113 FERC ¶ 61,062
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

OPINION NO. 481

Trans Alaska Pipeline System	Docket Nos. OR89-2-016 OR89-2-017
Exxon Company, U.S.A. v. Amerada Hess Pipeline Corporation	Docket Nos. OR96-14-005 OR96-14-006
Tesoro Alaska Petroleum Company v. Amerada Hess Pipeline Corporation	Docket Nos. OR98-24-000 OR98-24-002
BP Pipelines (Alaska), Inc.	Docket Nos. IS03-137-000 IS03-137-001
ExxonMobil Pipeline Company	Docket Nos. IS03-141-000 IS03-141-001
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Unocal Pipeline Company	Docket Nos. IS03-143-000 IS03-143-001
Williams Alaska Pipeline Company, L.L.C.	Docket Nos. IS03-144-000 IS03-144-001

OPINION AND ORDER ON INITIAL DECISION

Issued: October 20, 2005

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OPINION NO. 481

APPEARANCES

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*Patricia Godley and Richard A. Curtin o*n behalf of Petro Star, Inc.

Jeffrey G. DiSciullo and *Robert H. Benna* on behalf of Tesoro Alaska Petroleum Company

Randolph L. Jones, Jr., Melinda L. Kirk and Alex Goldberg on behalf of Williams Alaska Petroleum, Inc.

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Bradford Keithley, Jason F. Leif, Jones Day and Bradley S. McKim on behalf of BP Exploration (Alaska), Inc. and BP America Production Company

James M. Armstrong and Travis A. Pearson on behalf of Flint Hills Resource Alaska, LLC

Gregg D. Renkes, Robert E. Mintz, W. Stephen Smith and *Edward Twomey* on behalf of the State of Alaska

Marc Gary Denkinger and *Arnold H. Meltz* on behalf of the Federal Energy Regulatory Commission

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

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OPINION AND ORDER ON INITIAL DECISION

(Issued October 20, 2005)

1. This case is before the Commission on the exceptions to the Initial Decision (I.D.), issued August 31, 2004, by Administrative Law Judge Edward Silverstein (ALJ).[1] At

[1] *Trans Alaska Pipeline System*, 108 FERC ¶ 63,030 (2004).

issue is the method of making monetary adjustments among shippers of Alaska North Slope (ANS) oil on the Trans Alaska Pipeline System (TAPS). The adjustments are made through a "Quality Bank" which either compensates or charges a shipper for the difference in quality between the crude oil tendered by that shipper and the crude oil received by that shipper. The hearing resulted from remands of certain issues by the United States Court of Appeals for the District of Columbia Circuit in *Exxon Co. U.S.A. v. FERC*[2] and *Tesoro Alaska Petroleum Co. v. FERC*.[3] The Commission set the remand issues, as well as other issues, for hearing, by order issued November 7, 2001.[4] The order provided for concurrent hearing with the Regulatory Commission of Alaska (RCA), which has jurisdiction over intrastate shipments on TAPS.[5] The I.D. required certain changes in calculating the adjustments, with varying effective dates for these changes. The Commission largely affirms the I.D., but as required by recent Congressional action, limits any retroactive refunds resulting from the new valuations, to February 1, 2000, rather than back to December 1, 1993, as the I.D. had directed.

Background

2. TAPS is a 48-inch diameter common carrier crude oil pipeline owned and operated by the TAPS Carriers,[6] extending approximately 800 miles from Alaska's North Slope to Valdez, Alaska, on Alaska's south central coast. The TAPS Carriers are affiliated with major oil companies that own producing interests in the North Slope, and as such these major oil producers are shippers on the system they control. However, there are other shippers on TAPS who are not affiliated with the owners of the system.

3. Oil produced on the North Slope originates from several fields, each of which contains crude oil of differing characteristics. The crude oil produced from these fields is

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[2] 182 F.3d 30 (D.C. Cir. 1999) (*Exxon*).

[3] 234 F.3d 1286 (D.C. Cir. 2000) (*Tesoro*).

[4] *Trans Alaska Pipeline System*, 97 FERC ¶ 61,150 (2001).

[5] On August 31, 2004, the RCA ALJ issued a decision adopting Judge Silverstein's I.D.

[6] In the instant proceeding the TAPS Carriers consist of Amerada Hess Pipeline Corporation, BP Pipelines (Alaska), Inc., ExxonMobil Pipeline Company, ConocoPhillips Transportation Alaska (formerly Phillips Transportation Alaska, Inc.), Inc., Koch Alaska Pipeline Company, L.L.C. (formerly Williams Alaska Pipeline Company, L.L.C.) and Unocal Pipeline Company.

transported to Pump Station No. 1, where all of the production streams are commingled. The resulting common stream is then transported to Valdez. Along the system there are refineries, where a portion of the crude is removed from the TAPS common stream, refined primarily for generation purposes, and the unused portion is injected into the TAPS common stream. As a result of this commingling, a shipper will not necessarily receive at Valdez the same quality of crude which it tendered for transportation. In 1984, the Commission approved a Quality Bank using the American Petroleum Institute (API) gravity methodology, whereby shippers of crude with a higher quality than the common stream would be compensated, and shippers of lower quality crude would be charged.[7] This methodology puts a higher value on crudes with a higher specific gravity.[8]

4. In 1993, after producers constructed and put into operation a facility to process natural gas liquids (NGLs) found in ANS crude, the Commission held that a change in the existing gravity-based Quality Bank was required because the presence of substantial amounts of NGLs in the TAPS stream had skewed the relationship between the "gravity" of the stream and its value since NGLs with their low specific gravity do not have as high a value as crude with a similarly low specific gravity. The gravity method however, attributed the same value to them. To replace the gravity methodology, the Commission approved, as modified, a contested settlement that used a distillation method for valuing the streams.[9] Under that methodology the crude stream is separated into its component parts, or "cuts," market values are assigned to each cut, and the value of a crude stream is determined by the relative weighting of the cuts. The cuts under the distillation method are the following in the order in which they are distilled: Propane, Isobutane, Normal butane, Light Straight Run (natural gasoline, or light Naphtha), Naphtha (175°F - 350°F), Distillate (350°F - 650°F), Vacuum Gas Oil (VGO) (650°F - 1050°F), and Resid (over 1050°F).[10]

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[7] *Trans Alaska Pipeline System*, 29 FERC ¶ 61,123 (1984). The Quality Bank is administered by the Quality Bank Administrator (QBA). Administration costs are covered from the payments into the Quality Bank.

[8] The specific gravity of a substance is a comparison of its density to that of water.

[9] *Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 (1993).

[10] During the course of the TAPS proceedings there were slight changes in the temperature ranges of certain of the cuts.

5. In *OXY U.S.A., Inc. v. FERC*,[11] the Court affirmed the finding that a change in the methodology was required, and that no refunds were due, but remanded the valuation of the distillate and Resid cuts. Following the Court's decision in *OXY*, Exxon Company, U.S.A. (Exxon) filed a complaint, in Docket No. OR96-14-000, challenging the distillation methodology. The Commission consolidated Exxon's complaint with the *OXY* remand proceeding, and set the matters for hearing.[12] During the course of the consolidated proceedings, parties filed three different settlement proposals on the remanded issues, one by nine parties (Nine Party Settlement), and separate, unilaterally-proposed settlements by Exxon and Tesoro Alaska Petroleum Company (Tesoro). The Nine-Party Settlement was certified as a contested settlement, and the Commission approved it as a satisfactory resolution only of the valuation issues on remand of *OXY* (the 1997 Remand Order).[13] The order held that the changes required by the settlement would take effect prospectively. The order did not resolve Exxon's complaint in Docket No. OR96-14-000, which remained before the ALJ.

6. In *Exxon*, the Court generally affirmed the 1997 Remand Order, but nonetheless held that the method of valuing Resid did not bear a rational relationship to the actual value of Resid. The Court also found the decision to apply the settlement prospectively to be an abuse of discretion finding that the equitable factors on which the Commission based its decision to order only prospective changes did not overcome the strong equitable presumption in favor of retroactivity that would make the parties whole. The Court therefore vacated those portions of the order and remanded them to the Commission.

7. While the appeal in *Exxon* was pending, the hearing on Exxon's complaint in Docket No. OR96-14-000 proceeded before the ALJ. After argument and briefing on the issues, the ALJ issued an initial decision terminating the proceeding on the grounds that the arguments raised in the testimony were resolved in prior proceedings, and that there were no changed circumstances requiring a new Commission determination as to the reasonableness of the distillation methodology.[14] Further, the ALJ found that the arguments raised by Tesoro, an intervener in the complaint proceeding, were moot as a result of the dismissal of the complaint, but that Tesoro could file its own complaint challenging the lawfulness of the Quality Bank distillation methodology. Subsequently,

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[11] 64 F.3d 679 (D.C. Cir. 1995) (*OXY*).

[12] *Trans Alaska Pipeline System*, 76 FERC ¶ 61,119 (1996).

[13] 81 FERC ¶ 61,319 (1997) (the 1997 Remand Order).

[14] *Exxon Co., U.S.A. v. Amerada Hess Pipeline Corp.*, 83 FERC ¶ 63,011 (1998).

Tesoro filed its own complaint, in Docket No. OR98-24-000, alleging that the valuation of the Naphtha and VGO cuts under the distillation methodology resulted in inaccurate relative values in violation of the law.

8. On April 30, 1999, the Commission issued two orders. In one it affirmed the ALJ's dismissal of the Exxon complaint, and in the second it granted a motion to dismiss the Tesoro complaint.[15] Exxon and Tesoro appealed. In *Tesoro* the Court reversed the Commission. The court concluded that Exxon and Tesoro had presented sufficient evidence of changed circumstances as to the continued reasonableness of the distillation methodology and the valuation of the Naphtha and VGO cuts, and remanded those issues to the Commission for further proceedings.

9. On November 24, 1999, the TAPS' Quality Bank Administrator (QBA) notified the Commission of a change in one of the published prices used to determine the value of the Heavy Distillate component (450°F - 650°F). Pursuant to the Quality Bank methodology, the price for Heavy Distillate on the West Coast is set at Platt's Oilgram Price Report (Platt's) reported figure for West Coast High Sulfur (0.5 percent) Waterborne Gasoil. Platt's announced that effective November 1, 1999, it would no longer assess US West Coast Waterborne Gasoil reflecting a sulfur content of 0.5 percent sulfur.

10. On February 9, 2000, the Commission issued an order which accepted Platt's West Coast LA Pipeline LS No. 2 (0.05 percent) as the appropriate proxy for the West Coast Heavy Distillate cut, and referred the issue of the correct level of adjustment to a settlement judge.[16] When no settlement could be achieved, the matter was included in the Commission's November 7, 2001 Hearing Order.

11. During the course of the hearing, the Commission set for hearing two changes in the Naphtha valuation that had subsequently been proposed by the TAPS' QBA, since the issues were related to the issues in the hearing.[17] The hearing took 108 days, with 19 witnesses, and 1474 exhibits introduced into evidence, and resulted in the subject I.D.

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[15] *Exxon Co., U.S.A. v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,133 (1999), and *Tesoro Alaska Petroleum Co. v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,132 (1999).

[16] *Trans Alaska Pipeline System*, 90 FERC 61,123 (2000).

[17] *See Trans Alaska Pipeline System*, 102 FERC ¶ 61,345 (2003), and 104 FERC ¶ 61,201 (2003).

12. The I.D. decides the six issues set forth below, and there is a brief statement of the rulings made on each issue. Prior to the hearing the parties entered into a stipulation[18] relating to some of the issues, which will be considered when the issues are discussed.[19]

1. What is the appropriate method for valuing the Resid cut?

The I.D. describes the various steps in valuing the Resid, to be effective December 1, 1993. This will require the QBA to recalculate the Quality Bank adjustments from that time, and payments will go to and from shippers. However, in the event that the TAPS Carriers do not recover all the amounts due from shippers who will owe these additional amounts under the new reference price, the TAPS Carriers will not be responsible for the difference, and the shippers entitled to the additional amounts will be paid on a pro-rata basis.

2. What is the level of adjustment necessary to bring the Heavy Distillate cut into line with the specifications for Platt's West Coast LA Pipeline Low Sulfur No. 2? What should be the effective date of the change in the Heavy Distillate cut price?

The I.D. describes the necessary adjustments to bring the Heavy Distillate cut into line with the specifications for Platt's West Coast LA Pipeline Low Sulfur No. 2. The effective date for the new valuation is February 1, 2000.

3. Whether the current method for valuing the West Coast Naphtha Cut is just and reasonable, and if not, what is the appropriate method for valuing the Naphtha cut? What should be the effective date of any change to the West Coast Naphtha cut?

The I.D. adopts the "Tallett" methodology, which is based on a regression analysis, to value West Coast Naphtha. The change will be on a prospective basis from the date this order is issued.

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[18] Joint Stipulation (October 3, 2002).

[19] Prior to the hearing three other issues were to be determined at the hearing. However, the I.D. deferred ruling on these three issues. After issuance of the I.D., the parties filed a motion to withdraw these issues. The ALJ granted the motion on June 16, 2005, *see* 111 FERC ¶ 63,068 (2005). Thus, this order will address only the six issues described, and will not refer to the three other issues.

4. Whether the current method for valuing the West Coast VGO cut is just and reasonable, and if not, what is the appropriate method for valuing the VGO cut? What should be the effective date of any change?

The I.D. finds that this cut will be valued on the basis of Oil Pricing Information Service (OPIS) West Coast High Sulfur Vacuum Gas Oil weekly price. This change will be effective on a prospective basis.

5. Should the revised values for the cuts subject to the D.C. Circuit remand in *OXY* (Resid, Heavy Distillate and Light Distillate) be made retroactive to December 1, 1993?

The new valuations are retroactive to December 1993.

6. Are reparations an issue in this proceeding? If so, what reparations, if any, are appropriate?

The ALJ concluded that reparations are not an issue and cannot be awarded in this proceeding.

13. Exceptions were filed by the Eight Parties,[20] and six individual members of Eight Parties also filed separate exceptions on the Naphtha issue. Exceptions were also filed by Exxon Mobil Corp. and Tesoro Alaska Co., jointly (EMT), the TAPS Carriers, and Flint Hills Resources Alaska, LLC (Flint Hills).[21] Briefs opposing exceptions were then filed by all of them.

14. We will address the issues in the order set forth in the I.D.

Issue No. 1. What is the Appropriate Method for Valuing the Resid Cut?

15. Resid is the portion of the petroleum stream remaining after distillation of all other cuts at lower boiling points. Under the Quality Bank, Resid is any material that does not boil out until the temperature reaches or exceeds 1050°F.

[20] The Eight Parties are BP America Production Company, BP Exploration (Alaska) Inc., (jointly BP), Conoco Phillips Alaska, Inc. (CPAI), OXY USA, Inc., Petro Star, Inc., State of Alaska, Union Oil Company of California (Unocal), and Williams Alaska Petroleum, Inc. (Williams).

[21] Flint Hills Resources purchased an Alaska refinery from Williams in 2004.

16. The Commission had determined that Resid is best valued as a coker feedstock. A coker is "refinery equipment which breaks Resid down even further into lighter fuel products and a heavy residue, which might be asphalt at some plants, or other materials with differing uses."[22] As was noted in both *OXY* and *Exxon*, no active market exists for Resid which a value can be based on.[23] In *Exxon* the Court rejected the Commission's method for valuing Resid through specified proxies subject to certain adjustments

17. In the hearing order, the Commission stated that the Court was concerned "that the chosen proxy bear a rational relationship to the actual value of Resid."[24] Thus, in this proceeding, the ALJ was charged with the task of determining the appropriate method for valuing the Resid cut.

18. Before the hearing the parties stipulated how Resid should be valued. Specifically, they agreed that Resid should be valued as a coker feedstock by valuing the coker products minus the cost of producing these products using the following formula: "Resid = Before-Cost Value of coker Products – (Coking Costs * Nelson Farrar Index)."[25] The Stipulation provided that the Before-Cost Value is to be calculated using a 3-step process: (1) the product (Fuel Gas, Propane, Isobutane, Normal Butane, LSR, Naphtha, Heavy Distillate, VGO, and coke) yields are to be determined through the use of the Process Industry Modeling System, Version 11.0 (PIMS);[26] (2) values are to be determined for each; and (3) the product yields are to be multiplied by the product prices and the resulting values are added together.[27]

19. Further, the Coking Costs would be given a "single value," but the parties failed to agree on what that value should be.[28] While not agreeing as to the "base year" the parties

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[22] *Exxon*, 182 F.3d at 36.

[23] *OXY*, 64 F.3d at 688; *Exxon*, 182 F.3d at 42.

[24] 97 FERC at 61,652.

[25] Joint Stipulation of the Parties, filed October 3, 2002, at 1 (Joint Stipulation).

[26] "PIMS is a standard, commercially available computer model licensed by Aspen Technology, Inc., that is used to simulate refinery operations." Exhibit PAI-1 at 11. The PIMS model yield for ANS Resid can be found in Exhibit PAI-5.

[27] Joint Stipulation at 1-2.

[28] *Id.* at 3.

agreed that the Nelson Farrar Index to be used is a ratio of the Nelson Farrar Index (Operating Indexes Refinery) for the year in which the value is sought and the Nelson Farrar Index (Operating Indexes Refinery) for the base year.[29]

20. The ALJ addressed a number of issues concerning the before-cost value and coker costs that were in dispute. We affirm the ALJ's findings regarding these issues subject to one modification.

A. Coker Cost Issues

21. The parties adopted as the standard that the coker would have to be sized to be able to process 40,000 barrels per stream day of Resid with an 87 percent annual utilization rate.[30] However, the ALJ was presented with two diametrically opposite proposals on how to determine the cost of a typical delayed coker,[31] one by EMT and one by Eight Parties. The witness for EMT, Mr. John H. Jenkins, presented a detailed itemized cost study that identified the direct and indirect costs for each of the items of equipment that would be required for the coker and the related downstream refinery units necessary to process the coker products to bring them up to the quality specifications of the Quality Bank reference products. On the other hand, Eight Parties' witness, Mr. John B. O'Brien, based his coker cost estimate on the relationship between plant capacity and plant cost reflected in his firm's coker cost curves.

22. The ALJ found neither O'Brien's nor Jenkins's "overall approach" satisfactory stating:

> I am troubled with the complexity and subjectivity of Jenkins's itemized list of components. Also, I question whether Jenkins expended the effort necessary, described by Gary, to actually do a detailed estimate which I

[29] *Id.*

[30] I.D. at P 957, 960.

[31] A "delayed coker" is the term used for newer cokers. These delayed coking units use a relatively higher severity thermal cracking process. Delayed coking has been used by many refiners for bottom of the barrel up-gradation, because it can handle even the heaviest of residues.

