ORIGINAL

PUBLIC

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Tesoro Refining and Marketing Company,	)	OR07-2-000
Complainant,	)	Docket No. ______
v.	)	
SFPP, L.P.,	)	
Respondent.	)	

COMPLAINT OF TESORO REFINING AND MARKETING COMPANY AGAINST SFPP, L.P. AND MOTION FOR CONSOLIDATION WITH ON-GOING COMMISSION PROCEEDINGS INVOLVING SFPP, L.P.

Public Version

By: Melvin Goldstein
Matthew A. Corcoran
GOLDSTEIN & ASSOCIATES, P.C.
1757 P Street, N.W.
Washington, D.C. 20036
(202) 872-8740

Attorneys for Tesoro Refining and Marketing Company

Date: December 12, 2006

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9. Pursuant to Rule 206 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("the Commission" or "FERC"), 18 C.F.R. § 385.206; the Procedural Rules Applicable to Oil Pipeline Proceedings, 18 C.F.R. § 343.2; Sections 1(5), 8, 9, 13, 15, and 16 of the Interstate Commerce Act (ICA), 49 U.S.C. App. §§ 1(5), 8, 9, 13, 15 and 16 (1984); and Section 1803 of the Energy Policy Act of 1992 ("EPAct"), Tesoro Refining and Marketing Company (Tesoro) hereby files this Complaint against SFPP, L.P. ("SFPP"), challenging the justness and reasonableness of rates on SFPP's West Line and Calnev Line. Tesoro seeks the prescription of just and reasonable rates and reparations and refunds, including interest, for the unjust and unreasonable rates that SFPP has charged it in the past.

10. Tesoro is also requesting that the Commission consolidate its Complaint with on-going proceedings involving SFPP and include the time periods covered by this complaint in those proceedings. As discussed below, Tesoro is willing to be governed by the determinations previously made by the Commission and Administrative Law Judges in those proceedings.

11. In support thereof, Tesoro states as follows:

I.

COMMUNICATIONS AND CORRESPONDENCE

12. Communications and correspondence regarding this Complaint should be directed to the following persons:

Barron Dowling
Associate General Counsel
Tesoro Refining and Marketing Company
300 Concord Plaza Drive
San Antonio, TX 78216
Tele: (210) 283-2415
Email: bdowling@tsocorp.com

Melvin Goldstein
Matthew A. Corcoran
GOLDSTEIN & ASSOCIATES, P.C.
1757 P Street, N.W.
Washington, D.C. 20036
Tele: (202) 872-8740
Fax: (202) 872-8744
E-Mail: mgoldstein@goldstein-law.com
mcorcoran@goldstein-law.com

II.

PARTIES

13. Respondent SFPP is an oil pipeline engaged in the transportation of refined petroleum products in interstate commerce. It is regulated as a "common carrier" by the Commission under the Interstate Commerce Act and the Energy Policy Act of 1992. As part of its business activities, SFPP operates a petroleum products pipeline from Watson, CA, East Hynes, CA, and Colton, CA to Phoenix, AZ. This line is known as the "West Line." SFPP also operates a pipeline known as the "Calnev Line" that transports petroleum products from Watson, CA and East Hynes, CA to the Calnev Pipe Line L.L.C. (Calnev) in Colton, CA. Petroleum products are then transported from Colton, CA to various interstate destinations.

14. SFPP is a subsidiary of Kinder Morgan Energy Partners, L.P. (KMEP), a publicly-traded master limited partnership and registered tax shelter. In turn, Kinder Morgan, Inc. ("KMI") owns the general partnership interest of KMEP. KMEP is both a "Master Limited Partnership" ("MLP") and a "Publicly Traded Partnership" ("PTP") presently eligible to be taxed as a partnership.

15. Complainant Tesoro is a shipper of refined petroleum products on the SFPP pipeline system. As William M. Weimer of Tesoro states in the attached Sworn Declaration, Tesoro has shipped and continues to ship significant quantities of refined petroleum products on SFPP's West Line in interstate commerce. Tesoro has also shipped significant quantities of refined petroleum products on SFPP's Calnev Line.[1] Tesoro intends to continue to ship petroleum products on the West

[1] *See* Ex. A. Sworn Decl. of William M. Weimer in Supp. of Tesoro Refining and Marketing Company's Compl. at ¶ 3 (Dec. 11, 2006).

Line and Calnev Line in the foreseeable future. Tesoro therefore has a substantial economic interest in SFPP's West Line and Calnev Line rates and the unjust and unreasonable rates SFPP has charged in the past.

III.

BACKGROUND FACTS

A. Tesoro's Shipments on the SFPP Pipeline System.

8. SFPP holds a monopoly on the transportation of refined petroleum products by pipeline from California to Arizona and Nevada as well as from Texas to Arizona. It is subject to the jurisdiction of the Commission and has published transportation tariffs that are on file at the Commission. During the period December 1, 2004 through November 30, 2006, Tesoro has shipped more than ***[Privileged and Confidential Material Removed]*** barrels of refined petroleum products on the West Line and more than ***[Privileged and Confidential Material Removed]*** barrels on the Calnev Line at rates charged by SFPP under tariffs on file with the FERC.

9. Tesoro's shipments on the West Line and Calnev Line are set forth in Table I below.[2]

[Privileged and Confidential Material Removed]

[2] Tesoro is continuing to review shipments on the West Line and Calnev Line for the past two years. In the event that review indicates that Tesoro has shipped additional products, Tesoro will amend this Complaint to reflect those additional shipments.

[Privileged and Confidential Material Removed]

B. FERC and Court of Appeals Decisions With Respect to the West Line and Calnev Line.

10. In a series of decisions that were issued in 2004 and 2005, the Commission and the Court of Appeals for the District of Columbia Circuit have held that the rates that SFPP has charged shippers for shipping petroleum products on

the West Line and Calnev Line have been unjust and unreasonable and that SFPP's rates must be reduced.[3] Those decisions are the following:

a. *BP West Coast Products* – 374 F.3d 1263 (2004) –

11. In a decision issued on July 20, 2004, the Court of Appeals for the District of Columbia remanded to the Commission the issue of whether the West Line and Calnev Line had experienced "substantially changed circumstances" since 1992. The court held that if substantially changed circumstances exist, then the rates SFPP charged for transportation on the West Line and Calnev Line would not be subject to the "grandfathering" provision of Section 1803 of the Energy Policy Act of 1992. This statutory provision generally applies to pipeline transportation rates that were in effect for the 365 days prior to the enactment of the EPAct on October 24, 1992. A copy of the Decision of the Court of Appeals is attached to this Complaint as Exhibit B.

b. Order on Initial Decision – 106 FERC ¶ 61,300 (March 24, 2004) –

12. In this Decision, the Commission found that the threshold "changed circumstances" standard in Section 1803(b)(1) of EPAct had been satisfied with respect to the West Line and Calnev Line. In an Initial Decision, an Administrative Law Judge specifically found that the substantially changed circumstances standard had been satisfied with regard to West Line and Calnev Line rates for 1996, 1997, 1998, and 2000. The Commission subsequently confirmed that determination, concluding that "substantial changes in circumstances [existed] that

[3] Although SFPP files separate tariffs for its West Line and Calnev Line rates, both the Commission and the Court of Appeals consider the Calnev Line to be part of the West Line. The FERC and Court of Appeals decisions referred to in the text therefore apply both to the West Line and the Calnev Line.

were the basis for the Yuma, Calnev and West Tucson rates beginning in 1995, and for the West Phoenix rates beginning in 1997."[4] A copy of the Commission's Decision is attached to this Complaint as Exhibit C.

c. Order on Remand and Rehearing – 111 FERC ¶ 61,334 (June 1, 2005) –

13. This order addressed the remand to the Commission by the United States Court of Appeals for the District of Columbia Circuit in *BP West Coast Products*, the Phase I proceeding in Docket No. OR96-2-000, *et al.*, and issues raised by the Commission's March 24, 2004 Order in that proceeding. These issues all concerned the extent to which SFPP's rates for the West Line and the Calnev Line were subject to the grandfathering provision of Section 1803 of the Energy Policy Act. The Commission "again conclude[d] that there were substantially changed circumstances on the West Line for the years stated in the March 2004 Order."[5] A copy of the Commission's decision is attached to this Complaint as Exhibit D.

d. Order on Initial Decision and on Certain Remanded Cost Issues – 113 FERC ¶ 61,277 (December 16, 2005) –

14. Since the Commission had found the rates on the West Line and Calnev Line were not grandfathered, in a further order issued on December 16, 2005, the Commission clarified the methodology that SFPP must use in establishing new interim rates for the West Line and the Calnev Line. The Commission stated that "This order makes certain determinations for establishing interim just and reasonable rates for SFPP, L.P.'s (SFPP) East and West Line rates pursuant to section 15(1) of the Interstate Commerce Act."[6] Based on this Order, "the Commission [required] SFPP to make several compliance filings and to establish

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[4] 106 FERC ¶ 61,300, at P 53 (2004).
[5] 111 FERC ¶ 61,334 at P 39 (2004).
[6] 113 FERC ¶ 61,277 at P 1 (2005).

new interim rates for its West Line... as of May 1, 2006."[7] A copy of this Commission Decision is attached to this Complaint as Exhibit E.

e. Tariffs Nos. 120 and 121 and Commission Order Suspending Tariffs Subject to Refund.

15. As a result of the previous decisions, on March 7, 2006, SFPP filed FERC Tariff Nos. 120 and 121 for transportation on the West Line and Calnev Lines, respectively.[8] SFPP stated that the new rates it established in these tariffs for the West Line and Calnev Line were intended to comply with the Commission's December 16 Order and the Order on Rehearing issued February 13, 2006.[9] The Commission accepted and suspended SFPP Tariffs Nos. 120 and 121, subject to refund, to be effective May 1, 2006.[10] A copy of this Decision is attached to this Complaint as Exhibit F.

IV.

BASIS OF COMPLAINT

16. During the period December 1, 2004 to November 30, 2006, Tesoro has shipped petroleum products on the SFPP West Line and Calnev Line under the following SFPP tariffs[11]:

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[7] *Id.* at P 2.
[8] SFPP FERC Tariffs Nos. 120 and 121, filed March 7, 2006, are included in Exhibit G at pp. 18-22 of 45, attached to this Complaint.
[9] Order on Rehearing in Docket No. OR92-8 et al., 114 FERC ¶ 61,136 (February 13, 2006).
[10] Order Accepting and Suspending Tariff Filings, 115 FERC ¶ 61,125 (April 28, 2006).
[11] Ex. G. SFPP FERC Tariff Nos. 106, 113, 120, 126, 130, 139, 108, 115, 121, 124, 131, and 140.

Table II

West Line Rates

Tariff	Effective Date	Cancels	Rate	Notes
106	7/1/04	91	136.92 (Watson to Phoenix); 136.92 (East Hynes to Phoenix); 107.60 (Colton to Phoenix)	Indexes existing rates.
113	7/1/05	106	141.89 (Watson to Phoenix); 141.89 (East Hynes to Phoenix); 111.50 (Colton to Phoenix)	Indexes existing rates.
120	5/1/06	113	97.33 (Watson to Phoenix); 97.33 (East Hynes to Phoenix); 74.36 (Colton to Phoenix)	Filed in accordance with Compliance Filing. Interim rates under December 16 Order. Accepted and suspended by the Commission 4/28/06.
126	7/1/06	120	103.31 (Watson to Phoenix); 103.31 (East Hynes to Phoenix); 78.93 (Colton to Phoenix)	Indexes existing rates.
130	8/2/06	126	150.61 (Watson to Phoenix); 150.61 (East Hynes to Phoenix); 118.36 (Colton to Phoenix)	Reinstatement of grandfathered rates, and an index adjustment. Rejected by the Commission 8/31/06.
139	9/11/06	126	103.31 (Watson to Phoenix); 103.31 (East Hynes to Phoenix); 78.93 (Colton to Phoenix) (Plus .75 cents ULSD Recovery Fee)	Accepted and suspended by the Commission 9/8/06.
126	10/13/06	139	103.31 (Watson to Phoenix); 103.31 (East Hynes to Phoenix); 78.93 (Colton to Phoenix)	SFPP Withdraws Tariff No. 139, and reinstates Tariff No. 126.

Table III

Calnev Rates

Tariff	Effective Date	Cancels	Rate	Notes
108	7/1/04	93	26.67 (Watson to Calnev); 26.67 (East Hynes to Calnev)	Indexes existing rates.
115	7/1/05	108	27.64 (Watson to Calnev); 27.64 (East Hynes to Calnev)	Indexes existing rates.
121	5/1/06	115	22.97 (Watson to Calnev); 22.97 (East Hynes to Calnev)	Filed in accordance with Compliance Filing. Interim rates under December 16 Order. Accepted and suspended by the Commission 4/28/06.

124	7/1/06	121	24.38 (Watson to Calnev); 24.38 (East Hynes to Calnev)	Indexes existing rates.
131	8/2/06	124	29.34 (Watson to Calnev); 29.34 (East Hynes to Calnev)	Reinstatement of grandfathered rates, and an index adjustment. Rejected by the Commission 8/31/06.
140	9/11/06	124	24.38 (Watson to Calnev); 24.38 (East Hynes to Calnev) (Plus .75 cents ULSD Recovery Fee)	Accepted and suspended 9/8/06.
124	10/13/06	140	24.38 (Watson to Calnev); 24.38 (East Hynes to Calnev)	SFPP Withdraws Tariff No. 140, and reinstates Tariff No. 124.

17. As the Commission and the Court of Appeals held in the decisions referred to above, the rates that SFPP charged Tesoro for shipments on the West Line and Calnev Lines under these tariffs were unjust and unreasonable. Tesoro therefore seeks reparations and interest with respect to the unjust and unreasonable rates it was charged for its shipments in the past, and the prescription of just and reasonable rates for future shipments as well as further reparations and interest so long as SFPP continues to charge Tesoro unjust and unreasonable rates for shipments on the West Line and Calnev Line.

18. The damages that Tesoro has incurred as a result of the unjust and unreasonable rates that SFPP has charged from December 1, 2004 to November 30, 2006 are at least $1,400,181.38 plus interest in the amount of $120,603.98, for the West Line, and $80,203.28 plus interest in the amount of $7,002.83 for the Calnev Line, based on the rates SFPP itself calculated in its 2006 Compliance Filing. Furthermore, after making necessary adjustments to SFPP's Compliance Filing rates to reach a just and reasonable rate, Tesoro has determined that the damages Tesoro incurred as a result of SFPP's overcharges for its West Line shipments

amount to $2,015,145.07 plus interest in the amount of $165,219.74 and, for the Calnev Line, $133,836.55 plus interest in the amount of $11,171.33. The calculation of these damage amounts is described in detail in the attached Sworn Declaration of Peter K. Ashton, a noted transportation financial analyst.[12] In addition, damages continue to accrue.

19. Under the Energy Policy Act of 1992, the analysis of a pipeline rate challenge proceeds in two steps: First, the Commission determines whether the rate in question is grandfathered, *i.e.*, whether it is presumed to be just and reasonable pursuant to Section 1803 of the EPAct. If it is found to be grandfathered, the Commission asks whether the rate falls into one of the exceptions outlined in Section 1803(b) of the Energy Policy Act of 1992.[13] Section 1803 of the Act provides that any oil pipeline rate that was in effect for a full year prior to October 24, 1992 is deemed just and reasonable if it was not subject to "protest, investigation or complaint" during that 365 day period.[14] The grandfathered rates are immune to challenge under section 13 of the ICA except when:

> (1) evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the act-
>
> (A) in the economic circumstances of the oil pipeline which were a basis of the rate; or
>
> (B) in the nature of the services provided which were a basis for the rate;...[15]

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[12] See Ex. H. Attached Sworn Decl. of Peter K. Ashton in supp. of Tesoro Refining and Marketing Company's Complaint Against SFPP, L.P. and Mot. for Consolidation with On-Going Commission Proceedings Involving SFPP, L.P. (December 11, 2006).
[13] *BP West Coast Products, LLC v. F.E.R.C.*, 374 F.3d 1263, 1272 (D.C. Cir. 2004)
[14] *Id.* at 1271.
[15] *Id.* quoting the Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified as 42 U.S.C. ß ß 13201-556 (2003)) at § 1803(b)(1).

20. With respect to the West Line and the Calnev Line, the Commission has already determined that there has been a substantial change in the economic circumstances that were the basis for the West Line and Calnev Line rates. In *Texaco Refining and Marketing*, Administrative Law Judge Raymond M. Zimmet held that a "substantial change in circumstances has been shown to have occurred under § 1803(b) of the EP Act for every grandfathered rate on the West Line."[16] This decision, as indicated above, has been affirmed by the Commission and the Court of Appeals in *BP West Coast Products.*

21. Consequently, the provisions of Section 1803 of the Energy Policy Act are not an impediment either to Tesoro's collecting the damages specified in Paragraph 18 above or to the Commission's prescription of new just and reasonable rates.

22. Under 343.2(c)(1), a Complainant must also allege reasonable grounds for asserting that the rates charged by an oil pipeline are "so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable." That requirement has been satisfied with respect to the SFPP West Line and Calnev Line rates.

23. In fact, in the decisions referred to in Paragraph 10 above, the Commission expressly determined that SFPP's rates have been unjust and unreasonable.

24. More recent filings by SFPP have further substantiated the conclusion that SFPP's West line and Calnev Line rates have been so substantially in excess of its costs as to be unjust and unreasonable.

[16] *Texaco Refining and Marketing, Inc.*, 103 FERC ¶ 63,055 at P 253 (2003).

25. On March 7, 2006 SFPP made a Compliance Filing with the Commission. That Compliance Filing established significantly lower rates for the transportation of petroleum products for the past two years. To create its new rates, SFPP calculated a cost of service rate for the year 1999 and indexed the rates for each subsequent year in accordance with the Commission's *Order on Initial Decision and On Certain Remanded Cost Issues* (December 16 Order).[17] The Compliance Filing was the result of the Commission's determination that SFPP must change its rates to reflect its real costs. Accordingly, SFPP's rates in the Compliance Filing can be used as more representative of SFPP's actual costs than the rates that SFPP charged in its tariffs.

26. The Compliance Filing also constitutes an implicit admission by SFPP that there is a substantial disparity between the rates that SFPP charged Tesoro for the use of the West Line and the Calnev Line and the rates that should have been charged based on SFPP's actual costs.

27. Tables IV and V below compare the rates that SFPP actually charged Tesoro for use of the West Line and the Calnev Line during the past, with the rates that SFPP states should have been charged. The rates that SFPP states should have been charged are derived from its March 7, 2006 Compliance Filing under Docket Nos. OR92-8-024, *et al.*

[17] *Order on Initial Decision and On Certain Remanded Cost Issues*, 113 FERC ¶61,277 at P 2 (hereafter "December 16 Order").

Table IV:
Divergence in Rates Charged July 1, 2004 – June 30, 2005

Destination	Rate Collected ($/Bbl)	Adjusted Tariff ($/Bbl)	Divergence Between Rate Charged and Adjusted Rate	Percentage Divergence
Phoenix Terminal	$1.3692	$0.9392	$0.4300	45.8%
Calnev Terminal	$0.2667	$0.2217	$0.0450	20.3%

Table V:
Divergence in Rates Charged July 1, 2005 – April 30, 2006

Destination	Rate Collected ($/Bbl)	Adjusted Tariff ($/Bbl)	Divergence Between Rate Charged and Adjusted Rate	Percentage Divergence
Phoenix Terminal	$1.4189	$0.9733	$0.4456	45.8%
Calnev Terminal	$0.2764	$0.2297	$0.0467	20.3%

28. As Tables IV and V indicate, the disparity between the rates that SFPP actually charged and the rates that SFPP later admitted were the maximum rates it should have charged to reflect its actual costs range from 20.3% to 45.8%. Those percentage differences certainly amount to a substantial disparity within the meaning of Section 343.2(c)(1) of the Commission's regulations.

29. Despite its March 7, 2006 Compliance Filing, SFPP's rates since May 1, 2006, the effective date of the Compliance Filing rates, have continued to be unjust and unreasonable. This is largely due to the fact that SFPP's Compliance Filing either ignored or defied the requirements imposed on it by the Commission in the December 16 Order.

30. For example, in formulating the cost of service that led to the March 7, 2006 Compliance Filing rates, SFPP ignored the Commission's directive with respect to the attribution of overhead expenses to the West Line and Calnev Line. In the December 16 Order, the Commission made it clear that SFPP must include all of KMEP's subsidiaries in its overhead cost attribution.[18] SFPP's Compliance Filing ignored this directive. As a result, inappropriately high overhead costs are attributed to the West Line and the Calnev Line.

31. In addition, in SFPP's March 7, 2006 Compliance Filing, SFPP used a capital structure of 50.92% debt and 59.08% equity. That capital structure is incorrect. The appropriate capital structure of SFPP should have a significantly higher debt ratio, as various witnesses testified in Docket No. OR92-8 *et al.*[19] Compliance with this prescription would result in substantially lower rates than SFPP stated in its March 7, 2006 filing.

32. The December 16 Order makes it clear that SFPP has the burden of proof to establish that it is entitled to an income tax allowance.[20] SFPP has failed to do so. In its Compliance Filing, SFPP claims a weighted Federal and State income tax rate of 36.66%. This is inappropriate. SFPP should not be entitled to an income tax allowance, because it has not shown that it will incur any actual or potential income tax liability.

33. There are several reasons why SFPP is not permitted to take a tax allowance in its Compliance Filing. First, doing so violates the directive of the Court

[18] *Id.*at P 85.
[19] *Id.* at P 64.
[20] *Id.* at P 44.

of Appeals in *BP West Coast Products.*[21] As Administrative Law Judge Young explains in his recent Initial Decision regarding protests of SFPP's North Line rates,[22] *BP West Coast* "precludes SFPP from reflecting an income tax allowance."[23] *BP West Coast Products* clearly holds that "a limited partnership operating jurisdictional pipelines incurs no income tax liability."[24] Judge H. Peter Young explains:

> [T]he court's central tenet that an income tax allowance may be included in a utility's cost of service only insofar as it reflects an actual/potential cost to the utility. SFPP exhibits no actual/potential liability to pay tax on any income attributable to its regulated utility operations.[25]

Judge Young states that "*as a matter of law* SFPP is precluded from reflecting any income tax allowance..."[26]

34. In addition, the factual evidence adduced in the trial conducted by Judge Young showed as a matter of fact that no SFPP entity or shareholder incurred an actual or potential tax liability as a result of SFPP's overall operations.[27] Thus, the full income tax allowance of $6.454 million should be removed from SFPP's West Line Compliance Filing.

35. Finally, SFPP's ULSD surcharge in FERC Nos. 139 and 140 exceeded the rates permitted by its Compliance Filing. Section 1804 of the EPAct explicitly defines rates, stating the "The term 'rate' means all charges that an oil pipeline requires shippers to pay for transportation services." SFPP has always sought to

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[21] 374 F.3d 1263 at 1286, citing 26 U.S.C. ß 7704 (d)(1)(E).
[22] Initial Decision in *SFPP, L.P.*, Docket No. IS05-230-000, 116 FERC ¶63,059 (2006).
[23] *Id.* at P 127.
[24] 374 F.3d 1263 at 1286, citing 26 U.S.C. ß 7704 (d)(1)(E).
[25] 116 FERC ¶ 63,059 at P 127.
[26] *Id.* at P 127. (Emphasis in original).
[27] *Id.* at P 127.

raise its rates to the maximum allowed under the indexing rules. Accordingly, SFPP's surcharges have always been in excess of the rate increases permitted by the index. Clearly, this definition includes any surcharges as well as a rate charged shippers for transportation.

36. For all these reasons the rates and surcharges that SFPP has imposed on Tesoro for shipments on the West Line and Calnev Line since May 1, 2006 are unjust, unreasonable and contrary to law.

37. In his Declaration, Mr. Ashton discusses the further reductions that must be made in the rates that SFPP established in its Compliance Filing in order to reflect the adjustments to its cost of service discussed above. Mr. Ashton's analysis indicates that SFPP is continuing to substantially overcharge Tesoro for shipments on the West Line and the Calnev Line. Mr. Ashton further states that amount by which SFPP has overcharged Tesoro from May 1, 2006, the date on which the rates established in SFPP's Compliance Filing went into effect, through November 30, 2006. Those overcharges are included in the damage calculation specified in Paragraph 43 of this Complaint.

V.

MOTION TO CONSOLIDATE

38. Under Section 13(1) of the Interstate Commerce, any "person" may file a complaint[28] and a complaint may be filed at any time.[29] Consequently, even though prior proceedings involving other shippers of SFPP's West Line and Calnev

[28] 49 App. USC § 13(1) (1988).

[29] Order No. 561, [Regs. Preambles1991-1996] FERC Stats. & Regs. (CCH) ¶ 30,985, at 30,953 (1993), *aff'd, Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996) ("Order No. 561").

Line have been on-going for a considerable period of time, Tesoro is entitled as of right to file this Complaint at this time.

39. However, in order to minimize any disruption with on-going proceedings at the Commission, Tesoro is willing to have its Complaint consolidated with those on-going proceedings, provided that the time period December 1, 2004 to November 30, 2006 is included in the consolidated proceeding. With that stipulation, Tesoro would be willing to be subject to all determinations made in the on-going proceedings involving the West Line and Calnev Line. Those proceedings are the following:

(a) *Chevron Products Company v. SFPP, L.P.*, Docket No. OR03-5-000;

(b) *America West Airlines, Inc., et al. v. SFPP, L.P.*, Docket No. OR04-3-000;

(c) *BP West Coast Products LLC and ExxonMobil Oil Corporation v. SFPP, L.P.*, Docket No. OR05-4-000; and

(d) *ConocoPhillips Company v. SFPP, L.P.*, Docket No. OR05-5-000.

VI.

Further Compliance With Procedural Regulations

40. In further support of its Complaint, Tesoro states as follows in accordance with the provisions of 18 C.F.R. § 385.206:

a. Rule 206(b)(1): Action or Inaction

41. The action or inaction that caused Tesoro to file this complaint is SFPP's charging rates that are unjust and unreasonable on its West Line and Calnev Line.

b. Rule 206(b)(2): Violations of Statute or Regulation

42. SFPP's failure to charge Tesoro just and reasonable rates violates Sections 1(5), 8, 9, 13, 15, and 16 of the Interstate Commerce Act.

c. Rule 206(b)(3): Business, Commercial or Economic Issues Which Affect The Complainant

43. Tesoro ships a substantial quantity of petroleum products on the West Line and Calnev Line at the rates established by SFPP in its interstate tariffs. The rates Tesoro has been charged for that transportation have been unjust and unreasonable and substantially above the rates that the Commission directed SFPP to establish in its December 16, 2005 Order. Accordingly, the just and reasonable rates for the SFPP West Line and Calnev Line are substantially lower than the rate that SFPP is now charging. Tesoro has a substantial business, commercial and economic interest in being charged the just and reasonable rate, as opposed to the unjust and unreasonable monopoly rates.

d. Rule 206(b)(4): Financial Impact

44. A schedule, which is confidential under Commission Rule 1112, 18 C.F.R. § 385.1112, demonstrating the impact of SFPP's unlawful rates on Tesoro is attached as Exhibit I to this Complaint.[30] On the basis of the volumes shipped and the difference between the rate SFPP calculated in its Compliance Filing and the rate that Tesoro has been charged, Tesoro was overcharged by at least $1,607,991.47 for the period December 1, 2004 to November 30, 2006. However, after making the necessary adjustments to the Compliance Filing to reach a just and reasonable rate, Tesoro has determined that it has been overcharged by at least

[30] Ex. I. Schedule Demonstrating Impact of Rates.

$2,325,372.69 for the period December 1, 2004 to November 30, 2006. Tesoro is also continuing to incur damages for overcharges.

e. Rule 206(b)(5): Non-Financial Impacts

45. The adverse impact that Tesoro alleges under this Complaint is financial as set forth above.

f. Rule 206(b)(6): Related Matters

46. Although SFPP's West Line and Calnev Line rates have been litigated or are currently being litigated in other dockets,[31] the amount of damages that Tesoro is entitled to receive for SFPP's unjust and unreasonable rates for the West Line and Calnev Line has not been addressed in any proceeding. Complaints against SFPP's West Line and Calnev Line rates are currently at issue in four current proceedings: Docket Nos. OR03-5-000, OR04-3-000, OR05-4-000, and OR05-5-000. As stated above, Tesoro does not object to this Complaint being consolidated with those dockets, provided that the more recent time periods addressed in this Complaint are considered in the consolidation proceedings.

g. Rule 206(b)(7): Relief Requested

47. Tesoro seeks reparations from the period December 12, 2004 to the date of decision on its Complaint and the prescription of new rates plus interest. Tesoro also specifically seeks the prescription of just and reasonable rates for the West Line and Calnev Line.

h. Rule 206(b)(8): Documents

48. Tesoro has attached to this Complaint documents in its possession that support its Complaint.

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[31] *See* OR92-8-000, *et al.,* OR96-2-000, *et al.,* OR03-5-000, OR04-3-000, OR05-4-000, OR05-5-000.

i. Rule 206(b)(9): Alternative Dispute Resolution

49. We understand that an effort by the Alternative Dispute Resolution branch of the Commission's staff might be undertaken in the near future. However, the issues presented in this Complaint are at present unresolved. Consequently, Tesoro requests that these matters be set for hearing and consolidated with current on-going proceedings.

VII.

REQUEST FOR RELIEF

50 WHEREFORE, Complainant Tesoro Refining and Marketing Company respectfully requests that the Federal Energy Regulatory Commission:

51. Determine that the rates established by SFPP, L.P. in the following tariffs for the shipment of refined petroleum products are so substantially in excess of SFPP's actual costs as to be unjust and unreasonable and thereby violate Sections 1(4) and 1(5) of the Interstate Commerce Act and Section 343.2(c)(1) of the Commission's regulations:

West Line Tariffs:	FERC No. 106
	FERC No. 113
	FERC No. 120
	FERC No. 126
	FERC No. 130
	FERC No. 136
	FERC No. 139
Calnev Line Tariffs:	FERC No. 108
	FERC No. 115

FERC No. 121

FERC No. 124

FERC No. 131

FERC No. 134

FERC No. 140

52. Prescribe new rates that are just and reasonable for the shipment of refined petroleum products from Watson, East Hynes, and Colton, CA to Phoenix, AZ and from Watson, CA and East Hynes, CA to the Calnev Pipe Line L.L.C. (Calnev) in Colton, CA.

53. Determine that SFPP overcharged Tesoro for shipments of refined petroleum products from Watson, East Hynes, and Colton, CA to Phoenix, AZ and from Watson, CA and East Hynes, CA to the Calnev Pipe Line L.L.C. (Calnev) in Colton, CA from at least December 12, 2004 to the present; and is continuing to overcharge Tesoro for such shipments;

54. Order SFPP to pay refunds, reparations and damages, plus interest to Tesoro for shipments made by Tesoro under each of the tariffs specified in Paragraph 16 above from December 12, 2004;

55. Determine that Section 1803 of the Energy Policy Act of 1992 does not prevent Tesoro from filing this Complaint or the Commission from ordering the relief requested above.

56. Award Tesoro its costs and attorneys fees in prosecuting this Complaint;

57.Grant Tesoro's Motion to Consolidate this Complaint with on-going Commission proceedings in the following Dockets: OR03-5-000, OR04-3-000, OR05-4-000, OR05-5-000; and

58. Grant Tesoro such other, different or additional relief as the Commission may determine to be appropriate.

Date: December 12, 2006

Respectfully submitted,

TESORO REFINING AND MARKETING COMPANY

By: ______________________

Melvin Goldstein
Matthew A. Corcoran
GOLDSTEIN & ASSOCIATES, P.C.
1757 P Street, N.W.
Washington, D.C. 20036
Tele: (202) 872-8740
Fax: (202) 872-8744
E-Mail: mgoldstein@goldstein-law.com
mcorcoran@goldstein-law.com

Attorneys for Tesoro Refining and Marketing Company

Of Counsel:

Barron Dowling
Associate General Counsel
Tesoro Refining and Marketing Company
300 Concord Plaza Drive
San Antonio, TX 78216
Tele: (210) 283-2415
Email: bdowling@tsocorp.com

CERTIFICATE OF SERVICE

Pursuant to Rule 206(c) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, 18 C.F.R. § 385.206(c), I hereby certify that on December 12, 2006, Public copies of the *Complaint of Tesoro Refining and Marketing Company Against SFPP, L.P. Motion for Consolidation with On-Going Commission Proceedings Involving SFPP, L.P.* have been served on the following parties:

Via Electronic Mail and First Class Mail

Charles F. Caldwell, Esq.
Dean H. Lefler, Esq.
Vinson & Elkins, LLP
2300 First City Tower
1001 Fannin Street
Houston, TX 77002-5760
ccaldwell@velaw.com
dlefler@velaw.com

Thomas A. Bannigan
President, Products Pipelines
Kinder Morgan Energy Partners, L.P.
500 Dallas St., Suite 1000
Houston, TX 77002
tom_bannigan@kindermorgan.com

Peter M. Dito
Director, Economics & Regulatory Analysis
Kinder Morgan Energy Partners, L.P.
1100 Town & Country Rd.
Orange, CA 92868
ditop@kindermorgan.com

Dated: December 12, 2006

Melvin Goldstein

Attorney for Tesoro Refining and Marketing Company

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Tesoro Refining and Marketing Company,
Complainant
v.
SFPP, L.P.
Respondent

Docket No.

NOTICE OF COMPLAINT

Take notice that on December 12, 2006, Tesoro Refining and Marketing Company (Tesoro) filed a formal complaint against SFPP, L.P. pursuant to Rule 206 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, 18 C.F.R. § 385.206; the Procedural Rules Applicable to Oil Pipeline Proceedings, 18 C.F.R. § 343.2; Sections 1(5), 8, 9, 13, 15, and 16 of the Interstate Commerce Act (ICA), 49 U.S.C. App. §§ 1(5), 8, 9, 13, 15 and 16 (1984); and Section 1803 of the Energy Policy Act of 1992 ("EPAct").

Complainant alleges that SFPP's West Line and Calnev Line rates are unjust and unreasonable. Complainant requests that the Commission determine that the rates established by SFPP for the shipment of refined petroleum products are so substantially in excess of SFPP's actual costs as to be unjust and unreasonable; prescribe new rates that are just and reasonable for the shipment of refined petroleum products on SFPP's West Line and Calnev Line; determine that SFPP overcharged Tesoro for shipments of refined petroleum products on SFPP's West Line and Calnev Line from at least December 12, 2004 to the present, and is continuing to overcharge Tesoro for such shipments; order SFPP to pay refunds, reparations and damages, plus interest to Tesoro for shipments made by Tesoro on the West Line and Calnev Line from December 12, 2004; determine that Section 1803 of the Energy Policy Act of 1992 does not prevent Tesoro from filing this Complaint or the Commission from ordering the relief requested above; award Tesoro its costs and attorneys fees in prosecuting this Complaint; grant Tesoro's Motion to Consolidate this Complaint with on-going Commission proceedings in Docket Nos. OR03-5-000, OR04-3-000, OR05-4-000, OR05-5-000; and grant Tesoro such other, different or additional relief as the Commission may determine to be appropriate.

Tesoro certifies that copies of the complaint were served on the contacts for SFPP as listed on the Commission's list of Corporate Officials.

Any person desiring to intervene or to protest this filing must file in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211 and 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a notice of intervention or motion to intervene, as appropriate. The Respondent's answer and all interventions, or protests must be filed on or before the comment date. The Respondent's answer, motions to intervene, and protests must be served on the Complainants.

The Commission encourages electronic submission of protests and interventions in lieu of paper using the "eFiling" link at http://www.ferc.gov. Persons unable to file electronically should submit an original and 14 copies of the protest or intervention to the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426.

This filing is accessible on-line at http://www.ferc.gov, using the "eLibrary" link and is available for review in the Commission's Public Reference Room in Washington, D.C. There is an "eSubscription" link on the web site that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email FERCOnlineSupport@ferc.gov, or call (866) 208-3676 (toll free). For TTY, call (202) 502-8659.

Comment Date: 5:00 pm Eastern Time on (insert date).

Magalie R. Salas
Secretary

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Tesoro Refining and Marketing Company, Complainants, v. SFPP, L.P., Respondent.	)	Docket No.

REQUEST FOR PRIVILEGED TREATMENT OF DOCUMENTS AND INFORMATION

Pursuant to Rule 206(e)(1) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (the Commission),[1] and 18 CFR § 388.112 of the Commission's regulations, Tesoro Refining and Marketing Company (Tesoro) respectfully requests that privileged treatment be accorded to certain information contained in a Complaint that Tesoro filed with the Commission today.

Tesoro has filed a Complaint with the Commission in which it alleges that SFPP, L.P. (SFPP) has charged unjust and unreasonable rates on its West Line and Calnev Line. In the Complaint and in sworn declarations provided by Peter K. Ashton and William M. Weimer, Tesoro provides information regarding the quantities of the refined petroleum products that Tesoro has shipped on SFPP's West Line and Calnev Line. This information

[1] 18 CFR § 385.206(e)(1).

is protected and privileged under Section 15(13) of the Interstate Commerce Act. The information is not customarily revealed to members of the public and its disclosure could have a detrimental effect on Tesoro's competitive position. Data regarding the quantity of petroleum products shipped for its account is the only information that has been deleted from the public version of the Tesoro Complaint.

Accordingly, Tesoro respectfully requests that the Commission accord privileged treatment to this shipment information in the Tesoro Complaint.

We wish to inform the Commission that the person to be contacted with respect to this request for the privileged treatment of documents is:

Melvin Goldstein
Goldstein & Associates, P.C.
1757 P Street N.W.
Washington, D.C. 20036
Tele: (202) 872-8740
Fax: (202) 872-8744
Email: mgoldstein@goldstein-law.com

Dated: December 12, 2006

Respectfully submitted,

Melvin Goldstein
Matthew A. Corcoran
GOLDSTEIN & ASSOCIATES, P.C.
1757 P Street, N.W.
Washington, D.C. 20036
Tel: (202) 872-8740
Fax: (202) 872-8744
Email: mgoldstein@goldstein-law.com
mcorcoran@goldstein-law.com

Attorneys for Tesoro Refining and Marketing Company

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

SFPP, L.P. § Docket No.

PROTECTIVE ORDER

(Issued)

1. This Protective Order shall govern the use of all Protected Materials produced by, or on behalf of, any Participant. Notwithstanding any order terminating this proceeding, this Protective Order shall remain in effect until specifically modified or terminated by the Presiding Administrative Law Judge ("Presiding Judge") or the Federal Energy Regulatory Commission ("Commission").

2. This Protective Order applies to the following two categories of materials: (A) A Participant may designate as protected those materials which customarily are treated by that Participant as sensitive or proprietary, which are not available to the public, and which, if disclosed freely, would subject that Participant or its customers to risk of competitive disadvantage or other business injury; and (B) A Participant shall designate as protected those materials which contain critical energy infrastructure information, as defined in 18 CFR § 388.113(c)(1) ("Critical Energy Infrastructure Information").

3. Definitions -- For purposes of this Order:

(a) The term "Participant" shall mean a Participant as defined in 18 CFR § 385.102(b).

(b) (1) The term "Protected Materials" means (A) materials (including depositions) provided by a Participant in response to discovery requests and designated by such Participant as protected; (B) any information contained in or obtained from such designated materials; (C) any other materials which are made subject to this Protective Order by the Presiding Judge, by the Commission, by any court or other body having appropriate authority, or by agreement of the Participants; (D) notes of Protected Materials; and (E) copies of Protected Materials. The Participant producing the Protected Materials shall physically mark them on each page as "PROTECTED MATERIALS" or with words of similar import as long as the term "Protected Materials" is included in that designation to indicate that they are Protected Materials. If the Protected Materials contain Critical Energy Infrastructure Information, the Participant producing such information shall additionally mark on each page containing such information the words "Contains Critical Energy Infrastructure Information B Do Not Release".

(2) The term "Notes of Protected Materials" means memoranda, handwritten notes, or any other form of information (including electronic form) which copies or discloses materials described in Paragraph 3(b)(1). Notes of Protected Materials are subject to the same restrictions provided in this order for Protected Materials except as specifically provided in this order.

(3) Protected Materials shall not include (A) any information or document contained in the files of the Commission, or any other federal or state agency, or any federal or state court, unless the information or document has been determined to be protected by such agency or court,

or (B) information that is public knowledge, or which becomes public knowledge, other than through disclosure in violation of this Protective Order, or (C) any information or document labeled as "Non-Internet Public" by a Participant, in accordance with Paragraph 30 of FERC Order No. 630, FERC Stat. & Reg. & 31,140. Protected Materials do include any information or document contained in the files of the Commission that has been designated as Critical Energy Infrastructure Information.

(c) The term "Non-Disclosure Certificate" shall mean the certificate annexed hereto by which Participants who have been granted access to Protected Materials shall certify their understanding that such access to Protected Materials is provided pursuant to the terms and restrictions of this Protective Order, and that such Participants have read the Protective Order and agree to be bound by it. All Non-Disclosure Certificates shall be served on all parties on the official service list maintained by the Secretary in this proceeding.

(d) The term "Reviewing Representative" shall mean a person who has signed a Non-Disclosure Certificate and who is:

(1) Commission Litigation Staff;

(2) an attorney who has made an appearance in this proceeding for a Participant;

(3) attorneys, paralegals, and other employees associated for purposes of this case with an attorney described in Paragraph (2);

(4) an expert or an employee of an expert retained by a Participant for the purpose of advising, preparing for or testifying in this proceeding;

(5) a person designated as a Reviewing Representative by order of the Presiding Judge or the Commission; or

(6) employees or other representatives of Participants appearing in this proceeding with significant responsibility for this docket.

4. Protected Materials shall be made available under the terms of this Protective Order only to Participants and only through their Reviewing Representatives as provided in Paragraphs 7-9.

5. Protected Materials shall remain available to Participants until the later of the date that an order terminating this proceeding becomes no longer subject to judicial review, or the date that any other Commission proceeding relating to the Protected Material is concluded and no longer subject to judicial review. If requested to do so in writing after that date, the Participants shall, within fifteen days of such request, return the Protected Materials (excluding Notes of Protected Materials) to the Participant that produced them, or shall destroy the materials, except that copies of filings, official transcripts and exhibits in this proceeding that contain Protected Materials, and Notes of Protected Material may be retained, if they are maintained in accordance with Paragraph 6, below. Within such time period each Participant, if requested to do so, shall also submit to the producing Participant an affidavit stating that, to the best of its knowledge, all Protected Materials and all Notes of Protected Materials have been returned or have been

destroyed or will be maintained in accordance with Paragraph 6. To the extent Protected Materials are not returned or destroyed, they shall remain subject to the Protective Order.

6. All Protected Materials shall be maintained by the Participant in a secure place. Access to those materials shall be limited to those Reviewing Representatives specifically authorized pursuant to Paragraphs 8-9. The Secretary shall place any Protected Materials filed with the Commission in a non-public file. By placing such documents in a nonpublic file, the Commission is not making a determination of any claim of privilege. The Commission retains the right to make determinations regarding any claim of privilege and the discretion to release information necessary to carry out its jurisdictional responsibilities. For documents submitted to Commission Litigation Staff ("Staff"), Staff shall follow the notification procedures of 18 CFR § 388.112 before making public any Protected Materials.

7. Protected Materials shall be treated as confidential by each Participant and by the Reviewing Representative in accordance with the certificate executed pursuant to Paragraph 9. Protected Materials shall not be used except as necessary for the conduct of this proceeding, nor shall they be disclosed in any manner to any person except a Reviewing Representative who is engaged in the conduct of this proceeding and who needs to know the information in order to carry out that person's responsibilities in this proceeding. Reviewing Representatives may make copies of Protected Materials, but such copies become Protected Materials. Reviewing Representatives may make notes of Protected Materials, which shall be treated as Notes of Protected Materials if they disclose the contents of Protected Materials.

8. (a) If a Reviewing Representative's scope of employment includes the marketing of energy, the direct supervision of any employee or employees whose duties include the marketing of energy, the provision of consulting services to any person whose duties include the marketing of energy, or the direct supervision of any employee or employees whose duties include the marketing of energy, such Reviewing Representative may not use information contained in any Protected Materials obtained through this proceeding to give any Participant or any competitor of any Participant a commercial advantage.

(b) In the event that a Participant wishes to designate as a Reviewing Representative a person not described in Paragraph 3(d) above, the Participant shall seek agreement from the Participant providing the Protected Materials. If an agreement is reached that person shall be a Reviewing Representative pursuant to Paragraphs 3(d) above with respect to those materials. If no agreement is reached, the Participant shall submit the disputed designation to the Presiding Judge for resolution.

9. (a) A Reviewing Representative shall not be permitted to inspect, participate in discussions regarding, or otherwise be permitted access to Protected Materials pursuant to this Protective Order unless that Reviewing Representative has first executed a Non-Disclosure Certificate provided that if an attorney qualified as a Reviewing Representative has executed such a certificate, the paralegals, secretarial and clerical personnel under the attorneys instruction, supervision or control need not do so. A copy of each Non-Disclosure Certificate shall be provided to counsel for the Participant asserting confidentiality prior to disclosure of any Protected Material to that Reviewing Representative.

(b) Attorneys qualified as Reviewing Representatives are responsible for ensuring that persons under their supervision or control comply with this order.

10. Any Reviewing Representative may disclose Protected Materials to any other Reviewing Representative as long as the disclosing Reviewing Representative and the receiving Reviewing Representative both have executed a Non-Disclosure Certificate. In the event that any Reviewing Representative to whom the Protected Materials are disclosed ceases to be engaged in these proceedings, or is employed or retained for a position whose occupant is not qualified to be a Reviewing Representative under Paragraph 3(d), access to Protected Materials by that person shall be terminated. Even if no longer engaged in this proceeding, every person who has executed a Non-Disclosure Certificate shall continue to be bound by the provisions of this Protective Order and the certification.

11. Subject to Paragraph 17, the Presiding Administrative Law Judge shall resolve any disputes arising under this Protective Order. Prior to presenting any dispute under this Protective Order to the Presiding Administrative Law Judge, the parties to the dispute shall use their best efforts to resolve it. Any participant that contests the designation of materials as protected shall notify the party that provided the protected materials by specifying in writing the materials whose designation is contested. This Protective Order shall automatically cease to apply to such materials five (5) business days after the notification is made unless the designator, within said 5-day period, files a motion with the Presiding Administrative Law Judge, with supporting affidavits, demonstrating that the materials should continue to be protected. In any challenge to the designation of materials as protected, the burden of proof shall be on the participant seeking protection. If the Presiding Administrative Law Judge finds that the materials at issue are not entitled to protection, the procedures of Paragraph 17 shall apply. The procedures described above shall not apply to protected materials designated by a Participant as Critical Energy Infrastructure Information. Materials so designated shall remain protected and subject to the provisions of this Protective Order, unless a Participant requests and obtains a determination from the Commission's Critical Energy Infrastructure Information Coordinator that such materials need not remain protected.

12. All copies of all documents reflecting Protected Materials, including the portion of the hearing testimony, exhibits, transcripts, briefs and other documents which refer to Protected Materials, shall be filed and served in sealed envelopes or other appropriate containers endorsed to the effect that they are sealed pursuant to this Protective Order. Such documents shall be marked "PROTECTED MATERIALS" and shall be filed under seal and served under seal upon the Presiding Judge and all Reviewing Representatives who are on the service list. Such documents containing Critical Energy Infrastructure Information shall be additionally marked "Contains Critical Energy Infrastructure Information -- Do Not Release". For anything filed under seal, redacted versions or, where an entire document is protected, a letter indicating such, will also be filed with the Commission and served on all parties on the service list and the Presiding Judge. Counsel for the producing Participant shall provide to all Participants who request the same, a list of Reviewing Representatives who are entitled to receive such material. Counsel shall take all reasonable precautions necessary to assure that Protected Materials are not distributed to unauthorized persons.

If any Participant desires to include, utilize or refer to any Protected Materials or information derived therefrom in testimony or exhibits during the hearing in these proceedings in such a manner that might require disclosure of such material to persons other than reviewing representatives, such participant shall first notify both counsel for the disclosing participant and the Presiding Judge of such desire, identifying with particularity each of the Protected Materials. Thereafter, use of such Protected Material will be governed by procedures determined by the Presiding Judge.

13. Nothing in this Protective Order shall be construed as precluding any Participant from objecting to the use of Protected Materials on any legal grounds.

14. Nothing in this Protective Order shall preclude any Participant from requesting the Presiding Judge, the Commission, or any other body having appropriate authority, to find that this Protective Order should not apply to all or any materials previously designated as Protected Materials pursuant to this Protective Order. The Presiding Judge may alter or amend this Protective Order as circumstances warrant at any time during the course of this proceeding.

15. Each party governed by this Protective Order has the right to seek changes in it as appropriate from the Presiding Judge or the Commission.

16. All Protected Materials filed with the Commission, the Presiding Judge, or any other judicial or administrative body, in support of, or as a part of, a motion, other pleading, brief, or other document, shall be filed and served in sealed envelopes or other appropriate containers bearing prominent markings indicating that the contents include Protected Materials subject to this Protective Order. Such documents containing Critical Energy Infrastructure Information shall be additionally marked "Contains Critical Energy Infrastructure Information – Do Not Release."

17. If the Presiding Judge finds at any time in the course of this proceeding that all or part of the Protected Materials need not be protected, those materials shall, nevertheless, be subject to the protection afforded by this Protective Order for three (3) business days from the date of issuance of the Presiding Judge's decision, and if the Participant seeking protection files an interlocutory appeal or requests that the issue be certified to the Commission, for an additional seven (7) business days. None of the Participants waives its rights to seek additional administrative or judicial remedies after the Presiding Judge's decision respecting Protected Materials or Reviewing Representatives, or the Commission's denial of any appeal thereof. The provisions of 18 CFR " 388.112 and 388.113 shall apply to any requests for Protected Materials in the files of the Commission under the Freedom of Information Act. (5 U.S.C. § 552).

18. Nothing in this Protective Order shall be deemed to preclude any Participant from independently seeking through discovery in any other administrative or judicial proceeding information or materials produced in this proceeding under this Protective Order.

19. None of the Participants waives the right to pursue any other legal or equitable remedies that may be available in the event of actual or anticipated disclosure of Protected Materials.

20. The contents of Protected Materials or any other form of information that copies or discloses Protected Materials shall not be disclosed to anyone other than in accordance with this

Protective Order and shall be used only in connection with this (these) proceeding(s). Any violation of this Protective Order and of any Non-Disclosure Certificate executed hereunder shall constitute a violation of an order of the Commission.

21. The addenda reflected in Attachment A are hereby incorporated by reference. In the event of conflict, the language of the addenda shall control.

It is so ordered.

____

Presiding Administrative Law Judge

ATTACHMENT A

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

SFPP, L.P. § Docket No.

NON-DISCLOSURE CERTIFICATE

I hereby certify my understanding that access to Protected Materials is provided to me pursuant to the terms and restrictions of the Protective Order in this proceeding, that I have been given a copy of and have read the Protective Order, and that I agree to be bound by it. I understand that the contents of the Protected Materials, any notes or other memoranda, or any other form of information that copies or discloses Protected Materials shall not be disclosed to anyone other than in accordance with that Protective Order. I acknowledge that a violation of this certificate constitutes a violation of an order of the Federal Energy Regulatory Commission.

By: ___________________________

Title: _________________________

Representing: ___________________

Date: __________________________

SWORN DECLARATION OF WILLIAM M. WEIMER IN SUPPORT OF COMPLAINT OF TESORO REFINING AND MARKETING COMPANY AGAINST SFPP, L.P. AND MOTION FOR CONSOLIDATION WITH ON-GOING COMMISSION PROCEEDINGS INVOLVING SFPP, L.P.

Pursuant to 18 U.S.C. § 1746, William M. Weimer states as follows:

1. My name is William M. Weimer. My business address is 300 Concord Plaza Drive, San Antonio, TX 78216. I am presently employed as Director of Supply Logistics for Tesoro Refining and Marketing Company (Tesoro). Based upon my personal knowledge obtained in that capacity, I state the following.

2. Tesoro owns and operates several refineries in the Western United States. Since it does not control all the pipelines that are necessary to transport crude oil to its refineries or all the pipelines that transport petroleum products from those refineries to its customers, Tesoro relies on common carrier pipelines. Two of the common carrier pipelines that Tesoro uses are the SFPP, L.P.'s (SFPP) West Line, which originates at points in California and terminates in Phoenix, AZ, among other destinations; and SFPP's pipeline originating at Watson and East Hynes, CA and connecting to Calnev Pipe Line, L.L.C (Calnev Line).

3. Tesoro has shipped and continues to ship significant quantities of petroleum products in interstate commerce through both SFPP's West Line System and the Calnev Line. Tesoro is also currently shipping petroleum products on SFPP's West Line System and the Calnev Line and intends to continue to do so in the future.

4. Tesoro therefore has a substantial economic interest in the rates SFPP has charged and continues to charge on the West Line System and the Calnev Line.

5. Between December 1, 2004 and November 30, 2006, Tesoro has shipped the following quantities of petroleum products on the SFPP West Line System and Calnev Line:

[PRIVILEGED AND CONFIDENTIAL INFORMATION REMOVED]

[PRIVILEGED AND CONFIDENTIAL INFORMATION REMOVED]

6. We are continuing to review the records of Tesoro's shipments on the SFPP West Line and Calnev Line. I will supplement this Declaration in the event we determine that Tesoro has shipped additional quantities of petroleum products on these pipelines during the past two years.

I, William M. Weimer, hereby state under penalty of perjury that the foregoing is true and correct to the best of my information and belief. Executed on December 11TH, 2006.

William M. Weimer

LEXSEE 374 F3D 1263

BP WEST COAST PRODUCTS, LLC, PETITIONER v. FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA, RESPONDENTS, SFPP, L.P., ET AL., INTERVENORS

No. 99-1020 Consolidated with 99-1051, 00-1221, 00-1240, 00-1256, 01-1413, 01-1453, 01-1469, 01-1475, 02-1008, 02-1011, 02-1321

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

362 U.S. App. D.C. 438; 374 F.3d 1263; 2004 U.S. App. LEXIS 14930; 160 Oil & Gas Rep. 703

November 12, 2003, Argued
July 20, 2004, Decided

SUBSEQUENT HISTORY: Rehearing, en banc, denied by *Bp W. Coast Prods. L.L.C. v. FERC, 2004 U.S. App. LEXIS 20796 (D.C. Cir., Oct. 4, 2004)*
Rehearing denied by *Bp W. Coast Prods. L.L.C. v. FERC, 2004 U.S. App. LEXIS 20797 (D.C. Cir., Oct. 4, 2004)*
Rehearing denied by *Bp W. Coast Prods. L.L.C. v. FERC, 2004 U.S. App. LEXIS 20798 (D.C. Cir., Oct. 4, 2004)*
US Supreme Court certiorari denied by *BP W. Coast Prods. L.L.C. v. FERC, 2005 U.S. LEXIS 4126 (U.S., May 16, 2005)*
US Supreme Court certiorari denied by *SFPP, L.P. v. FERC, 2005 U.S. LEXIS 4127 (U.S., May 16, 2005)*

PRIOR HISTORY: [**1] On Petitions for Review of Orders of the Federal Energy Regulatory Commission.
Mobile Oil Corp. v. Sfpp, L.P., 86 F.E.R.C. P61022, 1999 FERC LEXIS 94 (F.E.R.C., 1999)
Mobil Oil Corp. v. Sfpp, L.P., 91 F.E.R.C. P61135, 2000 FERC LEXIS 994 (F.E.R.C., 2000)
Mobil Oil Corp. v. Sfpp, L.P., 96 F.E.R.C. P61281, 2001 FERC LEXIS 2380 (F.E.R.C., 2001)
Mobil Oil Corp. v. Sfpp, L.P., 97 F.E.R.C. P61138, 2001 FERC LEXIS 2686 (F.E.R.C., 2001)

DISPOSITION: Affirmed in part, vacated in part, and remanded.

COUNSEL: R. Gordon Gooch argued the cause for West Line Shippers. With him on the briefs were Elisabeth R. Myers, D. Jane Drennan, George L. Weber, Marcus W. Sisk, Jr., Steven A. Adducci, and Richard E. Powers, Jr.

Steven H. Brose argued the cause for petitioner SFPP, L.P. With him on the briefs were Timothy M. Walsh, Daniel J. Poynor, Alice E. Loughran, Albert S. Tabor, Jr., and Charles F. Caldwell.

Thomas J. Eastment argued the cause for East Line Shippers on Cost Allocation Issues. With him on the briefs were Joshua B. Frank, Michael J. Manning, and Glenn S. Benson.

Thomas J. Eastment, Joshua B. Frank, Michael J. Manning, George L. Weber, R. Gordon Gooch, Elisabeth R. Myers, Richard E. Powers, Jr., Steven A. Adducci, and Marcus W. Sisk, Jr. were on the brief for petitioners and intervenors supporting petitioners on Rate and Reparations Issues.

Dennis Lane, Solicitor, Federal Energy Regulatory Commission, and Lona T. Perry, Attorney, argued the causes for respondents. With them on the brief were Robert H. Pate III, Assistant Attorney General, U.S. Department of Justice, John J. Powers, III [**2] and Robert J. Wiggers, Attorneys, Cynthia A. Marlette, General Counsel, Federal Energy Regulatory Commission. Jay L. Witkin, Solicitor, and Susan J. Court, Special Counsel, entered appearances.

Thomas J. Eastment, Joshua B. Frank, Michael J. Manning, George L. Weber, R. Gordon Gooch, Elisabeth R. Myers, Richard E. Powers, Jr., Steven A. Adducci, and Marcus W. Sisk, Jr. were on the brief of Shipper intervenors in support of respondents.

Steven H. Brose, Timothy M. Walsh, Daniel J. Poynor, Alice E. Loughran, Albert S. Tabor, Jr. and Charles F. Caldwell were on the brief of SFPP, L.P. as intervenor in support of respondents.

JUDGES: Before: SENTELLE, ROGERS, and ROBERTS, Circuit Judges.

OPINION:

[*1270] Opinion for the Court filed PER CURIAM.

INTRODUCTION

The consolidated petitions before us seek review of four opinions of the Federal Energy Regulatory Commission ("FERC" or "the Commission"):

1. *SFPP, L.P.*, Opinion No. 435, *86 FERC P 61,022* (1999) ("Opinion No. 435");

2. *SFPP, L.P.*, Opinion No. 435-A, *91 FERC P 61,135* (2000) ("Opinion No. 435-A");

3. *SFPP, L.P.*, Opinion No. 435-B, *96 FERC P 61,281* (2000) ("Opinion No. 435-B"); and [**3]

4. *SFPP, L.P.*, *97 FERC P 61,138* (2001) ("Clarification and Rehearing Order").

In these opinions FERC considered the tariffs of SFPP, L.P., and complaints and other filings by shipper customers of SFPP. SFPP, L.P., both a petitioner and an intervenor-respondent in the consolidated dockets, operates pipelines that transport petroleum products in Texas, New Mexico, Arizona, California, Nevada, and Oregon. SFPP's operation includes a West Line and an East Line. The West Line consists of pipelines extending from Watson Station in Los Angeles, California, into Arizona to Phoenix and Tucson, and connects at Colton, California, with another pipeline system extending to Las Vegas. SFPP's East Line consists of pipelines from El Paso, Texas to Tucson and Phoenix. The orders under review consider, set, and otherwise govern rates on both lines. We consider three separate sets of petitions: the petition of SFPP, L.P.; the petition of the West Line Shippers ("WLS"); and the petition of the East Line Shippers ("ELS"). Petitioners and Intervenors include the following: BP West Coast Products LLC ("BP WCP"; formerly ARCO Products Company); Chevron Products Company ("Chevron"; [**4] including the former Texaco Refining and Marketing, Inc.); ConocoPhillips Company ("ConocoPhillips"); ExxonMobil Oil Corporation ("ExxonMobil"; formerly Mobil Oil Corporation); Navajo Refining Company, L.P. ("Navajo"); Western Refining Company, L.P. ("Western"); Ultramar Inc. ("Ultramar"); Valero Energy Corporation ("VEC"); Valero Marketing and Supply Company ("Valero"); and SFPP, L.P. ("SFPP").

[*1271] The administrative proceedings before FERC began with tariff filings by SFPP for both East and West Lines. The lengthy, complex, and convoluted proceedings that followed included complaints and/or protests filed by shippers on the two lines, as well as investigation into SFPP's tariff filings by FERC's Oil Pipeline Board. The issues are further complicated by novelty in that this is the first oil pipeline case in which the "changed circumstances" standard of the Energy Policy Act of 1992 ("EPAct") has arisen for litigation. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified as *42 U.S.C. ß ß 13201-556 (2003)*). While we will not detail the administrative proceedings before FERC's administrative law judge and the full Commission as we discuss them at [**5] length in the analyses that follow, we note that issues presented for review include, among other things, the important question of application of the grandfathering principle under the new EPAct, the allocation of litigation costs between the East and West Lines, tax pass-through problems involving non-taxed subsidiaries of taxable entities, the payment of reparations after a finding of unjust or unreasonable rates, and the correct determination of capital structure to determine a starting rate base. The reader is duly warned.

For reasons set forth more fully below, we are able to affirm many of FERC's answers to specific issues, but because we find error in several fundamental areas, we order the decisions under review vacated and remand the matter for further proceedings consistent with this opinion.

I. The West Line

A. *Grandfathering of Rates under the EPAct*

Section 1803 of the EPAct limits the ability of shippers to challenge pipeline rates in effect at the time of the enactment of the EPAct. Section 1803 provides that any oil pipeline rate that was "in effect" for a full year before the EPAct's enactment on October 24, 1992, and was not subject to "protest, [**6] investigation, or complaint" during that 365-day period, is "deemed to be just and reasonable." EPAct ß 1803(a)(1). These "grandfathered" rates are categorically immune from challenge in a complaint proceeding under Section 13 of the Interstate Commerce Act ("ICA"), *49 U.S.C. app. ß 13(1) (1988)* (repealed), n1 except when:

> (1) evidence is presented to the Commission which establishes that a substantial

> change has occurred after the date of the enactment of this Act-
>
> (A) in the economic circumstances of the oil pipeline which were a basis for the rate; or
>
> (B) in the nature of the services provided which were a basis for the rate; or
>
> (2) the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of this Act...

[*1272] *Id.* ß 1803(b). In the post-EPAct world, the analysis of a pipeline rate challenge thus proceeds in two steps: first, FERC determines whether the rate in question is grandfathered; if it is, FERC then asks whether the rate falls within either of the exceptions outlined in Section 1803(b). The Commission may not alter a grandfathered [**7] rate that does not fall within an exception.

n1 Although the ICA was repealed in 1978, *see* Pub. L. No. 95-473 ß 4(b), (c), 92 Stat. 1466, 1470 (Oct. 17, 1978), FERC has "the duties and powers related to the establishment of a rate or charge for the transportation of oil by pipeline or the valuation of that pipeline that were vested on October 1, 1977, in the Interstate Commerce Commission." *49 U.S.C. ß 60502 (2003).* The relevant version of the ICA was, but is no longer, reprinted in the appendix to title 49 of the United States Code. Therefore, when we refer to FERC's authority under the ICA, we cite to the 1988 edition of the U.S. Code, the last such edition that reprinted the ICA as it appeared in 1977.

B. *Grandfathering of West Line Rates*

The WLS contend that none of the West Line rates are grandfathered, and further argue that even if the rates are grandfathered, their challenges fall within the exceptions set out in Section 1803(b). We examine each of these contentions [**8] in turn.

1. *Rate "In Effect" for One Year*

To be eligible for grandfathering, a pipeline rate must have been "in effect for the 365-day period ending on the date of the enactment of this Act [October 24, 1992]." EPAct ß 1803(a)(1). Thus, to be grandfathered, a rate must have been "in effect" on October 25, 1991, and have remained in effect at least until the enactment of the EPAct.

The WLS do not contest this element with regard to the bulk of the West Line rates. Nor could they; the West Line rates became effective in 1989 pursuant to a settlement terminating a 1985 rate proceeding. *See* Opinion No. 435, *86 FERC at 61,057*; *Southern Pac. Pipe Lines, Inc., 45 FERC P 61,242* (1988) (order approving settlement). The WLS do, however, challenge the eligibility for grandfathering of certain improvements to the West Line made after October 1991.

a. *East Hynes Origination Point*

In July 1992, SFPP made revisions to its Tariffs Nos. 15, 16, and 17 to add a new origination point on its West Line -- the East Hynes station in Los Angeles County, California -- and to add a rate for shipping services from that new origination point to Arizona. The [**9] rate came into effect in October 1992. The rate, however, was not new; it was the same as the rates from SFPP's two other source points in the Los Angeles area. Examining this situation, the Commission concluded that the rates from the East Hynes station qualified for grandfathering because the July 1992 "filing did not involve a change to a rate or service SFPP was providing at the time the EPAct was enacted." Opinion No. 435, *86 FERC at 61,063*. SFPP's revision to its tariffs "only added another tap within an existing rate cluster... No rate ... was changed, and there was no change in the products transported or the services provided." *Id.*

The question essentially boils down to the Commission's interpretation of the term "rate" in Section 1803. As this is the first case to be litigated under the new standards of the EPAct, we must consider the level of deference -- if any -- to which FERC's interpretations of the EPAct are entitled. It is true, as some petitioners have noted, that the EPAct does not expressly confer rulemaking authority on the Commission. Section 1803 of the EPAct does, though, clearly contemplate that the Commission will enforce the terms and conditions [**10] of the statute through formal adjudications. *See* EPAct ß 1803(b) (referencing "proceeding instituted as a result of a complaint"). When Congress authorizes an agency to adjudicate complaints arising under a statute, the agency's interpretations of that statute announced in the adjudications are generally entitled to *Chevron* deference. *See United States v. Mead Corp., 533 U.S. 218, 229, 150 L. Ed. 2d 292, 121 S. Ct. 2164 (2001)* ("[A] very good indicator of delegation meriting *Chevron* treatment [is] express congressional [*1273] authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed."); *see also Trans Union Corp. v. FTC,* *317 U.S. App. D.C. 133, 81 F.3d 228, 230 (D.C. Cir. 1996)* ("We have expressly held that *Chevron* deference extends to interpretations reached in adjudications as much as to ones reached in a rulemaking." (citing *Midtec Paper Corp. v. United States, 273 U.S. App. D.C. 49, 857 F.2d 1487, 1497 (D.C. Cir. 1988))*). We see no reason to accord any less deference to FERC's interpretations of the EPAct.

Under the familiar *Chevron* two-part inquiry, we first ask whether [**11] Congress has directly spoken to "the precise question at issue." *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984).* If it has, that is the end of the inquiry; we "must give effect to the unambiguously expressed intent of Congress." *Id. at 843.* If Congress has not spoken so precisely, though, we reach the second step, and will defer to any reasonable interpretation of the statute by the agency. *Id.* Not surprisingly, Congress did not have occasion to confront the specific question of whether the addition of a new source point on an existing rate cluster would constitute a new rate. We thus proceed to the second step of *Chevron*, and inquire whether the Commission's construction is a reasonable one. It is. It is certainly permissible to conclude that the addition of a tap to an existing rate structure, completed without any change in the existing shipping rates, does not constitute a new rate. To employ an analogy that we find helpful, in adding the East Hynes station to its West Line, SFPP merely added an on-ramp to its existing expressway. We think that the Commission's conclusion reflects a permissible [**12] interpretation of the statute and thus affirm its holding that the rate for shipping from East Hynes is eligible for grandfathering.

b. *Watson Station Enhancement Facility*

Watson is the primary origin point for West Line shipments to Phoenix and Tucson. In 1989, SFPP notified its shippers that, starting in 1991, the minimum pumping rate and pressure from Watson Station would increase. SFPP gave its shippers the option of providing their own pressurization facilities by a date certain, or using, for a surcharge, a facility built by SFPP. By late 1991, most of SFPP's shippers had contracted to use SFPP's new enhancement facility, and on November 1, 1991, SFPP initiated the enhancement services. *See* Opinion No. 435, *86 FERC at 61,074*; *In re SFPP, L.P., 80 FERC P 63,014*, 65,156 & n.405 (1997) ("ALJ Decision"). SFPP, though, never filed those contracts with the Commission, because it believed its enhancement services were beyond the reach of FERC's jurisdiction. *See* Opinion No. 435, *86 FERC at 61,074*. The Commission, however, concluded otherwise and ordered SFPP "to file a rate equal to the historic charge in the shipper contracts. [**13] " *Id. at 61,076.*

Despite FERC's concession that "Section 1803 only addresses rates that were on file with the Commission," Opinion No. 435-A, *91 FERC at 61,502*, and its acknowledgment that the enhancement rates had never before been filed, FERC nevertheless concluded that, because "the charges for the Watson Station facilities are part of enforceable contracts," the rates were "the equivalent of a lawful, effective rate." Opinion No. 435, *86 FERC at 61,076*. The Commission reasoned that because all the Watson enhancement rate contract charges "were in effect before October 24, 1992," the shippers [*1274] challenging those charges had to establish "substantially changed circumstances." *Id. at 61,075, 61,076.* The fact that no statute permitted a shipper to challenge an unfiled rate before the Commission did not matter. For "if [the rates] had been filed ..., it is clear that they would have been grandfathered because there was no challenge to them during the 12 months proceeding [sic] the enactment of the Act." Opinion No. 435-A, *91 FERC at 61,502*.

We find the Commission's reasoning on this point to be fundamentally [**14] flawed, and vacate this portion of its order. First, if FERC is indeed correct in its interpretation that Section 1803 applies only to filed rates, the Commission may not grandfather unfiled rates on the assumption that if the rates had been filed, no challenge would have been brought. The Commission may not regulate rates as if they existed in a world that never was. It must take the rates as it finds them, and here, FERC found them unfiled. If FERC interprets Section 1803 to apply only to filed rates, then it may not extend the benefits of that provision to unfiled rates based on speculation about what would have happened had they in fact been filed. Invoking the so-called "filed rate" doctrine -- which "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority," *Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577, 69 L. Ed. 2d 856, 101 S. Ct. 2925 (1981)* -- the WLS argue that the pipeline's failure to file a Watson enhancement rate tariff with the Commission precludes the Commission's treatment of the unfiled rate as grandfathered. Our disposition of this issue -- which is based on the Commission's [**15] flawed reasoning, and not a flawed conclusion -- does not require us to decide definitively whether Section 1803 of the EPAct applies only to filed rates.

Second, Opinion No. 435 suggests that any rate agreed upon before the EPAct's enactment on October 24, 1992 could be grandfathered. *See* Opinion No. 435, *86 FERC at 61,075* ("The clear purpose of the EPAct's grandfathering provisions is to insulate pipelines from challenges to ... rates ... if those charges were in effect before October 24, 1992."). Section 1803, though, allows grandfathering of only those rates that were in effect (and unchallenged) for at least 365 days prior to the date of enactment of EPAct. EPAct ß 1803(a). Even if we assume as a general proposition that Section 1803 applies to unfiled rates, other statements sprinkled throughout Opinion No. 435 suggesting that some of the rates were contracted for after the 365-day window had closed would remain problematic. *See* Opinion No. 435, *86 FERC at 61,075* ("the contracts were entered into voluntarily by the parties, mostly before the end of 1991"); *id.* ("all the relevant contracts were required to be, and had been, executed well [**16] before June 1, 1992"). If the Commission allows Section 1803 to apply to unfiled rates, those rates, to be grandfathered, must be in effect for at least 365 days prior to the EPAct's enactment. The reasoning of Opinion No. 435 gives us no comfort that this was the case. Without such an assurance, we cannot affirm the Commission's conclusion that the Watson enhancement rate is subject to grandfathering.

c. *Turbine Fuel Service*

In December 1992, SFPP filed its Tariff No. 18, proposing the transportation on its West Line of a new product, turbine fuel (also known as jet fuel). The rate for the new turbine fuel service was equal to other grandfathered rates in Tariff No. 18 [*1275] that had been in effect since 1989. The shippers argue that because the turbine fuel rate was not initiated until 1992 -- long after the grandfathering window had closed (indeed, after the EPAct had been enacted) -- the rate cannot be grandfathered. The Commission does not contest this; it recognized that the turbine fuel service was new, and therefore could not be grandfathered. *Id. at 61,063*. It nevertheless foreclosed further challenge to the turbine fuel rate, concluding, as a *substantive* [**17] matter, that the turbine fuel rate was just and reasonable. *Id. at 61,078*. The Commission reasoned that because the turbine fuel rate was equal to other Tariff No. 18 rates that had been deemed just and reasonable, "there is no basis for providing a different rate level for turbine fuel at this time." *Id.*

That analysis falls far short of the mark. The fact that the Tariff No. 18 rates were *deemed* just and reasonable does not mean that the rates actually *are* just and reasonable. Perhaps if the Commission had undertaken a substantive review of the reasonableness of the West Line rates listed in Tariff No. 18, then its conclusion that the turbine fuel rate is reasonable -- because it is equal to those rates -- might be supportable. But here, the West Line rates had been "deemed just and reasonable" by operation of law -- solely because they had persisted without challenge for one year prior to the enactment of the EPAct. The turbine fuel rate, not itself eligible for grandfathering, cannot simply piggyback on the grandfathered status of other rates. The Commission's contrary conclusion reflects a fundamental misapprehension of the nature and purpose of the [**18] grandfathering provisions of the EPAct. The requirements for grandfathering -- the rate must be in effect and not subject to challenge for the year prior to the EPAct's enactment -- are not proxies for actual reasonableness. Those requirements instead operate principally as a means to constrain litigation over pre-EPAct pipeline rates. The fact that the turbine fuel rate is equal to other Tariff No. 18 rates thus says nothing about that turbine fuel rate's substantive reasonableness. The Commission's declaration that, as a *substantive* matter, the turbine fuel rate was just and reasonable -- a conclusion reached without the benefit of any substantive review of the underlying cost of service and rate of return -- was an arbitrary and capricious exercise of the Commission's authority and cannot stand.

2. *Complaints, Protests, or Investigations*

While the WLS concede that most of the West Line rates were in effect for the required year prior to the EPAct's enactment, they contend that no West Line rate is eligible for grandfathering because each of them was "subject to protest, investigation, or complaint" during that same one-year window. In support of their argument, the [**19] WLS point principally to protests filed by shippers El Paso Refinery, L.P. ("EPR") and Chevron, and an investigation opened by the Oil Pipeline Board ("OPB") pursuant to those protests. In October 1993, the Commission rejected these arguments, holding that the West Line rates were "presumed just and reasonable" and, therefore, a successful challenge had to "prove the existence of the extraordinary circumstances set forth in section 1803 of the Energy Policy Act." *SFPP, L.P., 65 FERC P 61,028*, 61,378 (1993); *see also SFPP, L.P., 66 FERC P 61,210* (1994) (denying rehearing).

What does it mean for "the rate" to be "subject to protest, investigation, or complaint"? EPAct ß 1803(a). The WLS [*1276] maintain that a general attack on a tariff is sufficient to challenge all the rates and activities described therein. *See* WLS Br. 14 ("a protest of a tariff filing did subject all rates in the tariff to review"). The Commission, though, in ruling that the shippers' pleadings did not challenge the West Line rates, interpreted this clause of Section 1803 to require that the protest, investigation, or complaint specifically challenge the reasonableness of the rate [**20] in question. *See SFPP, L.P., 65 FERC at 61,378 n.14* (while Chevron's protest did include "a request for suspension of revised tariff no. 16, which contains ... only west line rates," the protest "pled no concerns with the existing rates set forth in this tariff"). The WLS object to FERC's interpretation on a general level, arguing that it grafts onto the statute a particularity requirement not found in its text. Here, too, we find the *Chevron* deference that we must accord to the agency's interpretation to be dispositive. Because we cannot say that the Commission's adjudicative interpretation is an impermissible reading of the statute -- the statute provides, after all, that it is "the rate" (not the tariff) that must be subject to "protest, investigation, or complaint" -- we defer to the Commission's interpretation. And with that interpretation in mind, we turn to the particular contentions of the WLS.

a. *West Line Shipper Protests*

On September 4, 1992, EPR, an East Line shipper, filed a protest to SFPP's Tariffs Nos. 15 and 16, and followed with three supplements that same month, one of which requested the suspension of Tariffs Nos. 15 and 16 and that the [**21] Oil Pipeline Board ("OPB" or "Board") open an investigation into the same. That same month, Chevron, which shipped on both the East and the West Line, filed a protest to Tariffs Nos. 15 and 16, also calling for their suspension and investigation.

