UNITED STATES OF AMERICA 118 FERC ¶ 61,056
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

BP Pipelines (Alaska) Inc.	Docket Nos. IS06-466-003
ConocoPhillips Transportation Alaska, Inc.	IS06-467-003
ExxonMobil Pipeline Company	IS06-468-003
Koch Alaska Pipeline Company, LLC	IS06-469-003
Unocal Pipeline Company	IS06-470-003

ORDER DENYING REHEARING

(Issued January 26, 2007)

1. On September 1, 2006, the Commission issued an order[1] accepting the identical tariff sheets filed on July 3, 2006, by the TAPS Carriers[2] to comply with the Commission's Opinion Nos. 481, 481-A, and 481-B.[3] A number of parties protested the filings, including Petro Star Inc. (Petro Star), and Petro Star filed a request for rehearing of the September Order. For the reasons set forth below, the Commission denies rehearing.

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[1] *BP Pipelines (Alaska), Inc., et al.*, 116 FERC ¶ 61,208 (2006) (September Order).

[2] The TAPS Carriers are BP Pipelines (Alaska) Inc., ConocoPhillips Transportation Alaska, Inc. (Conoco), ExxonMobil Pipeline Company, Koch Alaska Pipeline Company, LLC, and Unocal Pipeline Company.

[3] *Trans Alaska Pipeline System*, 113 FERC ¶ 61,062 (2005) (Opinion No. 481), *order on reh'g*, 114 FERC ¶ 61,323 (2006) (Opinion No. 481-A), *order on reh'g*, 115 FERC ¶ 61,287 (2006) (Opinion No. 481-B). Appeals of the Commission's orders are pending in the United States Court of Appeals for the District of Columbia Circuit.

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Background

2. This case involves the method of making monetary adjustments among shippers of Alaska North Slope (ANS) oil on the Trans Alaska Pipeline System (TAPS). The adjustments are made through a "Quality Bank" which either compensates or charges a shipper for the difference in quality between the crude oil tendered by a shipper and the crude oil received by that shipper. The current method of valuing the oil tendered is the distillation methodology under which the crude oil tendered by a shipper is separated into its component parts, or "cuts" of petroleum products, and that delivery's value is the volume-weighted price of its component parts.

3. On August 31, 2004, Administrative Law Judge Edward Silverstein (ALJ) issued an initial decision (ID), 108 FERC ¶ 63,030 (2004), valuing certain cuts, including the West Coast Resid and West Coast Heavy Distillate cuts. Their value would depend on the amount of certain costs incurred in processing those cuts, including the capital investment associated with using the petroleum component, Resid, as a coker. At the hearing the parties entered into a stipulation to use the Nelson-Farrar Operating Cost Index as part of the formula for valuing the Resid component. The stipulation provided for the following definition of the Nelson-Farrar Index (NFI):

> **Nelson Farrar Index** is the ratio of: (a) the NFI (Operating Indexes Refinery) for the year in which the value is being determined to (b) the NFI (Operating Indexes Refinery) for the base year.

4. The TAPS Quality Bank Methodology Tariff also included a provision for the annual escalation of costs to reflect the inflation factor. That section provides as follows:

> In January of each year the adjustments to the prices … shall be revised in accordance with the changes in the NFI (Operating Indexes Refinery) … by multiplying the adjustments or costs for the previous year by the ratio of (a) the average of the monthly indexes that are then available for the most recent 12 consecutive months to (b) the average of the monthly indexes for the previous (*i.e.*, one year earlier) 12 consecutive months.

5. The Commission held that the capital investment costs for the Resid cut and the processing costs for the Heavy Distillate cut, which were stated on a 1996 basis during the hearing before the ALJ, should be adjusted from a 1996 base year to a 2000 base year

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using the NFI.[4] The TAPS Carriers' proposed tariff sheets reflected a Memorandum from the Quality Bank Administrator (QBA), an independent expert who administers the Quality Bank.[5] The QBA's Memorandum explained that two sets of NFIs were used to perform the calculations reflected on the proposed tariff sheets. The QBA used the first set to convert the 1996-based capital investment coking costs used to value the Resid and the 1996 processing cost used to value Heavy Distillate to a year 2000 basis. Because the NFIs for these two years were known, the QBA compared the average value of the NFIs for each year. Thus, the QBA calculated the average 2000 NFI and divided it by the average 1996 NFI. The average 1996 index was 413.3, and the average 2000 index was 444, which resulted in ratio of 1.0742. The QBA used the second set of NFI's to escalate those costs from the 2000 base year to each following year through 2005 to reflect the inflation factor. Specifically, the QBA recalculated the processing costs on an annual basis beginning February 1, 2000, as required by the Quality Bank tariff,[6] using the most recent twelve-months' data available in January of each year.