> could accept as accurate.[32] While I am troubled by O'Brien's lack of detail, in the final analysis, as will be seen below, I can adjust O'Brien's estimate in ways which satisfy me that the end result is as close a cost estimate as possible given the limitations of what can be accomplished in the hypothetical world in which we are trying to determine the cost of a Delayed Coker. I can find no way of modifying Jenkins's estimate to satisfy me that the end result is accurate and fair to all parties. In sum, there is nothing in Jenkins's testimony or Exxon's arguments that convinces me that Jenkins's itemized cost approach is objective or accurate enough to satisfy the needs of using it as part of the formula which will result in a determination of the value of Resid. Therefore I hold that, as modified below, O'Brien's cost curve should be used.[33]

23. Parties take exception to several of the ALJ's modifications and additions to O'Brien's cost estimate.

1. Capital Costs

24. The parties agreed that the coker capital costs consist of (a) the direct costs, referred to as "Inside Battery Limits" or "ISBL," which include the costs of the coker itself and related downstream refinery units, and (b) the indirect costs, referred to as "Outside Battery Limits" or "OSBL," which include facilities necessary to support refinery processing units such as storage facilities, steam generation systems, etc., and finance costs.[34]

a. ALJ's Findings

25. The ALJ found that Mr. O'Brien's ISBL cost estimate omitted the costs of several items of equipment that were included in Mr. Jenkins's itemized approach. In particular, the ALJ found that a typical delayed coker, *i.e.*, a coker capable of processing 40,000 barrels per stream day of Resid, would be expected to have: (1) four coke drums

[32] Jenkins admits that he and Dickman only spent three man weeks on "engineering" the project. Transcript at 2762, 2770. However, he further stated that, to do a detailed estimate to the level of which Gary spoke, *i.e.*, 30 percent engineering, would take "four to six months." *Id.* at 2770.

[33] I.D. at P 1184.

[34] Exxon Initial Brief at 59-60; Eight Parties Initial Brief at 28.

rather than the two assumed by Mr. O'Brien;[35] (2) automatic deheading equipment for safety and efficiency;[36] (3) adequate coke handling equipment, *i.e.*, "coke pit and crane, chutes and conveyor system, and covered storage," rather than the concrete "pad" and front end loader assumed by Mr. O'Brien;[37] and a coker gas plant.[38] The ALJ determined that these costs be added to Mr. O'Brien's base cost curve.

26. As to the determination of the OSBL cost estimate, the ALJ was presented with two approaches. Mr. O'Brien presented an approach using an average estimate for OSBL costs equal to 35 percent of the ISBL costs. Although Mr. Jenkins agreed that Mr. O'Brien's approach was typical, he presented a different approach which estimated the costs of the major process units needed to add a coker to an existing refinery, the costs of the additional storage facilities, steam generation systems, and cooling water systems that would be required to support the coker, and then applied a factor of 25 percent of the costs of the ISBL processing units to cover other OSBL costs. As both Mr. Jenkins and Mr. O'Brien agreed that the typical approach to be followed in calculating OSBL costs is to use a percentage of ISBL costs, the ALJ found that O'Brien's approach of using 35 percent of the ISBL estimate should be followed.

27. With regard to other remaining OSBL matters specifically addressed by the parties (storage costs, steam generation and cooling water facilities, and miscellaneous items), the ALJ found that O'Brien's suggestion that they be calculated by taking 35 percent of ISBL costs to be adequate when the modifications which the ALJ made in his ISBL estimate are taken into consideration.

b. <u>Exceptions</u>

28. Eight Parties argue that the ALJ erred by adding these capital costs to O'Brien's cost curve. They state that these additions result in a Resid value even below that proposed by EMT, who had advocated a low Resid value. In addition, Eight Parties argue that the costs for automatic deheading presented by Mr. Jenkins, which the ALJ adds as an ISBL cost, lack a relevant vendor quote, incorrectly assume top and bottom deheading systems, and are an estimate for a retrofit to an existing coker which is not consistent with Jenkins's assumption in his estimate for a new coke drum installation.

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[35] I.D. at P 1194.

[36] I.D. at P 1199.

[37] I.D. at P 1204.

[38] I.D. at P 1208.

Also, Eight Parties contend that basic coke handling costs, *i.e.*, costs for a coke pad and front loader, were already included in O'Brien's cost curve ISBL number, and that anything after the initial handling is covered by his OSBL estimate. Further, Eight Parties argue that O'Brien testified that he does not consider the gas plant to be a part of the ISBL and that since there already exists a gas plant at the refinery to which the delayed coker is to be added, there is no ISBL cost associated with the coker gas plant, but only some cost for processing the coker gas in the existing gas plant.

29. Also, Eight Parties argue that the inclusion of coke handling and coker gas plant costs in the ISBL costs results in a double counting of those units, at least when applied to O'Brien's cost curve and OSBL cost estimate. They state that O'Brien used a higher than normal OSBL multiplier of 35 percent to account for a number of costs such as coke handling costs not included in the cost curve ISBL cost and to include that portion of the existing coker gas plant credited to the delayed coker for its joint use of the facility. Eight Parties argue that the problems with the costs for the coke handling and coker gas plant are easily remedied by removing them from the ISBL costs and treating them as included in the OSBL cost amount calculated by using O'Brien's 35 percent multiplier.

30. EMT argue that the ALJ erred by failing to adjust O'Brien's OSBL cost calculation to include costs of storage because O'Brien made no allowance for storage costs.

c. <u>Opposing Exceptions</u>

31. EMT contend that Eight Parties' arguments are without merit as the evidence demonstrates that the four items of equipment that the ALJ added to Mr. O'Brien's coker cost estimate are necessary components of any modern coker. Nor, they argue, is there any valid basis for the concern that the coker handling equipment costs or the coker gas plant costs might be overstated or double counted under the ALJ's rulings. EMT state that the record indicates that O'Brien did not include either of these in his ISBL or OSBL estimates.

32. With regard to EMT's argument that additional storage costs should be included in OSBL, Eight Parties argue that they are unsubstantiated and that the factual record evidence demonstrates that refiners do not add new tankage, *i.e.*, storage, but rather utilize existing tankage when adding a coker to an existing refinery. Also, they argue that storage costs do not constitute processing costs and to include such costs for the Resid valuation would result in the Resid cut of the TAPS Quality Bank being valued inconsistently with other Quality Bank cuts.

d. Commission Determination

33. We affirm the ALJ's decision with modification to the ruling on automatic deheading equipment. Eight Parties do not challenge the ALJ's findings that these four additional items of equipment were not included in O'Brien's estimate of the ISBL costs of the coker. Instead, Eight Parties argue that the addition of these costs increases O'Brien's coker cost estimate higher than what Jenkins estimated and that, therefore, the additions must be invalid. As the evidence demonstrates, however, the four items of equipment that the ALJ added to Mr. O'Brien's coker cost estimate are necessary components of any modern coker and Mr. O'Brien did not account for them in his estimate.

34. The issue with regard to the amount of drums in a "typical" coker is how many drums are needed to process 40,000 barrels/stream day of ANS Resid. Although we agree with the ALJ that one could design a 2-drum coker to do just that,[39] we also agree that such a coker would not be typical. Evidence was presented demonstrating that only one 2-drum coker exists in the country with the ability to process 40,000 barrels/day of Resid[40] and that the range of all the 4-drum cokers in the country range from 17,500 bbl/d to 80,000 bbl/d. Therefore, we find that the ALJ was correct to find that the cost of a typical coker that can process 40,000 barrels/day should be based on a 4-drum, not 2-drum coker.

35. With regard to the automatic deheading equipment, the evidence demonstrated that most, if not all, cokers built in the last ten years had automatic deheading equipment.[41] In fact, O'Brien could not identify any installed coker since 1996 which did not have automatic deheading equipment.[42] Therefore, we agree that deheading equipment should be added to the ISBL estimate. We disagree, however, on the ALJ's adoption of Jenkins's position that a refinery would probably include automatic deheading equipment for both the top and the bottom heads simply because the incremental cost was low. As Jenkins admitted, the preponderance of automatic

[39] I.D. at P 1194.

[40] EMT-167 at 19-21.

[41] I.D. at P 1197; Jenkins, Transcript at 3894.

[42] Transcript at 374.

deheading systems are bottom systems and not top systems.[43] Therefore, we find that a typical coker would only have bottom automatic deheading equipment.

36. As to the coke handling equipment, O'Brien only included in his cost estimate a "coke pad" and a "front end loader."[44] However, Jenkins demonstrated that a typical coker, and particularly one on the West Coast, would include coke handling equipment consisting of a coke pit and crane, appropriate chutes and conveyor system, and covered storage to move and store the coke at the refinery and meet environmental requirements.[45] In fact, O'Brien admitted that, though a coke pad and front-end loader might have been acceptable in 1996, he did not "think it would be today."[46] He further admitted that he could not identify one coker currently operating on the West Coast with just a coke pad and front-end loader.[47] Therefore, we agree with the ALJ's finding that a typical coker would include all the equipment described by Jenkins and that O'Brien's estimate should be supplemented with the cost of the equipment not included in O'Brien's estimate.

37. Also, we agree with the ALJ's finding that the costs of the coker gas plant should be included in ISBL and that O'Brien did not adequately provide for these costs in his estimate. Both Jenkins and Gary, author of the Gary and Handwerk Treatise,[48] presented testimony that the coker gas plant should be included in ISBL.[49] Further, O'Brien admitted that the base refinery on which he based his analysis of the coker costs did not have a catalytic cracking unit[50] and that "[i]f . . . there was no cat cracker in the refinery, then the gas plant would have to be built for the coker."[51] In any event, the evidence

[43] Transcript at 3990.

[44] I.D. at P 1204 & n.454 (citing PAI-58 at 15).

[45] EMT-146 at 33-34; EMT-212 at 2-3.

[46] Transcript at 331-32.

[47] *Id.*

[48] James H. Gary & Glenn Handwerk, Petroleum Refining, Technology and Economics (4th ed. 2001).

[49] EMT-37 at 36; EMT-191 at 4.

[50] Transcript at 288, 1322-23.

[51] Transcript at 421; I.D. at P 1034.

demonstrated that gas plants are physically inside the battery limits as they are normally located as close as possible to the fractionator of the coker so that that the heat from the fractionator can be used in the plant.[52] With regard to Eight Parties' argument that the costs of the gas plant were included in O'Brien's OSBL estimate, we find it unpersuasive. O'Brien admitted that his list of items included in his OSBL cost estimate did not include the coker gas plant.[53] Moreover, the evidence demonstrated that if it were included, the OSBL cost estimate was not adequate to cover both the coker gas plant and the other OSBL cost items.[54]

38. Further, we find that OSBL should include appropriate storage costs for storing the Resid as a coker feedstock and for the storage associated with downstream units. Accordingly, we agree with the ALJ's adoption of O'Brien's OSBL methodology for accounting for storage costs. The evidence demonstrated that Gary and Handwerk suggested calculating OSBL by estimating 20-25 percent of ISBL,[55] and that O'Brien increased this percentage to 35 percent. The evidence also suggested that storage costs are usually estimated separately, along with some other items, from the OSBL costs. Thus, the 20-25 percent of ISBL to estimate OSBL would have to be increased to account for the inclusion of storage costs in OSBL. O'Brien's initial 35 percent estimate was increased as a result of the ALJ's rulings which increased the ISBL estimate. As the ALJ stated, "if no change is made in the manner in which he calculated the OSBL costs, his OSBL estimate will have a concomitant increase. This is especially true as I have held that the coker gas plant costs should be treated as an ISBL cost and not included in the OSBL estimate."[56] As a result we find that the increase in percentage of ISBL to estimate the OSBL costs, *i.e.*, 35 percent of ISBL instead of 20-25 percent of ISBL, coupled with the ALJ's decision to increase the ISBL costs, adequately provides for storage costs.

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[52] EMT-146 at 36-37; EMT-167 at 24-26; EMT-191 at 5-6; Transcript at 1327-28, 3493, 4084, 4093.

[53] I.D. at P 1205 n.455, 1208 n.459; O'Brien Transcript at 439-40.

[54] I.D. at P 1208 n.459.

[55] PAI-1 at 24; Exxon Initial Brief at 95.

[56] I.D. at P 1211.

2. West Coast Location Factor

a. ALJ's Findings

39. A location factor is an adjustment factor used to translate a construction cost estimate developed for a specific project in a specific location (usually the U.S. Gulf Coast) to obtain a cost estimate for the same project in different parts of the country under the assumption that the cost to build a similar facility will vary depending on where it is located.[57] The ALJ acknowledged the parties' apparent agreement that West Coast Resid, as opposed to the Resid in the U.S. Gulf Coast, should be valued on a West Coast basis, and that, generally, the prices on the West Coast tend to be higher than those on the Gulf Coast. The ALJ discounted O'Brien's coker cost curve for the value of West Coast Resid because it was geographically "generic," *i.e.*, O'Brien's conceptualized refinery with the added Coke was not located at a specific geographical location (neither West Coast nor Gulf Coast), and did not take into consideration higher West Coast costs. However, the ALJ did agree with Eight Parties that the location factor used should not be based on the cost of building and operating a Los Angeles refinery/coker. Since the refinery/coker is located on the West Coast without being focused on a specific geographical site, the location factor should be generic to that Coast. The ALJ decided upon a location factor of 1.27, which he derived by averaging the location factor for all 27 refineries on the West Coast.[58]

b. Exceptions

40. Eight Parties argue that a location factor should not be used. They state that the record indicates that location factors are highly subjective with no consistent pattern. Further, they argue that the only empirical data in the record demonstrating that the cost of a delayed coker on the West Coast when compared on an equivalent basis with the cost of a delayed coker on the Gulf Coast is lower. They assert that such data underscore and justify O'Brien's use of a generic cost curve without applying any location factor.

41. If a location factor is required, Eight Parties argue that the ALJ erred by using a location factor that is too high. First, they argue that the ALJ's location factor of 1.27 falls within the 1.26 to 1.30 range that EMT witness Jenkins applied in his detailed cost estimate that the ALJ rejected. Second, they argue that the ALJ's method of averaging is contrary to his holding that the location factor should represent a West Coast refinery and not a Los Angeles refinery. They state that the preponderance of the 27 refineries used in

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[57] Eight Parties Initial Brief at 138.

[58] *See* Exhibit EMT-208.

the ALJ's calculation are located in California, with all but four of those refineries located in the Los Angeles and San Francisco Bay area.[59] Moreover, they argue that since both Los Angeles and San Francisco have the same location factor of 1.35, 19 of the 27 refineries thus have a location factor that is the location factor used for Los Angeles,[60] resulting in a location factor weighted as if Los Angeles were the site.

42. Eight Parties argue that a location factor is not weighted by the number of facilities in a particular location. Therefore, to reflect a true West Coast generic location factor, it would be more appropriate to simply average the location factor for each refining region on the West Coast. The result would be a location factor of 1.21 based on three location factors: 1.35 for Los Angeles and San Francisco, 1.20 for the Bakersfield and Oildale, CA refineries, and 1.08 for the Washington and Oregon refineries.

c. <u>Commission Determination</u>

43. We agree with the ALJ's location factor of 1.27. The evidence demonstrated that construction costs, labor costs, and permitting costs are generally higher on the West Coast than on the Gulf Coast.[61] Therefore, a location factor is appropriate on the West Coast. As to the 1.27 location factor adopted by the ALJ, we also find it "the most logical."[62] The ALJ's simple averaging of the location factors for all 27 of the West Coast refineries takes into account all of the available data and appropriately gives proportionately greater weight to those West Coast locations that have the larger number of refineries. We do not believe that averaging the location factor for each defining region, as Eight Parties suggest, accounts for these factors.

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[59] Footnote 473 in Initial Decision P 1238 lists the 27 refineries. The four California refineries not located in the Los Angeles and San Francisco Bay area are: Equilon (Bakersfield, CA); Kern (Bakersfield, CA); San Joaquin (Bakersfield, CA); and Trico Refining (Oildale, CA).

[60] Besides the three Bakersfield, CA and the Oildale, CA refineries, the other four are the three Washington State refineries and one Oregon refinery listed in footnote 473.

[61] *See, e.g.*, EMT-116 at 7; EMT-169 at 6; EMT-146 at 13.

[62] I.D. at P 1240.

3. New Evidence

44. Flint Hills raises a number of issues regarding the ALJ's Resid valuation rulings based on evidence that was not introduced in the hearing or on new proposals that were not fully considered in the hearing.

45. We find that considering new evidence that is not in the record is in violation of our Rules. Section 18 C.F.R. 385.214(d)(3)(ii) states that "a later intervener must accept the record of the proceeding as the record was developed prior to the late intervention." As a late intervener, Flint Hills must accept the record as it was. Thus, we reject any new evidence or new proposals it sought to introduce.

B. Just and Reasonable Resid Value

46. Eight Parties, as does Flint Hills, argue that the Resid value produced by the ALJ is not just and reasonable. Essentially, they argue that the ALJ must have erred because the resulting coker cost, which has an inverse relationship to the value of Resid, is higher than the coker cost estimate that was presented by Jenkins, the witness for EMT. In addition, they argue that the ALJ erred by not calculating the precise Resid value that results from the rulings.

47. We disagree. We acknowledge that, as Eight Parties point out, the coker costs based on the ALJ's rulings may be higher than Jenkins's estimate.[63] However, Eight Parties have not shown that the ALJ's methodology for calculating coker costs, except as to the automatic deheading equipment, was incorrect. For instance, as to capital costs, discussed above, the record establishes that Eight Parties' coker cost estimate presented by O'Brien simply did not include or factor in certain equipment that a "typical" coker should have. Therefore, the ALJ added the unaccounted-for equipment to O'Brien's cost estimate. To argue now that regardless of the fact that O'Brien admits that he did not include certain equipment, the ALJ's methodology should be result-oriented and, therefore, should be modified so that it does not result in costs that exceed Jenkins's estimate would be to ignore the evidence and testimony presented in this hearing. In any event, Jenkins's and O'Brien's cost estimates were not the only estimates presented during the hearing.[64] In fact, O'Brien presented evidence which suggests that the coker cost estimate would be substantially higher than O'Brien's cost estimate as modified by

[63] Eight Parties Appendix B to Brief on Exceptions.

[64] *See* PAI-10.

the ALJ.[65] Therefore, Jenkins's coker cost estimate did not establish the "just and reasonable" ceiling that Eight Parties advance in their exceptions.

48. Secondly, we find that the ALJ was not required to calculate the precise Resid value, much less that such an omission automatically results in an unjust and unreasonable decision. In this instance, the ALJ ruled on a methodology and the specific components thereto, and directed the TAPS Carriers to file revised tariff sheets in accordance with the rulings.[66] Because the ALJ ruled on all the issues that were disputed between the parties, there was no need, as helpful as it may be, to calculate the precise Resid value.

49. Accordingly, we affirm that the ALJ's Resid value was based on a just and reasonable methodology, and the resulting Resid value is just and reasonable.

C. Clarifications

50. TAPS Carriers have requested clarifications relating to the coker product value and coker cost. As the ALJ found that O'Brien's cost curve should be used to value Resid, we clarify that the TAPS Carriers must use this approach along with O'Brien's cost figures unless the ALJ specifically referenced otherwise, *e.g.*, adopted Jenkins's estimate for a specific cost.

Issue No. 2 What is the level of adjustment necessary to bring the Heavy Distillate cut into line with the specifications for Platt's West Coast LA Pipeline Low Sulfur No. 2? What should be the effective date of the change in the Heavy Distillate cut price?

A. The I.D.

51. Pursuant to the Quality Bank methodology, the price for Heavy Distillate on the West Coast was set at Platt's Oilgram Price Report (Platt's) reported figure for West Coast High Sulfur (0.5 percent) Waterborne Gasoil. However, effective November 1, 1999, Platt's discontinued reporting that price but introduced Waterborne assessments for Gasoil reflecting a sulfur content of 0.05 percent.