The WLS contend that because EPR's and Chevron's protests challenged Tariff No. 16 -- which listed only West Line rates -- those protests had challenged the West Line rates. The Commission rejected this contention, looking beyond the relief requested by the protests to the shippers' substantive arguments for that relief. Examining the relevant pleadings, the Commission concluded that the protesting shippers "raised concerns with only three matters -- flow reversal, prorationing, and existing rates on SFPP's east line." *Id., 65 FERC at 61,378.* As "nothing within the four corners of these protests indicated a concern with the existing rates on SFPP's west line," the Commission rejected those protests as a basis for denying grandfathered status to the West Line rates. *Id.*

Our examination of the relevant pleadings convinces us that the Commission correctly concluded that EPR and Chevron did not challenge the reasonableness [**22] of the West Line rates in their protests to SFPP's Tariffs No. 15 and 16. The EPR and Chevron pleadings scarcely mention the West Line at all, let alone mount an attack on the reasonableness of its rates. The *only* mention of the West Line rates is found in EPR's first supplement to its protest: "Santa Fe's proposed Tariff Nos. 15 and 16 retain Santa Fe's previously effective rates for service on its East Line and West Line systems, but represent the first tariffs under which product will flow in a reversed direction on the 'Six-Inch Line' portion of the East Line system from Phoenix to Tucson." *In re SFPP, L.P.*, Supplement to Protest of El Paso Refinery, L.P., 1-2 (Sept. 9, 1992) (emphasis omitted). This statement obviously concerns the flow reversal on the Phoenix-Tucson pipe -- not the reasonableness of [*1277] West Line rates. Chevron's protest, as the Commission noted, "simply fails to contain any statement indicating a challenge to existing rates on SFPP's west line." *SFPP, L.P., 65 FERC at 61,378.* The Commission thus reasonably concluded that these protests by East Line shippers were insufficient to render the West Line rates "subject to protest." EPAct ß 1803(a). [**23] n2

n2 In August 1993, Chevron filed a complaint that *did* specifically challenge the reasonableness of the West Line rates. *See ALJ Decision, 80 FERC at 65,121.* The WLS maintain that this 1993 complaint should "relate back" to its 1992 protest. We do not agree. Relation back is a concept born in the context of statutes of limitations. Amendments to complaints are said to relate back to the date of the original complaint. *See Fed. R. Civ. P. 15(c).* Even assuming that this suggested use of the relation back doctrine could supersede the Commission's own time limitations governing amendments of protests, the WLS concede that to relate back "the claim ... in the amended pleading [must have] arisen out of the conduct, transaction, or occurrence set forth ... in the original pleading." *Fed. R. Civ. P. 15(c)(2).* That clearly is not the case here. As the Commission found, Chevron's initial protest "simply fails to contain any statement indicating a challenge to existing rates on SFPP's west line." *SFPP, L.P., 65 FERC at 61,378.*

[**24]

b. *Oil Pipeline Board Investigation*

On September 29, 1992, in response to the protests filed by EPR and Chevron, the OPB, pursuant to its authority under Section 15(7) of the ICA, *49 U.S.C. app. ß 15(7) (1988)*, opened an investigation of SFPP's rates listed in revised Tariffs Nos. 15, 16, and 17, suspended the tariffs for one day, and imposed refund obligations on SFPP. *SFPP, L.P., 60 FERC P 62,252* (1992). n3 In April 1993, the Commission vacated the suspension orders and the refund obligations. *SFPP, L.P., 63 FERC P 61,014* (1993). Observing that the protests against the tariffs did not challenge any change in a listed rate or practice (such as the addition of the East Hynes origination point or the turbine fuel service), but rather attacked only existing, unchanged rates and policies (the East Line rates and the flow reversal and prorationing practices), the Commission concluded that the OPB lacked authority to open an investigation under *Section 15(7) of the ICA*, which permits the Board only to investigate newly filed rates or practices. *Id. at 61,125* ("It was not appropriate for the Board to suspend the proposed tariff [**25] changes and initiate an investigation under *section 15(7)* when the focus of the protest was existing, unchanged, portions of the tariff."); *49 U.S.C. app. ß 15(7) (1988)* (limiting application to "any schedule stating any *new* individual or joint rate ... or charge") (emphasis added). The Commission held that the case should continue as a complaint proceeding before the Commission under *ICA Section 13(1), id. ß 13(1)*, and be limited to the issues properly raised by EPR, Chevron, and the intervenors. *SFPP, L.P., 63 FERC at 61,125*. But as the Board "does not possess delegated authority to order initiation of a *section 13(1)* proceeding," the Commission vacated the tariff suspensions and the refund obligations. *Id.* The Commission eventually terminated the Board's suspension docket entirely, stating that matters would proceed only in the instant complaint docket. *SFPP, L.P., 63 FERC P 61,275* (1993). And based on its conclusion that the OPB's investigation had been [*1278] unlawfully initiated, the Commission determined that SFPP's West Line rates were not "subject to investigation" for grandfathering purposes. *SFPP, L.P., 66 FERC at 61,480.* [**26]

n3 After SFPP filed Tariff No. 18, adding the turbine fuel service on the West Line, the OPB, acting pursuant to a protest by Chevron to Tariff No. 18, instituted an investigation and consolidated that case into the open investigation and suspension of SFPP's Tariffs Nos. 15, 16, and 17. *SFPP, L.P., 62 FERC P 62,060* (1993).

Parsing with care the words of the Commission's countermand of the Board, the WLS argue that the Commission never formally vacated the Board's investigation of the SFPP's Tariffs Nos. 15-18, and thus the rates within those tariffs -- including the West Line rates -- remained subject to investigation in 1992, precluding grandfathered status. We, like the Commission, are unpersuaded. First, while the WLS are quite right that the Commission did not, in its ordering clauses, vacate the Board's investigation, the shippers' interpretation of the Commission's action runs head-on into the Commission's statement that it was inappropriate "to suspend the proposed tariff changes and [**27] *initiate an investigation* under *section 15(7)*." *SFPP, L.P., 63 FERC at 61,125* (emphasis added). Moreover, the shippers offer no explanation how such an investigation by the Board could proceed in light of the Commission's order that the case would continue as a *Section 13(1)* complaint. But even if common sense bowed to formalism and the Board's investigation remained technically open, the scope of the Board's investigation -- lawful only insofar as it enforces *ICA Section 15(7)* -- must be limited to newly tariffed rates or practices. *See 49 U.S.C. app. ß 15(7) (1988)*. As SFPP's tariffs made no changes to the West Line rates (except to add the Watson enhancement and the turbine fuel services), the Board could not have investigated the West Line rates.

We therefore conclude that FERC reasonably determined that the West Line rates (except, as noted above, for the Watson Station enhancement and turbine fuel rates) were grandfathered and therefore deemed just and reasonable under the terms of Section 1803(a) of the EPAct.

C. *Exceptions to Grandfathering*

We turn now to the WLS' contention that the rates fall within the exceptions [**28] outlined in Section 1803(b) and therefore are still open to challenge under the ICA. Section 1803(b) permits a shipper to challenge a grandfathered rate if the shipper establishes either that (1) there has been a "substantial change" in the economic circumstances or services provided that "were a basis for the rate"; or (2) "the person filing the complaint" was under "a contractual prohibition against the filing of a complaint" on the date of the enactment of the EPAct. EPAct ß 1803(b). The complaining shipper bears the burden of proving the existence of one of the circumstances triggering an exception. The Commission concluded that the WLS had not met either requirement. *See SFPP, L.P., 68 FERC P 61,105*, 61,581 (1994) (contractual prohibition); Opinion No. 435, *86 FERC at 61,064-71* (changed circumstances). The shippers were therefore barred by the EPAct from challenging the grandfathered West Line rates. The WLS appeal both rulings.

1. *Substantially Changed Circumstances*

Before the ALJ and the Commission, the WLS argued that there were five circumstances that had substantially changed so as to permit a challenge to the grandfathered West Line [**29] rates, including increased throughput on the West Line and the impact of the Commission's *Lakehead* decisions on SFPP's income tax cost allocation. The ALJ rejected all the substantial change arguments. *See ALJ Decision, 80 FERC at 65,192-96*. Concerning the claim based on throughput, the ALJ concluded that the evidence of a forty-percent increase in throughput from EPAct's enactment [*1279] in October 1992 to 1995 (the last year for which data was obtained), by itself, could not prove a change in economic circumstances. *Id. at 65,194*. Missing, according to the ALJ, was any evidence demonstrating that the increase in throughput produced higher revenues and profits for SFPP. *Id.*

The Commission affirmed the holdings of the ALJ on each of the WLS' claims of substantial change, *see* Opinion No. 435, *86 FERC at 61,064-71*, but, with respect to the through-put claim, did so on somewhat different reasoning, *see id. at 61,067-69*. The Commission found that the ALJ had erred by measuring change from the date of enactment of the EPAct, and by using data generated after the filing of the shippers' complaint. *Id.*

Determining whether [**30] there has been a substantial change in economic circumstances providing the basis for the rate, the Commission held, requires comparing (a) the period before the rate first became effective (the basis for the rate) with (b) the period starting on the date of enactment and ending on the date of the complaint. *Id.* The WLS' substantial change claim based on increased throughput failed because the shippers measured changed circumstances against the "wrong base period" and with post-complaint evidence. *Id. at 61,069*. To establish a substantial change, FERC held, the shippers should have compared the period before the West Line rates became effective in 1989 to the period between October 24, 1992 (EPAct's enactment) and August 7, 1993 (the date of Chevron's complaint).

The shippers contest neither the Commission's interpretation of the substantial change provision of EPAct, nor its conclusion that the shippers failed to demonstrate a substantial change under that standard. The WLS do, however, maintain that the Commission's ruling employed a "newly articulated standard" and that they are, therefore, entitled to a remand so that they may have an opportunity to litigate [**31] under the Commission's "new" evidentiary requirements. WLS Br. 23. We reject this contention.

Even before the Commission announced this interpretation, the correct points of comparison in a substantial change analysis were clear from the face of the statute. The statute requires a shipper to show a change in economic circumstances "which were a basis for the rate." EPAct B 1803(b). As the Commission noted in its Opinion No. 435, this phrase could only mean "the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination." Opinion No. 435, *86 FERC at 61,068*. Any other moment in time would lack "correlation to the economic circumstances that were the basis of the rate at the time it was designed." *Id.*

The textual clues to the second point of comparison are perhaps less obvious but no less certain. The statute provides that "no person may file a complaint ... unless ... evidence is presented ... which establishes that a substantial change has occurred after the date of ... enactment." EPAct B 1803(b). From the "after the date of enactment" language [**32] we are given the earliest point at which a shipper may show a substantial change. The closing date for evidence is the day the complaint is filed; this conclusion follows from the language providing that no "complaint" may be filed unless "evidence is presented" with the complaint that demonstrates that a substantial change "has occurred." As the Commission stated, "it is difficult to see how language that so explicitly uses the past tense could apply to evidence that would be developed at some indeterminate time after the complaint is filed." Opinion [*1280] No. 435, *86 FERC at 61,069*. Because the foregoing requirements of the statute are clear from its face, the shippers had adequate notice of the standard they were required to meet. *See, e.g., Midtec Paper Corp., 273 U.S. App. D.C. 49, 857 F.2d 1487, 1510 (D.C. Cir. 1988)* (rejecting petitioner's argument that it had inadequate notice specific evidence was required to support its complaint where the text of the regulations at issue "clearly indicates" that such evidence was to be considered). n4

n4 *Consolidated Edison Co. v. FERC, 354 U.S. App. D.C. 235, 315 F.3d 316 (D.C. Cir. 2003)* and the other cases cited by the shippers (*see* WLS Br. 23) are distinguishable. Those cases stand for the unremarkable proposition that when an agency abandons its own precedent in the course of an adjudication, the new rule may be applied retroactively to the parties only "so long as the parties ... are given notice and an opportunity to offer evidence bearing on the new standard." *315 F.3d at 323* (citing *Hatch v. Federal Energy Regulatory Com., 654 F.2d 825, 835 (D.C. Cir. 1981))*. Here, FERC did not abandon its own precedent. Shippers point to *Santee Distrib. Co. v. Dixie Pipeline Co., 71 FERC P 61,205* (1995), *reh'g denied*, 75 FERC P 61,254 (1996), but that ruling -- issued nearly two years after Chevron's complaint was filed, and several months after the parties had submitted their direct cases to the ALJ, *see ALJ Decision, 80 FERC at 65,121* -- stands solely for the proposition that, to make out a substantial change under EPAct Section 1803, the complainant must show some change in circumstances since the enactment of the EPAct. *See Santee Distrib. Co., 71 FERC at 61,754* ("Comparisons of data for 1987 to data for 1993 cannot be the basis for showing a change in economic circumstances since enactment of the EPAct."). That holding is entirely consistent with the holding of Opinion No. 435.

[**33]

The WLS also argue that the Commission erred in rejecting their argument that the Commission's decision in *Lakehead Pipe Line Co., L.P., 71 FERC P 61,338* (1995) (*Lakehead*), *reh'g denied, 75 FERC P 61,181* (1996) ("*Lakehead II*"), insofar as it changed the ability of limited partnerships like SFPP to include certain income tax allowances in their cost of service, represented a substantial change in SFPP's economic circumstances. The Commission reasoned that the mere existence of the *Lakehead* policy, without any showing how the application of that policy affects the economic basis for the rates, cannot constitute substantially changed circumstances. *See* Opinion No. 435, *86 FERC 61,070-71*. In light of our conclusion below that aspects of the Commission's *Lakehead* policy are arbitrary and capricious, we think the best course is to remand this claim to the Commission for further consideration in light of our disposition in this case.

2. *Contractual Prohibition*

The WLS next contend that they may challenge the grandfathered West Line rates because they fit within the "contractual prohibition" exception. That exception [**34] allows a shipper to challenge a grandfathered rate when "the person filing the complaint was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of [the EPAct] and had been in effect prior to January 1, 1991." EPAct ß 1803(b)(2). Navajo, as a part of an earlier settlement with SFPP, was subject to such a prohibition and thus was permitted to file a complaint against the West Line rates without demonstrating substantially changed circumstances. *See SFPP, L.P., 67 FERC P 61,089*, 61,254 (1994). Navajo, however, reached another settlement with SFPP and withdrew its complaint against the pipeline. *SFPP, L.P., 79 FERC P 63,014* (1997). The Commission then terminated the Navajo complaint proceeding. *SFPP, L.P., 80 FERC P 61,088* (1997).

[*1281] The WLS nevertheless argue that they, too, should not have to show substantially changed circumstances. *First*, they assert that Navajo's invocation of the contractual prohibition exception effectively vitiated the West Line rates' grandfathered status as to *all* complaining shippers. *See* WLS Br. 18 ("The 'grandfathered' status of the West [**35] Line rates ... was thus revoked."). Alternatively, the WLS argue that because the ALJ conditioned Navajo's "withdrawal of the complaint" on "not prejudicing in any way the status and rights of any other participants in this proceeding," *SFPP, L.P., 79 FERC at 65,176*, the other complaining shippers should be able to pursue their complaint as if Navajo had not withdrawn -- that is, without showing substantially changed circumstances. The Commission rejected both of these arguments. From the first, the Commission recognized that the contractual prohibition exception is party-specific. "Because neither Chevron nor ARCO/Texaco was subject to a contractual bar [as was Navajo], it follows, under the plain meaning of the language of the statutory provision, that the complaints of Chevron and ARCO/Texaco [must show substantially changed circumstances]." *SFPP, L.P., 68 FERC at 61,581*. As for the shippers' claim that they had been prejudiced by Navajo's withdrawal, the Commission concluded that the condition on Navajo's settlement applied only to "the integrity of the record." Opinion No. 435, *86 FERC at 61,073*.

We agree with the Commission. [**36] The language of Section 1803(b)(2) is quite obviously party-specific. EPAct ß 1803(b)(2) ("*the person filing the complaint* was under a contractual prohibition") (emphasis added). An interpretation, like that suggested by the WLS, that would allow other shippers to piggyback on the status of a contractually-prohibited shipper, conflicts not only with the plain language of the statute, but also with Section 1803's overarching purpose of limiting litigation over pre-EPAct rates. On the other hand, the Commission's interpretation -- limiting the exception to those parties actually contractually prohibited from complaining -- is entirely consistent with the statute and therefore reasonable. We also find no merit to the WLS' claim that they were somehow prejudiced by Navajo's settlement. After examining the relevant proceedings, *see SFPP, L.P., 79 FERC at 65,176*, we think it clear that the ALJ, in implicitly promising that Navajo's withdrawal would not "prejudice ... the status and rights of any other participants in proceeding," was referring only to the evidence that Navajo had placed into the administrative record.

II. The East Line

SFPP's East Line rates [**37] were not grandfathered under ß *1803* of the EPAct, as EPR, as an ELS, had challenged them in the same September 1992 complaint in which it had protested SFPP's flow-reversal on the six-inch line. They were therefore "subject to protest, investigation, or complaint" within the year prior to the EPAct's enactment. Navajo later filed its own complaint against the East Line rates, and the Commission proceeded under the ICA, which, in *Section 15*, empowers the Commission to set aside rates it finds "unjust or unreasonable," and to "determine and prescribe what will be the just and reasonable ... rates, fares or charges to be thereafter observed." *49 U.S.C. app. ß 15(1) (1988)*. The ALJ evaluated SFPP's East Line rates pursuant to its cost of service regulations, *18 C.F.R. ß 346.2 (2004)*, found them unjust and unreasonable, and proceeded to set new ones in their place. *ALJ Decision, 80 FERC at 65,122-191*. The Commission substantially affirmed the ALJ's determination in Opinion No. 435. *86 FERC at 61,084-111*. Under [*1282] the Commission's rate-of-return methodology, this involved determinations of SFPP's embedded capital costs, [**38] its yearly operating expenses, allowances for other costs, and its appropriate rate of return. *See 18 C.F.R. ß 346.2(c)*.

The proceedings before the Commission were complex, and many of the issues it decided in setting new East Line rates (and in determining that the previous rates were unjust or unreasonable) have not been challenged. As relevant to our review, the parties dispute only four discrete issues regarding the Commission's East Line rate-setting: (1) the starting rate base to which SFPP was entitled; (2) what tax allowance, if any, should be factored into rates; (3) the proper means of recovery, if any, of SFPP's litigation expenses; and (4) the treatment of SFPP's claimed expenses for reconditioning portions of the East Line.

The court reviews the Commission's ratemaking decision to determine whether it was arbitrary and capricious, *see Association of Oil Pipelines v. FERC, 317 U.S. App. D.C. 376, 83 F.3d 1424, 1431 (D.C. Cir. 1996)* ("*AOPL*"), according special deference to the Commission's expertise, *id. at 1431*; *see also In re Permian Basin Area Rate Cases, 390 U.S. 747, 790, 20 L. Ed. 2d 312, 88 S. Ct. 1344 (1968).* [**39] The court thus examines the Commission's ratemaking decisions to determine whether the Commission has examined the relevant data and articulated a rational connection between the facts found and the choice made. *AOPL, 83 F.3d at 1431*. The Commission must "cogently explain why it has exercised its discretion in [the] given manner." *Exxon Corp. v. FERC, 340 U.S. App. D.C. 374, 206 F.3d 47, 54 (D.C. Cir. 2000)* (quoting *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 48-49, 77 L. Ed. 2d 443, 103 S. Ct. 2856 (1983))*.

A. *Starting Rate Base*

The Commission decided that to measure SFPP's overall investment upon which it is entitled to a return, SFPP should use its December 19, 1988 capital structure. Opinion No. 435-A, *86 FERC at 61,503-06*. In assessing the value of a pipeline's invested capital, the Commission's approach -- stemming from its opinion in *Williams Pipeline Co., 31 FERC P 61,377* (1985) ("Opinion No. 154-B") -- weighs equity and debt-financed capital investments made prior to 1985 differently, and SFPP contends that the Commission used the wrong historical ratio between [**40] the two in setting the starting rate base.

Some explanation of the "starting rate base" concept and its history is necessary. Prior to June 28, 1985, the rate base to be included in oil pipeline cost of service analysis was calculated under an Interstate Commerce Commission ("ICC") valuation method, which combined elements of original and reproduction cost. In *Farmers Union Central Exchange, Inc. v. FERC, 189 U.S. App. D.C. 250, 584 F.2d 408, 417-20 (D.C. Cir. 1978)* ("*Farmers I*"), the court expressed concerns about the ICC's valuation methodology, particularly its tendency to overvalue assets so as to "exceed[] investment by a substantial amount." *Id. at 415*. After the Commission proposed to continue to use the ICC's valuation method in *Williams Pipeline Co., 21 FERC P 61,260* (1982), the court, on review from that decision, remanded the case in *Farmers Union Central Exchange, Inc. v. FERC, 236 U.S. App. D.C. 203, 734 F.2d 1486, 1510-14 (D.C. Cir. 1984)* ("*Farmers II*"), and directed the Commission to consider alternatives, noting the widespread agreement among many experts that the ICC's method "lacks any economic rationale. [**41] " *Id. at 1511* (internal citation omitted).

[*1283] On remand from *Farmers II*, the Commission developed its current "trended original cost" method. Opinion No. 154-B, *31 FERC at 61,833-35*. This method starts from the original cost of a pipeline's assets but smooths out depreciation and equity recovery over the life of the pipeline, thereby avoiding the front-loading problems associated with a depreciated original cost methodology. Making the switch to this "trended original cost" method required the Commission to account for investments in existence at the time of the change. Under the ICC's valuation rate base methodology, many of these had been valued substantially above investment cost. *See Farmers I, 584 F.2d at 415*. Setting their value to depreciated original cost would, in many cases, have significantly decreased their valuation for rate-setting purposes. *See* Opinion No. 154-B, *31 FERC at 61,836*. To mitigate any abrupt reduction in pipeline earnings resulting from the change, the Commission permitted a one-time rate base adjustment -- creating a so-called starting rate base -- calculated by partially continuing the ICC's valuation [**42] method to the extent of a pipeline's equity ratio, but assessing its rate base at depreciated original cost to the extent of its debt ratio. Opinion No. 154-B, *31 FERC at 61,835-37*. Because the stated purpose of this approach was to protect the expectations of investors who had invested prior to the switch, the Commission determined that the relevant debt-to-equity ratio would be a pipeline's capital structure as of the date of Opinion 154-B, June 28, 1985, rather than its capital structure at the time rates are set. *See Williams Pipeline Co., 33 FERC P 61,327*, 61,640 (1985) ("Opinion No. 154-C").

The court has never reviewed the reasonableness of the Commission's Opinion No. 154-B methodology, nor need we do so now, as no party has challenged whether that approach is faithful to the court's remand order in *Farmers II, 734 F.2d at 1511-21*. The ELS support the Commission's application of the Opinion No. 154-B methodology, and SFPP contends only that the Commission's use of December 19, 1988 rather than June 28, 1985 as the relevant snapshot of the pipeline's capital structure is not faithful to Opinion No. 154-B and its progeny. We turn, [**43] then, to SFPP's contention that the Commission acted arbitrarily and capriciously, and departed from past precedent without adequate explanation, in rejecting use of the actual June 28, 1985 capital structure of the Santa Fe Southern Pacific corporation ("SFSP"), the pipeline's then-parent.

SFPP did not yet exist in 1985, and its predecessor corporation, Southern Pacific Pipelines, Inc. ("SPPL"), was a wholly-owned corporate subsidiary of SFSP. SPPL therefore had a 100% equity structure, and no party urged the Commission to use that capital structure to calculate SFPP's starting rate base. SPPL's parent, SFSP, was capitalized at 78.29% equity and 21.71% debt at the time, and SFPP urged the Commission to follow Opinion No. 154-B's instruction to use the parent's capital structure to calculate the starting rate base. Initially, in Opinion No. 435, *86 FERC at 61,089-90*, the Commission took the position that the 1988 settlement agreement between SPPL and several of its shippers, which had last set the pipeline's rates, required the use of SFSP's capital structure in the starting rate base. On rehearing in Opinion No. 435-A, however, the Commission decided that the settlement [**44] did not preclude it from independently examining SFPP's capital structure after the rates set by the settlement expired. The Commission determined that SFSP's capital structure should not be used in the starting rate base calculation because SFSP's high equity component in [*1284] June 28, 1985 did not "accurately reflect[] the risks of SFPP's underlying operations," and there was a "significant difference in the nature of the pipeline's operations and those of its parent company on June 28, 1985." Opinion No. 435-A, *91 FERC at 61,504-05*.

SFPP contends that Opinion No. 154-B requires, in cases where a pipeline is owned by a parent company and therefore does not issue debt in its own name, the use of a parent company's capital structure as of June 28, 1985. Opinion No. 154-C, which clarified Opinion No. 154-B, does contain the instruction that "the capital structure to be used in determining the starting rate base is as of the date of Opinion No. 154-B (June 28, 1985)." *33 FERC at 61,640*. The Commission qualified that approach, however, in *ARCO Pipeline Co., 52 FERC P 61,055*, 61,233-34 (1990), where it began applying its precedents from the rate-of-return [**45] context -- in which it first examines whether a parent company's capital structure is representative of its subsidiary's risk level before imputing it to the subsidiary -- to the capital structure used in the starting rate base calculation. While the Commission in *ARCO* ended up using the corporate parent's actual capital structure, it indicated that its decision to do so hinged on "whether the capital structure is representative of the pipeline's risks." *Id. at 61,233*.

ARCO did not contain much by way of explanation about why the representativeness of a parent's capital structure to the pipeline's risks should matter; its relevance to the starting rate base, where the equity component is standing in as a measure of investor reliance on the old ICC valuation method, appears less obvious than in the rate-of-return context, where pipelines receive different returns on debt and equity to compensate for their different risk levels, *see, e.g.*, *Kuparuk Transportation Co., 55 FERC P 61,122*, 61,375-78 (1991); *Alabama-Tennessee Natural Gas Co., 25 FERC P 61,151*, 61,417-18 (1983). But the Commission's basic premise that a capital structure [**46] representative of a pipeline's risks must be used in the starting rate base calculation is not at issue, for SFPP concedes that the Commission can depart from a parent's actual capital structure if it is "not ... representative of the pipeline's risks." SFPP Pet. Br. 17. SFPP's challenge goes only to whether the Commission made a reasoned decision applying that standard, and nothing about the Commission's determination of SFPP's, SPPL's, and SFSP's relative risk levels was arbitrary or capricious.

The Commission noted that the bulk of SFSP's business was in the railroad, trucking, and mineral exploration industries, which faced substantially higher amounts of competition than the pipeline, a regulated "monopoly for the entire period" guaranteed a fair rate of return and "sufficiently secure that it proposed to undertake a major expansion beginning in 1985." Opinion No. 435-B, *96 FERC at 62,067*. Most importantly, the Commission had a powerful piece of evidence of the pipeline's relatively low risk level: its initial public offering. When it first became a stand-alone entity on December 19, 1988, SFPP was able to adopt a capital structure financed with 60.74% debt and 39.26% [**47] equity. This strongly suggests a market judgment that the pipeline was significantly less risky than SFSP, which was financed with 78.29% equity and 21.71% debt. The Commission's view that SFPP's equity level as of its initial public offering more "accurately reflected the pipeline's risk" than that of its previous parent was based upon a reasoned view that "the financial market's perceptions of the pipeline's risk," as demonstrated through an "arms [*1285] length public offering," provide an accurate estimate of an entity's risk level. *96 FERC at 62,068*. SFPP misses the mark when it states that there is no single capital structure dictated by the market, for although other reasonable debt-equity ratios might have been adopted for SFPP, none would have market imprimatur. The reasonableness of the Commission's position is confirmed by the very different nature of the respective entities' business operations and the stark contrast between the capital structures each adopted. The same reasoning explains the Commission's choice to use December 19, 1988, the date of SFPP's initial public offering, as the relevant snapshot of its equity level, hardly an arbitrary date given its reliance [**48] on the judgment of the financial markets.

SFPP maintains, however, that by adopting SFPP's December 19, 1988 capital structure for purposes of the starting rate base calculation, the Commission improperly applied it "retroactively," thereby denying the pipeline a fair chance to bring itself in line with the capital structure hypothesized. The Commission's use of the December 19, 1988 capital structure was predicated on the conclusion that it was representative of the pipeline's risks in 1988, and that there were "no rational grounds here to believe that SPPL's operations or business substantially changed between June 28, 1985 and December 19, 1988." Opinion No. 435-B, *96 FERC at 62,067.* SFPP points to nothing that suggests otherwise. The starting rate base is an element of the determination of the prospective rates "in dispute in this proceeding," and the Commission was neither altering past rates nor seeking to recover the pipeline's past losses in future rates; rather, it was determining a just and reasonable valuation of the pipeline's investment for the purpose of setting present rates. As such, there was nothing "retroactive" about the Commission's setting of the [**49] starting rate base.

Because the record contained sufficient evidence on which the Commission could find that SPPL faced significantly lower risks than SFSP in 1985, and SFPP concedes that the Commission may depart from an actual capital structure in the starting rate base formula where it is not representative of a pipeline's risks, the court has no occasion to decide whether the Commission improperly relied on non-record material from Moody's Transportation Manual regarding the poor financial condition of the Southern Pacific Railroad during the relevant period. Nor need we decide whether the Commission's other basis for departing from SFSP's 1985 capital structure--its concern that SFSP's 78.29% equity component would yield an exorbitantly high starting rate base--would suffice to uphold its decision. Accordingly, we affirm the Commission's starting rate base decision.

B. *Cost Issues*

1. *Income Tax Allowance*

As one element of the cost of service allowable to SFPP, FERC included a 42.7% income tax allowance reflecting the interest in the regulated entity held by a subchapter C corporation. All petitioners assigned this tax allowance as error. The shipper petitioners, [**50] and intervenors supporting them, allege as error the recognition of any income tax allowance as SFPP is a limited partnership that pays no income taxes. SFPP alleges as error the denial of a full income tax allowance. Because FERC has not established that its 42.7% allowance is the product of reasoned decisionmaking and indeed has provided no rational basis for this part of its order, we find that allowance to have been erroneous and we vacate.

[*1286] There is no question that as a general proposition a pipeline that pays income taxes is entitled to recover the costs of the taxes paid from its ratepayers. We explained this proposition thoroughly in *City of Charlottesville v. FERC, 249 U.S. App. D.C. 236, 774 F.2d 1205 (D.C. Cir. 1985)* (Scalia, J.). While we will not fully discuss the analysis set forth in that decision, we will briefly review the basic principles as background for the current controversy.

The Commission must ensure that the rates of jurisdictional pipelines are "just and reasonable." *Id. at 1207* (quoting *15 U.S.C. ß 717c(a) (1982)*). This means that using the principles of cost of service ratemaking, Commission-approved rates [**51] must yield "sufficient revenue to cover all proper costs," and provide an appropriate return on capital. *Id.* (citing *Public Service Co. v. Federal Energy Regulatory Com., 653 F.2d 681, 683, 209 U.S. App. D.C. 426 (D.C. Cir. 1981))*. Taxes, including federal income taxes, are costs. *See id. at 1207*. The difficulty in the application of this seemingly straightforward principle arises when "the utility is part of a consolidated group," only a portion of which is regulated. *Id.* Historically, the Commission has employed two differing methodologies for attribution of tax costs in dealing with this difficulty. Again, *City of Charlottesville* provides the background for understanding the two methodologies. Under the older, "flow-through" methodology, the Commission "derived an effective tax rate by determining the ratio of each [regulated] pipeline's taxable income to the total taxable income of all affiliates, multiplied this fraction by the group's consolidated tax liability, and divided this figure by the pipeline's taxable income." *Id. at 1207*. Under the more recently derived "stand-alone" methodology, the Commission has sought to segregate the regulated utility, then determine "the taxable [**52] income and deductions ... specifically attributable to the utility's jurisdictional activities." *Id.* Under this approach, the Commission then applies "the statutory tax rate ... to the tax base to yield the stand-alone tax allowance." *Id.* The present controversy arises from the fact that neither of these historic methods can by its terms be literally applied to the rates of SFPP.

The name of the jurisdictional pipeline operator explains the origin of the difficulty. SFPP, L.P., is a limited partnership -- specifically a publicly-traded one. Both the flow-through and stand-alone methodologies presume taxable income generated by the regulated entity. Each arose in the context of corporate ownership of a jurisdictional pipeline by a tax-paying corporation which is part of an affiliated group. Shipper petitioners concede that were SFPP a subchapter C corporation, a tax allowance would be appropriate in order "to insure that the regulated entity has the opportunity to earn its allowed return on equity." *Lakehead, 71 FERC at 62,314*. But a limited partnership operating jurisdictional pipelines incurs no income tax liability. *26 U.S.C. ß 7704 (d)(1)(E)* [**53] . Therefore, shipper petitioners contend there is no rational basis for FERC to approve an income tax allowance for a limited partnership that incurs no income taxes. Thus, shippers argue, FERC erred in allowing even a 42.7% tax allowance in the rates of SFPP.

Shippers raised this argument before the Commission and the Commission discussed it in Opinion No. 435. *See 86 FERC at 61,101-07*; *see also* Opinion No. 435-A, *91 FERC at 61,508-09*; Opinion No. 435-B, *96 FERC at 62,077-78*. In all of its iterations, FERC's discussion of the issue has been in terms of the "*Lakehead* policy." FERC first announced that policy in *Lakehead, 71 FERC P 61,338*, and offered certain clarifications of the policy in *Lakehead II, 75 FERC P 61,181*. That [*1287] case also involved ratemaking of a limited partnership. In *Lakehead*, the Commission declared that where a regulated pipeline is a non-taxed limited partnership, it will not be permitted the same tax allowance as it would if the pipeline company were a corporation. However, FERC further ruled that where the limited partnership includes corporate partners, it would treat [**54] the partnership as being "in essence a division of each of its corporate partners" for purposes of determining an income tax component in the partnership's cost of service computation. *Lakehead, 71 FERC at 62,315*. Importantly, FERC's opinion in *Lakehead* was never subjected to judicial review, and neither this court nor any other circuit has ever passed on the validity of the *Lakehead* policy. Therefore, while FERC may deem itself bound to follow that policy, we are not so bound and consider its validity for the first time in this application. All petitioners urge us to reject it in whole or in part, though for differing reasons.

Commencing with the assumption that it should apply the *Lakehead* policy to SFPP's ratemaking, FERC considered the question before it to be the determination of how that policy applied to a limited partnership composed of one partner (or partners) that is a subchapter C (taxpaying) corporation and other partners that are not subchapter C corporations but rather individuals, subchapter S corporations, trusts, or other entities that do not incur corporate income tax. FERC's analysis is rooted in the rationale offered in *Lakehead* [**55] , discussed in the ALJ Decision, *see 80 FERC at 65,179*, and adopted by the Commission in Opinion No. 435, *see 86 FERC at 61,102*. The Commission bases that rationale on the "double taxation" incurred in the context of subchapter C corporations, in which the profitmaking corporation is liable for corporate income tax and the shareholders of the corporation are individually liable for their individual income tax on dividends generated by the profitmaking corporations. n5 The Commission in *Lakehead* ruled that "because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the cost-of-service to insure that the regulated entity has the opportunity to earn its allowed return on equity." *71 FERC at 62,314*. This same rationale guided the Commission's computation of tax allowance for the nontaxpaying limited partnership, including one or more subchapter C partners, throughout the *Lakehead* administrative litigation and the SFPP ratemaking now before us. Because SFPP, Inc., a subchapter C corporation, held a 42.7% interest n6 in the SFPP limited partnership, the Commission included in [**56] the cost of service computation for SFPP, L.P., a 42.7% allowance for income taxes that would have been incurred had the pipeline's jurisdictional earnings been subject to corporate taxation. *86 FERC at 61,103*.

n5 In our discussion of the double-taxation rationale, we are advertent to actual and proposed changes in corporate and dividend taxation occurring after the ratemaking we now review. In view of the timing of the ratemaking, and of our resolution of this issue, no such changes are germane to our further analysis.

n6 A 41.7% limited partnership interest and a 1% general partnership interest.

Shippers contend that FERC erred in including this income tax allowance, arguing that the ALJ was correct that because no income taxes have been or will be paid on SFPP's partnership income, the inclusion of an income tax allowance in the cost of service constitutes allowance for "phantom taxes." *Id.* SFPP, on the other hand, contends that the 42.7% allowance is in [*1288] fact inadequate to reflect cost [**57] of service. It argues that the *Lakehead* policy results in an understatement of the appropriate income tax allowance, and that the Commission should have applied a version of the "stand-alone" methodology discussed above, treating the regulated entity as if it alone were responsible for taxes which would have been incurred on the same income had the jurisdictional pipeline been a taxable corporation.

Because we conclude that FERC's rationale does not support its conclusion, we hold that inclusion of the 42.7% income tax allowance in the cost of service computation was erroneous and we vacate FERC's order to that effect. We further conclude that SFPP's arguments are not well-taken and reject the proposition that FERC should have included the 100% allowance that SFPP seeks. We further conclude that the shipper petitioners offer a convincing analysis consistent with ratemaking principles and governing law, and that on the record before us SFPP is entitled to no allowance for the phantom income taxes it did not pay.

We cannot conclude that FERC's inclusion of the income tax allowance in SFPP's rates is the product of reasoned decisionmaking. In *Lakehead*, as re-adopted in the opinion [**58] before us, the "reasoning" consists of a recitation of separately unassailable statements that do not together constitute a syllogism leading to the conclusion purportedly based on them. The Commission in *Lakehead* reasoned that:

> 1. Under cost-of-service ratemaking principles a regulated company is entitled to rates that yield sufficient revenue to cover its appropriate costs.
>
> 2. Income tax allowance is no different from the allowance for any other costs.
>
> 3. When the regulated entity is organized as a corporation, its revenues are taxed at the corporate tax rate and the earnings of the owners (shareholders) of the corporation are then taxed on dividends at their particular rate.

71 FERC at 62,314.

To that point the Commission's statements are unassailable. However, the Commission follows these statements with a rather cryptic statement. "Because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the cost-of-service to ensure that the regulated entity has the opportunity to earn its allowed return on equity. However, there is no allowance for the taxes paid by the owners of the corporation. [**59] " *Id.* Again, the second of these two sentences is inarguable, but it is not at all clear what the Commission means by the first. It would seem to follow from the Commission's own reasoning in the preceding elements of analysis, as well as fundamental principles of ratemaking, that if the corporate tax is to be included in the cost-of-service, it is not because it is "an extra layer of taxation," but rather because it is a *cost*. *Id.* In the Commission's own words, a tax allowance is "no different from the allowance for any other costs." *Id.* Presumably whatever tax rate was applicable to a tax-paying regulated entity would be included in the cost-of-service analysis, nor does anything said by the Commission in *Lakehead* or in the opinions before us dispute that presumption. From this line of "reasoning," FERC proceeded to conclude that the limited partnership operating a jurisdictional pipeline "is entitled to an income tax allowance with respect to income attributable to its corporate partners." *Id.* The only further explanation that FERC offers for this conclusion is "when partnership interests are held by corporations, the partnership is entitled to a tax allowance [**60] in its cost-of-service for those corporate interests because the tax costs will be passed [*1289] on to the corporate owners who must pay corporate income taxes on their allocated share of income directly on their tax returns." *Id.*

The Commission then goes on to "conclude[] that [the limited partnership pipeline] should not receive an income tax allowance with respect to income attributable to the limited partnership interests held by individuals ... because those individuals do not pay a corporate income tax." *Id. at 62,315.* Presumably, however, the individual owners pay individual income taxes. Also, presumably many owners (shareholders) of corporate holders of limited partnership interests will not be paying taxes on dividends as corporations often do not generate dividends. n7In the original *Lakehead* opinion, the Commission had little further to say about why it distinguished between the corporate taxes of corporate unit holders and the individual income taxes of individual unit holders. In *Lakehead II*, and in the opinions we review today, the Commission did offer some attempt to explain the distinction.

> n7 As noted in n.5, *supra*, changes in tax laws subsequent to the Commission's opinion herein may further affect the asymmetry of including in ratemaking allowance for the corporate tax of corporate unit holders but not the individual tax of individual unit holders.

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In *Lakehead II*, FERC considered the argument of the *Lakehead* limited partnership that the Commission's refusal to grant a tax allowance reflecting the tax liabilities of all limited partnership unit holders, whether or not each holder was a subchapter C corporation, did not comport with the Commission's own "actual taxes paid" rationale, because the Commission, under the "stand-alone" tax policy discussed above, would permit "a regulated entity to collect a fair tax allowance even where no actual tax liability is incurred." *Lakehead II, 75 FERC at 61,594*. *Lakehead II* went on to argue that under this rationale, even if the jurisdictional entity is a non-taxed limited partnership, "rate payers should be responsible for the tax liability otherwise associated with the revenue generated from the jurisdictional activities, without regard to any actual amount paid to the IRS." *Id.* In rejecting the argument, the Commission stated, no doubt correctly, that in the case of a jurisdictional corporate subsidiary of a corporate group, "the allowed equity return generates an actual tax liability for the pipeline that must be paid to the IRS, either in cash or through [**62] the use of another member's deductions... Either way, the tax liability of the jurisdictional company is a real cost of providing service." *Id. at 61,595* (citing *Northern Border Pipeline Co., 67 FERC P 61,194*, 61,110-11 (1994)). As applied to tax liability generating corporate subsidiaries engaged in jurisdictional activities, the Commission's statement is again quite defensible, when such a subsidiary does not itself incur a tax liability but generates one that might appear on a consolidated return of the corporate group. The difficulty arose when the Commission attempted to take the next step and explain why this reasoning applied to an entity that is a non-taxable limited partnership and to justify discriminating between allowances for the tax liability of corporate unit holders and the tax liability of those unit holders who are individuals or otherwise not subchapter C corporations. The Commission's reasoning on that point extends for two more paragraphs, but is summarized in the following statement immediately following the last quoted language from *Lakehead II*:

> In contrast, there is no corporate tax liability associated with individual [**63] partners' equity return and therefore it is [*1290] not appropriate to allow Lakehead to collect for such amounts in its cost-of-service.

Id. This does not supply reasoning for differentiating between individual and corporate tax liability. It is merely restating the proposition that the Commission is so differentiating. Otherwise stated, the Commission is once again simply declaring: we are including a tax allowance for corporate tax liability; we are not allowing a deduction for individual income tax liability. To rephrase a proposition is not the same as supplying supporting reasoning. In short, the Commission's opinions in *Lakehead* do not evidence reasoned decisionmaking for their inclusion in cost of service of corporate tax allowances for corporate unit holders, but denial of individual tax allowances reflecting the liability of individual unit holders.

Nonetheless, we could sustain the Commission's decision if the opinions we review had added the reasoned decisionmaking lacking in *Lakehead*. They do not. Before the court, the Commission's counsel argues that the distinction is justified in the reasoning offered by the ALJ in the portion of his decision affirmed [**64] by the Commission. The ALJ, attempting to apply the *Lakehead* policy, had reasoned that "investors in a regulated pipeline are entitled to a return 'commensurate with returns on investments in other enterprises having corresponding risk.' " *ALJ Decision, 80 FERC at 65,177* (quoting *FPC v. Hope Natural Gas Co., 320 U.S. 591, 603, 88 L. Ed. 333, 64 S. Ct. 281 (1944)*). Still struggling with the *Lakehead* policy which had permitted a corporate income tax allowance but not an allowance for the tax liability of other investors in the limited partnership, the ALJ concluded "because there is no dual taxation, a tax allowance is not necessary to ensure that an individual limited partner obtains a 'commensurate return.' " *Id.* We agree that the ALJ's invocation of the *Hope Natural Gas Co.* principle was apt, but unlike the Commission, we agree that the conclusion he based it on was sound.

The *Hope Natural Gas* decision did not itself involve attribution of tax liability for purposes of determining allowances and ratemaking. It did however, apply general principles of ratemaking that are instructive in that context. As the Commission argues to us, that decision teaches [**65] that the Commission's ratemaking function involves "a pragmatic assessment of whether the rates prescribed for a pipeline will support its services and provide a reasonable return to its investors." FERC Br. 60 (citing *Hope Natural Gas, 320 U.S. at 602*; *Farmers II, 734 F.2d at 1502*). However, the Commission's premise again does not lead to the Commission's conclusion. The ALJ correctly derived from *Hope Natural Gas* the more specific principle that the regulating commission is to set rates in such a fashion that the regulated entity yields returns for its investors commensurate with returns expected from an enterprise of like risks. Were the corporate unit holders investing in a non-regulated entity of like risk and otherwise similar return, they would of course expect to pay their own corporate tax on any profit they might realize from that investment. Should that profit generate dividends from the corporations, the shareholders would expect to pay their own taxes on such dividends. n8 Likewise, individual investors in such a non-regulated enterprise would expect to pay their individual taxes thereon. Granted, the second group of investors would [**66] pay one level of taxation; the first group, at least potentially, two layers of taxation. [*1291] This is a product of the corporate form, not of the regulated or unregulated nature of the pipeline or any comparable investment or of the risks involved therein. Therefore, consistent with *Hope Natural Gas*, the ALJ correctly concluded that where there is no tax generated by the regulated entity, either standing alone or as part of a consolidated corporate group, the regulator cannot create a phantom tax in order to create an allowance to pass through to the rate payer. The Commission erred when it rejected the ALJ's conclusion.

n8 *See* footnotes 5 and 7, *supra*.

As we have recited repeatedly above, and as the Commission itself has recognized in this very proceeding, under cost-of-service principles, a regulated company is entitled to a rate design to yield sufficient revenue to cover its appropriate cost; income tax allowance is no different from the allowance of any other costs. The regulated pipeline generates [**67] many costs, for example bookkeeping expenses. Presumably those bookkeeping expenses are recoverable in its rates. Its corporate unit holders, if any, presumably also have bookkeeping expenses. The bookkeeping expenses of the corporate unit holders are not recoverable in the rates of the pipeline, even though the corporation and its shareholders each may independently be paying bookkeepers and accountants unlike individual unit holders who pay only for their own accounting. All of this makes sense. It makes equal sense when applied to income taxes.

SFPP, while raising its own objections to the *Lakehead* policy, joins the Commission in opposing the shipper petitioners' arguments that no income tax allowance should be included in the ratemaking. SFPP, however, argues that the Commission not only did not err in including the potential tax liability of its corporate unit holders, it instead erred in not including the potential tax liability of its individual or other non-subchapter C corporate unit holders. That argument serves to illustrate further why the ALJ was correct in including no such pass-through or phantom taxes at all. Under the Commission's present order, the imputed tax [**68] liability of the corporate unit holders creates an allowance included in the making of the rate for the pipeline. The ratepayers pay that rate for the product shipped, but the allocation of the nontaxed profit of the limited partnership pipeline is, so far as the record reflects, subject to division among the unit holders rateably according to their interest in the limited partnership, not affected by how their share of the profits will ultimately be taxed. Therefore, even if the Commission's goal of changing the risk analysis of "double-taxed" investors were a valid one, it is not being accomplished. The inclusion of the phantom taxes in the rate changes the profit margin for all unit holders in the untaxed limited partnership, not just those who are under a particular tax structure. Therefore, SFPP may well be correct that if such an allowance were allowable at all, it should have been allowed for the imputed taxes potentially incurred by all unit holders who realized taxable income from the untaxed profits of the limited partnership of the pipeline. For the reasons set forth above, we hold that the first step of this analysis is erroneous -- that is, we hold that no such allowance [**69] should be included.

Both FERC and SFPP argue that the position we adopt today is inconsistent with the "stand-alone" methodology approved by this court in *City of Charlottesville*, for reasons related to the so-called "actual tax" principle discussed therein. *City of Charlottesville , 774 F.2d at 1207, 1215*. Again, we will not rehash the full analysis of *City of Charlottesville*, but simply will remind SFPP that the stand-alone principle as approved in *City of Charlottesville* [*1292] dealt with the imputation of taxes within a corporate structure where the imputation was made necessary not by the non-taxable, non-corporate nature of the regulated entity, but by the allocation of profits and losses among the related members maintaining separate balance sheets within a consolidated corporate group. While it is true that then-Judge Scalia posited the applicability of the stand-alone methodology to a circumstance in which taxes were "not necessarily ... paid," *id. at 1215*, that analysis dealt with the use of "actual or estimated taxes paid or incurred" rather than being limited to actual taxes paid. But the part of the *City of Charlottesville* opinion in which [**70] that discussion occurred dealt with the argument that the taxes, though properly estimated and actually incurred, might not ever be actually paid because of such factors as losses generated in the corporate structure, or the allocation of profits between and among taxable years in such a fashion as to result in a different tax actually being paid, if any at all. *See id. at 1214-15*. Nothing in the *City of Charlottesville* opinion suggests that it is the business of the Commission to create tax liability when neither an actual nor estimated tax is ever going to be paid or incurred on the income of the utility in the ratemaking proceeding. n9

n9 At least equally inapposite is *Carolina Power and Light v. FERC, 274 U.S. App. D.C. 5, 860 F.2d 1097 (D.C. Cir. 1988)*. SFPP relies on *Carolina Power and Light* for the proposition that "the Commission is not obligated in prospective ratemaking proceedings to match rates dollar for dollar with taxes paid to the Internal Revenue Service." *Id. at 1101* (internal quotations omitted). There, again, we dealt with the computation of the precise amount of taxes to be passed through, not whether the Commission could create a tax liability out of whole cloth to pass through to rate payers of a nontaxable utility.

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Finally, SFPP argues that adopting the *Lakehead* policy and applying it to this case to restrict the allowance to the taxes of the corporate unit holders as opposed to imputing the taxes of all unit holders "runs directly contrary to legislation in which Congress expressly sought to encourage the publicly traded partnership formed for oil pipelines and other selected industries." Underlying this argument is Congress's 1987 enactment of *Section 7704 of the Internal Revenue Code. 26 U.S.C. β 7704* (added by Pub L. 100-203, Title X, β 10211(a), Dec. 22, 1987, 101 Stat. 1330-403). Under *Section 7704*, Congress decreed that, in general, publicly traded limited partnerships would be taxed as corporations. However, Congress made the policy decision that for a limited number of industries, including "pipelines transporting gas, oil, or products thereof," limited partnerships should operate without taxation to encourage investment in those critical industries. *Id. β 7704(d)(1)(E)*. SFPP argues that because Congress singled out a narrow category of enterprises with the intent to facilitate investment in such enterprises by providing a tax-efficient [**72] means to raise capital, FERC's policy is inconsistent with congressional intent because it provides a smaller incentive than would be the case if it granted an allowance for phantom taxes based on all unit holders instead of simply the corporate ones. This is a classic case of an argument proving too much.

SFPP's argument would equally apply to any decision by the Commission that caused the pipeline lower allowances rather than higher. Unsurprisingly, SFPP is able to offer no precedent for the proposition that we should compel the Commission, or any other agency, to adopt a rate structure bringing it into line with the perceived intent of Congress to achieve objectives in general, as opposed to consistency with the mandate adopted by Congress [*1293] in furtherance of such objectives. As we have noted in other contexts, congressional mandates to agencies to carry out "specific statutory directives define[] the relevant functions of [the agency] in a particular area." *Michigan v. EPA, 348 U.S. App. D.C. 6, 348 U.S. App. D.C. 7, 268 F.3d 1075, 1084 (D.C. Cir. 2001)*. Such a mandate does not create for the agency "a roving commission" to achieve those or "any other laudable goal." *Id.* The [**73] mandate of Congress in the tax amendment was exhausted when the pipeline limited partnership was exempted from corporate taxation. It did not empower FERC to do anything, let alone to create an allowance for fictitious taxes.

For the reasons set forth above, we vacate the tax-allowance portion of the FERC opinion and order allowing recovery for income taxes not incurred and not paid.

2. *Litigation Costs*

This case has been an expensive one. At the time of the ALJ Decision, *80 FERC P 63,014*, SFPP sought to recover $ 15.1 million for litigation expenses and associated costs related to Commission and certain civil litigation. This included a $ 12 million litigation expenses reserve plus $ 3.1 million that SFPP claimed was a direct expense associated with this rate proceeding and related civil litigation. By the time this case reached its second rehearing in 2001, Opinion No. 435-B, SFPP's actual costs appear to have ballooned much higher; the pipeline's 2002 compliance filing places its cumulative costs litigating this rate proceeding, as well as litigating and settling related civil litigation, at over $ 48.1 million.

a. *Rate Litigation*

In keeping with *Iroquois Gas Transmission Sys. v. FERC, 330 U.S. App. D.C. 271, 145 F.3d 398 (D.C. Cir. 1998)*, [**74] and its own precedents, the Commission considered SFPP's rate litigation to be "part of its normal, ongoing operations" and allowed SFPP to recover these costs from shippers. It did not, however, permit recovery through a permanent rate increase. Reasoning that SFPP's regulatory litigation costs, if "included in embedded rates," would "artificially inflate the level of rates between rate cases," because the rate proceeding that caused most of the costs was now over and was not likely soon to recur, the Commission refused to factor them into SFPP's indexed rates. Instead, the Commission allowed SFPP to recover its actual regulatory litigation costs in the form of an amortized five-year surcharge, with recovery of costs incurred after the 1994 test year offset by the amount which SFPP had collected in excess of the just and reasonable rates from shippers that did not file complaints within the appropriate period. The court reviews, therefore, two distinct decisions of the Commission: to use a temporary surcharge in lieu of a rate increase to recover SFPP's rate litigation costs, and to offset the post-1994 surcharge by the amount of reparations that would have been due non-complaining [**75] shippers.

No party challenges the Commission's decision that SFPP's rate litigation costs are recoverable. This does not mean, however, that SFPP was automatically entitled to have those expenses treated as part of its indexed rates, as if the unusually high costs it incurred in this proceeding would regularly recur until the next rate proceeding. SFPP contends that it was entitled to have a litigation reserve factored into its cost of service, because it incurred significant regulatory litigation expenses in the test year, 1994, and was bound to continue to incur costs litigating matters before the Commission in the future. Yet nothing in the record suggests [*1294] that any other matters SFPP has pending before the Commission will generate costs close to those in this rate proceeding. A glance at SFPP's compliance filing confirms that its litigation expenses have dropped significantly from the levels they reached between 1994 and 1997. The Commission's reasoning for denying the rate increase, that there was "no assurance that SFPP's litigation costs would exceed $ 2,914,114 a year for the several years that the 1994 rates are likely to remain in effect," Opinion No. 435-B, *96 FERC at 62,075*, [**76] seems quite reasonable. The Commission has not denied all recovery of these costs but simply limited SFPP's recovery to its actual costs defending this proceeding and required that those costs be removed from rates once they were repaid.

Where the Commission took a more novel approach was in how it implemented this surcharge. While SFPP was permitted to recover its 1993 and 1994 regulatory litigation costs in full, the Commission offset the surcharge for later years by the amount SFPP had collected, in excess of rates ultimately set by the Commission, from shippers that did not challenge the rates and were therefore not entitled to reparations. SFPP contends that this novel approach of deducting "unclaimed reparations" from the surcharge deprived it of a full recovery, because, in effect, it recovered nothing at all for litigation costs incurred after the test year.

Although the Commission does not cite any precedent for this offset, the apparent novelty of this approach does not render it unreasonable. As the Commission noted, the costs of this proceeding were "high for all parties," and the issue is "how those costs can be most equitably allocated." *Id. at 62,074.* [**77] In setting prospective rates, the Commission could reasonably conclude that because SFPP had reaped a windfall by charging rates in excess of those ultimately deemed just and reasonable in the same past years for which it was claiming supplemental expenses above those it would prospectively incur as part of its cost of service, it should be required to first fund its litigation expenses out of that pool before it could begin charging those costs to its customers anew. While SFPP contends that this unfairly benefits shippers that sat on their rights by not filing complaints against SFPP's rates, and that *Section 16 of the ICA* only authorizes reparations for shippers who have filed such challenges, *see 49 U.S.C. app. β 16(1) (1988)*, it presents no justification for being entitled to keep this windfall. The court therefore affirms the Commission's surcharge mechanism and its corresponding offset, subject to the qualification that, depending on what rates ultimately result from this proceeding on remand, the surcharge might require recalculation.

b. *Civil Litigation Expenses*

SFPP also challenges the Commission's decision to disallow recovery in the East [**78] Line rates of significant expenses SFPP incurred in civil litigation defending its reversal of flow on a segment of six-inch pipe running between Phoenix and Tucson. SFPP's flow reversal removed capacity from the East Line in order to allocate it to the West Line. While this benefitted West Line shippers, it would be, as the Commission recognized, inequitable to include these costs in the East Line rates, for "there appears no reason why ratepayers should bear the expense of defending conduct that had no *ex ante* prospect of benefitting them." *See Iroquois Gas, 145 F.3d at 401*; *see also Mountain States Telephone & Telegraph Co. v. FCC, 291 U.S. App. D.C. 207, 939 F.2d 1035, 1043 (D.C. Cir. 1991)* ("*Mountain States I*"). The Commission's recognition that litigation of this sort lacks the requisite nexus to the provision of [*1295] SFPP's East Line service to justify inclusion in those rates was not unreasonable.

SFPP was embroiled in lengthy litigation in Arizona and Texas state courts with EPR and Navajo, two East Line shippers, regarding SFPP's reversal of flow on the six-inch line, one of SFPP's two pipes running between Phoenix and Tucson. That litigation [**79] ultimately cost SFPP, according to its 2002 compliance filing, over $ 23.7 million. SFPP also has an eight-inch pipe running between the two cities. The six-inch line had been in West Line service from 1989 to 1991. When SFPP undertook an expansion of the eight-inch line (which had been in East Line service) SFPP temporarily assigned the six-inch line to the East Line. Upon completion of the expansion project, SFPP entered an agreement with ARCO, a West Line shipper, to return the six-inch line to West Line service, thus restoring West Line service to Tucson. EPR and Navajo sued to enjoin the reversal, alleging that SFPP had contractually agreed to provide them the extra capacity, that they had engaged in costly investments in reliance on those agreements, and that the line reversal was motivated by a desire to drive the two shippers out of business. As noted, EPR also filed a complaint with the Commission challenging both the flow reversal and SFPP's East Line rates, thereby initiating this rate proceeding. The ALJ dismissed the portion of EPR's complaint dealing with the flow reversal for lack of jurisdiction, noting that because the Commission has no jurisdiction to prevent SFPP [**80] from abandoning service on the six-inch line, it also lacks authority to adjudicate allocation disputes as between shippers serving different markets along the line. *ALJ Decision, 80 FERC at 65,161-64.* No party has sought review of that ruling. The litigation then proceeded in other courts with SFPP ultimately entering into settlements with both shippers.

The ELS' lawsuit based on SFPP's reallocation of capacity from the East Line to the West Line, and the corresponding litigation costs incurred by SFPP, while caused, in the immediate sense, by ELS, were not costs of East Line service or expenditures benefitting the SFPP system generally. They were costs, if anything, of making capacity available to the West Line at the East Line's expense. SFPP did not seek to recover its costs from West Line shippers, either in the cost of service or by capitalizing them into the rate base, presumably because of the Commission's earlier ruling that the West Line rates were grandfathered under Section 1803 of the

EPAct, and therefore not subject to increase in this proceeding. Instead, SFPP sought to recover them from East Line shippers.

The Commission rejected this attempt, concluding [**81] that SFPP's costs in settling these matters "arose out of litigation unique to the conditions of [EPR and Navajo]," and, as such, were not costs that related to the provision of East Line service as a whole. Opinion No. 435, *86 FERC at 61,106*. On rehearing, the Commission ruled that the costs of litigating these matters were not recoverable, because "civil litigation of this type" involving "assertions of anti-competitive behavior and breach of contract to make capacity available" does not "address legal costs and remedies that SFPP would normally incur in the conduct of its common carrier operations." Opinion No. 435-A, *91 FERC at 61,513*. Therefore, the Commission concluded, SFPP's litigation expenses were "extraordinary." *Id.* On further rehearing, the Commission reaffirmed its ruling that SFPP could not recover such litigation costs in its rates. Opinion No. 435-B, *96 FERC at 62,070*.

Under the Commission's accounting regulations, extraordinary costs are defined as [*1296] costs that "possess a high degree of abnormality and [are] of a type clearly unrelated to, or only incidentally related to the ordinary and typical activities of the entity" [**82] and are "not reasonably expected to recur in the in the foreseeable future," *18 C.F.R. pt. 352*, General Instructions, 1-6(a). SFPP's flow reversal was not itself unique, for it had changed the direction of flow on the six-inch line a year before during the expansion of the eight-inch line. Nevertheless, as none of these prior reversals had generated legal disputes of this scope, the Commission could reasonably conclude that this type of civil litigation, "an action that would not arise in the normal course of the pipeline's operations," was not likely to recur. Opinion No. 435-B, *96 FERC at 62,070*.

The remaining question is whether the Commission used the correct standard in determining that these costs were "clearly unrelated to, or only incidentally related to the ordinary and typical activities of the entity." SFPP contends that any reading of this portion of the Commission's regulations must comply with *Iroquois Gas, 330 U.S. App. D.C. 271, 145 F.3d 398*, and *Mountain States Tel. & Tel. Co. v. FCC, 939 F.2d 1021, 1034, 291 U.S. App. D.C. 193*, particularly the latter decision's admonition that "if expenses are properly incurred, they must be allowed as part of the composition of [**83] rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above the expenses, would be a farce." *Mountain States, 939 F.2d 1021 at 1029* (internal citations omitted).

SFPP's position that capacity allocation litigation is an inevitable cost of doing business with two shipper camps competing for the same markets is not without some persuasiveness. The court has generally taken a somewhat broad view of which litigation costs entities regulated under rate-of-return ratemaking should be permitted to recover. In *Iroquois Gas*, the court vacated the Commission's presumptive disallowance of a gas pipeline's litigation costs defending alleged environmental violations during construction, reasoning that the Commission must analyze whether the purported environmental violations were for ratepayers' benefit rather than simply presuming the imprudence of supposedly illegal activity. *145 F.3d at 399-403*. Similarly, in *Mountain States I, 939 F.2d at 1029-35*, the court vacated an FCC order denying a carrier's recovery of antitrust litigation expenses, and, the same term, in *Mountain States Telephone and Telegraph Co. v. FCC, 291 U.S. App. D.C. 207, 939 F.2d 1035 (D.C. Cir. 1991)* [**84] ("*Mountain States II*"), remanded a rule presumptively denying recovery of litigation and judgment costs resulting from findings of illegal activity, expressing concern that such a rule might discourage utilities from taking appropriate legal risks that would ultimately benefit their ratepayers. *Id. at 1042-47*.

The Commission stated that it did not consider *Iroquois Gas* apposite because in that case, the underlying activity -- construction of the pipeline pursuant to the Commission's certificate authority -- was something over which the Commission had jurisdiction and whose prudence the Commission could evaluate. Opinion No. 435-B, *96 FERC at 62,070-71*. By contrast, the Commission viewed SFPP's underlying business decision to reverse flow on the six-inch line as "beyond the Commission's remedial authority." Proceeding on the premise that it lacks jurisdiction over market entry and exit, the Commission apparently takes the position that it is incapable of evaluating the prudence of legal expenses incurred in the course of either, and therefore cannot include them in common carrier rates.

The salient criterion under *Iroquois Gas* and *Mountain States II* [**85] for the recovery of legal expenditures by regulated entities is whether the underlying activity being [*1297] defended in the litigation serves the interests of ratepayers. *See Iroquois Gas, 145 F.3d at 401-02*; *Mountain States II, 939 F.2d at 1043-47*. The court need not address whether the Commission can reasonably deny the recovery of all nonjurisdictional litigation expenses associated with "both [market] entry and exit by the pipeline," Opinion No. 435-*96 FERC at 62,070*, because the issue in this proceeding is more narrow, and arises only with regard to the inclusion of market exit costs in the East Line rates, not market entry costs in the West Line rates. Whatever might be a common carrier's entitlement to recover any nonjurisdictional litigation costs associated with the initiation of common carrier service, it is not unreasonable for the Commission to refuse to allow a common carrier to charge ratepayers for the cost of taking capacity away from them. The Commission's initial determination that the flow-reversal litigation at issue was unrelated to the provision of East Line service was reasonable, and we affirm on that basis. The [**86] Commission recognized that, unlike in *Iroquois Gas*, SFPP's litigation did not "arise[] under regulatory obligations that apply to the system as a whole," and noted the "common sense observation by the East Line shippers that the costs and awards relating to their litigation will be borne primarily by themselves if the litigation and settlement costs are included in the East Line rates." *Id. at 62,071*. As only the East Line rates were at issue, the court understands the Commission's statement, that SFPP's civil legal expenses arising from the reversal dispute are not those "that SFPP would normally incur in the conduct of its common carrier operations," to refer narrowly to SFPP's "common carrier operations" on the East Line, and not more broadly to SFPP's "common carrier operations" generally. This approach is reasonable, because the cost of cancelling service is not a cost of providing it.

c. *Allocation of litigation costs*

More problematic is the Commission's decision that the East Line rates should bear half of SFPP's recoverable litigation costs. Opinion No. 435-A, *91 FERC at 61,513*. The rate proceeding included both East Line rates and [**87] the dispute about whether West Line rates were grandfathered. Some litigation costs may have been exclusive to each line, whereas others were common, but the record does not contain precise information regarding how much of SFPP's legal expenses can be attributed to each portion of the rate litigation. The West Line accounts for roughly twice the throughput of the East Line, and the Commission had initially reasoned that due to the more complex nature of the West Line issues litigated in the regulatory proceeding, costs should be apportioned volumetrically between the lines. Opinion No. 435, *86 FERC at 61,106*. On rehearing, the Commission reversed itself and split the costs evenly. Opinion No. 435-A, *91 FERC at 61,512*. The Commission stated that the ALJ, who initially presided over the case, was "in a position to observe complexity and flow" of the litigation, and could have reasonably concluded that it was the East Line issues, not the West Line issues, that accounted for the "greater portion" of costs generated in the proceeding. *Id.*

The ELS contend that the Commission departed from its well-established volumetric allocation policy for general costs [**88] without a rational basis, and thus was arbitrary and capricious in basing its allocation on which shippers created higher litigation costs. We see nothing problematic in an approach that attributes litigation costs to those for whose benefit the litigation is incurred, and prior Commission cases dealing [*1298] with legal expenses have allocated them similarly. *See, e.g., Southern California Edison Co., 56 FERC P 61,003*, 61,021 (1991). A volumetric approach might be appropriate for the recovery of commonly-incurred costs benefitting the entire system, but the Commission's focus here on who "generated the greater portion of a given litigation," Opinion No. 435-A, *91 FERC at 61,513*, is reasonable when litigation costs are specific to separately priced services.

The problem with the Commission's litigation-cost allocation is more basic: it lacks substantive analysis. The court is unable to discern why the Commission decided that 50%, as opposed to 40%, 30%, or any other number, fairly reflects the portion of SFPP's litigation expenses attributable to the East Line. It simply claimed to rely on the ALJ Decision for the 50% figure. *See 80 FERC at 65,167*. [**89] The ALJ Decision, at best, implicitly adopts the allocation suggested by a Staff witness. Other than describing the Staff's proposal as being developed as a representative amount of litigation expenses for inclusion in the test year cost of service, the ALJ Decision provides no analysis of why such a distribution is warranted. Hence, the Commission's reliance on the ALJ as being in the best position to observe the "complexity and flow" of the litigation leaves unexplained the basis for the allocation. While most of SFPP's litigation cost recovery has been offset by unpaid reparations, and the difference in rates resulting from the allocation may ultimately not be significant, the Commission must still explain its decision. The 50% allocation may or may not be a fair reflection of SFPP's rate litigation costs that were in fact attributable to the East Line. Accordingly, we remand for the Commission to explain its rationale for its allocation, either based on a 50-50 sharing between the East and West Lines or any other allocation it determines would be appropriate.

3. *Reconditioning Costs*

SFPP sought to have included in its East Line rates a projected annual cost of $ 3 million [**90] for a 15-year pipeline reconditioning program replacing the protective coating on parts of the East Line. Before the Commission, SFPP claimed to have spent upwards of $ 5.9 million of these reconditioning costs between 1995 and 1998. While acknowledging SFPP's expenditures on the project, the Commission refused to incorporate those costs, most of which were not incurred until after 1995, into SFPP's cost of service because they were too uncertain at the end of the test period in 1994. Opinion No. 435, *86 FERC at 61,106-08*. On rehearing, the Commission permitted SFPP to recover its actual expenses from shippers as part of the temporary surcharge it created for SFPP's rate litigation and environmental expenses. Opinion No. 435-A, *91 FERC at 61,518-19*. On further rehearing, however, the Commission reversed itself again and denied SFPP all recovery of its refurbishing costs. Opinion No. 435-B, *96 FERC at 62,078-79*.

Under its cost of service regulations, the Commission uses a "test year" methodology to determine a pipeline's annual cost of service. This approach looks to the actual costs the carrier incurs in the "test year" and then adjusts for any [**91] "known and measurable with reasonably accuracy" costs that "will become effective within nine months after the last month of the available actual experience utilized in the filing." *18 C.F.R. β 346.2(a)(1)(ii) (2004)*. The test year methodology accounts for the somewhat counterintuitive quality of these proceedings. The Commission, in issuing decisions after 1999 setting SFPP's cost of service for years after 1994, looked [*1299] not to SFPP's actual costs in those years but rather to what one could have predicted those costs to be, based on what was known in 1994. The Commission noted in Opinion No. 435 that it considers the test year a "relatively rigid concept simply because there must be some point at which the record closes and there is a known, factual basis for the conclusions." *86 FERC at 61,108*. Although this statement appears to mark a change from Commission policy in cases preceding the implementation of its cost of service regulations, where it indicated that it would approach test years more flexibly, *see, e.g., Lakehead, 71 FERC at 62,313*; *Williams Pipe Line Co., 21 FERC at 61,658*, the Commission's [**92] current cost of service regulations provide that it "may allow reasonable deviation from the test period" for "good cause shown." *18 C.F.R. β 346.2(a)(1)(ii)*.

The ALJ, using 1993 as the base year, decided that the refurbishing costs could not be recovered as part of SFPP's cost of service because the costs had not yet been incurred at that time, and SFPP's predictions of future costs were too uncertain. Finding that SFPP's board had not committed to the refurbishing program as late as 1995 and was simply funding the program year-by-year rather than committing itself to the entire proposed 15-year program, the ALJ reached a series of conclusions: that SFPP might decide to abandon the project or scale it back in the future, that the overall plan was subject to change, that there was little documentation to support estimates of the costs, and that it was uncertain whether significant amounts of the pipeline scheduled for refurbishing might be so corroded as to require outright replacement, which would be treated as a capital investment and factored into the rate base, not as an expense added to cost of service. In Opinion No. 435, the Commission essentially affirmed [**93] the ALJ's decision. *86 FERC at 61,106-08*.

SFPP contends that the Commission, which used a 1994 base period and the nine-month test period in 1995, could not reasonably affirm the ALJ's decision, which was based on data from an earlier period. There is some record evidence supporting SFPP's claim that it had more firmly committed to the reconditioning project, including beginning refurbishment of several miles of pipeline in 1995, within "nine months after the last month" of 1994. *Cf. 18 C.F.R. β 346.2(a)(1)(ii)*. There was testimony that SFPP's board had approved the project by 1994, that SFPP had recoated 13 miles of the pipeline in 1995, and that its prospective cost estimates were based upon its actual costs thus far.

Nonetheless, it was not unreasonable of the Commission to continue to have doubts about locking so large an expense into SFPP's cost of service (or, to put it more aptly given the test year methodology used here, it was not unreasonable for the Commission to have thought that doubts about the scope of the reconditioning project would still have been proper in 1995). At most the evidence before the Commission showed that, by [**94] 1995, SFPP had begun refurbishing certain portions of its pipeline; there was no guarantee from SFPP that the refurbishing would be as ambitious and expensive as claimed. Embedding SFPP's projections into its cost of service would have required its customers to pay for the refurbishing even if the project ultimately resulted in far smaller expenditures than those SFPP had projected. Indeed, given that SFPP now claims to have spent roughly $ 6 million on the project over four years, when it had predicted costs of at least $ 3 million a year over fifteen years, the Commission's judgment has been validated by hindsight.

[*1300] This does not end our inquiry, however, for SFPP also contends that having denied inclusion of reconditioning costs in SFPP's cost of service, it was arbitrary for the Commission not to permit recovery in a surcharge of SFPP's actual costs in 1995-98, which were not found to be imprudently incurred. The Commission's legitimate doubts over the ultimate scope and cost of the reconditioning do not explain the basis for the Commission's decision to deny recovery once actual costs of the project were known. Its decision, rather, stems from a combination of the Commission's [**95] test year approach and its interpretation of the filed rate doctrine. In Opinion No. 435-A, the Commission permitted SFPP to recover its actual reconditioning costs as part of the same surcharge whereby it permitted recovery of SFPP's regulatory litigation costs, similarly offset by any unpaid reparations; any cost not so offset could be included in a surcharge amortized over five years. Yet in Opinion No. 435-B, presented with SFPP's claim that it had expended

$ 5.9 million in actual East Line refurbishing costs between 1995 and 1998, the Commission denied recovery altogether because the expenditures "were not incurred in the 1994 cost of service test period." *96 FERC at 62,078.* In responding to protests that its Opinion No. 435-A ruling violated the filed rate doctrine, the Commission concluded "upon further review" that allowing a surcharge for costs not incurred in the test period or with any regularity thereafter "would permit SFPP to recover costs after the fact which were not even present in the test year itself and which thereafter could not be recovered in a cost of service rate filing," and that "to do so after the fact raises serious questions under the filed [**96] rate doctrine." Opinion No. 435-B, *96 FERC at 62,078.*

The difficulty for the court stems from three sources: the Commission's apparent failure in its test year approach to articulate a clear and consistent approach for dealing with the prudently incurred costs of providing pipeline service that do not regularly recur, the Commission's failure to explain adequately why SFPP's reconditioning costs would not be recoverable in a cost of service rate filing, and its failure to articulate why such a surcharge would violate the filed rate doctrine. Some prudent expenditures involved in the operation of a pipeline that are not capitalized, such as, for instance, rate litigation or refurbishing, are bound to be one-time or infrequent expenditures. A "test year" snapshot of a pipeline's operating costs, therefore, if applied too simplistically, risks over- or under-stating the "real" costs of providing pipeline service, depending on whether such costs happen, by chance, to fall in a test year or not. We do not understand the Commission to apply the test year concept so simplistically; its regulations deal with the possible overstating problem by disallowing nonrecurring costs as [**97] part of the cost of service, *see 18 C.F.R. ß 346.2(a)(1)(I)*, and both under- and over-stating problems by permitting deviation from the test year "for good cause shown," *id. ß 346.2(a)(1)(ii)*. Yet the Commission's approach in the instant case does not appear to deal consistently with costs incurred outside the test year, as evidenced by its different treatment of SFPP's rate litigation and reconditioning costs between 1995 and 1998. Both appear to be prudent, otherwise recoverable costs; both are nonrecurring (in the sense that they will not be permanent expenditures SFPP can be expected to incur each year); both were incurred chiefly outside the 1994 test year; and the Commission initially held that both past expenses could be recovered in prospective rates through a temporary surcharge because of "benefits that flowed to the system when the costs were incurred." [*1301] Opinion No. 435-A, *91 FERC at 61,518.*

The Commission then reversed course in Opinion No. 435-B and disallowed recovery of the reconditioning costs only. Its reasoning for disallowing one surcharge but permitting the other was that "unlike the [Commission] regulatory costs, [**98] none of [SFPP's reconditioning costs] were incurred in the test period." *96 FERC at 62,078.* The rate litigation surcharge included SFPP's actual costs after 1994. So the Commission's ruling suggests that it matters, to recovery of costs incurred outside of the test year, whether a carrier also incurred costs of the same general nature in the test year itself. The logic behind this distinction, as applied to costs that benefit the carrier's system but are not expected to regularly recur, is neither explained in Opinion No. 435-B itself, nor is it obvious. Should the Commission wish to rely on this reasoning on remand, it must articulate and justify more carefully what its policy on the recoverability of non-test-year expenses is.

The Commission did explain that SFPP's rates were indexed to account for cost increases after the test year, and that SFPP could not meet the "substantial divergence" standard for showing that indexing failed to account for increases in its cost of service due to reconditioning expenses after 1994. *Cf. 18 C.F.R. ß 342.4(a) (2004)*. Assuming that the Commission can explain its different treatment of rate litigation [**99] and reconditioning costs incurred in years after the 1994 test year, this may be a reasonable basis for denying recovery, but the Commission's opinion provides no analysis for why it is true. Where the Commission had found SFPP's cost of service to be roughly $ 14 million a year, SFPP was claiming reconditioning costs of roughly $ 1 million a year, a not insubstantial amount. The Commission provided no estimate or analysis of how any supplemental revenues to SFPP resulting from rate indexing, or from increased throughput in years after 1994, compare to those expenses.

The Commission also stated that permitting recovery of the refurbishing costs "after the fact" would "raise serious questions under the filed rate doctrine." Opinion No. 435-B, *96 FERC at 62,078.* The filed rate doctrine "forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority." *Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577, 69 L. Ed. 2d 856, 101 S. Ct. 2925 (1981)*. The Commission did not articulate what type of "serious questions" it thought such recovery would raise. Because a prospective surcharge would presumably [**100] be on file with the Commission, the court presumes that the Commission meant that an amortized surcharge, by prospectively recovering SFPP's expenses from past years, would violate the related rule against retroactive ratemaking, which requires that "a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle." *Southern California Edison Co. v. FERC, 256 U.S. App. D.C. 364, 805 F.2d 1068, 1070 n.2 (D.C. Cir. 1986)* (quoting

Nader v. FCC, 172 U.S. App. D.C. 1, 520 F.2d 182, 202 (D.C. Cir. 1975)).

This logic, again, raises the question of why such recovery is any more permissible for rate litigation expenses than it is for reconditioning costs. The Commission seems to place SFPP in a Catch-22: it cannot recover its reconditioning costs prospectively or contemporaneously because the cost of the project is too uncertain until the costs are incurred, but then once the costs are certain it is too late because recovery would involve retroactive charges. Absent a better explanation for the Commission's conclusion that SFPP [*1302] has recovered its reconditioning costs through the indexed rates, it is unclear how the [**101] costs of any multiyear project whose cost is not "known and measurable with reasonable certainty" in advance, *18 C.F.R. ß 346.2(a)(1)(ii)*, could ever be recovered, were this reasoning to be consistently adopted. The Commission ruled in Opinion No. 435-A that prospective recovery of SFPP's reconditioning costs would be appropriate because of "benefits that flowed to the system when the costs were incurred," *91 FERC at 61,518*, implying that it initially did not view the rule against retroactive rulemaking as an obstacle because the expenses provided an ongoing benefit that would continue to accrue in future years. In light of the Commission's failure to explain why it now considers the rule against retroactive rulemaking (or the filed rate doctrine) to bar recovery, and because no party has briefed this question in any detail, the court remands so that the Commission, if it wishes to continue relying on this reasoning, may better explain it.

The Commission may have answers to these concerns, but they are not provided in the Opinions on review. SFPP's shippers are presently enjoying the benefits of what appears to be an expensive pipeline reconditioning [**102] program without sharing in any of its costs. If, in the Commission's opinion, they should not have to, the Commission needs to provide a more thorough explanation of why not. Accordingly, we remand SFPP's request to recover its reconditioning costs for the East Line between 1995 and 1998 to the Commission for further consideration.

III. Reparations

A. *Background and Proceedings Below*

After determining that SFPP's East Line rates were not just and reasonable, the ALJ ordered SFPP to pay reparations to the ELS which had filed complaints against the rates. *ALJ Decision, 80 FERC at 61,308.* In Opinion No. 435, the Commission considered various objections to the reparations on the part of both SFPP and the shippers but reaffirmed that SFPP was to pay reparations as determined by the Commission. *See id. at 61,111*-14. Specifically, the Commission ruled that the period for the calculation of reparations would run from the date of each complaint until March 31, 1999, the effective date of revised East Line rates required by Opinion No. 435.