The Protests

6. Petro Star, and others, protested the filing. They all argued that the QBA's decision to use two different methods for computing the adjustment of the Resid and Heavy Distillate processing cost factors caused the inflation that occurred from September 1999 to December 2000 to be counted twice. This, they asserted, results in increasing the processing costs of each cut thereby reducing the value of the cut. Petro Star contended the inflation factor applied to these two cuts was larger than the inflation factor applied to other cuts, specifically the Light Distillate cut, and thus violated the

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[4] Resid was valued as a coker in the production of other cuts and capital investment was necessary to provide the required facilities. Heavy Distillate was valued by a proxy which requires the heavy distillate to be processed in order to meet the proxy's specifications. Thus, the amount of capital investment costs and processing costs incurred reduces the value of these petroleum cuts, so the larger these costs, the lower the value of the cut.

[5] *See* Ex. 6 of the QBA's June 22, 2006 Memorandum to All Shippers and Interested Parties regarding Bases for Revised Tariff (Memorandum).

[6] The current TAPS Quality Bank methodology to calculate annual inflation estimates has been in effect since February 1998 (ID at P 852), and was unchanged in the TAPS proceeding to keep the approach consistent by having all the annual adjustments to value the cuts change simultaneously, for administrative efficiency.

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consistency rule required by the court in *OXY USA, Inc. v. FERC*,[7] that the Commission "must accurately value all cuts – not merely some or most of them – or it must overvalue or undervalue all cuts to approximately the same degree."

7. They contended that the escalation factor effective February 1, 2001, uses NFI values in the calculation for the first eight months of 2000 and last four months of 1999, and that the escalation factor effective February 1, 2002, also uses NFI values in the calculation for the last four months of 2000. They asserted that the 1999 inflation was covered in the initial adjustment from 1996 to 2000 since that adjustment took into account all inflation between calendar years 1996 and 2000. Thus, they argued, the inflation for 1999 has been taken into account a second time in the 2001 annual adjustment because the base for that year adjustment is eight months of 1999 and four months of 1998. They contended that this two-step Nelson-Farrar calculation is inconsistent with the understanding of all of the parties and the ALJ that the choice of base year would not have a material effect on Quality Bank adjustments.

The September Order

8. The September Order accepted the tariff sheets finding the protestors' arguments unpersuasive and rejected the protestors' contention that the QBA must calculate the conversion of costs from a 1996 base year to a 2000 base year the same way he calculated the annual escalation or else there will be double counting. In other words, the protesters aver the QBA should have used the average NFI for September 1998 through August 1999 divided by the average NFI for September 1994 through August 1995 to convert the 1996 costs to the year 2000 costs.

9. The September Order held that the fact that the QBA used the 2000 NFI values in different calculations pertaining to different years does not result in a double count of the inflation in 2000. The September Order stated that the QBA did not use 2000 NFI values twice in the same ratio or calculation. Rather, in developing the adjustment factor of 1.0742 used to convert 1996 costs to 2000 costs, the QBA used the ratio of the average of all twelve monthly NFI values for 2000 divided by the average of all twelve monthly NFI values for 1996. On the other hand, to derive an inflation adjustment for 2001, the period February 2001 through January 2002, the QBA used the method described in the Quality Bank Methodology Tariff of using inflation in the two most recent years for which NFI data existed, namely September 1999 to August 2000, and September 1998 to August 1999.

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[7] 64 F.3d 679, 693 (D.C. Cir. 1995) (*OXY*).

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10. Moreover, the September Order explained that the methodology advocated by protestors results in converting 1996 costs into year 1999 costs, not year 2000 costs, as required by the Commission's orders, with a resulting index of 0.9810, rather than the QBA's index of 1.0742.

Request for Rehearing

11. Petro Star argues that the Regulatory Commission of Alaska (RCA) and the Commission erred by determining that the QBA's two-step method for calculating Nelson-Farrar inflation adjustments does not double-count inflation in determining the cost deductions for Resid and Heavy Distillate. Petro Star asserts that the Commissions' determination that "[t]he QBA did not use 2000 NFI values twice in the same ratio or calculation" [8] cannot controvert the fact that the QBA's Nelson-Farrar methodology accounted for September 1999 through December 2000 inflation both in its 1996-2000 adjustment and again in subsequent adjustments.

12. Petro Star further asserts that the September Order was not correct in stating that "the methodology advocated by protestors results in converting 1996 costs into the year 1999 costs, not the year 2000 costs," and "the methodology suggested by protestors would use no data from either 1996 or 2000, even though the average indices for both years are known."[9] Petro Star argues first, that its proposal calculates a ratio that, when multiplied times 1996 costs, translates into costs to be applied in the year 2000 (starting in February) that will be inflated to precisely the same degree as the Light Distillate deduction. Next, Petro Star argues that regarding the 1996 date, it uses the data that would have been used had the QBA made an adjustment to become effective in February 1997, which would have consisted of the most current data as of January 1997 and includes January through August 1996 data. Finally, Petro Star argues that regarding the 2000 data, it used the same data as did the QBA in the January 31, 2000, tariff filing, effective February 2000, because its goal was the same as the QBA's: To determine the appropriate cost deductions to attribute to the different Quality Bank cuts in the year 2000.

13. Petro Star also believes the Commission erred by accepting for filing tariffs that escalate the Resid and Heavy Distillate cost deductions ten percent above the Light Distillate cost deduction, contrary to the consistency requirement of *OXY*. [10] In this

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[8] September Order at P 10.

[9] September Order at P 12.

