%	-78.73%	**-66.79%**
1996	1,673	-84.44%	-81.66%	**-69.29%**
(c) 1997	1,811	-83.16%	-80.15%	**-68.00%**
1998	2,198	-79.56%	-75.91%	**-64.40%**
1999	2,440	-77.31%	-73.26%	**-62.15%**

Source: If b ≥ a, then (c-b)/a; Else if b > a, then (c-a)/a

[62,166]

[62,167]

Table 6. West Line: Percentage Cost of Service Change

h b e cch c e c b h gh e

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

	Base Period 1989			
(a)	($ mil)	56,918	*Cost of Service Percentage Change*	
	EP Act 1992 ($			
(b)	mil)	53,860	(c-a)/a	(c-b)/b	**(c-b)/a**
	1995	44,406	-21.98%	-17.55%	**-16.61%**
	1996	42,982	-24.48%	-20.20%	**-19.11%**
(c)	1997	42,995	-24.46%	-20.17%	**-19.09%**
	1998	43,457	-23.65%	-19.31%	**-18.28%**
	1999	42,262	-25.75%	-21.53%	**-20.38%**

Source: If b ≥ a, then (c-b)/a; Else if b > a, then (c-a)/a

[62,168]

[62,169]

[62,170]

Table 1. SFPP North Line Volume Per Point

	(a)	*(b)*	*(c)*				
NorthPoints	*V_{1989}(bbls)*	*$V_{1992EPAct}$(bbls)*	*1995*	*1996*	*1997*	*1998*	*1999*
Reno	11,625,000	11,148,000	12,916,253	12,909,324	12,992,651	13,557,683	
Nevada ANG (Reno)	0	0	109,658	40,065	91,766	48,043	29,043
Fallon	840,000	911,000	925,578	852,509	737,963	725,185	790,958

NAS						
Total	12,465,000	12,059,000	13,951,489	13,801,898	13,822,380	14,330,911

Source: North Line Interstate Volumes. *See* Exhibit No. ___(S-6) Protected. June 18, 2001.

[62,171]

Table 2. North Line: Percentage Volume Change per Point

North Line	*(a)*	*(b)*	*(c)*				
Point	V_{1989} *(bbls)*	V_{1992} *(bbls)*	*1995*	*1996*	*1997*	*1998*	*1999*
Reno	11,625,000	11,148,000	11.11%	11.05%	11.76%	16.63%	12.53%
Nevada ANG (Reno)	0	0	N/A	N/A	N/A	N/A	N/A
Fallon NAS	840,000	911,000	1.74%	-6.96%	-20.60%	-22.12%	-14.29%
Total	12,465,000	12,059,000	11.93%	10.73%	10.89%	14.97%	11.53%

Source: If b ≥ a, then (c-b)/a; Else if b < a, then (c-a)/a

[62,172]

Table 3. North Line: Percentage Rate Base Change

Base Period 1989 ($ (a)mil)	36.12534*	*Rate Base Percentage Change*		
(b) EP Act 1992 ($ mil)	27.742	(c-a)/a	(c-b)/b	**(c-b)/a**
1995	29.745	-17.66%	7.22%	**5.54%**
1996	30.191	-16.43%	8.83%	**6.78%**

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

(c) 1997	30.59	-15.32%	10.27%	**7.88%**
1993	30.475	-15.64%	9.85%	**7.57%**
1999	29.153	-19.30%	5.09%	**3.91%**

Source: If b ≤ a, then (c-b)/a; Else if b > a, then (c-a)/a

* Percentage of Interstate Revenues

[62,173]

[62,174]

Table 4. North Line: Percentage Allowed Total Return Change

Base Period 1989 ($	*Allowed Total Return Percentage*			
(a)mil)	4,403*	*Change*		
(b) EP Act 1992 ($ mil)	3,089	(c-a)/a	(c-b)/b	**(c-b)/a**
1995	3,296	-25.15%	6.70%	**4.70%**
1996	3,062	-30.46%	-0.87%	**-0.61%**
(c) 1997	3,160	-28.24%	2.30%	**1.61%**
1998	3,126	-29.01%	1.20%	**0.84%**
1999	3,206	-27.19%	3.79%	**2.66%**