In calculating the potential reparations, the Commission retroactively applied the test year approach it had used [**103] to set SFPP's prospective rates: SFPP was to develop an East Line cost of service for a test year, 1994; design a rate that reflected that cost of service; index that rate to December 31, 1998; and apply that indexed rate to designated volumes adopted by Opinion No. 435 for each calendar year for which an indexed rate had been developed. Using the new cost of service thus established for years 1994-1998 and partial year 1999, SFPP was to determine whether the revenues for each period resulted in an over or under-recovery of its cost of service. FERC's order permitted SFPP to "net out its over and under recoveries for each year and determine that net amount, if any, that is due its East Line Shippers." *Id. at 61,114.* FERC ordered a similar calculation of reparations for years prior to 1994 based on the calculation of under- or over-recovery of cost of service in those years. As to reparations in general, FERC held that no shipper was entitled to reparations for periods prior to the filing date of a complaint. *Id. at 61,112-13.*

On rehearing, FERC held that Navajo was the only complainant that had filed a challenge to East Line rates. Thus, only [*1303] Navajo could recover reparations. [**104] Opinion No. 435-A, *91 FERC at 61,514.* FERC granted Navajo reparations beginning one month prior to the filing of its December 23, 1993, complaint to SFPP's rates. FERC also noted that Navajo had entered a settlement with SFPP in 1989. That settlement barred Navajo from bringing action against SFPP until November 23, 1993. With those provisos, FERC ordered SFPP to calculate the limited reparations still in order on the East Line based on the difference between per-barrel rates charged and per-barrel rates that would have been charged had SFPP charged cost-based rates using a 1994 test year, and to index such rates annually going forward -- in other words, the difference between the charged rates and the rates that SFPP should have charged. In sum, the Commission modified its prior order and decreed that:

> SFPP will calculate the gross reparations that would be due if all shippers that had used the East Line had filed complaints for the applicable reparations period ... establishing the total revenue that was received in excess of the new East Line rates established by the prior order. Navajo will be paid its *pro rata* share of the

reparations for the relevant [**105] time frame.

Id. at 61,518. The Commission noted that because Navajo was the only shipper entitled to reparations, the calculations "should leave a surplus of revenues in excess of the East Line restated cost of service between the beginning of the reparations period and the actual date on which the restated rates began to be collected by SFPP." *Id.*

The shippers petitioned for rehearing of FERC's reconsideration order, which FERC granted in part. This time, FERC held that Chevron, Western, ConocoPhillips, and ExxonMobil were, like Navajo, entitled to reparations for over-charges that occurred two years prior to the filing of their complaints. Opinion No. 435-B, *96 FERC at 62,071-74.* FERC held that Valero was not entitled to reparations, because its complaint was filed after August 7, 1995, the last date complaints were consolidated in the proceedings. *Id. at 62,072.* The Commission subsequently clarified Opinion No. 435-B by stating that Chevron's eligibility for reparations was determined as of its August 3, 1993 complaint, not a protest it filed September 23, 1992. Clarification and Rehearing Order, *97 FERC P 61,138.* [**106]

SFPP now argues that the Commission ought not have awarded any reparations whatsoever. Navajo contends that it was improperly denied reparations prior to November 23, 1993. Chevron alleges that FERC improperly set the commencement date for calculating its reparations. And Valero, BP WCP, and Chevron all claim that they were improperly denied reparations.

B. *Analysis*

1. *SFPP*

SFPP argues that the underlying orders were arbitrary and capricious for four related reasons. First, SFPP contends that awarding ELS reparations is impermissible retro-active ratemaking, in violation of the Supreme Court's decision in *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co., 284 U.S. 370, 76 L. Ed. 348, 52 S. Ct. 183 (1932).* Second, it asserts that FERC's award of pre-complaint reparations violates the EPAct. Third, SFPP advances that FERC improperly awarded reparations based on a "test period," disregarding damages actually suffered and proved by complainants. Finally, SFPP argues that FERC failed to consider substantial arguments -- such as the novelty and complexity of SFPP's rate case -- that [*1304] militated against awarding reparations. For the reasons stated below, [**107] we reject all four claims.

a. *The* Arizona Grocery *Rule*

Arizona Grocery proscribes "the retroactive revision of established rates through ex post reparations." *Verizon Tel. Cos. v. FCC, 348 U.S. App. D.C. 98, 269 F.3d 1098, 1107 (D.C. Cir. 2001); see also Ala. Power Co. v. ICC, 271 U.S. App. D.C. 394, 852 F.2d 1361, 1373 (D.C. Cir. 1988).* Otherwise put, *Arizona Grocery* bars reparations that retroactively change a final Commission-approved rate. SFPP relies on *Arizona Grocery* to argue that Opinion No. 435 was a final order prescribing just and reasonable rates, and thus FERC was barred from awarding reparations when SFPP's rate was effectively further lowered as a result of FERC's subsequent orders. SFPP argues that Opinion No. 435 was a final order setting rates "to be thereafter observed" under *ICA Section 15(1),* and therefore that the subsequent orders were retroactive changes of Opinion No. 435. We disagree.

Arizona Grocery is of no help to SFPP in this case. *Arizona Grocery* applies only where the Commission has "declared what is the maximum reasonable rate to be charged by a carrier." *284 U.S. at 390.* [**108] Yet FERC did not finalize a maximum reasonable rate in Opinion No. 435 and in fact repeatedly stated it was not doing so. Thus Opinion No. 435 set no final rate; rather, FERC only established a final rate at the completion of the OR92-8 proceedings. *SFPP, L.P., 100 FERC P 61,353,* 62,625 (2002) ("September 26 Order"). The OR92-8 proceedings were compliance filings. SFPP's filing in Docket No. OR92-8-013 showed SFPP's calculations for determining how its East Line rates should be structured to reflect the requirements of Opinion No. 435-B. SFPP later amended that in Docket No. OR92-8-015 to address the exclusion of the interest element from the calculation of the total potential reparation pool that would be due under the Commission's prior orders. *Id. at 62,622.*

The record shows that at each point, the Commission said that final East Line rates would not be established until the OR92-8 proceedings were completed. September 26 Order, *100 FERC at 62,625.* In response to Opinion No. 435, SFPP filed a tariff establishing a rate, but the Commission concluded that the tariff could not be determined to be just and reasonable until review of the Docket No. OR92-8 compliance [**109] filing was completed. The Commission accepted the tariff for filing and suspended it, subject to refund, pending review of the compliance filing. *SFPP, L.P., 87 FERC P 61,056,* 61,225-26 (1999). Nor did FERC's next opinion on the subject make that rate final. Opinion No. 435-A merely reaffirmed the suspension of the previously filed tariff based on the significant chance that the proposed rate levels in it would change depending on how the protests and related requests for rehearing were resolved. *91 FERC at 61,520.* It did not finalize the rate.

FERC's subsequent orders concerning SFPP's proposed rates were similarly nonfinal. FERC accepted for filing SFPP's Tariff No. 60, filed to comply with Opinion No. 435-A, with a proposed effective date of August 1, 2000, but suspended it subject to refund. *SFPP, L.P., 92 FERC P 61,166*, 61,563-64 (2000). Opinion No. 435-B approved the August 1, 2000, effective date because that was the date the Commission accepted SFPP's compliance filing, and directed a further compliance filing, also to be effective August 1, 2000. *96 FERC at 62,071, 62,079*. SFPP filed Tariff No. 67 (later corrected [**110] in Tariff No. 68), with a proposed effective [*1305] date of December 1, 2001. *SFPP, L.P., 98 FERC P 61,177*, 61,657 (2002). The Director of the Division of Tariffs and Rates Central rejected the tariffs because Opinion No. 435-B required an effective date of August 1, 2000. *Id.* FERC's order memorializing the rejection made clear that FERC's previous orders suspended, subject to refund, SFPP's proposed tariffs

> pending resolution of the numerous compliance issues that have been raised in the course of these proceedings. In each of the prior Opinions the Commission has made clear that SFPP must recalculate the rates to be applied in compliance with those Opinions and that any prior calculations of reparations and surcharges must be adjusted accordingly.

Id.

The Commission has thus been clear from the outset and throughout that no final rate determination would be made until the OR92-8 proceedings were complete. September 26 Order, *100 FERC at 62,625*. As a result, the Commission's orders requiring reparations do not violate the prohibition in *Arizona Grocery* from subjecting a carrier to payment of reparations with respect to a final rate. The Commission [**111] did not establish final lawful rates where it has expressly reserved authority to make adjustments in the context of an ongoing proceeding in which the methodology for determining the rate had not even been established. *Id. at 62,626*.

SFPP contends that the Commission's reparations orders violate *ICA Section 15(7)*, which authorizes refunds of "such increased rates or charges" as "shall be found not justified." *49 U.S.C. app. β 15(7) (1988)*. But *Section 15(7)* is an authorization, not a prohibition, and FERC did not invoke this provision in awarding the shippers reparations. The Commission found it inappropriate for this complaint proceeding to go forward under *Section 15(7)*, *SFPP, L.P., 63 FERC P 61,014*, 61,124 (1993), and thus no relief was awarded under that section. Rather, FERC proceeded under *ICA β β 8, 9, and 16(1)*, which specifically authorize the Commission to award damages in a *Section 13* complaint. *49 U.S.C. app. β β 8, 9 & 16(1) (1988)*. SFPP also contends that FERC lacks authority to issue "interim" rates after ruling on a complaint. Yet nothing in *Section 15(1)* prohibits FERC from directing a pipeline to file [**112] an interim rate, subject to suspension and refund, if there is a possibility that the final rates will be lower than the interim rates. Indeed, the Supreme Court has held that under the ICA the Commission has authority -- in response to an initial rate filing -- to direct an oil pipeline to file interim rates to go into effect, subject to refund, during the suspension period for the initial rates. *Trans Alaska Pipeline Rate Cases, 436 U.S. 631, 654-56, 56 L. Ed. 2d 591, 98 S. Ct. 2053 (1978). See also FPC v. Tenn. Gas Transmission Co., 371 U.S. 145, 146, 9 L. Ed. 2d 199, 83 S. Ct. 211 (1962); FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 585, 86 L. Ed. 1037, 62 S. Ct. 736 (1942).*

Therefore, we hold that when the Commission awarded reparations, it was not constrained by *Arizona Grocery's* blanket prohibition on retroactive repeals of ratemaking.

b. *Pre-Complaint Reparations*

SFPP's second contention is that the EPAct precludes pre-complaint reparations in a *Section 13* proceeding, and that each complainant may seek reparations only for overcharges that date from the filing of its own complaint. We disagree. EPAct Section 1803(b) provides:

> If the Commission determines [**113] pursuant to a proceeding instituted as a result of [*1306] a complaint under section 13 of the Interstate Commerce Act that the rate is not just and reasonable, the rate shall not be deemed to be just and reasonable. Any tariff reduction or refunds that may result as an outcome of such a complaint shall be prospective from the date of the filing of the complaint.

EPAct B 1803(b). The ICA, however, allows reparations for up to two years prior to the date of the filing of a complaint if the rates paid in those two years exceed the just and reasonable rate established in the complaint proceeding. *See 49 U.S.C. app. β 16(3)(b) (1988).*

SFPP contends that the last clause of Section 1803(b) is applicable to any and all complaints filed under *ICA Section 13*, and therefore that reparations awarded for all complaints -- including those for East Line rates -- must be prospective from the filing of the complaints. We agree with SFPP that EPAct Section 1803(b) prohibits retroactive rate-making, but we think that it does so only for those rates that were "grandfathered" under this section. Section 1803(b) does not apply to complaints challenging non-grandfathered rates. [**114] In its prefatory clause, it explicitly refers only to "a complaint ... against a rate deemed just and reasonable under [Section 1803(a)]." The second-to-last sentence of Section 1803(b) expressly relates only to complaints on which FERC acts to determine grandfathered rates, otherwise "deemed to be just and reasonable," to be just and reasonable. The reference to "such a complaint" in the last sentence of Section 1803(b) plainly refers back to the prior references in Section 1803(b) to complaints against rates "deemed to be just and reasonable" under Section 1803(a).

Because the East Line rates were challenged within the one-year period prior to enactment of the EPAct, they are not grandfathered under Section 1803. Accordingly, relief for East Line rate complainants is governed by "the traditional standards of the ICA, including *section 16*'s provision for a two year reparations period retroactive from the date of the complaint." *SFPP, L.P., 68 FERC P 61,306*, 61,582 (1994).

FERC's order tracked this interpretation of the statute precisely. FERC found that shippers filing a complaint against SFPP's East Line rates may recover reparations for the two-year period [**115] prior to the date of their complaints. The Commission determined that the EPAct barred pre-complaint relief only for complaints against grandfathered rates. Thus, FERC correctly found that Section 1803(b) does not apply to complaints challenging the East Line rates that FERC held not to be grandfathered.

c. *Test Period*

Next, SFPP challenges the methodology FERC ordered SFPP to use to calculate reparations. In Opinion No. 435-A, FERC ordered SFPP to use the following method. First, FERC said, SFPP must determine what the just and reasonable rate would have been in each year between 1994 and August 1, 2000 -- as well as two years back from the date of the earliest complaint -- and then calculate what the appropriate gross revenues would have been from that rate. The difference between the gross revenue under the new just and reasonable rates would create the total reparations pool -- the amount SFPP would pay to all eligible shippers. SFPP would then calculate the reparations due each eligible shipper (including interest), leaving a residual in the pool of funds that could not be distributed because certain shippers had not filed a complaint within the time frame of the proceeding. [**116] The residual pool would then be credited against the total supplemental costs permitted [*1307] under Opinion No. 435-A between 1995 and 1998. Any remaining allowable costs would then be recovered through a five-year surcharge.

To estimate what gross revenues would have been in those years, the Commission directed that SFPP use a test year cost of service, divided by the test year's volumes, to replace the previous unit rate not found to be just and reasonable. Opinion No. 435-A, *91 FERC at 61,516*. The reparations payment due for each year would be the difference between the revenues generated in that year under the old rates and the revenues that would have been generated under the final new rates. *Id.*

SFPP challenges the estimation methodology proposed by FERC -- specifically FERC's direction to use a "test period" to estimate past gross revenues. SFPP contends that basing the reparations calculations on a rate derived from a historical test period "makes no sense in the real world, as it wrongly assumes SFPP's actual cost of service did not change appreciably over a period of eight years or more." We once again disagree.

The use of test periods to set the cost of service [**117] for rates intended to span a number of years is well established. *See, e.g., Williston Basin Interstate Pipeline Co. v. FERC, 334 U.S. App. D.C. 109, 165 F.3d 54, 56 (D.C. Cir. 1999)*. As we have noted, it is ordinarily impossible for a pipeline to know at the time of filing what its actual costs will be during the effective period of the filed rates, and so the use of a "test period" for calculating the cost of service is appropriate. *Id.* While use of a test period is not perfect, it is a reasonable proxy for actual costs. *See generally American Public Power Ass'n v. FPC, 173 U.S. App. D.C. 36, 522 F.2d 142 (D.C. Cir. 1975)*; *see also Public Serv. Co. v. FERC, 832 F.2d 1201, 1218 (10th Cir. 1987)*. It was therefore reasonable for the Commission to base reparations calculations on the same test period methodology it uses to calculate prospective rates. To the extent SFPP contends that the Commission's reliance on the test year approach unreasonably denied it recovery of certain expenses it incurred after the test period, those concerns are addressed in Part II of our opinion.

The Commission also properly determined that rates based on the test period could [**118] be used to calculate reparations for the two years prior to the filing of the complaints. *See ALJ Decision, 80 FERC at 65,203*. There is no basis to conclude that test period rates that are just and reasonable for all future years do not provide a just and reasonable basis for determining reparations in the two years prior to the complaints. *Id.*

SFPP further contends that it should have been allowed to offset under-recovery of its cost of service in some years with over-recovery of its cost of service in other years, based on ICC decisions permitting netting of multi-year data in determining reparations. As explained, however, the Commission reasonably found that consideration of the costs from every year was not feasible. While the Surface Transportation Board (formerly ICC) determines the total revenue stream required to recover the costs of particular service over its economic life, FERC has reasonably decided to calculate reparations by the difference in the unit value of the old and new rate, not the difference in gross and net revenues for the operation of the pipeline as a whole. *ALJ Decision, 80 FERC at 65,203*. Accordingly, the Commission reasonably [**119] found the netting of reparations across the entire reparations period inappropriate in these circumstances.

Moreover, this Court has previously rejected pipeline demands to permit offsetting [*1308] undercharges and overcharges in different years during a refund period. As we held in *Belco Petroleum Corp. v. FERC, 191 U.S. App. D.C. 157, 589 F.2d 680, 686-87 (D.C. Cir. 1978)*, the NGA -- like the ICA here -- gives the regulated entity no right to collect more than the just and reasonable rate in one period simply because it collected less than the just and reasonable rate in another.

SFPP cites a number of cases for the proposition that the concept of netting multi-year data to assure fairness in reparations is well established, but here a multi-year rate method was not employed. It is thus reasonable to base reparations on a year-to-year basis without netting.

d. *Reasoned Decisionmaking*

SFPP's fourth contention is that the Commission abused its discretion by failing to consider SFPP's arguments. Although SFPP acknowledges FERC's discretion to award reparations, it points out that it argued that SFPP's rate case was complex and presented issues of first impression, [**120] and that SFPP could not have predicted what lawful rates would have been. In sum, it argued before the Commission that it could not have reasonably adjusted its rates. SFPP claims that by giving no consideration to these arguments, FERC failed to engage in reasoned decisionmaking. We reject this contention.

FERC's orders reasonably addressed SFPP's concerns. Although FERC never explicitly responded to SFPP's point that its case was complex, it implicitly did so by finding SFPP's rates unjust and unreasonable. The fact that SFPP's rate case was complex does not alter the Commission's obligation to make a decision as to whether SFPP's rates were unjust and unreasonable. The Commission reasonably responded to SFPP's argument by simply performing its statutory duty to pass on the reasonableness of SFPP's rates, rather than dwelling on the difficulty of the task at hand. Assuming FERC's decision to find the rates just and reasonable was reasoned, it does not become unreasoned simply because FERC reached its decision without explicitly commenting on its difficulty. In any event, it is apparent from the length and complexity of FERC's discussion that it understood the complexity of SFPP's [**121] case.

As for SFPP's argument that it could not have predicted the eventual rates, the Commission expressly responded to that reliance argument by stating that SFPP was on notice that its rates were subject to review, and that "there was a risk that the rates could be found unjust and unreasonable and reparations awarded." Opinion No. 435, *86 FERC at 61,113*.

Accordingly, the Commission engaged in reasoned decisionmaking in awarding reparations. Although certain matters were complex issues of first impression, FERC did not need to acknowledge that complexity explicitly for its decision to stand.

2. *Navajo*

Turning next to the shipper petitioners, Navajo contends that it should be awarded reparations for the two years preceding the filing of its complaint on December 22, 1993. As noted above, the Commission concluded that a prior settlement agreement between SFPP's predecessor and Navajo foreclosed Navajo from collecting reparations for this two-year period. We find no error in FERC's decision.

The settlement Navajo entered into with SFPP's predecessor, provided -- in Section 2.3 -- that:

> For the five (5) year period following the effective date of FERC [**122] Tariff No. 88 -- *i.e.*, November 23, 1988 -- Navajo shall [*1309] not challenge, by complaint or any other means, East Line rates established or increased in conformity with the terms and conditions of this Article, nor shall they seek reparations or other damages with respect to such rates.

Southern Pac. Pipe Lines, Inc., No. IS85-15-000, Stipulation and Settlement Agreement ß 2.3 (Jan. 30, 1989) (approved in *Southern Pac. Pipe Lines Partnership, L.P.*, 49 FERC P 61,081 (1989)).

Navajo contends that this language permits it to seek reparations for the two years prior to filing its complaint, even though those two years are within the five-year settlement rate moratorium. In Navajo's view, this reading is compelled by the contrast between Section 2.3 and Section 1.3 of the 1989 settlement concerning West Line rates. Section 1.3 provides as follows:

> During the (5) year period following November 23, 1988 (the effective date of FERC Tariff No. 88), Navajo shall not challenge, by complaint or any other means, West Line rates established or increased in conformity with the terms and conditions of this Article, nor shall they seek reparations or other damages [**123] with respect to such rates for any part of that five (5) year period.

Id. ß 1.3.

According to Navajo, the last sentence "made clear that Navajo not only agreed to refrain from filing a complaint seeking reparations during the five-year period following November 23, 1988, but also agreed to waive its rights to reparations relating to that five-year period." In contrast, Navajo argues, "the provision pertaining to the East Line did not waive the right to seek reparations for rates paid for service on the East Line during the five-year period once the moratorium expired."

The ALJ disagreed with Navajo, concluding that a "fair reading of the settlement agreement and the Commission's order approving it precludes claims for reparation by Navajo for rates charged during the period when the settlement was in effect." *ALJ Decision, 80 FERC at 65,207-08*. The Commission affirmed the ALJ's interpretation as "the only reasonable interpretation" of the settlement agreement. Opinion No. 435, *86 FERC at 61,111*.

We find the Commission's interpretation of the settlement to be reasonable. Section 2.3 expressly provides that Navajo shall not "seek reparations [**124] or other damages" with respect to the East Line rates for the five-year period following November 23, 1988. *Southern Pac. Pipe Lines, Inc.*, No. IS85-15-000, Stipulation and Settlement Agreement ß 2.3 (Jan. 30, 1989). While an additional phrase does appear in Section 1.3, this does not alter the plain meaning of Section 2.3. It is unreasonable to assume that, although obtaining agreement to language expressly referring to a five-year moratorium period for all rate changes, SFPP nevertheless intended to permit Navajo to seek reparations for two of the five years.

Navajo advances a number of theories as to why SFPP might have agreed to a shorter moratorium on East Line reparations. However, there is no evidence that these theories played any part in the negotiations and none of them address the fundamental point that the settlement expressly says five years. The Commission's interpretation of the contract as such is therefore reasonable.

3. *Valero*

Valero, another shipper, contends that FERC erred by denying it reparations in Opinion No. 435-B. Valero argues that because FERC found that SFPP [*1310] charged it unjust and unreasonable rates in Opinion No. 435-A, FERC had an obligation [**125] to award reparations to it as well. FERC responds that because Valero was not a party to OR92-8, the Commission properly rejected Valero's claim that it is entitled to reparations "in the same manner" as the shippers in OR92-8. Valero may be correct that it is entitled to reparations, but we agree with FERC that it is not so entitled in this particular proceeding.

Valero's complaint involves distinct issues from the complaints at issue in this case, and accordingly FERC reasonably denied it recovery in these proceedings. This case concerns shippers who filed their claims prior to August 1995. The timing of their complaint matters, because FERC determined that they were entitled to reparations only for over-charges during the two years preceding the filing of their complaints. In contrast, Valero -- then Ultramar Diamond Shamrock -- filed its complaint in November 1997. *ARCO Products Co., 82 FERC P 61,043*, 61,183 (1998). That complaint was docketed as OR98-2, separate from the docket at issue here, OR92-8, consolidated with other complaints filed after August 7, 1995, and all held in abeyance with an opportunity to amend the complaints based on the findings in this [**126] proceeding. The post-August 7, 1995 complaints were consolidated in a proceeding separate from OR92-8 because those complaints involve different test periods and cost factors from those addressed in OR92-8. Because Valero filed its complaint in 1997 -- and because, as FERC points out, Valero's reparations will be determined based upon a different test period and cost factors, and will be limited to the two years prior to the filing of Valero's complaint -- it may well not be entitled to the same reparations as shippers who filed in 1994. Accordingly, Valero must have its reparations claims adjudicated in the OR98-2 proceedings.

Valero's arguments do not convince us otherwise. Valero alleges that FERC's failure to provide reparations to Valero is directly contrary to the plain language and intent of the ICA. Under *Section 8 of the ICA* , injured shippers are provided a right of action for damages. *See 49 U.S.C. app. ß 8 (1988)*. But FERC's denial of reparations in Opinion No. 435-B is perfectly consistent with this provision. FERC did not hold in that order that Valero was not entitled to reparations. Rather, FERC deferred consideration of Valero's entitlement. [**127] Accordingly, FERC's decision is consistent with the ICA.

Valero argues that under *A.J. Phillips Co. v. Grand Trunk Western Ry. Co., 236 U.S. 662, 665, 59 L. Ed. 774, 35 S. Ct. 444 (1915)*, its party status in OR92-8 "is of no moment in awarding reparations." Pet. Joint Brief on Rate and Reparations Issues 28. While *A.J. Phillips* held that finding a rate unreasonable "inured to the benefit of every person that had been obliged to pay the unjust rate," *A.J. Phillips, 236 U.S. at 665*, it also recognized that a shipper's right to reparations turns on the timely filing of its complaint, and its rights are limited by that complaint. *Id. at 665-66* ("But while every person who had paid the rate could take advantage of the finding that the advance was unreasonable, he was obliged to assert his claim within the time fixed by law"). Here, Valero -- which filed its complaint in 1997 -- is not entitled to the same reparations as the shippers who filed in 1994, since Valero's reparations will be determined upon a different test period and cost factors, and will be limited to the two-year period prior to the filing of Valero's complaint. *See 49 U.S.C. app. β 16* [**128] *(3)(b) (1988)*. Thus, deferring consideration of Valero's claim is consistent [*1311] with *A.J. Phillips Co.* While there is some commonality of issues between Valero's complaint proceeding and OR92-8, OR92-8 is not dispositive of Valero's reparations claims. Therefore Valero must await adjudication of its reparations claims in OR98-2.

4. *BP West Coast Products and Chevron*

Petitioners allege that because both BP WCP (formerly ARCO Products Co.) and Chevron (formerly Texaco Refining and Marketing, Inc.) were injured by SFPP's East Line rates and both jointly filed -- on January 14, 1994 -- a complaint, FERC violated the ICA by denying them reparations. FERC denied both of these entities damages from the East Line rates because they stated no claim regarding the East Line rates in their complaints. We again agree with FERC.

ARCO's and Texaco's complaint simply did not challenge the East Line rates. While their complaint referenced Tariff No. 15 along with other tariffs, which includes East Line rates, that reference was not specific to any rate, but alleged only that shippers shipped petroleum pursuant to one or more of those tariffs. That vague reference fails to state a cognizable [**129] complaint against the East Line rates, since otherwise the allegations solely concerned West Line rates. ARCO's and Texaco's complaint alleged, instead, that their "shipments basically originate in California and are transported by SFPP to Phoenix and Tucson." Transportation from California into Arizona occurs only on the West Line. Consistent with that allegation, the complaint addressed the grandfathering of the West Line rates, and sought reparations, at the least, from the date of the filing of their complaint, which is the standard for grandfathered rates. The affidavit submitted in support of the complaint concluded that "SFPP's rates on its West Line System exceed the rates that would result from an appropriate application of the Commission's ratemaking methodology by a significant amount." *SFPP, L.P.*, No. OR92-8-000, Affidavit of Marsha K. Palazzi 2 (Jan. 18, 1994). No mention of the East Line rates is made in the complaint or the supporting affidavit. Thus, the complaint was only applicable to the West Line rates. *See SFPP, L.P., 68 FERC at 61,582*. Under these circumstances, the Commission reasonably interpreted the complaint to state a claim only with [**130] regard to the West Line rates, and BP WCP and Chevron were properly denied reparations for the East Line rates.

ARCO's October 2, 1992, intervention in OR92-8 does not change this result, *see* Rate Br. 32, since BP WCP's stated ground for intervention was its "direct interest" in the "new origin point and applicable rates at East Hynes." As the East Hynes station is on the West Line, this intervention likewise stated no claim with regard to the East Line rates.

5. *Chevron*

On September 23, 1992, Chevron filed a protest concerning SFPP's reversal of the flow of the "six-inch line" between Tucson and Phoenix, and SFPP's modification of its pro-rationing policy. On August 3, 1993, Chevron filed a complaint alleging that SFPP's East Line rates were unjust and unreasonable. Chevron demanded reparations "for the period beginning two years preceding the filing of the Complaint."

The Commission properly calculated Chevron's East Line rate reparations based on Chevron's 1993 complaint challenging those rates. *See supra* at 14 n.2. While Chevron argued that its 1993 complaint should relate back to its 1992 protest, the 1992 protest did not challenge the East Line rates, but [**131] rather only challenged flow reversal on one of SFPP's [*1312] lines and its capacity allocation procedures.

Chevron now contends that its East Line reparations should be based upon the date of its 1992 protest because the Commission treated the protest as a complaint. The Commission, held, however, that "the scope of the complaint proceeding shall be defined by the issues raised by El Paso and Chevron which caused these proceedings to be instituted." *SFPP, L.P., 63 FERC P 61,275*, 62,769 (1993). Chevron's protest "complained against the reversal of one of SFPP's lines and its capacity allocation procedures, but did not complain against the East Line rates as such." Opinion No. 435-A, *91 FERC at 61,514 n.55*. Because the protest did not complain about the East Line rates, the Commission properly found that the protest did not trigger reparations for the East Line rates, and dated Chevron's right to reparations from Chevron's August 3, 1993, East Line complaint. *SFPP, L.P., 97 FERC P 61,138* 61,623-24 (2001) (citing *SFPP, L.P., 65 FERC P 61,028*); *see also SFPP, L.P., 102 FERC P 61,073*, 61,183-84 (2003).

The ALJ's [**132] determination that reparations demands could relate back to earlier-filed complaints does not aid Chevron. As the ALJ recognized, an amendment to a pleading may relate back when it arises out of the same transaction or occurrence set forth in the original pleading. *Fed. R. Civ. P. 15(c)(2)*. Because the Commission found that Chevron's original protest did not concern the East Line rates, but rather only the practice of prorationing and reversal of the "six inch line," however, Chevron's claim for East Line rate reparations cannot relate back to that protest. The Commission reasonably determined that Chevron's 1993 complaint, which first stated a claim with regard to the justness and reasonableness of the East Line rates, was the proper basis for determining Chevron's right to reparations.

For the reasons given above, we affirm the decisions of the Commission in awarding reparations and deny the petitions for review in full to the extent they challenge FERC's reparations order.

CONCLUSION

In conclusion, we affirm the decisions of the Commission and deny the petitions except as follows: As regards the West Line rates, we grant the petition [**133] and remand with respect to the Commission's decisions that the Watson enhancement and turbine fuel rates are grandfathered under the EPAct. We also remand with respect to the Commission's determination that changes in tax allowance policy constitute "substantially changed circumstances" under the Act. As regards the East Line rates, we reverse the Commission's decision to rely on *Lakehead* insofar as it pertains to tax allowances, and thus grant the petition and remand the Commission's determination regarding the proper tax allowance for SFPP. We also grant the petition and remand for the Commission to determine and explain an appropriate allocation of the civil litigation costs between the West Line and East Line shippers. Finally, we grant the petition and remand for the Commission to address SFPP's request to recover its reconditioning costs.

LEXSEE 106 FERC 61300

ARCO Products Co. a Division of Atlantic Richfield Company, Texaco, Refining and Marketing Inc., and Mobil Oil Corporation v. SFPP; Ultramar Diamond Shamrock Corporation, Ultramar, Inc. v. SFPP; Tosco Corporation v. SFPP; Navajo Refining Corporation v. SFPP; Refinery Holding Company v. SFPP; SFPP, L.P.

Docket Nos. OR96-2-000, OR96-10-000, OR98-1-000, OR00-4-000, OR92-2-002, OR96-15-000, OR96-17-000, OR97-2-000, OR98-2-000, OR00-9-000, OR98-1-000, OR98-13-000, OR00-9-000, OR00-7-000, OR00-10-000, OR96-2-002, OR96-10-002, OR96-17-002, IS98-1-000

FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION

106 F.E.R.C. P61,300; 2004 FERC LEXIS 585

ORDER ON INITIAL DECISION

March 26, 2004

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

OPINION:
[*62,139]

I. Summary

1. This order addresses a June 24, 2003, Phase I initial decision (ID) n1 on complaints against SFPP, L.P.'s (SFPP) interstate rates for the years 1996, 1997, 1998, and 2000. Those complaints alleged that SFPP's rates or charges on its West, East, North, and Oregon Lines, and for its Watson Station Drain Dry facilities were unjust and unreasonable. The principal issue addressed by the ID is whether the complainants have satisfied the threshold "changed circumstances" standard in Section 1803(b) (1) of the Energy Policy Act of 1992 n2 (EPAct) and thus may seek a just and reasonable determination under Section 15(1) of the Interstate Commerce Act (ICA). n3 This threshold standard requires a showing of evidence that establishes that a substantial change has occurred after the date of enactment of the EPAct in the economic circumstances of the pipeline which were a basis for the rate, n4 and is referred to here as the "substantially changed circumstances" standard.

n1 Texaco Refining and Marketing, Inc., *et al.* v. *SFPP, 103 FERC P 63,055 (2003)* (Texaco Refining). The Sepulveda Line cost issues in Docket No. IS98-1-000 were remanded to the instant proceeding by the Commission's orders in Docket No. OR98-11-000 reported at *102 FERC P 61,240 (2003)* and *104 FERC P 61,136 (2003)*.
[**2]

n2 Energy Policy Act, Public Law 102-486 (1992), 106 Stat. 2776 (1992).

n3 *49 App. U.S.C. 15*(1) (1988).

n4 Section 1803(b)(1) provides in part that no person may file a complaint against a rate that is deemed to be just and reasonable under Section 1803(a) of the EPAct [a grandfathered rate] unless evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of the Act in the economic circumstances of the oil pipeline which were a basis for the rate; or in the nature of the services provided which were a basis for the rate.

2. The Administrative Law Judge (ALJ) found that the substantially changed circumstances standard had been satisfied with regard to: SFPP's West Line rates for 1996, 1997, 1998, and 2000; the North Line for 1997, 1998, and 2000; the Oregon Line for 1997, 1998, and 2000; and in the case of the Watson Station Drain Dry facilities, for all years for which complaints were filed. After making those determinations, the ALJ further held that SFPP's rates for the West, North, [**3] and Oregon Lines were not just and reasonable for any of the years at issue, nor were the Watson Station Drain Dry charges. The ALJ also held that SFPP's East Line rates were not just and reasonable in the years 1997, 1998, and 2000. The ALJ further concluded that it was necessary to resolve issues regarding SFPP's cost structure in a Phase II of this proceeding in order to establish just and reasonable rates.

3. SFPP, the Association of Oil Pipelines (AOPL), and Chevron Products Company (Chevron) filed exceptions to the ID. Briefs opposing SFPP's and the AOPL's exceptions were filed by all other participants, n5 while SFPP filed in opposition to Chevron's. On review, the Commission affirms most of the ALJ's conclusions on the interpretation of the statute, but modifies the ALJ's method for making the specific calculations used to determine whether there are substantially [*62,140] changed circumstances. The Commission affirms the ALJ's findings of changed circumstances on the West Line, and the Commission reverses the ALJ's findings of changed circumstances on the North and Oregon Lines. Issues regarding the Watson Station Drain Dry facilities are now pending before the D.C. Circuit Courtof [**4] Appeals and will be addressed once the Court rules on those issues.

n5 Western Refining Company, L.P. (Western Refining); Chevron; the Commission Trial Staff (Staff); ConocoPhillips Company (Conoco), Valero Marketing and Supply Company, and Ultramar Inc., filing jointly (Ultramar/Tosco); BP West Coast Products LLC (BP WCP) and ExxonMobil Oil Corporation (ExxonMobil), filing jointly (Indicated Shippers); and Navajo Refining Company, L.P. (Navajo).

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

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

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

II. Background

7. The instant proceedings are a sequel to the protracted litigation between SFPP and several of its oil pipeline customers that began with the filing of a complaint against SFPP's East Line rates in Docket No. OR92-8-000 on September 2, 1992. n6 A series of complaints filed through August 7, 1995, asserted that SFPP's rates for its West Line between Los Angeles and Arizona and those for its East Lines between El Paso and Arizona were unjust and unreasonable. These complaints were consolidated with Docket No.OR92-8-000, and were addressedby Opinion [**6] No. 435, issued

January 13, 1999, n7 its rehearing orders in Opinion Nos. 435-A and 435-B, n8 and ending with the acceptance order of SFPP's compliance filings in Docket Nos. OR92-8-020 and -021 on June 5, 2003. n9

n6 *SFPP, L.P., 65 FERC P 61,028 (1993)*, reh'g denied, *66 FERC P 61,210 (1994).*

n7 See *SFPP, L.P., 86 FERC P 61,022 (1999)* (Opinion No. 435). A full procedural history of the relevant complaints is provided in *Opinion No. 435 at 86 FERC 61,058-60.*

n8 *SFPP, L.P., 91 FERC P 61,135 (2000)* (Opinion No. 435-A). *SFPP, L.P., 96 FERC P 61,281 (2001)* (Opinion No. 435-B), *SFPP, L.P., 100 FERC P 61,353 (2002)* (Order on Rehearing and Compliance Filings). See also, *SFPP, L.P., 102 FERC P 61,073 (2003)* (Order on Compliance Filing).

n9 *SFPP, L.P., 103 FERC P 61,287 (2003).*

[**7]

8. In those orders the Commission addressed (1) the "substantially changed circumstances" standard with regard to complaints against SFPP's West Line rates for the period before August 7, 1995, and (2) cost-of-service issues regarding the East Line. The Commission found that the complainants had based their case on a one year cost-of-service for the 12 months before the EPAct became effective, and not on the economic circumstances that underlay the challenged West Line rates in the year those rates were established, i.e., 1989 in the case of the West Line rates, which were filed with the Commission in early 1989. n10 The Commission thus concluded that the complainants had failed to meet the substantially changed circumstances standard. Further, because SFPP's East Line rates were not grandfathered under the EPAct, the Commission addressed the justness and reasonableness of those rates, determined that they should be reduced prospectively for all shippers as of August 1, 2000, and ordered reparations for those shippers that had filed complaints against those rates. n11

n10 See Opinion No. 435, 86 FERC at 61,067-68; Opinion No. 435-A, 91 FERC at 61,500.

[**8]

n11 The cited orders are on appeal to the United States Court of Appeals for the D.C. Circuit. BP West Coast Products LLC, et al., v. FERC, Nos. 99-1020, et al. (consolidated).

9. Additional complaints were filed against SFPP's rates in 1996, 1997, and 1998. When the Commission issued Opinion No. 435 in January 1999, the Commission issued a contemporaneous order permitting complainants to amend their pending complaints in light of the rulings in that Opinion. n12 The amended complaints, which were filed in January 2000, were consolidated with the pending complaints that had been filed after August 7, 1995, and set for hearing. n13 Additional complaints filed in August 2000 were likewise consolidated and were set for hearing. n14 As noted, the ID issued on June 23, 2003. The time for filing briefs on exceptions and briefs opposing exceptions was extended, the latter being filed on September 5, 2003.

n12 *SFPP, L.P., 86 FERC P 61,035 (2000).*

n13 *SFPP, L.P., 91 FERC P 61,142 (2000).*

[**9]

n14 *SFPP, L.P., 92 FERC P 61,244 (2000).*

10. The complaints filed after 1995 differed from the earlier series in that most challenged all of SFPP's rates, not just those of SFPP's East and West Lines. Thus, the challenges in the consolidated dockets here are directed against the West Line rates from Los Angeles to Phoenix and Tucson, Arizona, the East Line rates from El Paso to Phoenix and Tucson, Arizona, the North Line rates from Oakland to Reno, Nevada, and the Oregon Line rates between Portland and Salem. Complaints were also filed against SFPP's charges for the operation of its Watson Station Drain Dry facilities and its Sepulveda Line, both located in SFPP's Los Angeles origin market. The Drain Dry [*62,141] Facilities are used to assure that oil is inserted into SFPP's system at mainline operating pressures. The Sepulveda line connects certain refineries and storage facilities at Sepulveda Junction to SFPP's trunk system at Watson Station. The proceeding regarding the latter rates for service on Line 109 between Sepulveda Junction and Watson Station was held in abeyance [**10] until a recent Commission ruling that SFPP had not established that it lacked significant market power for transportation services over the Sepulveda line. n15

n15 *SFPP, L.P., 102 FERC P 61,240 (2003),* reh'g denied, *104 FERC P 61,136 (2003).*

11. The ID reviewed the various complaints filed in 1996, 1997, 1998, and 2000 in detail, including the dates that they were filed and the rates at which each filing was directed. n16 While all these dates need not be repeated here, the date that each of the complaints was filed is significant for at least two reasons. First, if a rate is grandfathered under the EPAct, any attempt to show substantially changed circumstances must be based on circumstances occurring after the date of the EPAct and before the filing of the complaint. n17 Second, if the complaint does satisfy the substantially changed circumstances standard, Section 1803 (b) of the EPAct provides that reparations of grandfathered rates are due only from the [**11] date of the complaint forward to the date on which any new rate is set prospectively. The dates of the complaints against the East Line rates, which are not grandfathered, will also determine whether reparations will be due, since only those complaints filed before new rates were set for the line on August 1, 2000, are eligible for reparations.

n16 ID at P. 68-77.

n17 Opinion No. 435-A, 91 FERC at 61,500 and Section 1803(b) of the EP Act.

12. The balance of this order reviews the ALJ's interpretation of Section 1803 of the EPAct and its application to the rates charged for service over SFPP's West, East, North, and Oregon Lines. While the issue of whether the Sepulveda Line (Line 109 between Sepulveda Junction and Watson Station) is grandfathered was not formally before the ALJ at the time the ID issued, he nevertheless ruled on the matter. n18 The parties have briefed that issue and the Commission at this time can resolve the issue. It is uncontested that the East Line rates are not grandfathered and those [**12] complainants need not meet the substantially changed circumstances standard for those rates. For the East Line rates the issue thus is whether they are just and reasonable under Section 15(1) of the ICA.

n18 ID at P. 34 and 35. The ALJ made the same determination in the Sepulveda line proceeding now consolidated with this case, on July 25, 2003. *104 FERC P 63,022 (2003)* at P. 4.

III. Discussion

13. The central issue in Phase I of this consolidated proceeding is the proper interpretation and application of Section 1803(b)(1) of the EPAct. That section provides that a rate deemed to be just and reasonable under the EPAct, i.e., a

grandfathered rate, may be challenged only if a complainant presents evidence to the Commission which establishes that a substantial change has occurred after the date of enactment of the Act:

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

(B) in the nature of the services providedthat were a basis for the [**13] rate;

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

15. In Opinion No. 435, the Commission concluded that a "substantial change" is more than a "material change," and that Congress would not have adopted the word "substantial" if the conventional accounting threshold of ten percent, or another relatively low quantity, were meant to be the test for establishing substantially changed circumstances. The Commission also addressed whether a complainant must establish that there has been a substantial change to every rate design element that may be the economic basis for a challenged grandfathered rate in order to meet the substantially changed circumstances standard. The Commissionconcluded that this is not [**14] the case, holding that a substantial change could be established by one or a number of rate elements, thereby triggering an investigation under Section 15(1) of the ICA as to whether the rate is just and reasonable. n19

n19 86 FERC at 61,065-66.

16. The Commission further held in Opinion No. 435 that the number of rate elements that significantly affect the economic basis for most rates is relatively small, and that the basic ones are volumes, asset base, operating costs, and, perhaps, capital costs. Since these elements in turn are most likely to influence the oil pipeline's revenue requirements and return, the Commission stated, complainant must establish substantial change to one or more of these important elements that are the basis for a grandfathered rate and explain why this change is likely to have rendered that rate unjust and unreasonable. The Commission also concluded that in assessing whether the substantially changed circumstances standard had been met, any change must have occurred after the date [**15] of enactment of the EPAct, and must be measured against the economic assumptions embodied in the grandfathered rate. n20

n20 Id. at 61,067.

[*62,142]

A. The ALJ's Determinations

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

18. In construing Section 1803(b) of the EPAct, the ALJ generally adopted theCommission's analysis in Opinion Nos. 435, 435-A, and 435-B. He concluded that Section [**16] 1803(b) requires that substantially changed circumstances must occur after the effective date of the EPAct but before the date of a complaint, and must be measured against the economic circumstances in the year in which a grandfathered rate was established (filed). He also concluded that the

measurement of change could be based on one or more important cost factors, such as volumes, rate base, total allowed return, and changes in tax rates and income tax allowances.

19. To measure whether there were substantially changed circumstances, the ALJ identified three different points in time, denoted "A," "B," and "C": "A" to represent the year that includes the economic basis for a grandfathered rate, i.e., the year when a grandfathered rate was filed and took effect; "B" to represent the 12-month period ending October 24, 1992, the date of enactment of the EPAct; and "C" to represent the year when a complaint was filed. The ALJ then concluded that a measurement to determine whether there were substantially changed circumstances required two comparisons. The first, to see if there was a substantialchange in economic circumstances from the date the rate became effective, "A", to the [**17] date the complaint was filed, "C", compared the cost factors at "A" to the cost factors at "C" to obtain a percentage difference relative to "A," i.e., (C-A)/A. If this comparison showed substantially changed circumstances, the ALJ then compared the cost factors at "B" to the cost factors at "C" relative to "B," i.e., (C-B)/B, to see if the substantial changes occurred after "B," the date of enactment of the EPAct.

20. As a final step before deciding whether there were substantially changed circumstances, the ALJ addressed what "A," the year grandfathered rates took effect, should be for each of the West, North, and Oregon Lines. For the West Line the ALJ determined that "A" was 1989 and that the economic basis for the rates filed in that year was a cost-of-service study submitted by SFPP. For the North Line the ALJ determined that "A" was also 1989 and that the economic basis for those rates was a cost-of-service study for the North Line submitted by SFPP. For the Oregon Line the ALJ determined that "A" was 1984, the year the rates were established. The ALJ concluded, however, that therewas no evidence of record that would enable a determination of the economic basis for [**18] the Oregon Line rates. In the absence of such evidence, the ALJ examined the period after "B" to determine if there had been a substantial change in economic circumstances between "B" and "C," relying on cost-of-service information such as changes in volumes, rate base, allowed returns, income tax rates, and income tax allowances. The ALJ also addressed the Watson Station Drain Dry rates, focusing on the fact that the rate base of those facilities had been fully recovered after the date of enactment of the EPAct. The ALJ's methodology and conclusions and objections thereto are reviewed below.

B. The Commission's Determinations

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

1. The Methodology for Measuring Changed Circumstances

22. As described earlier, the ALJ's methodology compared different points in time to determine whether there had been substantially changed circumstances. The ALJ held that change must have occurred after the date of enactment of the EPAct and should be measured by the [**19] percentage difference (1) between C and A, compared to A, and (2) the percentage difference between C and B, compared to B. The ALJ properly concluded that any substantially changed circumstances must occur after the effective date of the EPAct. The ALJ erred, however, by concluding that any change that occurred between B, the EPAct effective date, and C, the complaint date, i.e., C-B, should be evaluated relative to B. Rather, the change from B to C properly should be evaluated relative to A, since the EPAct requires a showing that there has been a change in the economic circumstances that were a basis for the rate, i.e., a change compared to A. That formula, i.e., (C-B)/A, was supported by the Commission's Trial Staff. The ALJ's use of a cumulative change from A to C is not needed to make this comparison.

23. As an example, assume the value for A is 100, B is 120, and C is 140. A comparison using the ALJ's approach of (C-B)/B would require comparing a change of 20 to B, or 120, and would result in a 16.7 percent change. The EPAct, however, requires that the change after the EPAct, C-B, or 20, be compared to the basis of the rate, A, or 100. This would result in a 20 [**20] percent change. If information regarding A is not readily available, however, only then would it be appropriate to compare any B to C change relative to B, as the ALJ did in addressing SFPP's Oregon Line. [*62,143]

24. When the value of B is less than A, however, the appropriate comparison is the change from A to C relative to A, i.e., (C-A)/A. This would apply to those factors that would be expected to increase in a changed circumstances situation, such as volumes. As an example, assume A is 100, B is 80 and C is 100. The change from B to C is 20, or a change of 20 percent relative to A, while the change from A to C is 0. Since the EPAct provides that evidence of a substantial

change in the circumstances that were the basis for a grandfathered rate is necessary to challenge the justness and reasonableness of that rate, it only makes sense to conclude that such a change must reflect an increase above the basis, i.e., above A, in this example a value of 100. In this instance, using a comparison of C-B relative to A would reflect a change from some point that is less than the basis value of A, i.e., from 80 to the basis value, 100, in the example. This comparison would reflect [**21] a change not in the basis for a grandfathered rate but rather in a value that is less than the basis for the rate.

25. Similarly, for factors expected to decrease, such as costs and rate base, the formula also would be (C-A)/A when the value for B is greater than A. If A is 100, for example, B is 120, and C is 100, this formula would reflect no change above A, the basis for the rate, at C. Again, using a comparison of C-B relative to A instead, would reflect a change from a point greater than the value of A, and thus would not reflect a change in the basis for the rate.

26. The comparisons thus would be inconsistent with the EPAct. The ALJ acknowledged that a comparison of C-B relative to A could lead to illogical results in these situations, but he discarded it completely in favor of (C-B)/B rather than adopting an approach that would account for such situations. Congress may have assumed that on the effective date of the EPAct, it was likely that oil pipelines would have had grandfathered rates that had been in effect for long periods and thus would have values at B that differed from those that long before at A were the bases for those grandfathered rates. That, however, is [**22] not always the case. On SFPP's West Line, for example, the volumes declined from 60,480,000 in 1989, which is A, to 52,160,000 at the enactment of EPAct, which is B. Volumes on SFPP's North Line likewise declined. See Appendix A, Table 1. Similarly, the West Line rate base for 1992 is greater than that for the base period 1989. See Appendix B, Table 3.

2. The Factors to be used for Measuring Change

27. In making his determinations of whether there were substantially changed circumstances for the various rates at issue here, the ALJ reviewed the following major cost factors: total volumes, income tax rate, income tax allowance, and allowed total return in the case of the West Line, together with some composite evidence prepared by Ultramar; n21 volumes, income tax rate and income tax allowance in the case of the North Line; n22 and volumes, income tax and income allowance in the case of the Oregon Line. n23

n21 ID at P. 117, 118-19, 120, and 121-22.

n22 ID at P. 200-2002 and 202-204.

n23 ID at P. 231-233 and 240-250.

[**23]
28. SFPP attacks this methodology on several grounds. First, it asserts that the ALJ relied in several cases on only one factor rather than several as is required by Opinion No. 435, that he failed to evaluate realized compared to projected returns, and that his decision places undue emphasis on the Lakehead tax allowance adjustment. n24 SFPP also asserts that the ALJ excessively relied on cost-of-service considerations. n25 The Complainant Parties and Staff reply that the ALJ did rely on more than one factor in most instances, that Opinion 435 specifically states the reliance on one or more factors is appropriate, and that the factors the ALJ used were consistent with the direction in Opinion No. 435.

n24 *Lakehead Pipe Line Company, L.P., 71 FERC P 61,338 (1995),* reh'g denied, *75 FERC P 61,181 (1998)* (Lakehead).

n25 SFPP also argues that the ALJ improperly required the preparation of cost-of-service studies for each of the complaint years at issue and for the 12 months prior to the effective date of the EPAct in 1992. Given the novel nature of this proceeding the Commission affirms the ALJ's decision to require cost-of-service studies for the years at issue. To the extent that SFPP prepared several such studies for each year to defend its theories on changed circumstances, that was its choice. Given the nature of the case, the cost-of-service evidence presented was helpful in validating the methodology adopted by the Commission and resolving disputes regarding the jurisdictional status of the rates for the North and Oregon Lines.

[**24]
29. The ALJ's reliance on a few important cost-of-service factors in making his determinations was consistent with Opinion No. 435 where the Commission identified the rate elements it considered would significantly affect the economic basis for most rates. However, the ALJ did not examine one factor, rate base, that is an important component of allowed return and a major factor that can affect a pipeline's return. He also relied too extensively on the changes in tax rates and tax allowances, which the Commission concludes below can lead to anomalous results. The ALJ's use of volume changes and allowed total return as major cost factors is affirmed. Volumes measure the growth or decline of the pipeline's business and are a good proxy for revenue growth. Allowed total return reflects the permitted return that would be permitted given its current rate base and the current weighted cost of capital. Changes in this cost factor therefore reflect changes in the rate base as well as changes in the cost of capital.

30. Changes to the rate base also reflect the increase and decrease in pipeline assets that may occur from additional investment, retirements, or the decline in rate base thatoccur [**25] as assets of different vintages are depreciated under the Commission's [*62,144] Opinion No. 154-B cost methodology. n26 The size of the rate base directly influences the return because the allowed rate of return is applied to it, thus determining the dollar amount of the return. As such, it is likely to be a significant factor because of the large amount of fixed costs present in a capital-intensive industry like oil pipelines. It is a figure carried on the company's books and should be readily allocated to a specific service based on the capital line items and related accrued depreciation recorded in the pipeline's property accounts.

n26 *Williams Pipe Line Company (Opinion No. 154-B), 31 FERC P 61,377 (1985)*, which was the first case establishing the Commission's current method for determining oil pipeline costs. The methodology has been applied in subsequent cases but continues to be referred to as the Opinion No.154-B methodology.

31. The ALJ also concluded that a change in regulatory policycould [**26] establish substantially changed circumstances. The ALJ therefore applied the so-called Lakehead tax allowance policy n27 in analyzing SFPP's income tax allowance. n28 The Lakehead case held that a pipeline partnership could take an income allowance only for the portion of the partnership interests that would be subject to double taxation on income distributions, primarily by corporate owners.

n27 See *Lakehead Pipe Line Company, L.P., 71 FERC P 61,338 (1995)*, reh'g denied, *75 FERC P 61,181 (1998)* (Lakehead). It was applied to SFPP's cost-of-service in Opinion No. 435, 86 FERC at 61,102-04.

n28 Opinion No. 435, 86 FERC at 61,070-71.

32. SFPP objects to the ALJ's reliance on the Lakehead policy in determining substantially changed circumstances. It asserts that the Commission itself described Lakehead as a continuation of existing Commission policy, and that in OpinionNo. 435 the Commission applied Lakehead to reparations [**27] for the calendar year 1992. SFPP further asserts that use of the Lakehead policy reflects a more fundamental error of including regulatory changes as a factor in the ALJ's determinations, if those changes occurred after the rate at issue was established. The Complainant Parties and Staff assert that SFPP's position has no merit because the Lakehead policy was announced in 1995 and became Commission policy only at that time. They further argue that the Commission expressly held in Opinion No. 435 that regulatory change was one factor to be addressed in evaluating whether there are substantially changed circumstances.

33. The Complainant Parties and Staff are correct that the Commission has previously determined in Opinion No. 435 that Congress did not reject changes in regulatory policy as a consideration in determining whether there are substantially changed circumstances. Moreover, SFPP's specific arguments regarding the Lakehead policy are without merit.

The policy was not final until after rehearing in the Lakehead proceeding was decided in 1996, and until that date pipeline partnerships were free to takethe full income tax allowance. In fact, SFPP did so in preparing [**28] the cost-of-service evidence it produced in 1989 to justify its West and North Line rates.

34. While Lakehead may have represented an evolution of Commission policy, this is only in the sense that the Commission has a long-standing policy that an income tax allowance should be permitted only for taxes that are actually incurred. n29 The argument that the policy was decided before 1992 because the Commission applied the policy in determining SFPP's 1992 reparations is equally specious. The Commission explicitly stated in Opinion No. 435 that it was following the standard procedure of applying current policy to the year at issue in the context of setting a reasonable rate. n30 This ruling applied as well to the reparations for 1993. The determination of rate reasonableness in either year did not address the relevance of Lakehead to determining whether there had been substantially changed circumstances to the economic basis of a rate.

n29 Lakehead, 75 FERC at 61,594-95.

n30 Opinion No. 435 at 61,104.

[**29]
35. The Commission also concludes, however, that the Lakehead policy should not be used as a stand-alone factor in addressing whether there have been substantially changed circumstances. The application of the policy in this case has already involved extensive discovery and litigation regarding its scope, which will vary from year to year as ownership ratios change. Because of these year to year variations, application of the policy involves the complexities associated with a full cost-of-service study n31 and should be utilized only in that context. Moreover, as the analysis of the North and Oregon Lines in the next part of this order indicates, there can be a very large reduction in income tax allowance in the years since 1992 even if many of the other principal cost factors, and in fact the total cost-of-service, increased after 1992. n32 For this reason the Commission reverses the ALJ to the extent that he relied on the use of the Lakehead factor outside the context of a full cost-of-service analysis in making his determinations.

n31 See UIT-42 at 63-67 for the depth of detail that can be involved in this issue.

[**30]

n32 See Appendices C and D, tables 5 and 7 comparing the years 1992 and subsequent years.

3. The Determinations for the Individual Facilities

36. There are two major steps involved in determining whether there has been a substantial change in the economic circumstances of each of SFPP's lines and facilities. The first step is determining what is the economic basis for the rate on each line and facility, which goes to finding when the particular rates became effective and what were the economic factors underlying those rates. [*62,145] The second step is determining whether there has been a substantial change to that economic basis. These steps are applied here to SFPP's West, North, and Oregon Lines. Since whether a rate is grandfathered determines if a changed circumstances finding must be made by the Commission, the issue of whether the Sepulveda Line are grandfathered is also reviewed here.

37. As has been discussed, the Commission concludes that the ALJ applied an incorrect formula when making determinations regarding substantially changed circumstances. However, much of the data the ALJ reliedon [**31] in making those calculations was correct, including updated cost-of-service information provided by SFPP at his direction and volume information provided by the Trial Staff and SFPP. Relying on this information, the Commission reevaluated whether there were substantially changed circumstances by applying the correct formula. This revised analysis is reflected in the tables and charts in the Appendices to this order. These tables and charts illustrate each of the changed circumstances calculations made here.

38. Appendix A displays the volumes for each of SFPP's lines and percentage changes in volumes for each line. Appendices B, C, and D display for the West, North, and Oregon Lines charts and graphs showing the change in absolute numbers of volume, rate base total allowed return, tax allowance, and cost-of-service trends for each of those lines. Certain charts also compare the import of the ALJ's two formulas [(C-A)/A and (C-B)/B] and that used by the Commission [(C-B)/A]. n33 When the overall trends are consistent, as in the case of the West Line, the conclusions of the ALJ and the Commission are the same. This is not the case, however, for the North and Oregon Lines due tothe [**32] fact that the costs of those lines increased after 1992.

n33 The figures the Commission used in making its determinations are highlighted.

a. The West Line

i. The Economic Basis for the Rates.

39. The ALJ determined that for SFPP's West Line rates the economic circumstances that were the basis for those rates were the "TOP Sheets" SFPP submitted to the Commission in on January 4, 1989, to justify the 25 cent per barrel increase to Tucson that became effective in February 1989, and thereafter a reinstated rate to Phoenix that became effective in early April 1989. n34 He further concluded that the rates were established on the date that they became effective. He also concluded that any change in the economic circumstances that were the basis for the West Line rates must be measured against the cost-of-service factors contained in the "TOP Sheets" submitted to the staff, particularly the forecasted volumes that were used in those sheets.

n34 "TOP Sheets" are normally cost-of-service data that is submitted by Staff to support its testimony in a cost-of-service proceeding. In the instant case the cost data prepared by SFPP was submitted to the Commission staff to justify a rate filing. Since the parties use the nomenclature "TOP Sheets," here the order uses the same term.

[**33]
40. SFPP argues on exceptions that the economic basis for the West Line rates is reflected in its settlement offer to the Airline-Intervenors in a February 26, 1988 letter from Mr. Abboud, an officer of SFPP, to Mr. John Cleary, counsel to the Airline-Intervenors. That letter, together with other correspondence, resulted in a settlement agreement between SFPP and the Airline-Intervenors in March of 1988. n35 SFPP further argues that the economic circumstance for the West Line rates should be determined by the volumes SFPP expected to flow over the West Line once those volumes reached the capacity upon which the 1998 expansion of that line was predicated (the mature volumes).

n35 Exs. JMA-10 and JMA-5 through 9.

41. SFPP also asserts that the filing with the Commission in 1989 of the revised Phoenix and reinstated Tucson rates after the completion of the West Line expansion did not establish the rates, but that they were established by negotiation. SFPP also argues that the Commission rejected the use of test yeardata [**34] as the economic basis for a rate in Opinion No. 435, and thus the use of the 1989 "TOP Sheets" is incorrect. SFPP argues that the Commission should use its projected 1991 "mature" volumes of 74.7 million barrels per year as the volume component for comparing any subsequent changes to its 1989 West Line rates. n36

n36 Derived from Ex. JMA-10, p. 3 of 5.

42. The Complainant Parties and the Commission Trial Staff support the ALJ, arguing that there were no exact rate levels established by Mr. Abboud's letter to Mr. John Cleary, or by the 1988 Settlement itself. They argue that the 1988

Settlement only established a 25-cent cap for the increase of any rates to recover the increased investment in the West Line, together with a bar to challenging those rates for a five-year period after the filing of Tariff 88. n37 They further assert that neither the 1988 Settlement nor Mr. Abboud's letter to Mr. John Cleary establishes what volumes would be used to design the rates, and that the volumes submitted to the FERC Staffin the [**35] 1989 "TOP Sheets" should control.

n37 Tariff 88 was filed to rollback SFPP's previous increases to the West and East Line Rates filed in 1987. See Ex. JMA-5 and Ex. JMA-18 at 22.

43. The Complainant Parties and the Commission Trial Staff further argue that if SFPP had used its anticipated long term volumes, then the Commission Staff would have required a lower rate based on those higher volumes. Finally, they argue that the Commission rejected the use of 1992 as a test year in Opinion No. 435 because it was the wrong year to use to determine the economic [*62,146] basis for the rate, not because the use of a cost-of-service approach was inherently incorrect. They state that the ALJ correctly adopted the1989 top sheet volume of 60.4 million barrels per annum as the volume component of the economic basis for SFPP's West Line rates.

44. The Commission agrees with the arguments of the complainants and the Commission Trial Staff and thus affirms the ALJ. First, it is clear that the rates for the West became effectivein early [**36] 1989, and as such were established once they became effective without suspension; the issue here is to determine the economic basis for those rates. The economic basis for those rates is the "TOP Sheets" that were submitted to the Commission's Oil Pipeline Board for its review in January 1989. As pointed out by Complainant parties, SFPP's own documentation indicates that SFPP expected a critical review by the Staff and the burden would be on SFPP to convince the Oil Pipeline Board, which had authority to suspend the rates, not to do so. n38 SFPP anticipated and planned for the submission of documentation to the Oil Pipeline Board to justify the modified West Line rates, n39 and recognized that any rates developed pursuant to the March 1988 Settlement were not in themselves justified by the 1988 Settlement. n40 In fact, SFPP therefore prepared a three-volume study to justify the rates and submitted the entire study to the Commission Staff. SFPP asserts that this study included forecasts ofthe 1989 and 1991 volumes. n41 As SFPP anticipated, prior to SFPP's January 1989 submission to Staff, the Commission took no action to accept any specific rates under the terms of the 1988 Settlement. [**37]

n38 See Exs. JMA-3 at 11, JMA-14 at 2, UIT-6, and UIT-45.

n39 See Ex. JAM-22 at 1.

n40 See Ex. UIT-46 at 11-12 and Ex. JMA-18, passim.

n41 Ex. JMA-1 at 20, as reflected in Ex. JMA-26.

45. In acting on the 1988 Settlement, the Commission - specifically declined to accept specific rates, holding that the rates actually filed pursuant to that Settlement would be reviewed to determine if they were just and reasonable, and that firms that were not party to the 1998 Settlement and the Commission Trial Staff could challenge those rates when filed. n42 Given its own expectation that the 25 cent increase would be embedded in rates that would have to pass Staff review, and the extensive justification SFPP prepared, the Commission concludes SFPP's argument that the detailed filing submitted to Staff has no relevance to its definition and justification of the West Line rates has no merit. The Commission therefore finds that the only effect of the 1988 Settlement was to permit SFPP to increase the [**38] rates on its West Line by up to 25 cents a barrel once the West Line expansion was completed. n43 Before the rates were actually filed in early 1989, there was no agreement on the specific size of the increase, which SFPP had indicated might be less

than 25 cents, n44 and equally important, the volumes upon which the rates would be premised. The Abboud letter is inadequate to establish the economic circumstances for the basis of the West Line rates.

n42 *SPPL, Inc., 45 FERC P 61,242 (1988)* at 61,715.

n43 See Ex. UIT-46.

n44 See Ex. JMA-8 (SFPP-21), p 2, JMA-12 (SFPP-25), p. 13 of 20, and JMA-14 (SFPP-23), p. 2 of 4.

46. At bottom, SFPP's position is essentially grounded in its financial expectations in expanding its West Line. SFPP argues that when corporations make investments of the magnitude of the West Line, the expected returns will be realized (the realized returns) only when anticipated utilization is achieved. Thus, the improvements are expected to underperform in [**39] the early years with full returns being achieved in later years. Under this theory, the conditions described in the Abboud letter reflect its corporate expectations from the expansion of the West Line, that the forecasted volumes of 74.7 million barrels per annum embody the fulfillment of those expectations, and that these expectations were embedded in the 1988 Settlement. SFPP therefore argues that changed circumstances should be measured against those volumes and the economic returns that it expected to obtain when the expansion matured.

47. The difficulty in SFPP's position is that its initial internal corporate analysis for the West Line rates was specifically designed in the context of the regulatory framework that existed at that time and in expectation of the Commission's review, or at least that of the Oil Pipeline Board. n45 SFPP anticipated that the rate level it deemed adequate to obtain a 14.1 percent incremental annual return would have to be justified in the context of a probable Oil Pipeline Board review. Exhibit JMA-3 is a project analysis for the West Lineexpansion prepared in October 1987. After discussing recent changes in tax law, the document evaluates possible [**40] system wide returns after the completion of the project based on 74.5 percent equity capital structure, a 25 cent per barrel increase, and a 10 to 11 percent system wide regulatory return. The assumptions include a 50 percent roll back of pending rate increases on the West Line and a 100 percent roll back on the East Line. n46

n45 As pointed out by Trail Staff witness Pride, it was routine to provide information to the Oil Pipeline Board to justify a filing as just and reasonable, including the filing of such information with the Secretary's office before it was transmitted to Staff. Thus, if SFPP responded to a Staff data request regarding a proposed filing, that material might also be filed with the Secretary's office. See Ex. S-48 at 8-9. In any event, material submitted to the Commission staff to support a regulatory filing is binding on the party providing the material.

n46 See Exs. JMA-3 and JMA-14. Its internal analysis indicates that SFPP evaluated its West Line project based on a review of anticipated cash flows and tax benefits from the accelerated amortization of the facility. In determining its corporate return, SFPP did not intend to rely solely on the level of the rate increase in relationship to any regulatory cost-of-service it might present to the Commission staff.

[**41] [*62,147]
48. Once the settlement was reached incorporating many of these features, Ex. JMA 14 indicates that an 18-cent per barrel incremental rate (on top of the rollbacks) would have been sufficient to give SFPP a projected return on its incremental investment in the West Line of 14.8 percent per year. n47 SFPP submitted the justification for proposed rates to the Commission in January 1989 based on the 60.4 million barrels in the "TOP Sheets". Clearly SFPP concluded that this level of volumes would be adequate to meet its corporate goals. n48 SFPP's internal documents thus disclose that the economic basis for the rate was embedded in the information eventually included in the January 1989 "TOP Sheets." This is true even though, as SFPP asserts, the 1988 Settlement negotiations and the Settlement occurred in early 1988 and the rates themselves were not filed until 1989. There is no merit to SFPP's argument that there is no connection between the time frame in which the 1988 Settlement was negotiated and the preparation of the Top Sheets. The 1989 "TOP Sheets" reflect a well thought through plan to design and justify the new West Line rates.

n47 This suggests that given SFPP's ability to increase the incremental rate by 25 cents, the returns might be even higher than those initially projected.

[**42]

n48 The Airline-Intervenors recognized that the return SFPP would earn on the expansion was sensitive to volume levels and the capital structure of the firm, and that the proposed Settlement terms might lead to returns that could exceed that normally permitted under the Commission's regulatory procedures. See Ex. JMA-12 at 11-13

49. Complainant parties also correctly argue, if SFPP had actually used the theory it advances here to design the rates, it would have had to use both the anticipated mature volumes, which SPFF projected to occur in 1991, and the mature costs, in order to obtain a determination at the Commission staff level that the proposed West Line rates were just and reasonable. But this is not what SFPP did. It justified the rates based on the projected volumes of the first year of operation (1989) and based its cost estimates on the same year. If it had used the mature volumes (reflecting "realized returns") to justify the rates in the first year of the analysis provided to the Oil Pipeline Board, the result would most likely have been a lower rate, which would have meant lowerrevenues [**43] in the initial years. The practical result would have been a greater probability of losses during the first two years of operations pending the achievement of mature volumes in 1991.

50. Thus, in order to maximize the probability that it would achieve its corporate return for its increased investment in the West Line, and to minimize its regulatory risk, SFPP's best tactic under the circumstances was to include in its "TOP Sheets" the minimum initial volume it believed would be acceptable to Staff, and then rely on the related growth assumptions to support obtain the return contained in its internal corporate analyses. In 1989, the test year approach SFPP attacks here worked to its advantage given the growth SFPP believed would occur in later years. The Commission therefore concludes, contrary to SFPP's assertions, that the West Line rates were designed from the outset based on a strategy of using the lowest forecast of volumes SFPP believed would be acceptable to the Commission staff based on the 25 cent increase. Given the indefinite nature of the Abboud letter and SFPP's carefully thought-out regulatory strategy to justify the 25 cent rate increase, the ALJ correctlyfound that [**44] the 1989 "TOP Sheets" were the best evidence of the circumstances that were the economic basis for the West Line rates.

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

ii. Analysis of Changed Circumstances

52. The ALJ found that therewere substantially [**45] changed circumstances for the West Line rates based on an increase in volumes by 1996, changes in income tax rates and income tax allowance by 1996, and allowed total return by 1996. The ALJ further found there were substantially changed circumstances based on Ultramar's estimate of SFPP's over-recovery when compared to SFPP's allowed total return. n49 The ALJ also found substantially changed circumstances for the years 1997, 1998, and 2000. n50 SFPP excepts on the grounds that the ALJ's analysis used the wrong volumes for the base year 1989, relied incorrectly on individual cost-of-service elements, and relied incorrectly on tax rate and tax allowance factors. The Complainant Parties and Staff support the ALJ's rationale, asserting that in fact he used more than one factor, that the factors were also combined based on a composite analysis by Ultramar, and that his reliance on volumes, tax rate changes, and tax allowance factors is consistent with Opinion No. 435.

n49 ID at P. 117-122.

n50 Id. at P. 167, 173, and 179.

[**46] [*62,148]
53. The Commission concludes that on the West Line there were substantial changes in the circumstances that were the basis for the Yuma, Calnev and West Tucson rates beginning in 1995, and for the West Phoenix rates beginning in 1997, based on cost decreases for the West Line and increases in volumes for those specific points. Since SFPP justified its West Line rates utilizing a projected 1989 cost-of-service that did not allocate costs among those different delivery points, the Commission agrees with the ALJ that it is appropriate to examine cost-of-service factors for all points on the West Line in the aggregate. Appendix B reveals that, compared to 1989, the allowed total return had declined by 17.77 percent between 1992 and 1995 and by 25.31 percent between 1992 and 1996 (Table 4). Table 6 of Appendix B reveals that total cost of service had declined by some 16.61 percent between 1992 and 1995 and by 19.11 percent between 1992 and 1996.

54. Thus, as long as the volumes projected for each of the delivery points on the West Line at least equaled those contained in the 1989 forecast, in general the yield for each unit of throughput had increased by at least 16.61 percent between1992 [**47] and 1995 based on the aggregate West Line cost-of-service that SFPP used to justify its rates in 1989. In fact, total volumes on the West Line increased some 16.4 percent in 1995 over 1989, suggesting a total increase in return of over 30 percent in 1995 compared to 1989 when the volume increase is combined with the cost-of-service decrease. n51 With a overall decline in expenses of 16.61 percent, based on SFPP's cost-of-service, combined with an increase of overall volume of 16.40 percent, it is not surprising that Staff calculated a cost over-recovery for the West Line as a whole of some 35.68 percent in 1995. When viewed as an aggregate, there were clearly substantially changed circumstances for the West Line as a whole beginning in complaint year 1995 and in each complaint year thereafter.

n51 The comparison is with 1989 instead of 1992 because volumes in 1992 were less than those for 1989. As has been discussed above, this requires that the 1989 value be used for measuring the change that occurred after 1992. In the case of the 1992 rate base, the rate base was greater than the 1989 rate base, and therefore the 1989 figure must be used. Thus, in both these instances the formula used is C-A/A.

[**48]
55. Section 1803(b) of the EPAct provides that evidence shall be submitted that establishes that there are "substantially changed circumstances has occurred in the to the economic circumstances of the oil pipeline that were a basis for the rate" to the extent such evidence can be elicited. While this level of detail is not available for a cost-of-service analysis, the Trial Staff included point-to-point flows for each origin and delivery point on the West Line (and the other lines) in the record. Thus it is appropriate to look at volumes for individual points on the West Line, rather than in the aggregate, to analyze whether there were substantial changes in the economic circumstances that were the basis for the rate at each of those individual points. Accordingly, the Commission will review the four West Line points with deliveries in 1995 to determine if there are substantially changed circumstances for the rates at Yuma, CalNev, Phoenix, and Tucson.

56. As shown by Table 2 of Appendix B, volumes to Yuma were 9.44 percent higher in 1995 compared to the 1989 volumes at a time when overall costs-of-service were had declined by 16.61 percent in the same time frame. The 9.44 [**49] percent increase in volume, when combined with a 16.61 percent decline in the cost-of-service between 1992 and 1995, compared to 1989, establishes there were substantially changed circumstances given a likely impact on return in excess of 20 percent. The fact that volumes declined thereafter does not change the result, although this may suggest the Yuma rates were not compensatory after 1995.

57. The increase in the CalNev volumes of 25.62 percent between 1992 and 1995 compared to 1989, and the 16.61 percent decrease in SFPP's cost-of-service from 1992 by 1995, results in substantially changedcircumstances to the economic basis for those rates in 1995. The same conclusion applies to the rates to Tucson. While volumes consistently

decreased from 1995through 1999, in absolute and percentage terms, the increase in volumes by 1995compared to 1989 amounted to 188 percent, due to a delay in substitution of West Line volumes for East Line volumes at Tucson. n52 The Commissionconcludes that there were substantially changed circumstances in the economicbasis for both the CalNev and Tucson rates as of 1995.

n53 The combined percentage change for the Yuma Line is 26.05 percent in 1995 and 26.65 percent for Phoenix West in 1997.

[**50]

n52 See Ex. UIT-42 at pp. 26-30 for an explanation of this result.

58. The analysis of the Phoenix deliveries is similar. It appears that the volumes to Phoenix did not grow as fast as SFPP had anticipated in its 1989 cost-of-service filing and in fact had declined by 1992 compared to 1989, and had increased by 1996 by only .68 percent over 1989 volumes. However, the increase in volumes between 1989 and 1997 was 7.56 percent compared to the 1989 base while cost-reductions between 1992 and 1997 were 19.09 percent compared to the 1989 base. The combined impact of the volume increase and cost decrease between 1992 and 1997, compared to 1989, is similar to that of the Yuma Line in 1995. n53 Thus, given the volume increase of 7.56 percent in 1997, when combined with the 19.09 percent decrease in costs by 1997, the Commissionfinds substantially changed circumstances as of 1997.

n53 The combined percentage change for the Yuma Line is 26.05 percent in 1995 and 26.65 percent for Phoenix West in 1997.

[**51] [*62,149]

b. The North Line

i. The Economic Basis for the Rates

59. With regard to the North Line, the ALJ based his determination of substantially changed circumstances on a 1989 cost-of-service study submitted to the Commission staff to justify the rate increase. n54 The Commission finds that to be appropriate for the same reasons involving the West Line rates. SFPP did present an alternative theory, asserting that rates for the North Line were constrained by truck competition at the time they were established. The Commission need not address that argument here because it finds below that there were no substantially changed circumstances to the economic basis of the North Line rates based on its analysis of the major cost-of-service factors.

n54 ID at P. 197-98. These "TOP Sheets" blended that certain inter-and intrastate cost factors, which the Commission factored out during its review of the ID.

ii. Analysis of Changed Circumstances

60. The ALJ concluded that changes in volumes after 1992 did not justify [**52] a finding of changed circumstances. The ALJ also found that there were substantially changed circumstances for the North Line rates for the complaint years 1997, 1998, and 2000 based on changes in the income tax rate and income tax allowances. SFPP excepted to this latter finding on the grounds that the ALJ failed to recognize cost increases that occurred after 1992, including additional investments in the North Line. SFPP also asserts that the cost evidence reviewed incorrectly blends inter-and intrastate cost factors.

61. Since earlier in this order the Commission has rejected the use of changes in tax rate and income tax allowances as stand-alone factors, as a result the ALJ's determinations that rely on those factors are reversed. However, his conclusions on the volume issue are correct. Appendix C, Table 2, indicates that the increase in volumes at Reno, the point on

the North Line with the highest increase, after 1992, ranged from 11 percent to 12.53 percent for the years 1995 through 1999 when compared to 1989 with the exception of the year 1998, where the difference between 1992 and 1998 was 16.63 percent when compared to 1989. For the North Line as a whole the percentage [**53] increase in volumes after 1992 compared to 1989 was consistently less than 15 percent. Moreover, the percentage increase in total costs between 1992 and 1999 ranged for 4.66 to 17.34 percent and mitigated the percentage increase in volumes between 1992 and 1999.

62. Ex. S-51 demonstrates that there were three years (1995, 1996, and 1999) in which SFPP had large over-recoveries of its North Line rates, as much as 23 or 24 percent in 1995 and 1996. Ex. UIT-42 at 41 likewise asserts that a restated rate for 1996 and 1999 would be approximately 17 percent below the rate developed in the 1989 cost-of-service study, and that most of this change occurred after 1992. However, the tables in Appendix C establish the contrary, suggesting that any significant gains in profits and return occurred before 1992 because cost-of-service factors increased in an amount sufficient to mitigate the effect of any gains in volumes. A 23 percent over-recovery is quite large, but the issue is not the level of the return but whether it has substantially changed since the enactment of the EPAct. A review of the cost and revenue factors for the North Line after 1992 in relationship to the 1989 base year suggests [**54] that as much as 50 percent of that return may be attributable to the years before 1992. Therefore Complainants have not established that there were substantially changed circumstances for the North Line.

c. The Oregon Line

i. Economic Basis For the Rates

63. Because no cost-of-service evidence was available for the Oregon Line for the calendar year 1985, the last time the rates were increased and filed with the Commission, the ALJ relied on changes to the 1992 volumes, tax rates, and income tax allowance to determine if there had been a substantial change in the economic circumstances that were the basis for the rate. n55 SFPP asserts first that this was wrong because the ALJ's analysis assumes a cost-of-service approach where none may have been involved. It asserts that his analysis also ignores the critical fact that SFPP greatly expanded the Oregon Line in 1984, and that the increases in volume in the late 1998 and 1999 reflect the first time that SFPP began to transport volumes sufficient to recover its costs. SFPP asserts that no pipeline would expandits system in the expectation of losing money.

n55 ID at P. 231-233 and 240-250.