52. The Commission accepted the parties' agreement to use Platt's West Coast LA Pipeline LS No. 2 (0.05 percent) as the appropriate proxy for the West Coast Heavy

[65] *Id.*

[66] I.D. at P 3084.

Distillate cut, but there was disagreement among the parties on the correct level of adjustment necessary to bring the TAPS Heavy Distillate cut into line with the new reference price with its much lower 0.05 percent sulfur specification. The November 2001 Hearing Order directed that the issues be determined at the hearing, as well as the effective date of any new valuation.

53. Consistent with the positions previously taken, at the hearing all parties stipulated to value West Coast Heavy Distillate at the published Platt's West Coast LA Pipeline LS (0.05 percent) No. 2 Fuel Oil price, less appropriate deductions.[67] The parties agreed that deductions should include the cost of desulfurizing to meet the 0.05 percent sulfur specifications in the new proxy, but did not agree as to the cost of desulphurization. They also disagreed as to whether there should also be a logistics adjustment to the reference price.[68] They also agreed on February 1, 2000, as the effective date for this new valuation, with refunds to be made to that date.

54. The ALJ accepted the adjustment proposed by Mr. O'Brien on behalf of Eight Parties subject only to the use of a West Coast location factor to reflect the fact that costs on the West Coast are higher than the Gulf Coast costs that Mr. O'Brien used in calculating his sulfur processing costs.[69] The ALJ rejected the logistic adjustment, first on the grounds it was outside the scope of the Heavy Distillate valuation issues referred by the Commission and, hence, was not properly before the ALJ.[70] However, the ALJ also found that Eight Parties had (1) "failed to satisfy their burden of showing" that any such adjustment "was warranted", and (2) failed to show that the particular adjustment of 1.1 cents per gallon that they proposed was warranted.[71] The ALJ followed the stipulation of a February 1, 2000 effective date for the new valuation.

B. <u>Exceptions to I.D.</u>

55. Eight Parties argue that a West Coast location factor should not be applied to Mr. O'Brien's Gulf Coast cost estimates. Eight Parties also argue that the ALJ erred in

[67] *See*, Joint Stipulation at 3.

[68] The adjustment reflects the costs incurred in transporting product inland to the pipeline from its arrival point at the harbor. I.D. at P 1443.

[69] I.D. at P 1416-1442.

[70] I.D. at P 1447.

[71] I.D. at P 1448.

rejecting their proposed "logistics adjustment," because first, their logistic adjustment was within the scope of the Commission's reference to the ALJ, and second, that their logistics adjustment is "warranted for consistency purposes" and that the amount of the proposed adjustment was reasonable.

56. Flint Hills excepts to the effective date ruling. It argues that notwithstanding the Joint Stipulation's effective date of February 1, 2000, for the new West Coast Heavy Distillate prices, the Commission should make the new West Coast Heavy Distillate valuation effective only on a prospective basis.

57. TAPS Carriers do not take issue with the ALJ's decision regarding the appropriate sulfur processing cost adjustment to the Heavy Distillate cut but urge the Commission to clarify three narrow cost issues. TAPS Carriers point out that the ALJ adopted the costing approach proposed by Mr. O'Brien but did not specifically adopt Mr. O'Brien's 20 percent capital recovery factor, or the methodology that he used in calculating fixed operating costs, and variable operating costs. TAPS Carriers request that the Commission confirm that Mr. O'Brien's 20 percent capital recovery factor, fixed operating costs, and variable operating costs should be used in calculating the sulfur processing cost adjustment for the West Coast Heavy Distillate cut.

C. Commission Rulings

1. Sulfur Processing Costs Adjustment

a. Capital Costs

58. The ALJ held that applying O'Brien's cost curve approach to determine the sulfur processing cost adjustment added a certain consistency to the Quality Bank calculations as such an approach was also used to determine the value of Resid. Taking all of the evidence into consideration, the ALJ found this method to be appropriate, and the result to be just and reasonable. TAPS Carriers assert that although the I.D. does not expressly adopt the 20 percent capital recovery factor in connection with the valuation of the Heavy Distillate component, it does generally accept O'Brien's valuation approach,[72] which includes a 20 percent capital recovery factor.[73] TAPS Carriers argue that the Commission should confirm that a 20 percent capital recovery factor should be used or, if not, specify what capital recovery factor should be used.

[72] I.D. at P 1419.

[73] *See* Exhibit PAI-19.

59. We find merit in TAPS Carriers' request particularly since no party opposes the request and EMT urges the Commission to grant it. Accordingly we direct that a 20 percent capital recovery factor should be used in the valuation of the Heavy Distillate component as used in witness O'Brien's valuation approach.[74]

2. <u>Location Factor</u>

60. The ALJ stated that with respect to the location factor issue, the parties made exactly the same argument as they did with respect to the use of a location factor on the Resid estimates. As to Resid, the ALJ determined that a location factor should be used inasmuch as the record clearly supported a conclusion that construction costs were higher on the West Coast, that the fact that a "specific" site for construction of the plant on the West Coast was irrelevant, and that a just and reasonable location factor to be used was 1.27. For the reasons stated in that discussion, the ALJ found that a location factor is appropriate to be used as to the Heavy Distillate cut and the appropriate location factor to be used is 1.27.

61. On exceptions, Eight Parties assert that the ALJ used the location factor of 1.27 to transform O'Brien's Gulf Coast hydrotreater capital costs to a West Coast location. Eight Parties state that accordingly, they incorporate the same arguments they raised concerning the use of the same location factor to determine the value of Resid. Eight Parties stipulate that whatever the Commission rules with respect to the location factor for the Resid valuation should be applied identically to the West Coast Heavy Distillate valuation.

62. As discussed in our evaluation of the application of a West Coast location factor to value Resid, we find the ALJ's adoption of a 1.27 West Coast location factor to determine the value of the Heavy Distillate cut to also be appropriate. Because Eight Parties stipulate that our ruling on the location factor for the Resid cut should apply to the West Coast Heavy Distillate cut, we need not address the issue again here, and thus, apply the 1.27 West Coast location factor to the Heavy Distillate cut. In any event, based on the record and evidence, we find that a West Coast location factor should be applied to the Heavy Distillate cut.[75] Accordingly, we affirm the ALJ's finding that a West Coast location factor of 1.27 is reasonable and should be used.

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[74] We also confirm TAPS Carriers' unopposed request that Mr. O'Brien's methodology for calculating fixed operating costs and variable costs should be used in calculating the sulfur processing costs adjustment.

[75] I.D. at P 1237.

3. Logistics Adjustment

63. In their initial brief, Eight Parties argued that "the Heavy Distillate reference price requires a logistics adjustment to bring it onto a consistent basis with all of the other liquid Quality Bank cuts" and that the 1.1 cents/gallon is "the average of costs incurred in transporting product inland [sic] to the pipeline from its arrival point at the harbor."[76] They suggested that because the pipeline reference price is inflated by this cost factor, the costs of transportation must be deducted in order for the value of Heavy Distillate to be set at the same waterborne level as the other liquid cuts.[77]

64. The ALJ found that the question of whether the Heavy Distillate reference price should be adjusted by the cost of transporting the product from the harbor to the pipeline was not before him. The ALJ stated that even if the issue were before him, he would find that Eight Parties failed to satisfy their burden by showing that it was warranted, in general, nor had they shown that the adjustment of 1.1 cents/gallon was just and reasonable.

65. On exceptions, Eight Parties assert that to the extent the ALJ decided that the proposed logistics adjustment was not before him based on EMT's argument, the ALJ incorrectly considered EMT's argument because EMT had waived that argument. Eight Parties contend that EMT's failure to object to the scope of these proceedings until its post-trial brief, and its decision to present testimony on the proposed logistics adjustment, constitutes a waiver of the objection. Accordingly, Eight Parties state, in making his decision, the ALJ should not have considered EMT's post-hearing assertion that the Heavy Distillate logistics adjustment was not before him.

66. Eight Parties state that the Court in *OXY* unequivocally stated that the "FERC must accurately value all cuts – not merely some or most of them – or it must overvalue or undervalue all cuts to approximately the same degree."[78] Eight Parties submit that the ALJ correctly stated that Eight Parties' primary justification for proposing a logistics adjustment is to achieve consistency in the location at which Quality Bank cuts are

[76] Eight Parties Initial Brief at 150-152.

[77] *Id.*

[78] 64 F.3d at 693.

valued.[79] Eight Parties argue that he then proceeds, however, to state incorrectly that such an adjustment is not necessary because no such consistency currently exists.[80]

67. Eight Parties argue that all four gas plant products or natural gas liquids are consistently valued based on the available market for those products - pipeline on the Gulf Coast, and truck/rail on the West Coast. They argue that as for the liquid products, all five Gulf Coast liquid products are consistently valued on a waterborne basis. They further argue that on the West Coast, Naphtha, Light Distillate and VGO are and will continue to be valued on a waterborne basis. Accordingly, in order to achieve complete consistency with respect to all liquid Quality Bank products, Eight Parties assert that the remaining liquid products, Resid and Heavy Distillate, must be valued on a waterborne basis.

68. Eight Parties maintain that their proposed logistics adjustment of 1.1 cents/gallon represents the average of costs incurred in transporting relevant product inland to the pipeline from its arrival point at the harbor. Specifically, Eight Parties submit, as to the product delivered into Los Angeles harbor, which is the relevant location for this discussion, "the added value at the pipeline hub largely reflects the logistics costs of moving product from a tanker or barge . . . into the Kinder Morgan pipeline terminal at Watson, California."[81]

69. Eight Parties state that the costs incurred in transporting product to the pipeline from the harbor consist generally of cargo inspection, dock and wharf fees, terminal charges and pipeline tariff charges.[82] Eight Parties submit that to determine what costs are actually incurred in the marketplace, and where within this range the logistics adjustment should fall, BP's witness Ross calculated the actual observed waterborne/pipeline differentials between West Coast Waterborne Low Sulfur Gasoil and Platts West Coast LA Pipeline No. 2.[83] Eight Parties assert that while these two products are not identical, Platts specifically stated that they are considered interchangeable.[84] Eight Parties further submit that as further support for the market-

[79] I.D. at P 1448.

[80] *Id.*

[81] Exhibit EMT 102 at 7-10.

[82] *See* Exhibit BPX-1 at 13.

[83] Exhibit BPX-1 at 13:10-11.

[84] Exhibit BPX-1 at 10:1-2; Exhibit BPX-55 at 1-2; Transcript 1780:3-9.

realized transportation costs, Ross also calculated the waterborne/pipeline differentials in reported prices for the similarly situated products of regular gasoline and jet fuel.[85]

70. Eight Parties maintain that each of the three waterborne/pipeline differentials calculated by Ross supports their 1.1 cents/gallon proposed logistics adjustment. They assert that the annual average between West Coast Waterborne Low Sulfur Gasoil and Platts West Coast LA Pipeline No. 2 shows that the waterborne price is almost precisely 1.1 cents/gallon less than the pipeline price.[86] Eight Parties state that Christopher Cavanagh, in support of Eight Parties, concluded that there is a statistically significant differential between West Coast Waterborne Low Sulfur Gasoil and West Coast LA Pipeline No. 2 and that differential is consistent with the proposed logistics adjustment of 1.1 cents/gallon. (Exhibit BPX-60 at 6:9-12, [87] BPX-60 at 11:17; BPX-60 at 9:11-13; BPX 60 at 9:15-17; BPX-60 at 9:17; and BPX 60 at 9:13-17.)

71. Eight Parties conclude that their proposed logistics adjustment to the Heavy Distillate reference price is necessary to achieve the consistency that the D.C. Circuit requires and the non-refuted evidence shows that the proposed 1.1 cents/gallon adjustment is just and reasonable.

72. We affirm the ALJ's decision not to accept the proposed 1.1 cents/gallon logistic adjustment. First, the ALJ correctly held that the logistic adjustment proposed by Eight Parties was not within the scope of the issues referred to the ALJ by the Commission. The November 2001 Hearing Order directed that the issue relating to Heavy Distillate to be addressed in this proceeding is "the level of the sulfur processing adjustment

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[85] Exhibit BPX-1 at 13:9-13.

[86] *See* Exhibit BPX-3. The first two months of data for the reported West Coast Waterborne Low Sulfur Gasoil were discarded when making this calculation because they appear to be distorted relative to the remainder of the time period. This distortion likely reflects start-up issues associated with the reporting of this product, which began in November 1999. *See* Exhibit BPX-1 at 14:12-14.

[87] Eight Parties argue that although Pavlovic testified that there are no systematic differentials between West Coast Waterborne Low Sulfur Gasoil versus Platts West Coast LA Pipeline No. 2, waterborne versus pipeline gasoline or waterborne versus pipeline jet fuel (Exhibit EMT-102 at 16:3-4), Pavlovic is wrong. As Cavanagh pointed out, "Dr. Pavlovic uses an inappropriate statistical methodology to test whether there is a statistically significant difference between West Coast waterborne and pipeline prices." Exhibit BPX-60 at 5:21-22.

necessary to bring the TAPS Heavy Distillate cut into line with the [new reference] price."[88]

73. As explained above, although the parties agreed on the replacement product when Platt's ceased publication of the price that the Commissions had previously designated as the West Coast reference product for the Heavy Distillate cut, the parties were unable to reach agreement on the amount of the costs that would be incurred in bringing the sulfur content of the TAPS Heavy Distillate cut into line with the much lower sulfur level of the new reference product.[89] The disagreement was over the level of these costs. The sulfur processing cost adjustment did not include any logistics adjustment. Accordingly, the ALJ properly held that the logistics adjustment was not within the scope of the hearing.[90]

74. Moreover, we agree with the ALJ, that even if this issue were before him, Eight Parties have not established that such an adjustment was warranted. Eight Parties assert that the adjustment is necessary "for consistency purposes" because "all liquid Quality Bank products" should be valued "on a waterborne basis." Eight Parties Br. at 86. However, there is no basis for Eight Parties' contention. The ALJ noted that even Eight Parties' witness, Ross, who sponsored the logistics adjustment, admitted that Heavy Distillate "is not the only liquid cut which is not valued on a waterborne basis."[91] Furthermore, the ALJ found that Eight Parties' claim that all "liquid cuts" are "consistently valued" by the Quality Bank "on a waterborne basis," was contrary to the

[88] *Trans Alaska Pipeline System*, 97 FERC ¶ 61,150 at 61,650, 61,652 (emphasis added).

[89] *Trans Alaska Pipeline System*, 90 FERC ¶ 61,123 at 61,371.

[90] Whether or not EMT could be considered as waiving the argument that the adjustment was not within the scope of the hearing, this would not confer jurisdiction on the ALJ that was not given to him in the Commission's order establishing this consolidated hearing. *See Sierra Pacific Power Co.*, 104 FERC ¶ 61,223 at 61,782-83 (2003) (vacating ALJ's initial decision insofar as it addressed issues "beyond the scope of what we set for hearing"); *City of Freeport, New York v. Consolidated Edison Co.*, 91 FERC ¶ 61,003 at 61,012 (2000) (affirming ALJ ruling that issues not addressed in the Commission's hearing may not been considered by him), *reh'g denied*, 101 FERC ¶ 61,225 (2002).

[91] I.D. at P 1448.

record because “there is no consistency in where the cuts are valued; some are valued at truck/rail location, others at a pipeline, still others are valued on a waterborne basis.”[92]

75. Finally, we agree with the ALJ’s finding that Eight Parties failed to prove that this “proposed adjustment is warranted,” particularly since the “proposed 1.1¢/gallon adjustment is based, at least in part, on specious evidence.” The ALJ cited to testimony by Ross that in many instances he had no reliable evidence to support his estimate of the costs he used in calculating costs incurred in transporting product inland to the pipeline from its arrival point at the harbor.[93] Accordingly, we agree that Eight Parties failed to prove that their proposed logistics adjustment was warranted.

4. Effective Date

76. The ALJ accepted the parties’ stipulation of February 1, 2000 as the effective date for the new valuation, with refunds back to that date. Flint Hills excepts to that ruling and requests that the effective date of the new West Coast Heavy Distillate price should be on a prospective only basis from the date of the Commission’s final order in this proceeding. Flint Hills asserts that while some parties may have stipulated to a February 1, 2000 effective date, Flint Hills was not a party to that stipulation, and is not bound by it. Flint Hills contends that under the filed rate doctrine and the teachings of *Arizona Grocery Co. v. Atcheson Topeka and Santa Fe Railway*,[94] the new price can be instituted on a prospective only basis.

77. We affirm the ALJ’s ruling of a February 1, 2000 effective date for the new West Coast Heavy Distillate price. Flint Hills, which acquired Williams’s Alaska refinery on March 31, 2004 was permitted to intervene in these proceedings by order dated April 20, 2004, after the hearing record had been closed, and the post-hearing briefing before the ALJ had been concluded. In these circumstances, Flint Hills is bound by the positions that Williams took in this litigation before the sale, including Williams’s agreement to the Joint Stipulation. The Commission’s rules expressly provide that “a late intervener must accept the record of the proceeding as the record was developed prior to the late intervention.”[95] Thus, Flint Hills is barred from attempting to avoid the Joint Stipulation of all parties that “the effective date of the new West Coast Heavy Distillate price will be

[92] I.D. at P 1448.

[93] I.D. at P 1446.

[94] 284 U.S. 370 (1932) (*Arizona Grocery*).

[95] 18 C.F.R. § 385.214(d)(3)(ii) (2005).

February 1, 2000." This is particularly appropriate here since all parties relied on the Joint Stipulation, and no evidence was presented on this issue except the stipulation.

78. Moreover, there is good reason for the February 1, 2000 effective date. In February 2000, the Commission accepted the parties' agreed-upon replacement product less the necessary sulfur processing cost. Because the parties could not agree on that adjustment, the Commission allowed the prior proxy price to continue to be used pending a final decision on the sulfur processing cost adjustment. That the new price might be applied on a retroactive basis was recognized by the Commission's February 2000 Order accepting the replacement product since it stated, "the issue of whether the new price should be applied on a retroactive basis" would be designated as an issue in this proceeding.[96] Thus, all parties were on notice that the new valuation might be applied on a retroactive basis, and the filed rate doctrine has no application.

Issue No. 3 Whether the current method for valuing the West Coast Naphtha Cut is just and reasonable, and if not, what is the appropriate method for valuing the Naphtha cut? What should be the effective date of any change to the West Coast Naphtha cut?

A. Background

79. As a result of the remand in *Tesoro*, the November 2001 Hearing Order set for hearing whether the existing valuation of the West Coast Naphtha cut was still just and reasonable, and if not, what was the appropriate method for valuing the Naphtha cut.