Source: If b a, then (c-b)/a; Else if b a, then (c-a)/a

* Percentage of Interstate Revenues

[62,175]

[62,176]

Table 5. North Line: Percentage Income Tax Allowance Change

Base Period 1989 ($ (a)mil)	3,150*	*Income Tax Allowance Percentage Change*		
(b) EP Act 1992 ($ mil)	1,161	(c-a)/a	(c-b)/b	**(c-b)/a**
1995	393	-87.52%	-66.15%	**-24.38%**
1996	346	-89.02%	-70.20%	**-25.87%**
(c) 1997	386	-87.75%	-66.75%	**-24.61%**
1998	489	-84.48%	-57.88%	**-21.33%**
1999	494	-84.32%	-57.45%	**-21.18%**

Source: If b ≤ a, then (c-b)/a; Else if b > a, then (c-a)/a

*Percentage of Interstate Revenues

[62,177]

[62,178]

Table 6. North Line: Percentage Cost of Service Change

Base Period 1989 ($ (a)mil)	17,457*	*Cost of Service Percentage Change*		
(b) EP Act 1992 ($ mil)	11,559	(c-a)/a	(c-b)/b	**(c-b)/a**
1995	12,384	-29.06%	7.14%	**4.73%**
1996	12,258	-29.78%	6.05%	**4.00%**

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

(c) 1997	14,429	-17.35%	24.83%	**16.44%**
1998	14,656	-16.05%	26.79%	**17.74%**
1999	12,778	-26.80%	10.55%	**6.98%**

Source: If b ≤ a, then (c-b)/a; Else if b > a, then (c-a)/a

*Percentage of Interstate Revenues

[62,179]

[62,180]

[62,181]

Table 1. SFPP Oregon Line Volume Per Point

Oregon Points	*(b)* $V_{1992EPAct}$ *(bbls)*	*(c)* *1995*	*1996*	*1997*	*1998*	*1999*
Eugene	12,011,000	12,972,743	13,119,622	12,858,631	14,563,780	15,502,885
Albany	801,000	658,446	596,066	186,301	0	0
Total	12,812,000	13,631,189	13,715,688	13,044,932	14,563,780	15,502,885

Source: Oregon Line Interstate Volumes. *See* Exhibit No. ___(S-8) Protected. June 18, 2001.

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

[62,182]

Table 2. Oregon Line: Percentage Volume Change Per Point

Oregon Points	*(b)* $V_{1392EPAct}$ *(bbls)*	*(c)* *1995*	*1996*	*1997*	*1998*	*1999*
Eugene	12,011,000	8.01%	9.23%	7.06%	21.25%	29.07%
Albany	801,000	-17.80%	-25.58%	-76.74%	-100.00%	-100.00%
Total	12,812,000	6.39%	7.05%	1.82%	13.67%	21.00%

Source: OR96-2-000. June 24, 2003. Judge stated (c-b)/b.

[62,183]

Table 3. Oregon Line: Percentage Rate Base Change

		Rate Base Percentage Change
(a) Base Period 1989 ($ mil)	N/A	
(b) EP Act 1992 ($ mil)	7,831	(c-b)/b
1995	8,728	11.45%
1996	8,619	10.06%
(c) 1997	8,532	8.95%
1998	8,814	12.55%
1999	8,999	14.92%

Source: Initial decision methodology (c-b)/b. OR96-2-000. June 24, 2003.

[62,184]

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

[62,185]

Table 4. Oregon Line: Percentage Allowed Total Return Change

			Allowed Total Return Percentage Change
(a)	Base Period 1989 ($ mil)	N/A	
(b)	EP Act 1992 ($ mil)	873	(c-b)/b
	1995	968	10.88%
	1996	874	0.11%
(c)	1997	882	1.03%
	1998	905	3.67%
	1999	989	13.29%

Source: Initial decision methodology (c-b)/b. OR96-2-000. June 24, 2003.