[**55]
64. The Commission concludes that the ALJ erred in part in his analysis of the Oregon Line. First, in the absence of other evidence that addresses the year in which the rates were established, it might be reasonable to use 1992 as the base year for measuring whether there was a change in the economic basis for the rate. As previously explained, one must examine whether there has been a substantial change in the economic circumstances that were the basis for the rate at the time it was established, and whether such change occurred after the enactment of the EPAct. While a complainant must show both prongs under the statute to show substantially changed circumstances that would trigger an investigation under Section 15(1) of the ICA, if a pipeline is unable to produce anything during discovery that bears on the economic basis of the rate at issue, it will not be permitted to defeat the purpose of the statute on the absence of evidence absentoffering an alternative theory on its own behalf. [*62,150]

65. SFPP, however, is correct that it should be permitted to argue, as it did here, that, in the absence of evidence showing the basis for its 1985 rates, the increase in volumes on the Oregon [**56] Line in 1998 and 1999 only began to fill the expanded capacity after many years in which SFPP failed to recover its cost of service. By focusing only on the volumes and tax factors, the ALJ unduly constrained his analysis and failed to properly determine whether the Oregon Line was recovering its cost-of-service. Therefore the Commission will review the cost-of-service information available here to determine whether there was likely to have been a substantial change in the economic circumstances that were the basis of the Oregon Line rates.

ii. Analysis of Changed Circumstances

66. The ALJ found that there were no substantially changed circumstances for the Oregon Line rates for the complaint years 1996 and 1997 with respect to volumes, but that there were substantially changed circumstances based on volumes for the complaint year 1999. The ALJ also found that there was a substantial change in the income tax rate and income tax allowancefor the complaint years 1997, 1998, and 2000. SFPP asserts that the 1999 finding does not allow for the fact that the line was oversized in 1984, the fact that the line may not have recovered its cost of service, or for offsetting cost increases [**57] that occurred in the years 1997, 1998, and 2000. The Complainant Parties support the ALJ's rationale as consistent with Opinion No. 435.

67. The Commission finds that the ALJ erred in using the percentage change in income tax rates and income tax allowances as a stand-alone factor to support his findings. As demonstrated by Tables 1, 2, and 7 of Appendix C, even if 1992 is used as the base and volume changes are measured against it, the percentage change in rate base in the same period works to offset those changes, and the increase in overall costs offsets it completely. In fact, the large increase in costs parallels the increase in volumes, suggesting that much of the increase may have been variable costs, and inferentially, that there were large amounts of excess capacity in the line. This is consistent with SFPP's argument that the line was performing below capacity for many years. In fact, Trial Staff Exhibit 51 suggests that in mostyears any over-recovery was marginal or negative. The record as a whole thus supports SFPP's contention that the Oregon Line underperformed for many years and has only recently begun to achieve design capacity and the likely volumes and revenues [**58] that were the economic basis for the rates. The Commission therefore concludes that there were no substantially changed circumstances to the Oregon rates for any of the years at issue here.

d. Sepulveda Line

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

69. The Commission affirms the ALJ's conclusion that the 5-cent rate established by SFPP in 1993 was premised on an entirely new rate structure. The priorrate for transportation over the Sepulveda line was 15 cents a barrel with an annual revenue cap. Once the revenue cap was reached, there were no additional charges, and further volumes served to reduce the effective per barrel charge in any one [**59] calendar year. In contrast, the 5-cent rate did not provide for a reduction in the total revenues generated once a guaranteed revenue level was reached and total annual revenues could exceed those generated by the prior rate. As such, the 5-cent rate was premised on entirely different business assumptions, including the risk involved. n56 The 5-cent per barrel rate was contained in new contracts, was not effective more than 365 days prior to the effective date of the EPAct, and therefore is not grandfathered.

n56 See *SFPP, L.P., 102 FERC P 61,240 (2003)* at P 10.

F. Other Exceptions and Issues

1. The substantially changed circumstances standard.

70. The previous part of this order reviewed the ALJ's determinations of whether there weresubstantially changed circumstances for particular facilities. On exceptions, SFPP and AOPL assert the ALJ's analysis relied too heavily on cost-of-service considerations that worked to undercut certain broader policy goals they claim are contained [**60] in the EPAct. They argue that the ALJ adopted a relatively low level for the jurisdictional threshold, often approaching single digit percentage changes for individual cost factors, in determining whether there had been a substantial change in the economic circumstances that were the basis for a rate. They conclude that a series of modest gains in operating efficiency or growth could quickly result in cumulative changes in volumes, costs, tax factors, or returns that exceed the relatively low numerical threshold adopted by the ALJ. They claim that this would subject more grandfathered rates to a reasonableness review than is contemplated by the statute.

71. SFPP and AOPL further argue that the methodology adopted by the ALJ is inconsistent with the statement in Opinion No. 561 that one [*62,151] advantage of the Commission's indexing methodology is that it permits a pipeline to

keep a percentage of any efficiency gains. n57 They also assert thatthe ALJ's determinations will encourage wasteful and complex litigation between pipeline and shippers and undermine a Congressional desire to maintain rate stability and encourage investment in the oil pipeline industry. AOPL asserts that a more appropriate [**61] approach is to define the total economic circumstances of the firm, including exogenous factors, and to determine how changes in such broader economic factors impact the economic basis of a rate. n58

n57 Since the index is based on average increase in oil pipeline costs, a pipeline that has cost increases that are less than the average may take an increase that exceeds the average, at least until such time a shipper "alleges reasonable grounds for asserting that the rate is so substantially in increase of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable." 18 C.F.R ß 343.2(c)(2).

n58 See Prepared Answering Testimony of Jeff D. Makholm, Ph.D. Ex. AOPL-1.

72. The parties opposed to SFPP argue that the approach adoptedby the ALJ is consistent with the guidance provided by Opinion No. 435 and that his analysis relies on the cost factors the Commission stated would be appropriate. They further argue that reliance on a cost-oriented approach to the substantially changed [**62] circumstances standard has not discouraged investment in the oil pipeline industry. They cite as an example SFPP's current proposal to quintuple its investment in its East line. They also argue that the efficiency argument is not the focus of this statute and that SFPP's and AOPL's rate stability arguments are without merit given the administrative orientation of the EPAct. They argue that adopting SFPP's and AOPL's broader policy assertions would create an impossibly high barrier for the review of grandfathered oil pipeline rates.

73. The Commission concludes that the central issue to be decided here is not whether the use of cost-of-service factors is appropriate or inappropriate in and of itself, but the level of the threshold that results. The Commission has concluded that changes in tax rates and tax allowance should not be considered as a stand-alone cost factor is making such determinations because this could lead to anomalousresults and result a threshold that does not adequately discourage challenges to grandfathered oil pipeline rates. Second, the Commission's analysis here has used a reasonable threshold for substantially changed circumstances. Third, the threat of ongoing [**63] litigation has not discouraged SFPP from proposing to at least quintuple its investment base in its East Line even though those rates are not grandfathered and are now subject to review in this proceeding. In a related proceeding SFPP acknowledged that the resulting rates would be subject to conventional cost-based regulation when they were filed. n59

n59 See *SFPP, Order on Petition for Declaratory Order, 102 FERC P 61,089 (2003)*, P. 2, 3, 5, 9, and 27.

74. Regarding the argument for rate stability on floor, the legislative history of the EPA does indicate that rate stability is one goal of the EPAct. n60 However, this language does not mean that a challenge to existing rates based on a cost-of-service approach is inappropriate. Rather, the mandate is to structure a threshold that restricts challenges to grandfathered rates that makes rate levels more predictable by limiting the disruptive influence of too frequent challenges. Thus, while providing rate stability against ready challenge [**64] may be a concern under the statute, this does not suggest that a cost-oriented approach to substantially changed circumstances is inappropriate. n61 Moreover, the efficiency gains to be achieved under the Commission's Opinion No. 561 indexing methodologies apply to all pipeline rates, whether or not those rates are grandfathered under Section 1803(a). There is no indication in the legislation that grandfathered rates are entitled to a higher standard of protection on such broad policy grounds.

n60 SPFF cites language from the related floor comments, which it asserts states that the purpose of Section 1803(b) was to provide "increased rate certainty, limit the opportunity for future challenges to rates which had been in effect without challenge for an extended period of time, and limit refund exposure with respect to such rates." 138 Cong Rec. S17684 (1992).

n61 As stated by Robert C. Means on behalf of ARCO in Ex UIT 40 at 2-3: Its [Section 1803(b)'s] purpose is to serve as a safety value. It permits the Commission to respond to cases were a rigid application of the grandfathering rule would allow a pipeline to charge unacceptably high rates.

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

[**65]
75. Finally, the Commission concludes that AOPL's argument that broader measures of economic change should be used, including exogenous factors, falls outside the scope of the statute. AOPL provides no definition of its broader factors and thus the Commission rejects this argument. n62

n62 For the limitations of analyzing discreet pricing decisions at such an aggregated level, see Hay and Morris, Industrial Economics - Theory and Evidence, Oxford University Press 1979, as summarized at pp. 22-23 and detailed in chapters 2, 4, and 9.

2. Basis for the Rate.

76. The substantially changed circumstances standard of the EPAct requires evidence of a substantial change in the economic circumstances "which are the basis for the rate." SFPP asserts that the evidence submitted by the complainants and Staff on substantially changed circumstances is invalid because it addresses the economic characteristics [*62,152] of rate groups, not individual rates. SPFF asserts that since their analysis is directed to aggregate volumes, [**66] operating revenues, and costs of, for example, the Los Angeles to Phoenix rates, and not to the individual rates to specific destinations between those points, it does not meet the statutory requirement. The Complainant Parties and Staff respond that the SFPP has always justified its individual rates based on the total revenues required to cover the West Line costs without distinguishing between the individual commodities that were moving between individual points. They further argue that the argument is untimely because it was not raised before the ALJ, thus depriving Staff and complainants an opportunity to respond to the argument.

77. SFPP should have raised its argument before the ALJ. Failing to doso denies the Commission a complete record on which to base a decision on the record. n63 Here, however, the issue can be addressed without prejudice. The complainant parties and Staff are correct that SFPP prepared the cost justifications for its rates on the West and North Lines by developing costs for the entire line, and not applying those costs to specific delivery points on the lines, the specific rates, or the individual commodities. To the extent that SFPP itself designed [**67] and justified the rates at issue by reference to the aggregated costs of all the rates in the year that the rates were established, then that portion of economic basis for each individual rate can be evaluated on the same basis. In any event, Staff provided volume data for each point on each line for every year at issue n64 and the Commission's review utilized that volume data. The Commission rejects SFPP's argument that complainant's order of proof is inadequate.

n63 Cf. *Harris vs. Secretary, U.S. Department of Veteran's Affairs, 126 F.3d 339, 343 (D.C. Cir. 1997); Dole vs. Williams Enterprises, Inc., 876 F.2d 186, 189 (D.C. Cir. 1989).*

n64 See Prepared and Direct Answering Testimony of Bonnie J. Pride, Ex. 3-12.

3. Cost of Service and Accounting Issues

78. ALJ concluded that there are a number of cost-of service issues that need further refinement in the second phase of this proceeding in order to determine the just and reasonable rate for some [**68] of the years at issue. The Commission agrees that the cost issues should be addressed in Phase II. After resolving the cost issues the ALJ previously iden-

tified, as well as any that may be raised by this order, the ALJ may make an initial determination of the appropriate level for a just and reasonable rate for each rate and year remaining at issue.

79. There is, however, one issue that the Commission will address here due to its central role in determining just and reasonable rates for the calendar year 1999 and later. On December 31, 1998 SFPP wrote up its rate base to reflect a purchase price adjustment for the premium over the regulatory return that Kinder Morgan Energy Partners (Kinder Morgan) paid to acquire SFPP in that year. As is shown on page 213, line 44, of SFPP's 1998 Form 6, net rate base, as reflected in carrier property, was increased from $ 642,740,093 to $ 1,232,374,000. The increase in the equity component of SFPP's balance sheet (Page 113, Line 65) increased from $ 274,278,274 to $ 1,062,269,257. The practical effect of these two balance sheet increases is to greatly increase the allowed depreciation rate and the equity component of the cost of capital. The former [**69] serves to increase the total cost-of-service and the latter increases the cash return permitted by the allowed total return on the increased rate base. This in turn would support significantly higher rates that would have been the case prior to these changes in SFPP's 1998 Form 6.

80. Line 34 of Column F on page 213 shows that only $ 13,916,548 of the huge increase in SFPP's rate base and equity component at the end of 1998 was for net physical improvements to its system. Thus the balance is the result of the write up of assets. The general rule on the write-up of assets acquired by one company from another is that such assets must be included in the acquiring company's rate base for rate making purposes at no more than their depreciated original cost, unless it can be shown by clear and convincing evidence that the acquisition results in substantial benefits to the ratepayers. This is to prevent rate payers from paying for the same assets twice. It was well established by the date of the hearing in this proceeding that it was SFPP's obligation to address this issue, but it provided no evidence of record that would meet the governing standard. n65 Therefore the parties are directed [**70] not to use the acquisition write-up in designing rates for the calendar year 1998 and years thereafter. Moreover, SFPP was required to obtain Commission approval before making this accounting adjustment to its Form 6 and it failed to do so. n66 During this review the Commission found no evidence in its files that suggests that SFPP sought or obtained the required approvals. Therefore SFPP is directed to file within 30 days after this order issues for permission to include the acquisition write-up in its1998 Form 6, and its Form 6 for all subsequent years.

n65 See *Longhorn Partners Pipeline, 73 FERC P 61,355 (1995).*

n66 See 18 C.F.R. Part 2352, General Instructions 3-11(c)(1).

4. Whether the East Line are Eligible for Reparations

81. All agree that SFPP's East Line rates are not grandfathered. On exceptions, however, SFPP argues that the challenged rate must be so substantially in excess of the level of the indexed East Line rate established by Opinion No. 435 before the [**71] Commission will entertain a complaint. It asserts that unless this standard is met, SFPP's East Line shippers will not be eligible for reparations. [*62,153] The Complainant Parties and Staff respond that the substantial divergence threshold applies only to the increase taken under the Commission's indexing regulations, and does not apply to the level of the underlying rate. They assert that since the underlying East Line rates are not grandfathered, the base rate remains open to challenge even if the increase under the indexing regulations does not substantially exceed the cost increases actually experienced by the pipeline.

82. SFPP's argument is without merit. Section 343.2(c) of the Commission's regulations provides that a complaint filed against an indexed rate must allege reasonable grounds for asserting that the rate increase is so substantially in excess of the pipeline's actual costincreases that the rate is unjust and unreasonable. Such a challenge must rest solely on a comparison of the changes in rates and costs from one year to the next. The complaints against SFPP's East Line, however, challenge SFPP's underlying rates rather than the rate increases established through indexing. [**72] As these underlying rates are not grandfathered, complainants can proceed under Section 13(1) of the ICA to try and show under Section 15(1) of the ICA that the East Line rates are not just and reasonable. If the rates are found to be unjust and unreasonable, the Commission will prescribe new just and reasonable rate. The fact that a rate has been indexed does not preclude reparations if the underlying base rate has been determined to be unjust and unreasonable. The Commission finds:

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

84. The were no substantial changes in the economic circumstances that were a basis [**73] for SFPP's North Line and Oregon Line rates as of any of the years at issue in this proceeding. These rates thus continue to be deemed just and reasonable.

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

The Commission Orders:

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

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

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

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

By the Commission.

APPENDIX:

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

Table 1. SFPP Volume for Each Line

	(a)	(b)	(c)	
Line	V[1989] (bbls)	V[1992] (bbls)	V[1995] (bbls)	V[1996] (bbls)
West	60,480,000	52,160,000	70,398,491	73,688,461
North	12,465,000	12,059,000	13,951,489	13,801,898
Oregon	N/A	12,812,000	13,631,189	13,715,688

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

[**74]

Table 1. SFPP Volume for Each Line

	(c)		
Line	V[1997] (bbls)	V[1998] (bbls)	V[1999] (bbls)
West	76,391,251	76,600,714	77,701,618
North	13,822,380	14,330,911	13,901,625
Oregon	13,044,932	14,563,780	15,502,885

Table 1. SFPP Volume for Each Line

Line	(c) V[1997] (bbls)	V[1998] (bbls)	V[1999] (bbls)

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

Table 2. Percentage Volume Change for Each Line

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

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

Percentage Volume Change for Each Line

[SEE FIGURE IN ORIGINAL]

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

Exhibit No. ___ (S-48)

FEDERAL ENERGY REGULATORY COMMISSION OFFICE OF MARKETS, TARIFFS AND RATES

ARCO Products Company, et al. v. SFPP, L.P.

DOCKET NO. OR96-2-000, [75] et al.**

PREPARED REBUTTAL TESTIMONY OF Bonnie J. Pride

SEPTEMBER 17, 2001

WASHINGTON, D. C. 20426

0109190326.2

Exhibit No. ___ (S-51)
SFPP Costs of Service 1995
Interstate

	Revenues	Revised COS<1>
Oregon Line	$ 5,106,000	$ 5,214,000
North Line	$ 15,347,000	$ 12,384,000
West Line	$ 60,251,000	$ 44,406,000
East Line	$ 19,460,000	$ 16,732,000
Sepulveda	$ 1,156,000	$ 508,000
Watson	$ 2,033,000	$ 434,000
Total Interstate	$ 101,164,000	$ 78,736,000

SFPP Cost of Service 1996
Interstate

	Revenues	Revised COS<1>
Oregon Line	$ 6,173,000	$ 5,911,000
North Line	$ 15,233,000	$ 12,258,000
West Line	$ 51,826,000	$ 42,982,000
East Line	$ 21,675,000	$ 21,283,000
Sepulveda	$ 1,050,000	$ 537,000
Watson	$ 2,106,000	$ 380,000
Total Interstate	$ 106,056,000	$ 83,361,000

SFPP Cost of Service 1997
Interstate

	Revenues	Revised COS<1>
Oregon Line	$ 6,004,000	$ 6,161,000
North Line	$ 15,429,000	$ 14,429,000
West Line	$ 63,931,000	$ 42,995,000
East Line	$ 22,383,000	$ 19,438,000
Sepulveda	$ 981,000	$ 1,129,000
Watson	$ 2,269,000	$ 389,000
Total Interstate	$ 110,997,000	$ 84,641,000

SFPP Cost of Service 1998
Interstate

	Revenues	Revised COS<1>
Oregon Line	$ 6,780,000	$ 7,649,000
North Line	$ 16,091,000	$ 14,658,000
West Line	$ 84,260,000	$ 43,457,000
East Line	$ 27,131,000	$ 20,011,000
Sepulveda	$ 965,000	$ 851,000
Watson	$ 2,297,000	$ 395,000
Total Interstate	$ 117,524,000	$ 87,013,000

SFPP Cost of Service 1999
Interstate

	Revenues	Revised COS<1>
Oregon Line	$ 7,130,000	$ 6,031,000
North Line	$ 15,429,000	$ 12,778,000
West Line	$ 64,113,000	$ 42,262,000
East Line	$ 24,581,000	$ 18,850,000
Sepulveda	$ 452,000	$ 2,041,000
Watson	$ 2,264,000	$ 439,000
Total Interstate	$ 113,969,000	$ 82,401,000

<1>Revised Cost of Service per Ganz' Exhibits Nos. ___ SFPP-187(GRG-84) to SFPP-216(GRG-113)

[**76]

SFPP Costs of Service 1995 Interstate	Excess Revenues over Costs	% change	Total Revenues Over Cost of Service

Oregon Line	$ 262,000	17.11%	
North Line	$ 2,963,000	23.93%	
West Line	$ 15,845,000	35.68%	
East Line	$ 2,728,000	16.30%	
Sepulveda	$ 658,000	129.53%	
Watson	$ 1,599,000	368.43%	
Total Interstate	$ 22,428,000	28.49%	$ 22,428,000

SFPP Cost of Service 1996

Interstate	Revenues over Costs	% change	
Oregon Line	$ 262,000	4.43%	
North Line	$ 2,975,000	24.27%	
West Line	$ 18,844,000	43.84%	
East Line	$ 392,000	1.84%	
Sepulveda	$ 513,000	95.53%	
Watson	$ 1,728,000	454.74%	
Total Interstate	$ 24,714,000	29.65%	$ 24,714,000

SFPP Cost of Service 1997

Interstate	Revenues over Costs	% change	
Oregon Line	-$ 157,000	-2.55%	
North Line	$ 1,000,000	6.93%	
West Line	$ 20,936,000	48.69%	
East Line	$ 2,945,000	15.15%	
Sepulveda	-$ 148,000	-13.11%	
Watson	$ 1,880,000	483.29%	
Total Interstate	$ 26,456,000	31.29%	$ 26,456,000

SFPP Cost of Service 1998

Interstate	Excess Revenues over Costs	% change	
Oregon Line	-$ 869,000	-11.36%	
North Line	$ 1,435,000	9.79%	
West Line	$ 20,803,000	47.87%	
East Line	$ 7,120,000	35.58%	
Sepulveda	$ 114,000	13.40%	
Watson	$ 1,902,000	481.52%	
Total Interstate	$ 30,505,000	35.06%	$ 30,505,000

SFPP Cost of Service 1999

Interstate	Excess Revenues over Costs	% change

Oregon Line	$ 1,099,000	18.22%	
North Line	$ 2,651,000	20.75%	
West Line	$ 21,851,000	51.70%	
East Line	$ 5,731,000	30.40%	
Sepulveda	-$ 1,589,000	-77.85%	
Watson	$ 1,825,000	415.72%	
Total Interstate	$ 31,568,000	38.31%	$ 31,568,000
		TOTAL	$ 135,671,000

<1>Revised Cost of Service per Ganz' Exhibits Nos. ___ SFPP-187(GRG-84) to SFPP-216(GRG-113)

[**77] APPENDIX B -- Comparative Figures for the West Line

SFPP Total West Line Volume

[SEE FIGURE IN ORIGINAL]

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

Table 1. SFPP West Line Volume Per Point

	(a)	(b)	(c)	
West Points	V[1989] (bbls)	V[1992EPAct] (bbls)	V[1995] (bbls)	V[1996] (bbls)
Yuma	603,000	531,000	659,934	425,675
Calnev	21,957,000	23,341,000	28,965,880	31,518,562
Phoenix W	36,450,000	26,870,000	35,615,075	36,697,244
Tucson W	1,470,000	1,418,000	4,234,239	3,870,184
Luke W	0	0	923,363	1,176,796
William AFB	0	0	0	0
Total	60,480,000	52,160,000	70,398,491	73,688,461

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

Table 1. SFPP West Line Volume Per Point

	(c)		
West Points	V[1997] (bbls)	V[1998] (bbls)	V[1999] (bbls)
Yuma	485,283	347,231	368,275
Calnev	32,534,730	33,497,773	34,417,627
Phoenix W	39,204,536	39,602,716	39,988,048

Table 1. SFPP West Line Volume Per Point

	(a)	(b)	(c)	
West Points	V[1989] (bbls)	V[1992EPAct] (bbls)	V[1995] (bbls)	V[1996] (bbls)
Tucson W	3,004,226	2,860,684	2,370,428	
Luke W	1,162,476	292,310	557,240	
William AFB	0	0	0	
Total	76,391,251	76,600,714	77,701,618	

Source: West Line Interstate Volumes. See Exhibit No. ___ (S-4) Protected.
June 18, 2001.
[**78]

SFPP West Line Volume Per Point

[SEE FIGURE IN ORIGINAL]

Source: West Line Interstate Volumes. See Exhibit No. ___ (S-4) Protected. June 18, 2001.
Table 2. West Line: Percentage Volume Change per Point

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

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

West Line: Percentage Volume Change Per Point

[SEE FIGURE IN ORIGINAL]

Source: West Line Interstate Volumes. See Exhibit No. ___ (S-4) Protected. June 18, 2001.
Table 3. West Line: Percentage Rate Base Change

			Rate Base
(a)	Base Period 1989 ($ mil)	162.439	Percentage Change

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

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
[**79]

West Line: Rate Base Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1).
April 3, 2001; Source: UIT-4 Protected Material.
1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001;
Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001

West Line: Percentage Rate Base Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1).
April 3, 2001; Source: UIT-4 Protected Material.
1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001;
Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001

Table 4. West Line: Percentage Allowed Total Return Change

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

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

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
[**80]

West Line: Allowed Total Return Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1).
April 3, 2001; Source: UIT-4 Protected Material.
1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001;
Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001

West Line: Percentage Allowed Total Return Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1).
April 3, 2001; Source: UIT-4 Protected Material.
1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001;
Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001
Table 5. West Line: Percentage Income Tax Allowance Change

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

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
[**81]

West Line: Income Tax Allowance Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1).
April 3, 2001; Source: UIT-4 Protected Material.
1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001;
Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001

West Line: Percentage Income Tax Allowance Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1).
April 3, 2001; Source: UIT-4 Protected Material.
1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001; Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001
Table 6. West Line: Percentage Cost of Service Change

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

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

[**82]

West Line: Cost of Service Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from UIT-4 Protected Material.
1992 calculated from 1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001; Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
And Ganz SFPP 233 (GRG-130). July 31, 2001.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001

West Line: Percentage Cost of Service Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from UIT-4 Protected Material.
1992 calculated from 1992 from O'Loughlin work papers. See Exhibit No. ___ (UIT-1). April 3, 2001; Source: OR96-2 Ex. 256. SFPP 287, (UIT-11). July 15, 1996.
And Ganz SFPP 233 (GRG-130). July 31, 2001.
1995 from Ganz SFPP-197 (GRG-94). July 31, 2001
1996 from Ganz SFPP-198 (GRG-95). July 31, 2001
1997 from Ganz SFPP-199 (GRG-96). July 31, 2001
1998 from Ganz SFPP-200 (GRG-97). July 31, 2001
1999 from Ganz SFPP-201 (GRG-98). July 31, 2001

APPENDIX C -- Comparative Figures for the North Line

SFPP Total North Line Volume [83]**

[SEE FIGURE IN ORIGINAL]

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

Table 1. SFPP North Line Volume Per Point

	(a)	(b)	(c)	
North Points	V[1989] (bbls)	V[1992EPAct] (bbls)	1995	1996
Reno	11,625,000	11,148,000	12,916,253	12,909,324
Nevada ANG (Reno)	0	0	109,658	40,065
Fallon NAS	840,000	911,000	925,578	852,509
Total	12,465,000	12,059,000	13,951,489	13,801,898

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

Table 1. SFPP North Line Volume Per Point

	(c)		
North Points	1997	1998	1999
Reno	12,992,651	13,557,683	13,081,624
Nevada ANG (Reno)	91,766	48,043	29,043
Fallon NAS	737,963	725,185	790,958
Total	13,822,380	14,330,911	13,901,625

Table 1. SFPP North Line Volume Per Point

	(a)	(b)	(c)	
North Points	V[1989] (bbls)	V[1992EPAct] (bbls)	1995	1996

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

SFPP North Line Volume Per Point

[SEE FIGURE IN ORIGINAL]

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

Table 2. North Line: Percentage Volume Change per Point

North Line	(a)	(b)	(c)	
Point	V[1989] (bbls)	V[1992] (bbls)	1995	1996
Reno	11,625,000	11,148,000	11.11%	11.05%
Nevada ANG (Reno)	0	0	N/A	N/A
Fallon NAS	840,000	911,000	1.74%	-6.96%
Total	12,465,000	12,059,000	11.93%	10.73%

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

[**84]

Table 2. North Line: Percentage Volume Change per Point

North Line	(c)		
Point	1997	1998	1999
Reno	11.76%	16.63%	12.53%
Nevada ANG (Reno)	N/A	N/A	N/A
Fallon NAS	-20.60%	-22.12%	-14.29%
Total	10.89%	14.97%	11.53%

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

North Line: Percentage Volume Change Per Point

[SEE FIGURE IN ORIGINAL]

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

Table 3. North Line: Percentage Rate Base Change

			Rate Base Percentage Change		
(a)	Base Period 1989 ($ mil)	36.12534*			
(b)	EP Act 1992 ($ mil)	27.742	(c-a)/a	(c-b)/b	(c-b)/a

Table 3. North Line: Percentage Rate Base Change

	1995	29.745	-17.66%	7.22%	5.54%
	1996	30.191	-16.43%	8.83%	6.78%
(c)	1997	30.59	-15.32%	10.27%	7.88%
	1998	30.475	-15.64%	9.85%	7.57%
	1999	29.153	-19.30%	5.09%	3.91%

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
*Percentage of Interstate Revenues

North Line: Rate Base Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 4. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, [**85] 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001

North Line: Percentage Rate Base Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 4. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001
Table 4. North Line: Percentage Allowed Total Return Change

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

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
* Percentage of Interstate Revenues

North Line: Allowed Total Return Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 1A. September 17, 2001.
1992 [**86] from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001

North Line: Percentage Allowed Total Return Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 1A. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001
Table 5. North Line: Percentage Income Tax Allowance Change

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

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
* Percentage of Interstate Revenues
[**87]

North Line: Income Tax Allowance Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 1A. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001

North Line: Percentage Income Tax Allowance Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 1A. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001

Table 6. North Line: Percentage Cost of Service Change

			Cost of Service Percentage Change		
(a)	Base Period 1989 ($ mil)	17,457*			
(b)	EP Act 1992 ($ mil)	11,559	(c-a)/a	(c-b)/b	(c-b)/a
	1995	12,384	-29.06%	7.14%	4.73%
	1996	12,258	-29.78%	6.05%	4.00%
(c)	1997	14,429	-17.35%	24.83%	16.44%
	1998	14,656	-16.05%	26.79%	17.74%
	1999	12,778	-26.80%	10.55%	6.98%

Source: If b </= a, then (c-b)/a; Else if b > a, then (c-a)/a
*Percentage of Interstate Revenues
[**88]

North Line: Cost of Service Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 1A. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001

North Line: Percentage Cost of Service Change

[SEE FIGURE IN ORIGINAL]

Source: 1989 from (UIT-10). Schedule No. 1A. September 17, 2001.
1992 from Ganz SFPP 234 (GRG-131). July 31, 2001.
1995 from Ganz SFPP-192 (GRG-89). July 31, 2001
1996 from Ganz SFPP-193 (GRG-90). July 31, 2001
1997 from Ganz SFPP-194 (GRG-91). July 31, 2001
1998 from Ganz SFPP-195 (GRG-92). July 31, 2001
1999 from Ganz SFPP-196 (GRG-93). July 31, 2001

APPENDIX D -- Comparative Figures for the Oregon Line

SFPP Total Oregon Line Volume

[SEE FIGURE IN ORIGINAL]

Source: Oregon Line Interstate Volumes. See Exhibit No. ___ (S-8) Protected. June 18, 2001.
Table 1. SFPP Oregon Line Volume Per Point

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

Source: Oregon Line Interstate Volumes. See Exhibit No. ___ (S-8) Protected.
June 18, 2001.
[**89]

SFPP Oregon Line Volume Per Point

[SEE FIGURE IN ORIGINAL]

Source: Oregon Line Interstate Volumes. See Exhibit No. ___ (S-8) Protected. June 18, 2001.
Table 2. Oregon Line: Percentage Volume Change Per Point

	(b)	(c)				
Oregon Points	V[1992EPAct] (bbls)	1995	1996	1997	1998	1999
Eugene	12,011,000	8.01%	9.23%	7.06%	21.25%	29.07%
Albany	801,000	-17.80%	-25.58%	-76.74%	-100.00%	-100.00%
Total	12,812,000	6.39%	7.05%	1.82%	13.67%	21.00%

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

Oregon Line: Percentage Volume Change Per Point (c-b)/b

[SEE FIGURE IN ORIGINAL]

Source: Oregon Line Interstate Volumes. See Exhibit No. ___ (S-8) Protected. June 18, 2001.
Table 3. Oregon Line: Percentage Rate Base Change

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

Table 3. Oregon Line: Percentage Rate Base Change

			Rate Base
(a)	Base Period 1989 ($ mil)	N/A	Percentage Change
	1999	8,999	14.92%

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

Oregon Line: Rate Base Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July [**90] 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001

Oregon Line: Percentage Rate Base Change

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001
Table 4. Oregon Line: Percentage Allowed Total Return Change

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

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

Oregon Line: Allowed Total Return Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 [**91] from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001

Oregon Line: Percentage Allowed Total Return Change

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001

Table 5. Oregon Line: Percentage Income Tax Allowance Change

(a)	Base Period 1989 ($ mil)	N/A	Income Tax Allowance Percentage Change
(b)	EP Act 1992 ($ mil)	325	(c-b)/b
	1995	96	-70.46%
	1996	81	-75.08%
(c)	1997	91	-72.00%
	1998	118	-63.69%
	1999	135	-58.46%

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

Oregon Line: Income Tax Allowance Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001 [**92]

Oregon Line: Percentage Income Tax Allowance Change

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001

Table 6. Oregon Line: Percentage Cost of Service Change

(a)	Base Period 1989 ($ mil)	N/A	Cost of Service Percentage Change
(b)	EP Act 1992 ($ mil)	4,697	(c-b)/b

	1995	5,214	11.01%
	1996	5,911	25.85%
(c)	1997	6,161	31.17%
	1998	7,649	62.85%
	1999	6,031	28.40%

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

Oregon Line: Cost of Service Analysis

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001

Oregon Line: Percentage Cost of Service Change

[SEE FIGURE IN ORIGINAL]

Source: 1992 from Ganz [**93] SFPP-246 (GRG-143). July 31, 2001.
1995 from Ganz SFPP-187 (GRG-84). July 31, 2001
1996 from Ganz SFPP-188 (GRG-85). July 31, 2001
1997 from Ganz SFPP-189 (GRG-86). July 31, 2001
1998 from Ganz SFPP-190 (GRG-87). July 31, 2001
1999 from Ganz SFPP-191 (GRG-88). July 31, 2001

LEXSEE 111 FERC 61334

SFPP, L.P.; Mobil Oil Corporation v. SFPP, L.P.; Tosco Corporation v. SFPP, L.P.; AROC Products Co. a Division of Atlantic Richfield Company, Texaco Refining and Marketing Inc., Mobil Oil Corporation v. SFPP, L.P.; Ultramar Diamond Shamrock Corporation, Ultramar, Inc. v. SFPP, L.P.; Tosco Corporation v. SFPP, L.P.; Navajo Refining Corporation v. SFPP, L.P.; Refinery Holding Company SFPP, L.P.

Docket Nos. OR92-8-024, OR93-5-015, OR94-3-014, OR94-4-016; Docket No. OR95-5-013; Docket No. OR95-34-012; Docket Nos. OR96-2-010, OR96-2-011, OR96-10-007, OR96-10-009, OR98-1-009, OR98-1-011, OR00-4-002, OR00-4-004; Docket Nos. OR96-2-003, OR06-2-004, OR96-10-008, OR96-10-009, OR96-17-004, OR96-17-006, OR97-2-004, OR97-2-005, OR98-2-005, OR98-2-007, OR00-8-005, OR00-8-007; Docket Nos. OR98-13-005, OR98-13-007, OR00-9-005, OR00-9-007; Docket Nos. OR00-7-005, OR00-7-006; Docket Nos. OR00-10-005, OR00-10-006; Docket Nos. IS98-1-001, IS98-1-002

FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION

111 F.E.R.C. P61,334; 2005 FERC LEXIS 1524

ORDER ON REMAND AND REHEARING

June 1, 2005

PANEL:

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

OPINION:
[*62,450]

1. This order addresses three proceedings involving SFPP, L.P. (SFPP) now pending before the Commission. One is the remand by the D. C. Circuit n1 in Docket No. OR92-8-000, *et al.*, and involves Opinion Nos. 435, 435-A, 435-B, and a related order on rehearing and compliance. n2 The second is the Phase I proceeding in Docket No. OR96-2-000, *et al.*, and involves the issues raised by the Commission's March 26, 2004 Order in that proceeding. n3 Many of these are similar to the issues raised by the remand opinion in Docket No. OR92-8-000, *et al.* The third proceeding is a compliance filing by SFPP to the March 2004 order. With the exception of the so-called *Lakehead* income tax allowance issue and the recovery of SFPP's reconditioning costs, the Commission adopts most the court's conclusions regarding the remanded issues. The Commission denies rehearing of the March 2004 Order and accepts the compliance filing for that order. The Commission also establishes further proceedings in certain issues involved in the remand.

n1 *BP West Coast Products, L.L.C. v. FERC, 374 F.3d 1263 (D. C. Cir. 2004)* (*BP West Coast* or "the remand opinion").

n2 *Opinion No. 435 (86 FERC P61,022 (1999)), Opinion No. 435-A (91 FERC P61,135 (2000)), Opinion No. 435-B (96 FERC P61,281 (2000)),* and an *Order on Clarification and Rehearing (97 FERC*

P61,138 (2001)) (collectively the Opinion No. 435 orders.)

n3 *SFPP, 106 FERC P61,300 (2004)* (the March 2004 Order).

I. **Background**

2. All three of these proceedings stem from the complex litigation between SFPP and several of its shippers that started in November of 1992. In this order the Commission addresses issues that are raised by the court's remand opinion and integrates its response to that remand with certain actions taken by the Commission while the Opinion No. 435 orders were on appeal. There are three discreet major proceedings involving SFPP now pending for decision before the Commission, each including a number of consolidated dockets. n4 The first proceeding, Docket No. OR92-8-000, *et al.*, began in December 1992 and addressed complaints against SFPP's rates filed through August 5, 1995. This docket culminated in Opinion Nos. 435, 435-A, 435-B, a subsequent order that clarified certain aspects of those orders, and related [*62,451] compliance filings. n5 In those orders the Commission determined that, with one exception, SFPP's West Line rates were grandfathered under section 1803(b) of the EPAct. n6 As such those rates could not be reviewed for reasonableness for the period covered by the relevant complaints, n7 which were filed between November 1992 and August 1995. The one exception involved rates for turbine fuel shipped over the West Line, which were not grandfathered. However, the Commission concluded that the turbine fuel rate was just and reasonable. The Commission also concluded that charges for the Watson Station drain dry facilities n8 were also grandfathered. Therefore the Commission dismissed the complaints against the West Line rates and the Watson Station drain dry facility charges.

n4 There were also a number of rate compliance filings involved in the Opinion No. 435 orders that require filings in separately captioned dockets that are not consolidated with the proceedings that established the rate design principles for those rates.

n5 Some of these were rate filings submitted in separate IS dockets to comply with the Commission's directions in the Opinion No. 435 orders.

n6 Section 1803(b) of the Energy Policy Act, Pub. L. 102-486, 106 Stat. 2772 (1992). Section 1803(b)(1) provides that no person may file a complaint against a rate that is deemed to be just and reasonable under section 1803(a) of the EPAct [a grandfathered rate] unless evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of the Act in the economic circumstances of the oil pipeline which were a basis for the rate; or in the nature of the services provided which were a basis for the rate.

n7 The West Line operates from Watson Station and East Hynes in greater Los Angeles transporting petroleum products to points to the east with ultimate destinations in Tucson and Phoenix, Arizona. The West Line has a connection to the CalNev Pipeline at Colton, California. CalNev transports the petroleum to the Las Vegas, Nevada area.

n8 The Watson Station drain dry facilities are located at Watson Station and are used in part to increase the pumping pressure of petroleum products tendered to SFPP at that point to a level that complies with its tariff.

3. The Commission also determined in Docket No. OR92-8-000, *et al.* that SFPP's then existing East Line rates were

not grandfathered and that those rates were not just and reasonable as of 1994. n9 In reviewing those rates, the Commission made numerous cost-of-service determinations. These included holding that the so-called *Lakehead* income tax allowance policy applied in setting the East Line rates, allocating legal costs between the West and East Lines, and finding that SFPP had not justified its proposed charges for the reconditioning of the East Lines. The Commission also made certain findings related to the Commission's oil pipeline cost-of-service rate making methodology, such as the starting rate base, capital structure, amortization rates, and the calculation of the allowance for deferred income taxes.

n9 See *49 App. U.S.C. 15*(1) (1988) governing the determinations of whether oil pipeline rates are just and reasonable.

4. The Commission therefore required SFPP to file new rates for transportation over the East Lines, to be effective August 1, 2000. After several rehearing requests and twice requiring SFPP to file revised East Line rates, the Commission ordered SFPP to make a final East Line rate filing to be effective August 1, 2000. n10 In response, SFPP filed Tariff 18 on February 13, 2003, which indexed the August 1, 2000 rates forward to that date. The Commission's June 5, 2003 order accepted Tariff 18 effective on February 13, 2003, and established the final terms for calculating reparations through that date. n11

n10 The Commission had made the rates contained in the earlier filings effective on an interim basis.

n11 *SFPP, L.P., 103 FERC P61,287 (2003).*

5. SFPP and certain shipper parties then filed petitions in the Court of Appeals for review of the Commission's Opinion No. 435 orders challenging many of those jurisdictional and cost determinations. While the appeals were pending, the Commission issued an order on March 26, 2004 addressing a second series of complaints filed in 1996, 1997, 1998, and 2000, all of which had been consolidated in Docket No. OR96-2-000, *et al.* Those complaints alleged that SFPP's rates on its West, East, North, and Oregon Lines, and the charges for its Watson Station drain dry facilities, were unjust and unreasonable. The principal issue addressed by that March 2004 order was whether the rates for the West, North, and Oregon Lines, and the Watson Station drain dry facilities, were grandfathered, or were subject to the Commission's rate jurisdiction. The central matter in each instance was whether under section 1803(b) of the EPAct there had been substantial changes to the economic circumstances that were the basis for those rates.

6. The Commission concluded that there had been a substantial change in the economic circumstances underlying the West Line rates to Yuma and Tucson, Arizona and to the CalNev interchange at Colton n12 as of 1995 and for the rates to Phoenix, Arizona, as of 1997. n13 Therefore those rates were deemed to no longer be just and reasonable as of those years. The Commission also found that SFPP's Sepulveda Line rates were not grandfathered as of the dates on which the complaints against those rates were filed. The Commission remanded the rates for the West Line to the Administrative Law Judge (ALJ) for a Phase II determination of the just and reasonableness of those rates and, as well as for those of the Sepulveda Line for the complaint years. n14 The Phase II proceedings in Docket No. OR96-2-000, *et al.* for the West Line rates are now before the Commission on an initial decision that will be addressed in a subsequent order. n15 The Sepulveda Line rates are at hearing before an administrative [*62,452] law judge and are in the post-hearing briefing phase of that proceeding. The March 2004 order held that there were no substantially changed circumstances on the North and Oregon Lines for the years at issue. Thus the Commission dismissed the complaints against the North and Oregon lines filed against SFPP in Docket No. OR96-2-000 *et al.* n16

n12 The March 2004 Order refers to these rates as the CalNev rates. Colton is the interconnection point between SFPP and the CalNev pipeline going to Las Vegas, NV.

n13 March 24 Order at PP 62, 66, and 84.

n14 *Id.*, PP 25, 31.

n15 The ALJ issued an initial decision (ID) in the Phase II proceedings on September 4, 2004. *See SFPP, L.P., 108 FERC P63,036 (2004).* The rulings here will affect certain issues raised by the ID, and to that extent will be controlling in the Commission's review of the ID in Phase II.

n16 Additional complaints are pending against the North and Oregon Lines in Docket Nos. OR05-4-000 and OR05-5-000. Those complaints have been held in abeyance pending the completion of Phase II of Docket No. OR96-2-000, *et al.*

7. On July 20, 2004, the Court of Appeals for the D.C. Circuit issued its opinion on the Opinion No. 435 orders in *BP West Coast Products, supra.* The court stated it could affirm many of the Commission's decisions on specific issues but because it found error in several fundamental areas, it ordered the decisions vacated and remanded the matter for further proceedings consistent with its opinion. n17 The court divided its opinion into three parts dealing with the West Line, the East Line, and Reparations. The first part addressed jurisdictional issues, the second, cost determinations, and the third, reparations.

n17 *BP West Coast* at 1271.

8. Regarding the West Line, the court affirmed the Commission's determinations of (1) the jurisdictional status of the East Hynes origination point, (2) whether certain of the complaints addressed a tariff or a rate, (3) whether certain of the complaints were directed at the West Line rates or only the East Line rates, and (4) the relevance of investigations by the Oil Pipeline Board. n18 The court also upheld the certain of the Commission's determinations of what factors should be used to determine substantially changed circumstances, including (1) the base time to be used for determining whether there were substantially changed circumstances, (2) the time frame in which to submit evidence on that matter, and (3) the scope of the contractual prohibition exemption contained in section 1803(b) (2). n19 The court also held that the Commission did not improperly deny certain shippers a chance to amend their complaints. n20 The court rejected the Commission's conclusions that (1) the charges for the Watson Station facilities were grandfathered, (2) the West Line turbine fuel rates were just and reasonable, and (3) a cost change from implementing the *Lakehead* tax allowance policy by itself could be a factor that would result in substantially changed circumstances. n21 These latter three issues are analyzed below in the sections dealing with substantially changed circumstances and the *Lakehead* income tax allowance issues.

n18 *Id., 1273 and 1276-79.*

n19 *BP West Coast* at 1278-81. Section 1803(b) (2) of the EPAct permits the filing of a complaint against a grandfathered rate by a person who was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of the EPAct and had been in effect prior to January 1, 1991, provided the complaint is filed within 30 days after the expiration of the prohibition.

n20 *BP West Coast* at 1279 and 1280-81.

n21 *Id. 1273-76.*

9. Regarding the East Line, the court upheld the Commission's cost-of-service determinations regarding (1) SFPP's starting rate base, (2) the method for recovering SFPP's regulatory litigation expenses, and (3) the denial of SFPP's civil litigation costs regarding its prior termination of service over the East Line. n22 The court remanded the Commission's conclusions regarding (1) income tax allowances, (2) the allocation of legal costs between the East and West Lines, (3) and the denial of SFPP's proposed reconditioning costs. n23 These issues are addressed below in the sections dealing with cost issues and the *Lakehead* income tax allowance issue.

n22 *Id. 1282-84, 1293-94, and 1294-97.*

n23 *Id. 1285-93, 1297-98, and 1298-1302.*

10. Regarding reparations, the court affirmed all of the Commission's conclusions, including (1) the relevance of the *Arizona Grocery* rule to the proceedings, n24 (2) whether pre-complaint reparations were allowed, (3) the application of a specific test period for SFPP's rate design, (4) the use of reasoned decision making related to SFPP's litigation status, (5) whether Navajo Refining Corporation (Navajo) was barred from collecting refunds for the period before its compliant, (6) the eligibility of Valero Marketing and Supply Company (Valero) for reparations in the context of the Order No. 435 opinions, (7) the failure of ARCO Products Company (ARCO) and Texaco Refining and Marketing, Inc. (Texaco) to challenge the East Line rates, and (8) that Chevron Products Company's (Chevron) September 23, 1992 complaint did not entitle it to reparations because it did not address rate issues. n25 The import of these rulings for some rehearing requests of the March 2004 Order is discussed below in the reparations section.

n24 *Arizona Grocery Co v. Atchison, Topeka & Santa Fe Railway Co., 284 U.S. 370 (1932) (Arizona Grocery). Arizona Grocery* bars reparations for changes to a final rate that has been approved by the Commission. The court held that the Commission properly found that *Arizona Grocery* did not bar reparations on the East Line as of August 1, 2000, because the East Line rates as of the date were not final, Commission approved rates.

n25 *BP West Coast*, Part III.

11. While the remand was pending, on November 2, 2004 the Interstate Natural Gas Association of America (INGAA) sent a letter to the Commissioners discussing certain policy issues involving the income tax allowance portion of the remand. On November 12, 2004, counsel to BP West Coast Products, LLC and ExxonMobil Oil (ARCO Group) Corporation filed a notice of illegal *ex parte* communication by INGAA based on the latter's November 2, 2004 letter. n26 Counsel asserted [*62,453] that the INGAA letter improperly addressed the tax allowance issues in litigation in the instant dockets and requested that the letter be placed in the non-decisional file. The ARCO Group filing also included copies of testimony from the Phase II proceedings in Docket No. OR96-2 addressing the income tax allowance issue. On November 12, 2004, SPFF filed comments requesting that the Commission hold a hearing on the remanded issues as the most efficient way of resolving those issues. In its filing SFPP presented arguments on how each of five remand

issues it summarized in its filing should be resolved. n27

n26 Counsel to the ARCO Group also directed a letter to the Commissioners on November 12, 2004, making the same arguments but omitting the litigation material.

n27 These were the decisions regarding the Watson Station and turbine fuel rates, the role of the *Lakehead* doctrine in determining substantially changed circumstances, the proper amount of the income tax allowance, the allocation of litigation costs between the West and East Line shippers, and the recovery by SFPP of reconditioning costs.

12. On November 17, 2004, INGAA filed a reply to ARCO Group's notice asserting that it had inadvertently failed to file a copy of its November 2, 2004 letter with the Commission's Secretary and subsequently did so. INGAA further argued that its letter was not an *ex parte* communication because it addressed only generic issues and did not speak to the tax allowance issues in any specific proceeding. INGAA also noted that it represents gas pipelines and was careful not to address the issues of the oil proceedings at issue here. The Commission subsequently placed the November 2 letter in the non-decisional file and has not relied on that letter in making its decisions here. n28 On November 17, 2004, the ARCO Group filed a preliminary answer to SFPP's comments on the remand arguing certain of the income tax allowance issues. On November 29, 2004, Tosco Corporation and ChevronTexaco Products Company (Tosco/CT) also filed an answer to SFPP's comments, as did the ARCO Group. On December 6, 2004, SFPP filed a motion for leave to file and made a limited response to the November 29 filing by the ARCO Group. SFPP's December 6 motion included analysis and arguments related to the structure and operation of partnership tax law intended to rebut assertions made by the ARCO Group. On December 7, 2004, Navajo Refining Company also filed an answer to SFPP's comments on the remanded issues.

n28 It should be noted that Counsel to the ARCO Group included a copy of the November 2 INGAA letter in his November 12 filing, and therefore that copy of the letter is included in the official decisional file because it was part of his duly filed pleading.

13. On December 2, 2004, the Commission issued a Notice of Inquiry Regarding Income Tax Allowances in Docket No. PL05-5-000. The Commission asked interested parties to comment when, if ever, it is appropriate to provide an income tax allowance for partnerships or similar pass-through entities that hold interests in a regulated public utility. Some forty-one comments were submitted by interested parties representing most interests involved in the jurisdictional activities regulated by the Commission. These included gas and oil pipelines and their shipper, refinery, and local distribution customers, gas and oil producers, public electric utilities, municipal electric utilities, and state regulatory commissions. On December 16, 2004, the ARCO Group filed additional comments on the income tax allowance issue. On May 4, 2004, the Commission concluded that such an allowance should be permitted on all partnership interests, or similar legal interests, if the owner of that interest has an actual or potential income tax liability on the public utility income earned through the interest. n29 On April 19, 2005, the ARCO Group filed an offer of proof containing additional evidence it had elicited in the Sepulveda phase of Docket No. OR96-2-000 regarding the income tax allowance issues.

n29 *Policy Statement on Income Tax Allowances, 111 FERC P61,139 (2005) (Policy Statement).*

14. The Commission has concluded that given the unusually complex nature of these proceedings it will accept the various filings regarding the remanded proceeding. While some of the filings are repetitious, they contain sufficient useful information to warrant their inclusion in the record. All parties have been afforded an opportunity to reply to the various assertions raised. However, the Commission will decide the generic income tax allowance issues involved in the court's remand only on the basis of the record and decision in Docket No. PL05-5-000. Income tax and remand issues specific to the instant dockets will be decided only on the factual record before the Commission in Docket Nos. OR92-8-000, *et al.* and OR96-2-000, *et al.*, and if relevant, the more generic arguments presented in the supplemental materials in those dockets regarding the structure and operation of partnership income tax law.

II. Discussion

15. The discussion part of this order is divided into six sections. The first, section A, addresses issues raised by the court's remand of the *Lakehead* income tax allowance issue. This matter is discussed in a separate section because of its importance to the Commission's rulings on substantially changed circumstances in the Opinion No. 435 orders and the March 2004 Order as well as rate determinations in the Opinion No. 435 orders. The second, section B, addresses the other remanded issues involving substantially changed circumstances. The third, section C, addresses cost-of-service determinations contained the Opinion No. 435 orders. The fourth, section D, addresses reparation issues on rehearing of the March 2004 Order. The fifth, section E, addresses SFPP's compliance filing to the March 2004 Order. The sixth, section F, details the filings that SFPP must make in response to this order and sets certain additional matters for hearing. Finally, because the Opinion No. 435 orders were vacated and remanded, the Commission adopts and affirms [*62,454] here the conclusions of those orders otherwise affirmed by the court.

A. The *Lakehead* Tax Allowance Issue

16. The remanded *Lakehead* income tax allowance issue is important because it affects a major component of the cost-of-service calculations for the East Line rates developed under the Commission's prior orders and directly impacts further proceedings to develop just and reasonable rates for the transportation of turbine fuel over the West Line, the Watson Station drain dry facilities, the Sepulveda line, and the determination of just and reasonable rates for the West Line rates now before the Commission in Phase II of Docket No. OR96-2-000. Moreover, the March 2004 Order relied in part on a full Opinion No. 154-B cost-of-service analysis in making its determination whether there were substantially changed circumstances to the rates for two of the three lines at issue in Docket No. OR96-2-000, namely the North and Oregon Lines. The Commission concludes that given the Commission's ruling in Docket No. PL05-5-000, it will no longer apply its former *Lakehead* income tax allowance policy. Thus several of those issues must be revisited in this order.

1. Background

17. As was discussed in the Commission's May 5 decision in Docket No. PL05-5-000, the *Lakehead* income tax allowance issue is at bottom a finance issue that turned on the pipeline's ownership structure. As discussed in the court's remand opinion, partnerships, or other pass-through entities, pay no actual federal income taxes. n30 However, as the Commission determined in the *Policy Statement*, income of such entities is attributed to the partners through an information partnership tax return. The partnership income is then reported on, and any actual tax liability is paid by means of, the returns of the partners.

n30 *See BP West Coast*, at 1288-70 for the court's discussion.

18. In *Lakehead,* the Commission concluded it would permit partnerships to have a federal income tax allowance in proportion to the partnership interests owned by a subchapter C corporation or other taxable entity. However, those cases denied the partnership a tax allowance in proportion to the partnership interests owned by individual partners. n31 In its 1995 *Lakehead* decision, the Commission concluded that Lakehead "is entitled to an income tax allowance with respect to income attributable to its corporate partners." n32 The Commission then further stated that the partnership is entitled to a tax allowance for its corporate interests because the tax cost is passed on to the corporate shareholder who then pay corporate income taxes on their allocated share of the income, resulting in double taxation.

n31 *Lakehead Pipe Line Company, L.P., 71 FERC P61,388 (1995), reh'g denied, 75 FERC P61,181 (1998) (Lakehead).*

n32 71 FERC at 62,314, *citing* at footnote 54 *Pelican Interstate Pipeline Gas System, 29 ERC P61,062 at p. 61,135 (1984).* Other cases that permitted partnerships to have an income tax allowance were *Highland Offshore System, 55 F.P.C. 2674 at 2688 (1976); Sea Robin Pipeline Co., 28 FERC P61,092 at 61,173 (1984).* However, none of these cases analyzed why such an allowance was appropriate. The first effort to establish why it was appropriate to continue such an allowance for the corporate partner, and not the individual partner, was in the two *Lakehead* orders, *supra.*

19. However, the Commission also stated that Lakehead should not receive an income tax allowance with respect to income attributable to limited partnership interests held by individuals because there is no corporate income tax paid on income distributed to individual partner. The Commission stated that this comports with the principle that there should not be a cost element in the cost-of-service to cover costs that are not incurred. n33 As a second rationale for denying an income tax allowance on the individual partnership interests, the Commission first stated that the individual partners are entitled to an after-tax return commensurate with returns on investments in other enterprises having similar risks. It concluded that if Lakehead were to receive a corporate tax allowance with respect to the individual partnership interests, Lakehead and those individual investors would earn an after-tax return on equity in excess of that to which they are entitled for Lakehead's risks. n34 Therefore that partnership was denied an income tax allowance in proportion to the partnership interests that were held by individual partners.

n33 71 FERC at 62,315.

n34 *Id.*

20. In contrast to its corporate general partner, SFPP, Inc. a subchapter C corporation, SFPP, L.P. was organized as a limited partnership. Its equity structure consisted of 99 percent limited partnership interests and a 1 percent general partnership interest. At the time of the Opinion No. 435 orders, SFPP, L.P. was controlled by SFPP, Inc., which owned 42.7 percent of the limited partnership interests and the 1 percent general partnership interest. n35 The remaining 56.30 percent of the limited partnership interests was held by the public and traded on national exchanges. Thus, in applying *Lakehead* in the Opinion No. 435 orders, the Commission only allowed SFPP an income tax allowance equal to the limited partnership interests held by SFPP, Inc., or 43.7 percent.

n35 SFPP, Inc. was acquired by Kinder Morgan Energy Partners (KEMP) on March 6, 1998. KEMP is a master limited partnership with 99 percent limited partnership interests and a one percent general partner, KMEP Inc. A master limited partnership is one that controls other limited partnerships. This does not change the analysis here as a corporate general partner during the time frame of the Opinion No. 435 proceedings.

2. The Remand

21. As discussed above and in the *Policy Statement*, the focus in the *Lakehead* orders was on the income tax allowance to be denied the partnership [*62,455] in proportion to its individual partnership interests rather than the income tax allowance allowed in proportion to the partnership interests held by the corporate investor. However, it was the income tax allowance attributed to the corporate partnership interests, and the absence of a corresponding that was the focus of the recent appeal, and it was that income tax allowance scheme that the court determined was not adequately justified. While the court left open to the Commission the option of developing a superior rationale to support a continued federal income tax allowance solely for corporate partners, the Commission concluded in the *Policy Statement* that this was not possible. The Commission further concluded that all entities providing jurisdictional services should be permitted an income tax allowance, including partnerships and other forms of pass-through entities. The Commission did qualify this decision, however, by stating that partnerships and other pass-through entities would be permitted an income tax allowance only in proportion to those that have an actual or potential income tax liability. n36 To the extent that a partner or other owner of a pass-through interest did not have an actual or potential income tax liability, the tax allowance would be reduced. n37

n36 *Policy Statement*, PP 32 and 40-42

n37 The Commission recognized that, as with the consolidated corporate returns, this might require review of several layers of pass-through ownership to determine where the ultimate, if any, actual or potential tax liability lies. *Id.* P 42.

22. In reaching this conclusion, the Commission expressly reversed the income tax allowance holdings of its earlier *Lakehead* orders. As was stated in Edison Electric Institute's (EEI) comments in Docket No. PL05-5-000, *Lakehead* mistakenly focused on who pays the taxes rather than on the more fundamental cost allocation principle of what costs, including tax costs, are attributable to regulated service, and therefore properly included in a regulated cost of service. n38 Relying on *BP West Coast*, some commenters in that docket asserted that because a pass-through entity pays no cash taxes itself, this results in a phantom tax on fictional public utility income. However, the comments summarized in sections A and D of Part II of the *Policy Statement* demonstrated that this assumption was incorrect.

n38 EEI comments at 8. In support of this point commentors in Docket No. PL05-5-000 cited to *City of Charlottesville v. FERC, 774 F.2d 1205 (D.C. Cir. 1985)* for the proposition that a tax cost involves real taxes but does not necessarily require that cash taxes be paid by the regulated entity. *See* EEI at 11-13; INGAA at 12-13; Interested Gas Pipeline Partnerships at 10-12; Association of Oil Pipe Lines (AOPL) at 8-9.

23. Thus, while the pass-through entity does not itself pay income taxes, the owners of a pass-through entity pay income taxes on the utility income generated by the assets they own via the device of the pass-through entity. n39 As such, the taxes paid by the owners of the pass-through entity are just as much a cost of acquiring and operating the assets of that

entity as if the utility assets were owned by a corporation. The numerical examples discussed in sections A and D of Part II of the *Policy Statement* also established that the return to the owners of pass-through entities would be reduced below that of a corporation investing in the same asset if such entities are not afforded an income tax allowance on their public utility income.

n39 The comments and numerical examples submitted by the EEI, INGAA, and Northern Border Pipe Line Company (Northern Border) in Docket No. PL05-5-000 demonstrate that under partnership law the partners, or members, of pass-through entities pay taxes on the public utility income of the operating entities that they control through the partnership or other pass-through entity. *See* EEI at 13-15; INGAA at 15-17; and Northern Border at 5-8.

24. As several commentors in Docket No. PL05-5-000 pointed out, a detailed discussion of the realities of partnership tax practice was not before the court when it reviewed the Opinion No. 435 orders. Because public utility income of pass-through entities is attributed directly to the owners of such entities and the owners have an actual or potential income tax liability on that income, the Commission concluded that its rationale in the *Policy Statement* did not violate the court's concern that the Commission had created a tax allowance to compensate for an income tax cost that is not actually paid by the regulated utility.

25. As explained in detail by the comments summarized in sections A and D of Part II of the *Policy Statement*, just as a corporation has an actual or potential income tax liability on income from the public utility assets it controls, so do the owners of a partnership or limited liability corporation (LLC) on the assets and income that they control by means of the pass-through entity. Moreover, it should be noted that if such first tier assets are owned only by Subchapter C corporations, their rates would include an income tax allowance designed to recover the 35 percent maximum corporate marginal tax rate. n40 Thus, the same rate result obtains if the assets are owned by a partnership or an LLC that is in turn owned either by Subchapter C corporations or by individual investors in the maximum individual tax bracket.

n40 This analysis suggests that if partnerships and limited liability companies are not permitted to have an income tax allowance, there are incentives to shift to the taxable corporate ownership form. This might be done by converting a partnership to an LLC and then electing to have it taxed as a Subchapter C corporation. Once this is done, the newly taxable entity, which would be operating the same assets as it did as a pass-through entity, would be entitled to a 35 percent income tax allowance. *Cf.* AOPL at 9.

26. Thus, the *Policy Statement* the Commission adopted in Docket No. PL05-5-000 should not result in increased costs to public utility ratepayers beyond those which would result from use of the corporate form. The Commission therefore concluded that, as is argued by the commentors urging an income tax allowance for all public utility [*62,456] entities, providing an income tax allowance to partnerships in proportion to the interests owned by entities or individuals with an actual or potential income tax liability does not create a phantom income tax liability. The Commission also concluded that the fact that some partnerships or LLCs may be used for financial investments rather than for making infrastructure investments does not warrant a different policy result here. n41 Moreover, the Commission emphasized that the primary rationale for reaching the conclusion in the *Policy Statement* is to recognize in rates the actual or potential income tax liability attributable to regulated utility income. Finally, since it had concluded that such an income tax allowance does not result in phantom income taxes, the Commission further concluded that permitting partnerships an income tax allowance will facilitate important public utility investments. n42

n41 The partners of master limited partnerships have tax liability for any income recognized by the partnership. As the supplemental comments filed in this proceeding establish, distributions may substantially exceed partnership book income. Such distributions have an ultimate income tax liability depending on the status of the capital account of the individual partners. However, these matters can present complex allocation and timing issues that would be addressed in this proceeding once SFPP files a revised cost of service to comply with this order

n42 *See, e.g., Trans-Elect NTS Path 15, LLC, 109 FERC P61,249 (2004), order denying rehearing, 111 FERC P61,140 (2005).*

27. Given the Commission's *Policy Statement* and the application of its policy in this opinion, the Commission concludes that SFPP, L.P. should be afforded an income tax allowance on all of its partnership interests to the extent that the owners of those interests had an actual or potential income tax liability during the periods at issue here. In the Opinion No. 435 orders the Commission significantly reduced the income tax allowance permitted SFPP by excluding those ownership interests that were not subject to double taxation. Thus, when SFPP develops its revised cost-of-service for the East Lines and new rates once all the relevant cost factors have been established, it will permitted to include a full income tax allowance in its cost of service if 100 percent of the interests in the relevant test years are owned by individuals or entities that had an actual or potential income tax liability in those years. The procedures for doing so are discussed below in the section F of this order dealing with further proceedings. n43

n43 Several parties made supplemental filings in this docket asserting that the income tax allowance issue was raised through improper *ex parte* proceedings. As explained in Docket No. PL05-5-000, the fact that all parties had an opportunity to comment in that docket on this generic policy issue renders such arguments moot.

3. The *Lakehead* Doctrine and Substantially Changed Circumstances.

28. In the Opinion No. 435 orders the Commission concluded that a change in policy, such as the adoption of the *Lakehead* income tax allowance policy in 1995, could be grounds for concluding that there were substantially changed circumstances provided that a complainant established the impact stemming from that change. The Commission therefore concluded that a change in policy could not establish substantially changed circumstances in and of itself absent evidence of the actual impact of the policy change. n44 In the March 2004 Order the Commission concluded that the application of the *Lakehead* policy, and the cost changes that would result, would not be used as a stand-alone criterion in determining if substantially changed circumstances had occurred. The Commission stated that application of the *Lakehead* policy could lead to anomalous results, citing to the example of the North and Oregon Lines. In both cases, the statistical tables analyzing those lines showed an extensive decline in the amount of the permitted tax allowance, as much as 25 percent in the case of the North Line, in a time frame when the total costs of operating that line were increasing. n45 Since substantially changed circumstances turns on improvements to the pipeline's return, this was an anomalous result. This was in contrast to other factors such as changes in rate base, allowed return, and volume which proved in the March 2004 Order to be more reliable indicators of the trends in the pipeline's return because they are tied more directly to pipeline operations. n46

n44 *Opinion No. 435*, 86 FERC at 61,070-71.

n45 March 2004 order, P 35.

n46 *Id.* at PP 29-30.

29. As has been discussed above, on appeal, the court vacated that portion of Opinion No. 435 that suggested that the implementation of the *Lakehead* policy could be a basis for substantially changed circumstances. n47 Thus the court's remand was congruent with the Commission's revised position in its March 2004 order. On remand, the Commission is adopting the position established in Docket No. PL05-5-000 reversing the *Lakehead* doctrine. Since that doctrine is no longer applicable to any aspect of oil pipeline rate making, there is no basis at this point for including the *Lakehead* tax allowance factor in determining substantially changed circumstances either as a stand-alone factor or as an element in a full cost-of-service determination. This does not change the result in the Opinion No. 435 orders regarding the West Line rates since the Commission did not rely on a cost-of-service including the *Lakehead* adjustment in making its determination that there were no substantially changed circumstances to the economic basis of SFPP's West Line rates.

n47 *BP West Coast* at 1280.

30. In the March 2004 Order the Commission utilized a standard Opinion No. 154-B cost-of-service analysis as a factor in its determination of [*62,457] whether there were substantially changed circumstances for SFPP's North and Oregon lines, and as a control for its determination that there were substantially changed circumstances for the West Line rates for the years stated earlier in this order. Those calculations included the *Lakehead* adjustment in developing the tax allowance to be included in that cost-of-service analysis. Since the Commission is no longer applying the *Lakehead* income tax allowance doctrine, it is necessary here to adjust the cost-of-service used in developing the substantially changed circumstances determinations in the March 2004 order. That adjustment increases the relevant costs and thereby decreases any improvements in the SFPP's return that were contained in the March 2004 analysis. Since it is the relative improvement to the pipeline's return that underpins the analysis of substantially changed circumstances, there would be no change in the determinations in the March 2004 Order regarding the North and Oregon Lines. This is because the Commission found that there were actual cost increases rather than a decrease in costs. As such, this did not warrant a determination that there were substantially changed circumstances to the economic basis of the rates on those two lines. An adjustment to the income tax allowance serves to increase costs further. As was previously discussed, the determination that there were substantially changed circumstances to West Line rates did not turn primarily on the cost-of-service analysis, but rather on increases in volume and decreases in two stand-alone cost factors. However, as discussed below, the change in the income tax allowance is such that the Commission has revised the cost-of-service calculations for the West Line rates in the March 2004 Order to assure consistency with the analyses made in that order.

B. Determinations of Substantially Changed Circumstances

31. The remand opinion also requires further review of the Commission's prior conclusions regarding the jurisdictional status of the Watson Station drain dry facility charges. The remand opinion and the Commission's conclusions regarding the *Lakehead* policy also require that the prior rulings on substantially changed circumstances regarding the North and Oregon Lines in the March 24 Order be revisited here. There are no changes in the determinations regarding the North, Oregon, and West Lines.

1. The Watson Station Drain Dry Facilities.

32. The Commission determined in the Opinion No. 435 orders that charges that are included in private contracts and are effective for 365 days before the enactment of the EPAct were grandfathered even though not on file with the

Commission. The Commission further concluded that the contractual charges for the Watson Station drain dry facilities met this standard and therefore were grandfathered. n48 The same issue arose in the Docket No. OR96-2-000 proceedings, but the Commission deferred ruling on the matter until completion of judicial review of the Opinion No. 435 orders. On review the court held that neither conclusion was adequately justified and vacated those rulings. In doing so, the court noted that its ruling was based on the Commission's reasoning and not necessarily on its conclusion. The court held that the first conclusion addressing contractual but unfiled rates was inadequately grounded in the filed rate doctrine, and that the second regarding the length of time the rates were in effect was not supported by record evidence. The court left open for reconsideration by the Commission on remand (1) whether the EPAct requires that rates or charges be filed with the Commission for the grandfathering provisions of the EPAct to apply, and (2) if relevant, the date the charges were effective for the Watson Station drain dry facilities. n49

n48 *Opinion No. 435, 86 ERC at 61,007-76.*

n49 *BP West Coast* at 1273-74.

33. On remand, the Commission concludes that the charges for the Watson Station drain dry facilities can not be grandfathered because they were not effective for the required 365 day period before the enactment of the EPAct. In its Opinion No. 435 orders the Commission focused on the execution date of the various Watson Station contracts. However, the statute does not speak in terms of the execution date of contracts, but when the rates (or charges) were effective. These dates are not necessarily the same. Based on the additional evidence submitted in Docket No. OR96-2-000, *et al.*, the Commission finds that SFPP executed a series of contracts under which it would build the Watson Station drain dry facilities to enhance the pressure of its system at the Watson Station receipt point. The contracts were in lieu of shippers providing their own pumping facilities to assure that petroleum products were tendered to SFPP at pressures that met the pipeline's tariff requirements. Some of these contracts were executed before October 25, 1991, and some thereafter. n50

n50 *See* Prepared Answering Testimony of Mary F. Morgan dated May 15, 2001, Ex. MFM-1 at Tab D. The execution dates were: Union Oil Company of California (Unical), July 26, 1991; Mobil Oil Corporation, August 20, 1991; ARCO Products Company, October 3, 1991; Chevron Oil Company, October 28, 1991 (based on letter to which there is attached an unexecuted contract); and Shell Oil Company, April 9, 1992. The date of enactment of the EPAct was October 24, 1992.

34. However, the actual charge could not be determined and set until the facilities were completed and SFPP knew what the total volume would be. On October 18, 1991, SFPP sent all shippers that had signed contracts a letter stating that the charge had been temporarily reduced to 3.2 cents a barrel and would likely increase to 4 cents on January 1, 1993. The same letter stated that the "letter served as official notice that the [*62,458] facilities will be operational by November 1, 1991, and thus billing will commence on that date." n51 It is clear that no final charge was determined before October 18, 1991, and thus the various contract dates are not controlling. The question then is when the 3.2 cent charge was in effect.

n51 *Id.*, Tab E.

35. As a common carrier SFPP may not bill for any services before it is in a position to hold itself out as able to provide

the service on demand. n52 Thus any charges for service may not become effective until such time the carrier can actually provide the service on demand and bill for it. According to SFPP's letter, this date was November 1, 1991. Thus, for purposes of the EPAct, this date was less than 365 days before the enactment of the EPAct. Therefore, the charges for the Watson Station drain dry facilities were not in effect for 365 days before the enactment of the EPAct and cannot be considered as grandfathered. As with the case of a rate that becomes effective for all shippers when the service commences, this assures that the rate paying status of all shippers will be the same regardless of when their contracts were executed. n53

n52 The Commission's regulations treat rates and charges equally in all regards. *See 18 F.F.R.* §§ 340.1(a), (b), and (c). The regulations also require no rate can become effective before shippers are advised of the effective date of rate or charge with a minimum of 30 days notice. *See* 18 C.F.R. § 341.2(b) and (c). While SFPP did not provide 30 days notice, it did follow the common carrier protocol embedded in the Commission's regulations by advising the shippers when the charges would be in effect.

n53 The contracts are similar to condition precedent contracts for the construction of gas pipeline facilities. The rates for these contracts are not in effect until (1) a final determination of the projects costs and volumes enables the pipeline to calculate the rate and (2) the pipeline notifies the Commission of the in-service date. The rates become effective on the in-service date.

36. The court also remanded the issue of whether charges in private contracts could be grandfathered under the EPAct even though not on file with the Commission. Because the Commission has concluded that the charges for the Watson Station drain dry facilities were not in effect for more than 365 days prior to the effective date of the EPAct, and therefore could not be grandfathered, there is no need to address this later point. Similarly, there is no need to address the ALJ's conclusion in his June 24, 2003 initial decision in Docket No. OR96-2-000, *et al.* that there were substantially changed circumstances to those rates because SFPP had recovered all the capital costs of those facilities. n54 The structure for further proceedings with regard to the charges for the Watson Station drain facilities is outlined in section F of this order.

n54 *See 103 FERC P63,055 (2003)* at PP 180-195, pp. 65,160-61.

2. <u>The West, North and Oregon Lines.</u>

37. As discussed, the Commission concluded in its March 2004 Order that there had been a substantial change to the economic circumstances that were the basis of the rates for the West Line, but no such change for SFPP's North and Oregon Lines. While the Commission's March 2004 Order did not contain a precise definition of the phase "substantially changed circumstances," the March 2004 Order was grounded in the analysis contained in Opinion No. 435. There the Commission concluded that the degree of change could not be 10 percent or other similarly low number. n55

n55 *SFPP*, 86 FERC at 61,065-67. This conclusion was not appealed and therefore is not addressed by the remand opinion.

38. In its subsequent March 2004 Order the Commission focused on three elements used in pipeline rate design, volume, rate base, and allowed return, in determining whether there were substantially changed circumstances on the West, North, and Oregon Lines. The March 2004 Order used volume as proxy for revenue, and changes to rate base and allowed return as major indicia of changes in total expense. n56 In analyzing whether there were substantially changed circumstances, the Commission summed the increase in volume with a decrease in an expense factor (or total expenses) because an increase in volumes (revenues) coupled with a decrease in expenses increases the pipeline's net, and hence, its return compared to that in the base year. n57 For example, [*62,459] an increase in revenues of 13 percent combined with a decrease in rate base or allowed return of 12 percent, when measured against the same factors for the base year, would imply an overall increase in the pipeline's return of some 25 percent compared to the base year. n58 The Commission reiterates here that it is changes in return, and hence a pipeline's profit expectations, that ultimately determines whether there had been a change in the economic basis of the rate. n59

n56 The rationale for the use of these three factors is explained in the March 2004 order at PP 16 and 29-31. The Commission utilized the full Opinion No. 154-B cost-of-service without a full income tax allowance as a check on those three narrower elements and concluded that there was a relatively close correlation between the stand-alone factors, rate base and rate of return allowance, and of the change in SFPP's cost-of-service. The Commission did not adopt the latter as standard protocol to be used in determining substantially changed circumstances. Tables 1, 2, and 3 to this order indicate that inclusion of a full income tax allowance significantly reduces or eliminates any correlation between the two stand-alone factors and a full Opinion No. 154-B cost of service. As discussed in the text, *infra*, this has required the Commission to rely more heavily on the cost-of-service comparisons in making its determinations here.

Because the correlation in the March 2004 order has weakened, this suggests that a full cost-of-service and revenue comparison should be used in making any determination of whether there are substantially changed circumstances to the economic basis of a rate. Since this may only be possible after discovery and preparation of such an analysis by a complainant, complainants at a minimum should make some showing of a substantial change in return when filing the initial complaint utilizing the information on revenues and expenses contained in the pipeline's Form-6. While SFPP complained about the preparation of the full cost of services for the complaint years in the instant proceeding, its position on the merits of the substantially changed circumstances issue was clearly improved by it doing so. As noted, given the novel issues involved here, the Commission concludes that the ALJ did not abuse his discretion by so requiring.

n57 The base year is the year in which the rate was created and reflects the economic circumstances that were the basis for the rate. The changes must occur after the effective date of the EPAct and before the complaint. *See Opinion No. 435*, 86 FERC at 61,065-67, as affirmed by *BP West Coast* at 1279-80. This results in the formula discussed in detail at PP 22-26 of the March 2004 Order, and incorporated herein.

n58 The percentage change for each of the three elements for the five years 1995-1999 for all three lines is contained in Table 1 of the appendix. The net percent change of volumes and three cost factors (following the example in the text) is contained in Table 2 of the Appendix. Both tables use the same volumes as in the March 2004 Order, but use cost factors and a cost-of-service that includes a full income tax allowance. This permits the reader to review the impact of a full the income tax allowance. For a detailed comparison with the March 2004 order, compare the line graphs and the charts contained in the appendix to this order with those contained in the appendix of the March 2004 Order.

n59 March 2004 Order at PP 16, 29, 45-46, 50, and 74 (particularly footnote 61).