80. During the course of the hearing, two changes to the Naphtha cut reference price were initiated by the QBA, which became issues in the hearing. Effective February 3, 2003, Platts began publishing a Gulf Coast Waterborne Heavy Naphtha price which was in addition to the Naphtha price assessment previously used as the proxy price for the Naphtha cut on both coasts. The Commission accepted and suspended tariffs that substituted the new price assessment for Heavy Naphtha for use in the Quality Bank on both the Gulf Coast and West Coast. Although all the parties appeared to support the use of the Platts Gulf Coast Heavy Naphtha price quote, since a number sought to have added

[96] *Trans Alaska Pipeline System*, 90 FERC ¶ 61,123 at 61,372.

to that price 1.5 cents per gallon as an "N+A" [97] adjustment thereto, the Commission consolidated that proposal with the ongoing hearings.[98]

81. The QBA, on June 18, 2003, filed a Notice setting forth his intention to use an average of separate Platts Gulf Coast Heavy Naphtha price quotes for barge and cargo transactions as the proxy price for the Naphtha cut. The Commission accepted this change and also consolidated this issue with the ongoing hearings.[99]

82. The ALJ ruled that the current method for valuing Naphtha was no longer just and reasonable and, that the replacement methodology, a regression-based formula recommended by EMT's witness Tallett should be adopted on a prospective basis. The ALJ also ruled that the previously used Platts Gulf Coast Naphtha assessment should be replaced with Platts Gulf Coast Heavy Naphtha assessment for all Quality Bank purposes effective March 1, 2003. The ALJ rejected the proposed N+A adjustment noting that it could be raised again during the next phase of the proceedings.[100] Finally, the ALJ ruled that averaging the cargo and barge assessments as proposed by TAPS Carriers following the QBA's notice, established a just and reasonable Naphtha value, and should be made effective on August 17, 2003.

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[97] N+A refers to the volume percent of Naphthenes plus the volume percent of Aromatics. When a material is referred to as having a 40 N+A, it means that 40 percent of the material is Naphthenes and/or Aromatics. The most fundamental of the Naphthenes are benzene, toluene, and xylene. The adjustment would be based on a 0.15¢ adjustment for each percentage increase in N+A above 40 to a maximum of 50 N+A. I.D. at P 2749.

[98] *BP Pipelines (Alaska) Inc.*, 102 FERC ¶ 61,345 (2003).

[99] *Trans Alaska Pipeline System*, 104 FERC ¶ 61,201 (2003).

[100] The ALJ rejected the proposal for the N+A adjustment but deferred a final ruling on it, as well as deferring ruling on certain intra-cut issues, as to which further hearings were to be held. Subsequently, the parties filed a motion in which the intra-cut issues were withdrawn, and the parties agreed that the ALJ could make a final ruling on the N+A adjustment issue on the existing record. On June 16, 2005 the ALJ issued an Initial Decision in Docket No. OR89-2-016, *et al.*, which reaffirmed his prior ruling rejecting the proposal for an N+A Adjustment, *see Trans Alaska Pipeline System*, 111 FERC ¶ 63,308 (2005). Briefs on Exceptions, and Briefs Opposing Exceptions were filed with respect to that Initial Decision. The N+A adjustment issue will be considered in a separate order, and this order will not address that issue.

83. Briefs on exceptions on the Naphtha issues were filed by the State of Alaska, EMT, CPAI, Unocal/OXY, Williams, Petro Star, Inc., jointly BP Explorations Alaska Inc., BP America Production (BP) and Flint Hills.[101] Briefs opposing exceptions on the Naphtha issue were filed by EMT, Unocal/OXY, Williams, Petro Star, Inc., and BP.

B. <u>Is The Present Method Just and Reasonable</u>?

1. <u>The ALJ's Findings</u>

84. The ALJ found that material changes in circumstances had occurred since the Commission determined, in 1993, that West Coast Naphtha should be valued on a Gulf Coast basis.[102] The ALJ stated that "the Commission has changed its policy and no longer refuses to consider adjusted proxy prices for ANS cuts. Moreover, virtually no ANS is being shipped to the Gulf Coast any longer; in fact, on the whole, ANS production has greatly diminished since 1993."[103] Further, since the parties have agreed that West Coast VGO will no longer be valued on a Gulf Coast basis, West Coast Naphtha would be the only ANS cut still valued on a Gulf Coast basis. Finally, the ALJ further stated that "it is clear that the restrictive California Air Resources Board (CARB) and reformulated gasoline specification have impacted the West Coast market."[104] Accordingly, for all these reasons, if not for any one reason alone, the ALJ concluded that circumstances have changed since the Commission's 1993 holding that warrant a change in the valuation of the West Coast Naphtha cut and the new valuation should be implemented on a prospective basis

[101] Flint Hills raises a number of issues regarding the ALJ's Naphtha valuation rulings based on evidence that was not introduced in the hearing or on new proposals that were not fully considered in the hearing. Both BP and EMT oppose Flint Hills's position. As a late intervenor, under section 18 C.F.R. 385.214(d)(3)(ii) of the Commission's Rules, Flint Hills must accept the record as it was. Accordingly, we deny Flint Hill's request that we consider new evidence that is not in the record or new proposals based on that evidence.

[102] I.D. at P 2664.

[103] *Id.*

[104] *Id.*

2. Exceptions

85. Unocal/OXY and Petro Star argue that the current method for valuing West Coast Naphtha is just and reasonable, and that no change in the existing method is warranted.

86. Specifically, Unocal/OXY argue that the ALJ used the wrong legal standard and focused on the wrong issue when he found that the West Coast and Gulf Coast markets for Naphtha were different and concluded that therefore Gulf Coast prices should no longer be used. First, they argue that those challenging the existing method to value West Coast Naphtha, *i.e.*, Exxon and ConocoPhillips, had the burden of proving that it was not just and reasonable. Unocal/OXY argue that the ALJ erred by shifting the burden onto the parties defending the existing methodology. Secondly, they argue that the issue was not merely whether the markets are different, but whether West Coast Naphtha has a higher value than Gulf Coast Naphtha. Unocal/OXY state that all the evidence relied upon in the I.D. on the latter issue is either inferential or reflects subjective expert opinion. They state that the different price series for products other than Naphtha were cited to infer that the West Coast value of Naphtha must be different than the Gulf Coast value. Unocal/OXY argue that the market structure evidence, discussion of refinery margins, refinery characteristics on the two coasts, trade and import considerations, and different gasoline grades were all used to infer what the West Coast Naphtha value might be but failed to prove what the West Coast value is. They conclude that absent evidence that West Coast Naphtha is undervalued by the current methodology, the ALJ erred in overturning the existing method.

87. Williams argues that in order to find the discontinuance of the Gulf Coast Naphtha price to value the West Coast Naphtha is unjust and unreasonable, one must establish changed circumstances based on three required steps: (1) material change in circumstances have occurred that require reviewing the valuation being used; (2) the material changed circumstance results in the existing valuation no longer being just and reasonable; and (3) the alternative is found to be reasonable. Williams asserts that none of these requirements have been met.

88. Williams states that the changed circumstance, that West Coast VGO will no longer be valued on a Gulf Coast basis, is immaterial and has nothing to do with the actual valuation of Naphtha. Williams asserts that while there is no published West Coast Naphtha price, it is still preferable to use a published intermediate product price without adjustment, rather than a formula, especially a type of formula not used to value any other Quality Bank cut on the West or Gulf coasts. Williams contends that the ALJ's statement supports rejection of the Tallett formula because the West Coast Naphtha cut is the only cut valued based on a regression formula and based on gasoline, a product made from a *number* of Quality Bank cuts (butane, isobutene, Light Straight Run, Naphtha,

VGO and Resid) and that cannot be made without blending components made from other Quality Bank cuts.

89. Williams contends that the ALJ failed to recognize that the reasons for not applying the Gulf Coast Naphtha price to the West Coast apply equally to the Tallett methodology, because the formula used in the Tallett methodology is based on Gulf Coast price relationships that are applied directly to the West Coast. Williams claims that the ALJ erred by failing to give any credence to the testimony that there is market linkage of the Gulf Coast and West Coast crude markets in light of Sanderson's testimony that "over the long haul, the price of crude oils on the two coasts are similar, very close to being the same over an annual average and longer periods of time. Therefore, I believe the Naphtha prices won't differ very much."[105]

90. Williams submits that the ALJ recognized and accepted witness Sanderson's market linkage position, but the ALJ ignored his own conclusions proving that the market linkage exists. Williams concludes that if there is no market linkage, then there is no way that the Tallett formula can be used since it applies a Gulf Coast relationship to the West Coast.

91. Williams argues that the ALJ ignored the fact that petrochemical demand on the Gulf Coast makes up approximately 15 percent of Gulf Coast Naphtha use, versus none on the West Coast. The presence of petrochemical demand increases the value of the Gulf Coast Naphtha. Williams claims that it is impossible for Tallett's formula to take a partial Gulf Coast relationship for Naphtha and relate it to the value of Naphtha on the West Coast if that formula does not reflect the added demand for Naphtha on the Gulf Coast in the Gulf Coast Naphtha relationship and regression formula. This, Williams argues, is especially relevant since Tallett admitted on cross examination that the petrochemical market could have at least the same effect on the Gulf Coast Naphtha price as the jet fuel market does.[106]

92. Williams further contends that the ALJ erred by ignoring the relationship between intermediate feedstock prices on both coasts where those feed stocks are similar to Naphtha and support the use of the Gulf Coast Naphtha price to value West Coast Naphtha. Williams avers that the record evidence undeniably establishes that the Tallett regression formula attributes all but two tenths of one cent of the higher West Coast gasoline refiner's margin to Naphtha and results in over evaluation of West Coast Naphtha just under seven cents per gallon. When this is corrected, the West Coast

[105] Transcript 9060:3-8.

[106] *Citing* Transcript 6838:1-17.

Naphtha value is virtually the same as the Gulf Coast Naphtha value. When the Tallett regression formula is applied to VGO, it overvalues West Coast VGO by about 4.5 cents per gallon. Such over valuations are unjust and unreasonable and violate the *OXY* decision that all Quality Bank cuts be valued the same, or all have to be over-or undervalued to the same extent.

3. Commission Determination

93. We affirm the ALJ's finding that circumstances had changed materially since 1993 when the Commission determined that West Coast Naphtha should be valued on a Gulf Coast basis and that "there is substantial evidence that continuing to base the value of West Coast Naphtha on the basis of Platts Gulf Coast Naphtha assessment no longer is just and reasonable."[107]

94. We find that the material changes cited by the ALJ include: (1) the change in the Commission's policy regarding its refusal to consider adjusted proxy prices for (ANS) cuts; (2) the virtual end to ANS shipments to the Gulf Coast; (3) the parties' agreement to value West Coast VGO using the published OPIS West Coast High Sulfur VGO weekly price instead of a Gulf Coast price assessment; and (4) the impact of reformulated gasoline specifications on the West Coast market. We agree with the ALJ's finding that the record contains more than sufficient evidence to establish that the West Coast markets for gasoline and intermediate petroleum products differ greatly from those on the Gulf Coast and, therefore, there is no basis for a Gulf Coast Naphtha assessment that can be said to represent the value of West Coast Naphtha.

95. We find that continuing to value West Coast Naphtha on the basis of Gulf Coast prices would violate the D.C. Circuit's internal consistency requirement since West Coast Naphtha then would be the only West Coast valuation to be based upon the Gulf Coast market, a market that no longer receives substantial volumes of ANS crude.[108]

96. We find that the ALJ properly determined that continued use of the Gulf Coast Naphtha price to value the West Coast Naphtha cut was no longer just and reasonable, and therefore, the Commissions should replace the current West Coast Naphtha valuation, which uses a Gulf Coast price assessment, with a viable, appropriate West Coast methodology.

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[107] I.D. at P 2679; *see also* I.D. at P 2664.

[108] *See OXY*, 64 F.3d at 693.

C. How Should the West Coast Naphtha Cut Be Valued?

1. The ALJ's Ruling That the West Coast Naphtha Contracts Were Not Probative Evidence

97. In attempting to support their position on how the West Coast Naphtha should be valued, certain parties introduced 350 contracts involving the purchase and sale of West Coast Naphtha. This number was reduced when duplicates were removed as well as contracts where the price was unclear, so that only 200 contracts over an eight year period remained. The issue before the ALJ was the probative value of these contracts in establishing the value of West Coast Naphtha cut.

98. The ALJ stated that no reporting service assesses Naphtha's West Coast value because the trade is not robust and not transparent.[109] What was presented were approximately 200 contracts spread over an eight year period – an average of fewer than 25 each year or no more than two per month.[110] The ALJ stated that "it strains credulity to suggest that these few contracts could represent anything, much less the value of the Naphtha which refiners supplied to themselves," and thus, at best, the contracts "provide isolated or anecdotal evidence respecting West Coast [N]aphtha transactions, particularly for the pre-1999 period."[111] The ALJ concluded that based on this evidence, and for the specific reasons stated above, the contracts did not reflect the value of West Coast Naphtha and were unusable for any purpose in this proceeding.[112]

2. Exceptions

99. CPAI, Alaska, and EMT except to the ALJ's ruling that the contracts are not of probative value. They argue the findings in the I.D. that the West Cost Naphtha contracts "are unusable for any purpose in this proceeding," is erroneous as a matter of fact. They contend that the West Coast Naphtha contracts represent the best evidence on the record as to what willing buyers paid sellers for Naphtha on the West Coast, and provide important support for the findings in the I.D. regarding how West Coast Naphtha should be valued.

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[109] I.D. at P 2681.

[110] I.D. at P 2682 n.779.

[111] I.D. at P 2582.

[112] I.D. at P 2685.

100. CPAI requests that the Commission find that the Naphtha contracts provide corroboration of the ALJ's findings that a West Coast value of Naphtha should be adopted and that the Tallett methodology represents a reasonable proxy. CPAI submits that the contracts can be used as a benchmark to evaluate the various claims made in the hearing regarding the West Coast value of Naphtha, and they provide important support for the findings made in the I.D.

101. CPAI states that moreover, the application of Tallett's methodology (as well as O'Brien's proposed methodology) leads to West Coast Naphtha values that are in the same range as the West Coast Naphtha contract values presented in the contract analyses for the period 1994-2001.[113] CPAI claims that again, this corroborates the finding in the I.D. that Tallett's methodology appropriately values West Coast Naphtha.

102. CPAI states that in contrast to the ALJ's conclusion, two economists stated that the contracts are the "most direct evidence" for evaluating the value of West Coast Naphtha.[114]

103. CPAI states that this expert economic testimony, in the absence of any trained economist testifying that the contracts are not probative, would justify the Commission's relying on the contracts to support any findings regarding the value of West Coast Naphtha. CPAI further states that the ALJ's concerns regarding the limited amount of sales of Naphtha under those contracts as compared to the amount of Naphtha actually used on the West Coast do not justify simply ignoring the contracts.

104. CPAI concludes that the Commission should not be dissuaded from using the contract analyses simply because the witnesses disagreed on exactly which contracts should be included in the analysis, as the ALJ found.[115] CPAI submits that the fact that the four analyses reached similar results notwithstanding their use of different subsets of contracts actually supports the validity of those results.

105. Unocal/OXY argue that the ALJ erred by ruling that the West Coast contracts could not be relied upon to establish West Coast Naphtha value. They state that the various analyses of these contracts were cited by all parties to support their respective positions and that to the extent they can be used to support the Tallett method, they can be used with equal credibility to support the continued use of Gulf Coast pricing.

[113] *See* Exhibits PAI-155, SOA-28, EMT-562, and UNO-56.

[114] *See* Exhibits EMT-67 and SOA-1 at 18.

[115] I.D. at P 2683.

3. Commission Determination

106. We affirm the ALJ's ruling that the West Coast Naphtha contracts submitted are not probative of the value of West Coast Naphtha refined as it is actually produced and used.

107. The Commission uses arm-length transactions as market value indicators in the markets in which the transactions took place, while the contracts submitted here are often between related parties.[116] Moreover, relative to the volume of Naphtha production and usage on the West Coast, the number of contracts submitted to the ALJ to establish the value of Naphtha was properly held too small to be considered representative of the entire amount.[117]

108. We find that the ALJ properly based his conclusions on several factors, including witness credibility, the small number of contracts identified and analyzed, disagreement on which contracts were representative, and the lack of a West Coast Naphtha market.[118] We agree with the ALJ's finding that, at best, the contracts "provide isolated or anecdotal evidence respecting West Coast [N]aphtha transactions, particularly for the pre-1999 period."[119]

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[116] The cases cited by Alaska do not alter this principal. Thus, in *Portland Gen. Elec., Co.*, 20 FERC ¶ 61,294 at 61,563 (1982), the Commission accepted as reasonable a charge that had been negotiated in an arms length negotiation by the parties involved; the case in no way involved extrapolation from that transaction to any other transaction. In *Welch v. Tenn. Valley Auth.*, 108 F.2d 95, 101 (6th Cir. 1939), the court allowed that "[s]ales at arms length of similar property are the best evidence of market value," but concluded that it was doubtful that the market value of farm land could readily be determined by recourse to any one measure of value except in rare instances. Finally, Estate of Paul Mitchell, T.C. Memo 2002-098, 2002 WL 531148 at 11 (U.S. Tax Ct. 2002), is consistent because unsold stock is functionally similar to sold stock whether it is listed or not.

[117] Petro Star states in its Brief Opposing Exceptions that contract volumes range from a low of 1260 barrels per day in 1998 to a high of 7190 barrels per day in 2000, compared to total West Coast Naphtha production of approximately 470,000 barrels per day. (WAP-203 at 5, 8.)

[118] I.D. at P 2682-85.

[119] I.D. at P 2685.

D. What Methodology Should Be Used?

1. ALJ's Findings

109. The parties agree that any party suggesting a new methodology must establish that its proposal is just and reasonable. In other words, consistent with the Circuit Court's rulings in *OXY*, *Exxon* and *Tesoro*, the new manner of valuing West Coast Naphtha must be shown to be consistent with the manner of valuing the remaining eight cuts.

110. Since we have affirmed the ALJ's finding that the current method for valuing West Coast Naphtha is unjust and unreasonable because of changed circumstances, the issue presented is what methodology should be used in determining the new valuation. The ALJ selected the Tallett methodology as the appropriate method for valuing West Coast Naphtha and that it should be implemented on a prospective basis.[120]

111. Tallett's methodology is based on a regression formula which establishes relationships between the Gulf Coast Naphtha value as a feedstock and the prices of end-products derived from it, namely gasoline and jet fuel.[121] He then uses those relationships and West Coast prices for those same end-products to calculate the value of West Coast Naphtha.[122] The ALJ found the new formula to be an objective approach which requires no judgment on the part of the calculator.[123] The Tallett formula for valuing West Coast Naphtha is:

> Calculated Naphtha price in $/bbl = 0.653*gasoline price + 0.306*jet fuel price – 0.780, where gasoline price = Platt's Unleaded Regular (ULR) mid value waterborne, and jet fuel price = Platt's Jet fuel 54 waterborne.

2. Exceptions Opposing Tallett's Methodology

112. Petro Star and Unocal/OXY assert that the ALJ erred in concluding that the Tallett methodology should be used to value Naphtha.

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[120] I.D. at P 2731.

[121] I.D. at P 459-531 (2004).

[122] *Id.*

[123] I.D. at P 2713.