[62,186]

[62,187]

Table 5. Oregon Line: Percentage Income Tax Allowance Change

			Income Tax Allowance Percentage Change
(a)	Base Period 1989 ($ mil)	N/A	
(b)	EP Act 1992 ($ mil)	325	(c-b)/b
	1995	96	-70.46%
	1996	81	-75.08%

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

(c) 1997	91	-72.00%
1998	118	-63.69%
1999	135	-58.46%

Source: Initial decision methodology (c-b)/b. OR96-2-000. June 24, 2003.

[62,188]

[62,189]

Table 6. Oregon Line: Percentage Cost of Service Change

		Cost of Service Percentage Change
(a) Base Period 1989 ($ mil)	N/A	
(b) EP Act 1992 ($ mil)	4,697	(c-b)/b
1995	5,214	11.01%
1996	5,911	25.85%
(c) 1997	6,161	31.17%
1998	7,649	62.85%
1999	6,031	28.40%

Source: Initial decision methodology (c-b)/b. OR96-2-000. June 24, 2003.

[62,190]

[1] *Texaco Refining and Marketing, Inc., et al. v. SFPP*, 103 FERC ¶63,055 (2003) (*Texaco Refining*). The Sepulveda Line cost issues in Docket No. IS98-1-000 were remanded to the instant proceeding by the

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

Commission's orders in Docket No. OR98-11-000 reported at 102 FERC ¶61,240 (2003) and 104 FERC ¶61,136 (2003).

[2] Energy Policy Act, Public Law 102-486 (1992), 106 Stat. 2776 (1992).

[3] 49 App. U.S.C. §15(1) (1988).

[4] Section 1803(b)(1) provides in part that no person may file a complaint against a rate that is deemed to be just and reasonable under Section 1803(a) of the EPAct [a grandfathered rate] unless evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of the Act in the economic circumstances of the oil pipeline which were a basis for the rate; or in the nature of the services provided which were a basis for the rate.

[5] Western Refining Company, L.P. (Western Refining); Chevron; the Commission Trial Staff (Staff); ConocoPhillips Company (Conoco), Valero Marketing and Supply Company, and Ultramar Inc., filing jointly (Ultramar/Tosco); BP West Coast Products LLC (BP WCP) and ExxonMobil Oil Corporation (ExxonMobil), filing jointly (Indicated Shippers); and Navajo Refining Company, L.P. (Navajo).

[6] *SFPP, L.P.*, 65 FERC ¶61,028 (1993), *reh'g denied*, 66 FERC ¶61,210 (1994).

[7] *See SFPP, L.P.*, 86 FERC ¶61,022 (1999) (*Opinion No. 435*). A full procedural history of the relevant complaints is provided in Opinion No. 435 at 86 FERC pp. 61,058-60.

[8] *SFPP, L.P.*, 91 FERC ¶61,135 (2000) (*Opinion No. 435-A*). *SFPP, L.P.*, 96 FERC ¶61,281 (2001) (*Opinion No. 435-B*), *SFPP, L.P.*, 100 FERC ¶61,353 (2002) (*Order on Rehearing and Compliance Filings*). *See also, SFPP, L.P.*, 102 FERC ¶61,073 (2003) (*Order on Compliance Filing*).

[9] *SFPP, L.P.*, 103 FERC ¶61,287 (2003).

[10] *See Opinion No. 435*, 86 FERC at pp. 61,067-68; *Opinion No. 435-A*, 91 FERC at p. 61,500.

[11] The cited orders are on appeal to the United States Court of Appeals for the D.C. Circuit. *BP West Coast Products LLC, et al., v. FERC*, Nos. 99-1020, *et al.* (consolidated).

[12] *SFPP, L.P.*, 86 FERC ¶61,035 (2000).

[13] *SFPP, L.P.*, 91 FERC ¶61,142 (2000).

[14] *SFPP, L.P.*, 92 FERC ¶61,244 (2000).

[15] *SFPP, L.P.*, 102 FERC ¶61,240 (2003), *reh'g denied*, 104 FERC ¶61,136 (2003).

[16] ID at PP 58-77.