39. Tables 1 and 2 recalculate the results contained in the March 2004 Order for the West Line, as do the related charts in the appendix. n60 Given the display of the net change in the West Line return reflected in Table 2 when the improvement in volumes is combined with any of the cost factors, even when a full income tax allowance is included, the Commission affirms the findings regarding the West Line in the March 2004 Order. n61 In the aggregate there is an improvement of over 25 percent for the West Line rates in any of the years in dispute when comparing the percentage improvement in volumes and that of the overall cost of service. In the case of the analysis for the delivery points on the West Line reflected in Table 3 of the appendix the gain is at least 20 percent for each year in which the Commission found substantially changed circumstances to the economic basis for a rate to a specific West Line delivery point in the March 2004 Order. n62 Thus the Commission again concludes there were substantially changed circumstances on the West Line for the years stated in the March 2004 Order. This includes its prior determination that there were substantially changed circumstances at the Phoenix West delivery point in 1997, the year in which the cost-of-service analysis, and all calculations, shows an improvement over the base year of at least 20 percent. n63

n60 In all the charts the heavy black bar reflects the figure used in making the decisions here. The formula used is the same as in the March 2004 Order and is the one upheld by the court in *BP West Coast*. *See* the March 2004 order at PP 22-26 and *BP West Coast* at 1278-81.

n61 The March 2004 Order text incorrectly states that volume increased by 16.61 percent. The correct figure from Table 2 of the March 2004 appendix is 16.40 percent.

n62 The analysis for the individual delivery points in the March 2004 Order relied on volumes plus the average cost decline for the West Line since individual cost figures for each point were not available. However, as Table 3 to this order shows, the results are the same here These revised cost figures do not modify the conclusions contained in the March 2004 Order for the individual destinations in the year for which the Commission determined that there were substantially changed circumstances for that delivery point.

n63 As Table 3 shows, this is consistent with the determination for the other West Line delivery points, all of which also show changes in excess of 20 percent.

40. In its March 2004 Order the Commission also found that there had been no change in the economic circumstances of the North and Oregon Lines. In the case of both lines the cost-of-service increased in most years compared to the base year even as volume also increased. As is also reflected in Tables 1 and 2 of this order, with the use of a full income tax allowance, the North Line the resulting change still falls below the 10 percent line contained in Opinion No. 435. This is also true for the rate base factor and for all but two years for the allowed return factor, both of which are less than 15 percent. n64 In the case of the Oregon Line, with or without a full income tax allowance, the results here reflect a negative return. For the other cost factors, the combination of the percentage change in volumes and those cost factors is negative or less than ten percent. The Commission affirms its prior conclusion in the March 2004 Order that there were no substantially changed circumstances to the rates of the North and Oregon Lines. n65

n64 The results here thus show even less of a change in the pipeline's economic circumstances in the March 2004 Order.

n65 The Commission reaches its conclusions for these two lines recognizing, as the court stated, "Section 1803' overarching purpose of limiting litigation over pre-EPAct rates,"<65> and that the dictionary definition of the word "substantial" suggests a change that is considerable in quantity or significantly large. A change of less than 15 percent does not meet this standard given the Commission's prior rejection in Opinion No. 435 of a threshold of 10 percent or some other similarly low number.

C. Cost-of-Service Determinations

41. The court affirmed the cost-of-service determinations in the Opinion No. 435 orders with two exceptions, the allocation of regulatory litigation costs between the East and West Lines, and the Commission's denial of East Line reconditioning costs for the period 1993 through 1998. The Commission modifies its prior ruling on the allocation regulatory litigation costs, but affirms its prior holding regarding the reconditioning costs.

1. Allocation of Regulatory Litigation Costs

42. The Commission's Opinion No. 435-B allocated 50 percent of SFPP's regulatory litigation costs to each of the East and West Lines. n66 In reviewing the Commission's allocation of regulatory litigation costs between the East and West [*62,460] Lines, the court stated that allocating such costs to the parties that benefited could be appropriate. However, the court concluded that the record did not support an allocation of 50 percent each to the West and East Lines based on the ALJ's observation of the flow of litigation. n67 On remand, the Commission concludes that it should adopt the volumetric allocation initially used in Opinion No. 435. The Opinion No. 435 orders stemmed from extensive litigation on four groups of issues: the jurisdictional status of the West Line rates, the reasonableness of the East Line rates, the legal and economic consequences of reversing portions of the West Line, and general regulatory issues relating to pro-rationing and tariff publication. Of these, matters of general regulatory policy applied to all parties, while issues relating to the reversal of the West Line were relevant mainly to East Line shippers and were relatively narrow in scope and the extent of argument. Thus, neither of these issues is determinative of the allocation matter at issue here.

n66 *See* 96 FERC at 61,080.

n67 *BP West Coast* at 1297-98.

43. The jurisdictional issues affected only the West Line rates. Nevertheless, most shipper parties addressed those issues as well. A principal factor underlying the Commission's prior determination that 50 percent of legal fees should be allocated to each line was the extensive cost-of-service litigation to establish the just and reasonableness of the East Line rates. At the time it did not appear equitable to allocate these costs on the basis of volume given that the West Line had 83 percent of the volumes on the SFPP South Lines (the West and East Line combined), and the East Lines only 17 percent. n68 While a number of cost issues unique to the West Line were not addressed at that time, n69 the Commission has determined in its March 2004 Order that the West Line rates are no longer deemed just and reasonable for certain years.

n68 Footnote 56, *supra*.

n69 *Id*. at 61,078.

44. Thus, the Commission's prior rulings on such basic issues as starting rate base, rate base allocation, capital structure, amortization, the deferred equity component, accumulated deferred income taxes, allowance for funds during construction, accumulated depreciation, cost of capital, the use of a rate cap, allocation of costs between jurisdictional and non-jurisdictional service, military services and costs, and some aspects of the rulings on litigation costs, power costs, reconditioning costs, and environmental costs are directly relevant to West Line rates, and in many cases, beneficial. Given this and the continued participation by West Line shippers on those issues during the Opinion No. 435 orders litigation, allocation of legal costs on the basis of volumes is appropriate and the result that is most adequately grounded in the record.

2. Reconditioning Costs

45. In the Opinion No. 435 orders the Commission concluded that SFPP had not justified the inclusion of any reconditioning costs for the East Line under the Commission's rate making procedures. The Commission found that SFPP had no reconditioning costs during the 1994 test year used to establish rates in the Opinion No. 435 order proceedings, and that no such costs were established during the additional nine month period for adjustments for costs that will be know and measurable during that period. The court remanded, stating that the Commission had departed from the strict test period concept in permitting SFPP to recover non-recurring legal costs it incurred in the years 1995 through 1998, which were outside the 1994 test year, and thus appeared to be inconsistent in denying the non-recurring reconditioning costs. The court instructed the Commission to review its prior conclusion in light its departure from the test period method in allowing recovery of legal costs and to further explain why recovery of reconditioning costs incurred outside the test year the those expenses might violate the filed rate doctrine. n70

n70 *BP West Coast* at 1299-1302.

46. The test period methodology works as follows. If a pipeline's regular costs increase from the amount embedded in a pipeline's existing rates, the pipeline can file a rate case to adjust its rates to recover those cost changes, based on a test year that reflects its current rather than historical cost profile. This procedure permits an orderly review of the pipeline's entire cost structure and prevents an over-recovery of the pipeline's cost-of-service by assuring that both positive and negative changes in revenue and expenses are included in the evaluation. Even if costs increase during the period that the rate case is pending, the normal procedure is for the pipeline to file another case and to establish a new test year which reflects those additional costs.

47. Here the Commission has permitted SFPP to recover unusually large, non-recurring legal expenses through the use of prospective surcharges that expire once the expenses are recovered. This has been done to allow recovery of costs that resulted from litigation that SFPP did not commence, and to that extent did not have control over the timing of when the expenses would be incurred. n71 The procedure adopted in the Opinion No. 435 orders recognizes this fact but serves to prevent these non-recurring costs from becoming embedded in the pipeline's rates. Filing a new rate case to recover legal costs based on the expenses for the years 1995-1998 would have gained SFPP nothing because these additional costs also could not have been included in SFPP's rates because they were also non-recurring costs. In contrast to [*62,461] the non-recurring legal costs, in the Opinion No. 435 proceedings, SFPP projected reconditioning expenses to be a 15 year program beginning in 1995 after adoption of the reconditioning program by SFPP's Board of Directors in 1994. SFPP sought an annual charge of three million dollars to be included in its cost-of-service to fund what it represented would be a systematic reconditioning program. Alternatively, SFPP suggested an annual surcharge that varied with the amount of the expenditures actually made. However, SFPP did not contend that the expenditures would be non-recurring, and in fact took the opposite position. It was the regularity of the program that distinguished it in the Commission's analysis from the non-recurring legal costs allowed in the Opinion No. 435 orders. n72 Therefore the Commission excluded the reconditioning expenses from SFPP's rates.

n71 SFPP did have some control over the amount of the costs that would be incurred and the Commission has expressed its concerns in this regard. This does not change the fact that SFPP did not have control over the timing of the litigation.

n72 In this regard, the Commission never stated that the proposed reconditioning costs would be non-recurring. As noted, SFPP's representations were to the contrary.

48. On remand the Commission concludes that it should affirm its previous conclusion excluding the reconditioning costs for the period 1994 to 1998. While it is true that the costs are now more know and measurable based on SFPP's compliance filings, this does not change the fact that the reconditioning costs were intended to have some regularity and were to be incurred over an extended period of time. When the costs would be incurred, and the amount, was under SFPP's control. As such, those costs should have been established as a known and measurable item during the test period. SFPP elected to follow a more general procedure by establishing a reserve against future earnings. This might well be proper based on generally accepted accounting principles, but is not in keeping with the Commission's well established regulatory procedures regarding costs that are to be recovered over a long period and expected to be recurring in their nature.

49. The recovery of non-recurring costs is limited to narrow situations where the cost involved is both recognized as a legitimate cost-of-service expense and it is difficult to incorporate the cost into the pipeline's cost-of-service as recurring operating expenses. Otherwise, when facing a cost increase oil pipelines are required by the Commission's regulations to establish that any increase in costs cannot be recovered through the annual increase permitted by the Commission's indexing methodology. If a pipeline believes the increase permitted under the annual index is inadequate, it may file to further increase its rates by establishing that a substantial divergence exists between costs actually incurred by the carrier and the rate allowed by the indexing methodology such that the resulting rate would not may then file a rate case consistent with the information required to justify a new cost-based rate or a general rate increase. n73

n73 This assures that the pipeline establishes that costs it claims have increased are not offset by other changes that benefit it, such as increases in revenues or reductions in other costs. As such, the indexing methodology is consistent with the general test period rate design methodology discussed above.

50. In the instant case SFPP itself proposed the use of a surcharge procedure as an alternative to eliminate the need for addressing the issue in a rate design context. The Commission has accepted such surcharges when the cost to be incurred is a legitimate cost-of-service expense but is likely to vary in its application. This is particularly true if the expense is of a type that is not expected to be continuously incurred over the life of the pipeline and is not of the type that would be periodically adjusted as part of a general rate case. Here SFPP could have made a limited rate filing justifying the surcharge on the grounds that the reconditioning costs resulted in an indexed rate that would not enable SFPP to recover its costs, *i.e.*, the rate would be too low to be a just and reasonable rate. Such a filing would have also enabled SFPP to develop a rate that could have been trued-up on an annual basis and would have avoided the difficulty of embedding the costs in SFPP overall cost-of-service.

51. As the Court noted, by the time SFPP made the compliance filing addressed by Opinion No. 435-B (issued September 13, 2001), the Commission had before it the actual reconditioning costs for the East Line incurred through 1998. The record shows that while the reconditioning costs were not as high as SFPP had predicted, they were substantial and essential for the safe operation of the pipeline. However, the knowledge of the cost specifics reflects the

benefit of hindsight for a cost-of-service element that should have more appropriately been included in rate filing that was consistent with the Commission's indexing regulations. For this type of normalized operating expense, which SFPP had projected in Docket No. OR96-2-000, *et al.*, the annual indexing regulations apply to all oil pipelines whether or not they are in litigation about the reasonableness of their rates. SFPP may have been reluctant to apply for a surcharge out of concern that such a filing would open all of its cost-of-service rates to review without regard to whether they were grandfathered because SFPP would have to file information consistent with that required to establish a new rate. n74 But such litigation concerns should not compromise the Commission's oil pipeline rate making procedures through an accommodation that allows SFPP to justify higher costs midstream in a rate case when those costs (unlike its regulatory costs) were not engendered by the proceeding itself. The Commission notes that SFPP had to prepare cost of service studies for the each of the years at issue (1996-1999) in Phase II of Docket No. OR96-8-000, *et al.*, and will have an [*62,462] opportunity to justify much of its long-term reconditioning expenses in those dockets. For these reasons the Commission affirms its original decision to deny SFPP reconditioning expenses in Docket No. OR92-8-000, *et al.*

n74 *See* 18 C.F.R. Part 346, Oil Pipeline Cost-of-Service Filing Requirements (2004).

D. <u>Reparation Issues</u>

52. The court affirmed the Commission's rulings regarding all the reparation issues addressed by the Opinion No. 435 orders. n75 The reparation issues addressed by this order are raised by rehearing requests of the Commission's March 2004 Order in Docket No. OR96-2-000, *et al.* That order included a short discussion of whether the *Arizona Grocery* doctrine n76 precluded East Line shippers from obtaining reparations during the Phase II litigation of Docket No. OR96-2-000, *et al.* The Commission concluded that doctrine did not preclude reparations for most East Line shippers under the circumstances of that docket. n77 However, two parties, the Western Refining Company, L.P. and Navajo Refining Company, L.P. (the rehearing parties) filed requests for rehearing of one sentence in the background section of the March 2004 Order, which stated that reparations would not be available to complaints filed by East Line shippers after August 1, 2000. n78

n75 *BP West Coast*, Part III.

n76 March 2004 Order PP 81-82

n77 *Id.*

n78 *Id.*, P11.

53. The rehearing parties state that the cited comment misapplies the *Arizona Grocery* doctrine by barring reparations for complaints filed against the East Line rates after August 1, 2000. They cite numerous passages from the Opinion No. 435 orders stating (1) that the Commission did not intend that any Commission determination of a just and reasonable rate for the period November 1992 through August 1, 2000 bar reparations for complaints filed after August 1, 1995, and (2) that the rate established as of August 1, 2000 was not intended to be a final, lawful rate. They thus claim that the August 1, 2000 East Line rates were always intended to be interim rates, that the related compliance filings were nothing more than proposed rates filed by SFPP, and were accepted and suspended by the Commission on that basis. They argue that this interpretation of the Commission's prior orders is consistent with the Commission's numerous statements that its Opinion No. 435 orders were not intended to prejudice the right to reparations of East Line shippers filing complaints after August 5, 1995.

54. The rehearing parties further argue that it was arbitrary and capricious to establish a cutoff date of August 1, 2000, and thereby exclude from a claim for reparations two complaints that were filed on August 4, 2000 and August 8, 2000. They also claim that the cited comment deprives them of the right that all shippers have to file a complaint and to obtain reparations for a two year period before the complaint if the challenged rate is shown to be unjust and unreasonable. Finally, they assert that the cited statement is an incentive for protracted litigation because the pipeline has an incentive to prolong litigation in order to delay the effective date of any rate that will be applied prospectively.

55. The Commission denies rehearing. The first step in explaining this issue is a summary of what the Commission actually did in the Opinion No. 435 orders regarding the East Line rates. Because those rates were not grandfathered under EPAct, the Opinion No. 435 orders made numerous rulings on cost-of-service factors and required SFPP to make a series of compliance filings conforming to those orders. In each case SFPP was required to prepare a filing that explained how a rate would be determined based on the rulings and to actually make a rate filing that conformed to those calculations. When SFPP filed new East Line rates in response to the Opinion No. 435-A, the Commission accepted and suspended that rate, effective August 1, 2000. The Commission required SFPP to make additional compliance filings that required modification of the August 1, 2000 rates, but any changes were effective on that date. The effect of the Commission's action was to provide some relief to all of SFPP's East Line shippers as of August 1, 2000, not just to those who would be entitled to reparations if the Commission had delayed setting new rates for the East Line until all cost issues had been resolved.

56. In fact, it was not until February 15, 2002, that an order issued finalizing new rates for the East Line, effective on August 1, 2000. n79 Thus, for over one and half years all shippers had the benefit of lower East Line rates while the Commission worked out the nuances of SFPP's compliance filing. During this period, and on appeal, SFPP argued that the Commission had violated the *Arizona Grocery* doctrine by modifying the new East Line rates after they first became effective on August 1, 2000, and continuing to make those rates effective on that date. The court rejected this argument, stating (1) that the *Arizona Grocery* doctrine applies only to final Commission rates, and (2) that the Commission clearly did not intend the August 1, 2000 rates to be final rates when they were first filed with the Commission. n80 Therefore the Commission was free to require that any modifications of the East Line rates be effective on August 1, 2000. Because of the rulings on certain issues in this remand order SFPP will have to file revised rates for its East Line. The Commission will also require those rates to be effective on August 1, 2000, with the intent of eventually taking final action on the new East Line rates on that date. When there is no more Commission action on those revised East Line rates, the rates will become final rates under the *Arizona Grocery* doctrine.

n79 *See SFPP, L.P., 98 FERC P61,177 at 61,657 (2002).*

n80 *BP West Coast* at 1304-05.

[*62,463]

57. Since any final lawful East Line rates will be effective as of August 1, 2000, they may only be changed prospectively. The rehearing parties assert that it is arbitrary and capricious for the Commission to choose August 1, 2000 as a date that the new East Line rates will become lawful rates. There is no merit in this argument. The Commission chose August 1, 2000 as the effective date in the normal course of its proceedings, and clearly could not have known that the rehearing parties intended to file additional challenges to the East Line rates. In any event, the Commission has afforded complaining parties adequate time to file complaints before that date. When the Commission issued Opinion No. 435 in January 1999, it afforded all parties that had filed complaints between August 5, 1995 and that date to refile their complaints in light of the Commission's rulings. Numerous parties did so in January 2000, which included additional challenges to the East Line rates. Thus, the rehearing parties had ample time to review the Commission's rulings Opinion No. 435, and the related modifications in 435-A, issued May 17, 2000, and to determine what action they wished to take. In any event, while it may be true that there is some incentive to prolong litigation if a

rate may only be changed prospectively, this is true for all lawful rates under the statutory scheme.

58. Finally, given the rehearing parties' arguments that the Commission is departing from the statements in its prior orders, it may be helpful to reiterate how the August 1, 2000 rate was designed and the implications for the complaints now before the Commission in Phase II of Docket No. OR96-2-000, *et al.* In the Opinion No. 435 orders the Commission found that SFPP's East Line rates were unjust and unreasonable. In establishing new prospective rates, the Commission first determined what the just and reasonable rates should be for the year 1994 using a cost-of-service for that year. The rates were then indexed forward under the Commission's index regulations to the August 1, 2000 effective date. This determined what the just and reasonable East Line rates should have been for each of the years 1994 through August 1, 2000. To the extent that any complainant paid rates that were higher than the rates so determined, the complainant would be awarded reparations for the relevant years and for two years before the date of the complaint. If a shipper was not a complainant in the Opinion No. 435 proceedings, that shipper would receive lower rates but would not receive reparations for those years. This dischotomy was affirmed on appeal.

59. Thus, as of August 1, 2000, there were several categories of shippers on SFPP's East Line. All shippers paid the same rates as of August 1, 2000, because those rates were set prospectively and applied to all shippers. Shippers who were complainants in the Opinion No. 435 proceedings had their rates reduced for the period between the date of their complaint and August 1, 2000. Shippers who were not complainants did not have their rates reduced for the period before August 1, 2000. Any complaint filed against the East Line rates after August 1, 2000 will be constrained by the lawful rate the Commission establishes as of August 1, 2000.

E. The Compliance Filing to the March 2004 Order

60. The Commission's March 2004 Order stated two concerns regarding KMEP's December 31, 1998 acquisition of SFPP, L.P. The order noted that SFPP had used the purchase method of accounting to reflect that acquisition. Under the method, SFPP's balance sheet was adjusted to reflect the difference between its book value in prior years and the value of the transaction. The Commission's first concern was that SFPP did not obtain Commission permission to restate its accounts as of December 31, 1998. Second, the Commission stated that SFPP wrote up its rate base, thus potentially increasing the amount of depreciation and return used to determine its rates in Phase II of Docket No. OR96-2-000, *et al.* The Commission therefore directed SFPP to seek permission from the Chief Accountant within 30 days to restate its accounts as of December 31, 1998. The Commission further stated that SFPP could not use any increase in its accounts from the December 31, 1998 write-up to design its rates. n81

n81 March 2004 Order at PP 79-80.

61. On April 26, 2004, SFPP made a compliance filing to the March 2004 Order. SFPP stated that on November 18, 1999, it submitted to the Chief Accountant's office a request for confirmation it had complied with the Commission's regulations regarding the restatement of its accounts. SFPP attached a copy of that letter to its filing and stated that it included pages in the Form 6 format reflecting the implementation of the proposed adjustments as of the acquisition date. It further stated that the adjustments were well known to the Commission and the shipper parties because they were utilized to develop the record in Docket No. OR96-2-000. SFPP further stated that the Commission's accounting regulations, Instruction for Carrier Property Accounts No. 3-11(b), require that SFPP must record the assets at costs as of the date of acquisition, and that the write-up did just that.

62. Indicated Shippers and ConocoPhillips filed protests on May 11 to SFPP's compliance filing. They address seven main points. n82 First, they content that SFPP made no filing since there was no formal notice or acknowledgement by the Chief Accountant's office. Second, the Commission's accounting regulations do not apply to SFPP nor does the

regulation require SFPP to write-up its accounts. Third, SFPP did not comply with the [*62,464] Commission's requirement that SFPP submit the evidence of value required to support the valuation. Fourth, that SFPP was inconsistent in its use of the purchase method. Fifth, that SFPP did not comply with the regulation requiring that a purchase price in excess of net assets acquired not be booked to tangible assets, from which rate base is taken. Sixth, SFPP wrote up the equity component of its rate base, which distorts Page 700 of its Form 6 used to set the annual increase under the Commission index procedures and that this page should be restated. Seventh, the accounting treatment will result in distortions in the allocation of overhead costs between KMEG and SFPP, SFPP's capital structure, income taxes, and the amount of Arizona property taxes to be included in its costs, thus distorting the rates to be established in Phase II of Docket No. OR96-2-000, *et al.* Indicated Shippers also included a lengthy argument as to why a write-up should not be permitted and its probable impact on rate payers by changes to various accounts. On May 25, 2004, SFPP filed an answer contesting these assertions, which was opposed by several shippers. n83 This was followed by more comments by Indicated Shippers. n84

n82 At that time Indicated Shippers consisted of BP West Coast Products LLC (formerly ARCO Products Company, A Division of Atlantic Richfield), ExxonMobil Oil Corporation ("ExxonMobil) (formerly Mobil Oil Corporation).

n83 Conoco Phillips Company, Ultramar Inc., and Valero Marketing and Supply Company, and Chevron Products Company.

n84 Indicated Shippers on June 9 and June 19, 2004.

63. The Commission will first address some procedural matters. Indicated Shippers' protest to the compliance filing is filed as a matter of right. SFPP's May 25 answer to the protest addresses a series of assertions not previously stated by the parties, contains useful information, and is accepted. Beyond this, none of the subsequent comments filed provide any meaningful or helpful information and in the main only reargue positions stated in the initial protests. Therefore they are rejected and SFPP's proposed reply is unnecessary. In addition, on June 9, 2004, a motion to intervene was filed out-of-time and protest was filed by America West Airlines, followed by similar motions on June 14, by Northwest Airlines and on June 16 by the Air Transport Association of America. SFPP filed a timely objection to these motions. It is far too late for interventions in this docket and the late filed motions to intervene are denied.

64. Turning to the merits, in its April 26, 2004 compliance filing, SFPP states that it had previously requested approval of the purchase accounting adjustments in question and provided copies of a letter purportedly sent to the Commission's Chief Accountant dated November 18, 1999. There is no record of the Commission having received SFPP's letter and no indication that the Commission considered or acted on the accounting proposal contained in it. Regardless of these circumstances, a compliance filing detailing the accounting adjustments applied upon KMEP's acquisition of SFPP is now before the Commission. This resolves the issue of whether SFPP complied with the requirement to obtain Commission approval to modify its accounts to reflect the acquisition of SFPP by KMEP.

65. The second issue is whether SFPP properly modified its accounts and the potential impact of any such changes on the design of SFPP's rates. KMEP accounted for the transaction using the purchase method of accounting and used "push-down accounting" n85 to establish a new accounting and reporting basis for SFPP's assets and liabilities, reflecting KMEP's cost of acquisition. Through the use of "push-down" accounting KMEP restated SFPP's pipeline property to conform to the purchase accounting requirements of Instruction 3-11(b), Accounting Under a Purchase, of the Uniform System of Accounts Prescribed for Oil Pipeline Companies (USofA). Instruction No. 3-11(b) requires an entity to record purchased assets at their acquisition cost. As a result of the revaluation SFPP's net carrier property increased from $ 468 million to $ 1.2 billion.

n85 Under "push down" accounting, the difference between the purchase price and the book value of the company acquired is "pushed down" to the books of the acquired company.

66. Under push-down accounting the basis of accounting for purchased assets and liabilities is the same (acquisition cost) as if the acquired entity was merged into its parent's operation. Push-down accounting is an acceptable option under Generally Accepted Accounting Principles (GAAP). Although the Commission is not bound to follow GAAP, it generally does so provided that it does not conflict with sound regulatory principles.

67. Consistent with GAAP, the intent of Instruction No. 3-11 of the USofA is to record property acquired as a result of a merger or consolidation at its acquisition cost. Additionally, while push-down accounting is not specifically provided for in the USofA, the Commission has permitted its use for accounting and financial reporting purposes. Consequently, consistent with its past actions n86, the Commission will allow SFPP to use push-down accounting to record the business combination for financial accounting purposes. However, the purchase accounting adjustment, regardless of which entity's books it may be recorded, on cannot be reflected in rates absent a showing of specific benefits to ratepayers. In order to ensure that this regulatory principle is adhered to, the Commission's approval is conditioned on SFPP maintaining full and complete information related to the business combination so that original cost records are available for use by the Commission for ratemaking purposes, and the amount of the original cost of carrier property, the amount of acquisition premium paid [*62,465] for such property, and related depreciation and amortization are disclosed in footnotes to the financial statements.

n86 See letter order issued on June 18, 1992 in Docket No. AC91-17-000, TE Products Pipeline Company, L.P., approving the use of push down accounting.

68. The protesting parties are correct that SFPP was required to provide supporting information on the fair market value of the acquired assets. Instruction 3-11(c) (2) further provides that the purchase price shall be equitably apportioned among the appropriate property or other accounts based upon the percentage relationship between the purchase price and the original cost or the fair market value of the properties. However, this instruction limits the amounts recorded for the properties and other assets acquired to the total purchase price. Instruction 3-11(c)(3)(a) also provides that where the purchase price is in excess of amounts recorded for the net assets acquired (e.g. goodwill), the excess shall be included in Account 40, Organization Costs and Other Intangibles. In addition, the portion of the total price assignable to the physical property is to be supported by independent appraisal or other such information as the Commission may consider appropriate.

69. SFPP filed as Exhibit 85 in Docket No. OR96-2-000 *et al.* an appraisal of SFPP's assets and liabilities, which SFPP asserts fully supports both the purchase price and its allocation to various accounts. Exhibit 85 supports the assignment of the purchase price to SFPP's property accounts. This is sufficient and accepted at this point. The Commission will not review the validity of the price paid because it was an arms length transaction and, as has been discussed, the increase in asset value that resulted may not be used to establish SFPP's rates.

70. Protesting parties also assert that KMEP did not apply the purchase method to its acquisition of the Calnev Pipeline. SFPP on the other hand asserts that it did in fact apply the purchase method to that acquisition. However, the point is irrelevant since, as discussed above, the Commission permits the use of push down accounting in these types of business combinations.

71. On the remaining issues, SFPP asserts that the net book value reflected on page 700 of its 1998 Form 6 does not

reflect the purchase price adjustment and is consistent with the methodology used to develop the same page in its 1997 Form 6. SFPP's representation is correct on this point in the context of the questions raised by the Commission's March 2004 Order. Protesting parties have raised the issue regarding page 700 of Form in greater detail in Docket No. IS04-323-000 and thus the Commission will explore issues underlying page 700 in that docket. n87 Finally, issues related to the pipeline's capital structure, overhead cost allocations, and Arizona property taxes are best addressed in Phase II of Docket No. OR96-2-000, *et al.*, since these are the specifics that are used to design SFPP's rate. Finally, any changes in rate levels required by Phase II of the Docket No. OR96-2-000, *et al.*, proceedings will result in refunds that return to the shippers a reduction in the base rates, and as such, a corresponding reduction in any increases to those rates under the index methodology.

n87 The docket involves SFPP's May 24, 2004 filing to adjust its rates pursuant to the Commission's indexing regulations. *See SFPP, L.P., 107 FERC P61,134 (2004).* As such, it is more appropriate to address any issues related to the index calculation there.

F. <u>**Further Proceedings**</u>

72. The court remand and the rulings here require a number of further proceedings. These include determining just and reasonable rates for the East Line in light of the remanded dockets and determining whether further adjustments are to those rates are required based on the complaints in Docket No. OR96-2-000, *et al.* As noted, the West Line rates are now before the Commission in Phase II of that proceeding. The cost-of-service for both the East and West Lines is directly impacted by the *Policy Decision* and the proposed use of full income tax allowance in designing SFPP's rates. Separate proceedings are required to establish a just and reasonable charge for the Watson Station drain dry facilities and the turbine fuel rates for the West Line that are now at issue in Docket No. OR92-8-000, *et al.* Each is discussed below.

1. <u>**The East Line**</u>

73. The East Line rates are presently before the Commission in two contexts. One is revisions that must be made to the 1994 test year in Docket OR92-8-000, *et al.* in light of the remand and the determinations here. The second is whether there should be further prospective changes to the East Line rates based on the 1999 test year (as it may be modified) in Docket No. OR96-2-000, *et al.* In both instances the most difficult issue at this point may well be the tax allowance issue since the record in both proceedings appears oriented to the *Lakehead* doctrine and the rulings in the court remand rather than the Commission's recent *Policy Statement.* While other issues should be able to be resolved on the existing record of these related proceedings, it may be necessary to supplement the record to determine whether SFPP meets the standards of the *Policy Statement* in the those two years.

2. <u>**The West Line.**</u>

74. In the March 2004 Order n88 and in this order the Commission has found that there were substantially changed circumstances beginning in 1995 to the West Line delivery points of Yuma, CalNev, and West Tucson and beginning in 1997 for the West Phoenix rates. Since complaints were pending against those rates in 1996 and 1997 or 1998, this suggests that it may be necessary to develop a record on tax allowances for the cost-of-service test years utilized for determining whether [*62,466] the rates to those points were just and reasonable in those test years. n89 After a new rate is established for any of the West Line complaint years, any further changes to the West Line rates would be on a prospective basis only. Thus, the next most logical year for determining whether the West Line rates are just and reasonable would be the calendar year 2000, the last year in which the amended complaints in these consolidated proceedings were filed. n90 Again, it is unclear whether the record for the years test year for the 1996 and 1997 or 1998 complaints, or the 2000 complaints, contains sufficient information to determine if SFPP's partnership structure met the

standard contained in the *Policy Statement* in those years. Other issues have been briefed on the record before the Commission in Phase II.

n88 March 2004 order P 53.

n89 The test year and the complaint year are not necessarily the same because the calendar year prior to the complaint year may be used to determine the relevant costs since the prior year would provide a full 12 months data to support any determinations.

n90 An issue before the Commission in Phase II is whether 1999 or 2000 should be used as the test year for resolving those complaints.

3. **The Watson Station drain dry facilities and the West Line turbine fuel rates.**

75. The Commission has concluded here that the charges for the Watson Station drain dry facilities were not grandfathered in the years for which complaints were filed against those charges. Since there is no record before the Commission on the merits of whether those charges were and are just and reasonable, the Commission sets those charges for hearing. The West Line turbine fuel rates are a subset of the West Line rates that were involved in Docket No. OR92-8-000, *et al.* and are now before the Commission on remand from the court. Thus the Commission must make a reasonableness determination for the turbine fuel rates for the years in which those rates were at issue in those proceedings. The Commission will defer further proceedings on the turbine fuel rates until it completes its analysis of the initial decision before it in Phase II of Docket No. OR92-6-000 *et al.* The Commission will be making determinations on the reasonableness of the turbine fuel rates in that proceeding for the relevant complaint years involved there since the West Line turbine fuel rates are a subset of the broader West Line rate issues discussed in the previous paragraph of this order. Any determination of the West Line turbine fuel rates in Phase II will not decide the reasonableness of those rates in the remanded proceeding in Docket No. OR92-8-000, *et al.*, but may establish basic principles that would facilitate the resolution of that docket.

4. **Disposition of Further Proceedings on East and West Line Rates.**

76. In subsections 1 and 2 of this section the Commission discussed, but did not resolve, the relationship between the *Policy Statement* and the rate proceedings before it on remand and Phase II of Docket No. OR96-2-000, *et al.* The change in the tax allowance policy involved in these proceedings creates sufficient uncertainty on how that issue should be addressed that the Commission will not rule on it with finality here. For example, some statements in the briefs on exception in Phase II and in procedural motions filed in the Sepulveda Line proceeding suggest that SFPP may have provided substantial information on the structure of the SFPP partnership and the status of its owning interests for the various years at issue in several of the proceedings now before the Commission. However, the Commission does not have that information clearly before it and it appears necessary to render an efficient and complete decision both in the remanded proceedings in Docket No. OR92-8-000, *et al.* and in Phase II. Therefore, in the interests of administrative efficiency, the Commission directs SFPP to file a brief within 15 days after this order issues describing, with supporting affidavits, the location and quantity of information regarding the tax allowance information with regard to the years at issue for the East and West Line rates. Reply briefs by other parties will be due 30 days after this order issues.

77. On brief, the parties shall explain, with examples and supporting analyses, whether such information is adequate to establish whether SFPP met the standard contained in the *Policy Statement* for any given year at issue and to what years that standard should apply and why. The parties should further explain whether the data is sufficient that it can be certified to the Commission and tax allowance matters resolved on brief, or if, alternatively, the issue of whether SFPP has met the standards of the *Policy Statement* should be set for hearing. The Commission wishes to resolve this narrow,

if important, technical issue in sufficient time to utilize the results in a single final compliance order resolving most outstanding rates issues involving the East and West Line rates now before it for the years 1992 through 2000. n91 As such, the Commission will look with disfavor on generalized statements that (1) detailed hearings are necessary to assure due process on the tax allowance issue, or (2) that a particular party has already met its burden of proof based on the overall content of the record. If any party believes either to be the case, that party should plead the point with specificity.

n91 This is unlikely to involve the Watson Station drain dry charges or the West Line turbine fuel rates discussed in subsection 3 of this section of the order. It may also not include a specialized rate such as the Sepulveda Line.

The Commission orders:

(A) The remanded issues are decided as discussed in the body of this order.

(B) The requests for rehearing of the March 2004 hearing are denied. [*62,467]

(C) SFPP's compliance filing to the March 2004 order is accepted as discussed in the body of this order.

(D) The issue of the just and reasonableness rates for the Watson Station drain dry facility charges is set for and hearing.

(E) Further proceedings regarding the West Line turbine fuel rates are deferred pending the completion of Phase II of Docket No. OR96-2-000, *et al.*

(F) Within 15 days after this order issues the SFPP shall file the brief required in the body of this order. Reply briefs are due 30 days after this order issues.

(G) A Presiding Administrative Law Judge (ALJ), to be designated by the Chief Administrative Law Judge, for the purpose pursuant to 18 C.F.R. § 375.302 (1996), shall convene a prehearing conference with regard to the charges for the Watson Station drain dry facilities, said conference to be held within 20 days of the issuance this order in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. The prehearing conference shall be held to clarify the positions of the participants, and for the ALJ to establish any procedural dates for the hearing. The ALJ is authorized to conduct further proceedings pursuant to this order and the Commission's Rules of Practice and Procedure.

By the Commission.

APPENDIX:

1. Table 1 - Display of Percentage Change in Volumes and Three Cost Factors Discussed in the Text Compared to the Base Years Discussed in the March 2004 Order and this Order.

2. Table 2 - Estimated Percentage Change in Return When the Percentage Change in Volume is combined with the Percentage Change in the Three Cost Factors Displayed in Table 1.

3. Table 3 - Estimated Percentage Change in Return at Specific Delivery Points When the Percentage Change in Volume is Combined with the Percentage Change in the Three Cost Factors Displayed in Table 1

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Table 1

Display of the Percentage Change in Volumes and Three Cost Factors Discussed in the Text Compared to the Base Years Discussed the March 2004 Order and this Order

West Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	16.40	-18.14	-21.55	-10.92
1996	21.84	-19.65	-29.10	-14.26
1997	26.31	-21.52	-29.49	-14.07
1998	26.65	-25.25	-33.14	-10.81
1999	28.47	-21.58	-25.43	-12.00
5 Year Average	23.93	-21.23	-27.74	-12.41

North Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	11.93	2.52	1.98	9.28
1996	10.73	3.52	-3.34	8.07
1997	10.89	4.42	-1.29	20.75
1998	14.97	3.82	-2.27	24.14
1999	11.53	-0.03	-0.82	13.59
5 Year Average	12.01	2.85	-1.15	15.17

Oregon Line

Year	Volume	Rate Base	Allowed Return	Cost of Service

1995	6.39	7.62	7.10	16.39
1996	7.05	6.09	-3.44	30.64
1997	1.82	4.84	-2.75	36.21
1998	13.67	8.21	-0.34	70.30
1999	21.00	10.28	8.82	36.38
5 Year Average	9.99	7.41	1.88	37.98

[*62,468]

Note 1 - All figures are in percentages.

Note 2 - All figures are derived from the Appendices to the March 2004 Order and to this Order.

Note 3 - A positive number is an improvement in the pipeline's return. A negative number indicates a deterioration in the pipeline's return.

Table 2

Estimated Percentage Change in Return When the Percentage Change in Volumes is combined with the Percentage Change in the Three Cost Factors Displayed in Table 1

West Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	16.40	34.54	37.95	27.32
1996	21.84	41.49	50.94	36.10
1997	26.31	47.83	55.80	40.38
1998	26.65	51.90	59.79	37.46
1999	28.47	50.05	53.90	40.47
5 Year Average	23.93	45.16	51.68	36.35

North Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	11.93	9.41	9.95	2.65
1996	10.73	7.21	14.07	2.66
1997	10.89	6.47	12.18	-9.86

1998	14.97	11.15	17.24	-9.17
1999	11.53	11.56	12.35	-2.06
5 Year Average	12.01	9.16	13.16	-3.16

Oregon Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	6.39	-1.23	-0.71	-10.00
1996	7.05	0.96	10.49	-23.59
1997	1.82	-3.02	4.57	-34.39
1998	13.67	5.46	14.01	-56.63
1999	21.00	10.72	12.18	-15.38
5 Year Average	9.99	2.58	8.11	-28.00

[*62,469]

Note 1 - All figures are in percentages.

Note 2 - All figures are derived from the Appendices to the March 2004 Order and to this Order.

Note 3 - A positive number is an improvement in the pipeline's return. A negative number indicates a deterioration in the pipeline's return.

Table 3

Estimated Percentage Change in Return at Specific Delivery Points When the Percentage Change in Volumes is combined with the Percentage Change in the Three Cost Factors Displayed in Table 1

Delivery Point	Year	Volume	Rate Base	Allowed Return	Cost of Service
Yuma	1995	9.44	27.58	30.99	20.36
CalNev	1995	25.62	43.76	47.17	36.54
Phoenix W	1996	0.68	20.33	29.78	14.94
Phoenix W	1997	7.56	29.08	37.05	21.63
Tucson W	1995	188.04	206.18	209.59	198.96

Delivery Point	Year	Volume	Rate Base	Allowed Return	Cost of Service
Luke AFB	N.A	N.A	N.A	N.A	N.A
William AFB	N.A	N.A	N.A	N.A	N.A

[*62,470]

Note 1 - All figures are in percentages

Note 2 - All figures are derived from the Appendices to the March 2004 Order and to this Order

Table 4 - Change in Rate Base Analysis

WEST LINE

				Rate Base Difference		Rate Base Percentage		
Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	162.439					
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287	(b)	1992	163.043	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-221 (GRG-118) (July 31, 2001)	(c)	1995	133.573	-28.866	-29.470	-17.77%	-18.07%	-18.14%
Ganz SFPP-222 (GRG-119) (July 31, 2001)		1996	131.128	-31.311	-31.915	-19.28%	-19.57%	-19.65%
Ganz SFPP-223 (GRG-120) (July 31, 2001)		1997	128.088	-34.351	-34.955	-21.15%	-21.44%	-21.52%
Ganz SFPP-224 (GRG-121) (July 31, 2001)		1998	122.030	-40.409	-41.013	-24.88%	-25.15%	-25.25%
Ganz SFPP-225		1999	127.987	-34.452	-35.056	-21.21%	-21.50%	-21.58%

WEST LINE

Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	162.439	Rate Base Difference		Rate Base Percentage		
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287 (GRG-122) (July 31, 2001)	(b)	1992	163.043	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a

NORTH LINE

51% from interstate UIT-10, Schedule No. 1A (9-17-2001)	(a)	1989	36.125	Rate Base Difference		Rate Base Percentage		
SFPP-234 (GRG-131) (July 31, 2001)	(b)	1992	27.742	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-235 (GRG-132) (July 31, 2001)	(c)	1995	28.652	-7.473	0.910	-20.69%	3.28%	2.52%
Ganz SFPP-236 (GRG-133) (July 31, 2001)		1996	29.014	-7.111	1.272	-19.69%	4.59%	3.52%
Ganz SFPP-237 (GRG-134) (July 31, 2001)		1997	29.340	-6.785	1.598	-18.78%	5.76%	4.42%
Ganz SFPP-238 (GRG-135) (July 31, 2001)		1998	29.121	-7.004	1.379	-19.39%	4.97%	3.82%

WEST LINE

Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	162.439	Rate Base Difference		Rate Base Percentage		
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287	(b)	1992	163.043	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-239 (GRG-136) (July 31, 2001)		1999	27.732	-8.393	-0.010	-23.23%	-0.04%	-0.03%

OREGON LINE

				Rate Base Difference	Rate Base Percentage Change
SFPP-246 (GRG-143) (July 31, 2001)	(b)	1992	7831	c-b	(c-b)/b
Ganz SFPP-247 (GRG-144) (July 31, 2001)	(c)	1995	8428	597	7.62%
Ganz SFPP-248 (GRG-145) (July 31, 2001)		1996	8308	477	6.09%
Ganz SFPP-249 (GRG-146) (July 31, 2001)		1997	8210	379	4.84%
Ganz SFPP-250 (GRG-147) (July 31, 2001)		1998	8474	643	8.21%

WEST LINE

Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	162.439	Rate Base Difference		Rate Base Percentage			
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287	(b)	1992	163.043	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-251 (GRG-148) (July 31, 2001)		1999	8636	805			10.28%	

[*62,471]

Table 5 - Change in Total Return Analysis

WEST LINE

Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	19,534	Allowed Total Return Difference		Allowed Total Return Percentage Change		
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287	(b)	1992	18,975	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-221 (GRG-118) (July 31, 2001)	(c)	1995	14,766	-4,768	-4,209	-24.41%	-22.18%	-21.55%
Ganz SFPP-222 (GRG-119) (July 31, 2001)		1996	13,291	-6,243	-5,684	-31.96%	-29.96%	-29.10%
Ganz SFPP-223		1997	13,215	-6,319	-5,760	-32.35%	-30.36%	-29.49%

WEST LINE

				Allowed Total Return Difference		Allowed Total Return Percentage Change		
Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	19,534					
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287 (GRG-120) (July 31, 2001)	(b)	1992	18,975	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-224 (GRG-121) (July 31, 2001)		1998	12,502	-7,032	-6,473	-36.00%	-34.11%	-33.14%
Ganz SFPP-225 (GRG-122) (July 31, 2001)		1999	14,008	-5,526	-4,967	-28.29%	-26.18%	-25.43%

NORTH LINE

				Allowed Total Return Difference		Allowed Total Return Percentage Change		
51% from interstate UIT-10, Schedule No. 1A (9-17-2001)	(a)	1989	4,403					
SFPP-234 (GRG-131) (July 31, 2001)	(b)	1992	3,089	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-235 (GRG-132) (July 31, 2001)	(c)	1996	3,176	-1,227	87	-27.87%	2.82%	1.98%

WEST LINE

				Allowed Total Return Difference		Allowed Total Return Percentage Change		
Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	19,534					
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287	(b)	1992	18,975	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-236 (GRG-133) (July 31, 2001)		1996	2,942	-1,461	-147	-33.19%	-4.76%	-3.34%
Ganz SFPP-237 (GRG-134) (July 31, 2001)		1997	3,032	-1,371	-57	-31.14%	-1.85%	-1.29%
Ganz SFPP-238 (GRG-135) (July 31, 2001)		1998	2,989	-1,414	-100	-32.12%	-3.24%	-2.27%
Ganz SFPP-239 (GRG-136) (July 31, 2001)		1999	3,053	-1,350	-36	-30.67%	-1.17%	-0.82%

OREGON LINE

				Allowed Total Return Difference	Allowed Total Return Percentage Change
SFPP-246 (GRG-143) (July 31, 2001)	(b)	1992	873	c-b	(c-b)/b
Ganz SFPP-247	(c)	1995	935	62	7.10%

WEST LINE

				Allowed Total Return Difference		Allowed Total Return Percentage Change		
Loughlin UIT-1 (April 3, 2001); Source: UIT-4 Protected	(a)	1989	19,534					
Loughlin UIT-1 (April 3, 2001); OR96-2 Exh 256. SFPP 287 (GRG-144) (July 31, 2001)	(b)	1992	18,975	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-248 (GRG-145) (July 31, 2001)		1996	843	-30			-3.44%	
Ganz SFPP-249 (GRG-146) (July 31, 2001)		1997	849	-24			-2.75%	
Ganz SFPP-250 (GRG-147) (July 31, 2001)		1998	870	-3			-0.34%	
Ganz SFPP-251 (GRG-148) (July 31, 2001)		1999	950	77			8.82%	

Table 6 - Change in Income Tax Analysis

WEST LINE		YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change		
Loughlin UIT-1 (April 3, 2001); UIT-4 Protected Material	(a)	1989	10,754					
Loughlin UIT-1 (April 3, 2001); SFPP 287, UIT-11	(b)	1992	9,124	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-221 (GRG-118) (July 31, 2001)		1995	5,930	-4,824	-3,194	-44.86%	-35.01%	-29.70%
Ganz SFPP-222 (GRG-119) (July 31, 2001)		1996	5,187	-5,567	-3,937	-51.77%	-43.15%	-36.61%
Ganz SFPP-223 (GRG-120) (July 31, 2001)	(c)	1997	5,493	-5,261	-3,631	-48.92%	-39.80%	-33.76%
Ganz SFPP-224 (GRG-121) (July 31, 2001)		1998	7,318	-3,436	-1,806	-31.95%	-19.79%	-16.79%
Ganz SFPP-225 (GRG-122) (July 31, 2001)		1999	8,223	-2,531	-901	-23.54%	-9.88%	-8.38%

NORTH LINE		YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change		

WEST LINE		YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change		
Loughlin UIT-1 (April 3, 2001); UIT-4 Protected Material	(a)	1989	10,754					
Loughlin UIT-1 (April 3, 2001); SFPP 287, UIT-11	(b)	1992	9,124	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
51% from interstate UIT-10, Schedule No. 1A	(a)	1989	3,150					
SFPP-234 (GRG-131) (July 31, 2001)	(b)	1992	1,161	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-235 (GRG-132) (July 31, 2001)		1995	1,310	-1,840	149	-58.41%	12.83%	4.73%
Ganz SFPP-236 (GRG-133) (July 31, 2001)		1996	1,176	-1,974	15	-62.66%	1.29%	0.48%
Ganz SFPP-237 (GRG-134) (July 31, 2001)	(c)	1997	1,270	-1,880	109	-59.68%	9.39%	3.46%
Ganz SFPP-238 (GRG-135) (July 31, 2001)		1998	1,748	-1,402	587	-44.50%	50.56%	18.64%
Ganz SFPP-239 (GRG-136) (July 31, 2001)		1999	1,804	-1,346	643	-42.73%	55.38%	20.41%

WEST LINE		YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change		
Loughlin UIT-1 (April 3, 2001); UIT-4 Protected Material	(a)	1989	10,754					
Loughlin UIT-1 (April 3, 2001); SFPP 287, UIT-11	(b)	1992	9,124	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a

OREGON LINE		YEAR	Income Tax Allowance	Income Tax Allowance Difference	Income Tax Allowance Percentage Change
SFPP-246 (GRG-143) (July 31, 2001)	(b)	1992	325	c-b	(c-b)/b
Ganz SFPP-247 (GRG-144) (July 31, 2001)		1995	383	58	17.85%
Ganz SFPP-248 (GRG-145) (July 31, 2001)		1996	338	13	4.00%
Ganz SFPP-249 (GRG-146) (July 31, 2001)	(c)	1997	362	37	11.38%
Ganz SFPP-250 (GRG-147) (July 31, 2001)		1998	505	180	55.38%
Ganz SFPP-251		1999	550	225	69.23%

WEST LINE		YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change		
Loughlin UIT-1 (April 3, 2001); UIT-4 Protected Material	(a)	1989	10,754					
Loughlin UIT-1 (April 3, 2001); SFPP 287, UIT-11 (GRG-148) (July 31, 2001)	(b)	1992	9,124	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a

[*62,472]

Table 7 - Change in Cost-of-Service Analysis

WEST LINE		YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
UIT-4 Protected Material	(a)	1989	56,918					
Ganz SFPP-233 (GRG-130) (July 31, 2001)	(b)	1992	53,860	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-221 (GRG-118) (July 31, 2001)	(c)	1995	47,647	-9,271	-6,213	-16.29%	-11.54%	-10.92%
Ganz SFPP-222 (GRG-119) (July 31, 2001)		1996	45,743	-11,175	-8,117	-19.63%	-15.07%	-14.26%
Ganz SFPP-223 (GRG-120) (July 31, 2001)		1997	45,853	-11,065	-8,007	-19.44%	-14.87%	-14.07%

WEST LINE		YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
UIT-4 Protected Material	(a)	1989	56,918					
Ganz SFPP-233 (GRG-130) (July 31, 2001)	(b)	1992	53,860	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-224 (GRG-121) (July 31, 2001)		1998	47,710	-9,208	-6,150	-16.18%	-11.42%	-10.81%
Ganz SFPP-225 (GRG-122) (July 31, 2001)		1999	47,031	-9,887	-6,829	-17.37%	-12.68%	-12.00%

NORTH LINE		YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
51% from interstate UIT-10, Schedule No. 1A (9-17-01)	(a)	1989	17,457					
SFPP-234 (GRG-131) (July 31, 2001)	(b)	1992	11,559	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-235 (GRG-132) (July 31, 2001)	(c)	1995	13,179	-4,278	1,620	-24.51%	14.02%	9.28%
Ganz SFPP-236 (GRG-133) (July 31, 2001)		1996	12,967	-4,490	1,408	-25.72%	12.18%	8.07%
Ganz SFPP-237 (GRG-134) (July 31, 2001)		1997	15,182	-2,275	3,623	-13.03%	31.34%	20.75%

WEST LINE		YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
UIT-4 Protected Material	(a)	1989	56,918					
Ganz SFPP-233 (GRG-130) (July 31, 2001)	(b)	1992	53,860	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-238 (GRG-135) (July 31, 2001)		1998	15,774	-1,683	4,215	-9.64%	36.47%	24.14%
Ganz SFPP-239 (GRG-136) (July 31, 2001)		1999	13,932	-3,525	2,373	-20.19%	20.53%	13.59%

OREGON LINE		YEAR	Cost of Service	Cost of Service Difference	Cost of Service Percentage Change
SFPP-246 (GRG-143) (July 31, 2001)	(b)	1992	4,697	c-b	(c-b)/b
Ganz SFPP-247 (GRG-144) (July 31, 2001)	(c)	1995	5,467	770	16.39%
Ganz SFPP-248 (GRG-145) (July 31, 2001)		1996	6,136	1,439	30.64%
Ganz SFPP-249 (GRG-146) (July 31, 2001)		1997	6,398	1,701	36.21%
Ganz SFPP-250 (GRG-147) (July 31, 2001)		1998	7,999	3,302	70.30%

WEST LINE		YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
UIT-4 Protected Material	(a)	1989	56,918					
Ganz SFPP-233 (GRG-130) (July 31, 2001)	(b)	1992	53,860	c-a	c-b	(c-a)/a	(c-b)/b	(c-b)/a
Ganz SFPP-251 (GRG-148) (July 31, 2001)		1999	6,406	1,709			36.38%	

Chart 1

West Line: Rate Base Analysis

[SEE Chart 1 IN ORIGINAL]

[*62,473] **Chart 2**

West Line: Percentage Rate Base Change

[SEE Chart 2 IN ORIGINAL]

Chart 3

West Line: Allowed Total Return Analysis

[SEE Chart 3 IN ORIGINAL]

[*62,474] **Chart 4**

West Line: Percentage Allowed Total Return Change

[SEE Chart 4 IN ORIGINAL]

Chart 5

West Line: Income Tax Allowance Analysis

[SEE Chart 5 IN ORIGINAL] [*62,475]

Chart 6

West Line: Percentage Income Tax Allowance Change

[SEE Chart 6 IN ORIGINAL]

Chart 7

West Line: Cost of Service Analysis

[SEE Chart 7 IN ORIGINAL] [*62,476]

Chart 8

West Line: Percentage Cost of Service Change

[SEE Chart 8 IN ORIGINAL]

Chart 9

North Line: Rate Base Analysis

[SEE Chart 9 IN ORIGINAL] [*62,477]

Chart 10

North Line: Percentage Rate Base Change

[SEE Chart 10 IN ORIGINAL]

Chart 11

North Line: Allowed Total Return Analysis

[SEE Chart 11 IN ORIGINAL] [*62,478]

Chart 12

North Line: Percentage Allowed Total Return Change

[SEE Chart 12 IN ORIGINAL]

Chart 13

North Line: Income Tax Allowance Analysis

[SEE Chart 13 IN ORIGINAL] [*62,479]

Chart 14

North Line: Percentage Income Tax Allowance Change

[SEE Chart 14 IN ORIGINAL]

Chart 15

North Line: Cost of Service Analysis

[SEE Chart 15 IN ORIGINAL] [*62,480]

Chart 16

North Line: Percentage Cost of Service Change

[SEE Chart 16 IN ORIGINAL]

Chart 17

Oregon Line: Allowed Total Return Analysis

[SEE Chart 17 IN ORIGINAL] [*62,481]

Chart 18

Oregon Line: Percentage Allowed Total Return Change

[SEE Chart 18 IN ORIGINAL]

Chart 19

Oregon Line: Rate Base Analysis

[SEE Chart 19 IN ORIGINAL] [*62,482]

Chart 20

Oregon Line: Percentage Rate Base Change

[SEE Chart 20 IN ORIGINAL]

Chart 21

Oregon Line: Income Tax Allowance Analysis

[SEE Chart 21 IN ORIGINAL] [*62,483]

Chart 22

Oregon Line: Percentage Income Tax Allowance Change

[SEE Chart 22 IN ORIGINAL]

Chart 23

Oregon Line: Cost of Service Analysis

[SEE Chart 23 IN ORIGINAL] [*62,484]

Chart 24

Oregon Line: Percentage Cost of Service Change

[SEE Chart 24 IN ORIGINAL]

LEXSEE 113 FERC 61277

SFPP, L.P.; Mobil Oil Corporation v., SFPP, L.P.; Tosco Corporation v., SFPP, L.P.; ARCO Products Co. a Division of Atlantic Richfield Company, Texaco Refining and Marketing Inc., Mobil Oil Corporation v. SFPP, L.P.; Ultramar Diamond Shamrock Corporation, and Ultramar, Inc. v. SFPP, L.P.; Tosco Corporation v. SFPP, L.P.; Navajo Refining Corporation v. SFPP, L.P.; Refinery Holding Company; SFPP, L.P.

Docket Nos. OR92-8-024, OR93-5-015, OR94-3-014, OR94-4-016; Docket No. OR95-5-013; Docket No. OR95-34-012; Docket Nos. OR96-2-010, OR96-2-011, OR96-10-007, OR96-10-009, OR98-1-009, OR98-1-011, OR00-4-002; Docket Nos. OR96-2-003, OR96-2-010, OR96-10-008, OR96-10-009, OR96-17-004, OR96-17-006, OR97-2-004, OR97-2-005, OR98-2-005, OR98-2-007, OR00-8-005, OR00-8-007; Docket Nos. OR98-13-005, OR98-13-007, OR00-9-005, OR00-9-007; Docket No. OR00-7-005, OR00-7-006; Docket No. OR00-10-005, OR00-10-006; Docket No. IS98-1-001, IS98-1-002; Docket No. IS04-323-002

FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION

113 F.E.R.C. P61,277; 2005 FERC LEXIS 3027

ORDER ON INITIAL DECISION AND ON CERTAIN REMANDED COST ISSUES

December 16, 2005

HISTORY: As Amended January 10, 2006.

PANEL:

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

OPINION:

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[*62,084]

1. *This order makes certain determinations for establishing interim just and reasonable rates for SFPP, L.P.'s (SFPP)* East and West Line rates pursuant to section 15(1) of the Interstate Commerce Act. n1 The determinations here address *(1) ongoing tax allowance and cost-of-service issues stemming from the rulings in the Commission's order dated June 1,* 2005, n2 (2) outstanding cost issues involved in the remanded proceedings regarding SFPP's East Line rates at issue in Docket No. OR92-8-000, *et al.*, n3 (3) West Line *cost-of-service issues involved in* Phase II of Docket No. OR96-2-000, *et al.* now before the Commission on exceptions to an initial decision dated September [*62,085] 9, 2004, *n4 and (4) requests for rehearing of the Commission's June 30, 2004 Order in Docket No. IS04-323-000, which* accepted SFPP's index filing based on cost increases in the prior calendar year 2003. n5

n1 *49 App. U.S.C. § 15*(1) (1988) governs determinations of whether oil pipeline rates are just and reasonable.

n2 *SFPP, L.P., 111 FERC P 61,334 (2005)* (June 1 Order).

n3 *See BP West Coast Products, L.L.C. v. FERC, 374 F.3d 1263 (D. C. Cir. 2004)* (*BP West Coast* or "the Remand Opinion").

n4 *SFPP, L.P., 108 FERC P 63,036 (2004)* (ID).

n5 *SFPP, L.P., 107 FERC P 61,334 (2004)* (2004 Index Order).

2. The rulings here include specific guidance on the procedures and data required for determining whether SFPP will be allowed to include an income tax allowance in its rates, that the calendar year 1999 will be used as the test year in this proceeding, a requirement that SFPP remove its 1998 purchase price adjustment from its balance sheet for ratemaking purposes, the capital structure and cost-of-capital to be used in designing rates for the West and East Lines, the overhead allocation and depreciation methods to be used here, the recovery of regulatory expenses and local taxes, and standards for reparations and refunds. This order also establishes procedures for reviewing the West Line turbine fuel rates now before the Commission as a result of the Remand Opinion. Based on those rulings, the Commission is requiring SFPP to make several compliance filings and to establish new interim rates for its West Line (and if necessary, its East Line) as of May 1, 2006. The Commission denies the requests for rehearing of the 2004 Index Order.

I. Background

3. The protracted litigation between SFPP and certain of its shippers began in November 1992 and has continued through the filing of additional complaints in the latter part of 2004 and early 2005. Three periods are involved. The first period involves various complaints addressed in the consolidated proceedings in Docket No. OR92-8-000, *et al.*, and includes the complaints filed between November 1992 and August 1995 against the East and West Line rates and the Watson Station Drain Dry charges (Watson Station charges). These were the complaints resolved by the Commission's Opinion No. 435 Orders n6 and reviewed by the Remand Opinion in *BP West Coast*. The jurisdictional and most cost-of-service issues involved in the Remand Opinion were addressed by the June 1 Order. The remaining East Line rate issues involve refinements to the income tax allowance policy adopted in the Commission's *Policy Statement on Income Tax Allowances*, dated May 4, 2005. n7 A secondary issue is the specific modifications to the East Line rates required by the reallocation of regulatory costs between the East and West Lines.

n6 *Opinion No. 435 (86 FERC P 61,022 (1999)), Opinion No. 435-A (91 FERC P 61,135 (2000)), Opinion No. 435-B (96 FERC P 61,281 (2000))*, and an *Order on Clarification and Rehearing (97 FERC P 61,138 (2001))* (collectively the Opinion No. 435 Orders).

n7 Id. P 17-27, citing the *Policy Statement on Income Tax Allowances, 111 FERC P 61,139 (2005)* (*Policy Statement*).

4. The second period includes the consolidated proceedings in Docket No. OR96-2-000, *et al.*, and involves the complaints filed against SFPP's East, West, North, and Oregon Lines, and the Watson Station charges filed during the latter part of 1995 through 2000. The ID now before the Commission presents a wide range of cost-of-service issues, including the income tax allowance, if any, to be afforded for this period, the test year to be used in designing a cost-of-service, the size of SFPP's rate base, its capital structure and cost of capital, the allocation of overhead costs, the amount and allocation of regulatory expenses, the recovery of local real estate taxes, the depreciation methodology, and the calculation of reparations and refunds.

5. The third period includes complaints filed against the East, West, North and Oregon Line rates and the Watson Station charges in July 2003, and again in 2004 and 2005 in four additional dockets, all of which have been held in abeyance pending the issuance of this order. n8 These complaints involve jurisdictional issues for the North and Oregon Lines and the same range of cost-of-service issues raised by the ID now before the Commission. On August 24, 2005, the ALJ issued an initial decision addressing the complaints against the Sepulveda Line rates in Docket No. OR96-2-012. n9 The complaints filed against the Watson Station charges through August 1995 were set for hearing in a separate proceeding, Docket No. OR92-8-025. The Commission consolidated all issues related the Watson Station charges in that docket. n10

n8 Docket Nos. OR03-5-000, OR04-3-000, OR05-4-000, and OR05-5-000. As discussed below, these dockets will be set for hearing in a separate order.

n9 This proceeding is referenced in a number of other dockets that are included in the case caption, but is generally referred to as the Sepulveda Line proceeding.

n10 *SFPP, L.P., 112 FERC P 61,209 (2005).*

6. When the first complaints were filed in 1992, SFPP was an oil pipeline limited partnership that had been formed in 1988 by its then railroad owner, the Santa Fe Southern Pacific Railroad (SFSP). After a public offering in 1988, SFSP owned some 47 percent of the limited partnership interests and two different general partnership interests through a series of wholly owned subsidiary companies. By 1994 SFSP was owned by Burlington Northern Santa Fe, Inc. but this did not represent a material change in SFPP's corporate relationships or capital structure. However, in March 1998, SFPP was acquired by KinderMorgan Energy Partnership (KMEP), a master limited partnership controlling several other energy enterprises, a number of them also entities whose rates are regulated by the Commission. n11 KMEP's general partner is Kinder Morgan GP, Inc. (KMPG), a subchapter C corporation that does not provide jurisdictional services. Rather, the jurisdictional [*62,086] services are provided by various entities that KMEP owns in whole or in part. The acquisition of SFPP by KMEP resulted in significant changes to SFPP's capital structure and balance sheet and ownership by a firm with a notably more complicated ownership structure, material factors here.

n11 *See* KMEP's SEC Form 10-K for 1999, Ex. UIT-59.

7. The Commission's June 1 Order contains a more detailed description of the prior proceedings in these dockets, n12 including the Commission's prior orders in Opinion Nos. 435, 435-A, 435-B, and a related order on rehearing and compliance. n13 In summary, the June 1 Order reiterated and incorporated the Commission's conclusions regarding income tax allowances. The June 1 Order also concluded that SFPP was entitled to a full income tax allowance if it could demonstrate that it complied with the standards contained in the *Policy Statement.* n14 The Commission also directed the parties to file briefs as a first step in making a determination on that matter.

n12 June 1 Order, P 2-14.

n13 *Opinion No. 435 (86 FERC P 61,022 (1999)), Opinion No. 435-A (91 FERC P 61,135 (2000)), Opinion No. 435-B (96 FERC P 61,281 (2000)),* and an *Order on Clarification and Rehearing (97 FERC P 61,138 (2001))* (collectively the Opinion No. 435 Orders).

n14 June 1 Order, P 21-27.

8. The June 1 Order also reviewed and affirmed the Commission's earlier March 26, 2004 determinations regarding the jurisdictional status of SFPP's West, North, and Oregon lines in Phase I of Docket No. OR96-2-000, *et al.* n15 The Commission held that there had been a substantial change to the economic circumstances of the West Line rates for the years 1995 and 1997, but that there were no such changes to the rates for the North and Oregon Line rates for the years at issue in that docket. n16 The Commission therefore affirmed its prior dismissal of complaints against the North and Oregon Line rates for the years at issue in Docket No. OR96-2-000, *et al.* and retained jurisdiction over the reasonableness of SFPP's West Line rates for Phase II of that proceeding. n17

n15 *See SFPP, L.P., 106 FERC P 61,300 (2004)* (March 2004 Order) for these earlier jurisdictional rulings.

n16 *Id.* P 28-30 and P 37-40.

n17 The Commission's jurisdiction over the reasonableness of SFPP's East Line rates is not at issue in any of these proceedings.

9. The June 1 Order also found that the Watson Station charges were not grandfathered under the Energy Policy Act of 1992 because those charges were not in effect more than 365 days prior to the date of the enactment of that Act n18 and set those charges for hearing. n19 The Commission deferred hearing on the reasonableness of SFPP's turbine fuel rates between Los Angeles and certain points to the east in Nevada and Arizona until it resolved (which is does in this order) certain cost methodology matters at issue in the Phase II proceedings. n20 Regarding the East Line rate issues remanded in Docket No. OR92-8-000, *et al.*, the Commission concluded that 50 percent of regulatory litigation expenses should be allocated each to the East and West Lines and that SFPP had not adequately justified the inclusion of reconditioning expenses in its base East Line rates. n21 The Commission also accepted SFPP's compliance filing regarding its use of the purchase method of accounting for calendar year 1998, n22 and denied rehearing requests of certain reparation issues discussed in its earlier March 2004 Order. n23

n18 *Id.* P 32-35. *See* section 1803(b) of the Energy Policy Act, Pub. L. 102-486, 106 Stat. 2772 (1992) (EP Act). Section 1803(a)(1) provides that any rate in effect for the 365-day period ending on the date of the enactment of this Act shall be deemed just and reasonable (within the meaning of section 1(5) of the Interstate Commerce Act).

n19 June 1 Order, P. 75.

n20 *Id.*

n21 *Id.* P 42-44 and P 45-51.

n22 *Id.* P 60-72

n23 *Id.* P 52-59.

II. <u>Discussion</u>

A. <u>Income Tax Allowance Issues</u>

10. The Commission's May 4, 2005 *Policy Statement* addressed whether a jurisdictional partnership, or other jurisdictional pass-through entity such as limited liability corporation (LLC), should be allowed to have an income tax allowance embedded in its jurisdictional rates. The June 1 Order concluded that SFPP would be entitled to a full income tax allowance if SFPP could establish that it meets the standards contained in the Commission's *Policy Statement, viz.*, whether the partner, unit holder, or other member of a pass-through entity is subject to an actual or potential income tax liability for the income of a jurisdictional pass-through entity. n24 The Commission directed the parties to file briefs on the status of the record in both the consolidated dockets at issue here, and to state if those records were sufficient to determine if SFPP met the standards contained in the *Policy Statement*, or whether further proceedings might be required. n25 SFPP filed its brief on June 16, 2005, and Opposing Parties filed their reply briefs on July 1. n26

n24 *Policy Statement* at P 32.

n25 *Id.*, P 76-77.

n26 The Opposing Parties include Chevron Products Company (Chevron), Tosco Corporation

(Tosco), Ultramar Inc. (Ultramar), and Valero Marketing & Supply Company (Valero), filing as Joint Shippers, and Navajo Refining Company, L.P. (Navajo).

11. SFPP asserts that the *Policy Statement* establishes certain key elements for compliance with its standards. First, the allowance is to reflect the weighted tax liability of the owners. Second, the tax status of the partners or units holders must be demonstrated by the regulated entity and the tax liability is to be traced to the point of ultimate ownership. Third, that the phrase "subject to an [*62,087] actual or potential income tax liability" is the key concept, and this appears to be related and derived from the principles established in *City of Charlottesville* n27 that an income tax allowance is allowed to reflect "actual or estimated income taxes paid or incurred."

n27 *City of Charlottesville v. FERC, 774 F.2d 1205 (D.C. Cir. 1985)* (*City of Charlottesville*).

12. SFPP then argues that it meets the requirements of the *Policy Statement*, asserting that information now in the record of both proceedings establishes that virtually all of the limited partners or the unit holders of SFPP and KMEG, its parent master limited partnership, were subject to an actual or potential income tax liability for partnership income in the years at issue. SFPP analyzes several categories of limited partners or unit holders to support this conclusion. The first category is corporations, including Subchapter C and Subchapter S corporations. SFPP notes that a Subchapter C corporation is subject to a tax on all income, including any income received from SFPP. It further states that a Subchapter S corporation is a pass-through entity and the income is recognized and taxed directly to its shareholders. SFPP asserts that for the years at issue mostly individuals and only a limited number of certain estates and trusts were eligible shareholders of a Subchapter S corporation. n28

n28 The Commission notes that SFPP did not mention limited liability corporations. However, such corporations are either taxed as Subchapter C corporations, or as pass-through entities similar to partnerships or Subchapter S corporations, depending on their characteristics or by election of the shareholders.

13. A second category is individuals, including foreign individuals, who are liable for federal income tax on their share of SFPP's income. Two additional categories are estates and trusts, which are legal entities separate from the individuals that may be their beneficiaries. An estate will pay a tax on income from SFPP units unless the income is distributed to the beneficiary of the estate, in which case the income tax liability rests with the beneficiary. In the case of a grantor trust, the trust income is taxed directly to the grantor, or if the trust is not a grantor trust, to the trust. SFPP also notes that partnerships are pass-through entities and that income tax liability is governed by the tax status of the partners.

14. SFPP also discusses several possible categories of unit holders that face a common tax issue, unrelated business taxable income (UBTI). These include mutual funds, tax exempt organizations, such tax sheltering devices a traditional Individual Retirement Accounts (IRAs) and Roth IRAs, Qualified Pension Plans, and Profit Sharing Plans. If income is UBTI, it is taxed directly to the entity and not to the holder or the beneficiary of the investment entity. SFPP therefore concludes that there are strong incentives for these various savings devices not to hold SFPP or KMEP units. In addition, SFPP states that a mutual fund is taxed if it does not distribute at least 90 percent of its income from dividends, interest, and capital gains. Thus, income derived from a mutual fund is normally taxed to the fund's shareholders. Based on the forgoing, SFPP concludes that all of its unit holders are subject to an actual or potential income tax liability.

15. The Opposing Parties first assert that, for various reasons, the *Policy Statement* is inconsistent with the Remand Opinion n29 in Docket No. OR92-8-000, *et al.*, and as such it may not be applied in these proceedings. The Opposing Parties conclude that SFPP has not complied, or is unable to comply, with the standards of the *Policy Statement*, because it has not demonstrated that its partners have an actual or potential income tax liability for income generated by the SFPP's jurisdictional activities. These arguments are discussed below.

n29 *BP West Coast at 347 F.3d 1285-1293.*

1. **Arguments Directed at the Policy Statement**

16. The Opposing Parties first argue: (1) that a partnership may not receive an income tax allowance because it does not pay income taxes; (2) that an income tax allowance will result in over-recovery of a partnership's cost-of-service; (3) that the Commission cannot create a phantom income tax allowance to encourage investment; and (4) that granting an income tax allowance to a pass-through entity will result in ratepayer costs beyond those that are incurred through the corporate ownership form.

17. These four arguments are outside the scope of the comments requested by the Commission's June 1 Order and as such are inapposite. In any event, the four enumerated arguments are based on the Remand Opinion's rejection of the Commission's *Lakehead* doctrine. n30 The *Policy Statement* and the June 1 Order both addressed these arguments and concluded that the *Lakehead* doctrine should no longer be applied to rate determinations for the jurisdictional entities regulated by the Commission. The four arguments asserted here were analyzed in detail in the *Policy Statement* issued in response to the Remand Opinion and were rejected. Instead the Commission chose to adopt a new policy governing income tax allowances, which is applicable here. Thus, as in the case of the June 1 Order, the Commission relies on the conclusions contained in the *Policy Statement* and will not pursue these four enumerated issues further.

n30 *Lakehead Pipe Line Company, L.P., 71 FERC P 61,388 (1995)* (Opinion No. 397), *reh'g denied, 75 FERC P 61,181 (1998)* (Opinion No. 397-A) (*Lakehead*).

18. The Opposing Parties advance two further arguments based on their interpretation of the Remand Opinion. They assert that SFPP may not obtain an income tax allowance to the extent that any income items or any offsetting expense deductions are allocated among the partners other than [*62,088] in proportion to their ownership percentages. They argue that Commission policy precludes granting the partnership an income tax benefit to the extent of any such allocations, an argument based on a ruling in *Lakehead* to that effect. n31 As has been discussed elsewhere, for the period beginning in March 1998, SFPP was controlled by KMEP. Since the KMEP partnership agreement allocates a portion of partnership income to the KMEP general partner that substantially exceeds the percentage of its partnership interests under various circumstances, they assert that any income tax allowance should be reduced proportionately. Navajo also argues that because the Commission and the court held in the Opinion No. 435 order proceedings that SFPP could not have a full income tax allowance, the law of that case precludes granting SFPP one here.

n31 *Lakehead*, Opinion No. 397-A, 75 FERC at 61,597-99.

19. Neither argument has merit. The Opposing Parties are correct that the *Lakehead* doctrine disallowed any portion of an income tax allowance if income or expenses were allocated among the partners other than in proportion to each

partner's ownership interests. While this was conceded to some extent by SFPP in its brief on exceptions to the ID, n32 the Commission concludes here that this particular policy is no longer appropriate given the rulings in the *Policy Statement*. The allocation policy in question was adopted in Opinion No. 397-A as an element of the Commission's former *Lakehead* doctrine. Since the *Lakehead* doctrine denied an oil pipeline partnership a tax allowance in proportion to the interests not owned by a Schedule C corporation, any allocation of income items and deductions from the individual to the corporate partners would shift any related tax benefits between the two categories of partners and thereby defeat the purpose of the *Lakehead* policy. As the *Lakehead* doctrine no longer applies to any jurisdictional entity, the purpose underlying that ruling is no longer relevant, and therefore the Commission will no longer apply this subsidiary element of its former *Lakehead* policy.

n32 SFPP Brief on Exceptions at 45.

20. Navajo's argument regarding the rule of the case is also incorrect. The Commission's rulings in the Opinion No. 435 Orders preceding the June 1 Order were in the context of the *Lakehead* policy, which the Commission revisited in the *Policy Statement*. The court held that the Commission had not justified the application of the *Lakehead* doctrine on the record before the court at the time of the appeal, but explicitly stated that the Commission was free to explore the issue further. n33 The Commission explored the issue further as permitted by the court and authorized an income tax allowance for pass through entities based on the new record before it in Docket No. PL05-5-000. Therefore, the Commission may apply this new policy in this case since the income tax allowance issue was open on remand and was not precluded by the Remand Opinion.

n33 *BP West Coast* at 1288, 1290, and 1293.

2. <u>Responses to the Requirements of the June 1 Order</u>

21. The *Policy Statement* reserved for resolution in individual rate proceedings several issues that may depend on the structure of the specific partnership or other pass-through entity involved in a proceeding. These include (1) the application of the phrase "subject to an actual or potential income tax liability," (2) the marginal tax bracket to be used to determine the allowance imputed to the partnership or other pass-through entity; (3) the number of ownership layers to be reviewed in any proceeding; and (4) the possible allocation of any permitted income tax allowance among the various partners or unit holders. n34 The issues are addressed by the parties both in their responses to the June 1 Order and in their respective briefs and reply briefs on exceptions in Phase II of Docket No. OR96-2-000, *et al*. Because the Phase II ID was issued on September 9, 2004, before the *Policy Statement* on May 4, 2005, the tax issues are discussed in the context of the *Policy Statement* and the June 1 Order with references to the various materials included in the record of Docket No. OR92-8-000, *et al*., and in Phase II of Docket No. OR96-2-000, *et al*. n35

n34 *Policy Statement* at P 32, 41, and 42.

n35 The only extensive analysis on income tax allowance issues on exceptions to the ID is pages 34 through 46 of SFPP's Brief on Exceptions.

a. <u>Subject to an Actual or Potential Income Tax Liability.</u>

22. The *Policy Statement* provides that a tax allowance will be permitted in proportion to the partnership interests (or units) that are subject to an actual or potential income tax liability for the income of a regulated entity, but that the

detailed explanation of that concept will be left to specific proceedings. n36 Here SFPP asserts that all partnership income is eventually taxed, either at ordinary income levels or at capital gain rates. It asserts that as such, virtually all, if not all, of SFPP's or KMEP's unit holders are subject to an actual or potential income tax liability on the units they hold. n37 In response, the Opposing Parties argue that SFPP has not established that its unit holders have an actual or potential income tax liability [*62,089] because: (1) individuals holding publicly traded partnership interests may have received distributions that are considered a return of capital and are therefore not taxed; (2) the sale of a partnership interest may result in the partner paying capital gains tax on the sale before any income tax liability becomes due; (3) partnership income allocated to a partner may be offset by deductions and credits that eliminate any tax liability in a given year; and (4) the partner's tax liability may be offset by deductions or credits from other economic activity. They conclude these facts make it is possible for a partner to hold a MLP partnership interest, receive substantial benefits from it, and possibly never pay any income taxes, which, they claim, occurs frequently.

n36 *Policy Statement* at P 42. *See Trans-Elect Path NTD-15 (Trans-Elect), Order Denying Rehearing, 111 FERC P 61,140 (2005), Order Denying Rehearing, 112 FERC P 61,200 (2005)* and *Order Conditionally Accepting Compliance Filing, 112 FERC P 2002 (2005).*

n37 As discussed elsewhere, the unit holders held their units from Santa Fe Pacific Pipeline Partners, L.P. (SFPPP, L.P..), a master limited partnership (MLP) which controlled SFPP, L.P. (the operating limited partnership) for the period before 1998. Thereafter the unit holders were limited partner in Kinder Morgan Energy Partners (KMEP), another MLP which now controls SFPP, L.P., the operating limited partnership. Thus, there was a transfer of control through the acquisition of SFPP (the MLP) by KMEP on March 6, 1998, but the operating partnership remained the same. *See* SFPP's 1998 FERC Form No. 6 at 122, note 1.