113. Petro Star argues that the record evidence does not support Mr. Tallett's and the ALJ's assumption that the relationship among prices for gasoline, jet fuel, and Naphtha is the same on the West Coast as it is on the Gulf Coast. Petro Star claims that the relationship shows instead that: (1) Mr. Tallett's regression formula describes price relationships on the Gulf Coast, not on the West Coast; and (2) market conditions for gasoline are very different on the West Coast than they are on the Gulf Coast, and that similar differences, albeit of lesser magnitude, exist for jet fuel. With regard to the former, Petro Star argues that the formula is an hypothesis and does not describe empirical data and relate observed prices for Naphtha to observed prices for gasoline and jet fuel. As to gasoline, Petro Star argues that because of the stringent environmental standards in California, *e.g.*, CARB gasoline, and outside California, gasoline markets are unstable on the West Coast and, in California, even minor upsets can cause significant price upswings because of restricted refining capacity, inadequate logistics infrastructure, and commercial barriers. In contrast, Petro Star states that the larger refining base on the Gulf Coast is less volatile and supplies large export markets in the Midwest and Northeast. As to jet fuel, Petro Star argues that there is more emphasis on jet fuel production on the West Coast because of the major airport hubs and the fuel requirements of trans-Pacific flights, and jet fuel on the West Coast is subject to the very different market forces that affect the Pacific Rim as compared to the Caribbean.

114. Unocal/OXY argue that absent evidence of what the West Coast value of Naphtha is, it was not possible for the ALJ to approve the Tallett methodology as just and reasonable. In addition, they argue that the Tallett methodology, based on a regression of Gulf Coast gasoline and jet fuel prices against Gulf Coast Naphtha prices, is similar to a proposed formula for Naphtha which the Commission has previously rejected.[124]

115. Also, Unocal/OXY argue that the record does not sustain the findings and conclusions that the Tallett methodology establishes the approximate value of West Coast Naphtha. Unocal/OXY argue that the Tallett methodology applies a non-uniform methodology to the Naphtha cut in violation of *OXY, and*relies on price relationships that do not apply on the West Coast.

116. Further, Unocal/OXY argue that the ALJ's finding that the Tallett method lacks subjectivity is wrong. They point out that professor Baumol testified that any application

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[124] *Citing Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 at 62,288, 62,289 (1993).

of the results of a regression involves subjectivity.[125] Unocal/OXY also argue that the I.D. wrongly concluded that there are no market structure differences between the Gulf Coast and the West Coast that affect the Naphtha margins on the two coasts. They state that, in fact, the ALJ cited Gulf Coast petrochemical demand and Naphtha quality as examples of the market differences.[126]

117. Unocal/OXY also argue that the I.D. wrongly concluded that the Tallett methodology was supported by the O'Brien analysis.[127] They argue that the I.D. recognized O'Brien's analysis to be "so rampant with subjective determinations that it cannot meet the objectivity standard set out by the Circuit Court in *Exxon*."[128] Also, they believe that O'Brien's model uses a gasoline blend that cannot be sold on the West Coast, and reflects costs that are grossly understated.[129]

118. If the valuation method does need to be changed, Petro Star and Unocal/OXY argue that the ALJ should have adopted the Dudley methodology. That methodology first determines the price differentials between the Gulf Coast and the West Coast for VGO and LSR. Second, it determines the relative contributions of VGO and LSR to the Alaska North Slope crude oil common stream. Third, it applies the volume-weighted LSR and VGO price differentials to the reported Gulf Coast Naphtha price to determine an imputed West Coast Naphtha price to be used by the Quality Bank.[130]

119. In the alternative, Petro Star and Unocal/OXY argue that the ALJ should have adopted a methodology adding a $4.00 per barrel processing cost adjustment to the Los Angeles price for ANS crude oil, or a methodology adding a transportation differential to Gulf Coast Naphtha prices.

120. Williams essentially argues that the Tallett methodology fails the ALJ's consistency test of valuing the West Coast Naphtha cut consistently with the manner of valuing the other cuts - because: (1) no other cut where there is a published intermediate

[125] *Citing* Transcript 5130.

[126] *Citing* I.D. at P 2676

[127] I.D. at P 2704, 2702.

[128] I.D. at P 2702.

[129] I.D. at P 2698, 2701.

[130] *See* Petro Star's Brief on Exceptions On Naphtha at 18.

product price uses anything other than an unadjusted published price; (2) no other cut, for which there is a published intermediate product price is valued using a regression formula; (3) no other cut where there is no published intermediate product prices uses a finished product price that cannot be produced entirely from the intermediate product being valued; and (4) no other cut for which there is a published intermediate product price or which uses an adjusted finished product price relies on an assumed relationship on one coast to calculate an assumed price on the other coast.

121. Williams also argues that the ALJ never provided the necessary analysis to reach the conclusion that the Tallett regression formula is just and reasonable, and the ALJ ignored conclusive evidence that the Tallett regression formula significantly overvalues West Coast Naphtha by attributing the higher West Coast gasoline and jet fuel margins to Naphtha. Williams claims that adopting the Tallett methodology to value West Coast Naphtha failed to take into consideration the major change in the West Coast market caused by the advent of CARB gasoline.

3. <u>Commission Determination</u>

122. We find that Unocal/OXY's, Petro Star's and Williams's exceptions opposing the Tallett methodology are without merit.[131] They contend that since the West Coast Naphtha cut is the only Quality Bank cut which has no published West Coast price assessment, with the exception of the Resid cut, it is impossible to value the West Coast Naphtha cut by using a published West Coast price assessment in the same way that the other Quality Bank cuts are valued. We affirm the ALJ's rejection of Williams's argument that Tallett's regression uses Gulf Coast prices to value West Coast Naphtha because Tallett used Gulf Coast prices to find the relationship between the prices of gasoline, jet fuel, and Naphtha.[132] We find that the Tallett methodology is objective because it determines the value of West Coast Naphtha based squarely on "objective" published West Coast prices for regular unleaded gasoline and jet fuel.[133] The standard statistical formula in the Tallett methodology is portable, can run on any computer, and

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[131] A number of parties filed exceptions in support of the other methodologies proposed to determine the value of the West Coast Naphtha cut, which methodologies the ALJ rejected. Since we affirm the ALJ's finding that the Tallett methodology should be used, we need not consider whether another methodology could also be used to determine that value.

[132] I.D. at P 2705.

[133] I.D. at P 2713.

no judgment is required to calculate the formula and anyone running the same analysis will come up with the same result.

123. We find that Williams's evidence relating to margins involving gasoline and crude oil, indicate nothing about the relative value of Naphtha, and as a result, provide no factual basis for Williams's argument regarding refining margins.[134]

124. We find that evidence shows that higher West Coast gasoline prices led directly to higher West Coast Naphtha values, and in view of the evidence that the Gulf Coast price of Naphtha is determined almost entirely by the prices of gasoline and jet fuel in the same market, the appropriate conclusion to be drawn from the fact that West Coast gasoline and jet fuel prices are substantially higher than Gulf Coast gasoline and jet fuel prices is that the value of Naphtha on the West Coast is also substantially higher than the price of Naphtha on the Gulf Coast. We also find that the evidence shows that the value of Naphtha on the Gulf Coast more closely tracks the price of Gulf Coast gasoline than the price of crude oil.[135] We also find that Tallett's regression formula properly reflects the major change in the West Coast market caused by the advent of CARB gasoline requirements.

125. We affirm the ALJ's finding that the evidence shows that CARB requirements make Naphtha more valuable because the CARB requirements have attributes such as reformate's very high octane and low Reid vapor pressure (RVP), along with attributes related to the removal of impurities such as zero olefin and sulfur content. We find that the evidence shows that prior to the introduction of CARB requirements, most California refiners had already installed the equipment required to remove benzene from the reformate that they make from Naphtha. We find that the additional costs that California refineries have to incur to produce CARB gasoline have resulted in significantly higher prices for CARB gasoline than for conventional gasoline.

126. The additional costs must be incurred to process Naphtha into CARB on the West Coast, does not mean that Naphtha has lost value as compared to its value in producing conventional gasoline on the Gulf Coast. We find that Tallett's regression formula compensates for any potential impact that the introduction of CARB gasoline might have on Naphtha's West Coast value by using West Coast jet fuel prices as well as the West Coast prices for regular unleaded gasoline. We affirm the ALJ's finding that Tallett's regression analysis confirms that, as Naphtha's value as a gasoline and jet fuel feedstock

[134] I.D. at P 2705, 2708.

[135] I.D. at P 2710.

is higher than its value as a petrochemical feedstock, the former use creates a ceiling on its use for the latter.[136]

127. We also affirm the ALJ's decision that the evidence shows that the Naphtha used on the Gulf Coast as a petrochemical feedstock is a different, lighter Naphtha than the heavier reformer-grade used on the West Coast.[137] Also, we reject Williams's arguments that petrochemical demand on the Gulf Coast undermines the application of Tallett's Gulf Coast regression formula for the West Coast since: (1) the evidence shows that over 98 percent of the variation in Gulf Coast prices for Naphtha can be explained by movements in the Gulf Coast price of gasoline and jet fuel; and (2) small variations between the Gulf Coast prices of Naphtha and gasoline are almost entirely explained by movements in the Gulf Coast price of jet fuel.

128. We reject the argument that Tallett's use of a Gulf Coast regression equation to value West Coast Naphtha is inappropriate because, when applied to a different regression equation relating to VGO, another Quality Bank cut, the regression equation fails to predict West Coast VGO prices. We find that Tallett had performed a separate analysis of the VGO prices on both coasts to verify that OPIS West Coast VGO prices were as reliable as OPIS Gulf Coast VGO prices.[138]

E. Recomputation by QBA of the Value of the Naphtha Cut

1. ALJ's Findings

129. The ALJ stated that "I further hold that the QBA should have the discretion to re-compute the value of West Coast Naphtha whenever circumstances require, but not less than once each year.[139] TAPS Carriers and Unocal/OXY filed exceptions to the ALJ's ruling.

2. Exceptions

130. TAPS Carriers claim that it seems likely that the intent of this statement is that a new regression analysis will be run periodically to derive new constants for the valuation

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[136] I.D. at P 2715.

[137] *Id.*

[138] I.D. at P 1985.

[139] I.D. at P 2720, 2732.

formula set forth by Tallett since the ALJ noted that "Tallett's regression analysis can be updated periodically . . . ."[140] TAPS Carriers assert that it does not seem likely that the I.D. intended that the West Coast Naphtha value to be used in the monthly Quality Bank calculations would be updated perhaps as infrequently as once each year. TAPS Carriers submit that under the routine operation of both the current and projected Quality Bank methodologies, each component is valued monthly based upon current market data. TAPS Carriers further submit that thus it is the QBA's understanding that, under the formula proposed by Tallett, West Coast Naphtha would be valued each month for purposes of the Quality Bank using the current West Coast gasoline prices and West Coast jet fuel prices and the regression equation. TAPS Carriers request that the Commissions confirm that it is the constants in the regression equation rather than the West Coast Naphtha value that should be recomputed "whenever circumstances require, but not less than once each year."

131. Unocal/OXY argue, with Petro Star's support, that the ALJ's rule that the QBA should have the discretion to re-compute the value of West Coast Naphtha whenever the circumstances require is unprecedented, unwarranted and fraught with difficultly and uncertainty. Unocal/OXY complain that unfettered discretion on the QBA to make future changes to Naphtha valuation, notwithstanding what is resolved in this case, would violate the most basic principles that govern a Quality Bank. [141]

3. Commission Determination

132. It is apparent that what the ALJ was referring to was the QBA fulfilling his ministerial functions in rerunning the Tallett regression equation using new pricing data to re-compute the values of the constants in the West Coast Naphtha valuation formula. This would not require any subjective judgment on the part of the QBA. The only discretion that the QBA was given was how frequently such a re-computation of the formula should be performed.[142]

133. Accordingly, we find merit in the ALJ's ruling that the QBA should have the ability to recompute the value of West Coast Naphtha, but clarify that the QBA can recompute the constants in the regression equation whenever circumstances require, but not less than once each year.

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[140] I.D. at P 2714.

[141] Williams filed Briefs on Exceptions raising the same arguments as Unocal/OXY concerning the QBA's revision rights.

[142] I.D. at P 2720, 2732.

F. What Is The Effective Date For Implementing The New Methodology?

1. ALJ's Findings

134. The ALJ states that "The formula by Tallett should be implemented on a prospective basis. While there have been suggestions that it be implemented at an earlier date, substantial evidence does not support such a determination."[143] CPAI and EMT filed exceptions to the ALJ's I.D.

2. Exceptions

135. CPAI believes the ALJ failed to recognize that the Interstate Commerce Act (ICA), the Alaska Pipeline Act (APA) and prior rulings of the Commissions require that the new Naphtha valuation methodology be applied effective March 1, 2003 rather than prospectively.[144]

136. CPAI submits that the finding in the I.D. that "substantial evidence does not support" a determination that the Tallett methodology should be applied retroactively, is erroneous as a matter of law. CPAI argues that the Commission's orders in 2003 setting the Heavy Naphtha price for hearing made clear that any change to this price would be implemented as of March 1, 2003, a result that also is required by the relevant provisions of the ICA and the APA.

137. CPAI asserts that under the complaint provision of the ICA and APA that had been applied to assess Tesoro's argument that a West Coast Naphtha value should be adopted, the Commission was without power to give retroactive effect to any decision that use of the Gulf Coast Naphtha price no longer was just and reasonable.[145]

138. CPAI states that this changed, however, on February 27, 2003, when the TAPS Carriers made a filing that changed the reference price used in the Quality Bank to value Naphtha, both on the Gulf Coast and the West Coast, from the Platts Gulf Coast Naphtha price to the Platts Gulf Coast Heavy Naphtha price. CPAI argues that this new filing represented a change in the Quality Bank methodology, which CPAI and others protested as inappropriately applying a Gulf Coast price to derive a West Coast value. CPAI

[143] I.D. at P 2731.

[144] EMT filed Briefs on Exceptions raising the same arguments as CPAI in support of the March 1, 2003 retroactive effective date for the new West Coast Naphtha value.

[145] *See, e.g.*, *OXY*, 64 F.3d at 699.

contends that as such, this filing is governed by section 15(7) of the ICA[146] which apply to changes in rates.

139. CPAI states that section 15(7) of the ICA provides that the Commission can, when a new rate such as the one at issue here is filed, set the rate for hearing subject to refund. CPAI asserts that the D.C. Circuit held in *OXY* that section 15(7) would authorize a retroactive application of a change in Quality Bank rates initiated by the TAPS Carriers.[147]

140. CPAI submits that the Commission's Order stated that:

> [T]he Commission will accept and suspend the tariffs, *to be effective March 1, 2003, subject to refund* and subject to the conditions set forth in the body of this order and in the ordering paragraphs below.[148]

141. CPAI asserts that after the Commission's orders on the change to the use of the Heavy Naphtha price filing, Judge Silverstein's investigation of the reasonableness of using a Gulf Coast Naphtha price to value West Coast Naphtha was conducted under section 15(7) of the ICA. CPAI claims that as a matter of law, when the ALJ found that it is not just and reasonable to value West Coast Naphtha based on a Gulf Coast price, that finding had to be made effective as of March 1, 2003.

142. CPAI claims that the effective date for the West Coast Naphtha value is not a factual issue that depends on substantial evidence, but rather a legal matter dictated by earlier Commission rulings and as a pure matter of law, the effective date must be set at March 1, 2003 for the reason that this is the date the TAPS Carriers changed the price that they used to value West Coast Naphtha from the Gulf Coast Naphtha price to the Gulf Coast Heavy Naphtha price. CPAI states that now that use of the Gulf Coast Heavy Naphtha price has been rejected in favor of Tallett's methodology to value West Coast

[146] CPAI makes reference to the APA and rulings by the RCA. We will not consider those references as applicable to this proceeding.

[147] 64 F.3d at 698-99.

[148] *BP Pipelines (Alaska) Inc.*, 102 FERC ¶ 61,345 at P 13 (emphasis added). CPAI does not assert that the TAPS Carriers are obligated to make refunds from their own funds, since they redistribute to other shippers the Quality Bank payments that they receive. Rather, the TAPS Carriers should be obligated to recalculate Quality Bank payments and receipts and implement a retroactive redistribution of those payments and receipts, as provided in the RCA's Order No. P-89-1 (98).

Naphtha, as a matter of law that ruling relates back to the moment when the new price was put into effect, subject to refund and that date is March 1, 2003.

143. CPAI asserts that in basing his ruling on substantial evidence, Judge Silverstein appears to have missed the argument that CPAI raised regarding its position that the effective date should be March 1, 2003. CPAI maintains that because a March 1, 2003 effective date is required as a matter of law, Judge Silverstein's holding, based on substantial evidence, should be reversed.

144. Unocal/OXY agree with the ALJ and state that if a change is warranted, the Commission can only make a change effective on a prospective basis.

3. <u>Commission Determination</u>

145. We affirm that the ALJ appropriately found that the newly adopted West Coast Naphtha valuation method should be implemented on a prospective basis only.

146. The West Coast Naphtha cut stands on a different footing than the Resid cut. That cut was challenged when the Commission accepted the distillate method, and then until the present proceeding there has not been an approved value for the Resid cut. This is not so for the Naphtha cut. In *Tesoro* the Court did not upset the validity of the West Coast Naphtha calculation but required the Commission to determine whether the existing valuation of the West Coast Naphtha cut was still just and reasonable.[149] However, until there was a determination, the existing rate was the filed rate, and any change can only be made on a prospective basis.

147. The fact that under the existing valuation the Gulf Coast Naphtha was used to value the West Coast Naphtha does not make our determination here retroactive in the date of the change made in the Gulf Coast Naphtha valuation. The change in the Gulf Coast valuation was the result of the of the QBA decision that when Platts began publishing a new Waterborne Heavy Naphtha price assessment for the Gulf Coast in addition to the Full Range Gulf Coast Naphtha price then in use, he determined that the new Platts Heavy Naphtha assessment should be used in the Quality Bank Naphtha valuations and the TAPS Carriers filed tariff revisions to implement his decision. On March 28, 2003, the Commission accepted for filing the TAPS Carriers' filings to be effective on March 1, 2003, suspended their effectiveness, subject to refund and further

[149] This issue is more fully addressed in our discussion of Issue No. 5, *infra.*

Commission order.[150] The order also set the TAPS Carriers' filings for hearing and consolidated the dockets with the ongoing Quality Bank litigation.[151]

148. The QBA determined that the new assessment should be used to value both Gulf Coast and West Coast Naphtha. The QBA, however, recognized that the issue of whether to value West Coast Naphtha other than by reference to Platts' Gulf Coast assessment was before the Commissions.

149. That the Commissions adopted the new Gulf Coast assessment subject to refund and consolidated the proceedings does not mean that the Commissions intended that the results of the pre-existing challenges to the use of the Gulf Coast reference price for valuing West Coast Naphtha would be implemented at the suspension date included in the Gulf Coast Naphtha order.

150. Moreover, the parties[152] have stipulated that Naphtha and VGO valuations on the West Coast should be effective on the same date and making the West Coast Naphtha valuation method retroactive to March 1, 2003, would deviate from the effective date for VGO, which the ALJ appropriately decided would be applied prospectively. Under the Joint Stipulation, the parties agreed that:

> If a different West Coast Naphtha valuation methodology is adopted in this proceeding, it and the new West Coast VGO value should have the same effective date.[153]

151. As discussed, *infra*, we affirm the ALJ's ruling that the new valuation of the VGO cut should be implemented prospectively. We find that the ALJ honored that agreement and found that both West Coast Naphtha and West Coast VGO should be implemented

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[150] 102 FERC ¶ 61,345 at P 3.

[151] *Id.*

[152] The parties to the Joint Stipulation were: BP, CPAI, Petro Star, Williams, Unocal/OXY, EMT, and the State. Neither the TAPS Carriers nor Commission Staff joined in the stipulation. However, neither opposed the stipulation and the TAPS Carriers agreed not to contest it. *See* I.D. at P 25 n.10.