[17] *Opinion No. 435-A*, 91 FERC at p. 61,500 and Section 1803(b) of the EP Act.

[18] ID at PP 34 and 35. The ALJ made the same determination in the Sepulveda line proceeding now consolidated with this case, on July 25, 2003. 104 FERC ¶63,022 at P 4 (2003).

[19] 86 FERC at pp. 61,065-66.

[20] *Id.* at p. 61,067.

[21] ID at PP 117, 118-19, 120, and 121-22.

[22] ID at PP 200-202 and PP 202-204.

[23] ID at PP 231-233 and PP 240-250.

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

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

[25] SFPP also argues that the ALJ improperly required the preparation of cost-of-service studies for each of the complaint years at issue and for the 12 months prior to the effective date of the EPAct in 1992. Given the novel nature of this proceeding the Commission affirms the ALJ's decision to require cost- of-service studies for the years at issue. To the extent that SFPP prepared several such studies for each year to defend its theories on changed circumstances, that was its choice. Given the nature of the case, the cost-of-service evidence presented was helpful in validating the methodology adopted by the Commission and resolving disputes regarding the jurisdictional status of the rates for the North and Oregon Lines.

[26] *Williams Pipe Line Company* (*Opinion No. 154-B*), 31 FERC ¶61,377 (1985), which was the first case establishing the Commission's current method for determining oil pipeline costs. The methodology has been applied in subsequent cases but continues to be referred to as the Opinion No.154-B methodology.

[27] *See Lakehead Pipe Line Company, L.P.* , 71 FERC ¶61,338 (1995), *reh'g denied*, 75 FERC ¶61,181 (1996) (*Lakehead*). It was applied to SFPP's cost-of-service in *Opinion No. 435* , 86 FERC at pp. 61,102-04.

[28] *Opinion No.435*, 86 FERC at pp. 61,070-71.

[29] *Lakehead*, 75 FERC at pp. 61,594-95.

[30] Opinion No. 435 at p. 61,104.

[31] *See* UIT-42 at 63-67 for the depth of detail that can be involved in this issue.

[32] *See* Appendices C and D, Tables 5 and 7 comparing the years 1992 and subsequent years.

[33] The figures the Commission used in making its determinations are highlighted.

[34] "TOP Sheets" are normally cost-of-service data that is submitted by Staff to support its testimony in a cost-of-service proceeding. In the instant case the cost data prepared by SFPP was submitted to the Commission staff to justify a rate filing. Since the parties use the nomenclature "TOP Sheets," here the order uses the same term.

[35] Exs. JMA-10 and JMA-5 through 9.

[36] Derived from Ex. JMA-10, p. 3 of 5.

[37] Tariff 88 was filed to rollback SFPP's previous increases to the West and East Line Rates filed in 1987. *See* Ex. JMA-5 and Ex. JMA-18 at 22.

[38] *See* Exs. JMA-3 at 11, JMA-14 at 2, UIT-6, and UIT-45.

[39] *See* Ex. JAM-22 at 1.

[40] *See* Ex. UIT-46 at 11-12 and Ex. JMA-18, passim.

[41] Ex. JMA-1 at 20, as reflected in Ex. JMA-26.

[42] *SPPL, Inc.*, 45 FERC ¶61,242, at p. 61,715 (1988).

[43] *See* Ex. UIT-46.

[44] *See* Ex. JMA-8 (SFPP-21), p. 2, JMA-12 (SFPP-25), p. 13 of 20, and JMA-14 (SFPP-23), p. 2 of 4.

[45] As pointed out by Trial Staff witness Pride, it was routine to provide information to the Oil Pipeline Board to justify a filing as just and reasonable, including the filing of such information with the Secretary's office before it

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

was transmitted to Staff. Thus, if SFPP responded to a Staff data request regarding a proposed filing, that material might also be filed with the Secretary's office. *See* Ex. S-48 at 8-9. In any event, material submitted to the Commission staff to support a regulatory filing is binding on the party providing the material.