23. The fundamental difference between the position of SFPP and that of the Opposing Parties turns on the distinction between a partner that is "subject to" an actual or potential income tax liability and a partner that "has" an actual or potential income tax liability. The former reflects the position advanced by SFPP and recognizes that (1) a partner that holds a partnership interest over the life of the partnership will eventually pay income tax on all distributions and all gains, and that (2), at all times a partner that is participating in the partnership has an obligation to file a return disclosing either positive or negative income that the partnership has in a given year. The second reflects the position advanced by the Opposing Parties, argues that the partner must actually derive positive income from the partnership in a given year, or will have discernable ordinary taxable income in the later years that the partner holds the partnership interest. In this regard, the Opposing Parties' central point is that there is no necessary correlation between the taxable income reported by the partnership on its 1065 information return and the cash distributions that are made to the partners in any given year. They assert that the cash distributions may exceed the income imputed to the partners, and that no taxes will be paid on the difference between the income imputed to partners for tax purposes and the cash that was distributed to them. Their argument is that this difference in timing means that individual partners may never have an actual or potential income tax liability based on the units they hold.

24. The Opposing Parties' argument turns on two basic principles of partnership law, either of which could result in the dichotomy between reported income and distributions that Opposing Parties assert here. While actual partnership income (positive or negative) must always be reported by a partner, the difference between the level of the distributions and the amount of reported partnership income may be due to the timing of deductions and credits that are taken by the partnership or allocations of income and expenses items among the partnership. n38 On the first point, net *operating* cash flow is not necessarily congruent with income tax expense items that are based on book expenses such as depreciation, amortization, and investment credits. Thus it is in theory possible, although improbable in the case of a

large commercial partnership, that a partnership could generate $100 from operations that none of that income would be taxable in a given year if there was depreciation, amortization, and credits to offset it. In fact, as KMEP's income figures for 2000 and 20001 and SFPP's income figures for 1999 and 2000 suggest, the most likely result is that net income would be reduced given that both partnerships had substantial net income during those periods. n39 In any event, as of such time as the accelerated depreciation, special amortization, or tax credits are exhausted, partnership net income would increase. At that point income taxes would be due on that income from the partners holding units at that time, as well as on any distributions that exceeded the amount contributed to each partner's capital account. Which partners would bear that tax burden, and when, is a matter of timing that depends on the economic and accounting cycle of the partnership's capital investments. While potentially tax free distributions to a partner in a given year are considered particularly objectionable by the Opposing Parties, a difference between partnership net income and the cash flow available for distributions is not necessarily different from the asset and investment cycle of Form 1120 (Subchapter C) corporations. Thus, a corporation may have similar results depending on the cash flow that is generated by its assets and the depreciation, amortization, and tax credit strategy that is adopted by the corporation, and at such times may pay dividends out of retained earnings. n40

n38 Thus, as discussed further below, the difference between the income reported by a partner and the partner's distribution may also be due to the allocation of income and losses among the partners.

n39 In fact, KMEP net income for the six months ended June 30, 2000 was $131,369,000. Of that amount $49, 260,000 was the general partner's interest and $82,109,000 the limited partners' interest. For the six months ended June 30, 2001, net income was $205,893, 000 of which $92,228,000 was the general partner's interest and $113,665,000 the limited partners' interest. *See* Ex. UIT-49. SFPP, L.P., the operating unit whose rates are under review here had operating income of $113,586,418 in 1999 and $107,519,252 in 2000. SFPP's distributions to its general and limited partners (via KMEP) were $78,500,000 in 1999 and $105,900,000 in 2000. *See* SFPP's 2000 FERC Form No. 6 at 110 and 111. The same type of figures for the SFPP parent master limited partnership for the years 1996, 1997, 1998, and 1999 (some of which is for the period before the KMEP acquisition) are contained at page 50 of SFPP's Brief on Exceptions in Docket No. IS98-1-000. It is also possible for a partnership or corporation to have income that is not reported as taxable income because the income is from sources that are exempt from federal or state income taxes.

n40 To the extent either a corporation or a partnership does not pay out all income in dividends, the difference is added to retained earnings. Losses or payment of dividends during a year in which an income loss occurs reduces retained earnings by the amount of the loss.

[*62,090]

25. On this matter of timing, under *City of Charlottesville*, Commission policy recognizes that there is an imputed tax cost to the corporation of investing and owning regulated assets even if the actual timing of the payment of the taxes on the income generated by those assets may vary depending on the depreciation, credit, and amortization practices that corporation adopts. The fact that a corporation's reported income for tax purposes may vary in any given year does not preclude a corporation from obtaining an income tax allowance based on the return component included in its cost-of-service. However, a Schedule C corporation (like a partnership) will eventually pay tax on the income generated by the assets, or the gain that comes from the sale of those assets, with a negative tax impact on the reported income of the corporation and the interests of its investors. Moreover, because the tax allowance is based on the overall tax bracket of the corporation, the regulatory tax allowance does not necessarily turn on whether the components of the corporation's taxable income are characterized as ordinary income or taxable gains; it is sufficient that the ordinary income regularly earned by the corporation is sufficient to place it in the maximum income bracket. n41 The same approach should apply to a Form 1040 tax payer filing an individual return, or that of any other taxable entity. For the

same reason, the offsetting of deductions and credits within the partnership return, and on a partner's K-1 and Form 1120 or Form 1040 return, does not affect whether the partners are subject to an actual or potential income tax obligation. Assuming that there is no allocation of items of income, deductions and credits among the partners other than in proportion to their partnership interests, over time a partnership's net income is reflected proportionately on the returns of the individual partners.

n41 In determining the income tax allowance component of a costs of service the Commission use a presumption that that most corporations will have the equivalent of a 35 percent income bracket.

26. The Opposing Parties' second argument is that the allocation of income and expense items among the partners may result in the deferral of actual income tax payments and result in distribution of cash to some partners exceeding the income reflected on their tax returns. However, to the extent that income, deductions, and credits are allocated among the partners, this does not affect the total taxable income of the partnership reported on the partnership's 1065 information return it files with the Internal Revenue Service, the annual report it must file with the Commission, or the collective income tax liability of the partners. As SFPP points out, if all income were allocated to KMEP and all losses, deductions, and credits to the other partners, the income allocated to KMEP would equal the partnership's net operating income, KMEP would be subject to an actual or potential tax on that income. Thus, assume that SFPP reported $100 million in net income on its partnership information return. Even if $150 million in gross income was allocated to KMEP and $50 million in losses to the other partners, KMEP would still have a tax liability for 100 percent of that $100 million assuming, as has been discussed, there were no offsetting expenses or deductions from other income sources. n42 A different allocation could lead to different reporting obligations of the partners, but the $100 million in actual net income would be allocated to some, or all, of the non-KMEP partners. However the allocation is made, there is still an imputed tax cost to the partnership, and hence to the partners, for the funds invested in the enterprise. Allocation of income among the partners may affect the marginal tax bracket of the partners involved because the allocation might change the amount of both gross and taxable income that may be reflected on the partners' returns, and therefore influence the weighted income tax allowance to be included in the partnership's cost of service. However a partner that can be identified through the partnership's information return and K-1s will be subject to an actual or potential income tax liability for that income. Each such partner is involved in the allocation and is subject to an actual or potential income tax liability regardless of exactly how the allocation of income and losses occurs.

n42 SFPP's Brief on Exceptions dated October 7, 2005 in Docket No. IS98-1-000 indicates at 48 that KMPG had very substantial corporate income in 2000. While the exact number is contained in the protected section of SFPP's brief, it is derived from Ex UIT-104, SF177621-2, in the Docket No. IS98-1-000 proceeding. As discussed below, the determinations to be made here materially simplified if KMPG were to include the same information in Docket Nos. OR92-8-000, *et al* and OR98-6-000, *et al.*

27. As has been discussed, the Opposing Parties also assert that a partner may have no income tax liability in a given year because there are deductions and credits other than those attributed to the partnership that may negate any investment income from the partnership. However, as explained in the Policy Statement, under the Commission's "stand alone" tax policy, corporations are not denied an income tax allowance because deductions or losses from one subsidiary or operation may act to offset income from the regulated entity if the corporation files a consolidated return. n43 If the partner is a corporation, the income from the partnership likewise becomes part of the corporation's overall income tax return and should be subject to the same result. Similarly, when a Form 1040 taxpayer files a return, all sources of income, including the relevant proportion partnership net income reported on the partner's K-1, are reported on the relevant portions of the Form 1040. These sources of income may be offset by losses from other activities or by

itemized deductions [*62,091] included on Schedule C of a Form 1040 return. Consistent application of the "stand alone" policy means that a partner filing a Form 1040 return, and the partnership, should not be penalized because such a partner has losses, deductions, or credits from other sources that may offset income reported on the K-1 of a specific partnership.

n43 *Id.* P 38.

28. Thus, for purposes of determining whether a partnership should have an income tax allowance, the impact on a partner filing a Form 1040 return of losses or deductions from other sources should be no different than the impact on a corporate partner that files a Form 1120 corporate return containing the same type of offsets within its corporate structure. Even though the income of a partnership and that attributed to its partners may vary whether a partner has an actual tax liability in a given year is not determinative given the Commission's stand-alone policy. What is relevant is that a partner is subject to an actual or potential liability for any income earned from regulated assets, regardless of whether it is offset by deductions, losses, or other subtractions. This result is consistent with the philosophy in *City of Charlottesville* n44 that the actual or potential tax liability test does not require that actual cash tax payments be paid by an entity on regulated income in a particular fiscal year. Therefore, if a partner is required to file a Form 1040 or Form 1120 return that includes a partnership income or loss, the Commission concludes that such partner that has an actual or potential income tax liability for the partnership income. n45 The relationship of this standard to the weighted tax rate, multiple levels of pass-through entities, and the allocation of tax benefits among partners is discussed further below.

n44 *Policy Statement* at P 15, n. 12, and P 33, n. 28.

n45 While the Commission is not requiring that the regulated entity have actual income that would be taxable to its partners in the relevant test year, as previously stated, having such income, or a pattern of such income, would materially simplify a regulated entity's case. *Cf. Trans-Elect.*

b. <u>The marginal tax bracket to be applied.</u>

29. The *Policy Statement* states that the Commission will determine on a case by case basis the marginal tax bracket to be used to determine the tax allowance for pass through entities such as partnerships or limited liability corporations (LLCs). n46 In that regard the *Policy Statement* discusses an example of a partnership consisting of both regulated electric utilities and municipal electric companies. The former pay income taxes but the latter do not. In that instance the partnership was structured to provide an income tax allowance in proportion to the partnership interests owned by the regulated electric companies, but none was provide for those owned by the municipal electric entities. Thus the income tax allowance was based on the weighted average of the marginal tax brackets of the owning partners. n47 However, the *Policy Statement* did not indicate how the marginal tax rate would be developed in a specific proceeding. The Commission does so here following the categories in SFPP's June 16 brief.

n46 *Policy Statement* at P 32-34.

n47 *Id.* PP 8-9. The jurisdictional partnership owned and operated transmission facilities used in interstate commerce. As is discussed further below, the partnership documents allocated the tax benefits in a manner to prevent the non-taxpaying partners from obtaining any of the tax benefits.

30. The simplest determination of the marginal tax bracket occurs when all the partnership interests are owned by Schedule C corporations, by LLCs that are required to be taxed as Form 1120 corporations, or LLCs that have elected to be taxed as such. n48 The Commission has long held that there is a rebuttable presumption that a Subchapter C corporation owning interests in a regulated entity has a marginal tax bracket equal to the maximum corporate tax bracket because of the size and scale of the operations of most such corporations. n49 Thus, the Commission adopts here a presumption that corporate partners owning interests in SFPP or KMEP pay the maximum marginal tax rate of 35 percent for purposes of calculating any tax allowance that may be granted to SFPP.

n48 *Cf. Trans-Elect, supra..* In this case all the partnership interests were ultimately controlled by a Schedule C corporation or an LLC that was required to file the Form 1120 tax return as an entity that would be taxed as a Schedule C corporation.

n49 In 1994, 1999 and 2000 the maximum corporate tax bracket was 35 percent. All income over $75,000 had a marginal tax bracket of at least 34 percent. *See IRS Publication 542* for 1994 at 7, for 1999 at 9, and for 2000 at 10.

31. Determining the marginal tax brackets for partners that are not Schedule C corporations is more difficult. As the Opposing Parties assert, individual taxpayers, or the entities of which individuals are often the beneficiaries, n50 may have a wide range of tax brackets, and in theory any SFPP limited partner or KMEP unit holder could fall in these different brackets. Moreover, since tax returns are confidential, it would be very difficult for a regulated pass-through entity to obtain actual tax data on the marginal tax rates of the entity filing a return. To address this issue, the Commission reviewed two official Internal Revenue Service publications, *Individual Income Tax Rates and Tax Shares, 1994*, n51 and *Individual Income Tax Rates and Tax Shares, 1999*, n52 and takes administrative notice of both. Both contain a figure C displaying the marginal tax brackets in effect for each year, the number and percent of returns by each such bracket, the distribution of modified taxable income and percent of such income by each such bracket, and the amount of [*62,092] income tax generated by each bracket and that tax as a percent of total tax generated. n53 The Figure C for 1994 discloses that 29.1 percent of income taxes were paid by individuals in the 36 percent bracket or higher. n54 The Figure C for 1999 states that some 40.3 percent of total taxes were paid by individuals in the 36 percent bracket or higher. n55 In 1994, 74.7 percent of total income taxes were paid by Form 1040 taxpayers in the 28 percent bracket or higher, n56 and in 1999, 79.5 percent of taxes were paid by Form 1040 taxpayers in the 28 percent bracket or higher. n57

n50 These include pension funds, IRA Plans of various types, Keogh Plans, mutual funds, and investment clubs.

n51 Individual Income Tax Rates and Tax Shares, 1994 (1994 Tax Data).

n52 Individual Income Tax Rates and Tax Shares, 1999 (1999 Tax Data).

n53 1994 is the test year at issue in Docket No. OR92-8-000, *et al.*, and 1999 the principal test year in Docket No. OR96-2-000, *et al.*

n54 1994 Tax Data at 10.

n55 1999 Tax Data at 9.

n56 1994 Tax Data at 10.

n57 1999 Tax Data at 9.

32. Given the high percentage of tax revenues generated by the 28 percent tax bracket or higher in those two years, the Commission will adopt a presumption of 28 percent marginal tax bracket for entities other than those filing an 1120 corporate return. n58 This is a conservative estimate of the marginal tax bracket of individuals holding SFPP or KMEP interests, either directly or indirectly, given that the complainants argue that KMEP serves mostly as a tax shelter for wealthy individuals. Thus, it is likely that the use of the 28 percent bracket actually understates the marginal tax rate of most individuals that have invested in SFPP or KMEP partnership interests. The same presumption will apply to such entities if those entities are deemed to have unrelated business taxable income (UBTI), unless the Internal Revenue Code prescribes a different level. n59 Thus, unless a party provides evidence to the contrary, the marginal tax bracket for partners that are Schedule C corporations or LLCs filing a Form 1120 return of 35 percent, for partners that are tax payers other than a Schedule C corporation the marginal tax bracket is 28 percent, and for municipalities and other exempt entities the relevant marginal tax bracket is zero. n60

n58 The next lower, which is the lowest bracket, was 15 percent in both years.

n59 *See* SFPP's June 16 filing at p. 26 for a list of entities that may be subject to UBTI. However SFPP does not address the marginal tax rate that should be attributed to such entities having UBTI. This should be clarified in the compliance filing if the marginal tax bracket would differ from the rebuttable presumption created here.

n60 A pass-through entity may provide evidence that the marginal tax bracket of any partner or unit holder is greater than 28 percent if the evidence is available.

c. **Multiple Levels of Ownership.**

33. The *Policy Statement* also recognized that, like corporations, partnerships and other pass-through entities may have multiple layers of ownership. Thus, it is not unusual for a partnership or LLC to be owned by another partnership or LLC, and for that entity in turn to be owned by Form 1040 or 1120 partners. As noted, partnership or pass-through LLC interests can also be owned by trusts, pension plans, IRA Plans, Keogh Plans, and mutual funds. There is no objection to such arrangements as long a partner that is subject to an actual or potential income tax level can be identified during the test case year at issue in a particular proceeding. As SFPP noted, it is the obligation of the regulated entity to identify who has the ultimate responsibility for income that is subject to an actual or potential income tax liability.

d. **Flow of the Tax Allowance Benefits among the Partners.**

34. One of the Remand Opinion's criticisms of the Commission's *Lakehead* policy is that it was mathematically impossible for the policy to accomplish its purpose. Specifically, the court stated that even if a partnership were denied an income tax allowance in proportion to the interests not owned by a corporation, the non-corporate partners would still share in a portion of any more limited income tax allowance that was allowed. This is because all partners would continue to share in the benefits that flowed from whatever tax allowance was authorized in proportion to their partnership interests. n61 However, as was also stated in the *Policy Statement*, this issue can be resolved in the instant case by using the weighted marginal tax bracket of the different unit holders to determine the tax allowance. This reflects the cost to the partnership of the marginal tax brackets of the partners, thus assuring that *ratepayers* are not

charged more than the income tax cost imputed to the partnership. This is the same methodology the Commission uses when computing weighted cost of capital which reflects the fact that debt and equity instruments are imputed different costs of capital. That is, once the weighted cost of capital is determined, the Commission does not go further and determine whether the purchaser of a particular instrument may be earning more or less than the weighted cost of capital. The same logic applies to the determination of the income tax allowance. e. Other Income Tax Allowance Issues.

n61 *BP West Coast* at 1291.

35. The Opposing Parties raise three additional arguments regarding any income tax allowance for SFPP in Docket No. OR92-8-000, *et al.* The first issue here involves SFP Pipeline Holdings, Inc., which was created as a holding company for SFPP, Inc. in 1990. SFPP, Inc. was owned 100 percent by SFP Pipeline Holdings, Inc., which in turn was owned 100 percent by Santa Fe Pacific Corporation. SFP Pipeline Holdings, Inc. issued $219 million in debentures in a public offering. n62 The interest payments on these debentures were [*62,093] structured to equal, under most circumstances, 100 percent of the distributions received by SFPP, Inc. from its 47.1 percent limited partnership interest in Santa Fe Partners. The argument in the prior proceedings is that this arrangement insulated SFPP, Inc. and all its parent companies from having to pay income tax on any income generated by SFPP, as reflected via the 47.1 percent limited partnership interest held by SFPP, Inc. in Santa Fe Partners. The Commission rejected that conclusion and a related ruling by the ALJ in Opinion No. 435 on the grounds that the Commission's stand-alone policy warranted granting SFPP an income tax allowance because the 47.1 percent interests were owned by corporate partners. n63 Thus, under *Lakehead*, SFPP was granted an income tax allowance as the 47.1 percent limited partnership interest was owned by a corporation.

n62 *See* Ex. 873 in Docket No. OR92-8-000, *et al.* for the prospectus issued with regard to those debentures.

n63 *Opinion No. 435* at 61,103-04; *Opinion No. 435-B* at 61,509.

36. The Opposing Parties renew their previous argument here. They assert that the *Policy Statement* the Commission repudiated the stand-alone argument for purposes of partnerships and other pass-through entities unless an actual income tax liability can be shown. They argue that because an actual income tax liability must be shown, SFPP, L.P. could never meet the standard because the debentures shelter any income that SFPP, Inc. may have received from its 47.1 percent limited partnership interest. Therefore no income tax allowance should be afforded SFPP, L.P. in proportion to those interests. This argument overlooks two critical points. First, the Commission has not repudiated the stand-alone argument for pass through entities. As was previously discussed, the fact that an owning partner may have offsetting credits or losses from sources other than SFPP (or KMEP) on Schedule D of Form 1040 or 1120 does not eliminate the right to an income tax allowance. Nor does the fact that timing issues, or short term losses, may result in a partner's K-1 having negative income in a particular tax year, or income that is other than ordinary income.

37. Second, the payments on the debentures are keyed to *distributions*, which, as Opposing Parties state, are not the same as the *income* that is reported by the partnership for information purposes, and by the individual partners (positive or negative) because of their Form 1040 or Form 1120 return obligations. Because the corporate structure above SFPP, Inc. involved 100 percent ownership, all of those corporations could file a consolidated return, and therefore the intermediate corporate levels would not have paid an income tax on SFPP, Inc.'s income. However, any *income or loss*

to SFPP, L.P., a partner, flows up the corporate chain by means of the consolidated return. That income or loss must be reported at the highest level of the consolidated return. In this case this was Burlington Northern Santa Fe Corporation. Under the previous analysis, the imputed tax rate is the maximum corporate tax rate for the 1994 test year at issue, 35 percent. Since interest on the corporate debentures was paid based on *distributions*, not *income*, the income tax impacts of any given year would still fall on the corporate owner filing the consolidated return. As such, the SFP Pipeline Holdings, Inc. debentures are not a barrier to SFPP having an income tax allowance in the 1994 test year.

38. The second issue involves the curative allocation designed to compensate for the contribution of depreciated assets to a partnership by one of the partners. In the Phase II ID in Docket No. OR96-2-000, *et al.*, the ALJ held that when such an allocation occurs, the allocation should not be used in determining any income tax allowance because this would unfairly shift income tax cost to the ratepayers. The ALJ then devised a method for correcting the curative allocation to conform to Commission policy based on a methodology developed by Navajo. n64 On exceptions, SFPP conceded that Commission policy supported the ALJ's conclusion that a curative allocation would not be allowed for purposes of the income tax allocation, but objected to the ALJ's method for reallocating the income. While the Opposing Parties did not address this issue on exceptions, they did so in their responses to the June 1 Order. They base their arguments on the prior discussion of allocation issues in the Opinion No. 435 Orders and the underlying discussion of such issues in *Lakehead, supra*. The Commission reverses the ALJ in this regard based on its prior discussion of allocation issues and the general relationship of such issues to the Commission's former *Lakehead* doctrine.

n64 ID at P 370.

39. Curative allocations are a part of partnership law mechanics that address the allocation of income among the partners based on the market value of their capital contributions. To summarize, the IRS requires that if a partner contributes depreciated property to a partnership, that contribution must be deemed contributed at its fair market value for the purpose of allocating income and expenses among the partners. This assures that all partnership interests are valued for tax purposes at market value when the assets are contributed. For example, assume that one partner contributes $100 in cash and a second contributes property with a depreciated basis of $50, but market value of $100. In the absence of the curative doctrine, the total value of the partnership might be $150 and the allocation of income and expenses between the two partners would be two-thirds and one-third respectively. The application of the IRS curative allocation doctrine results in a total value for tax purposes of $200 and equal allocation of tax items between the two partners. Since the *Policy Statement* holds that any tax allowance should be based on the income tax imputed to the partners, and the IRS doctrine rationally reflects the current [*62,094] economic value of the assets a partner contributes, the IRS income allocation should control.

40. The third additional issue advanced by the Opposing Parties centers on incentive distributions. It is not contested here that many master limited partnership agreements have provisions for income and distributions to be allocated from the limited partners to the general partners as the partnership's economic performance improves. Thus, once distributions to the limited partners reach a certain level, more of the distributions flow to the general partner. SFPP asserts that in its June 15 filing that as distributions are shifted to the general partner, more of the income items are allocated to the general partner. In its June 15 filing, SFPP provides a simple example in which partnership income is $100 million, noting that partnership tax law permits the income and expense items to be allocated among the partners pursuant to the partnership agreement. SFPP posits that $150 million in income items might be allocated to the general partner and $50 million in expense items to the limited partners. The latter would thus obtain the maximum cash distribution of $50 million due them under the partnership agreement plus a tax deduction for the loss included in their Form K-1. SFPP asserts that whatever the impact on the Form 1040 or 1120 returns of the individual partners, there would still be an entity with an actual liability for the $100 million in income reported on the partnership return.

41. The Opposing Parties assert that this example distorts and over-simplifies a complex situation. They assert that their evidence shows that SFPP's distributions greatly increased by the year 2000, that these distributions and the related income shifts greatly distort the income tax cost that should be imputed to SFPP based on its partners' tax liabilities. They further assert that the ALJ found that the payments under the incentive distributions were due in large part to a substantial over-recovery of SFPP's operating costs. n65 They also assert that most of the increase in KMEP's income, and therefore the income allocated to the general partner, was due to increased earnings from KMEP operating entities other than SFPP. They therefore conclude that any attribution of a tax allowance to SFPP based on those increases would be unfair to SFPP's rate payers because the income tax allowance would be overstated.

n65 *See* ID at P 372-73.

42. As previously noted, this issue was discussed on exceptions to the ID, but was more fully discussed in response to the Commission's June 1 Order. However, the Commission concludes that SFPP has the better part of the argument. First, to the extent that distributions have increased in part to SFPP's rate levels, the historical argument would appear inconsistent with the assertion by the ALJ and the Opposing Parties that SFPP's income was stable or actually declined through 1999. If SFPP's income is the base against which any income tax allocation should be measured, the fact that its past rates may have been high is simply not relevant. Under the Commission's stand-alone policy, if a corporate parent files a consolidated return, the parent's marginal tax bracket is used to determine the income tax allowance even if it is income from other sources that causes the parent company to fall within the maximum tax bracket. n66 The level of SFPP rates in *past* periods is a matter for determining refunds, if appropriate, and does not affect the income tax allowance that would be used for determining a *prospective* rate defined by *projected* income based on the test period.

n66 The Remand Opinion did not question this practice.

43. The shifting of the income allocation as a part of providing incentive distributions is a third issue. The *Policy Statemen* t provides that the tax allowance should be based on the weighted marginal tax bracket of the partners. The prior portions of this order concluded that there should be somewhat different tax rates attributed to various types of ownership interests based on the rebuttable presumptions discussed earlier in this order. Given this, if income is shifted from one type of ownership interest to another, the weighted average of the differing partnership interests could change resulting in a different tax allowance for the operating entity, in this case SFPP. The Commission concludes that it is SFPP's prerogative to allocate income and losses among its partners as it determines as long as the maximum tax rate imputed to individuals does not exceed the maximum corporate rate. Given this, under the *Policy Statement* the maximum impact on the ratepayers is the same whether the regulated assets are controlled by a corporation or a partnership. Thus, if all partners are corporations at the maximum tax bracket, then the regulated entity's rates would be based on the maximum possible tax allowance. For these reasons the Commission reverses the contrary conclusions in Phase II ID in Docket No. OR96-8-000, *et al.* n67

n67 *Cf.* ID at P 376.

3. **Further proceedings regarding income tax allowance issues.**

44. In the preceding paragraphs the Commission has ruled on a number of basic principles to be used in determining SFPP's income tax allowance in this proceeding. A review of the briefs filed in response to the Commission's June 1

Order indicate that the record in both the proceedings at issue here is oriented toward establishing whether SFPP and KMEP's units holders are Schedule C taxpaying corporations. Giving the narrow focus of the arguments regarding that evidence, the Commission concludes that it is premature to determine if SFPP meets the income tax allowance standards contained in the *Policy Statement*. [*62,095] Further analysis is necessary because much of the information in the record must be reformatted to address the matters at issue here. As in *TransElect*, additional information is required because the legal standards have changed since the record closed in all of the consolidated dockets at issue here. As a result the Commission directs SFPP to file information explaining the interests that SFPP's or KMEP's limited and general partners had in partnership's net income in each of the years at issue here. Because this is not the necessarily the same as the income that may be allocated to limited and general partners in each year, SFPP and KMEP shall also state the amount of the income that was allocated to the limited and general partners for each year, including the amount of taxable income that was allocated between the two types of partners.

45. The Commission also directs SFPP to determine the estimated income tax allowance as follows. Using materials at hand in each proceeding at issue here, SFPP for the years prior to 1998, and KMEP for the year 1998 forward, will separate their respective partners (unit holders) into six broad categories and include supporting detail on the units holders within each category: (1) Subchapter C corporations, (2) individuals, (3) mutual funds, (4) other unit holders such as pension funds, IRAs, Keogh Plans, and other entities that are not normally tax paying entities, but would be expected to have taxpaying beneficiaries or owners, (5) those entities listed in (4) that may be taxpaying entities because income from SFPP or KMEP would be deemed unrelated business income, and (6) those institutions and exempt entities, if any, which have no obligation to pay out income or to declare it, such as municipalities. n68 To the extent that the unit holders are pass-through entities such as other partnerships, Subchapter S corporations, and pass-through LLCs, SFPP or KMEP should identify the nature of the entity or individual ultimately subject to an actual or potential income tax liability and place that entity or individual in the appropriate category of unit owner. SFPP should identify the percentage of unit holders that falls into each group.

n68 The parties have already attempted to do much of this in the context of their arguments about the application of the *Lakehead* doctrine. *See* Docket No. OR92-8-000, *et al.*, Exs. 477, 478, 479, 926, 931; Docket No. OR96-2-000, *et al.*, Ex. Nos. MFM-13, SFPP-79 - 81, UIT-1 at 83. For a more recent example see the filing by Northern Border Pipeline Company dated November 1, 2005, in Docket No. RP06-72-000, Vol. II, Ex. No. NB-16, Schedules 2-4.

46. SFPP and KMEP will then calculate the percentage of taxable partnership income imputed to each group, which the Commission recognizes may not be the same as the percentage of the actual units held by each group depending on how expenses, deductions and income are allocated among the partners. SFPP and KEMP will then develop a weighed tax allowance accordingly. The weighted tax allowance so calculated would be used to develop the required cost-of-service and the interim rate for the related rate filing. SFPP shall prepare supporting affidavits explaining the methodology chosen and include work papers in a separate binder, to be available to parties and the Commission, to support this portion of its compliance filing. n69 If a statistical approach is used, SFPP must explain why the sample is statistically valid, and if necessary, explain why any failures to meet the standards discussed here are not statistically significant or relevant.

n69 The Commission recognizes that there are challenges to the various studies on the income tax allowance issue that SFPP and the Opposing Parties have prepared to date. However, it would be more efficient to address such issues in the context of a filing that focuses more closely on the guidance provided in this order.

47. Moreover, in order to implement new interim East and West Line rates as soon as possible, the Commission will require SFFP to develop a cost-of-service for both lines and develop estimated rates, including the estimated income tax allowance component SFPP is to prepare in response to this order. n70 As discussed further below, the Commission directs SFPP to file interim rates based on the related cost-of-service compliance filing it must prepare in response to this order. Interim rates are necessary because the litigation over the current rates has been ongoing since 1995 in the case of the complaints in Docket No. OR98-2-000, *et al.*, and even longer for the proceedings in Docket No. OR92-8-000, *et al.* The Commission contemplates that the rates filed in compliance with this order should be less than those now in effect and thus some relief should be accorded shippers given that litigation over the appropriate tax allowance may continue for some time.

n70 The authority to require this filing stems from the Commission's remedial authority in section 15(1) of the Interstate Commerce Act, *49 U.S.C. app 15*(1) (1988). The remand opinion affirmed the use of an interim rate and held that such a rate is not a final rate for purposes of the *Arizona Grocery* doctrine. *BP West Coast*, Part III, B. 1. a., *passim*, discussing the relevance of *Arizona Grocery Co. v. Atchison, Topeka, & Santa Fe Railway Co., 284 U.S. 370 (1932)(Arizona Grocery).*

B. East Line Rate Issues Remanded in Docket No. OR92-8-000, et al.

48. In addition to its concerns about income tax allowances, the Remand Opinion addressed two other issues regarding the East Line rates established by the Commission's Opinion No. 435 orders. These were the allocation of Commission regulatory costs between the East and West Line rates and SFPP's reconditioning costs. In its June 1 Order the Commission concluded that regulatory costs should be allocated on the basis of relative East and West Line volumes for the period covered by the Opinion No. 435 orders. The Commission determined that it would not modify its prior ruling regarding SFPP's proposed reconditioning costs for its East Line. In preparing a new East Line compliance filing SFPP shall apply those two rulings, together with the tax allowance methodology [*62,096] described in the previous part of this order.

49. In all other matters SFPP shall follow the same compliance methodology developed in the Opinion No. 435 Orders and ultimately defined by the Commission in its *Order on Rehearing and Compliance.* n71 Pursuant to that methodology, SFPP must prepare a revised cost-of-service for the 1994 test year utilized in Docket No. OR92-6-000, *et al.* and prepare a separate tariff filing based on that year. Since the revised East Line rates required here address only the periods addressed in Docket No. OR92-6-000, *et al.* and the Opinion No. 435 Orders, to be consistent with the ruling in those orders, the rate based on the 1994 cost of service will be indexed forward to August 1, 2000. Consistent with the Commission's practice in the Opinion No. 435 Orders, the rate so developed will be an interim rate until such time as any challenges to the income tax allowance portion of the rate can be resolved and a final rate developed. The revised rate will be compared to the indexed rate actually in effect since August 1, 2000 (and retrospectively for reparations two years prior to the filing of the relevant complaints). This will determine whether a new East Line rate should be established for each year since August 1, 2000 depending on the results of the additional calculations required here in response to the Remand Order. n72 Moreover, as the previous discussion suggests, any revised East Line rates to be effective as of August 1, 2000, may be further revised depending on the final resolution of the income tax allowance issue. The analysis here resolves SFPP's argument on exceptions that the ALJ prematurely concluded that its East Line rates are unjust and unreasonable.

n71 *SFPP, L.P., 106 FERC P 61,138 (2001).*

n72 The Commission's prior orders ultimately allocated 50 percent of Commission regulatory costs allowed under those orders to the East Line rates. Here the allocation is based on relative volumes, which are notably lower for the East Line rates. This suggests fewer regulatory costs will be allocated to the East Line rates.

C. Cost-of-Service Issues in Phase II of Docket No. OR96-2-000, et al.

50. The second proceeding at issue here is Phase II of Docket No. OR96-2-000, *et al.* As previously discussed, the June 1 Order affirmed the prior jurisdictional determinations made in Phase I of that proceeding regarding the status of the North, Oregon and West Line rates. Thus complaints filed against the Yuma, CalNev, and West Tucson rates in 1996 were valid complaints in that year and all years thereafter, as are complaints against the West Phoenix rates for the year 1997 and for all years thereafter. Complaints that were pending against SFPP's East Line rates in the same years are valid complaints because SFPP's East Line rates were never grandfathered. In addressing those complaints, there are several issues that are common to both the East and West Lines in addition to the income tax allowance issues discussed in the first part of this order. These include: (1) the test year to be used in these proceedings; (2) rate base and capital structure issues; (3) cost of capital issues, (4) overhead cost allocation issues; (5) the recovery of regulatory costs; (6) Arizona real estate tax cost matters; and (7) modification of SFPP's current depreciation methodology. There are other minor points that involve one or both lines, but do not warrant separate itemization here.

1. Test year issues.

51. The ID utilized a 1999 test year with limited changes and certain modifications for the year 2000. The latter included additional capital expenditures made by SFPP in 2000, with a related issue of how depreciation, amortization, and the related allowance for deferred income taxes (ADIT) should be calculated given the inclusion of those capital expenditures in SFPP's cost of service. n73 The ID concluded that if SFPP included 2000 year capital additions in its 1999 cost-of-service, it should depreciate all capital accounts by carrying the deprecation forward through the year 2000. The ID also required SFPP to adjust ADIT through year 2000 if the 2000 capital costs were included in its rate base. n74 The ID also determined that 2000 volumes should be used to construct SFPP's cost-of-service for its East and West Line rates. n75 As discussed further below, the ALJ also addressed certain capital structure factors using 2000 year balance sheet information. However, the ALJ rejected at hearing SFPP's proposal to utilize a full calendar year 2000 test year to develop SFPP's cost of service. The ALJ concluded that this was unfair to complainants who had prepared their complaints and cases-in-chief using a 1999 cost of service. The ALJ also concluded that SFPP's proposed 2000 test year was incomplete. n76

n73 ID at P 319-327.

n74 *Id.* P 324.

n75 *Id.* P 320-22.

n76 *Id.* P 314-16.

52. On exceptions SFPP asserts that the ALJ erred in excluding its proposed 2000 test year cost of service, which it claims was the most recent and accurate information available. It further asserts that use of the 2000 year data would not have precluded complainants from updating their cost of services accordingly. SFPP further asserts that the ID erred in requiring it to carry all depreciation and ADIT through the 2000 year and requiring SFPP to utilize 2000 year volumes to develop its cost-of-service. In contrast, Western Refinery and Navajo assert that the ID should have also required

allowance for funds used during construction (AFUDC) to be carried forward through the 2000 test year. Staff argues that the ID should have excluded some $3.8 million in 2000 year capital expenditures that the ALJ permitted SFPP to include in the 1999 test year the ID adopted. On [*62,097] reply, Western Refinery and Staff support the ID's conclusion requiring SFPP to carry all depreciation and ADIT through the year 2000. SFPP asserts that the Staff incorrectly urges the exclusion of the $3.8 million in capital costs, arguing that SFPP followed the ALJ's directions to list only the more important items involved in its 2000 capital program and to aggregate the rest. It further asserts that proposals to include more 2000 data in the 1999 test year would result in confusion and supports its argument to use 2000 year cost information.

53. The Commission concludes that the best way to resolve these disputes is to use a 1999 cost-of-service for all items unless a cost issue is sufficiently discreet that it warrants the use of a different year. Given the limitations and confusion regarding the use of some 2000 year cost figures and the fact that such figures were not fully litigated, less rather than greater clarity will result from the use of those figures. All of the complainant's testimony and analysis were based on the use of a 1999 test year, which was the data that was the most consistently tested at hearing. It simply too late to pursue an alternative course here. For these reasons the Commission reverses the ALJ's decision to use a modified 1999 calendar year cost of service that includes some 2000 costs figures. It is important to use all cost-of-service factors from the same year to assure internally consistent results. For example, since volumes determine how the costs are distributed on a unit basis, the test years for costs and volumes should be the same to assure that volume sensitive costs are correctly matched to the volumes of the same year. Thus, if the cost of service utilizes 1999 costs, then 1999 volumes should be used, particularly since the SFPP route guide that allocates volumes among the different lines and delivery points on the system is keyed to 1999 volumes. n77 This is true, even though as here, SFPP's West Line volumes increased by 4 to 6 percent in 2000 over 1999 (depending on the methodology used) and East Line volumes declined somewhat. Similarly, the ALJ's instructions regarding the inclusion of some 2000 year capital costs in the 1999 test year only resulted in further debate about the accuracy of those costs based on Staff's assessment, as well as a protracted debate about whether depreciation, ADIT and ADUC should be carried through the year 2000 in light of the inclusion of certain 2000 calendar year capital costs in the 1999 test year. For these reasons the Commission will use the 1999 test year to develop the cost-of-service for the rates at issue here. Finally, given the ruling here, there is no to need address arguments that the 1999 cost-of-service should include 2000 year cost elements. n78

n77 *Cf.* Staff Brief Opposing Exceptions at 48-49, *citing* Ex. S-56 and SFPP Brief on Exceptions at 82. *See* SFPP Cost of Service for 1999, Schedule 14-A for the route directory which separates the volumes by pipeline segment.

n78 For example, Navajo's argument that SFPP's debt levels should be carried forward through 2000 to match the equity adjustment made in the ID.

2. **Rate base and capital structure issues.**

54. The rate base issues on exceptions are: (1) the inclusion of additional capital items in the rate base of the 1999 year cost-of-service; (2) the inclusion in SFPP's capital accounts of the purchase price adjustment (PPA) involved in KMEP's acquisition of SFPP in 1998; (3) the amount of debt to be included in the capital structure, (4) whether SFPP's capital structure (rather than KMEP's) should be used to calculate the reparations due (if any) for the years 1998 and 1999, (5) the failure of the ID to expressly enforce the proper amortization period for SFPP's starting rate base write-up, and (6) whether certain capital items should be removed from SFPP's 1999 rate base.

55. The first issue, the inclusion of additional capital expenditures in the rate base was discussed in the context of the test year issues and need not be discussed further here. The second issue, the 1998 PPA, involves KMEP's write-up of the equity component of both KMEP's and SFPP's capital structure to reflect the difference between SFPP's book value at the time of its purchase by KMEP and SFPP's value based on the purchase price of the transaction. The ID concluded

that the difference between SFPP's existing net book value (cost minus depreciation) at the time of purchase and its book value after the PPA write-up was some $793 million. The ID concluded that this figure improperly inflated the equity component of SFPP's capital structure because the additional dollar value did not commit any new assets to a public use and did not provide any additional benefits to the ratepayers. As such, the PPA write-up violated Commission policy. n79

n79 ID at P 335-40

56. In addition, the ALJ held that KMEP had improperly classified some $124.5 million of some $209 million dollars of 1999 debt due in one year as short term debt. He concluded this improperly increased the equity component of KMEP's capital structure and hence the overall cost of equity to be used in designing SFPP's rates. Finally, the ALJ held that SFPP's, not KMEP's, capital structure should be used for determining reparations in 1998 and 1999 because KMEP had not guaranteed SFPP's debt in those years. The ID also required KMEP to remove the PPA included in SFPP's equity in 1988 when the pipeline was converted to a publicly traded limited partnership by the Southern Pacific Transportation Company and to use the resulting capital structure to determine reparations for periods before 1998 and 1999.

57. On exceptions SFPP asserts that the ID's conclusion is inconsistent with the Commission's prior Opinion No. 435 Orders in which the Commission permitted a 1988 PPA to be included in [*62,098] SFPP's equity component. n80 It further argues that the ID applied the wrong test for determining whether the PPA is appropriate, asserting that the Commission's prior orders only preclude using a PPA to increase the rate base and are not applicable to changes in the capital structure. SFPP further asserts that the ID ignored uncontroverted evidence that retention of the 1998 PPA in KMEP's capital structure would not result in a higher weighted average cost of capital. It also argues that the ID fails to explain why removal of the 1998 PPA amount should affect only the equity component of KMEP's capital structure. SFPP further asserts that the Commission has traditionally treated short term debt as equity in determining the equity component of the capital structure. As such, the determination by KMEP's accountants and financial experts that some $124.5 million of SFPP's long term debt should be reclassified as short time debt was appropriate. Given this professional advice, SFPP asserts that KMEP's determination of what its capital structure should be is appropriate and should be affirmed on exceptions.

n80 *Opinion No. 435-A*, 91 FERC at 61,506-507. There the Commission reversed its earlier conclusion in *Opinion No. 435*, 86 FERC at 61,096-97.

58. SFPP advances several additional arguments to support the use of KMEP's book capital structure in designing a 1999 cost of service. It asserts that the record strongly controverts the conclusion that SFPP was independently financed as late as 1999. SFPP asserts that KMEP advised all interested financial parties that after 1998 they should look only to KMEP for the ultimate payment of debts and for the management of the pipeline. It argues that KMEP had large lines of credit in place as early as 1999 and was therefore able to fully control SFPP's finances and its capital structure. Since SFPP had no independent financing in 1999, SFPP asserts that its parent company's capital structure should be used to determine SFPP's capital structure. SFPP asserts that KMEP has a long term capital structure goal of 40 percent debt and 60 percent equity, a goal it asserts that is only 2 to 4 percentage points more than the 56 to 58 percent equity ratio of the sample group of products pipelines used to determine cost of capital issues in this proceeding.

59. SFPP further asserts that in any event the financing used to acquire SFPP in 1998 was 35 percent debt and 65 percent equity and that this capital ratio should be honored. It also asserts that, while SFPP accounted for some 70 to 80 percent of its operations in 1998, KMEP has had other transactions involving a PPA. SFPP states it is therefore difficult

to trace precisely which portions of the PPA included in KMEP's balance sheet should be attributed to the SFPP acquisition, and what part of that PPA should be attributed to other transactions.. SFPP further argues that the Commission held that the inclusion of a PPA in SFPP's equity in 1998 was warranted given the lack of proof by the opponents and the fact that failure to do so would result in negative equity for SFPP. It argues that this precedent should control here and the 1988 PPA should be used to determined reparations before 1998.

60. Staff and Western Refinery support the ID on all points. Western Refinery asserts that the Commission generally requires that the costs of acquired assets be set no higher than their net book value, which is original cost minus accumulated depreciation. n81 It asserts the only exceptions to this rule are situations in which both the assets are put to new public use, and the ratepayers will reap substantial, quantifiable benefits from the sale they would not otherwise enjoy and which would exceed the increased costs they would have to bear if the PPA were recognized for ratemaking purposes. n82 While acknowledging that the Commission has usually applied this rule to pipelines that attempt to write up their rate base, Western Refinery asserts that the Commission expressly prohibited SFPP from using the PPA to write up its depreciation expense or to thicken the equity component of its capital structure. n83 It asserts that SFPP has failed to explain why these principles should not apply here and has not demonstrated that it has met the standard. The Staff reaches the same conclusion regarding the PPA.

n81 Citing *Northern Border Pipeline Co. v. FERC, 129 F.3d 1315, 1318 (D.C. Cir. 1987).*

n82 *Citing Enbridge Pipelines (KPC), 109 FERC P 61,042 (2004); Rio Grande Pipeline Co., 78 FERC P 61,020 at 61,082 (1997), reh'g denied, 82 FERC P 61,147 at 61,545-49 (1998), remanded on other grounds, Rio Grande Pipeline Co. v. FERC, 178 F.3d 533 (D.C. Cir. 1999).*

n83 Citing *ARCO Products Company v. SFPP, L.P., 106 FERC P 61,300 at 62,152 (2004).*

61. Western Refinery further argues that KMEP's desire to have a 40 percent debt and 60 percent equity structure for corporate purposes is irrelevant for rate-making purposes. It asserts that if KMEP wanted SFPP to have a 60 percent equity structure for rate making purposes, it could first remove the PPA from SFPP's equity and then make sufficient equity contributions to the pipeline's capital structure to obtain that result. Western Refinery further asserts that the ID properly required KMEP to remove the PPA entirely from the equity component of its capital structure since this is how the PPA was reflected in the partner's capital accounts. It further asserts that the ID properly required the PPA to be removed entirely from the jurisdictional portion of SFPP's assets since no part of the PPA should be used to increase SFPP jurisdictional rates. Staff's Brief on Exceptions reaches similar conclusions.

62. Western Refinery and Staff also conclude that the ID correctly required the use of SFPP's own capital structure for determining reparations for the years 1998 and 1999. They assert that KMEP did not provide any formal guarantees of SFPP's debt until 2000, and formal, not informal, guarantees control in this regard. The fact that [*62,099] SFPP had no financial employees of its own after 1998 and that KEMP notified various interests that it had taken control at that time are insufficient to support a finding that SFPP's debt was guaranteed by KEMP in 1999. They assert that the record indicates that SFPP was using third-party external financing in 1998 and 1999 and was not relying on the KMEP guarantee in doing so. They support the ID's conclusion that there was virtually no change in SFPP's capital structure from that adopted in the Opinion No. 435 Orders once the PPA was netted out, and it is within the range of proxy companies adopted by SFPP's own witness Williamson.

63. Finally, both Western Refinery and the Staff assert that the ID correctly rejected SFPP's efforts to reclassify certain long term debt as short term debt. They assert that SFPP does not a cite single case to support this proposition, but relies

on a case in which the Commission stated it would reclassify short-term debt as long-term debt when short term debt is a permanent part of the company's capital structure. n84 Western Refinery further argues that SFPP does not dispute the KMEP issued more than enough long term debt to replace all of the long-term debt that was maturing in 1999 and 2000. Western Refinery notes that while SFPP asserts that KMEP had a corporate strategy of 40 percent debt and 60 percent equity, the debt reclassification would result in an equity ratio of 64 percent based on an assumption that all the maturing long-term debt could be classified as short term debt. Western Refinery asserts that the 40 percent debt figure would then be reached by issuing or classifying sufficient debt to reach the 40 percent debt component.

n84 *Transok, Inc., 70 FERC P 61,177 at 61,555 (1995).*

a. **The PPA**

64. The PPA is an accounting adjustment that adjusts the book value of the entity's assets (original cost less accumulated depreciation) to reflect an acquisition price that exceeds that value. This is done by stating the purchase price of the assets as the gross plant as of the time of purchase and reducing prior depreciation to zero. The company then begins a new depreciation or amortization curve based on the restated gross plant as valued by the purchase. Both changes can materially affect the entity's property accounts and its debt and equity ratios. n85 For example, Ultramar's witness O'Loughlin calculates that SFPP's 1999 capital structure would be 53.43 percent debt and 46.57 percent equity without the PPA. n86 Navajo's Witness Horst's initial testimony asserts it would be 59.5 percent debt and 41.5 percent equity, n87 and his reply testimony puts the debt at 51.1 percent and equity at 48.9 percent in 1999. n88 Staff asserts that it should be 59.90 percent debt and 41.10 percent equity. n89 In contrast, with the PPA included in its capital structure, SFPP's debt ratio drops to 25 percent and its equity ratio increases to 75 percent. n90 However, even with these different perceptions on the amount of the PPA, without the PPA SFPP's capital structure are well within the norms of the oil and products pipeline industry, and results in more appropriate debt and equity ratios. n91 Thus, while the witnesses disagree on how the PPA should be calculated and the debt and equity percentages that would result, the potential impact on the rate payers of retaining the PAA is clear. n92

n85 In designing rates the company does include the PPA in its rate base but continues to use the historical rate base as adjusted for historical depreciation and additions and deletions based on the addition of and deletion of assets in the company's rate base. *See* Ex. 105 at 11.

n86 Ex. UIT-1 at 78.

n87 Ex. NAV-1 at 10.

n88 Ex. NAV-10.

n89 Ex. S-64 at 10. The calculation assumes, as discussed below, that the certain long term debt due in one year and characterized by SFPP as short term debt should be considered long term debt.

n90 *See* NAV-10 for a numerical and graphic depiction of the difference.

n91 It should be noted that if the 1998 PPA is removed from KMEP's capital structure, the results are comparable. *See* Ex. NAV-1 at 17; NAV-10.

n92 In this regard SFPP argues that the ID overlooks uncontroverted evidence that the PPA had no impact of KMEP's equity cost of capital. The argument is irrelevant. The issue with the PPA is the impact of the debt to equity ratio on the total dollars billed the ratepayers because a greater equity component increases the relative weight of the equity component in the cost-of-service. That fact that the PPA may not affect the price that KMEP must pay for every dollar of equity on its balance sheet (*i.e.* whether the cost is 11 percent or 12 percent per dollar) is irrelevant since that price can be constant whether the equity component is 70 percent or 30 percent. The impact on the ratepayers comes from the total dollars in the equity component.

65. As discussed in the June 1 Order, the use of a PPA is consistent with generally accepted accounting principles and is acceptable under Commission accounting practices for booking, but not rate-making, purposes. In fact, it is required for reporting purposes in an oil pipeline's FERC Form No. 6 annual report, but a PPA write-up may not be used for ratemaking purposes. n93 The ALJ, Western Refinery, and Staff therefore have made the correct analysis regarding the PPA and the application of Commission policy. Thus, to prevent an unwarranted increase in the cost-of-service to the ratepayers, the PPA must be removed unless it meets the new service and benefits to ratepayer standards. SFPP has not shown that it provided new service or substantial benefits to its ratepayers that exceeded the additional cost. Given that its operations were unchanged and there would be no material change in its capital structure without the PPA, it could hardly do so. n94

n93 *See* June 1 Order at P 61, 66, and 67. The Commission required SFPP to maintain its records so that alternative costs could be used for ratemaking purposes.

n94 See the discussion *infra* about the stability of SFPP's long term debt.

[*62,100]

b. Capital structure Issues

66. This conclusion regarding the PPA raises the second question: which capital structure should be adjusted since the 1998 PPA is reflected both in KMEP's balance sheet and capital structure and SFPP's. The record here strongly suggests that KMEP's 1999 capital structure cannot be used here. First, to the extent that KMEP's capital structure contained PPAs from other transactions in 1999, the test year adopted here, such PPAs introduce the same type of distortions as discussed in the preceding paragraphs. This is because if other assets owned by KMEP were purchased at a price exceeding their book value, the write-up of the equity component would likely modify the debt to equity ratio in KMEP's capital structure by increasing the equity component. This would also increase the weighted cost-of-capital attributed to SFPP if KMEP's capital structure is imputed to SFPP, and to SFPP's ratepayers. SFPP's argument that KMEP had a corporate "goal" of 40 percent debt and 60 percent equity is irrelevant. Since the 40 percent debt and 60 percent equity capital is a subjective goal, it could just as easily have been 35 percent debt and 65 percent equity given SFPP's own statement that this was the ratio used to finance its purchase by KMEP.

67. Second, SFPP's assertions that KMEP has access to substantial amounts of equity and credit lines, and that KMEP's capital structure is one that could and should be reached at KMEP's discretion, simply highlight the degree of control that KMEP has over SFPP's finances. This further emphasizes the ability of KMEP has the ability to manipulate SFPP's partnership structure to obtain its corporation goals. In this context, SFPP's argument that the 40 percent debt and 60 percent equity capital structure is close to the average structure of the proxy group (give or take some 2 to 4 points) is both irrelevant and of questionable accuracy, and as such appears contrived. The matter of KMEP's 1999 capital structure is further complicated by the fact that SFPP itself asserts that it is impossible to determine how much of its and KMEP's long term debt due in 1999 was refinanced in 2000 by debt and how much by equity. This statement suggests that it is difficult to determine if KMEP's capital structure has any reasonable correlation to SFPP's jurisdictional operations and finances.

68. Thus there are several reasons that the Commission should use SFPP's capital structure to establish a cost-of-service for the 1999 test year. As the annual FERC Form No. 6 filed by SFPP indicates, SFPP has its own balance sheets, income statements, and capital structure. Since balance sheet changes are mechanical and prescriptive under the Commission's regulations, it is more realistic to use SFPP's financial and capital structure and to utilize SFPP's FERC Form No. 6 for the years 1997 through 2000 to resolve a number of other basic balance sheet and accounting issues that are in dispute. In that regard, the Commission reiterates that it is *not* regulating KMEP; it is regulating SFPP, a jurisdictional entity with a different legal status than KMEP.

69. The third capital structure issue raised by the parties is the role of long term debt in designing the capital structure. As noted, SFPP asserts that some $124.5 million of long term debt coming due in 2000 should be classified as short term debt on SFPP's (KMEP's) balance sheet. SFPP's Form 6 for the years 1997 through 2001 belie this argument. These reports, as summarized in Table 1, demonstrate that SFPP refinanced all long term debt that came due in each year. n95 SFPP utilized long term debt during the years 1997 through 1999 and utilized so called short term debt in the years 2000 and 2001. However, the sharp increase in the net sums due affiliates from $14,651,890 to $272,980,742 in 2000 establishes that SFPP was borrowing so called short term funds from KMEP but treated those funds like long term debt by continuing to carry them as sums due affiliates for several years on SFPP's balance sheet. In fact, both KMEP and SFPP were treating SFPP's affiliated obligations as long term debt that was being used to finance SFPP's capital plant. n96 Even in 2001 the sums SFPP owed affiliates remained at $258,203,692. Therefore the Commission concludes that SFPP's 1999 debt due in one year was long term debt.

n95 *See* SFPP FERC Form No. 6 for the years 1998 through 2001 at 110-13.

n96 *Cf.* the observation in NAV-1 at 11 and supporting tables, which discusses the substitution of KEMP debt for SFPP long term debt coming due in 2000.

70. The issue then becomes how the various adjustments required here should be accomplished. The ID required a reduction in SFPP's cost of service of some $734.4 million after concluding that the PPA should be reduced by $793 million less the level of depreciation taken by KMEP/SFPP in 1999, some $55.6 million. This was derived from the numbers contained in Ex. Nav-20, an exhibit that was ultimately relied on by Staff in reaching its final recommendation. n97 However, as was noted, the PPA adjustment recommended by the ID was based on KMEP's financials, which the Commission has concluded should not be relied on here. An alternative source is SFPP's 1998 FERC Form No. 6 report, the year in which the 1998 acquisition PPA became effective. The impact of the PPA is reflected on pages 120 and 121, which contain the sources and uses of funds that cause the modifications to the company's balance sheet in any calendar year. Line 64 on page 121 of SFPP's 1998 FERC Form No. 6 shows an increase in partnership equity of $787,990,983 due to purchase accounting adjustment [*62,101] and contributions by the general partner interests. Line 29 of the same report shows an adjustment to carrier property of $734,052,370, consisting of an increase of $642,740,093 in the purchase accounting price adjustment to reflect the assets and a reduction of $91,312,277 in the accrued depreciation adjustment.

n97 Staff Brief Opposing Exceptions at 15, *referencing* Ex. S-26 at 10-11, Tr. 12410.

[SEE Table 1 IN ORIGINAL]

71. This difference between the adjustment to the partnership equity (the right side of the balance sheet) and the adjustment to the carrier property and depreciation accounts (the left side of the balance sheet) is $53,983,613, a

significant difference that does not appear to have been accounted for in the ID's analysis. To the extent those contributions were used for SFPP's jurisdictional activities, they could represent a legitimate increase in the pipeline's assets. Whether this is the case cannot be determined with certainly given the level of detail in the cash flow and balance sheet statements contained in the FERC Form No. 6. Finally, the ID used a 1999 depreciation figure of $55.6 million to adjust the PPA based on KMEP's depreciation for the year 1999, but the depreciation figure reported in SFPP's 1999 FERC Form No. 6 is $28,260,844. This again demonstrates [*62,102] the significant cost and accounting differences that occur at the SFPP and KMEP levels, the differing impact that the two sets of accounting data can have on rate design and the differing perceptions of the most reliable accounting information for ratemaking purposes. n98

n98 The ID does not explain the reason for the discrepancy.

72. Given the decision that SFPP's capital structure and the related internal balance sheet, income, and cash flow accounting records are the most reliable source of financial data in this proceeding, SFPP is directed to develop a second set of books for ratemaking purposes for the years 1998 and 1999. While the Commission may not instruct SFPP to refile its FERC Form No. 6 reports for those years since the reports as filed conform to the reporting requirements, it may direct SFPP to remove the PPA from the Form No. 6 accounts for 1998 and 1999 and reconstitute the relevant balance sheet, income statements, and cash flow statements for rate making purposes. n99 This means removing those portions of the increase in rate base and equity accounts attributable to the PPA and developing year end statements that reflect the carrier accounts and depreciation methodology that was in effect in 1997. SFPP may adjust the balance sheet (including the equity component) and cash flow statements to reflect any cash or other asset contributions to the partnership's balance sheet, and any allocation between jurisdictional and non-jurisdictional uses. SFPP must include an explanation of any resulting changes to the other accounts that appear in the FERC Form No. 6 balance sheet, income, and cash flow statements, including increases or decreases in current and long term liabilities and amounts due to and from affiliates.

n99 *See* June 1 Order at P 61, 66, and 67, which impose this obligation.

73. There are two additional rate base issues that are raised on exceptions. Western Refinery asserts that the ID erred by explicitly requiring SFPP to amortize its starting rate base over 16.8 years. It states that SFPP acknowledges that Opinion No. 435-B required that the amortization period be 16.8 years but chose to rely on the 20.6 year period contained in Opinion No. 435. The Commission affirms that SFPP must use the 16.8 period to amortize its starting rate base. Second, Staff asserts that some $3.8 million of rate base items should be excluded from SFPP's 1999 rate base. Since this dispute is grounded in the inclusion in the 1999 rate base of certain 2000 capital items, the exception is no longer relevant given the Commission's decision to utilize only a 1999 cost-of-service.

3. Cost of Capital Issues

74. Cost of capital issues the cost of debt, the cost of equity, and the weighted cost of capital based on the two elements. The ID used KMEP's capital structure and therefore used KMEP's cost of debt in 1999, equal to 7.335 percent. n100 Since the Commission has concluded that it cannot use KMEP's capital structure to establish SFPP's rates, it is not possible to utilize this debt cost. However, the ID also determined that SFPP's 1999 capital structure should be used to determine reparation calculations for that year. The ID concluded that SFPP's debt cost for 1999 was 8.54 percent, which the Commission adopts here. n101 The ID also developed a cost-of-equity to be used in designing SFPP's East and West Line rates. In doing so, the ID accepted the use of a proxy group consisting of oil and gas pipeline master limited partnerships, but excluded KMEP for two reasons. First, the ID concluded that it makes no sense to include

KMEP because it is the entity whose rates are under review. The second reason was that the KMEP used a short term growth rate of 15 percent that was much higher than that of the other members of the group. After reviewing the information submitted by the differing parties, the ID adopted a 13.69 nominal equity rate based on 2000 calendar year data and concluded that SFPP has less than average risk based on its monopoly transportation position in the southwest and its strong growth prospects. The ID then adjusted this rate by removing an inflation factor based on the average of 1999 and 2001 factors since there was no 2000 year inflation factor in the record.

n100 ID at P 347.

n101 *Id.* P 610.

75. On exceptions SFPP asserts that the ID erred in removing KMEP from the pipeline proxy group sample. It argues that this is inconsistent with the Commission's earlier rulings in the Opinion No. 435 Orders, which included SFPP in the proxy group. n102 It also argues that the Commission has never excluded the parent company from the proxy group on the grounds of circularity and this could result in the averaging of risks that does not properly reflect the industry group as a whole. SFPP further asserts that in 1999, KMEP had at least five product pipelines and excluding KMEP from the proxy group would deprive the Commission of information regarding the financial market's view of a significant segment of the oil pipeline industry. SFPP also excepted to the ID's conclusion that SFPP has less than average risk and that therefore the nominal rate for equity should be placed at the lower end of the proxy group. It asserts that the Commission has a strong presumption in favor of placing a pipeline in the median of the proxy group range. SFPP then argues that this presumption can only be overcome by highly unusual situations and only through the presentation of detailed evidence regarding (1) the pipeline's risks; (2) the risks of other pipeline companies in the proxy group; (3) the need for a downward adjustment; and (4) the rationale for [*62,103] placing the return at a particular point below the median. n103

n102 As previously discussed, SFPP was not owned by KMEP at that time.

n103 SFPP Brief on Exceptions at 31-32, *citing Transcontinental Gas Pipe Line Corp., 90 FERC P 61,279 at 61,926 (2000) (Transco).*

76. SFPP argues that the ID did not even address these standards and that no evidence was presented that would change the Commission's prior conclusions that SFPP faces average risk. To the extent Staff witness Manganello claimed the contrary, SFPP asserts that he was unable to identify any risk not analyzed by the Commission in Opinion No. 435. SFPP further asserts that even companies with a higher equity percentage have been found to have medium risk. It further argues that no evidence exists that KMEP risks are different from those of the proxy companies, and that the stock buy and sell recommendations that Staff relies on are not necessarily evidence of business risk but reflect an opinion of whether the stock will increase in value. SFPP also rejects Staff's argument that adopting KMEP's risks imposes on SFPP's ratepayers the return required for KMEP's aggressive growth strategy. It then cites a May 1999 Standard & Poors report evaluating KMEP's acquisition strategy, which concluded that KMEP warrants an overall credit rating of A-because it has average business risk, a very good track record, stable cash flows, limited commodity price risk, and conservative financial policy. It claims that nothing in the record contravenes this conclusion that KMEP has neither unusually high risk nor unusually low risk.

77. The Commission will revise the ID's determinations of SFPP's cost of equity. First, as in the other portions of this

order, the Commission will use calendar year 1999 data, including the 1999 inflation rate of 2.68 percent to develop the real equity cost of capital. n104 Second, the Commission concludes that KMEP should be included in the proxy group of master limited partnerships for the reasons asserted by SFPP. While KMEP's short term growth rate may be higher growth rates than other members of the proxy group, this does not preclude its use in a proxy group of master limited partnerships, and no party argues otherwise here. KMEP is one of the major entities involved in that portion of the equity market and its exclusion would distort the average cost of equity for similar firms.

n104 The Commission agrees with the ID that in this proceeding there is no practical alternative to treating distributions as the equivalent of dividends and using distributions in the conventional discounted cash flow (DCF) formula. As the ID states, the distributions are what investors use to determine the capitalized value of the publicly traded limited partnership interests. *Cf.* Staff's Brief on Exceptions at 13.

78. The Commission also concludes that the median cost of capital should be used to determine SFPP's cost of capital based on KMEP's average business risk. First, the test for departing from the use of the median cost of capital was explained in *Transco, supra*, and further reiterated in *High Island Offshore System, L.L.C.* n105 The Commission stated that it is skeptical of its ability to make carefully calibrated adjustments within the zone of reasonableness to reflect the generally subtle differences in risk among pipelines. Thus, unless a party makes a very persuasive case in support of the need for an adjustment and the level of the adjustment proposed, the Commission will set the pipeline's return at the median of the range of reasonable returns. n106 Second, SFPP had no publicly traded equity in 1999 and the expectations for equity investors in SFPP in that year are governed by their perceptions of the risk and return from investing in KMEP. The record here does not support a conclusion that SFPP's risks are materially different from those of KMEP or materially different from those discussed in the Opinion No. 435 Orders. As SFPP asserts, its operations, market, and financial position were unchanged since the discussion of these risk factors in the Commission's earlier decisions. For these reasons, there is no persuasive case here that the Commission should change the use of the median that was adopted in the prior proceeding. Moreover, unless there are clear grounds to conclude that SFPP's risk is different than KMEP's, n107 KMEP's cost of equity capital should be used as KMEP is the funding source for SFPP's equity, either through its control of reinvestment decisions of SFPP cash flows or its access to capital markets.

n105 *High Island Offshore System, L.L.C., 110 FERC P 61,043 (2005) (HIOS).*

n106 *Id.* at P 154, *citing Transco* at 61,936.

n107 *Cf. Transco, supra.*

79. For these reasons the Commission will adopt the average of the equity cost of capital for 1999 suggested by Staff and Ultramar-Tosco. The former used a range with a low of a 13.27 percent return to a high of an 18.86 percent return and a median of a 15.27 percent return. The latter used a range from a 13.31 percent to an 18.46 percent return with a median of 15.42 percent. n108 Averaging the two results in a 15.36 percent nominal return, which results in a 13.68 percent real return after the inflation component is removed. The Commission notes that the ID relied on 2000 estimates and some parties included 2001 estimates, both of which resulted in lower equity returns, notably so in the case of 2001. However 2001 numbers are far outside the test period and the Commission will not adopt them. The calculation of the weighted cost of capital to be included in SFPP's cost-of-service for the East and West Line rates to be developed in Docket No. OR96-2-000, *et al.* must be based on the capital structure required by this order.

n108 ID at P 352-53.

4. **Allocation of Overhead Costs**

80. During the test period (calendar year 1999), SFPP maintained operating personnel, but no administrative, financial, or legal employees of [*62,104] its own. All of these overhead functions were provided by, and consolidated with, KMEP, which performs such functions for all of its operating subsidiaries. The Commission's standard ratemaking practice requires an allocation of these costs among the affiliates controlled by the parent, KMEP, and within each affiliate, among their different operations. The Massachusetts and KN Formulas are respectively used for these purposes. For the reasons discussed below, the Commission affirms the ALJ with respect to adopting Staff's KN formula to functionalize indirect overhead costs from KMEP to SFPP, but reverses the ALJ's ruling that denies SFPP's inclusion of overhead expenses in its rates. n109

n109 ID at P 322-24.

a. **The Massachusetts Formula**

81. The Massachusetts formula allocates indirect or residual overhead costs from a parent company to a subsidiary or an affiliate. The ALJ found that the general partner, Kinder Morgan Inc. failed to provide its total overhead costs for its organization, or how any of its subsidiaries or divisions determined the amount of that overhead for assignment to KMEP. The ALJ cited to SFPP's subsequent admission to its failure to provide the requisite data. Further, the ALJ notes SFPP's non-compliance with an element of the Commission's ratemaking policy through the use of 13-month averages for gross plant and labor expenses, rather than using end-of-period data. n110 Consequently, the ALJ concluded that SFPP presented no credible evidence supporting its proposed allocation of overhead costs from KMEP and concluded that no overhead costs should be included in SFPP's rates due to this failure of proof. n111

n110 *See Midwestern Gas Transmission Co., Opinion No. 44 4, 32 FPC 993 (1964)*, as reaffirmed in *Tennessee Gas Pipeline Co., Opinion No. 240, 32 FERC P 61,086 (1985).*

n111 ID at 322.

82. On exceptions, SFPP argues that the ALJ ignored all record evidence and Commission precedent in eliminating all overhead costs and that it properly applied the Massachusetts Formula. SFPP asserts that: (1) it properly used its gross revenue figures to allocate costs rather than volumes; (2) the ALJ erred by requiring the removal of the PAA attributable to SFPP and included in KMEP's capital structure for the purpose of determining gross plant; and (3) it properly applied the labor allocation required by the formula. SFPP further asserts that the ALJ improperly excluded SFPP's proposed 13-month average for gross plant because the 13-month average provides a more accurate result.

83. In its opposing exceptions, Staff took no position on whether SFPP should have overhead costs included in its rates or in the gross revenue component of the Massachusetts factor. However, Staff generally supports the ALJ's conclusions that no PAAs should be included in the gross plant allocation factor within the Massachusetts formula, that the payroll figures used to calculate the labor factor were unreliable, and that the use of a 13-month average to calculate gross plant is inconsistent with Commission practice. Staff concludes that its allocation of the overhead accounts was correct and the ID should be upheld. Western Refining supports the Staff position regarding the role of the PAAs in determining the allocation of overhead costs.

84. Based on a review of Commission policy and the record on this issue, the Commission will allow SFPP to include a portion of KMEP's overhead costs in its rates if SFPP recalculates its overhead expenses based on the following. First, while SFPP revised its initial data and allocation procedures in response to Staff testimony and corrected many of the mathematical errors contained in Staff's testimony, n112 SFPP's revised use of the Massachusetts formula remains flawed. In general, the formula uses three components to calculate allocation factors: (1) gross revenues, (2) gross property plant and equipment costs, and (3) direct labor costs. For each factor, ratios are calculated based on the subsidiary's costs to the parent's costs. The three ratios are averaged and the resulting allocation factor is applied to the indirect costs assigned by the parent to the subsidiary. A variation of the Massachusetts formula uses a net revenue factor (gross revenues less cost of goods sold, or in this case, transportation revenues). n113

n112 S-18, p. 12-17.

n113 *See* Opinion No. 240, *Tennessee Gas Pipeline Co., 32 FERC P 61,086 (1985)* at 61,232.

85. With respect to SFPP's reported level of gross revenues, the Commission denies the Opposing Parties' assertions that the revenues are overstated because they are based on rates subject to pending litigation that may not just and reasonable. The Commission finds that SFPP appropriately calculates the gross revenues using its currently effective tariff rates because a different level of revenues cannot be established until the overhead allocations are determined on the basis of historical information available to the Commission. However, for gross plant, SFPP fails to include all of KMEP's subsidiaries (e.g., Red Lightning, Plantation Pipeline Co., Kinder Morgan Interstate Gas Transmission, and Trailblazer Pipeline Co.) and includes the PAAs for other KMEP subsidiaries, including SFPP. Gross plant is the net book value of plant - the original plant cost less accumulated depreciation of the facilities. SFPP's use of the purchase premiums in its calculations of gross plant for KMEP and itself results in an inflated ratio of overhead costs. n114

n114 *See Williams Pipe Line Co., 21 FERC P 61,260 at 61,636 (1982)* (the Commission found that the purchase price of a facility is not entitled to any recognition for ratemaking purposes).

86. Accordingly, the Commission requires SFPP to recalculate its Massachusetts Formula allocation factors based on Staff's calculation of [*62,105] gross plant. This adds the costs attributable to the additional KMEP subsidiaries acquired during the test period (calendar year 1999), and removes the PAAs from KMEP's subsidiary plant costs. The Commission will allow SFPP to use its stated gross revenues and direct labor costs to determine its allocation factors for each component.

b. The KN Formula

87. The KN formula allocates administrative and general (A&G) overhead costs (or jointly used assets) between the subsidiary's jurisdictional and non-jurisdictional activities (or geographically separate jurisdictional activities) within the company. In this case, SFPP allocates costs between its carrier and non-carrier functions. The ALJ found that SFPP combined the gross plant and labor costs contrary to Commission policy, which requires that the KN formula take into account the nature (character) of the costs whether plant or labor. Consequently, the ALJ adopted Staff's KN-allocation formula which correctly applies the allocation factors derived from the subsidiary's direct costs to properly allocate such costs to its carrier and non-carrier operations.

88. On exceptions, SFPP argues that it properly applied the KN allocation procedures consistent with Commission

practice. SFPP claims that the ALJ improperly rejected its inclusion of the PAA in SFPP's gross property balance for purposes of allocating costs between SFPP's carrier and non-carrier functions. In its opposing exceptions, Staff objects to SFPP's KN allocation factors in two respects: (1) SFPP uses the property balances that include the PAAs, similar to its gross plant allocations under the Massachusetts formula; and (2) SFPP uses a combined labor and plant ratio for all A&G costs without considering the nature of those costs. Refinery Holding and Navajo support the ALJ and Staff.

89. The Commission concurs with the ALJ's finding that SFPP's inclusion of the PAA in SFPP's property balances and its use of a combined labor and plant ratio to allocate A&G costs between its carrier/non-carrier functions was not appropriate for the reasons discussed earlier in this order. Given that conclusion, in this case proper application of the KN method requires the calculation of the carrier and non-carrier allocation percentages by reducing the gross property balances by the PAAs, and using the direct plant costs and labor costs reported by SFPP in its cost of service data. Accordingly, the Commission directs SFPP to recalculate its KN allocation formula consistent with Staff's allocation procedures based on SFPP cost-of-service data (as corrected for Staff's mathematical errors) n115 to: (1) eliminate the PAA from its gross property balance; and (2) use direct labor costs to allocate the appropriate A&G costs to its carrier and non-carrier operations. The compliance filing must document how SFPP had complied with the Commission's ruling on the allocation of overhead costs.

n115 *See* Ex. SFPP-106.

5. <u>Recovery of Regulatory Litigation Costs.</u>

90. SFPP has been in rate litigation with its shippers since November 1992 when the first complaints were filed against the East and West Lines rates. The Opinion No. 435 Orders established new just and reasonable rates only for the East Line and therefore addressed cost-of-service issues only for that Line. As discussed in greater detail in those Orders, the Commission permitted SFPP to recover its Commission regulatory costs attributable to the East Line litigation through 1998. n116 The Commission required SFPP to first estimate the reparations that would be due all East Line shippers for the period through August 1, 2000, whether or not they had filed complaints, *i.e.*, the gross reparations. After subtracting the reparations due the East Line shippers that had filed complaints for the years prior to August 1, 1995, the Commission required SFPP to apply the difference (the net gross reparations) to Commission East Line regulatory costs for the period between the first East Line complaint in 1992 and the end of 1998. If any Commission regulatory costs remained, SFPP was authorized to recover those costs through a surcharge amortized over 5 years. The Commission did not authorize SFPP to embed any Commission regulatory expenses in the East Line rates that become effective on August 1, 2000. n117 This approach, the net gross reparations methodology, was affirmed on appeal subject to any adjustments that might be required on remand. n118

n116 As discussed earlier in the order, this required SFPP to allocate a certain proportion of the regulatory costs incurred in the Docket No. OR92-8-000, *et al.* to the East Line rates. The other regulatory costs incurred in that proceeding through 1998 were effectively allocated to rates that were not under review by the Commission.

n117 *Opinion Nos. 435*, 86 FERC at 61,105-06, and *435-A*, 91 FERC at 61,512-13.

n118 Remand Opinion at 1293-94.

91. The prior determinations must be modified as a result of the Remand Opinion. First, as has been discussed, the

regulatory costs attributed to the East Line rates through 1998 have been revised in light of the remand. Second, litigation has proceeded on the East, West, North, Oregon, Watson Station and Sepulveda Line rates since 1999, the cost of service year used here, and some of the complaints at issue in Docket No. OR98-2-000, *et al.* antedate that year. In the instant case the ID combined and averaged the regulatory costs incurred in these proceedings for the years 1999 and 2000, allocated those costs among the various lines, and permitted them to be amortized over five years. The ID did not permit any regulatory cost to be embedded in the rates at issue and recommended that SFPP not be allowed to recover any regulatory costs in these or other proceedings after 2003. [*62,106]

92. SFPP objects to these rulings, arguing that they do not recognize its ongoing costs in other proceedings and argues that those proceedings have continued well beyond any 1999-2000 test year. It asserts that the failure to embed at least some of these costs in its base rates precludes it from recovering those costs, as would the attempt at normalization by other parties based on the year 1999 and various years preceding it. Western Refinery supports the ID's conclusions regarding the years 1999 and 2000 and that SFPP must institute a new proceeding to recover its legal costs in subsequent years. Staff did not take a position on this issue.

93. Given the multi-faceted nature of this ongoing rate litigation, it is impossible to develop a normalized cost to be included in the 1999 cost-of-service. In fact, overall litigation costs were lower in 1999 than in 2000 and the costs attributed to the three major proceedings varied in their relative weight in those years. For example, with regard to the three major regulatory proceedings underway in 1999, the costs attributed to Docket No. OR92-8-000, *et al.* were $464,036 in 1999 and $189,315 in 2000, a total of $653,351. The costs attributed to Docket No. OR96-2-000, *et al.* in 1999 were $157,064 and $2,171,916 in 2000, a total of $2,328,980. The costs attributed to Docket No. OR98-11-000 (the Sepulveda case) were $1,627,531 in 1999 and $836,202 in 2000. The total costs for the two years were $2,248,631 in 1999 and $3,197,433 in 2000. n119 This demonstrates the volatility of SFPP's regulatory costs and the difficulty in finding a representative number. For this reason the Commission will follow the approach used in the Opinion No. 435 Orders for the period 1999 through May 30, 2005, with one modification. In addition to costs allocated to the three major dockets just discussed, SFPP's 1999 test year included $153,857 for regulatory cost items other than the those three enumerated proceedings, a sum that is based on a five year average through 1999. n120 SFPP may include the $153,857 for regulatory costs other than the three large enumerated proceedings in the new East and West Line rates in proportion to its 1999 East, West, North, and Oregon Line volumes. n121

n119 *See* Ex. SFPP-111 at 13.

n120 *See* Ex.SFPP-111 at 4, Line 31. The number is conservative considering that the same category of Commission regulatory costs increased to $296,211 in 2000.

n121 The sum allowed here will provide some funds to cover SFPP's more routine tariff filings and matters such as Docket No. PL05-5-000, all of which have been contested and are outside the scope and regulatory costs of the three major regulatory proceedings analyzed at Ex. SFPP-111, page 13.