[153] *Id*.

on a prospective basis.[154] We find no merit in the exceptions calling for implementation of the West Cast Naphtha valuation methodology on a retroactive basis to March 1, 2003.

G. The QBA's Replacement Proxies

152. The QBA took two actions involving the Gulf Coast Naphtha valuation that became issues in this proceeding. The first involved the QBA's decision to use Platts Gulf Coast Heavy Naphtha assessment. The second involved the QBA's determination to average the price of two types of Naphtha shipments, one for barge shipments, and the second for ships.

1. The Heavy Naphtha Issue

a. The ALJ's Ruling

153. As for the change to the Platts Heavy Naphtha price, the ALJ found that "substantial evidence supports that TAPS Carriers' determination to replace the previously used Platts Gulf Coast Naphtha assessment with Platts Gulf Coast Heavy Naphtha assessment for all Quality Bank purposes, that such a substitution is just and reasonable, and that such determination should be implemented effective March 1, 2003."[155] Unocal/OXY filed exceptions opposing the heavy Naphtha reference price.

b. Exceptions

154. Unocal/OXY oppose the change to the "Heavy Naphtha" price quote because they believe that the old Naphtha quote was and is still available, no implementation problems were presented by the advent of the new Heavy Naphtha quote. They believe that the QBA exceeded his authority to change the rate under the circumstances that nothing had occurred to prevent or frustrate the continued use of the old price.

155. Unocal/OXY argue that instead of changing to the Heavy Naphtha price, the QBA should have continued use of the old price and thereby left any interested party, who preferred to use the new price, the option of initiating a change by filing a complaint with the Commission.

[154] I.D. at P 2731, 2770. CPAI, a member of Eight Parties, supports the prospective implementation of the new West Coast VGO valuation method.

[155] I.D. at P 2739.

c. Commission Ruling

156. There was no record evidence to support Unocal/OXY's claim that Platts continued to publish the full-range Naphtha price assessment after February 2003 when Platts began publishing the Heavy Naphtha price assessment. We affirm the ALJ's ruling to accept the QBA's decision to use the Heavy Naphtha price as the proxy.

2. The Averaging Issue

a. The ALJ's Ruling

157. On May 1, 2003, Platts began publishing its Heavy Naphtha price assessments for the Gulf Coast into two separate price assessments: one for ship's cargo transactions involving quantities up to 250,000 barrels, and the other for barge transactions of less than 50,000 barrels. The QBA's proposed to use the arithmetic average of the two types of transactions. When certain parties protested, the Commission accepted the proposal, set it for hearing subject to refund, and consolidated with this proceeding.[156]

158. The ALJ found that substantial evidence supported finding that the QBA's action was consistent with the manner in which Quality Bank cuts are valued. Thus, the ALJ accepted the proposed action to be effective August 17, 2003, the date the Commission accepted the proposal and set it for hearing.[157]

b. Exceptions

159. Unocal/OXY and Petro Star argue that the QBA's averaging proposal is unnecessary and unwarranted in the pricing of the Naphtha cut since nothing had happened that would require the QBA to make a change of any kind, and the proposal would treat the Naphtha cut in a manner that is inconsistent with the treatment of other Quality Bank cuts, as averaging of posted prices for different quotes is not done for any of the other cuts.

160. Unocal/OXY also states that since the QBA relied on language in the tariff that allows him to make a change for a "radical alteration," he overstepped his authority by exceeding what Unocal/OXY considers as a test. Unocal/OXY contend that the test is if the previous Heavy Naphtha price is still published, there would be a "radical alteration"

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[156] 104 FERC ¶ 61,201 (2003).

[157] *Id.* at P 9.

only if the values reflected in that price were changed so substantially that the price could no longer be used. Unocal/OXY further contend that there was only a one-cent difference between the cargo and barge assessments, and the remedy proposed by the QBA would reduce that difference to one half of a cent.

161. Unocal/OXY claim that if the Commission does not approve the proposal to average the barge and cargo quotes, then shippers that paid higher Quality Bank assessments as a result of the change that took effect on August 17, 2003, will be entitled to a refund for the increase amount they paid.

c. Commission Determination

162. Nowhere in the tariff is there any support for their argument that a change in a Quality Bank reference price must be shown to have some minimum magnitude or financial impact before the QBA can bring it to the attention of the Commission. In fact Unocal/OXY expressly state that the QBA's averaging proposal will have "a substantial impact" on the parties involved in this case.[158] Thus it is patently inconsistent for Unocal/OXY to assert that a change in the reference price is "not large" enough to permit the QBA to bring it to the attention of the Commission while at the same time arguing that it will have "a substantial economic impact" on the parties.

163. In addition there is no support to the assertion of BP and Unocal/OXY that there exists a "convention" that when there are two or more available reference prices for a particular Quality Bank cut, the Quality Bank has always chosen the reference price representing "the largest available quantities for valuing each cut."[159] Rather the only principle that has been applied is the selection of a reference price which most accurately reflects the *market value* of the particular cut, and that is the only standard that has been applied by the QBA.[160]

164. The evidence establishes that there are two reliable Platts price assessments for Heavy Naphtha, that both are supported by "numerous transactions," and that "[b]oth

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[158] Unocal/OXY Brief on Exceptions at 79.

[159] BP Brief on Exceptions at 62; Unocal/OXY Brief on Exceptions at 84.

[160] For example, in 1998, the QBA recommended adoption of the OPIS VGO barge assessment because that price assessment was "the most representative indicator of High sulfur VGO market value and therefore seems to be the best single price to reflect the market for High Sulfur VGO on the Gulf Coast." Exhibit TC-23 at 4 (emphasis added).

markets are therefore representative of the market for Heavy Naphtha on the Gulf Coast."[161] We agree that there is no factual basis in the record, therefore, for selecting one of those two price assessments over the other, and an appropriate just and reasonable solution is to simply average the two Heavy Naphtha price assessment, as the Quality Bank proposed.[162] Accordingly, we affirm the ALJ's ruling accepting the QBA's action to average the two prices effective August 1, 2003.

Issue No. 4 <u>Is the Current Method for Valuing the West Coast Vacuum Gas Oil Cut Just and Reasonable, and If Not, What is the Appropriate Method for Valuing the Vacuum Gas Oil Cut? What Should Be the Effective Date of Any Change to the West Coast Vacuum Gas Oil Cut</u>?

A. <u>The ALJ Rulings</u>

165. In May 1994 the Commission modified the reference price for valuing the VGO cut, which covers the 650ºF to 1,000ºF range: The Commission directed that the reference price for both the Gulf Coast and the West Coast would be OPIS Gulf Coast price for high sulfur VGO.[163] The Commission also rejected use of the West Coast price because of concern that the West Coast price was thinly traded, and was thus subject to manipulation. The reference price for VGO was not an issue in the *OXY* case.

166. In August 1998, Tesoro filed its complaint in Docket No. OR98-24-000 in which it objected to the existing VGO valuation and proposed that the West Coast VGO be valued using the OPIS West Coast VGO published price. This was the reference price that the Commission had rejected in the May 1994 Order. The Commission dismissed the complaint finding that Tesoro's proposal had been previously considered and rejected by the Commission, and that Tesoro had not shown any changed circumstances that would require reconsideration of the issue by the Commission.[164]

167. In *Tesoro*, the Court held that the Commission should have addressed Tesoro's claim that the Commission's reason in the May 1994 Order for not using the West Coast VGO price was no longer valid.

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[161] Exhibit TC-22 at 4.

[162] I.D. at P 2745.

[163] *Trans Alaska Pipeline System*, 67 FERC ¶ 61,175 (1994).

[164] *Tesoro Alaska Petroleum Company v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,132 at 61,520 (1999).

168. At the hearing in this proceeding, the parties stipulated in the Joint Stipulation[165] that the West Coast VGO should be valued on the basis of the OPIS West Coast High Sulfur VGO weekly price, but disagreed as to the effective date. Eight Parties argued that the new price should be put into effect on a prospective basis. EMT argued that the effective date for the new price should be March 1, 2003. In support of its position, EMT referred to the stipulation which provided that there should be the same effective date for any new West Coast Naphtha value and the agreed-upon West Coast VGO value.

169. The ALJ held that there was no evidence in the record which supports making the agreed-upon West Coast VGO price effective on a retroactive basis. Accordingly, he held that the West Coast VGO would be valued using the OPIS West Coast High Sulfur VGO weekly price on a prospective basis.[166] He added that since he had determined that the new West Coast Naphtha value also should be made effective on a prospective basis, his ruling coincided with the parties' October 3, 2002, Stipulation. EMT and Flint Hills filed exceptions to this ruling.

B. <u>Exceptions</u>

170. EMT claims the ALJ erred in not making the new valuation retroactive since the new valuation corrects the Commission's error in dismissing the Exxon and Tesoro complaints. EMT refers to both since the parties stipulated that any revised valuation for West Coast Naphtha and West Coast VGO should have the same effective date. In support of its position EMT relies on *Tennessee Valley Municipal Gas Ass'n v. FPC*,[167] which EMT asserts also involved the erroneous dismissal of a complaint by an agency where the agency subsequently reinstated the complaint and found merit in the complaint.

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[165] The stipulation provided:

Stipulation to Issue No. 4 – West Coast VGO Valuation

1. West Coast VGO shall be valued based on the published OPIS West Coast High Sulfur VGO weekly price.

2. The Parties disagree as to the effective date of the new West Coast VGO value. However, the Parties agree that if a different West Coast Naphtha valuation methodology is adopted in this proceeding, it and the new West Coast VGO value should have the same effective date.

[166] I.D. at P 2770.

[167] 470 F.2d 446 (D.C. Cir. 1972) (*Tennessee Valley*).

In that case, EMT contends the Court held that when relief is granted upon a complaint erroneously dismissed the relief must put the parties in the same position they would have been in if the error had not occurred. Here, EMT claims there were 920 days between the Commission's erroneous dismissal of the Exxon and Tesoro complaints on April 30, 1999, and the reinstatement of the complaint by the Commission's December 7, 2001 hearing Order.

171. Flint Hills excepted to the effective date asserting that it should be October 3, 2002, when the parties stipulated what the value for the West Coast VGO should be.

C. Commission Ruling

172. We find no merit in the exceptions. In *Tesoro,* the Court required the Commission to address the issue raised by Tesoro that the reference price for the West Coast VGO cut should be the West Coast VGO price. The parties have now stipulated what that price should be. Nothing in that stipulation provided for any retroactive application of that price or that it should apply from the date of the stipulation. Rather, the stipulation provided that if a new West Coast Naphtha price was established, the effective date of both that price and the new West Coast VGO price should be the same, as it is under the ALJ's ruling.

173. EMT's reliance on *Tennessee Valley* is misplaced. There, the agency had dismissed a complaint on the grounds that there was a stale record, and thus no basis for going ahead on the merits. The agency then reversed itself, stating that it should not have dismissed the complaint but should have reopened the record, which it did, and directed the complaint to proceed to hearing. Subsequently, the agency issued an order finding merit in the complaint. The period in between the agency's dismissal of the complaint and its own reinstatement of the complaint was 112 days. In *Tennessee Valley* the Court held that there should be some limited retroactive relief for this period of 112 days.[168]

174. In this case, the Commission did not reverse itself, but rather the Court directed the Commission to consider the complaint. Since then there has been no merits order on

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[168] In *Tennessee Valley*, the rate that was challenged in the complaint was superseded by a new rate that went into effect on March 17, 1971, subject to refund. The merits order finding the challenged rate unjust and unreasonable and ordering a reduction was issued May 5, 1971. The 112 days of retroactive relief would put the effective date of the May 5, 1971 order back to January 3, 1971. The Court held that only the period prior to March 17, 1971 was subject to retroactive relief, because the new superseding rate would apply for the period after that date, so there were 61 days of retroactive relief, from January 13, 1971, to March 17, 1971.

this issue. The parties have stipulated on the appropriate price, but there has been no finding that the prior reference price was no longer just and reasonable. The relief approved in *Tennessee Valley* was described by that court in a later opinion as "permissible under certain circumstances" because it "cuts to the heart of the concerns and values which inform the 'filed rate doctrine'."[169] Here, the existing West Coast VGO reference price was approved by the Commission's May 1994 Order and was not an issue in *OXY*. Thus it is the lawful, just and reasonable rate until replaced by another rate. While the parties stipulated as to a new reference price, until the Commission issues an order adopting that price, the existing reference price continues as the lawful rate.

175. Accordingly, we affirm the ALJ's ruling that the new reference price for West Coast VGO will be applied on a prospective basis.

Issue No. 5 Should the revised values for the cuts subject to the D.C. Circuit remand in OXY (Resid, Heavy Distillate and Light Distillate) be made retroactive to December 1, 1993?

176. The I.D. concluded that the revised values should be made effective on a retroactive basis, and the retroactive period would be back to December 1993. After issuance of the I.D., however, and after the parties filed exceptions, Congress passed legislation limiting the period of any retroactive refunds in a pending TAPS proceeding to February 1, 2000. Section 4412 (b)(1) of the Motor Carrier Safety Reauthorization Act of 2005, Pub.L. No. PL 109-59, 119 Stat. 1144, enacted August 10, 2005, provides that for TAPS proceedings commenced before the date of enactment of that act, the Commission "may not order retroactive changes in TAPS quality bank adjustments for any period before February 1, 2000." Since the new valuations of the remanded cuts other than the Resid cut have been in effect since February 1, 1998, pursuant to the 1997 settlement, *infra*, P 182, there would not be any retroactive refunds applicable to those cuts. There may be retroactive refunds as to the Resid cut, though not for any period before February 1, 2000.

177. Accordingly, the issue presented is whether the Commission should affirm the I.D.'s determination that the new values should be applied on a retroactive basis, given that the retroactive period will be limited to February 1, 2000. As we conclude that the new values should be applied retroactively, we direct the Quality Bank Administrators to

[169] *Northwest Pipeline Corp. v. FERC*, 863 F.2d 73, 78 (D.C. Cir. 1988).

re-calculate the adjustment from February 1, 2000, forward.[170] It must be recognized that Eight Parties' equitable, and other arguments, were addressed to the I.D.'s conclusion that refunds were to be paid back to December 1, 1993. Since that no longer is the period for the refunds, and those arguments must be considered in light of this change, those arguments no longer have the same validity that they might have had if the refund period was back to December 1, 1993. As of the Congressionally mandated adjustment limit of February 1, 2000, all parties were well aware that in 1999, in *Exxon*, the Court had again rejected the existing Resid cut valuation, and also rejected the Commission's ruling that any new quality bank values would be applied only prospectively. Thus, the vitality of the arguments against retroactive adjustments has essentially been undermined by the Congressional action limiting the retroactive refund period to February 1, 2000.

A. Background

178. In 1995, the Court in *OXY* upheld the Commission's 1993 decision to change from the gravity methodology to the distillation methodology. However, the Court remanded the valuation of the Light and Heavy Distillate, Fuel Oil and Resid cuts. Subsequently, in 1997, the Commission approved a contested settlement which established new proxies for each of the remanded cuts.[171]

179. In that order, the Commission concluded that the settlement should be implemented on a prospective basis, as had other TAPS' settlements, and set forth the equitable grounds for doing so. This was consistent with the Commission's 1993 Order which applied the new distillation methodology prospectively, which the Court affirmed in *OXY*. In 1999, the Court in *Exxon* affirmed the Commission's order, with the exception of the valuation for the Resid cut, which is determined in this proceeding, and the Commission's ruling on the effective date for the new valuations of the remanded cuts.

180. In *Exxon*, the Court agreed that the Commission does have a measure of discretion in determining whether a new rate should apply retroactively. However, the Court

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[170] As discussed above, the new valuation for the West Coast Naphtha and VGO cuts are to be implemented on a prospective basis, so there are no refunds as to those valuations.

[171] 81 FERC ¶ 61,319 (1997).

concluded that the equitable factors on which the Commission based its decision[172] did not overcome the strong equitable presumption in favor of retroactivity which would make the parties whole. The Court found that the factors that the Commission had relied on had no bearing on the decision not to make whole the parties that were injured by the erroneous valuation of the remanded cuts. The Court noted that all parties were on notice that the Commission's 1993 Order was being challenged, so reliance on the values of the cuts established by that order was unwarranted. The Court's concern was that the settling parties might have chosen prospective application of the settlement "to divvy up a windfall at the expense of the contesting parties."[173] The "windfall" referred to would be the inappropriate valuation of the distillate and Resid cuts from the 1993 date the distillation method was adopted until the revised valuation of these cuts upon the remand was implemented. Given the strong presumption in favor of making injured parties whole and the incentive that this creates for the parties to litigate regarding past errors and for the agency to correct those errors, the Court concluded that "on the record before us" the Commission "abused its discretion when it failed, without adequate explanation to make the revaluation and concomitant Quality Bank adjustments retroactive to 1993, when the distillation method was adopted."[174] The Court remanded the issue of the effective date of the new valuation method for action consistent with the Court's opinion.

181. The Commission's 2001 Hearing Order permitted the parties to introduce evidence why it would be inequitable to require retroactive application of the revised valuations for the distillate and Resid cuts.

B. <u>The ALJ's Decision</u>

182. The question addressed in Issue No. 5 was what should be the effective date of the proxy values approved by the Court in *Exxon*, and what should be the effective date of the Resid proxy determined in this proceeding. In addition to the Resid cut, the Court had remanded valuation of the Heavy Distillate, Light Distillate and Fuel Oil or Light

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[172] The Court stated that the Commission had relied on the following factors: (1) that parties supported the Nine Party Settlement only if it were implemented prospectively; (2) that all prior TAPS cases resolved by settlements have been on a prospective basis; (3) that the changes adopted by the 1997 Order only modify limited aspects of the distillation methodology put in place in 1993; and (4) that the TAPS Quality Bank is *sui generis*. 182 F.3d at 49.

[173] *Id.* at 50. The Court thus held that making the settlement conditional upon its being prospective could not be a factor that the Commission could rely upon.

[174] *Id.* at 50.

Resid Cut. The parties had agreed to revised valuations for the Light Distillate and Heavy Distillate effective February 1, 1998, pursuant to a 1997 settlement which was not challenged. The Fuel Oil cut was folded into the VGO cut, effective February 1, 1998, pursuant to the 1997 settlement. The Court, in *Exxon*, approved this with respect to the Fuel Oil cut, 192 F.3d at 45.[175] The ALJ stated that the parties had agreed that if the new Resid proxy "is made retroactive to December 1993, the Nine Party Settlement valuations of the other three Remanded Cuts [*i.e.*, those which were approved in *Exxon*] should be retroactive for the period between December 1993 and implementation of the Nine Party Settlement in 1998." Thus, the ALJ stated, it was only necessary to analyze the situation regarding the Resid cut.[176] As to Resid, the ALJ stated that it was not disputed that since the Commission adopted the distillation methodology for calculating cut values for Quality Bank purposes in 1993, the court had not accepted the Commission's designated Resid valuations.