[46] *See* Exs. JMA-3 and JMA-14. Its internal analysis indicates that SFPP evaluated its West Line project based on a review of anticipated cash flows and tax benefits from the accelerated amortization of the facility. In determining its corporate return, SFPP did not intend to rely solely on the level of the rate increase in relationship to any regulatory cost- of-service it might present to the Commission staff.

[47] This suggests that given SFPP's ability to increase the incremental rate by 25 cents, the returns might be even higher than those initially projected.

[48] The Airline-Intervenors recognized that the return SFPP would earn on the expansion was sensitive to volume levels and the capital structure of the firm, and that the proposed Settlement terms might lead to returns that could exceed that normally permitted under the Commission's regulatory procedures. *See* Ex. JMA-12 at 11-13.

[49] ID at PP 117-122.

[50] *Id.* at PP 167, 173, and 179.

[51] The comparison is with 1989 instead of 1992 because volumes in 1992 were less than those for 1989. As has been discussed above, this requires that the 1989 value be used for measuring the change that occurred after 1992. In the case of the 1992 rate base, the rate base was greater than the 1989 rate base, and therefore the 1989 figure must be used. Thus, in both these instances the formula used is C-A/A.

[52] *See* Ex. UIT-42 at pp. 26-30 for an explanation of this result.

[53] The combined percentage change for the Yuma Line is 26.05 percent in 1995 and 26.65 percent for Phoenix West in 1997.

[54] ID at PP 197-98. These "TOP Sheets" blended that certain inter-and intrastate cost factors, which the Commission factored out during its review of the ID.

[55] ID at PP 231-233 and PP 240-250.

[56] *See SFPP, L.P.*, 102 FERC ¶61,240 at P 10 (2003).

[57] Since the index is based on average increase in oil pipeline costs, a pipeline that has cost increases that are less than the average may take an increase that exceeds the average, at least until such time a shipper "alleges reasonable grounds for asserting that the rate is so substantially in increase of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable." 18 C.F.R §343.2(c)(2).

[58] *See* Prepared Answering Testimony of Jeff D. Makholm, Ph.D. Ex. AOPL-1.

[59] *See SFPP, Order on Petition for Declaratory Order*, 102 FERC ¶61,089 at PP 2-3, 5, 9, and 27 (2003).

[60] SPFF cites language from the related floor comments, which it asserts states that the purpose of Section 1803 (b) was to provide "increased rate certainty, limit the opportunity for future challenges to rates which had been in effect without challenge for an extended period of time, and limit refund exposure with respect to such rates." 138 Cong. Rec. S17684 (1992).

[61] As stated by Robert C. Means on behalf of ARCO in Ex UIT 40 at 2-3:

Its [Section 1803(b)'s] purpose is to serve as a safety value. It permits the Commission to respond to cases were a rigid application of the grandfathering rule would allow a pipeline to charge unacceptably high rates.

While that purpose is not sufficient to resolve detailed issues of interpretation and application, its does provide the framework within which those issues should be resolved. It implies that the goal in resolving such issues should be make successful challenges to grandfathered rates uncommon, but equally important not make them

Unofficial FERC-Generated PDF of 20050711-0206 Issued by FERC OSEC 06/01/2005 in Docket#: -

practically impossible.

[62] For the limitations of analyzing discreet pricing decisions at such an aggregated level, *see* Hay and Morris, *Industrial Economics – Theory and Evidence*, Oxford University Press 1979, as summarized at pp. 22-23 and detailed in chapters 2, 4, and 9.

[63] *Cf. Harris vs. Secretary, U.S. Department of Veteran's Affairs*, 126 F.3d 339, 343 (D.C. Cir. 1997); *Dole vs. Williams Enterprises, Inc.*, 876 F.2d 186, 189 (D.C. Cir. 1989).

[64] *See* Prepared and Direct Answering Testimony of Bonnie J. Pride, Ex. 3-12.

[65] *See Longhorn Partners Pipeline*, 73 FERC ¶61,355 (1995).

[66] *See* 18 C.F.R. Part 352, General Instructions 3-11(c)(1).

© 2005, CCH INCORPORATED. All Rights Reserved. A WoltersKluwer Company