94. As has been discussed, the revised East Line rates established in Docket No. OR92-8-000, *et al.* were made effective on August 1, 2000. Thus, after that date all East Line shippers paid the same rate on a prospective basis and there were no reparations required in that docket for the period thereafter. While SFPP's regulatory costs, as allocated to the East Line shippers, continued in 1999 and 2000, the Commission did not apply its gross reparations offset methodology to those years in the Opinion No. 435 Orders. At this point, since the actual regulatory expenses for those years are available, it will do so through the end of the reparations period in Docket No. OR92-8-000, *et al*, which ends July 31, 2000. Thus, to recover regulatory costs incurred in that docket through that date, SFPP may offset the East Line's share of its regulatory costs against any East Line reparations paid up to August 1, 2000, based on the 1994 cost-of-service.

Thereafter, the East Line proportion of any regulatory costs incurred in Docket No. OR92-8-000, *et al.* may be recovered through a five year surcharge added to the new East Line rates beginning March 1, 2006, the projected effective date of any new rates established under this order. Finally, for the period beginning August 1, 2000, the Commission will allocate regulatory costs in that docket between the East and West Lines based on their relative volumes in 1999, as established here. Given a situation where a surcharge is being allocated on a going forward basis it is more equitable to allocate costs among all of SFPP shippers on the basis of the more recent volumes so that all West and East Line shippers will benefit from the rater reductions required here.

95. In Docket No. OR96-2-000, *et al.* the Commission will allocate the regulatory costs based on the relative volumes of four lines, the East, West, North and Oregon lines rather than on the percentages adopted by the ID, which are based primarily on the ALJ's perceptions of relative effort. n122 Recovery of regulatory costs attributable to the West Lines will utilize the methodology contained in the Commission's Opinion No. 435 Orders. In the instant case any revised West Line rates will be based on the rate established from the 1999 cost-of-service established by this order. Those rates will be indexed back to the date of the relevant complaints and forward to the proposed March 1, 2006 effective date. Reparations will be due accordingly and SFPP will calculate the gross reparations that would have been due if all West [*62,107] Line shippers had filed complaints. The difference between that gross figure and the refunds due shippers that actually filed complaints will be offset against West Line regulatory costs for the date of the complaints through May 31, 2005. Any remaining costs will be amortized over 5 years through a surcharge effective May 1, 2006. n123

n122 Because the interstate portion of Watson Station volumes flow over the West and North Lines, regulatory costs involving the Watson Station facilities should be allocated proportionately to the rates for those Lines in the absence of a discrete proceeding such as that established in Docket No. OR92-8-025 for the Watson Station charges. This will avoid overstating the importance of the volumes of this subsidiary asset in allocating costs. The ID recognized that an allocation of regulatory costs based on relative volumes of the East Lines, West Line, and Watson Station facilities would distort the allocations and therefore attributed only, 5 percent to the Watson Station facilities. Contrary to the statement in its text, the ID did not establish charges for the Watson Station facilities in Phase II. It only found that certain costs had been fully recovered and that the existing charges were unjust and unreasonable. *See* ID at P 571-73, 586-88. The conclusion here about the allocation of certain overhead costs does not change the fact that historically the Watson Station facilities have been a separate cost center on the SFPP system and as such has had its own rate structure.

n123 SFPP did not except to the ID's conclusion that it could not recover as regulatory or litigation costs sums paid certain shippers to settle some of the complaints filed against its East Line rates. The Commission notes that the ID's ruling is consistent with the holding in Opinion No. 435 that settlement costs are non-recurring costs. In any event, such costs are similar to refunds or reparations which a pipeline cannot recover from the shippers who paid an unjust or unreasonable rate.

96. The situation for the regulatory costs involved in two other assets, the Sepulveda Line and Watson Station facilities, is relatively simple. SFPP has been in litigation over the Sepulveda Line rates since early 1995. That proceeding is separate and unique and any regulatory costs incurred in that proceeding should be allocated to it alone. Similarly, for the period June 1, 2005 forward, all litigation concerning the Watson Station charges has been consolidated in a single proceeding and all costs related to that proceeding should be separated. The means for recovering SFPP's prudent regulatory costs in the Sepulveda Line and Watson Station proceedings will be addressed in the respective orders on the merits of those proceedings.

6. **Arizona Real Estate Tax Issues.**

97. The ID addressed the level of the Arizona real estate taxes SFPP pays on its right-of-way in that state, how those taxes should be allocated between carrier and non-carrier property, and technical accounting issues related to tax refunds received during 1999. The ID held that SFPP should not be permitted to recover increased real estate taxes paid in 1999 since that increase stemmed from the inclusion of the 1998 PPA in SFPP's rate base. In doing so, the ID suggested that the Commission should pre-empt the level of taxes involved because the increase in those taxes was based on a cost-of-service element that the Commission should reject, namely the PPA. The ID also held that SFPP incorrectly used the so-called central versus local method for allocating real estate taxes between jurisdictional and non-jurisdictional elements. Finally, the ID held that certain refunds received in 1999 for the tax years 1995-98 should be included in SFPP's cost of service. SFPP excepts to all three conclusions for the reasons discussed below. The Commission staff asserted that if the Commission retains its existing policy of accepting state taxes, the Commission should require SFPP to establish that the assessment increase has not been offset by increased depreciation. Refinery Holding asserts that SFPP should not recover the higher taxes since they resulted from the inclusion of the 1998 PPA in SFPP's property accounts.

98. The difficult issue here is the level of the assessment, which increased by some $4 million due to the increase in the book value of SFPP's assets in Arizona when SFPP included the 1998 PPA in its accounts. While state and local governments use many factors in determining the assessed value of real estate, there are no grounds here for disputing the connection between the increased assessment and the inclusion of the 1998 PPA in SFPP's property accounts. This fact pattern places two Commission policies in potential conflict. One is the Commission tradition that it will not review or contradict decisions regarding the level of state and local taxes, which are simply accepted as one of the pipeline's cost-of-service elements. The other is that a purchase price that involves a premium over book value should not result in an increase in costs to the rate-payers except under well defined, limited circumstances. The ID suggests that the Commission abandon its current policy of deferring to state and local government assessment decisions and preempt the state assessment decision. SFPP argues that none of this theory applies here.

99. The issue here is not the assessment, or challenging the State of Arizona's standards or conclusions in making the assessment, but whether the extra $4 million should be included in SFPP's cost-of-service in light of the Commission's prior conclusion that the 1998 PPA should not be used in designing the pipeline's rates. In this case the Commission will permit SFPP to include the additional $4 million in additional real estate taxes in its cost-of-service because it is an out-of-pocket cash expenditure with one condition. The condition is that if SFPP prevails in its appeal of the assessment in the state proceedings, the $4 million must be removed from its cost of service (or adjusted to such lower amount as might result), and any tax refund distributed to its shippers.

100. On the two secondary tax points, the Commission agrees that SFPP did not err in using the traditional allocation method under Arizona state law for allocating real estate taxes between jurisdictional and non-jurisdictional facilities. It is also clear the Arizona state real estate tax refund received in 1999 was a non-recurring event related to the prior four calendar years. As such, SFPP is not required to include in its 1999 cost-of-service a sum that is not related to that year.

7. **Modification of SFPP's Depreciation Methodology**

101. At hearing Staff testified that SFPP's depreciation rates needed to be modified to reflect the different composite depreciation rates for SFPP's East, West, North, and Oregon Lines. Staff concluded that because investment in certain of those lines had grown more rapidly than in others, their depreciation rates should be adjusted. The ID stated that SFPP did not object to the establishment [*62,108] of new depreciation rates as long as they went into effect on a prospective basis and recognized the merit of adjusting depreciation rates to reflect the expansions that have occurred on each line. However, the ID concluded that Staff's proposed depreciation methodology was defective in two ways. First, Staff failed to explain how its concern with use of a system-wide depreciation rate squared with the fact that the method had been in effect since 1991, especially since there have been a number of plant expansions on SFPP's various lines both before and after 1991. Second, the ID held that Staff had relied on system-wide data, rather than line-by line data,

for two elements of its recent depreciation study - survivor curves and net salvage-Staff excepts to the ID's conclusions and reiterates its position that line-by-line depreciation rates for most elements will result in rates that are just and reasonable by more accurately assigning costs. It asserts that system-wide survivor and salvage curves are reliable because the data on individual lines would result in small samples and could yield inconclusive curves. SFPP supports the ID's conclusion that consistency is required. It asserts that the Commission's general instructions regarding depreciation rates provide that depreciation shall be described by account, and not individual system components, absent a specific request of the carrier. n124 It states that SFPP did not request component rates and in fact opposes them, preferring to retain its current composite rates. SFPP further asserts that while the Commission has approved component depreciation rates for gathering and other facilities that have shorter economic lives than the remainder of a pipeline system, it has not approved component rates for segments of a system when each segment has the same supply and the same projected rates. SFPP asserts that Staff's 1991 depreciation study underlying SFPP's current depreciation rates recommended use of account-by-account rates even though expansion occurred on only some of SFPP's lines.

n124 *Citing* 18 C.F.R. Pt. 32, General Instruction 1-8(b).

102. The Commission will affirm the continued use of system-wide depreciation accounts for SFPP. As regards SFPP's argument that component costs should not control, the Commission has concluded that SFPP's East, West, North, and Oregon Lines should be treated as separate assets for rate purposes. As such, it is by no means clear that treating them as separate components for depreciation purposes would be improper. Moreover, as Staff points out, a specific type of asset within an account may age at the same rate regardless of the location of the asset on the system, but the distribution of that aging (and therefore the composite rate) may vary depending on when the investments were made and the total amount. However, in the instant proceeding the Commission is examining under its rate jurisdiction only the rates for the East and West Lines, and is taking no action on the costs or rates for the North and Oregon Lines. Thus, reallocating the depreciation costs for the entire system in this proceeding would require the Commission to address assets and costs that are not before the Commission in this proceeding.

8. <u>Other Cost-of-Service Issues.</u>

103. On exceptions SFPP opposes six other rulings on cost-of-service issues. The first involves the write-off in test year 1999 of the central control software program that SFPP was developing before its acquisition by KMEP. The ID held that the rate-payers received no benefit from past costs incurred prior to the write-off and denied the costs. SFPP asserts that this ruling is incorrect because it is not supported by evidence that the undertaking was imprudent and the ruling would discourage innovation. It concludes it should be permitted to amortize the write-off over 5 years. Staff and Western Refinery support the ID. Since the record does not support a conclusion that SFPP's efforts to adopt a more efficient way of dispatching its system were imprudent, the Commission will permit SFPP to write of 50 percent of the development costs over a five-year write off beginning in 1999. This is consistent with a long standing policy in Commission electric regulation that permits 50 percent of the prudent costs of cancelled investment to be recovered by the regulated entity. n125 This policy creates incentives for prudence and efficiency in pursuing investment in plant, equipment, and software without placing all risk of failure on the regulated entity. The Commission further notes that since the write-off will be completed in the locked-in period and the cost will not be included in SFPP's prospective rates beginning May 1, 2006.

n125 *Public Service Company of New Mexico, 75 FERC P 61,266 at 61,859 (1996), but see Southern California Edison Co., 112 FERC P 61,014 at P 58-61, reh'g denied, 113 FERC P 61,143 at 9-15 (2005),* where 100 percent recovery was permitted when the regulated entity had no control over the decision make the investment and the company's shareholders would not share in the benefit.

104. The ID rejected SFPP's proposed adjustment to its 1999 cost-of-service by excluding the reversal of a $1.5 million maintenance cost accrued in 1998. As SFPP explains it, it accrued $1.5 million in 1998 for expenses that it had not yet incurred, and excluded the same sum in 1999 because the related work was not needed and would not be performed. In other words, SFPP concludes that because it did not actually need to make the accrual in the first instance in 1998, elimination of the expense in both years leaves the actual cost-of-service in the same position as if the accrual had not been made. Staff and Western Refinery support the ALJ. The Commission accepts SFPP's reasoning on this point because the elimination of the costs in both years is offsetting.

105. The ID rejected SFPP's efforts to include a 3 percent salary increase in its cost of service that resulted from its calendar year 2000 merit increase program. Because the Commission is relying [*62,109] only on a 1999 calendar test year, this point is moot. The ALJ also rejected SFPP's proposal to average its 1999 and 2000 oil losses and shortages. SFPP asserts that the 1999 figures are not representative, a position Staff and Western Refinery say is not supported by SFPP's actual experience. Given the Commission's use of the 1999 cost-of-service year, the ID is affirmed. The ID also rejected SFPP's proposed adjustment to reflect increased power costs that became effective on January 4, 2001 as a result of increased electric rates in California. SFPP presents four pages of argument why this adjustment was appropriate and is long term in nature. As Staff replied, the short answer is that this increase is far outside the test period and is the type of operating cost that would be subsumed within the Commission's annual indexing methodology. The indexing procedure provides a simplified method of recovering the net increases based on changes to the PPI. n126 As was discussed in the June 1 Order, the Commission's regulatory structure requires the carrier to demonstrate that there was a substantial divergence between the cost increases that it actually incurred and the relief provided by the index. The increase in power costs is a classic example of the type of cost that is governed by the indexing procedure and the rationale contained in the June 1 Order controls here. The ID is affirmed on this point.

> n126 Compare the costs for the years 2000 and 2001 as reflected on Page 700 of SFPP's 2001 FERC Form No. 6 Report. The total cost of service for 1999 was $88,870,968 and for 2001 was $89 ,487,649, a difference of, 7 percent (0.007). The percentage increase permitted by the indexing methodology in 1991 was, 9565 percent (0.009565). *See Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992, 99 FERC P 61,219 (2002).*

D. The West Line Turbine Fuel Rates

106. The Remand Opinion held that the Commission erred in Docket No. OR92-8-000, *et al.* when it declined to determine whether SFPP's West Line turbine fuel rates were just and reasonable. Therefore, on remand the Commission must address the complaints filed against those rates on the merits and determine a just and reasonable rate for the transportation of turbine fuel. The technical difficulty presented on remand is that only the turbine fuel component of SFPP's West Line rates is before the Commission in Docket No. OR92-8-000, *et al.* The projected volumes for that service were 365,000 barrels per year in comparison to total 1993 volumes on the West Line of 32,850,000, or approximately 1 percent. The challenge here is to determine a just and reasonable rate for this relatively small portion of West Line volumes without undue administrative expenses, including the additional regulatory costs that will apply to the service if litigation proceeds beyond the compliance phase.

107. The Commission's June 1 Order deferred action on the turbine fuel rates until the Commission had an opportunity to review litigated West Line rate issues to determine if there are any issues unique to those rates that might materially influence the calculation of the turbine fuel rate. Based on the analysis in the preceeding cost-of-service section of this order, and a review of the Opinion No. 435 Orders, the Commission concludes that it is not necessary to send this matter to hearing and the matter should be resolved on the instant record. The Opinion No. 435 Orders made formal

rulings on all issues that affect the cost of service for both the West and East Line rates and established standards for allocating the costs between them. One highly technical issue, the separation of volumes and costs between jurisdictional and non-jurisdictional services for the West Line rates, was not ruled on in Docket No. OR92-8-000, *et al.*, but neither was it contested.

108. Therefore, SFPP should make a compliance filing using the 1994 cost-of-service included in its last compliance filing in Docket No. OR92-8-000, *et al.* and use the allocations between the East and West Lines contained therein to complete a West Line cost-of-service, including the application of the income tax allowance methodology adopted here. Once the West Line costs are derived from the system-wide 1994 test year, these would then be allocated proportionately by volume to the actual turbine fuel volumes transported in 1994. SFPP must then prepare a related rate filing that establishes an interim just and reasonable rate as of January 1, 1994 and then index this interim West Line turbine fuel rate forward to December 31, 1998. Thereafter, if a lower rate results from the use of the 1999 cost of service, the West Line rate after January 1, 1999 will be based on that cost-of-service. Otherwise the existing 1994 rate will be indexed forward to April 30, 2006.

E. Reparations Issues

109. The ID's discussion of reparation addresses three main issues. After summarizing the filings SFFP made to comply with the Commission's Opinion No. 435 Orders, the ID first stated that none of the East Line rates under review here were grandfathered. The ID then proceeded to analyze *Arizona Grocery Co. v. Atchison, T. and S. F. Ry.* Based on that analysis, the ID concluded that reparations would be available for two years before the East Line complaints at issue in this proceeding. The ID also concluded that *Arizona Grocery* does not preclude awarding reparations for two years before the filing of the complaints against the West Line rates at issue here.

110. On exceptions, SFPP asserts that the ID misapplied *Arizona Grocery*, arguing that the Commission established final East Line rates based on the 1994 cost-of-service developed in Docket No. OR92-8-000, *et al.* and then indexed those rates forward to August 1, 2000. It argues that this precludes setting an East Line rate that is lower than the indexed rate for the period between 1994 and August 1, 2000, and that the East Line rates [*62,110] may be modified only prospectively. SFPP also asserts that awarding reparations for the East Line rates would be inconsistent with the standards established by the Commission's indexing procedures. SFPP further argues that the Energy Policy Act of 1992 (EP Act) bars pre-complaint relief of any complaints that were filed against the grandfathered West Line rates. Moreover, on exceptions Chevron argues that it is the successor-in-interest to TRMI n127 and should be able to obtain reparations from the date of the TRMI's complaint. Ultramar asserts that the ID could lead to an erroneous reading of the ICA that would restrict pre-complaint relief. Western Refinery asserts that SFPP's reading of *Arizona Grocery* would eviscerate the two year pre-compliant relief available under the ICA and would be inconsistent with the statements in the Opinion No. 435 Orders that the rulings in those orders would not preclude reparations here. On reply, SFPP argues that the Commission has stated numerous times that Chevron is not entitled to substitute itself for TRMI and thereby obtain complainant and reparations status.

n127 Texaco Refinery and Marketing, Inc.

111. The first step is to summarize what *Arizona Grocery* holds and how it has been applied to date in the various dockets at issue here. Simply put, *Arizona Grocery* holds that once the Commission establishes a prescriptive, final rate, that rate may only be changed prospectively. On appeal of the Opinion No. 435 Orders, the issue before the court was whether the Commission had established such a rate. The court upheld the Commission's position that it had established only interim rates as of August 1, 2000, and that therefore those rates could be modified by subsequent Commission orders and the related compliance filings. Thus, the rates established on an interim basis as of August 1, 2000, became

final only after the Commission accepted SFPP's last compliance filing to Opinion No. 435 Orders and ruled on related rehearing requests on September 26, 2002. n128 The Remand Opinion also held that a shipper party must actually file a complaint to be eligible for reparations and intervention alone was inadequate to establish standing for reparations. n129 Thus, the Remand Opinion established the time frames to which *Arizona Grocery* applies and the threshold requirement for reparations.

n128 Remand Opinion at 1305, *citing SFPP, L.P., 98 FERC P 61,177 at 61,657 (2002)* (September 26 Order).

n129 *Id.* 1310.

112. What the Commission did in the Opinion No. 435 Orders was to establish SFPP's East Line rates as of January 1, 1994, the beginning of the relevant test year, and then index the rates forward to an effective date of August 1, 2000, subject to suspension and refund. At that point the rate applied to all East Line shippers regardless of whether they were complainants in Docket No. OR92-8-000, *et al.* and these shippers could get refunds if the East Line rates were lowered for the period after August 1, 2000. Since the East Line rates were not grandfathered, reparations were due eligible shippers (those filing complaints before August 7, 1995) with certain narrow exceptions that were limited by statute. n130 After several adjustments those rates became final rates for purposes of *Arizona Grocery* when the Commission issued its September 26, 2000 order and there were no further administrative actions by the Commission. Thereafter those East Line rates were remanded on July 24, 2004, and as such are now before the Commission for revision. This has the effect of reopening those East Line rates and requires the Commission to establish new East Line rates based on a revised 1994 cost-of-service. Once the Commission accepts the revised East Line cost-of-service, a new set of East Line rates must be designed based on that cost-of-service and indexed forward to August 1, 2000.

n130 The Commission's determinations in this regard were also upheld. *Id.*

113. Under the Commission's indexing procedures, those revised East Line rates would be further indexed to establish their current level as of December 31, 2005. Thus, if the complaints filed in the consolidated dockets in OR96-2-000, *et al.* result in lower rates for the East Line than those in effect on January 1, 1999, as indexed forward from January 1, 1994, any further reduction could be prospective only from the date established by this order. By way of example only, assume that the new East Line rate established by this order would be $1.00 on January 1, 1994, and the indexed rate would be $1.10 on August 1, 2000 and $1.20 on May 1, 2006 (the target date of new interim rates in this proceeding). These levels ultimately become the January 1, 1994 indexed final rates adopted by the Commission in this decision for Docket No. OR92-8-000, *et al.* The projected final rate developed from the 1999 cost-of-service in Docket No. OR96-2-000, *et al.* are $1.05 as of August 1, 2000 and $1.15 as of May 1, 2006. This latter and lower rate of $1.15 would be effective prospectively on May 1, 2006 because the East Line rates previously established in Docket No. OR92-8-000, *et al.* are subject to the *Arizona Grocery* doctrine.

114. Under these circumstances no reparations are due for most East Line shippers because any new East Line rate based on the 1999 cost-of-service may be prospective only as of May 2006 at the $1.15 level. n131 However, there is one situation where an East Line shipper may be eligible for reparations for complaints filed against the East Line rates between August 8, 1995 and August 1, 2000. If such a shipper had not filed a valid complaint against the East Line rates before August 7, 1995, it would not have heretofore received reparations for East Line movements occurring before [*62,111] August 1, 2000. n132 Under such circumstances the complaining East Line shipper may receive reparations for a period two years before its complaint, and forward to August 1, 2000, the date the new East Line rates became

applicable to all shippers. However, this will occur only if the rate paid in the reparations period was higher than the *Arizona Grocery* rate for the same period. The Commission did not intend in its prior orders that reparations would be available for all complaints filed against the East Line rates between August 1995 and August 1, 2000.

n131 Conversely, if any newly designed rate based on the 1999 cost-of-service is higher than the East Line rate in effect on August 1, 2000, the issue is moot.

n132 *Cf.* Remand Opinion at 1310.

115. Moreover, the Commission reverses that ALJ's ruling that the 1988 PPA should be removed for purposes of calculating reparations that are due for the East Line rates before August 1, 2000. Opinion No. 435-A afforded complainants an opportunity to pursue the issue further in the context of complaints filed after August 1995. n133 While the complainants provided extensive evidence on the relevance and import of the 1998 PPA, they did not do so with regard to the 1988 PPA. Therefore, for the same reasons as in Opinion No. 435-A, the Commission will not pursue the further in either of consolidated proceedings at issue here.

n133 91 FERC at 61,506-07.

116. Two additional issues raised here turn on the technical requirements for filing a complaint. The first is an argument by Ultramar that the ID could lead to an erroneous application of section 1803 (b) of the EPA that would restrict pre-complaint relief. Ultramar notes that it filed complaints against SFPP's West Line rates on October 21, 1996, and against the West, East, North, and Oregon Line rates on November 21, 1997, and amended those complaints on January 10, 2000. It notes that Tosco also filed complaints against all West, East, North, and Oregon rates on April 28, 1998, and that both companies filed further complaints against those rates on August 17, 2000, and August 21, 2000, respectively. n134 Ultramar asserts that since the Commission found that certain of the West Line rates were no longer grandfathered as of 1995 and others as of 1997, that complaints filed against those rates after those dates were not required to show substantially changed circumstances. Thus, pre-complaint reparations would not be barred as to those complaints by section 1803(b) of the EP Act because the rates would no longer be grandfathered at the time those complaints were filed. n135 The Commission agrees with this analysis. However, such complaints may be barred from some portion of pre-complaint reparations by the *Arizona Grocery* doctrine for the same reasons stated in the discussion of the East Line rates. Specifically, a rate established in the first complaint that prevails against specific West Line rates establishes a just and reasonable rate and rate floor that could limit the reparations or refund that could be obtained from subsequent complaints.

n134 Ultramar also filed a complaint against the Watson Station charges on August 30, 1996. Ultramar's concern does not reach those rates because the Commission has held they are not grandfathered.

n135 Section 1803(b) of the Energy Policy Act, Pub. L. 102-486, 106 Stat. 2772 (1992) (EP Act). Section 1803(a)(1) provides that any rate in effect for the 365-day period ending on the date of the enactment of this Act shall be deemed just and reasonable (within the meaning of section 1(5) of the Interstate Commerce Act).

117. The remaining reparation issues involve Chevron's continuing quest for complainant status before July 3, 2003. On October 23, 2003, the Commission accepted a complaint Chevron filed against SFPP's North, East, West, and Oregon Line rates, as well as the Watson Station Drain-Dry facilities. n136 The Commission had previously rejected as inadequately filed a complaint Chevron filed on February 11, 2002, n137 and denied rehearing and reconsideration of that decision. n138 However, in the proceedings below Chevron asserts that it succeeded to the complainant interests of TRMI as a result of its merger with Texaco on October 9, 2001. The ALJ in this proceeding rejected this argument on April 12, 2002. n139 On exceptions, Chevron first revisits certain arguments related to its intervention status in Docket No. OR92-8-000, *et al.* It also urges the Commission to reverse the ALJ's April 12 ruling. SFPP opposes Chevron's arguments at length. The Commission rejects Chevron's arguments.

n136 *Chevron Products Company v. SFPP, L.P., 105 FERC P 61,142 (2003),* Docket No. OR03-4-000, held in abeyance pending this order.

n137 *Chevron Products Company v. SFPP, L.P., 99 FERC P 61,196 (2002).*

n138 *Chevron Products Company. SFPP, L.P., 100 FERC P 61,231 (2002)* and *103 FERC P 61,231 (2003).*

n139 *Texaco Refining and Marketing Inc. v. SFPP, L.P., 99 FERC P 63,009 (2002)* (April 12 Order).

118. Chevron's first assertions reiterate why its initial intervention in Docket No. OR92-8-000, *et al.*, should grant it complainant status based on its protest against SFPP's proposed Tariff Nos. 15 and 16 in September, 1992. The Commission concluded that this protest had nothing to do with the West Line rates. n140 These decisions eliminated any prospect that Chevron would be deemed to have filed a complaint against the West Line rates more than 365 days prior to the enactment of the EP Act. Chevron eventually filed a complaint against all of SFPP's West Line rates in August 1993, but failed in its efforts to relate that complaint back to its prior protests. As such, Chevron was required to prove substantially changed circumstances, and like the other West Line complainants in Docket No. OR92-8-000, *et al.*, it failed to meet its burden. On appeal, the Remand Opinion held that the Commission properly denied Chevron complainant status based on its interventions and protests prior to July 1993 and rejected [*62,112] Chevron's relation back theory in a footnote. n141 Its attempt to relate its July 1993 complaint against SFPP's West Line rates to proceedings involving SFPP's East Line rates is rejected here for the same reasons as stated in the prior orders.

n140 *See SFPP, L.P.*, 65 FERC at 61,378 (1992); SFPP, *L.P., 63 FERC P 61,104 (1993).*

n141 Remand Opinion at 1311-12.

119. The ALJ's April 12 Order contains an exhaustive analysis of why Chevron failed to establish that it is the successor-in-interest to the second round of complaints filed against SFPP's West Line rates (among others) beginning December 1995 by TRMI and others. Chevron intervened in those proceedings in May 1996. The ALJ held that Chevron had not adequately documented that it was a successor in interest, that granting successor status would result in confusion regarding rights to reparations, and that the relation-back doctrine did not apply to Chevron's 1996 intervention. On exceptions, Chevron disputes each of these rulings, and further argues that equitable considerations

require granting it complainant status before July 3, 2003, the point at which it finally filed an adequate complaint in Docket No. OR03-4-000. These equitable factors are that SFPP would retain profits that were unjust and unreasonable at Chevron's expense, that Chevron was never given notice that its reparation rights would be terminated in the absence of a complaint in light of the long delays involved in these proceedings, that the ALJ applied FERC's procedural rules too narrowly to Chevron's injury did so in a manner that was too protective of SFPP, and that the ALJ erred by not recognizing that an intervenor has the same reparation rights as a complainant.

120. None of these arguments suffice. The ALJ exhaustively examined the documentation involved and reasonably concluded that Chevron had not proven that it was the successor in interest to TRMI. This is particularly true since in a complaint filed on January 10, 2000, Equilon Enterprises, LLC (Equilon) claimed that it was the successor in interest to TRMI. n142 Thus, any successor in interest status is at best ambiguous. Moreover, the ALJ correctly concluded that there is another problem. Different shippers ship oil products from different facilities and in different volumes. It is undisputed that in 1995 Chevron and TRMI were different shippers. Thus, both Chevron and TRMI shipped petroleum products from separate facilities in California, as TRMI did from its. As the ALJ points out, granting Chevron successor status would allow it to obtain reparations for flows from its facilities before the merger in 2001, even though during that period complainant status attached only to TRMI's flows and these were clearly different than Chevron's flows.

n142 *See* Exhibit A to SFPP's October 19, 2004 filing in Docket No. OR96-2-000, *et. al.*

121. The ALJ was correct in refusing to give these different flows the same legal status because the complaint status for the different flows arose at different times. This was particularly wise given that a dispute about which entity is the proper successor in interest to TRMI is reflected on the face of January 10, 2000 Equilon complaint. Keeping the flows separate for accounting and reparations purposes was the prudent thing to do under these circumstances. In any event, the ALJ's April 26 Order was notably evenhanded in this regard. He denied successor in interest status to the assets and entities in other mergers, or transfers of assets, where the ownership of the assets prior to the transaction involved parties having different legal identities. n143 The only exception was the substitution of Western Refinery for Refinery Holding Company when the latter became Western Refinery through a bankruptcy proceeding. All that entailed was a name change for the entity controlling a given set of assets, and hence the related shipments, without any reallocation or change in the title to the assets among entities that had previously had separate legal status and separate transportation interests. Where the record suggested that there could be confusion about which entity shipped which volumes from what assets, and in what time frame, the ALJ uniformly denied successor in interest status.

n143 April 12 Order at 65,034-35.

122. Regarding Chevron's other claims, as was previously discussed, the Remand Opinion made quite clear that intervention does not support the complainant status necessary to support a claim for reparations. n144 The Remand Opinion also rejected the relation-back argument in support of an effort to relate an eventual complaint back to earlier interventions and protests. This was true even though all those filings involved pleadings directed against the East Line rates. The fact that they were made at different times was sufficient to defeat the relation-back plea. The result should be no different here and would undercut the clear distinction between interventions and complaints. The EP Act is clearly intended to discourage complaints against oil pipeline rates n145 and acquiescing in the relation-back theory would have the opposite effect.

n144 Remand Opinion at 1310.

n145 *Id.*, 1311-12.

123. Moreover, as the ALJ found, consistent with its formerly passive approach to these proceedings, Chevron did nothing to avail itself of an opportunity in 2000 to file amended or additional complaints, and did not file a legally sufficient complaint until July 2003. SFPP correctly notes that it never conceded complainant status to Chevron before 2003, and correctly asserts that the fact that Chevron filed testimony under its 1996 intervenor status is an inadequate basis upon which to grant it complainant status. While there was a long delay between Chevron's filing as an intervenor in May 1996 and the Commission's statements in Order No. 435-A (May 17, 2000) that complainant [*62,113] status is required, n146 that delay does not relieve Chevron of the obligation to have acted aggressively to protect its own interests. The relevant case states that each shipper must filed its own complaint to have any eligibility for reparations status. The ALJ's April 26 order is affirmed on this point.

n146 *Opinion No. 435-A*, 91 FERC at 61,514 (2000).

F. <u>Issues Regarding the Commission's Indexing Procedures</u>

124. On exceptions BP West Coast asserts that any inflation adjustments that may have been built into the rates at issue here are not grandfathered and may be challenged by complaint. It asserts that therefore any issues related to inflation adjustments may be addressed in the compliance phase. BP West Coast also asserts that inflation adjustments can be challenged through complaints, that it has done so here, and that certain adjustments should be rolled back in the compliance phase. SFFP responds to BP West Coast's assertions with three pages of argument asserting that BP West Coast has not challenged any of the index adjustments related to the rates at issue here. While conceding that any index increases to the underlying base rates are reduced in a proportional reduction to reductions in the base rates, SFPP argues that there is no basis in this proceeding for a complete reduction of any index-based increases to the base rates at issue here. In particular, it asserts that BP West Coast has failed to challenge SFPP's North and Oregon Line index adjustments and that there is no basis here for rolling back prior adjustments. In addition to these arguments, SFPP and Indicated Shippers have pending rehearing requests of the Commission's June 30, 2004 Order accepting SFPP's index filing based on SFPP's calendar year 2003 cost increases. n147

n147 *SFPP, L.P., 107 FERC P 61,334 (2004)* (June 30 Order). The case involves Docket Nos. IS04-323-000 and 001 and reviews SFPP's May 19, 2004 index filing.

125. When SFPP made its 2004 filing to recover its 2003 year costs increases, Indicated Shippers challenged the integrity of the index, asserting that it was impossible for them to verify the accuracy of the calculations because SFPP controlled all the relevant information. They further asserted that SFPP overstated its 2003 costs and was substantially over-recovering them. They asserted that an income tax allowance was included in the index filing and objected that such a cost component was illegal based on the ruling in the Remand Opinion. n148 They therefore concluded that they had "alleged reasonable grounds for asserting that the rate increase was so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable." n149 At bottom, they argue that because SFPP's rates were already unjust and unreasonable, any increase necessarily results in a rate that is unjust and unreasonable. They assert that the June 30 order did not adequately address these concerns.

n148 Because the Remand Opinion was dated July 24, 2004, and the Commission's order on the index issued on June 30, 2004, this accorded Indicated Shippers an opportunity to include this argument in their rehearing request.

n149 *Citing* the June 30 Order at P 5. The quoted language was derived from 18 C.F.R. § 343.2(c)(1).

126. The Commission will deny rehearing of both SFPP's and Indicated Shippers' rehearing requests. SFPP is correct that the Commission had not previously suspended index rate increase or subjected the increase to a refund obligation. However suspension is a matter for the Commission's sole discretion. In June 2004 when the Commission acted it had made no final determination whether the North and Oregon rates were grandfathered because requests for rehearing of the Commission's March 2004 order were pending. While the Commission could lift the suspension and refund obligation attached to those rates, it sees no need to do so until all matters are completed in this proceeding. Given the complexity of the litigation here, the Commission's action was reasonable and the suspension will remain in effect.

127. The Commission also concludes that Indicated Shippers' request for rehearing should be denied. As noted, Indicated Shippers assert that they "alleged reasonable grounds for asserting that the increase is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable." The request for rehearing has three specific points: (1) What is the standard for a protest, an allegation or a showing? (2) If the standard is a showing, how can protestors meet that burden since the pipeline controls all the information? (3) Since the underlying rates are being adjudicated in Docket No. OR96-2-000, *et al.*, will SFPP have the burden to prove that its actual costs increases between 2002 and 2003 were sufficient to qualify for the index increase that became effective in 2004? The answer to these questions lies in the Commission's past explanations of the indexing regulations, all of which have been explained in prior orders involving SFPP. n150

n150 *See SFPP, L.P., 96 FERC P 61,322 (2001)* at 62,272, and *SFPP, L.P. 102 FERC P 344 at P 10, 12.*

128. Moreover, in Order Nos. 561 and 561-A the Commission specifically addressed what could be protested in the context of a filing. n151 The Commission made clear in those orders that in an index proceeding it is only the amount of the increase in the underlying rate that may challenged, not the level of the resulting rates. n152 The [*62,114] two Orders are equally clear that if a shipper wishes to challenge the level of the rate that results from an index-based increase, the shipper must file a challenge against the base rate that has been indexed. n153 The answer to the first question is that the shipper must allege reasonable grounds that the rate increase is so substantially in excess of the carrier's actual cost increase that the resulting rate would be unjust and unreasonable. This can be done on the basis of the information contained on Page 700 of the carrier's annual FERC Form No. 6. n154 Page 700 of SFPP's 1993 FERC Form No. 6 report discloses total jurisdictional expenses and total jurisdictional revenues for the years 1992 and 1993, thus permitting a comparison of one year's expenses with the other. n155 This can be used to determine the percentage increase in the expenses and calculate the percentage increase. In 1993 SFPP's increase in costs exceeded the percentage increase permitted by the Commission's index for rate increases.

n151 *Revision to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. P 30,985 and Order No. 561-A, FERC Stats. and Regs. 31,000 (1994).

n152 *Opinion No. 561* at 30,955; *Opinion No. 561-A* at 31,103-104.

n153 *Opinion No. 561* at 30,955 and *Opinion No. 561-A* at 31,104.

n154 *Opinion No. 561-A* at 31,098.

n155 The expense accounts are Operating and Maintenance Expense, Depreciation Expense, AFUDC, Amortization of Deferred Earnings, Rate of Return, Return on Rate Base, Income Tax Allowance, and Total Cost of Service (Lines 1 through 9) The remaining three lines are Total Interstate Revenues, Throughput in Barrels, and Throughput in Barrel-Miles. The underlying accounts are required to conform to the Commission's Opinion No. 154-B costing methodology.

129. Under the Commission's regulations the increase can only be unjust and unreasonable if the increase in the rate so substantially exceeds the increase in the carrier's costs that the amount of the increase is unjust and unreasonable. Indicated Shippers argue here that the increase is unreasonable because the profits earned under the base rate are unreasonable, and allowing the index to go into effect will result in profit margins that are even more unreasonable. But as has been previously discussed, the matter of the reasonableness of the base rate, and as such the profit margin that results, can be examined only in a complaint proceeding. Under the Commission's regulations, if the base rate is reduced, the increase in the dollar amount generated by the index is proportionately reduced. Because the index operates on the basis of system-wide costs and revenues, any concerns about the level of the base rate after the index is applied can be addressed only in complaints directed against a specific rate. As such, the fact that the index may include an increase in an underlying tax allowance, which Indicated Shippers consider to be of questionable legality, is irrelevant to the index computation since an income tax allowance is an existing component of the rate design that can be modified only in response to a complaint.

130. At bottom, all that can be challenged during an index rate proceeding is whether the increase in the rate so exceeds the increase in the carrier's costs as to be unjust and unreasonable, or the accuracy with which SFPP reported them in 1993. The first test fails because the percentage increase in SFPP's costs in 1993 exceeded, as those costs were reported, the increase permitted by the index. Thus, for the year 1993, the sole issue is whether SFPP accurately reported the costs. While it is true that only SFPP has control of the underlying cost data, the remedy is to file a complaint stating the costs involved in the filing at issue are incorrect. This would not, contrary to what Indicated Shippers seem to imply, be the equivalent of a complaint against the base rates for the purpose of examining rate design. Thus, to the extent Indicated Shippers attempt to attack the reasonableness of the North or Oregon Line rates, or costs of those lines that are embedded in the index, that effort must fail. To the extent that Indicated Shippers' protest is directed to the resulting level of the East and West Line rates, any adjustment to those rates is addressed in the portions of this order dealing with Docket No. OR98-2-000, *et al.*, not here. Rehearing is denied regarding SFPP's 1993 indexing of the West, East, North and Oregon line rates.

G. Residual Jurisdiction Issues

131. The ID addressed certain jurisdictional and threshold issues related to the Watson Station charges and to SFPP's adding an additional origination point at East Hynes, California. The ALJ held that charges for the Watson Station Drain Dry facilities were not grandfathered. The ALJ further held that SFPP's creation of an additional origination point at East Hynes created a new service and therefore was not grandfathered. n156 On exceptions SFPP asserts that those issues were simply not before the ALJ at the time he issued the ID. Ultramar asserts that the ID erroneously concluded that SFPP should continue to publish the Watson Station Drain Dry charge as a separate rate. It asserts that the ID first found that the Watson Station Drain Dry rates were not grandfathered and that all capital investment in those facilities had been recovered. Ultramar therefore concludes that the Watson Station facilities should be folded into the West Line rate structure. SFPP replied that Ultramar had not demonstrated that there were reasonable grounds to eliminate the Watson Station Drain Dry facilities as a separate cost center with its own rates. BP West Coast supports the ID, arguing

that none of SFPP's rates was ever grandfathered, including the East Hynes rates.

n156 ID at P 581-85.

132. The Commission concludes that Ultramar's arguments regarding the Watson Station Drain Dry facilities are premature, and therefore so is SFPP's reply. By way of background, the ALJ found that the charges for the Watson Station Drain Dry facilities were not grandfathered in Phase I of Docket No. OR98-2-000, *et al.* The Commission's March 26, 2004 order reviewing [*62,115] the ALJ's Phase I determinations deferred decision on the jurisdictional status of those charges until the reviewing court acted on the Commission's earlier determinations in the Opinion No. 435 Orders. n157 The June 1 Order concluded that the Watson Station Drain Dry facility charges were not grandfathered based on the effective dates of those contracts. n158 However, since the Phase I decision did not address all of the costs relevant to the Watson Station Drain Dry facilities, but only their rate base, the Commission set the issue of the just and reasonable rate for hearing in a separate proceeding. n159 Since Ultramar's argument is based solely on the ALJ's prior, and yet to be reviewed, determination regarding the rate base issue, it is premature to determine whether the Watson Station Drain Dry facilities should continue to have a separate rate. Finally, the Remand Opinion resolved the addition of the East Hynes origination point in the Commission's favor n160 and on the grandfathered status of the West Line rates. There is no need to discuss these issues further.

n157 *SFPP, L.P., 106 FERC P 61,300 at P 2-3 (2004)* (March 2004 Order).

n158 June 1 Order at P 31-36.

n159 June 1 Order at P 36, 74.

n160 Remand Opinion at 1272-73.

H. Compliance Filings and Related Proceedings.

133. This order requires SFPP to make several compliance filings that have two elements. These comprise a cost-of-service for the relevant service and period that conforms to this order and a related but separate rate filing that conforms to the cost-of-service. These filings include: (1) a revised cost-of-service for the West Line turbine fuel service based on the 1994 and 1999 cost-of-service established here and in the Opinion No. 435 Orders, together with an interim just and reasonable rate determined as of the first day of each year; (2) the indexing of each of those turbine fuel rates forward to April 30, 2006 and inclusion of the lower of the two rates as an interim rate applying to all West Line shippers on May 1, 2006; (3) a revised East Line cost-of-service in Docket No. OR92-8-000, *et al.* based on the 1994 cost of service, together with just and reasonable rates that should be indexed forward to April 30, 2006; (4) a revised East Line cost-of-service based on the 1999 cost of service in Docket No. OR96-2-000 *et al.*, together with interim just and reasonable rates that should be indexed forward to April 30, 2006; (5) the filing of the lower of those two sets of East Line rates as interim rates applying to all shippers on May 1, 2006; (6) developing a West Line cost of service for 1999 and interim just and reasonable rates determined as of the first day of 1999; (7) the indexing of those West Line rates (which include the turbine fuel rate) forward to April 30, 2006, to apply to all shippers on May 1, 2006. SFPP must also prepare reports on estimated reparations that are consistent with the analysis of reparation issues earlier in this order. The preparations, where applicable, are measured by the difference between rates actually paid and the just and reasonable rate established for 1994 and 1999, as indexed forward to the effective date for the revised rates, in this case May 1, 2006.

134. All of the compliance filings required here must be supported by verified statements explaining how the cost-of-of service and proposed rates were designed. As indicated in the body of this order, this requirement extends to certain components of the filing, such as the income tax allowance, for which a separate explanation and verification is required. Parties commenting on the compliance filings should include with their comments verified statements supporting their comments and not simply relying on arguments with citations to the record. This is because the Commission is requiring that certain of evidence previously submitted be recast in forms that could facilitate the resolution of the issues raised by this order without further on-the-record proceedings. If such proceedings should prove necessary, the more extensive comment format required here should enable the Commission to further narrow the range of disputes and expedite the completion of these protracted proceedings.

135. The Commission directs SFPP to make its compliance filing not later than February 15, 2006, so that any interim new rates can become effective on May 1, 2006, subject to suspension and refund. Because the filings will be complex, interested parties will have until March 31, 2006 to file comments. Reply comments are be filed on April 15, 2006. Finally, the Commission will address the procedural schedule for complaints filed against SFPP rates in 2003, 2004, and 2005 in a separate order.

The Commission orders:

(A) SFPP shall make the compliance filings required by this order by no later than February 15, 2006, with the proposed interim rates contained therein to be effective May 1, 2006 subject to suspension and refund. Comments on that filing are due March 31, 2006 and reply comments due on April 15, 2006.

(B) The requests for rehearing of the Commission's June 30 Order in Docket No. IS04-323-000 are denied.

(C) All compliance filings and comments thereon must conform to the filing requirements established in Part H of this order.

By the Commission.

115 FERC ¶ 61,125

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

SFPP, L.P. | Docket No. IS06-215-000
Docket No. IS06-229-000

ORDER ACCEPTING AND SUSPENDING TARIFF FILINGS

(Issued April 28, 2006)

1. On March 7, 2006, SFPP, L.P. (SFPP) under Docket No. IS06-215-000 filed FERC Tariff Nos. 119 – 121, canceling FERC Tariff Nos. 112, 113, and 115, respectively, with a proposed effective date of May 1, 2006. SFPP's proposed filing is made to comply with the Commission's order issued December 16, 2005, in Docket Nos. OR92-8-000, *et al.* and OR98-2-000, *et al.*,[1] as clarified by the subsequent rehearing order issued February 13, 2006.[2] As required by the December 16 Order, SFPP proposed a May 1, 2006 effective date. The December 16 Order expressly stated that the rates to be included in the tariff filed pursuant to that order would be interim rates. On March 27, 2006, SFPP filed under Docket No. IS06-229-000 Supplement No. 1 to FERC Tariff No. 119 (Correction Supplement) correcting FERC Tariff No. 119, with an effective date of May 1, 2006.[3] Therefore the Commission accepts and suspends the tariffs, subject to refund, to become effective May 1, 2006. Any further action will require a subsequent order of the Commission.

Interventions

2. Oil pipeline tariffs are noticed by filing them with the Commission and sending a copy of the proposed tariffs to all subscribers, and in this instance, to parties of record in

[1] *SFPP, L.P.*, 113 FERC ¶ 61,277 (2005) (December 16 Order).

[2] *SFPP, L.P.*, 114 FERC ¶ 61,136 (2006) (February 13 Order).

[3] Item 310A corrects and replaces Item 310 to correct a typographical error in the symbols used to indicate if the rate is increased or decreased. SFPP corrected the letter designation for rates from El Paso and Diamond Junction, Texas to indicate a rate decrease with the [D] symbol.

the dockets addressed by the December 16 and February 13 Orders. Interventions, initial comments, and protests were filed on March 22 by: the Airlines;[4] Western Refining Company, L.P.; ConocoPhillips and Tosco Corporation, filing jointly; BP West Coast Products LLC, Chevron Products Company, and ExxonMobil Oil Corporation, filing jointly; Navajo Refining Company, L.P.; and Ultramar Inc. and Valero Marketing and Supply Company, filing jointly. Detailed comments were due April 21, 2006, and, except for the Airlines, these parties filed comments on that date. SFPP's reply is due on May 1. A number of these parties also filed discovery requests related to the December 16 Order in the weeks preceeding their interventions in these dockets. SFPP filed replies to those requests. These related pleadings will be addressed in the compliance phase of the Docket Nos. OR92-8-000, *et al.* and OR98-2-000, *et al.* proceedings once all the comments and reply comments have been received.

Discussion

3. As mentioned above, the December 16 Order explicitly held that the rates included in the tariffs under discussion here would be interim rates. Therefore there is no need for the more extended discussion that might be included in an oil pipeline suspension order. It is sufficient to say that the protests assert that the filed rates are unjust and unreasonable for the following reasons, among others. They assert that SFPP is not entitled to an income tax allowance as a matter of law and that SFPP, in any event, calculates the income tax allowance incorrectly. The latter concerns include the inclusion of a state income tax allowance, the inclusion of certain revenues allocated to the corporate general partners in determining its income, the use of marginal rather than actual tax rates, and calculation of the income tax allowance on the basis of income allocations rather the nominal partnership shares. They further assert that SFPP did not correctly calculate the equity cost of capital, that SFPP has failed to justify the inclusion of master limited partnerships in the proxy group used to determine the equity cost of capital, and that certain factors were improperly included in SFPP's rate base calculations, including the deferred equity component, the amortization of the rate base, and the allowance for deferred income taxes. Protestants direct other challenges to the allocation of overhead costs and the indexing of the rates to proposed effective date. Finally, the protesting parties assert that the Commission should accept and suspend the tariff filings subject to refund.

4. The Commission will consider all these matters when a complete record on the tariff filings and the compliance filing is before it. Because the matters raised are before the Commission in the context of a compliance filing, the Commission will not refer the

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[4] American West Airlines, Inc., Continental Airlines, Inc., Northwest Airlines, Inc., and Southwest Airlines Co.

matter to a settlement judge or set the tariff filings for hearing. Moreover, as the filed rates are interim rates under the terms of the December 16 Order, and as such will not be just and reasonable until a ruling on the matters presented, the Commission accepts and suspends the tariffs, subject to refund, to become effective May 1, 2006.

The Commission orders:

FERC Tariff Nos. 119 – 121 and Supplement No. 1 to FERC Tariff No. 119 are accepted and suspended, subject to refund, to be effective May 1, 2006.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

ORIGINAL

KINDER MORGAN
ENERGY PARTNERS, L.P.

SFPP, L.P.
Operating Partnership

IS04-323-000

Oil Pipeline Filing
SFPP, L.P.
May 19, 2004

FILED
OFFICE OF THE SECRETARY
2004 MAY 20 A 11:26
FEDERAL ENERGY REGULATORY COMMISSION

Ms. Magalie R. Salas,
Secretary
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

Dear Secretary Salas:

In accordance with the requirements of the Interstate Commerce Act (ICA) and the Rules and Regulations of the Federal Energy Regulatory Commission (F.E.R.C.), SFPP, L.P. (SFPP) submits for filing four copies of the following tariffs, effective July 1, 2004:

- F.E.R.C. Tariff No. 104 covers SFPP North Line Interstate movements (Cancels F.E.R.C. Tariff No. 89)
- F.E.R.C. Tariff No. 105 covers SFPP East Line Interstate movements (Cancels F.E.R.C. Tariff No. 90)
- F.E.R.C. Tariff No. 106 covers SFPP West Line Interstate movements (Cancels F.E.R.C. Tariff No. 91)
- F.E.R.C. Tariff No. 107 covers SFPP Oregon Line Interstate movements (Cancels F.E.R.C. Tariff No. 92)
- F.E.R.C. Tariff No. 108 covers SFPP interstate movements from Watson and East Hynes to Calnev Pipe Line, L.L.C. (Cancels F.E.R.C. Tariff No. 93)
- F.E.R.C. Tariff No. 109 covers SFPP interstate movements from Sepulveda Junction to Watson (Cancels F.E.R.C. Tariff No. 94)
- F.E.R.C. Tariff No. 110 - Index of Tariffs (Cancels F.E.R.C. Tariff No. 95)

SFPP is making this filing in compliance with 18 CFR § 342.3, to index the existing rates. All rates in the above submitted tariffs are increased from the prior tariffs. Attached is a summary table of SFPP tariff rates which includes 2003 and 2004 index ceilings, current rates and proposed rates.

We are also enclosing herewith one additional copy of this transmittal, including all attachments, and respectfully request that it be stamped at the time of filing with the Commission's file stamp and returned for our records.

I hereby certify that copies of these tariffs have been sent via First Class U.S. Postal Service, or other means of transmission agreed upon by the subscriber, to all subscribers on the SFPP, L.P. subscriber list.

1100 Town & Country Road Orange, California 92868 714/560-4600 714/560-4601 Fax

In accordance with 18 CFR § 343.3(a), SFPP hereby requests that any protest of the attached tariffs be telefaxed to SFPP in care of Peter M. Dito at (714) 560-4602.

If you have any questions regarding this filing, please contact the undersigned at (714) 560-4640.

Sincerely,

Jeffrey R Hulbert

Jeffrey R. Hulbert
Sr. Project Manager
Economics and Regulatory Analysis

cc: David Ulevich
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

SFPP, L.P.

Tariff Schedule Changes
Issued: May 20, 2004
Effective: July 1, 2004
In compliance with 18 CFR § 342.3
(Rates are in Dollars per Barrel)

		Prior Ceiling				Calculation of new Ceiling Rate		
Origin	Destination	Tariff Number	Jul-03 Ceiling	Current Rate		Tariff Number	Jul-04 Ceiling	New Rate
Watson Volume Deficiency Charge		FERC 89	$ 0.0337	$ 0.0320		FERC 103	$ 0.0348	$ 0.0320
Sepulveda	Watson CA	FERC 94	$ 0.0513	$ 0.0493		FERC 109	$ 0.0529	$ 0.0509
Watson CA	Phoenix AZ	FERC 91	$ 1.3272	$ 1.3272		FERC 106	$ 1.3692	$ 1.3692
East Hynes CA	Phoenix AZ	FERC 91	$ 1.3272	$ 1.3272		FERC 106	$ 1.3692	$ 1.3692
El Paso TX	Lordsburg NM	FERC 90	$ 0.3248	$ 0.3248		FERC 105	$ 0.3351	$ 0.3351
Diamond Jct TX	Lordsburg NM	FERC 90	$ 0.3248	$ 0.3248		FERC 105	$ 0.3351	$ 0.3351
El Paso TX	Tucson AZ	FERC 90	$ 0.5585	$ 0.5585		FERC 105	$ 0.5762	$ 0.5762
Diamond Jct TX	Tucson AZ	FERC 90	$ 0.5585	$ 0.5585		FERC 105	$ 0.5762	$ 0.5762
El Paso TX	Phoenix AZ	FERC 90	$ 0.7518	$ 0.7518		FERC 105	$ 0.7756	$ 0.7756
Diamond Jct TX	Phoenix AZ	FERC 90	$ 0.7518	$ 0.7518		FERC 105	$ 0.7756	$ 0.7756
Richmond CA	Reno (Sparks) NV	FERC 89	$ 1.1568	$ 1.1568		FERC 104	$ 1.1934	$ 1.1934
Concord CA	Reno (Sparks) NV	FERC 89	$ 1.1568	$ 1.1568		FERC 104	$ 1.1934	$ 1.1934
Portland OR *	Eugene OR	FERC 92	$ 0.4797	$ 0.4797		FERC 107	$ 0.4949	$ 0.4949
*Includes Willbridge & Linnton OR								
Watson CA	Tucson AZ	FERC 91	$ 1.6228	$ 1.6228		FERC 106	$ 1.6742	$ 1.6742
East Hynes CA	Tucson AZ	FERC 91	$ 1.6228	$ 1.6228		FERC 106	$ 1.6742	$ 1.6742
Watson CA	Tucson AZ	FERC 91	$ 1.6228	$ 1.6228	[1]	FERC 106	$ 1.6742	$ 1.6742
East Hynes CA	Tucson AZ	FERC 91	$ 1.6228	$ 1.6228	[1]	FERC 106	$ 1.6742	$ 1.6742
Colton CA	Phoenix AZ	FERC 91	$ 1.0430	$ 1.0430		FERC 106	$ 1.0760	$ 1.0760
Colton CA	Tucson AZ	FERC 91	$ 1.3315	$ 1.3315		FERC 106	$ 1.3737	$ 1.3737
Watson CA	Calnev PL, CA	FERC 93	$ 0.2585	$ 0.2585		FERC 108	$ 0.2667	$ 0.2667
East Hynes CA	Calnev PL, CA	FERC 93	$ 0.2585	$ 0.2585		FERC 108	$ 0.2667	$ 0.2667

[1] These rates apply to jet fuel only.

F.E.R.C. No. 106
(Cancels F.E.R.C. No. 91)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) and
Colton Transmix Facility (San Bernardino County), CA
To Phoenix (Maricopa County) and Tucson (Pima County), AZ

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. [W] 103, Supplements thereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued in compliance with 18 CFR § 342.3.

ISSUED: May 20, 2004 **EFFECTIVE: July 1, 2004**

Issued By:

Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:

Jeffrey R. Hulbert
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4640; Fax (714) 560-4602
hulbertj@kindermorgan.com

Notes:	
①	Applies to Turbine Fuel only.
②	Applies to all Petroleum Products except Turbine Fuel.
③	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
④	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks	
Reference Mark	Explanation
[I]	Increased rate.
[W]	Change in wording.

F.E.R.C. No. 108
(Cancels F.E.R.C. No. 93)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County), CA
To Calnev Pipe Line L.L.C. (San Bernardino County), CA

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

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Issued in compliance with 18 CFR § 342.3.

ISSUED: May 20, 2004 **EFFECTIVE: July 1, 2004**

Issued By:

Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:

Jeffrey R. Hulbert
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4640; Fax (714) 560-4602
hulbertj@kindermorgan.com

Section 2
Tariffs in which SFPP, L.P. is the delivering Carrier of PETROLEUM PRODUCTS

FERC No.	ISSUING CARRIER	TO	FROM
108	SFPP, L.P.	Calnev Pipe Line, L.L.C., at Colton, CA	East Hynes, CA Watson, CA
107	SFPP, L.P.	Eugene, OR	Portland, OR
105	SFPP, L.P.	Lordsburg, NM	Diamond Junction, TX El Paso, TX
106	SFPP, L.P.	Phoenix, AZ	Colton Transmix Facility, CA East Hynes, CA Watson, CA
105	SFPP, L.P.	Phoenix, AZ	Diamond Junction, TX El Paso, TX
104	SFPP, L.P.	Reno (Sparks), NV	Concord, CA Richmond, CA
106	SFPP, L.P.	Tucson, AZ	Colton Transmix Facility, CA East Hynes, CA Watson, CA
105	SFPP, L.P.	Tucson, AZ	Diamond Junction, TX El Paso, TX
109	SFPP, L.P.	Watson, CA (interstate movements only)	Sepulveda Junction, CA

Section 3
Effective Tariffs Issued by SFPP, L.P., listed in numerical order

FERC No.	TARIFF DESCRIPTION
5	Adoption Notice
103	Rules and Regulations
104	Nevada destinations via SFPP's North Line
105	New Mexico and Arizona destinations via SFPP's East Line
106	Arizona destinations via SFPP's West Line
107	Oregon destinations via SFPP's Oregon Line
108	SFPP to Calnev Pipe Line
109	Sepulveda Pipeline Interstate
110	Tariff Index

KINDER MORGAN
ENERGY PARTNERS, L.P.

ORIGINAL

SFPP, L.P.
Operating Partnership

MAY 31 1:32

Oil Pipeline Filing
SFPP, L.P.
May 27, 2005

Ms. Magalie R. Salas,
Secretary
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

IS05-327-000

Dear Secretary Salas:

In accordance with the requirements of the Interstate Commerce Act (ICA) and the Rules and Regulations of the Federal Energy Regulatory Commission (F.E.R.C.), SFPP, L.P. (SFPP) submits for filing four copies of the following tariffs, effective July 1, 2005:

- F.E.R.C. Tariff No. 112 covers SFPP East Line Interstate movements (Cancels F.E.R.C. Tariff No. 105)
- F.E.R.C. Tariff No. 113 covers SFPP West Line Interstate movements (Cancels F.E.R.C. Tariff No. 106)
- F.E.R.C. Tariff No. 114 covers SFPP Oregon Line Interstate movements (Cancels F.E.R.C. Tariff No. 107)
- F.E.R.C. Tariff No. 115 covers SFPP interstate movements from Watson and East Hynes to Calnev Pipe Line, L.L.C. (Cancels F.E.R.C. Tariff No. 108)
- F.E.R.C. Tariff No. 116 covers SFPP interstate movements from Sepulveda Junction to Watson (Cancels F.E.R.C. Tariff No. 109)
- F.E.R.C. Tariff No. 117 covers SFPP North Line Interstate movements (Cancels F.E.R.C. Tariff No. 111)
- F.E.R.C. Tariff No. 118 - Index of Tariffs (Cancels F.E.R.C. Tariff No. 110)

SFPP is making this filing in compliance with 18 CFR § 342.3, to index the existing rates. All rates in the above submitted tariffs are increased from the prior tariffs. Attached is a summary table of SFPP tariff rates which includes 2004 and 2005 index ceilings, current rates and proposed rates.

In addition to the tariff rate increase, item numbers have been assigned to the Rate Tables for easier identification.

We are also enclosing herewith one additional copy of this transmittal, including all attachments, and respectfully request that it be stamped at the time of filing with the Commission's file stamp and returned for our records.

I hereby certify that copies of these tariffs have been sent via First Class U.S. Postal Service, or other means of transmission agreed upon by the subscriber, to all subscribers on the SFPP, L.P. subscriber list.

In accordance with 18 CFR § 343.3(a), SFPP hereby requests that any protest of the attached tariffs be telefaxed to SFPP in care of Peter M. Dito at (714) 560-4602.

If you have any questions regarding this filing, please contact the undersigned at (714) 560-4640.

Sincerely,

Jeffrey R Hulbert

Jeffrey R. Hulbert
Sr. Project Manager
Economics and Regulatory Analysis

cc: David Ulevich
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

F.E.R.C. No. 113
(Cancels F.E.R.C. No. 106)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) and
Colton Transmix Facility (San Bernardino County), CA
To Phoenix (Maricopa County) and Tucson (Pima County), AZ

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. 103, Supplements thereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued in compliance with 18 CFR § 342.3.

ISSUED: May 31, 2005 EFFECTIVE: July 1, 2005

Issued By:

Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:

Jeffrey R. Halbert
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4640; Fax (714) 560-4602
halbertj@kindermorgan.com

[N] Item 310. [W] Local Rates

(All movements are via SFPP, L.P. pipelines)

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	③	141.89 [I]
	Tucson, AZ (Pima County)	② ③	173.50 [I]
	Tucson, AZ (Pima County)	① ③	173.50 [I]
East Hynes, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	③ ④	141.89 [I]
	Tucson, AZ (Pima County)	② ③ ④	173.50 [I]
	Tucson, AZ (Pima County)	① ③ ④	173.50 [I]
Colton Transmix Facility, CA (San Bernardino County)	Phoenix, AZ (Maricopa County)	④	111.50 [I]
	Tucson, AZ (Pima County)	④	142.35 [I]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.

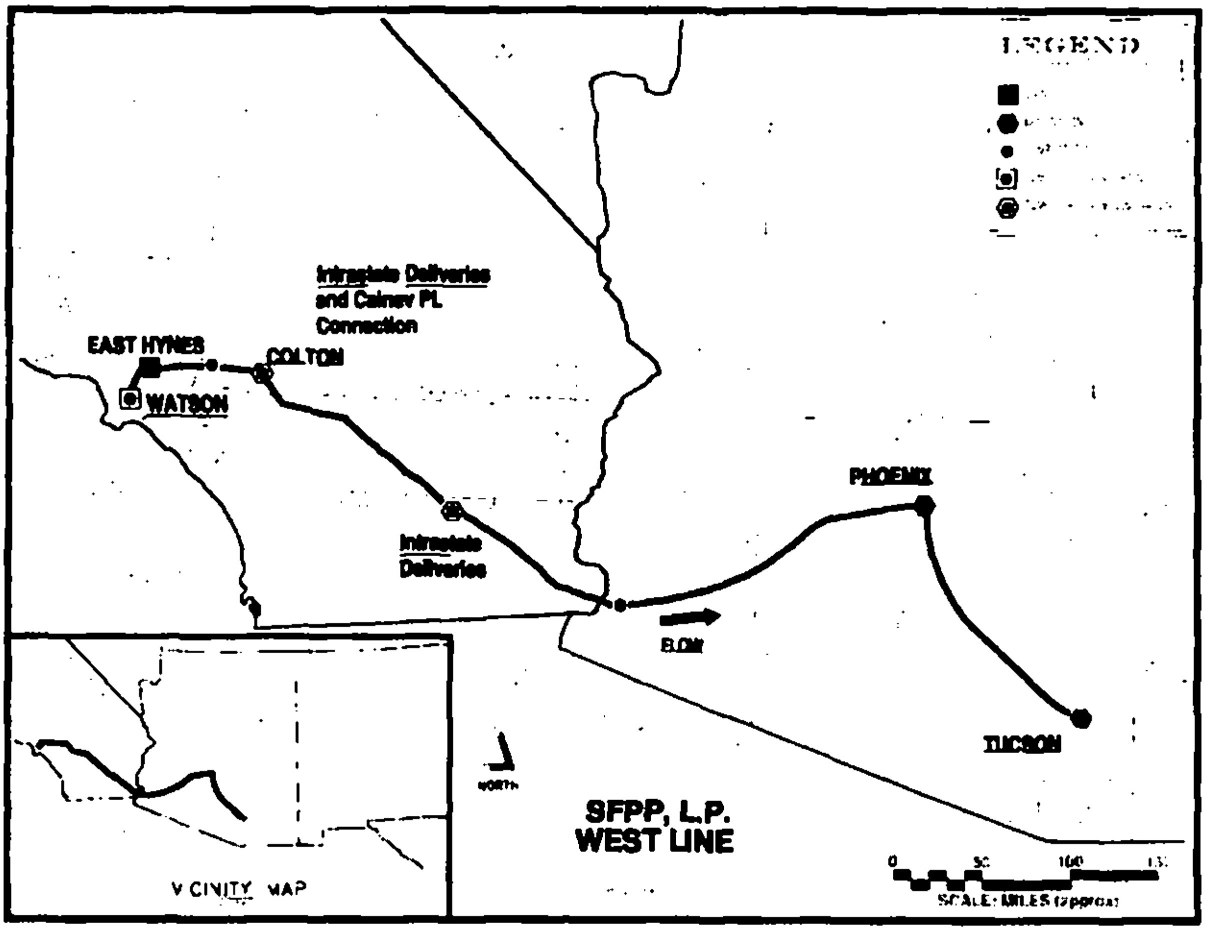
Item 40. Minimum Batch and Delivery Requirements

Minimum Batch sizes at Origin and Delivery Barrels at Destination are shown in the table below.

Origin	Destination	Minimum Batch	Minimum Delivery
Watson, East Hynes	All	10,000 Bbls	2,500 Bbls
Colton Transmix Facility	All	5,000 Bbls	2,500 Bbls

Notes:	
①	Applies to Turbine Fuel only.
②	Applies to all Petroleum Products except Turbine Fuel.
③	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
④	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks	
Reference Mark	Explanation
[I]	Increased rate.
[W]	Change in wording.
[N]	New.


LEGEND
Intrastate Deliveries and Calnev PL Connection
EAST HYNES
COLTON
WATSON
Intrastate Deliveries
PHOENIX
FLOW
TUCSON
NORTH
SFPP, L.P.
WEST LINE
VICINITY MAP
SCALE: MILES (approx)

F.E.R.C. No. 115
(Cancels F.E.R.C. No. 108)

SFPP, L.P.

LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County), CA
To Calnev Pipe Line L.L.C. (San Bernardino County), CA

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. 103, Supplements thereto and reissues thereof.

NOTICE: The provisions published herein will, *if effective*, not result in an adverse effect on the quality of the human environment.

Issued in compliance with 18 CFR § 342.3.

ISSUED: May 31, 2005 **EFFECTIVE: July 1, 2005**

Issued By:

Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:

Jeffrey R. Halbert
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4640; Fax (714) 560-4602
halbertj@kindermorgan.com

[N] Item 310. [W] Local Rates

(All movements are via SFPP, L.P. pipelines)
Applies only as a proportional rate on traffic moving beyond Colton and only to stations served by Calnev Pipe Line L.L.C in Nevada

FROM:	TO:	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Calnev Pipe Line L.L.C., Colton, CA (San Bernardino County)	①	27.64 [I]
East Hynes, CA (Los Angeles County)	Calnev Pipe Line L.L.C., Colton, CA (San Bernardino County)	① ②	27.64 [I]

Exceptions to *RULES AND REGULATIONS* Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.	
Item 40. Minimum Batch and Delivery Requirements	
40.1	The minimum quantity of any one Batch from one Shipper which will be accepted shall be 5,000 Barrels.
40.2	The minimum quantity which shall be delivered to Calnev Pipe Line L.L.C. shall be 5,000 Barrels.

Notes:	
①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[I]	Increased rate.
[W]	Change in wording.
[N]	New.

Unofficial FERC-Generated PDF of 20060310-0216 Received by FERC OSEC 03/07/2006 in Do

ORIGINAL

KINDER MORGAN
ENERGY PARTNERS, L.P.
SFPP, L.P.

SFPP, L.P.
Operating Partnership

Oil Pipeline Filing
SFPP, L.P.
March 6, 2006

Ms. Magalie R. Salas
Secretary
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

IS06-215-000

In accordance with the requirements of the Interstate Commerce Act, Rules and Regulations of the Federal Energy Regulatory Commission (F.E.R.C.), the F.E.R.C. Order on Initial Decision and on Certain Remanded Cost Issues issued December 16, 2005, in Docket No. OR92-8-000 et al., and the F.E.R.C. Order on Rehearing issued February 13, 2006, the accompanying tariffs are being submitted for filing by SFPP, L.P.:

- F.E.R.C. Tariff No. 119 (Cancels F.E.R.C. Tariff No. 112)
- F.E.R.C. Tariff No. 120 (Cancels F.E.R.C. Tariff No. 113)
- F.E.R.C. Tariff No. 121 (Cancels F.E.R.C. Tariff No. 115).

These local pipeline tariffs decrease SFPP, L.P. rates from (i) El Paso and Diamond Junction, Texas to Phoenix and Tucson, Arizona, as shown in Tariff No. 119; (ii) Watson, East Hynes, and Colton Transmix Facility, California to Phoenix, Arizona, as shown in Tariff No. 120 and (iii) Watson and East Hynes, California to Calnev Pipe Line L.L.C., California as shown in Tariff No. 121. There is a slight increase in the Tariff No. 119 rate from El Paso and Diamond Junction, Texas to Lordsburg, New Mexico.

These rate changes are in accordance with SFPP, L.P.'s filing being submitted on March 7, 2006 in compliance with the above orders.

We are also enclosing herewith one additional copy of this transmittal, including the attachments, and respectfully request that it be stamped at the time of filing with the Commission's file stamp and returned for our records.

I hereby certify that copies of this tariff have been sent via First Class U.S. Postal Service, or other means of transmission agreed upon by the subscriber, to all subscribers on the SFPP, L.P. subscriber list.

In accordance with 18 CFR § 343.3(a), SFPP hereby requests that any protest of the attached tariff be telefaxed to SFPP in care of the undersigned at (714) 560-4602.

1100 Town & Country Road Orange, California 92868 714/560-4400 714/560-4601 Fax

If you have any questions regarding this tariff filing, please contact the undersigned at (714) 560-4780.

Sincerely,

Peter M. Dito
Director, Economics and Regulatory Analysis

Enclosures

cc: David Ulevich
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

F.E.R.C. No. 120
(Cancels F.E.R.C. No. 113)

SFPP, L.P.

LOCAL PIPELINE TARIFF

**CONTAINING
RATES**

**APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) and
Colton Transmix Facility (San Bernardino County) CA
To Phoenix AZ (Maricopa County)**

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by **Rules and Regulations** provided in SFPP, L.P.'s **Tariff F.E.R.C. No. 103**, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Filed in compliance with the F.E.R.C. Order on Initial Decision and on Certain Remanded Cost Issues issued December 16, 2005 in Docket No. OR92-8-000 et al., and Order on Rehearing issued February 13, 2006.

[N] The rates contained herein for movements from Watson, East Hynes, and Colton Transmix Facility, California are being filed in accordance with the above orders. Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this compliance filing is based. Such vacation may result in the rates shown on this compliance filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.

ISSUED: March 7, 2006 **EFFECTIVE: May 1, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
[W] Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
[W] Voice (714) 560-4910; Fax (714) 560-4602
[W] Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	①	97.33[D]
East Hynes, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	① ②	97.33[D]
Colton Transmix Facility, CA (San Bernardino County)	Phoenix, AZ (Maricopa County)	②	74.36[D]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements

Minimum Batch sizes at Origin and Delivery Barrels at Destination are shown in the table below

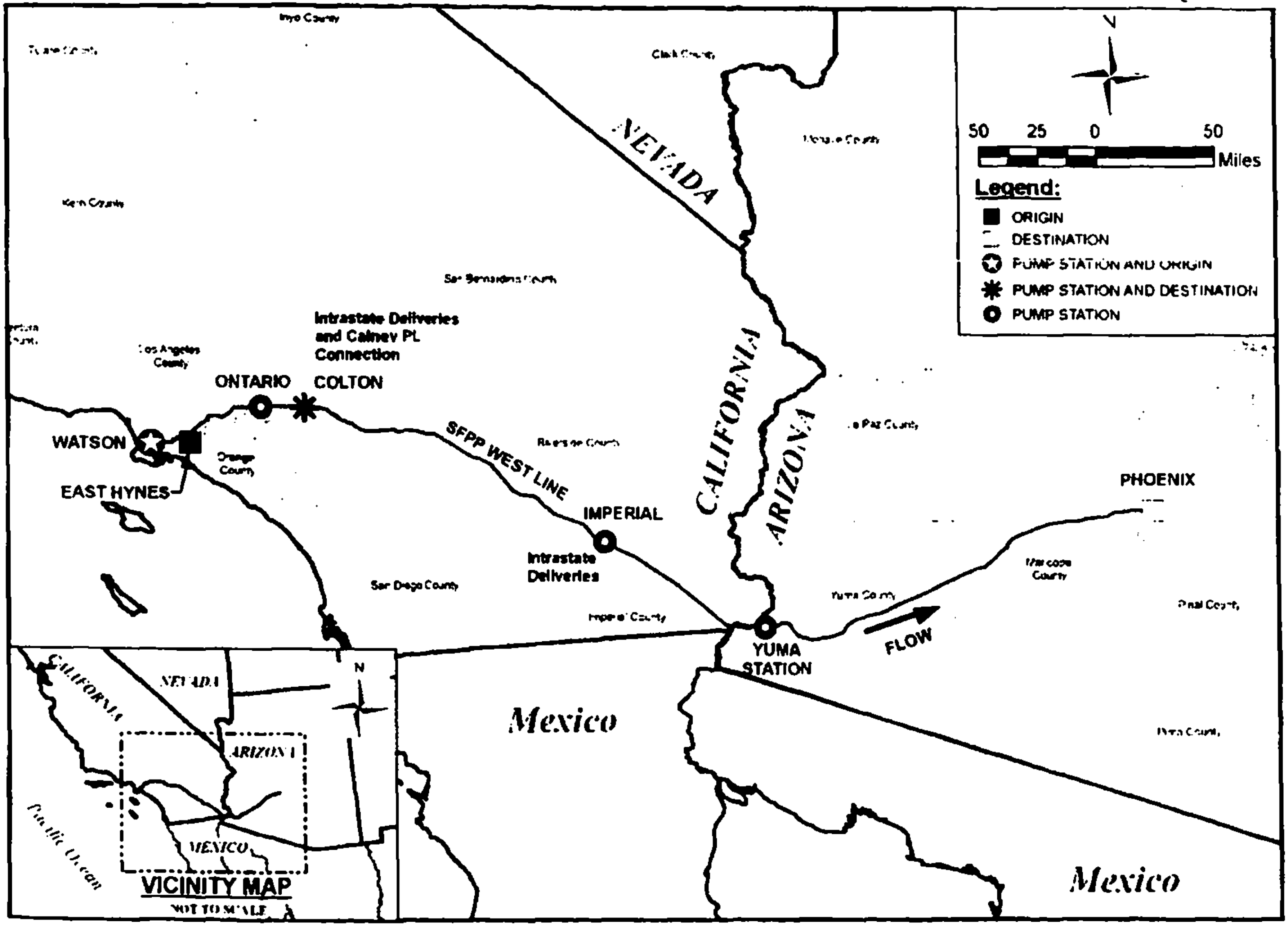
Origin	Destination	Minimum Batch	Minimum Delivery
Watson, East Hynes	Phoenix, AZ	10,000 Bbls	2,500 Bbls
Colton Transmix Facility	Phoenix, AZ	5,000 Bbls	2,500 Bbls

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[D]	Decreased rate.
[N]	New wording.
[W]	Change in wording.


Inyo County
Clark County
NEVADA
Kern County
San Bernardino County
Legend:
ORIGIN
DESTINATION
PUMP STATION AND ORIGIN
PUMP STATION AND DESTINATION
PUMP STATION
50 25 0 50
Miles
Intrastate Deliveries and Calnev PL Connection
Los Angeles County
ONTARIO
COLTON
WATSON
EAST HYNES
Orange County
SFPP WEST LINE
Riverside County
CALIFORNIA
ARIZONA
La Paz County
PHOENIX
IMPERIAL
Intrastate Deliveries
San Diego County
Imperial County
Yuma County
Maricopa County
Pinal County
YUMA STATION
FLOW
Mexico
Pima County
Mexico
CALIFORNIA
NEVADA
ARIZONA
MEXICO
Pacific Ocean
N
VICINITY MAP
NOT TO SCALE

F.E.R.C. No. 121
(Cancels F.E.R.C. No. 115)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) CA
To Calnev Pipe Line L.L.C. (San Bernardino County) CA

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by **Rules and Regulations** provided in SFPP, L.P.'s **Tariff F.E.R.C. No. 103**, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Filed in compliance with the F.E.R.C. Order on Initial Decision and on Certain Remanded Cost Issues issued December 16, 2005, in Docket No. OR92-8-000 et al., and Order on Rehearing issued February 13, 2006.

[N] The rates contained herein for movements from Watson and East Hynes, California are being filed in accordance with the above orders. Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this compliance filing is based. Such vacation may result in the rates shown on this compliance filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.

ISSUED: March 7, 2006 **EFFECTIVE: May 1, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
[W] Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
[W] Voice (714) 560-4910; Fax (714) 560-4602
[W] Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)
Applies only as a proportional rate on traffic moving beyond Colton and
Only to stations served by Calnev Pipe Line L.L.C. in Nevada

FROM:	TO:	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	①	22.97[D]
East Hynes, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	① ②	22.97[D]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements	
40.1	The minimum quantity of any one Batch from one Shipper which will be accepted shall be 5,000 Barrels.
40.2	The minimum quantity which shall be delivered to Calnev Pipe Line L.L.C. shall be 5,000 Barrels

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[D]	Decreased rate.
[N]	New wording.
[W]	Wording change.