183. The ALJ concluded that "As there never has been a Resid proxy since the Commission implemented the distillation method on December 1, 1993, it follows that the value of the Resid proxy established by this order should be made effective on that date as well. However, Eight Parties strenuously argue in support of a prospective only implementation."[177]

184. The ALJ described Eight Parties "equitable" grounds for implementation only on a prospective basis, but found no merit in them. The grounds were:

(1) Exxon benefited from the manner in which Natural Gas Liquids were treated prior to 1993 while the gravity method was challenged, and would benefit again were the Resid proxy valuation be made effective on December 1, 1993;

(2) the affected refiners were not able to arrange their operations to mitigate the impact of the new valuations;

(3) allowing refunds is not in the public interest; and

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[175] I.D. at P 2937.

[176] I.D. at P 2939.

[177] I.D. at P 2941.

(4) the evidence does not reflect that the new proxy values were "just and reasonable" for the whole period from December 1, 1993, forward.[178]

185. Further he stated Eight Parties had argued that making the new Resid valuation effective on December 1, 1993, would not put the parties in the same position in which they would have been had the Commission made a determination approved by the Court. Moreover, according to Eight Parties, Exxon failed to show that it would have received the monies it claims as refunds had the Commission previously made the determination which is made herein regarding the value of a Resid proxy.

186. The ALJ stated that Eight Parties made "a strong case, based on equitable considerations for holding that the values of the remand cuts should be made effective on a prospective basis only," nevertheless "since the adoption of the distillation method there never had been a just and reasonable Resid proxy until this proceeding, and the proxy which is determined herein for Resid is the only just and reasonable value for it since December 1, 1993, and it must be *made effective on that date notwithstanding any equitable consideration*."[179] (emphasis supplied). To that conclusion the ALJ appended a footnote that stated "I am satisfied, based on a reading of the entire record, that the Resid value established in this I.D. is just and reasonable, and was just and reasonable throughout the period from December 1, 1993, forward."[180]

187. Eight Parties had argued that since during the period from 1989 to December 1993, when the gravity method was under challenge (the First Period), Exxon received Quality Bank payments greater than the amount that it would have received if the distillation method had been in place but was not required to repay the excess amount when the Commission in 1993,found that the gravity method was no longer just and reasonable, Exxon should not also get all the benefit from implementing the new valuations back to 1993 (the Second Period) when the existing valuations under the Commission's order was also under challenge. The ALJ first held that the calculation of the financial benefit that Exxon, as well as others, received during the First Period was questionable. Next he found that the evidence did not show "that there is a clear delineation between them (as a group) and Exxon with regard to being benefited during

[178] I.D. at P 2942.

[179] I.D. at P 2945.

[180] I.D. at n.871.

the period when the Commission was considering replacing the gravity method."[181] Thus, some members of Eight Parties also benefited from the gravity method not being replaced until 1993, and some members of that group also benefit from the retroactive application of the Resid valuation to 1993.[182]

188. As to the argument that it was unfair to apply the new valuations to refinery operations back to 1993 because refiners have to operate their refineries based on the Quality Bank valuations in effect when refiners decide how to operate, the ALJ held that all parties were on notice that the Resid valuation was being challenged. Accordingly, the refiners could not rely on the challenged valuations, and he rejected the contention that the refiners would have operated their refineries differently to minimize their Quality Bank payments if they had known the Resid cut valuation ordered here would be in effect throughout the period. Thus, he stated, "while they might not have known exactly how Resid eventually would be valued, they were on notice that it probably would not be valued as the Commission first did in 1993 since, at least, the issuance of the *OXY* decision by the Circuit Court in 1995. Under these circumstances, the prudent businessman would have taken steps to protect his business."[183]

189. The ALJ held that cases cited by Eight Parties such as *Town of Concord, Norwood and Wellesley v. FERC*,[184] did not support their position that there should not be retroactive application of the new valuation back to 1993. In this case, he found, that on equitable grounds even though no party was at fault, "the equities lean in favor of granting refunds to those who overpaid into the Quality Bank."[185]

190. As to the public interest argument advanced by Eight Parties, he concluded "the public has no interest in this case which solely involves how a pool of money is to be divided amongst multi-billion dollar corporations."[186]

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[181] I.D. at P 2946.

[182] Eight Parties consist of both refiners (Williams Alaska and Petro Star), as well as producers.

[183] I.D. at P 2947.

[184] 955 F.2d 67 (D.C. Cir. 1992).

[185] I.D. at P 2949.

[186] I.D. at P 2950.

191. Accordingly, he directed that "the Quality Bank Administrator re-calculate the Quality Bank from December 1993 forward and make appropriate refunds (footnote omitted). However, as it is clear that the TAPS Carriers are not liable for payment of such refunds, in the event that collections, less costs, do not equal the refunds due, such refunds are to be made on a *pro rata* basis."[187] The ALJ's Resid valuation will result in the Resid being worth less than it was under the prior valuation. This will increase the payments due to the producers of the light oil, such as Exxon, and will increase the payment obligations of the refiners and heavy oil producers.

C. Eight Parties' Exceptions

192. As noted above, the exceptions filed by the Eight Parties were based upon a retroactive date back to December 1993. Now that period will be limited to February 1, 2000. We have considered the arguments urged by the Eight Parties in light of this change.

193. In their exceptions Eight Parties argue that the ALJ erred in his basic premise that the new valuations of the remanded cut had to be applied retroactively to December 1, 1993. They contend that *Exxon* did not require that result, because the Court recognized the Commission's discretion when ordering refunds.

194. Eight Parties basic argument is that the equitable grounds urged by them here were not before the court in *Exxon*. Moreover, they contend that retroactive application of the remanded cuts would not put the parties in the positions they would have been in if the Commission had not erred, which is the basis for retroactivity.

195. Eight Parties' exceptions include two different approaches as to why the new Resid valuation should not be applied back to December 1993. The first basically involves the refund obligation of refiners, and the second is the "inter-period equities" argument.

196. As to the first, Eight Parties argue that it is inequitable to apply the new value of the Resid cut to the refiners' operations back to 1993 because if refiners knew the value being assigned to the Resid cut at that time, they would have changed their product output to minimize their Quality Bank obligations. Only when the refiner knows what the Quality Bank cut valuations are, can it decide what is the optimal operation to minimize its Quality Bank obligations.

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[187] I.D. at P 2952.

197. Eight Parties assert that evidence in the record established that refiners successfully optimized their refinery output to reduce the Quality Bank impacts. They cite to the testimony of witness Dayton that "refiners have always been successful in having their Quality Bank obligations less than what we projected." Transcript 12674: 14-23. Eight Parties argue that the refiners, who will be paying the majority of the refunds from the retroactive application of the new Resid valuation, have to operate their refineries based upon what the valuations are at the time they make their output decisions. Refiners could not have protected themselves from future changes by establishing reserves, as the ALJ seemingly suggested, because there was no benchmark which they could have used. Thus, the refiners were not in a position to protect themselves against the retroactive application of the new valuation. This, Eight Parties argue, differentiates this case from cases cited by the ALJ where a party would know the consequences if a challenged rate was later held to be illegal, and a different rate would be applicable retroactive to the time of challenge.

198. Eight Parties' position is that when it is impossible or difficult to return the parties to the position they would have been in absent agency error, neither the Commission nor the court will require retroactive application, citing *Panhandle Eastern Pipeline Co. v. FERC*.[188] There, the Commission had authorized retroactive abandonment of a purchase contract by an interstate pipeline, as well as elimination of the payment obligations under the contract when the interstate pipeline seller accepted a blanket certificate because the Commission had committed legal error in originally rejecting the purchaser's abandonment application The Court remanded because the seller had been unable to sell its gas to others until the error was corrected and retroactively would not put the parties in the same position they would have been absent the legal error. Eight Parties contend that the ALJ recognized this in n. 880, but totally ignored this finding in his ruling to apply the new valuation back to 1993.[189]

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[188] 907 F.2d 185, 189 (D.C. Cir. 1990).

[189] Eight Parties refer to the following in n.880:

> Eight Parties also suggest that implementing the Resid value ordered here as of December 1, 1993, would not put the parties in the same position in which they would have been had the value been determined in 1993. Eight Parties Reply Brief at pp. 143-45. Inasmuch as about 15 years of litigation has passed since this matter first was initiated, and that, over that period, there have been multiple changes in the circumstances involving the ANS fields, the participants, and local, national and worldwide economic conditions, it is hard to argue with their claim.

199. Moreover, Eight Parties contend, the I.D. inappropriately established a Resid value on the West Coast outside the range of Resid values proposed by any of the litigants, including Exxon and Tesoro. In other words, Eight Parties assert, applying the ALJ's valuation of Resid retroactively results in a larger refund obligation than the refund obligation that would result from adopting the proposed Resid valuation of any party to this proceeding, including Exxon.

200. Finally, Eight Parties assert, the ALJ failed to recognize that the parties here liable for the refunds differ from regulated entities where a rate is challenged. The parties here compete with others, and cannot provide in their contracts for additional payment if a subsequent decision is given retroactive effect and results in an increase in their costs. In contrast, if a regulated entity charges rates that are being challenged, the entity can hedge its risk from the consequences of a successful challenge by establishing a reserve equal to that part of the rate being challenged. If the rate in effect is reduced by a subsequent order, the entity can make refunds from the reserve it established and would be in the same position as if the new rate had been in effect the entire time. If the rate is upheld on appeal, the entity terminates the reserve and takes the full amount of the reserve into its revenues. In either event, the entity is in the same position as if the final decision on the rate had been in effect during the entire period. Here, Eight Parties assert, the refiners had no way of knowing what part of the valuations in effect was being challenged, and what reserves should be established in case of a reversal.

201. In sum, Eight Parties assert that in contrast to the usual rate proceeding when there is a pre-error status quo, here refiners and heavy oil producers could not estimate what the consequences of upsetting the Commission's 1993 Order would eventually lead to in terms of the valuation of the Resid cut. It is only with this order, assuming no further court reversal, that a Resid cut valuation has been established. In the interim there were numerous proposals for valuing the Resid cut, some accepted, others rejected, none of which would value the Resid cut as low as the decision by the ALJ here.[190] For all these reasons, Eight Parties argue, the ALJ's decision to not grant some relief was erroneous.

202. The other equity argument advanced by Eight Parties involved the inter-period equities, which they contend the ALJ erroneously rejected. Regardless of the methodology, producers of the relatively heavier oil and the instate refiners would make

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[190] Exhibit WAP-253 tabulated the numerous proposals for the Resid valuation which included the following: the 1997 Nine Parties Settlement, the 1997 Tesoro proposal, the 2000 Eight Parties settlement, the 2000 EMT proposal, Eight Parties 2002-3 hearing proposal, the EMT, 2002-3, First Round Testimony proposal, and the EMT Reply Testimony proposal.

payments into the Quality Bank. Producers of the relatively lighter oil would receive payments from the Quality Bank.

203. Although there were a number of different projections of what the refunds would be in each period, depending upon what cuts are included and the values assigned, the basic equity argument by Eight Parties is that producers of heavier petroleum who made payments into the Quality Bank when the gravity methodology governed, but were denied refunds for the First Period because the distillation method was applied prospectively in 1993, would owe refunds in the Second Period to producers of the lighter petroleum, who had received the overpayment from the Quality Bank in the First Period, and were not required to refund those overpayments. Specifically, Exxon, which would receive the bulk of refunds in the Second Period from the new Resid valuations, had also received overpayments in the First Period when the gravity method was in place, which overpayment it did not have to repay.[191] Eight Parties assert that the ALJ misunderstood the argument advanced by them based upon the balance of equities for the two periods. First, they cite to the ALJ's statement that "I find that the equities lean in favor of granting refunds to those who overpaid the Quality Bank."[192] Eight Parties argue that that was never the issue in this case because Exxon has never paid into the Quality Bank, but instead has always received payments from the Quality Bank. Rather, they argue, the issue here is whether parties who received more than they should have in Period I, because the gravity method rather than the distillate method controlled but did not have to repay the excess amount they received, should also receive more in the Second Period by applying the new valuation retroactive for the entire period, not whether anyone "overpaid," as the ALJ stated.

204. Eight Parties assert that the evidence showed that producers injured by the failure to give refunds for the unjust rates in the First Period, when the gravity methodology applied, would be injured a second time if refunds were required retroactive to 1993 in the Second Period, and that Exxon, which earned unfair windfalls in the First Period

[191] Although Eight Parties' witness asserted "that shippers of lighter petroleum benefited greatly from the application of the gravity methodology during that time period, much more so than shippers of heavier petroleum have benefited by not having revisions in the distillation methodology made retroactive for the Second Period," Exhibit No. PAI 22 at 14-15, Exxon's calculation showed that it would be owed at least $40 million more in the Second Period that it would have owed in the First Period, and probably more than $55 million if all the cuts were considered. *See* Exhibit EMT-589.

[192] I.D. at P 2949.

because the gravity methodology overvalued its light oil, would benefit again in the Second Period if refunds were ordered on a retroactive basis.[193]

205. The ALJ reasoned, however, that the two periods were not legally comparable. During the First Period, he stated, a lawful, Commission-approved rate was in effect, even though it was later found to be unjust and unreasonable, while in the Second Period, "there has never been a lawful proxy price for the Resid cut."[194] Thus, no refunds could be awarded in the First Period, but must be for the Second Period.

206. Eight Parties argue that this begs the question. Equity, they contend, is relied upon to give relief when there is no adequate remedy at law. Finding a legal distinction between the two periods, therefore, does not disqualify the granting of equitable relief.

207. Eight Parties argue that the ALJ also wrongly relied on the supposed lack of a "clear delineation" between Eight Parties as a group and Exxon as to being benefited by the failure to apply the distillation methodology retroactively in 1993, whereas the new valuations are being applied retroactively for period 2 since 1993.[195] Eight Parties stated that there are two producers, Unocal and OXY who were harmed by the denial of retroactive relief in the First Period and who would also be harmed by the granting of it in the Second Period. At the same time, there was one producer, Exxon, who benefited from the denial of retroactive relief in the First Period, and who would also benefit from the granting of retroactive relief in the Second. Thus, they contend, regardless of the impact on other parties, for purposes of illustrating the inequity of awarding refunds retroactively in the Second Period, when they were denied in the First Period, it is enough to show that Unocal and OXY would be doubly harmed by the inconsistent treatment, and that Exxon would be doubly benefited, even if such a double impact does not affect every party.

208. Eight Parties assert that the ALJ's conclusion that the Resid values determined by him are just and reasonable for the past is not based on reasoned decision making. First they argue that he cited no record evidence; in addition he did not consider whether the equipment he ordered to be used in the cost calculations was typically used in 1993 or 1994, or whether it was even available. Moreover, if the new Resid valuation is imposed retroactively, the valuations of Resid and other cuts will change according to different

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[193] Exhibit PAI-22 at 23.

[194] I.D. at P 2946.

[195] I.D. at P 2946.

timetables, and only by the wildest coincidence will the Quality Bank accurately value all cuts retroactively as well as prospectively.

209. Eight Parties also assert that the ALJ erred because he denied that the public interest would be disserved by imposition of retroactive refunds. Basically Eight Parties contend that prospective implementation of Quality Bank methodologies facilitates efficient economic planning, while retroactive implementation frustrates efficient economic planning.

210. Finally, they assert that the ALJ erred in adopting an all-or-nothing approach to the refund issue. They state that the ALJ found that no party was at fault in the delay in reaching the decision as to the valuation of Resid cut.[196] Despite this, Eight Parties state he failed to consider the circumstances, and concluded that refunds must be ordered retroactively "to put salve on the wounds of those who were injured."[197] Rather, Eight Parties contend, he should have considered alternatives, such as not requiring interest on any refunds.

211. In this connection Eight Parties argue that when retroactive application will not place the parties in the same position that they would have been absent agency error, as here, the Commission has the discretion to order an intermediate remedy. They argue that in an analogous case, *Panhandle Eastern Pipe Line Co. v. FERC*,[198] which involved a complex fact history that included numerous Commission orders, three appeals, and several attempted settlements spanning more than eleven years, full retroactivity was not required.

212. In *Panhandle*, the Court had reversed the Commission's approval of the pipeline's recovery of certain costs through direct billing of its customers. In the subsequent remand order, the Commission concluded that it would not require complete retroactivity because the Commission "cannot restore the parties to the position they would have occupied in the absence of the Commission's error."[199] The uncertainty was due to the fact that the pipeline could have acted in a different way to legally recover the amount from its customers if the Commission had not authorized the illegal method, and that the Commission had induced the pipeline to act in the way it did. Accordingly, the

[196] I.D. at P 2949, n.880.

[197] I.D. at P 2947.

[198] 95 F.3d 62 (D.C. Cir. 1996) (*Panhandle*).

[199] *Panhandle Eastern Pipe Line Co.*, 70 FERC ¶ 61,167 at 61,521.

Commission decided to apportion the liability resulting from its legal error by requiring the pipelines to refund the full principal amount of the costs they had illegally collected, but did not require the pipelines to pay interest on those amounts. The two amounts were almost the same, so the refund was half of what would have resulted from the full retroactive relief. The Court affirmed, stating:

> If the Commission could not reasonably determine what would make each party whole, and had no reason to impose a greater share of the burden of uncertainty upon one party than the other, then ordering a refund of principal without interest at a time when the principal and interest are of roughly equal value is a reasonable compromise.[200]

213. Eight Parties argue that the circumstances here are directly analogous to those in *Panhandle*. Thus, Eight Parties argue, the Commission could decide, as it did in *Panhandle*, that the balance of equities does not require the refiners and heavy oil producers to pay interest on the principal amount of any refunds ordered, or the Commission should order some alternative relief short of full retroactivity back to 1993.[201]

D. <u>Commission Ruling</u>

214. The issue now presented is not whether to require refunds back to December 1993 but back to February 1, 2000. We will, however, refer to Eight Parties' arguments that referred to the December 1, 1993 refund date.

215. In *OXY*, the Court affirmed the Commission's decision to apply the distillation methodology prospectively. The court stated that the Commission relied on two grounds. The first ground was that the investigation ordered in 1989 was pursuant to section 13(2) of the ICA which does not provide for refunds. The second ground relied on was the filed rate doctrine. The Court agreed that the Quality Bank methodology has been "an integral element of the TAPS Carriers' tariff structure since [the Commission] approved the 1984 settlement."[202] Moreover, the Commission had properly relied on ICA section 13(2) that no refund could be ordered because the TAPS Carriers' 1989 annual filing did not propose a change in methodology. That filing would not be the type of

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[200] 95 F.3d at 72.

[201] The TAPS Carriers request clarification whether the refunds ordered include interest from the effective date, and if it is, at what rate.

[202] 94 F.3d at 699.

notice that would put all parties on notice that there could be a future adjustment in the existing rate so the filed rate bar would not be applicable.

216. A different situation is present with respect to the refunds ordered here. In *Exxon*, as explained *supra*, the Court concluded that "on the record before us we hold that FERC abused its discretion when it failed without adequate explanation to make the revaluation and concomitant Quality Bank adjustment, retroactive to 1993, when the distillation method was adopted."[203]

217. Given the Court's ruling in *Exxon*, the question presented now is whether there is anything in the present record that was not present before that provides a basis for not applying the new valuations on a retroactive basis, but limited to February 1, 2000.