ORIGINAL

KINDER MORGAN
ENERGY PARTNERS, L.P.

SFPP, L.P.
Operating Partnership

2006 MAY 31 P 4:38

Oil Pipeline Filing
SFPP, L.P.
May 30, 2006

IS06-356-000

Ms. Magalie R. Salas,
Secretary
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

Dear Secretary Salas:

In accordance with the requirements of the Interstate Commerce Act (ICA) and the Rules and Regulations of the Federal Energy Regulatory Commission (F.E.R.C.), SFPP, L.P. (SFPP) submits for filing four copies of the following tariffs, effective July 1, 2006:

- F.E.R.C. Tariff No. 123 covers SFPP interstate movements from Sepulveda Junction to Watson (Cancels F.E.R.C. Tariff No. 116)
- F.E.R.C. Tariff No. 124 covers SFPP interstate movements from Watson and East Hynes to Calnev Pipe Line, L.L.C. (Cancels F.E.R.C. Tariff No. 121)
- F.E.R.C. Tariff No. 125 covers SFPP East Line Interstate movements (Cancels F.E.R.C. Tariff No. 122)
- F.E.R.C. Tariff No. 126 covers SFPP West Line Interstate movements (Cancels F.E.R.C. Tariff No. 120)
- F.E.R.C. Tariff No. 127 covers SFPP North Line Interstate movements (Cancels F.E.R.C. Tariff No. 117)
- F.E.R.C. Tariff No. 128 covers SFPP Oregon Line Interstate movements (Cancels F.E.R.C. Tariff No. 114)
- F.E.R.C. Tariff No. 129 - Index of Tariffs (Cancels F.E.R.C. Tariff No. 118)

SFPP is making this filing in compliance with 18 CFR § 342.3, to index the existing rates. All rates in the above submitted tariffs are increased from the prior tariffs. Attached is a summary table of SFPP tariff rates which includes 2005 and 2006 index ceilings, current rates and proposed rates.

We are also enclosing herewith one additional copy of this transmittal, including all attachments, and respectfully request that it be stamped at the time of filing with the Commission's file stamp and returned for our records.

I hereby certify that copies of these tariffs have been sent via First Class U.S. Postal Service, or other means of transmission agreed upon by the subscriber, to all subscribers on the SFPP, L.P. subscriber list.

1100 Town & Country Road Orange, California 92868 714/560-4400 714/560-4601 Fax

In accordance with 18 CFR § 343.3(a), SFPP hereby requests that any protest of the attached tariffs be telefaxed to SFPP in care of Peter M. Dito at (714) 560-4602.

If you have any questions regarding this filing, please contact the undersigned at (714) 560-4910.

Sincerely,

Eileen Mizutani

Eileen Mizutani
Sr. Business Analyst
Economics and Regulatory Analysis

cc: David Ulevich
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

SFPP, L.P.
Tariff Schedule Changes
Issued: May 31, 2006
Effective: July 1, 2006
In compliance with 18 CFR § 342.3
(Rates are in Cents per Barrel)

Origin	Destination		Prior Ceiling: Tariff Number	Prior Ceiling: Jul-05 Ceiling	Prior Ceiling: Current Rate	Calculation of new Ceiling Rate: Tariff Number	Calculation of new Ceiling Rate: Jul-06 Ceiling	Calculation of new Ceiling Rate: New Rate
Watson Volume Deficiency Charge			FERC 103	3.61	3.20	FERC 103	3.83	3.20
Sepulveda	Watson CA		FERC 116	5.48	5.28	FERC 123	5.820	5.82
Watson CA	Phoenix AZ	[1]	FERC 120	97.33	97.33	FERC 128	103.31	103.31
East Hynes CA	Phoenix AZ	[1]	FERC 120	97.33	97.33	FERC 128	103.31	103.31
El Paso TX	Lordsburg NM	[2]	FERC 122	56.43	56.43	FERC 125	59.90	59.90
Diamond Jct TX	Lordsburg NM	[2]	FERC 122	56.43	56.43	FERC 125	59.90	59.90
El Paso TX	Tucson AZ	[2]	FERC 122	94.30	94.30	FERC 125	100.10	100.10
Diamond Jct TX	Tucson AZ	[2]	FERC 122	94.30	94.30	FERC 125	100.10	100.10
El Paso TX	Phoenix AZ	[2]	FERC 122	125.63	125.63	FERC 125	133.36	133.36
Diamond Jct TX	Phoenix AZ	[2]	FERC 122	125.63	125.63	FERC 125	133.36	133.36
Richmond CA	Reno (Sparks) NV		FERC 117	144.40	144.40	FERC 127	153.28	153.28
Concord CA	Reno (Sparks) NV		FERC 117	144.40	144.40	FERC 127	153.28	153.28
Portland OR *	Eugene OR		FERC 114	51.29	51.29	FERC 128	54.44	54.44
*Includes Willbridge & Linnton OR								
Colton CA	Phoenix AZ	[1]	FERC 120	74.36	74.36	FERC 128	78.93	78.93
Watson CA	Calnev PL, CA	[1]	FERC 121	22.97	22.97	FERC 124	24.38	24.38
East Hynes CA	Calnev PL, CA	[1]	FERC 121	22.97	22.97	FERC 124	24.38	24.38

[1] SFPP Compliance Filing dated March 7, 2006, FERC Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005 in Docket No. OR92-8-000 et al., and Order on Rehearing issued February 13, 2006.

[2] Cost of Service Rate Effective June 1, 2006

F.E.R.C. No. 124
(Cancels F.E.R.C. No. 121)

2006 MAY 31 P 4: 39

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) CA
To Calnev Pipe Line L.L.C. (San Bernardino County) CA

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. 103, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued in compliance with 18 CFR § 342.3.

The rates contained herein for movements from Watson and East Hynes, California are [W] calculated in accordance with the Commission's Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005, and Order on Rehearing, issued February 13, 2006, in Docket Nos. OR92-8-000, *et al.* Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this [W] rate filing is based. Such vacation may result in the rates shown on this [W] rate filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.

ISSUED: May 31, 2006 **EFFECTIVE: July 1, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4910; Fax (714) 560-4602
Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)
Applies only as a proportional rate on traffic moving beyond Colton and
Only to stations served by Calnev Pipe Line L.L.C. in Nevada

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	①	24.38 [I]
East Hynes, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	① ②	24.38 [I]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements	
40.1	The minimum quantity of any one Batch from one Shipper which will be accepted shall be 5,000 Barrels.
40.2	The minimum quantity which shall be delivered to Calnev Pipe Line L.L.C. shall be 5,000 Barrels

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[I]	Increased rate.
[W]	Wording change.

FILED OFFICE OF THE SECRETARY
2006 MAY 31 P 4:39

F.E.R.C. No. 126
(Cancels F.E.R.C. No. 120)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) and
Colton Transmix Facility (San Bernardino County), CA
To Phoenix (Maricopa County)

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. 183, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued in compliance with 18 CFR § 342.3.

The rates contained herein for movements from Watson and East Hynes, California are [W] calculated in accordance with the Commission's Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005, and Order on Rehearing, issued February 13, 2006, in Docket Nos. OR92-8-000, *et al.* Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this rate filing is based. Such vacation may result in the rates shown on this rate filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.

ISSUED: May 31, 2006 | **EFFECTIVE: July 1, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4910; Fax (714) 560-4602
Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	①	103.31 [I]
East Hynes, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	① ②	103.31 [I]
Colton Transmix Facility, CA (San Bernardino County)	Phoenix, AZ (Maricopa County)	②	78.93 [I]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements

Minimum Batch sizes at Origin and Delivery Barrels at Destination are shown in the table below.

Origin	Destination	Minimum Batch	Minimum Delivery
Watson, East Hynes	Phoenix, AZ	10,000 Bbls	2,500 Bbls
Colton Transmix Facility	Phoenix, AZ	5,000 Bbls	2,500 Bbls

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[I]	Increased rate.
[W]	Wording change.

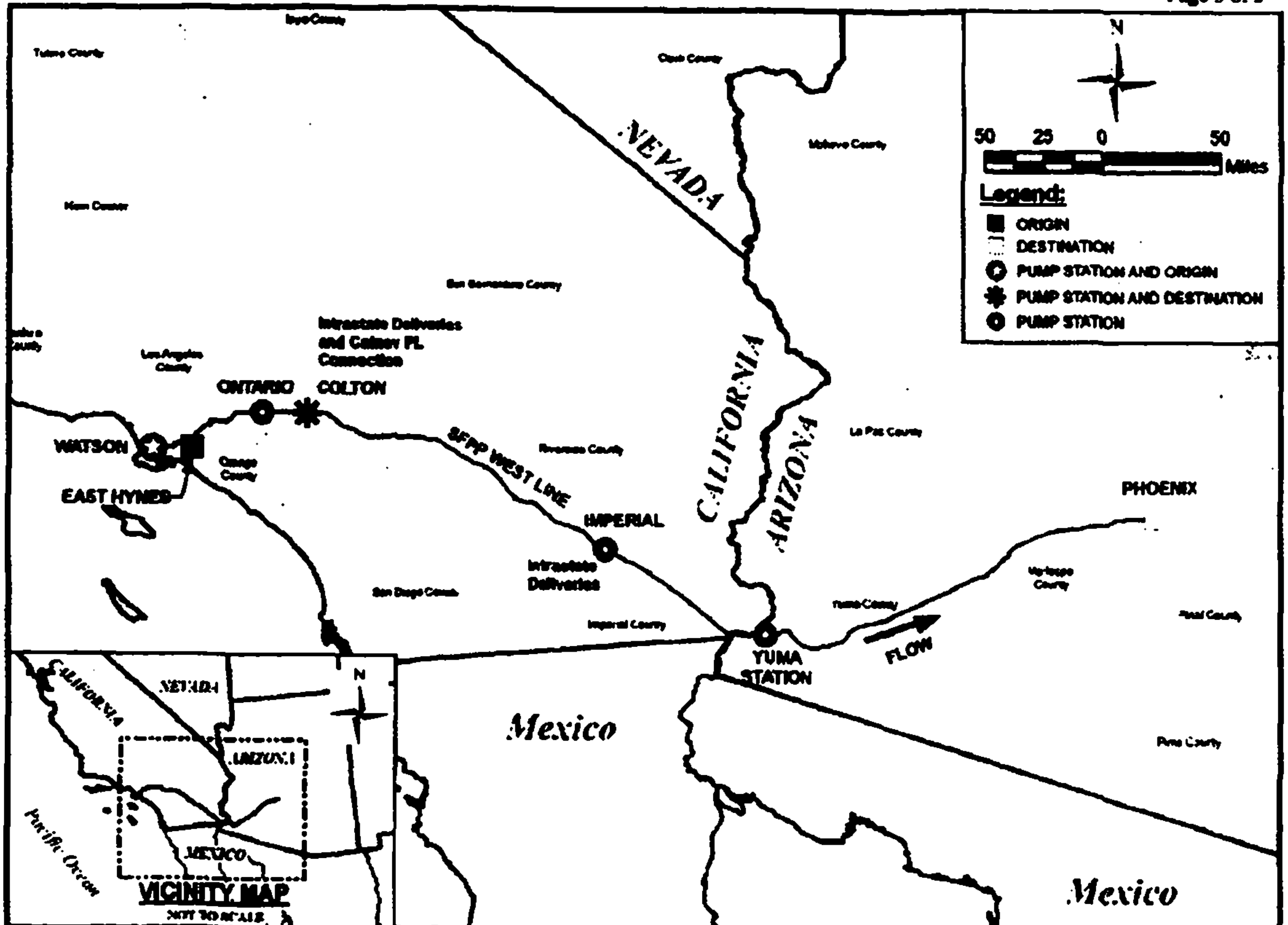


Exhibit G
Page 30 of 45

ORIGINAL

KINDER MORGAN
ENERGY PARTNERS, L.P.
SFPP L.P.

FILED
OFFICE OF THE
SECRETARY

SFPP, 2006 AUG -1 P 4:44
Operating Partnership

FEDERAL ENERGY
REGULATORY COMMISSION

Oil Pipeline Filing
SFPP, L.P.
August 1, 2006

IS06-502-000

Ms. Magalie R. Salas,
Secretary
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

Dear Secretary Salas:

In accordance with the requirements of the Interstate Commerce Act (ICA) and the Rules and Regulations of the Federal Energy Regulatory Commission (F.E.R.C.), SFPP, L.P. (SFPP) submits for filing four copies of the following tariffs, effective August 2, 2006:

- **F.E.R.C. Tariff No. 130 covers SFPP West Line Interstate movements (Cancels F.E.R.C. Tariff No. 126)**
- **F.E.R.C. Tariff No. 131 covers SFPP interstate movements from Watson and East Hynes to Calnev Pipe Line, L.L.C. (Cancels F.E.R.C. Tariff No. 124)**

In filing these tariffs, *SFPP is reinstating its West Line interstate rates grandfathered under Section 1803(a) of the Energy Policy Act of 1992 (EPAct). This reinstatement is warranted in light of the Commission's recent acknowledgment of error in its previous orders (*see SFPP, L.P.*, 106 FERC ¶ 61,300 (2004) ("March 2004 Order"); SFPP, L.P., 111 FERC ¶ 61,334 (2005) ("June 2005 Order")) removing grandfathering protection from such rates and its request for partial remand of such rulings from the U.S. Court of Appeals for the D.C. Circuit in Case No. 04-1102, *et al. See* "Brief of Respondents Federal Energy Regulatory Commission and United States of America," *ExxonMobil Oil Corp. v. FERC*, Case No. 04-1102, *et al.*, filed July 31, 2006, at pages 6 & 15.

On the basis of the March 2004 and June 2005 Orders, the Commission had directed SFPP, by its order dated December 16, 2005 in the Docket No. OR96-2,. *et al.*, proceedings to file reduced West Line rates effective May 1, 2006. With the Commission's acknowledgment of error and request for remand, the West Line rates in effect prior to May 1, 2006 are the lawful rates for the affected movements, and, pending further action by the Commission on remand as to the status of grandfathering of these rates, SFPP is entitled under EPAct to charge these rates. Therefore, SFPP is herein canceling Tariff Nos. 124 and 126 and superseding them with F.E.R.C. Tariff Nos. 130 and 131. F.E.R.C. Tariff Nos. 130 and 131 incorporate the West Line interstate rates in effect prior to May 1, 2006 under F.E.R.C. Tariff Nos. 113 and 115, which were superseded by F.E.R.C. Tariff Nos. 124 and 126, effective May 1, 2006.

Contemporaneously with this filing, SFPP is filing its Motion for Reinstatement of Lawful West Line Rates in the OR92-8, *et al.*, and OR96-2, *et al.*, proceedings.

1100 Town & Country Road Orange, California 92868 714/560-4400 714/560-4601 Fax

Since the Commission has accepted SFPP's filing to apply the Commission's index to its rates, including the West Line rates, *see SFPP, L.P.*, 115 FERC ¶ 61,388 (2006), SFPP is making this filing in compliance with 18 CFR § 342.3, to index the rates which were in effect prior May 1, 2006.

SFPP is requesting that these rates be made effective under 18 CFR § 341.14 on one day notice. SFPP requests waiver of Section 6(3) of the ICA and respectfully submits that the Commission's acknowledgment of error in its orders removing grandfathering protection from SFPP's West Line rates and, based on those orders, its direction that SFPP lower these rates effective May 1, 2006 present unusual circumstances and an emergency situation. Each day that the reduced West Line rates remain in effect SFPP is charging rates below the level deemed lawful by Congress in EPAct Section 1803(a) and forgoing lawful revenue that it is entitled to receive, recovery of which is uncertain as a practical matter and under the provisions of the ICA. Immediate reinstatement of SFPP's West Line rates at the grandfathered level will prevent further, potentially irreparable loss of revenue to the Carrier.

All rates in the above submitted tariffs are increased from the prior tariffs. Attached is a summary table of SFPP tariff rates which includes 2005 and 2006 index ceilings, current rates and proposed rates.

We are also enclosing herewith one additional copy of this transmittal, including all attachments, and respectfully request that it be stamped at the time of filing with the Commission's file stamp and returned for our records.

I hereby certify that copies of these tariffs have been sent via First Class U.S. Postal Service, or other means of transmission agreed upon by the subscriber, to all subscribers on the SFPP, L.P. subscriber list.

In accordance with 18 CFR § 343.3(a), SFPP hereby requests that any protest of the attached tariffs be telefaxed to SFPP in care of Peter M. Dito at (714) 560-4602.

If you have any questions regarding this filing, please contact the undersigned at (714) 560-4780.

Sincerely,

Peter M. Dito
Director
Economics and Regulatory Analysis

Enclosure

cc: David Ulevich
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

SFPP, L.P.
Tariff Schedule Changes
Issued: August 1, 2006
Effective: August 2, 2006
In compliance with 18 CFR § 342.3
(Rates are in Cents per Barrel)

		Prior Ceiling				Calculation of new Ceiling Rate		
Origin	Destination	Tariff Number	Jul-05 Ceiling	Current Rate		Tariff Number	Jul-06 Ceiling	New Rate
Watson CA	Phoenix AZ	FERC 126	141.89	103.31		FERC 130	150.61	150.61
East Hynes CA	Phoenix AZ	FERC 126	141.89	103.31		FERC 130	150.61	150.61
Colton CA	Phoenix AZ	FERC 126	111.50	78.93		FERC 130	118.36	118.36
Watson CA	Calnev PL, CA	FERC 124	27.64	24.38		FERC 131	29.34	29.34
East Hynes CA	Calnev PL, CA	FERC 124	27.64	24.38		FERC 131	29.34	29.34

F.E.R.C. No. 130
(Cancels F.E.R.C. No. 126)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) and
Colton Transmix Facility (San Bernardino County), CA
To Phoenix (Maricopa County)

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. 183, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued on one day's notice under authority of 18 CFR § 341.14. This tariff publication is conditionally accepted subject to refund pending a 30-day review period.

Issued in compliance with 18 CFR § 342.3.

[C] ~~The rates contained herein for movements from Watson and East Hynes, California are [W] calculated in accordance with the Commission's Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005, and Order on Rehearing, issued February 13, 2006, in Docket Nos. OR92-8-000, et al. Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this rate filing is based. Such vacation may result in the rates shown on this rate filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.~~

ISSUED: August 1, 2006 **EFFECTIVE: August 2, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4910; Fax (714) 560-4602
Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	①	150.61 [I]
East Hynes, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	① ②	150.61 [I]
Colton Transmix Facility, CA (San Bernardino County)	Phoenix, AZ (Maricopa County)	②	118.36 [I]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 103, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements

Minimum Batch sizes at Origin and Delivery Barrels at Destination are shown in the table below.

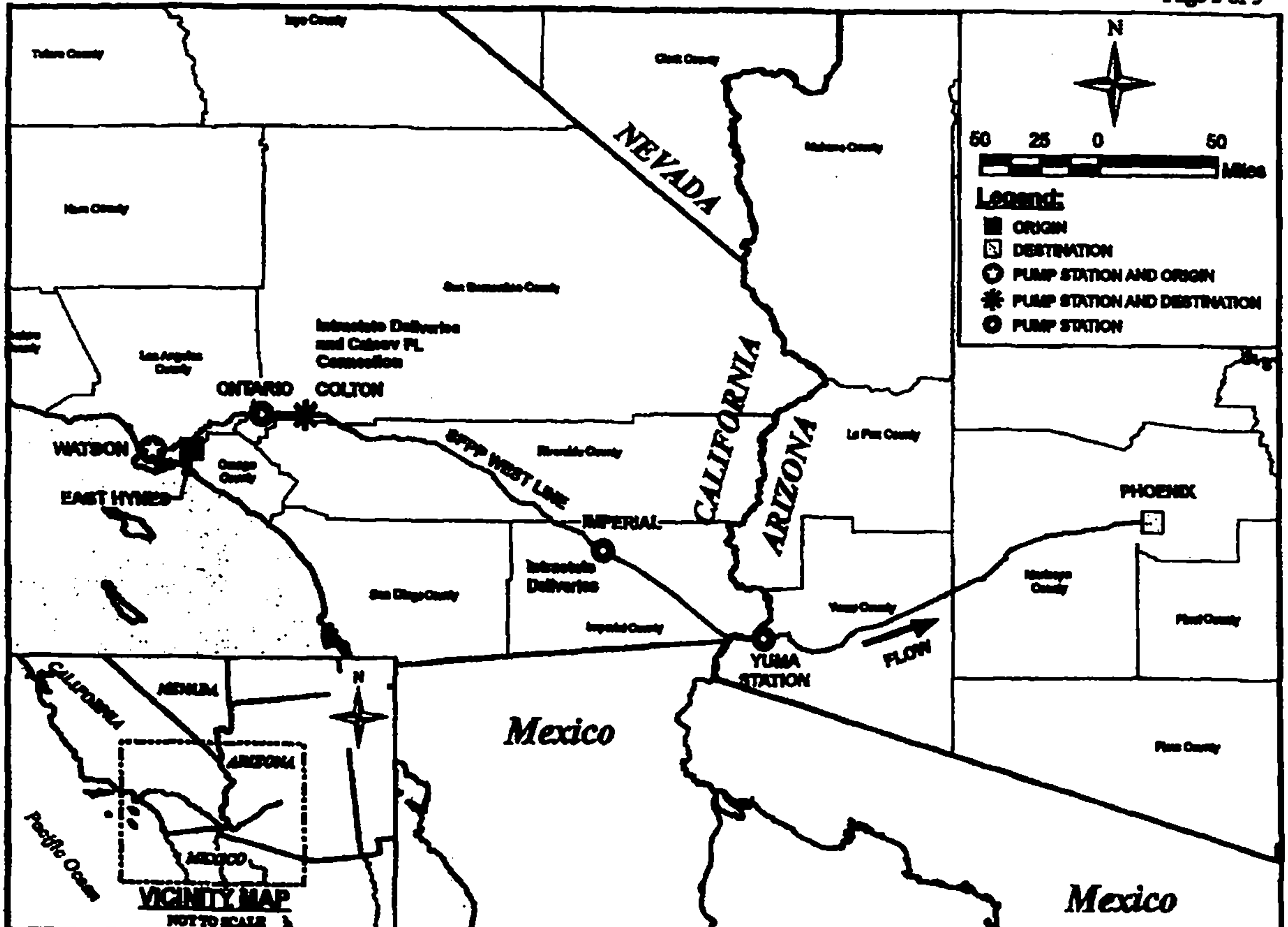
Origin	Destination	Minimum Batch	Minimum Delivery
Watson, East Hynes	Phoenix, AZ	10,000 Bbls	2,500 Bbls
Colton Transmix Facility	Phoenix, AZ	5,000 Bbls	2,500 Bbls

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[I]	Increased rate.


Inyo County
Clark County
NEVADA
N
50 25 0 50
Miles
Legend:
ORIGIN
DESTINATION
PUMP STATION AND ORIGIN
PUMP STATION AND DESTINATION
PUMP STATION
Los Angeles County
Interstate Deliveries and Calnev PL Connection
ONTARIO
COLTON
WATSON
EAST HYNES
Orange County
SFPP WEST LINE
CALIFORNIA
ARIZONA
La Paz County
PHOENIX
IMPERIAL
Interstate Deliveries
San Diego County
Maricopa County
Yuma County
YUMA STATION
FLOW
Mexico
Mexico
CALIFORNIA
ARIZONA
MEXICO
Pacific Ocean
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VICINITY MAP
NOT TO SCALE

F.E.R.C. No. 131
(Cancels F.E.R.C. No. 124)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) CA
To Calnev Pipe Line L.L.C. (San Bernardino County) CA

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

FILED
OFFICE OF THE SECRETARY
2006 AUG -1 P 4:45
FEDERAL ENERGY REGULATORY COMMISSION

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. 183, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued on one day's notice under authority of 18 CFR § 341.14. This tariff publication is conditionally accepted subject to refund pending a 30-day review period.

Issued in compliance with 18 CFR § 342.3.

[C] ~~The rates contained herein for movements from Watson and East Hynes, California are [W] calculated in accordance with the Commission's Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005, and Order on Rehearing, issued February 13, 2006, in Docket Nos. OR92-8-000, et al. Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this [W] rate filing is based. Such vacation may result in the rates shown on this [W] rate filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.~~

ISSUED: August 1, 2006 **EFFECTIVE: August 2, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4910; Fax (714) 560-4602
Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)
Applies only as a proportional rate on traffic moving beyond Colton and Only to stations served by Calnev Pipe Line L.L.C. in Nevada

FROM:	TO:	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	①	29.34 [I]
East Hynes, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	① ②	29.34 [I]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. 183, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements	
40.1	The minimum quantity of any one Batch from one Shipper which will be accepted shall be 5,000 Barrels.
40.2	The minimum quantity which shall be delivered to Calnev Pipe Line L.L.C. shall be 5,000 Barrels

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.

Explanation of Reference Marks

Reference Mark	Explanation
[I]	Increased rate.

ORIGINAL

KINDER MORGAN
ENERGY PARTNERS, L.P.
SFPP, L.P.

FILED
OFFICE OF THE SECRETARY
2006 SEP -8 P 12:36
REGULATORY COMMISSION

SFPP, L.P.
Operating Partnership

Oil Pipeline Filing
SFPP, L.P.
Docket No. IS06-508-00_

IS06-508-003

September 8, 2006

Ms. Magalie R. Salas,
Secretary
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

Dear Secretary Salas:

In accordance with the requirements of the Interstate Commerce Act (ICA) and the Rules and Regulations of the Federal Energy Regulatory Commission (F.E.R.C.), SFPP, L.P. (SFPP) submits for filing the following tariffs to be effective September 11, 2006, on 2 days notice:

- F.E.R.C. Tariff No. 139 (Cancels F.E.R.C. Tariff No. 126) covers SFPP West Line Interstate movements
- F.E.R.C. Tariff No. 140 (Cancels F.E.R.C. Tariff No. 124) covers SFPP interstate movements from Watson and East Hynes to Calnev Pipe Line, L.L.C.

SFPP is filing the above tariffs to replace FERC Nos. 134 and 136 which were withdrawn effective September 8, 2006.

The base rates in the above submitted tariffs are unchanged from FERC Nos. 124 and 126. These proposed tariffs include an Ultra-Low Sulfur Diesel (ULSD) Recovery Fee as described below, applicable only for all diesel movements, in addition to the base rate, as previously advised in the withdrawn tariffs.

This tariff establishes a means for Carrier to recover the costs necessary to comply with the regulations of the Environmental Protection Agency (EPA), contained in Title 40 CFR Part 80 Subpart 1. This surcharge is to recover costs necessary for carrier to facilitate the handling of diesel products in the ULSD environment.

The ULSD Recovery Fee will be in effect for ten years from the effective date of this filing. On an annual basis Carrier will assess the previous year's applicable actual volumes and costs and file an adjustment to the ULSD Recovery Fee as required.

Supporting documents for the ULSD Recovery Fee calculation were previously submitted in this Docket. The calculation is based on the Trended Original Cost (TOC) methodology. As ordered by the FERC in *Magellan Pipeline Company, L.P.* Docket Nos. IS06-254-000 and IS06-265-000, issued May 31, 2006 and in *Wood River Pipe Line, LLC*, Docket No. IS06-280-000 dated May 31, 2006, Carrier will seperately account for all costs and revenues related to the ULSD recover fee. Carrier will footnote the amount of dollars attributed to the surcharge invested in Carrier Plant on page 212 in the Form No. 6 and any revenues and expenses attributable to the fee on Page 700 of the Form No. 6 in its annual filing to the Commission, as well as footnote any current and accrued amounts in its quarterly reports to the Commission.

SFPP requests the waiver of the 30-day filing requirement pursuant to 18 CFR § 341.14 to file FERC Nos. 139 and 140 on 2 days notice. SFPP needs to have an ULSD Recovery Fee in place in order to recover costs necessary for SFPP to facilitate the handling of diesel products. Therefore, SFPP seeks to have the effective date of these tariffs coincide with our previously filed ULSD related tariffs, which is September 11, 2006. SFPP understands that FERC Nos. 139 and 140 are conditionally accepted subject to refund pending a 30-day review period.

We are also enclosing herewith one additional copy of this transmittal, including all attachments, and respectfully request that it be stamped at the time of filing with the Commission's file stamp and returned for our records.

I hereby certify that copies of these tariffs have been sent via First Class U.S. Postal Service, or other means of transmission agreed upon by the subscriber, to all subscribers on the SFPP, L.P. subscriber list.

In accordance with 18 CFR § 343.3(a), SFPP hereby requests that any protest of the attached tariffs be telefaxed to SFPP in care of Peter M. Dito at (714) 560-4602.

If you have any questions regarding this filing, please contact the undersigned at (714) 560-4910.

Sincerely,

Eileen Mizutani

Eileen Mizutani
Sr. Business Analyst
Economics and Regulatory Analysis

cc: David Ulevich
Federal Energy Regulatory Commission
888 First Street NE
Washington DC 20426

F.E.R.C. No. 139
(Issued in lieu of FERC No. 136, which was withdrawn)
(Cancels F.E.R.C. No. 126)

SFPP, L.P.
LOCAL PIPELINE TARIFF

**CONTAINING
RATES**

**APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) and
Colton Transmix Facility (San Bernardino County), CA
To Phoenix (Maricopa County)**

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. [W] 133, Supplements hereto and reissues thereof.

Issued on two days notice under authority of 18 CFR § 341.14. This tariff is conditionally accepted subject to refund, pending a 30 day review period.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

The rates contained herein for movements from Watson and East Hynes, California are calculated in accordance with the Commission's Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005, and Order on Rehearing, issued February 13, 2006, in Docket Nos. OR92-8-000, *et al.* Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this rate filing is based. Such vacation may result in the rates shown on this rate filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.

ISSUED: September 8, 2006 | **EFFECTIVE: September 11, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4910; Fax (714) 560-4602
Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	① [N] ③	103.31 [U]
East Hynes, CA (Los Angeles County)	Phoenix, AZ (Maricopa County)	① ② [N] ③	103.31[U]
Colton Transmix Facility, CA (San Bernardino County)	Phoenix, AZ (Maricopa County)	② [N] ③	78.93 [U]

Exceptions to RULES AND REGULATIONS

Contained in FERC No. [W] 133, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements

Minimum Batch sizes at Origin and Delivery Barrels at Destination are shown in the table below.

Origin	Destination	Minimum Batch	Minimum Delivery
Watson, East Hynes	Phoenix, AZ	10,000 Bbls	2,500 Bbls
Colton Transmix Facility	Phoenix, AZ	5,000 Bbls	2,500 Bbls

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.
[N] ③	To recover the costs of complying with the Environmental Protection Agency's (EPA's) regulation of 40 CFR Part 80 Subpart I, Carrier has established a diesel handling recovery fee for the recovery of prudently incurred costs necessary for Carrier to facilitate the handling of diesel products as defined in Carrier's Rules and Regulations Tariff, FERC No. 133, Item 265, supplements thereto and reissues thereof. The ULSD Recovery Fee is 0.75 cents per Barrel on all diesel movements.

Explanation of Reference Marks

Reference Mark	Explanation
[N]	New.
[U]	Unchanged rate.
[W]	Wording change.

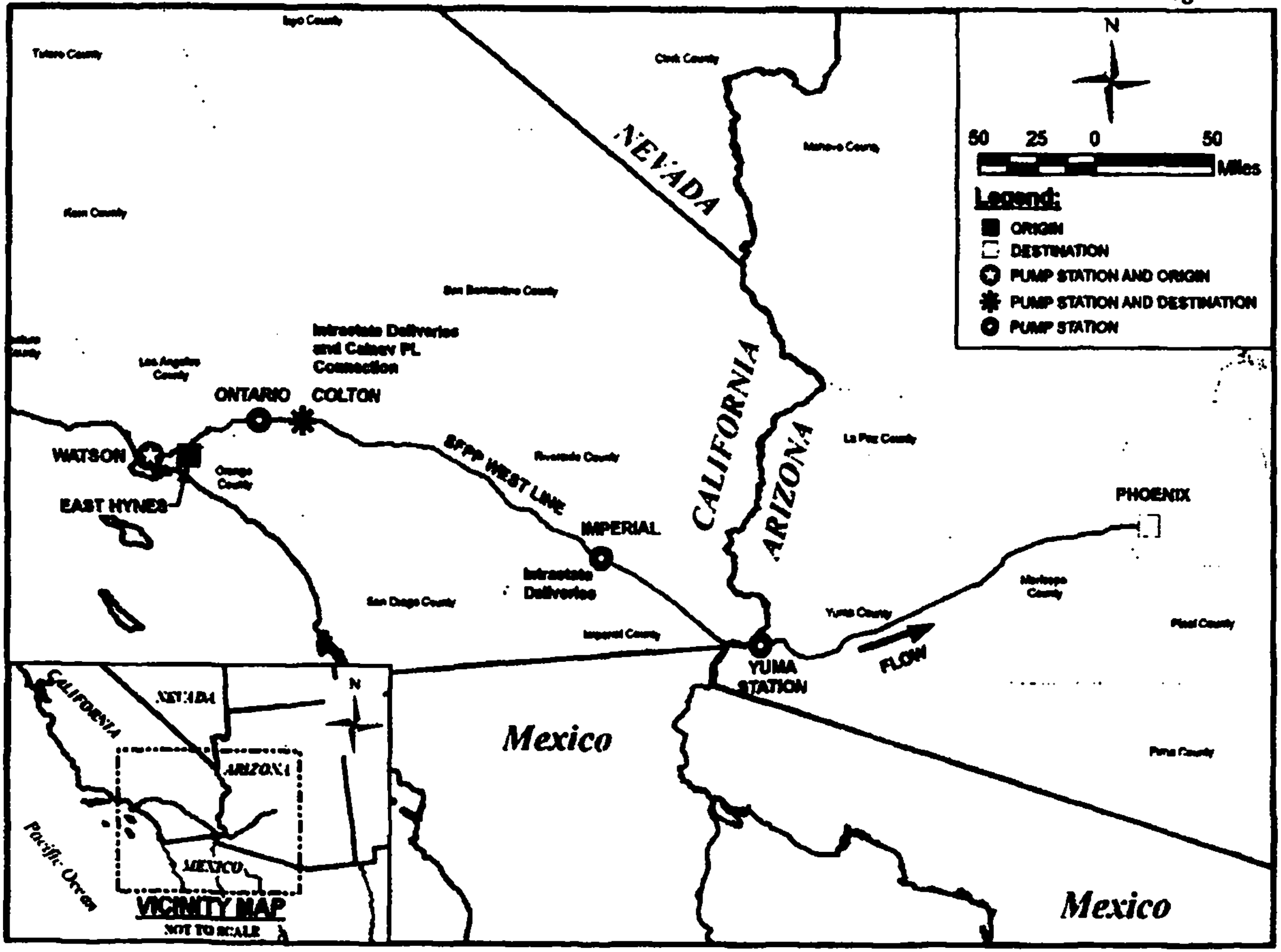

Exhibit G
Page 43 of 45

F.E.R.C. No. 140
(Issued in lieu of FERC No. 134, which was withdrawn)
(Cancels F.E.R.C. No. 124)

SFPP, L.P.
LOCAL PIPELINE TARIFF

CONTAINING
RATES

APPLYING ON THE TRANSPORTATION
OF
PETROLEUM PRODUCTS
BY PIPELINE
From Watson and East Hynes (Los Angeles County) CA
To Calnev Pipe Line L.L.C. (San Bernardino County) CA

THIS TARIFF APPLIES TO INTERSTATE TRAFFIC ONLY

Rates herein are governed by Rules and Regulations provided in SFPP, L.P.'s Tariff F.E.R.C. No. [W] 133, Supplements hereto and reissues thereof.

NOTICE: The provisions published herein will, if effective, not result in an adverse effect on the quality of the human environment.

Issued on two days notice under authority of 18 CFR § 341.14. This tariff is conditionally accepted subject to refund, pending a 30 day review period.

The rates contained herein for movements from Watson and East Hynes, California are calculated in accordance with the Commission's Order on Initial Decision and on Certain Remanded Cost Issues, issued December 16, 2005, and Order on Rehearing, issued February 13, 2006, in Docket Nos. OR92-8-000, *et al.* Judicial review or Commission rehearing of the Orders may result in the vacation of FERC findings and orders upon which this rate filing is based. Such vacation may result in the rates shown on this rate filing being lower than those SFPP will be permitted to charge in light of such vacation. SFPP accordingly reserves all of its rights and remedies with respect to this tariff, including but not limited to, the right to obtain from shippers, whether by a retroactive payment, a prospective surcharge, or other means approved by the Commission, the difference between the amounts charged hereunder and the amounts that may properly have been charged.

ISSUED: September 8, 2006 **EFFECTIVE: September 11, 2006**

Issued By:
Thomas A. Bannigan, for
SFPP, L.P.
500 Dallas St., Suite 1000
Houston TX 77002

Compiled By:
Eileen Mizutani
1100 Town & Country Road
Orange CA 92868
Voice (714) 560-4910; Fax (714) 560-4602
Eileen_Mizutani@kindermorgan.com

Item 310. Local Rates

(All movements are via SFPP, L.P. pipelines)
Applies only as a proportional rate on traffic moving beyond Colton and Only to stations served by Calnev Pipe Line L.L.C. in Nevada

FROM :	TO :	Notes	RATE In cents per barrel
Watson, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	① [N]③	24.38 [U]
East Hynes, CA (Los Angeles County)	Calnev Pipe Line L.L.C. Colton CA (San Bernardino County)	① ② [N]③	24.38 [U]

Exceptions to RULES AND REGULATIONS
Contained in FERC No. [W] 133, Item 40, including supplements thereto and reissues thereof.

Item 40. Minimum Batch and Delivery Requirements	
40.1	The minimum quantity of any one Batch from one Shipper which will be accepted shall be 5,000 Barrels.
40.2	The minimum quantity which shall be delivered to Calnev Pipe Line L.L.C. shall be 5,000 Barrels

Notes:

①	It will be the responsibility of the Shipper to deliver Petroleum Products to Carrier's Watson and East Hynes, CA Origins.
②	Item 260 "Watson Volume/Pressure Deficiency Charge" does not apply.
[N] ③	To recover the costs of complying with the Environmental Protection Agency's (EPA's) regulation of 40 CFR Part 80 Subpart 1, Carrier has established a diesel handling recovery fee for the recovery of prudently incurred costs necessary for Carrier to facilitate the handling of diesel products as defined in Carrier's Rules and Regulations Tariff, FERC No. 133, Item 265, supplements thereto and reissues thereof. The ULSD Recovery Fee is 0.75 cents per Barrel on all diesel movements.

Explanation of Reference Marks

Reference Mark	Explanation
[N]	New
[U]	Unchanged rate.
[W]	Wording change.

SWORN DECLARATION OF PETER K. ASHTON IN SUPPORT OF COMPLAINT OF TESORO REFINING AND MARKETING COMPANY AGAINST SFPP, L.P. AND MOTION FOR CONSOLIDATION WITH ON-GOING COMMISSION PROCEEDINGS AGAINST SFPP, L.P.

Pursuant to 28 U.S.C. Sec. 1746, Peter K. Ashton hereby states as follows:

1. My name is Peter K. Ashton, and I am the President of Innovation & Information Consultants, Inc. (IIC, Inc.), an economics and management consulting firm located in Concord, Massachusetts. IIC, Inc. performs applied microeconomic analysis of issues pertaining primarily to the energy industries. We have analyzed all facets of the petroleum industry including regulatory issues related to pipeline ratemaking and pipeline operations. I have filed testimony in several rate matters before FERC in which I analyzed rates and developed cost of service models and stand alone cost models. These cases include *Big West Oil Co. and Chevron Products Co. v. Anschutz Ranch East Pipeline, Inc.*, Docket No. OR01-03-000 and OR01-05-000 (consolidated); *Big West Oil Co. and Chevron Products Co. v. Frontier Pipeline Co.*, Docket No. OR01-02-000 and OR01-04-000 (consolidated); *Big West Oil, LLC, Chevron Products Company, and Tesoro Refining and Marketing Company v. Express Pipeline LLC and Platte Pipe Line Company*, Docket No. OR02-5-000; *Big West Oil, LLC, Chevron Products Company, Sinclair Oil Corporation and Tesoro Refining and Marketing Company v. Express Pipeline LLC*, Docket No. OR02-8-000; *Big West Oil, LLC, Chevron Products Company, and Tesoro Refining and Marketing Company v. Platte Pipe Line Company*, Docket No. IS02-384-000; *Sinclair Oil Corporation v. BP Pipelines (N.A.), Inc.*, Docket No. OR02-6-02; and most recently in *SFPP, L.P.*, Docket No. IS05-230-000.

2. I have also worked on and filed testimony before FERC and other regulatory bodies including the California Public Utilities Commission ("CPUC") on matters such as market-based rates, terms of access, and the need for quality banks. I have also testified on issues relating to pipeline operations and functions in *The People of the State of California, et al. v. Chevron Corp., et al.*

3. I have assisted various shippers in other matters before FERC, including the Commission's review and analysis of the Form 6 reporting requirements (*Revision to and Electronic Filing of the FERC Form 6 and Related Uniform Systems of Accounts,* Docket No. RM99-10-000) and the five-year review of the rate indexation rules (*Five Year Review of Oil Pipeline Pricing Index*, Docket No. RM00-11-000 and Docket No. RM05-22-000). In addition, I have been retained in several matters before regulatory agencies to develop and analyze cost allocation methodologies for various transportation companies and regulated utilities. Attachment 1 to my declaration is a copy of my curriculum vitae, which provides more information on my qualifications.

4. I have been asked by counsel for Tesoro Refining and Marketing Company (Tesoro) to develop a cost of service analysis and the maximum rates that SFPP could lawfully charge for interstate service on its West Line and Calnev Line for the period December 2004 to November 2006.[1] To do so I have relied on the Compliance Filing made by SFPP in March 2006.[2] In this Compliance Filing, SFPP calculated cost of service rates for the West Line for the year 1999 and indexed those 1999 rates for each subsequent

[1] Although SFPP files separate tariffs for its West Line and Calnev Line rates, both the Commission and the Court of Appeals consider the Calnev Line to be part of the West Line. Therefore, unless otherwise noted, I will use the term West Line to refer to both the West Line and the Calnev Line.

[2] SFPP, L.P. Compliance Filing, Docket Nos. OR 92-8-024, et al. (March 7, 2006).

year pursuant to the Commission's *Order on Initial Decision and On Certain Remanded Cost Issues* ("December 16 Order").[3] SFPP filed its Compliance Filing after the Commission had ruled that SFPP must change its rates to reflect its real costs. Accordingly, SFPP's rates in the Compliance Filing can be used as more representative of SFPP's actual costs than the rates that SFPP charged in its tariffs. I have computed the reparations that Tesoro would be owed if the rates found in the Compliance Filing were accepted by the Commission for the period December 2004 and November 2006.

5. In my review and analysis of the Compliance Filing, I have noted several adjustments that I believe are necessary to bring the cost of service analysis in line with prior Commission precedent. These adjustments to the West Line cost of service are consistent with rulings of both the Commission and the United States Court of Appeals for the District of Columbia Circuit. After making these adjustments, I have computed new rates for the West Line. Based on these "adjusted" rates, I then made a second computation of the reparations that SFPP owes Tesoro for its shipments on the West Line between December 2004 and November 2006. The first calculation indicates that using the Compliance Filing that SFPP made with the Commission in March 2006, Tesoro is owed at least $1,607,991. After making adjustments to the SFPP Compliance Filing to reflect the decisions of the Commission and the Court of Appeals, I determined that SFPP owes Tesoro at least $2,325,372 in reparations for the period December 2004 to November 2006. In the remainder of this declaration, I first discuss the adjustments I have made to SFPP's Compliance Filing cost of service. I then discuss the two separate sets of reparation calculations.

[3] *Order on Initial Decision and On Certain Remanded Cost Issues*, 113 FERC ¶61,277 (hereafter "December 16 Order"), at P 2.

Revisions to the Cost of Service Analysis Contained in SFPP's Compliance Filing

6. As noted above, as a starting point for analyzing SFPP's cost of service on the West Line, I have relied on the Compliance Filing made by SFPP in March 2006. In this Compliance Filing, SFPP calculated cost of service rates for the year 1999 and indexed the rates for each subsequent year pursuant to the Commission's December 16 Order.

7. As I stated above, although the SFPP Compliance Filing is more reflective of the actual costs that SFPP incurred than the rates it originally filed with the Commission, I found it necessary to make several adjustments to the Compliance Filing in order to comply with rulings of the Commission and the Court of Appeals. The first and most significant of these adjustments relates to the income tax allowance that SFPP took in its Compliance Filing. Consistent with the decision of the United States Court of Appeals for the District of Columbia in *BP West Coast Products*[4] as well as Administrative Law Judge H. Peter Young's Initial Decision in Docket No. IS05-230,[5] SFPP is not entitled to any income tax allowance. Both the court and Judge Young have held that as a matter of law, SFPP is not entitled to an allowance for income taxes in its cost of service. Yet, in the Compliance Filing, SFPP computed an income tax allowance for the West Line of approximately $6.5 million. I have removed this income tax allowance as my first adjustment to SFPP's West Line cost of service.

8. The second adjustment I made was to SFPP's rate of return computation in the Compliance Filing. In the December 16 Order, the Commission directed SFPP to use the actual capital structure of SFPP for 1999 after deducting so-called purchase accounting

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[4] *BP West Coast Products LLC v. FERC*, 374 F. 3d 1263 (D.C. Circ. 2004).

[5] Initial Decision, SFPP, L.P., 116 FERC ¶ 63,059 (September 25, 2006).

adjustments (PAAs).[6] There is some discussion in the Commission's Order as to the amount of the PAA to be deducted, and SFPP was directed to develop a second set of books for SFPP for 1998 and 1999 indicating the computation of capital structure based on certain source material. SFPP has not provided either the source material or the second set of books. I therefore have not yet had the opportunity to examine this material. However, I would note that the capital structure that SFPP has computed for 1999 is 50.92% debt and 49.08% equity. This capital structure is different from the capital structure that Ultramar, Inc. witness Matthew O'Loughlin testified was appropriate. Moreover, in the December 16 Order the Commission cited with approval Mr. O'Loughlin's calculation of SFPP's capital structure as consisting of 53.43% debt and 46.57% equity.[7] Since SFPP's Compliance Filing erred in its interpretation of the Commission's Order, I have substituted the capital structure proffered by witness O'Loughlin and cited with approval by the Commission. This adjustment would reduce the rate of return SFPP used in its Compliance Filing and therefore the cost of service by approximately $150,000.

9. There are other elements of the rate of return that SFPP used in its Compliance Filing with which I do not necessarily agree, such as the rate of return on equity. However at this point I do not have sufficient data from the Compliance Filing to make further adjustments. As noted below, I believe that this means that the adjusted rates I have

[6] A purchase accounting adjustment (PAA) reflects the write-up of a company's equity portion of its rate base. For example, when KMEP acquired SFPP in 1998, SFPP wrote up the equity portion of its rate base to reflect the premium over the regulatory return that KMEP paid to acquire SFPP. The result was a write-up in both the carrier property and equity component of SFPP's balance sheet. This write-up overly inflates the equity portion of the capital structure.

[7] See December 16 Order at P 64. The Commission cites to other possible capital structures resulting from the removal of the purchase accounting adjustments, each of which would lead to lower rates of return.

computed should in fact be even lower once all data and information have been obtained to properly compute the rate of return.

10. The third adjustment I made to the SFPP Compliance Filing relates to the appropriate method for allocating overhead costs to SFPP's West Line. The December 16 Order directs SFPP to recompute the allocation of KMEP's overhead costs based on a single tier Massachusetts Method that includes all KMEP entities. SFPP had previously excluded certain KMEP entities including Plantation Pipeline, Red Lightening, Trailblazer, and Kinder Morgan Interstate Gas, among others, from its overhead cost allocation.[8] In its Compliance Filing, SFPP did include Red Lightening. However, the SFPP Compliance Filing continues to exclude Plantation, Trailblazer and Kinder Morgan Gas. It is also unclear whether there may be other entities that should be included by SFPP and were not. I would expect that the impact of adding these entities into the Massachusetts Method formula would be fairly significant since two companies, Kinder Morgan Gas and Plantation, are large entities. In the Compliance Filing, 53.25% of KMEP's corporate overhead is allocated to SFPP. A reduction of that percentage amount by only 3.25 percentage points to 50% would reduce the amount of overhead costs allocated to the West Line by $363,000. Of course, the inclusion of all SFPP affiliated entities in the application of the Massachusetts formula would undoubtedly reduce the overhead amount allocated to the West Line by an even greater amount. However, I do not have the data at this point to make this computation. Therefore, I have reduced the operating expenses portion of the cost of service by only $363,000 to reflect this adjustment to the allocation of overhead expense.

[8] See December 16 Order at P 85.

11. These three adjustments reduced the Compliance Filing cost of service for the West Line by approximately $7 million as shown below in Table 1. As I indicated above, we do not have access at this point to all of the data that underlies the SFPP Compliance Filing. After we have obtained that data in discovery from SFPP, it is very likely that the adjusted cost of service for the West Line will be even lower than calculated in Table 1.

Table 1
Revised Cost of Service for West Line
(000)

	Compliance Filing		Adjusted	
Return on Rate Base	$	15,722	$	15,579
Income Tax Allowance	$	6,454	$	-
Operating Expenses	$	17,353	$	16,990
Depreciation	$	4,713	$	4,713
Amortization of AFUDC	$	63	$	63
Amortization of Deferred Return	$	731	$	731
TOTAL	$	45,036	$	38,076

Computation of Rates

12. The next step in my analysis of SFPP's cost of service was to take the adjusted cost of service of $38.076 million for the West Line and develop adjusted rates. In doing so, I followed the same methodology SFPP used in its Compliance Filing.[9] Rates are based on a fully allocated cost methodology in which the cost of service is divided into distance and non-distance factors. I used my adjusted cost of service data in developing these allocation factors and then developed total rates for each of the five destination points on the West Line.[10] These 1999 rates are shown below in Table 2.

[9] See Schedule 26 of "Part 3: 1999 Cost of Service and Tariff Support" of March 6, 2006 Compliance Filing.

[10] These destination points include Phoenix, Tuscon, Calnev, Luke AFB, and Yuma MCAS.

Table 2
1999 Adjusted Cost of Service Rates on the West Line

	1999 Rate
Phoenix	$ 0.7269
Tuscon	$ 0.9383
Calnev	$ 0.1802
Luke AFB	$ 0.7269
Yuma MCAS	$ 0.4865

13. Since the Compliance Filing represents a cost of service and rates for 1999, I followed the procedure used by SFPP to develop rates for the period 2004-2006. I took the 1999 rates and indexed them forward using the Commission's accepted indexation formula. The rates for 2004-2006 are shown in Table 3.

Table 3
Adjusted Cost of Service Rates on the West Line: 2004-2006

Rates as July 2004:	
Phoenix	$ 0.7891
Tuscon	$ 1.0186
Calnev	$ 0.1956
Luke AFB	$ 0.7891
Yuma MCAS	$ 0.5281
Rates as of July 2005	
Phoenix	$ 0.8178
Tuscon	$ 1.0556
Calnev	$ 0.2027
Luke AFB	$ 0.8178
Yuma MCAS	$ 0.5473
Rates as of July 2006	
Phoenix	$ 0.8681
Tuscon	NA
Calnev	$ 0.2151
Luke AFB	$ 0.8681
Yuma MCAS	$ 0.5809

14. There is another adjustment that must be made to the rate for transmix, originating at Colton. There is no reference to this rate in the SFPP Compliance Filings, but rates were

listed in SFPP's tariff for this service and it is my understanding that Tesoro did ship a relatively small volume under this tariff. I have adjusted this rate by the same percentage amount that the other rates in the Compliance Filing were reduced. That percentage reduction is approximately 19 percent.

Reparations

15. The results of my cost of service analyses indicate that SFPP has significantly overcharged Tesoro for the petroleum products that Tesoro has shipped on the SFPP West Line. I have computed reparations, including interest, which Tesoro is entitled to receive as compensation for the illegal charges levied on it by SFPP for interstate shipments between December 2004 and November 2006.

16. I have made four sets of computations. Table 4, which I have included as an attachment to my declaration, states the reparations SFPP owes Tesoro for West Line (Phoenix) shipments under the rates found in the Compliance Filing for the period December 2004 to November 2006. Table 5 states the reparations SFPP owes Tesoro for West Line (Phoenix) shipments on the basis of the revised cost of service that I calculated using SFPP's Compliance Filing and making appropriate adjustments to it. Table 6, which I have also included as an attachment to my declaration, states the reparations SFPP owes Tesoro for Calnev shipments under the rates stated in the Compliance Filing for the period December 2004 to November 2006. Table 7 indicates the reparations SFPP owes Tesoro for Calnev shipments on the basis of my adjustments to the SFPP Compliance Filing.

17. In computing reparations, I have been provided with the actual rates charged Tesoro under the applicable SFPP tariffs over the course of the reparations period. These rates

are shown in Column B in Tables 4 through 7. Column C states the rate that should have been in effect, either using the Compliance Filing rates, or my revised cost of service rates. The monthly overcharge margin, Column D, is the difference between the SFPP tariff as implemented and the maximum just and reasonable rate that should have been allowed.

18. I was also provided the monthly Tesoro West Line volumes shipped under the applicable SFPP actual tariffs. These data are shown in Column E in Tables 4 through 7. The monthly reparations amount excluding interest, shown in Column F, is calculated by multiplying the monthly overcharge margin (Column D) by the monthly volume (Column E) shipped. I understand that Tesoro is continuing to review its records over the past two years. If that review leads to the conclusion that Tesoro shipped additional products over the SFPP West Line, I expect to submit a supplemental analysis of the reparations that SFPP owes Tesoro.

19. In May 2006, Tesoro shipped a small quantity of petroleum products under SFPP's Colton tariff rate, in addition to the shipments I have previously discussed on the SFPP Phoenix West Line tariff. I therefore computed the reparations for each rate separately for May 2006. These computations are contained in the Note section below the main table results in Tables 4 and 5. I subsequently aggregated the monthly reparations amounts for May 2006, and included these results in the body of the table.

20. In September and October 2006, the SFPP changed its tariff for the West Line in the middle of the month. Tesoro's records indicate the particular SFPP tariffs under which shipments were made during this period. I was therefore able to base my determination of reparations on the actual tariffs under which Tesoro's shipments were made.

21. With respect to the Calnev Line, I was not able to determine with precision the actual SFPP tariffs under which Tesoro shipped petroleum products in September and October 2006. I therefore determined the period of time that each SFPP tariff was in effect during the month. I then prorated Tesoro's shipments accordingly. These computations are stated in the Note section below the main table results in Tables 6 and 7. I subsequently aggregated the monthly reparations amounts for September and October 2006, and included these results in the body of the table.

22. In calculating the interest that Tesoro is owed, I used the average prime rate for each calendar quarter, in accordance with established Commission precedent.[11] The average prime rate is determined by taking the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin, or in the Federal Reserve's "Selected Interest Rates" (Statistical Release H.15) for the most recent three months preceding the calendar quarter.[12] Therefore, the monthly interest rate to be applied to the reparations represents the monthly average of the average prime rate for the preceding calendar quarter. The monthly interest rates I used are shown in Column G of the attached tables.[13]

23. I calculated the monthly interest, shown in Column K, based on the assumption that payments made for the prior month's shipments occur mid-month in the following month. For example, the transportation charges associated with shipments in June would be paid on the 15th of July. Consequently, the interest does not begin accruing until the

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[11] *SFPP, L.P.*, Opin. No 435-A, 91 FERC ¶ 61, 135 at p. 61, 516.
[12] 18 C.F.R. § 340.1(c)(2)(i) 2006. The regulations state the interest rate shall be taken from the Federal Reserve's Statistical Release G.13. However, this release was discontinued by the Federal Reserve in 2002, but all applicable rates, including the bank prime rate, are available in Release H.15.
[13] The monthly rate is simply the quarterly rate divided by 3.

transportation charges are assumed to have been paid, and lag by half a month from the end of month reparations amount.

24. In conformance with Commission regulations, I also computed interest on a compound quarterly basis,[14] and included the quarterly amounts in Column L. The final reparations due, including interest, represent the end of month reparations for November 2006, plus the monthly interest accrued in the first two months of the fourth quarter of 2006. Damages, including interest, using the rates listed in the Compliance Filing total $1,607,991.47. Damages, including interest, using the rates determined on the basis of my revised cost of service total $2,325,372.69. These amounts are shown in Tables 3 through 6, and are summarized in the following table:

	Adjusted Tariff Rate	Reparations Excluding Interest	Interest	Total Reparations
West Line	Compliance Filing Rates	$1,400,181.38	$120,603.98	**$1,520,785.36**
	Revised CoS Rates	$2,015,145.07	$165,219.74	**$2,180,364.82**
Calnev Line	Compliance Filing Rates	$80,203.28	$7,002.83	**$87,206.11**
	Revised Cos Rates	$133,836.55	$11,171.33	**$145,007.87**
Total Damages	Compliance Filing Rates			**$1,607,991.47**
	Revised Cos Rates			**$2,325,372.69**

[14] 18 C.F.R. § 340.1(c)(2)(ii).

I, Peter K. Ashton, hereby state under penalty of perjury that the foregoing is true and correct to the best of my information and belief.

Executed on December 11, 2006.

Peter K. Ashton

Attachment 1

Peter K. Ashton

Peter K. Ashton is a founder of Innovation & Information Consultants, Inc. and serves as its president. Prior to founding Innovation & Information Consultants, Inc., Mr. Ashton was a senior consultant with Putnam, Hayes & Bartlett, Inc. and Charles River Associates Incorporated. He has directed major consulting projects for private clients as well as in the public sector. Mr. Ashton's primary fields of expertise are antitrust and regulatory analyses, valuation of intellectual property, energy economics, and labor market studies. A sample of Mr. Ashton's recent work includes the following:

Expert Testimony and Litigation Support

- Reviewed and analyzed the rates filed by various pipeline companies in several matters before FERC. He has analyzed the cost of service computations of these companies, evaluated rates in comparison with competing carriers, and assessed the impact that rates have on shippers. He has evaluated the market and business environment of pipelines to ascertain the relative riskiness in which such pipelines operate and he has developed financial measures relating to the operating performance of such pipelines. He has employed the Commission's DCF methodology to develop estimates of the required return on equity, evaluated issues related to capital structure, operating expenses and the income tax allowance under 154-B ratemaking principles. Further, he has developed fully-allocated cost procedures for multi-origin/destination pipelines to permit rate analysis along individual origin/destination points.

- Mr. Ashton prepared an expert report and testified regarding the value of crude oil produced in the Gulf of Mexico, and evaluated the cost of transporting this crude oil to onshore marketing points. He evaluated the prices reported by producers of crude oil in this area, and reviewed various transactions relating to this crude oil to determine the market value of this crude oil.

- Mr. Ashton prepared an expert report and testimony on the market value of crude oil produced on federal lands in the United States over the period 1988-1998. He compiled a large database of crude oil transactions that formed the basis for the computation of the arm's length prices for crude oils produced in the Louisiana Gulf, Texas, the Rocky Mountain area and the West Coast. As part of the work he analyzed rates on various crude oil pipelines in each of the affected regions.

- Mr. Ashton provided expert analysis relating to the pricing of gasoline in California and other West Coast markets. He performed various analyses of the relevant markets, pricing trends, reviewed relevant company and third party documents, and assisted counsel in development of the theory of the case. He also assisted other experts in analysis of price and supply data. More recently, Mr. Ashton has analyzed the pricing of gasoline is the states of Florida and Massachusetts, as well as the Midwest area.

- He has prepared expert reports and testified on numerous occasions in cases involving the computation of lost earnings, lost profits, and other economic losses associated with wrongful death, personal injury and breach of contract claims. Mr. Ashton has also developed various models of earnings capacity in different professions and has performed studies of comparative earnings growth in a variety of professions.

- Mr. Ashton provided expert testimony defining the relevant product and geographic markets for window shade products and also analyzed claims that a distributor and retailer of such products had been charged anticompetitive prices and had been unfairly harmed as a result of violations of California's state antitrust laws. He also developed damage estimates to indicate the dollar value of the harm suffered by the retailer/distributor.

- He provided expert testimony on the damages suffered by the owner of a marina as a result of a gasoline spill. Mr. Ashton's testimony focused on various economic losses including lost profits, loss of goodwill and business interruption losses as well as the general economic conditions facing relevant marina owners at that time.

- Prepared expert testimony before the Maine Public Utilities Commission regarding the ability of a regulated transportation company to set predatory (below-cost) rates in an unregulated business through cross-subsidization. Analyzed the extent to which the regulated utility had market power in the unregulated industry and whether its decision to add additional capacity in the regulated industry would allow it to unfairly expand its business in the unregulated sector.

- Prepared expert testimony before FERC and the California Public Utilities Commission on the filings of several newly-regulated common carrier pipeline companies in California. Mr. Ashton assessed the degree to which the pipeline companies may have been able to exercise market power in setting their rates and compared the carriers' rates to the rates of existing alternative non-regulated carriers and other modes of transportation. Analyzed the rates and critiqued the rate-making methods used by the various pipeline companies.

- Mr. Ashton analyzed the structure and behavior of several major oil companies in the West Coast petroleum industry, focusing on pricing behavior and alleged anticompetitive activities in the crude oil production and refining segments of the business. Mr. Ashton has assessed the degree to which control of the transportation system by the majors has influenced crude oil pricing behavior in this market area. Mr. Ashton has also examined the crude pricing behavior of various refiners, traders, and others during the 1970s, 1980s and 1990s to assess whether posted prices reflected market value and the role played by spot prices in determining market value. He has also prepared expert analyses regarding the structure of pipeline markets in California and their effect on pricing and on the trend in spot prices.

Public Policy and Tax Issues

- Mr. Ashton has performed a detailed analysis of the impacts of deepwater royalty relief on leasing, exploration and production in the Gulf of Mexico. This study involved the use of econometric models of MMS leasing behavior that analyzed the impacts of competition, royalty relief, changes in technology, movements in oil and gas prices and numerous other factors on lease bonus bids and the number of leases sold. Mr. Ashton also projected future impacts of various royalty relief scenarios on royalty and lease bonus revenue as well as impacts on future exploration, development and production of oil and gas resources in the Gulf of Mexico.

- For the U.S. Small Business Administration, Mr. Ashton directed a study that examined the differential impact of the trend toward electronic commerce and procurement by the federal government. The study concluded that small firms generally are less effective in taking advantage of e-business and e-procurement tools, although small firms are making improvements in their ability to attract business via the web.

- Mr. Ashton is currently analyzing various cost sharing agreements in the pharmaceutical and medical products industries and associated buy-in and buy-out payments for the transfer of intellectual property related to these agreements. Mr. Ashton is valuing the intangible property under these agreements and estimating the reasonably anticipated benefits accruing from such intangibles. He has computed running royalty payments and lump sum payments as compensation for the buy-in and buy-out payments. Mr. Ashton is also reviewing and analyzing the expert reports provided by others on these issues.

- Mr. Ashton directed a study to develop a comprehensive model of the exploration, development and production process of oil and gas resources in the Gulf of Mexico for the Minerals Management Service (MMS). He has developed the economic module that models decision-making behavior with regard to the decision to bring on new resources and determine when it is economic to begin producing from these fields.

- Mr. Ashton completed an expert report valuing various intangible assets transferred by a domestic parent to various foreign corporations for purposes of developing an appropriate arm's length royalty rate consistent with the Section 482 transfer pricing regulations. He examined the relative profitability contributed by these intangible assets domestically and also applied a CPM approach to the application of the intangibles in various foreign markets. He also reviewed and assessed the Section 6662 transfer pricing report of the taxpayer.

- He directed a major study of the transfer pricing program of a major Fortune 500 company and developed alternative benchmarks for determining appropriate transfer prices consistent with Section 482 of the Internal Revenue code. He also analyzed various cost sharing agreements maintained by the company for the allocation of R&D expenses, and the provision of various services provided to foreign subsidiaries.

- He analyzed the fair market value of the worldwide assets of a major multinational company for purposes of determining an appropriate method and basis for allocating interest expense under Section 861 of the IRS regulations. Mr. Ashton has provided expert advice on this issue in several matters, pointing out the need for consistency with the relevant regulations and use of appropriate valuation methods.

- Analyzed the extent to which certain insurance companies were able to pass on an unconstitutional tax to their customers. Mr. Ashton assessed potential market share impacts and the regulatory framework that permitted cost-plus pricing to determine the extent of pass-on. He also utilized tax incidence analysis and econometric studies to derive preliminary estimates of the extent of passthrough of the tax.

- Prepared expert analyses computing an arm's length royalty consistent with Section 482 of the IRS regulations for various intangible assets transferred under a licensing agreement between a domestic parent and a foreign subsidiary. The work involved estimating the value of the technology being transferred and determination of an appropriate royalty rate.

- Analyzed the impact of various tax expenditure programs on small and large firms. Mr. Ashton utilized detailed data from the Treasury to assess the impact on effective tax rates of various programs such as foreign tax credits, low income housing credit, accelerated depreciation, and the business means and entertainment tax deduction.

- Mr. Ashton has analyzed the value of various petroleum companies' upstream oil and gas reserves utilizing a conventional discounted cash flow (DCF) method. As part of this work he has assessed future price forecasts, operating costs, capital costs and abandonment costs of various reserves in a variety of locations throughout the world.

Business Strategy Studies

- For an oil producer, Mr. Ashton evaluated a proposed sliding scale royalty agreement that was pegged to future oil prices. Mr. Ashton analyzed the most likely royalty payment under the proposed scheme given information on projections of crude oil prices, inflation and production costs over the next ten years. He analyzed alternatives to the proposed royalty schedule and quantified the effect of these alternatives on the estimated royalty payments.

- For an independent crude oil producer, evaluated the various options this producer had to move its crude oil from the field to an ocean terminal in order to be able to qualify for an export license. Mr. Ashton recommended various strategies and performed cost/benefit analyses of each.

- Prepared a detailed study of crude oil marketing in the United States and changes which have occurred in the manner in which crude oil is bought, sold, and traded over the last twenty years. Examined the manner in which crude oil is shipped throughout the country, and the impact of transportation alternatives on marketing options. Also compiled a large database on spot and other relevant crude oil prices and data on quality adjustment factors for use in evaluating various crude oils. Provided supplemental analyses regarding specific market areas in the United States including the Rocky Mountain producing area.

- Mr. Ashton recently completed a forecast of supply and demand factors influencing future oil and gas development and production activity in the Rocky Mountain states. This work included an analysis of the demand and supply for crude oil and refined products in the Rocky Mountain states, including imports of refined products from states outside the area. He also examined the role of Canadian imports into the Rocky Mountain area and projected the demand for such imports over the next 40 years.

- Assisted a major computer manufacturer develop and implement a strategic plan for marketing its computer technology to law firms and other legal entities. This assignment involved developing an overall understanding of the legal marketplace and the demand for automated litigation support equipment as well as planning a strategy to assist in properly positioning the company's products.

- Conducted a detailed study of the business strategies of the leading manufacturers in the motorcycle marketplace to test various hypotheses regarding the dramatic shift in market structure that occurred during the 1980s. Mr. Ashton analyzed trends in market growth, the effects of various government policies, and the effects of various macroeconomic effects on the changes in industry structure.

- Analyzed the fair market value of a large, privately-held corporation with principal operations overseas. Involved assessing the relationship between the host government and the corporation, and providing an estimate of the relative political and environmental stability of conducting business in that country, and its impact on the company's market value.

Mr. Ashton received an A.B. degree in Economics and Political Science from Colby College (*magna cum laude* and *Phi Beta Kappa*) in 1976, and received an M.I.A. degree in International Economics and Business from the School of International Affairs at Columbia University in 1978. Mr. Ashton is a member of the American Economic Association and the Southern Economic Association.

Publications and Speeches (Last 10 Years)

Crude Oil Marketing, prepared for Minerals Management Service, Valuation and Standards Division, July 1997.

"Financial and Economic Indicators of Local Tax Burdens and Incentives to Invest in Various Localities," November 2000.

"Recent Volatility in Gasoline Prices: Is it the Market or the Marketers?" May 2002.

"Cost Sharing Regulations Embodied in the IRS Section 482 Transfer-Pricing Regulations: Recent Experience and Lessons Learned," Internal Revenue Service, CPE Seminars, August 2002.

Modeling Exploration, Development and Production in the Gulf of Mexico, U.S. Department of Interior, Minerals Management Service, Environmental Studies Program, Herndon, VA, OCS Study MMS 2—4-018, March 2004.

The Impact of Tax Expenditure Policies on Incorporated Small Businesses, with Justin White, U.S. Small Business Administration, Office of Advocacy, Washington, D.C., April 2004.

Trends in Electronic Procurement and E-Commerce and Their Impact on Small Business, with Mary Ann Buescher, U.S. Small Business Administration, Office of Advocacy, Washington, D.C., June 2004.

Report on Gasoline Pricing in Florida, with Dr. Keith Leffler, prepared for the Office of the Attorney General, State of Florida, June 2005.

Effects of Royalty Incentives for Gulf of Mexico Oil and Gas Leases, U.S. Department of Interior, Minerals Management Service, Economics Division, Herndon, VA, OCS Study MMS 2004-077, September 2005.

An Empirical Approach to Characterize Rural Small Business Growth and Profitability, with Lee O. Upton and Meghan Overom, U.S. Small Business Administration, Office of Advocacy, Washington, D.C. December 2005.

Testimony (Last 10 Years)

Union Oil Company of California v. Pioneer Oil and Gas et al., Case No. SM92229, Deposition testimony, October 1996; Live testimony, January 1997. Work performed on behalf of McMahon & Spiegel, Los Angeles, CA.

Blind Design, Inc. v. Hunter Douglas, Inc. et al., Case No. 686230, Deposition testimony, February 1997. Work performed on behalf of Sheppard, Mullin, Richter & Hampton, San Diego, CA.

In the Matter of Beacon Oil Company, Contract No. DE-SC01-79-RA-32028, Deposition testimony, February 1997; trial testimony, March 1997. Work performed on behalf of the U.S. Department of Energy.

Brenda Reeves v. George Anderson et al., Case No. CV-95-506, Deposition testimony February 1997. Work performed on behalf of Platz & Thompson, Lewiston, ME.

State of Texas, et al. v. Amoco Production Co. et al., No. 95-08680, Deposition testimony, April 1997. Work performed on behalf of Susman Godfrey, L.L.P.

Timothy Morse v. Frozen at Sea Partners, III et al., Docket No. 96-361-P-H, Deposition testimony, September 1997. Work performed on behalf of Welte & Welte, Camden, ME.

Execu-Tech Business Systems Inc., et al. v. Appleton Papers Inc., et al., Case No. 96-9639, CACE 05, Deposition testimony, September 1997; trial testimony, November-December 1997. Work performed on behalf of Heins, Mills & Olsen, Minneapolis, MN.

Olde Port Mariner Fleet, Inc. Complaint re Casco Bay Island Transit District's Tour and Charter Service, Docket No. 98-161, prepared written direct and rebuttal testimony before the Maine Public Utilities Commission, July and September 1998. Oral testimony, October 1998. Work performed on behalf of Edward F. Bradley, Jr., Portland, ME.

SouthPort Marine v. Boston Towing & Transport and Gulf Oil Corp., deposition and trial testimony, April 1999, work performed on behalf of Welte & Welte, Camden, ME and Flanagan & Hunter, Boston, MA.

Peter R. Bragdon v. Irving J. Morrison, Docket No. CV-98-76, deposition testimony, June 1999, work performed on behalf of Platz & Thompson, P.A., Lewiston, ME.

Northern Utilities, Inc. Petition for Waivers from Chapter 820, Docket No. 99-254, written testimony filed before the Maine Public Utilities Commission, May 2000. Work performed on behalf of Edward F. Bradley, Jr., Portland, ME.

United States ex rel. J. Benjamin Johnson, et al. vs. Shell Oil Company, et al., Case No. 9:96CV66, expert reports and deposition testimony, February, May, and July 2000. Work performed on behalf of the Justice Department, Civil Division, Washington, D.C.

Fidelity Oil Co. vs. Shell Western E&P Inc. and Shell Oil Co., Case No. DV-98-5817, expert report, June 2001, rebuttal report, December 2001. Work performed on behalf of Crowley, Haughey, Hanson, Toole, & Dietrich, P.L.L.P.

Big West Oil Co. v. Frontier Pipeline Company and Express Pipeline Partnership and *Chevron Products Company v. Frontier Pipeline Company and Express Pipeline Partnership*, Docket Nos. OR01-02-002 and OR01-04-001, prepared direct testimony, November 2001. Worked performed on behalf of Goldstein & Associates, Washington, D.C.

Big West Oil Company v. Anschutz Ranch East Pipeline, Inc. and Express Pipeline Partnership, and *Chevron Products Company v. Anschutz Ranch East Pipeline, Inc. and Express Pipeline Partnership*, Docket Nos. OR01-03-002 and OR01-05-001, prepared direct testimony, November 2001. Work performed on behalf of Goldstein & Associates, Washington, D.C.

"Gas Prices: How Are They Really Set?" Hearings before the Permanent Subcommittee of Investigations of the Committee on Governmental Affairs, U.S. Senate, May 2, 2002.

Big West Oil, LLC, Chevron Products Company, and Tesoro Refining and Marketing Company v. Express Pipeline LLC and Platte Pipe Line Company, Docket No. OR02-5-000; Big West Oil, LLC, Chevron Products Company, Sinclair Oil Corporation and Tesoro Refining and Marketing Company v Express Pipeline LLC, Docket No. OR02-8-000; Big West Oil, LLC, Chevron Products Company, and Tesoro Refining and Marketing Company v. Platte Pipe Line Company, Docket No. IS02-384-000. Prepared direct and answering testimony, March 27, 2003. Worked performed on behalf of Goldstein & Associates, Washington, D.C.

Sinclair Oil Corporation v. BP Pipelines (N.A.), Inc., Docket No. OR02-6-02; Prepared direct testimony, September 2003; rebuttal testimony, March 2004. Work performed on behalf of Goldstein & Associates, Washington, D.C.

Public Hearing on Property Tax Classification, Hearings before Massachusetts Department of Revenue, May 2004, direct testimony on proposed modification to state property tax classification system.

Marc Leslie and Mary Leslie v. Winslow Marine, Inc., Docket No. BATSC-CV-2003-00031; Deposition testimony, February 2005. Work performed on behalf of Tompkins, Clough, Hirshon and Langer, P.A.

Five Year Review of Oil Pipeline Pricing Index, Docket No. RM05-22-000, Declarations filed October 2005, January 2006. Work performed on behalf of Goldstein & Associates, Washington D.C. and Venable LLP, Washington, D.C.

In the matter of *SFPP, L.P.*, Docket No. IS05-230-000, Prepared answering testimony, November 2005; cross examination, February 2006. Work performed on behalf of Goldstein & Associates, Washington D.C.

United States ex. Rel. Bobby Maxwell v. Kerr McGee Corp. et al. C.A. No. 04-1224-PSF. Expert report and deposition testimony, March 2006. Work performed on behalf of Law Offices of Michael Porter, Wheat Ridge, CO.

Attachment 2

[PRIVILEGED AND CONFIDENTIAL INFORMATION REMOVED]

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[PRIVILEGED AND CONFIDENTIAL INFORMATION REMOVED]

Reparations Due Tesoro for Shipments on SFPP West Line and Calnev Line

	Adjusted Tariff Rate	Reparations Excluding Interest	Interest	Total Reparations
West Line	Compliance Filing Rates	$1,400,181.38	$120,603.98	**$1,520,785.36**
	Revised CoS Rates	$2,015,145.07	$165,219.74	**$2,180,364.82**
Calnev Line	Compliance Filing Rates	$80,203.28	$7,002.83	**$87,206.11**
	Revised Cos Rates	$133,836.55	$11,171.33	**$145,007.87**
Total Damages	Compliance Filing Rates	$1,480,384.66	$127,606.81	**$1,607,991.47**
	Revised Cos Rates	$2,148,981.62	$176,391.07	**$2,325,372.69**

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Interest Rates

Month	Rate	Monthly	Quarterly
Jul-04	4.25%	0.35%	
Aug-04	4.43%	0.37%	
Sep-04	4.58%	0.38%	
Oct-04	4.75%	0.40%	0.37%
Nov-04	4.93%	0.41%	0.37%
Dec-04	5.15%	0.43%	0.37%
Jan-05	5.25%	0.44%	0.41%
Feb-05	5.49%	0.46%	0.41%
Mar-05	5.58%	0.47%	0.41%
Apr-05	5.75%	0.48%	0.45%
May-05	5.98%	0.50%	0.45%
Jun-05	6.01%	0.50%	0.45%
Jul-05	6.25%	0.52%	0.49%
Aug-05	6.44%	0.54%	0.49%
Sep-05	6.59%	0.55%	0.49%
Oct-05	6.75%	0.56%	0.54%
Nov-05	7.00%	0.58%	0.54%
Dec-05	7.15%	0.60%	0.54%
Jan-06	7.26%	0.61%	0.58%
Feb-06	7.50%	0.63%	0.58%
Mar-06	7.53%	0.63%	0.58%
Apr-06	7.75%	0.65%	0.62%
May-06	7.93%	0.66%	0.62%
Jun-06	8.02%	0.67%	0.62%
Jul-06	8.25%	0.69%	0.66%
Aug-06	8.25%	0.69%	0.66%
Sep-06	8.25%	0.69%	0.66%
Oct-06	8.25%	0.69%	0.69%
Nov-06	8.25%	0.69%	0.69%

Source: Federal Reserve Statistical Release H.15, available at http://www.federalreserve.gov/releases/h15/data.htm

Note: As of 11/22/06, Bank Prime Rate had not changed, it is left here at 8.25% for Nov-06 - due to Commission preferred interest rate calculation methodology of using lagged quarterly interest rates, this value does not factor into current reparations calculations

Note: In 18 C.F.R. § 340.1(c)(2)(i), the regulations state the interest rate shall be taken from Statistical Release G.13, however this release was discontinued by the Federal Reserve in 2002 - all applicable rates are available in Release H.15