218. Some of the exceptions urged by Eight Parties do not require much discussion. Thus, the public interest contention would hardly satisfy the court's test for not applying the ruling retrospectively. We agree with the ALJ that no public interest is at stake, but the issue is determining how a pool of money is to be divided among shippers, and does not involve the public at large. Eight Parties' argument that applying the new Resid value retroactively impairs economic efficiency is unconvincing. Similarly, Eight Parties' contention that there is no support for the ALJ's conclusion that the new Resid value is the just and reasonable valuation going back to 1993 disregards the purpose of the hearing, which was to establish the just and reasonable value for all the remanded cuts, including the Resid cut.[204]

219. Analyzing Eight Parties' remaining exceptions, we find they basically consist of two grounds, with varying ways of expressing them.

220. The first is that the "inter-period" equities suffice to not requiring applying the new valuation back to December 1993. Basically, Eight Parties argue that it would be inequitable to require the new valuations retroactive to 1993 because it would result in Exxon recovering refunds back to 1993, when that same party received more from the Quality Bank than it would have been entitled to had the gravity method not been in place from 1990 to 1993, but was not required to refund that excess amount it had received. Eight Parties seemingly are arguing that in determining when equitable relief should be

[203] 182 F.3d at 50.

[204] The ALJ in n. 871 stated " I am satisfied, based on a reading of the entire record, that the Resid value established in this Initial decision is just and reasonable throughout the period from December 1, 1993, forward."

awarded, the legal distinction between the two periods is irrelevant because "[e]quity is relied upon to give relief when there is no adequate remedy at law."[205]

221. Despite their attempts, it is inescapable that to accept this argument would basically be to ignore the ruling in *OXY* affirming the Commission's decision that no refunds can be awarded for the 1989-1993 period because the gravity method was the filed rate during that time. To say that if we accepted Eight Parties' contention that the Commission should not order refunds for the post-1993 period because the party receiving those refunds was not required to pay refunds in the pre-1993 period that no refunds are being awarded for that earlier period, but are merely being used to offset other refunds, does not respond to the Court's analysis in OXY, because the "filed rate" doctrine would be ignored for the pre-1993 period, and another rate would be applied for that period. Moreover, the other equity argument of Eight Parties' that it is unfair to award refunds for the post-1993 period when no refunds were awarded in the prior period was rejected by the court. In *Exxon* the court held that the Commission's reliance on the fact "that all prior TAPS cases resolved by settlements have been on a prospective basis" did not support its decision to apply the same approach to the 1997 settlement because this "equitable factor[] ha[s] no bearing on the decision and do[es] not explain [the FERC's] decision not to make whole parties who are clearly injured by undervaluation."[206]

222. Even absent that bar to accepting Eight Parties' position, the ALJ set forth his reasons for rejecting it on the merits. Eight Parties assert that his rejection of their argument was in error in a number of ways but we find no merit in their contentions. First they assert that the ALJ "did not fully understand" their inter-period equities argument. However, the ALJ addressed Eight Parties' argument but found it "unconvincing" because the calculation of the "benefits" in the two periods were questionable, and that there was no clear delineation between Exxon, and the members of Eight Parties as to the benefits each would receive in the two periods.

223. Eight Parties claim that the ALJ wrongly relied on the lack of a "clear delineation" between those parties who were allegedly harmed by the absence of retroactive relief in Period 1, and those parties who will pay refunds if retroactive relief is granted for Period 2. The ALJ pointed out that Williams, one of Eight Parties, as well as Exxon greatly benefited under the gravity method. Moreover, he referred to the fact that while

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[205] Eight Parties Brief on Exceptions at 139-140.

[206] 182 F.3d at 48-49.

Exxon will benefit from applying the new valuation retroactively to December 1, 1993, so will at least Alaska, BP and Phillips, three members of Eight Parties.[207]

224. Eight Parties also take issue with the ALJ's finding that the calculation of the financial benefit during the First Period is "questionable." Eight Parties exceptions acknowledge that the calculation did not use consistent data for the two time periods, and their explanation that the two sets of data were used for different purposes does not respond to the question. Moreover, Eight Parties acknowledges that in preparing the First Period calculations many factors were simply assumed. Accordingly, we see no reason to reject the ALJ's conclusion that these calculations are questionable, and conclude, as he did, that the inter-period equities argument does not provide a basis for not applying the new valuations on a retroactive basis.

225. Eight Parties other equitable argument relates to the refiners' refund obligation. In essence Eight Parties argue that to apply the new Resid valuation retroactively to December 1993 would not put the parties in the same position they would have been in had the Commission not made the legal error of adopting the wrong proxy for the remanded cuts. Eight Parties assert that if the valuation of the remanded cuts had been different, the refiners would have operated their refineries differently to minimize their Quality Bank obligation, and, therefore, their refund should not be based on those valuations applied to their operations back to 1993.

226. However, as of the February 1, 2000 date, the Court had rejected the existing Resid valuation, so refiners should have taken this into consideration in their operations after the *Exxon* decision in 1999.

227. While Eight Parties cite to the ALJ's "supposed" recognition in n. 880 that retroactive application of the new valuation that would not put the parties back in the same position they would have been in had the new valuations been determined in 1993, they overlook the balance of the footnote which explained why refunds were necessary in spite of Eight Parties' argument. The balance of n. 880 stated:

> On the other hand, there may be parties injured by the Commission's failure to determine a Resid value which can be judged just and reasonable and there may be parties who benefited from those circumstances who should not have. Under these circumstances, the Commission has an obligation to do what it can to put salve on the wounds of those who were injured. It follows, therefore, that refunds, if warranted, must be paid to

[207] I.D. at P 2946.

> those who paid too much into the Quality Bank and that those who paid in too little must be billed for their underpayments.

228. Eight Parties take issue with the ALJ's conclusion in P 2947 that he found "unconvincing" the claim that "they might have operated their businesses differently had the Resid value ordered here been in effect throughout the period."

229. The ALJ's reasoning was:

> The Eight Parties were aware, from the beginning, that Exxon and Tesoro challenged the Commission's initial determination as to how Resid would be valued for Quality Bank purposes. While they might not have known exactly how Resid eventually would be valued, they were on notice that it probably would not be valued as the Commission first did in 1993 since, at least, the issuance of the OXY decision by the Circuit Court in 1995. Under these circumstances, the prudent businessman would have taken steps to protect his business. While the record does not reflect what they did, I assume that the affected members of the Eight Parties are operated by prudent businessmen.[208]

230. This reasoning paralleled the Court's reasoning in *Exxon* that the filed rate doctrine, which was applicable to why there were no refunds in the 1989-1993 period, did not apply to the refunds at issue here because that doctrine:

> Has no bearing on FERC's discretion to reallocate Quality Bank credit to correct FERC's erroneous valuation of the distillate and Resid cut because all the TAPS shippers were on notice as of 1993 that the valuations were contested.[209]

231. Eight Parties basically are arguing that the refiners were entitled to rely on the existing valuation notwithstanding that they were under legal challenge. Clearly the Court rejected this position in *Exxon*, as well as in *OXY*, where the Court stated:

> The rule against retroactive ratemaking, 'does not extend to cases in which [customers] are on adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of

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[208] I.D. at P 2947 (footnotes omitted).

[209] 192 F.3d at 49.

service.'[210]

Clearly, after 1999, refiners could not rely on the existing Resid valuation since the Court had rejected it in *Exxon*.

232. Eight Parties argue that the situation here is analogous to the situation in *Panhandle, supra*, where the Commission did not order a full retroactive refund. Rather, it apportioned the refund, and the Court affirmed because there, as here, absent the Commission error, the refunding parties could have acted in a different manner which would have resulted in a smaller refund being due.

233. There are striking differences between the two situations. In *Panhandle,* the pipeline could have recovered the disputed amounts from customers legally, but in a different manner. Thus, in *Panhandle*, the Commission in denying the interest basically awarded half the full amount so there was an equal sharing of the relief. Here there is no way of knowing what the refiners' refund obligation would have been if they knew the Resid cut valuation from 1993 on. Thus, there is no basis for denying interest because to do so has no relation to what is appropriate relief in this case.

234. Moreover, Eight Parties' argument fails because even if it were true that had the refiners been aware of the valuation now assigned to the Resid cut they could have attempted to minimize their Quality Bank obligations, it does not follow that they would have been able to substantially reduce the amount of the refund that they will owe under aluation. What Eight Parties are arguing is that because the refund amount could have been a lesser figure, if the refiners had known the Resid valuation from 1993 on or from 2000 on, no refunds are due. We cannot accept that argument to eliminate the entire retroactive refund obligation. Thus, we affirm the ALJ's ruling that the Resid cut valuation must be applied on a retroactive basis.

235. Whether the period for the retroactive refunds should be less than back to December 1993 is in a different posture because Congress has limited the period back to February 1, 2000. We conclude that none of the equitable arguments advanced by Eight Parties justifies limiting the period of refunds beyond that date. Accordingly, we will modify the I.D. by limiting the retroactive application of the new valuations as to the

[210] 64 F.3d at 699 (quoting *Natural Gas Clearinghouse*, 965 F.2d 1066 at 1075 (1992)).

Resid cut to February 1, 2000, and the Quality Bank Administrator is to re-calculate the adjustment from February 1, 2000, forward.[211]

Issue No. 6 [212] Are Reparations an Issue in This Proceeding? If So, What Reparations, If Any, Are Appropriate?

A. Background

236. The reparations issue relates solely to the valuation of the West Coast Naphtha and VGO cuts. The parties stipulated in an October 7, 2002 stipulation that the current method of valuating the West Coast VGO cut on the basis of the OPIS Gulf Coast spot price for high sulfur VGO should be changed to the OPIS West Coast spot price for high sulfur.[213] According to Exxon, the West Coast VGO price has been significantly higher than the OPIS Gulf Coast High Sulfur VGO price that has served as the Quality Bank proxy price for West Coast VGO since December 1993. Exxon, along with Alaska and Phillips, also contends that West Coast Naphtha prices over the past decade have differed substantially from Gulf Coast Naphtha prices and, indeed, generally have been significantly higher than Gulf Coast Naphtha prices. As a result, these parties maintain that the Quality Bank has substantially undervalued West Coast Naphtha. The claim for reparations would be the difference between the West Coast Naphtha and VGO values that have been in effect, and the values for those cuts ultimately determined to be lawful.[214] The reparations claim would include the two years before Exxon filed its June 19, 1996 complaint in Docket No. OR96-14-000, and extending to the date of this decision.

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[211] As discussed above, the new valuation for the West Coast Naphtha and VGO cuts are to be implemented on a prospective basis, so there are no refunds as to those valuations.

[212] Issue Nos. 6, 7, and 8 were not discussed by the ALJ. *See* n. 19 *supra.*

[213] EMT also contend that *Tennessee Valley*, *supra*, requires retroactive application of the revised Naphtha and VGO values to compensate Exxon Mobil for the financial loss it suffered arising from the erroneous dismissal of the Exxon and Tesoro complaints. We have explained in the discussion of Issue No. 4, *supra*, why *Tennessee Valley* is not applicable here,

[214] Eight Parties asserted that Exxon's reparations claim for Naphtha totals some $64 million through 2002, offset by a negative $30 million (credit) for VGO reparations, for a net of some $34 million. I.D. at P 2954.

B. The ALJ's Ruling

237. In an earlier stipulation of December 14, 2001, Joint Exhibit 12, EM and Tesoro stipulated that the TAPS Carriers have not violated the ICA "except to the extent that implementation of the Quality Bank methodology that the [Commission] has directed the TAPS Carriers to implement constitutes such a violation." Further, paragraph 3 of that stipulation clarifies that reparations were not being sought from the TAPS Carriers' own funds.

238. The I.D. stated that according to Exxon, reparations is the term given to relief provided under section 16 of the ICA, in response to a complaint filed by a shipper under section 13(1) of the Act, for damages sustained for payment of existing rates that are ultimately found not to be just and reasonable.[215] Exxon's position was that the standard for the award of reparations is the difference between the unlawful rate and the lawful rate, and other evidence of loss by that shipper,[216] and the Commission has applied this standard in many cases.[217] Exxon relies on ICA section 16 which provides that reparations may be awarded up to two years prior to the date on which a complaint is filed, and through the period until the new rates are implemented.

239. The ALJ referred to Commission Staff's position that no claim was made by complainants that the TAPS Carriers violated their tariff. Rather, the claim is for refunds from other shippers who received more under the old reference prices than they would have received had the new reference prices applied. Staff asserted that there is no basis for an award of reparations because no damages were being sought from the TAPS Carriers, nor was there any showing of a violation of the TAPS tariffs. The claims against the other shippers who allegedly received more, Staff contended, should be considered in connection with Issues No. 3 and 4 concerning the effective dates for any changes in the valuation methodologies for the Naphtha and VGO cuts, and any refunds that may result from such changes. Those reference prices were not at issue in *OXY*,

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[215] I.D. at P 2972.

[216] Exxon relies on I.C.C., 289 U.S. at 390; *Louisville & Nashville R.R. v. Sloss-Sheffield Steel & Iron Co.*, 269 U.S. 217, 235 (1925); *Chicago, Milwaukee, St. Paul & Pacific R.R. Co. v. Alouette Peat Products*, 253 F.2d 449, 455 (9th Cir. 1957).

[217] Exxon cites to *Union Oil Co. of California v. Cook Inlet Pipe Line Co.*, 71 FERC ¶ 61,300 at 61,184 (1995); *see also Kerr-McGee Refining Corp. v. Williams Pipe Line Co.*, 63 FERC ¶ 61,349, at 63,224 (1993); *see also SFPP, L.P.*, 96 FERC ¶ 61,281, at 62,071 (2001).

whereas in *OXY* the Court remanded the valuations of the Resid and distillate reference prices.

240. The ALJ concluded that reparations were not an issue in the proceeding before him. The ALJ adopted Staff's analysis which rejected Exxon's argument that the complainants had sought reparations. Staff argued that while in its complaint Exxon contended that the TAPS Carriers had violated their tariffs, which would be a basis for reparations, subsequently Exxon entered into the stipulation which eliminated that claim against the TAPS Carriers. Staff also asserted that while there may have been a reference to reparations in past Commission TAPS orders that merely indicated that such a claim might be raised, but the stipulation Exxon subsequently entered removed that claim.

241. The ALJ held that "since Exxon has agreed that it is not seeking reparations from the TAPS Carriers, the Commission lacks jurisdiction to hear its complaint."[218] The ALJ added that even if reparations were an issue, he would not grant any because the reparations apply only to the new West Coast Naphtha reference price, and in this I.D. he had already ruled that that new reference price should be applied on a prospective basis.[219] Finally, the ALJ concluded that reparations could not apply to the new reference prices for West Coast Naphtha and West Coast VGO because these existing rates are the lawful rates, and under *Arizona Grocery*, only prospective changes could be ordered.[220]

C. Exceptions

242. EMT filed exceptions on the ALJ's ruling but only in a limited manner. They state that they do not take exception to his ruling that reparations could not be ordered under the Supreme Court's decision in *Arizona Grocery* because the existing method for valuing West Coast Naphtha and VGO had been approved by the Commission in its 1993 Order, and no party objected to that ruling at that time. Rather, they state that they except to his ruling that the Commission had no jurisdiction under the ICA to consider reparations because the complainants allegedly were "not seeking reparations from the TAPS Carriers."[221] EMT argue that since the legal issues may arise in future Quality

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[218] I.D. at P 3075.

[219] As noted previously, the effective date of any new West Coast VGO reference price was stipulated to be the same as the effective date for the new West Coast Naphtha reference price.

[220] I.D. at P 3080-82.

[221] I.D. at P 3075.

Bank proceedings the Commission should vacate that portion of the ALJ's decision because it is clearly not correct.

243. EMT refers to the Commission's order setting Exxon's complaint for an investigation,[222] where the Commission specifically invoked section 13(1) of the ICA, which entitles a complainant to reparations against the carrier. Moreover, Exxon argues, in a subsequent order the Commission stated that, "If Exxon should prevail in its complaint case, then relief will be prospective from the date of the finding and *reparations are available to correct any inaccuracies that have occurred*."[223]

D. Commission Ruling

244. There is no need to rule on this request that the Commission vacate a portion of the I.D. because our function here is to pass on the ALJ's ruling that reparations could not be ordered and EMT do not take exception to that finding. However, even if we were to address the request we find no merit in it. Although they contend that the complaint did request reparations from the TAPS Carriers, it is clear that they are actually seeking refunds from the shippers who received excess payment under the old reference prices. This is manifest from the 2001 stipulation, Joint Exhibit 12, executed by EM and Tesoro after the cited Commission orders, which stated:

> ExxonMobil and Tesoro further agree (1) that they do not seek payment of any amounts by the TAPS Carriers except in the event, and only to the extent, that the TAPS Carriers recover such amounts from shippers that were overpaid pursuant to Quality Bank tariff provisions ultimately determined to be unjust and unreasonable, and (2) that they do not seek payment of any amounts by the TAPS Carriers from the TAPS Carriers' own funds.

245. The ALJ recognized what was at issue in this proceeding in the last footnote of the I.D. which stated:

> I feel compelled to note that, in essence, Exxon really is not seeking "reparations" which, in this case, would be damages awarded against the TAPS Carriers for violating their Tariff. As all parties have agreed that the TAPS Carriers did not violate the terms of their Tariff, that there are no

[222] *Trans Alaska Pipeline System*, 76 FERC ¶ 61,119 at 61,621 (1996).

[223] *Trans Alaska Pipeline System*, 82 FERC ¶ 61,343 at 62,352 (emphasis supplied).

> damages sought from them, and that what is sought is an order requiring the Quality Bank Administrator to re-calculate the Quality Bank for a period of time, it is clear that what is sought is refunds, not reparations.[224]

Accordingly, we affirm that no reparations apply to the new West Coast Naphtha and VGO reference prices.

Miscellaneous Motions

1. BP Motion to Require Interim Refunds

246. On June 24, 2005, BP moved that the Commission modify the Heavy Distillate price that had been in place since February 2000, and to order interim refunds back to February 2000 based upon this new price. It requests that the price should be a value which more closely reflects the ongoing, current market value for the product, and should be the Platt's spot price quote for West Coast L.A. Pipeline low sulfur No. 2 Fuel Oil, as that price may vary from month to month, minus $0.0501/gallon to adjust for processing costs. This modified interim pricing methodology, is equivalent to the value that the ALJ found to be just and reasonable in the I.D.

247. BP states the reason for the request is to minimize the further compounding of additional refunds – which are currently growing at a rate of approximately $9.6 million per month – until the Commissions issue an order permanently revising the Heavy Distillate valuation.

248. A number of parties filed in opposition, and the TAPS Carriers sought clarification.

249. The motion is moot since in this order the Commission establishes the reference price for the Heavy Distillate cut, with retroactive refunds to February 1, 2000, *supra* P 77.

2. Williams's Motion to Strike

250. Williams moved to strike footnote 124 of the Brief on Exceptions of EMT. This footnote noted that Williams had indicated in a news release issued two and a half weeks after the I.D. that, like Petro Star, Williams also "had established a reserve for the possibility of refunds resulting from this litigation." EMT opposed the motion.

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[224] I.D. at P 3082 n.909.

251. Since this order does not refer to that footnote, the motion is moot.

The Commission orders*:*

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

(B) Any motions or requests filed by the parties after issuance of the Initial Decision and not specifically referred to herein are hereby denied.

(C) TAPS Carriers are hereby directed to make a compliance filing with respect to matters directed in this order. The TAPS Carriers must make this filing within thirty days of this order, unless there is a request for rehearing, in which case the compliance filing must be made within thirty days of a final order by the Commission.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.