[10] 64 F.3d at 693.

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respect, the September Order failed to address Petro Star's contention that the QBA's calculations result in valuations for Resid and Heavy Distillate that violate the consistency requirement in *OXY*. Petro Star submits that the processing cost adjustment for Light Distillate was set at 0.5 cents per gallon (cpg) by the 1997 Settlement,[11] and at 0.6287 cpg in the July 3, 2006, tariff filing (Revised Tariffs).[12] Thus, Petro Star argues, under the QBA's methodology, he escalated the Light Distillate cost adjustment by a factor of 1.257 from the 1996 base year to 2006,[13] but escalated the Resid and Heavy Distillate adjustments by a factor of 1.377 during the same 1996 base year to 2006 time period.[14]

14. Petro Star requests that if the Commission approves the QBA's methodology for adjusting processing costs for Resid and Heavy Distillate from a 1996 base year to a 2000 base year, it must address the inconsistency between Resid and Heavy Distillate and Light Distillate inflation adjustments that such approval allows, or the Revised Tariffs will become fatally flawed under *OXY*. To address this apparent inconsistency, Petro Star contends the Commission should use the Nelson-Farrar adjustment set forth in the parties' Joint Stipulation.[15] The Joint Stipulation requires that the 2006 processing cost for Resid be escalated by the ratio of the NFI for 2006 to that for 2000 thereby escalating Resid processing costs to approximately the same degree as Light Distillate costs are increased.

Commission Determination

15. The Commission denies Petro Star's request for rehearing. First, in the September Order, the Commission found that the QBA's calculations are consistent with the directives of the ID and Opinion No. 481, and do not result in double counting. While Petro Star continues to argue that this is incorrect, it has failed to show how the explanation in the September Order is deficient.

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[11] *Trans Alaska Pipeline System*, 81 FERC ¶ 61,319, at 62,462-63 (1997) (1997 Settlement).

[12] Revised Tariffs at Attachment 2 at p. 2.

[13] 0.6287 cpg ÷ 0.5 cpg = 1.257.

[14] *See* Ex. 6 of the Memorandum.

[15] *Trans Alaska Pipeline System*, Docket No. OR89-2-007, Joint Stipulation of Parties (filed October 3, 2002) (Joint Stipulation).

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16. Petro Star erroneously asserts that its proposal to inflate 1996 costs to year 2000 costs, which applies the tariff's annual escalation methodology of using eight months of the current year with four months of the previous year is superior to the QBA's method which compares the full calendar 12 consecutive months of the same year to the full calendar months of the previous year. Petro Star's proposal misconstrues the understanding of the parties to the Joint Stipulation and ALJ's directive to the QBA to use the most current NFI's available. As detailed above, the QBA appropriately used NFI's for the full calendar year as they were known when he performed his calculations.

17. Moreover, all parties in the Joint Stipulation understood that the process to inflate 1996 costs to 2000 costs was exclusive to the tariff's escalation methodology for calculating the annual adjustment. The tariff's methodology necessarily extrapolates using NFI's for 12 consecutive months that span portions of the previous two years because of the timing of the reporting of the indices by the index publisher.

18. As shown above, the inflation factor experienced during September 1999 to December 2000 is used in both sets of calculations by the QBA, but that does not equate to double counting of the inflation in that period. For the escalation from 1996 to 2000, the index numbers were known, and the QBA calculated the ratio, which came to 1.0742. That established the cost figures for going forward from 2000, and permitted the QBA to make the required annual inflation adjustments for the subsequent years. Each annual adjustment going forward requires the QBA to calculate the ratio of (a) the average of the monthly indices that are then available for the most recent twelve months to (b) the average of the monthly indices for the previous (*i.e.*, one year earlier) twelve consecutive months. Thus, the QBA calculated the annual escalation for the year 2006 in January 2006. At that time, the most recent NFIs available were through August 2005. Therefore, the escalation ratio used was the average index for the twelve months of September 2004 through August 2005, because those were the monthly indices that were also available on the previous twelve consecutive months from September 2003 through August 2004 that completes the ratio and allows derivation of the inflation adjustment. The processing adjustment used from February 2005 through January 2006 was multiplied by this ratio to obtain the new adjustment to be used for the next year. The same process is repeated to make the 2001 inflation adjustment.

19. However, for the conversion of the 1996 base year costs to year 2000 costs, all the indices were available, so the correct approach to convert data representative of one year to data representative of another year is to compare the average value of the indices for each year, which the QBA did, to arrive at the 1.0742 figure. The fact that the indices from September 1999 to December 2000 are included initially in the conversion calculation, and then used in the calculation of the annual adjustment for the year 2001 does not result in double counting. The tariff requires that in calculating the 2001 adjustment, which would be done in January 2001, the twelve months to use would be

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September 1999 to August 2000, since this period comprises all the indices available in January 2001, for comparison to the same twelve months of the prior year or September 1998 to August 1999.

20. Petro Star argues that the QBA must calculate the conversion of the 1996 base year costs to a 2000 base year the same way as the "going forward" annual escalation. It urges the Commission to use the average NFI for September 1998 through August 1999 divided by the average NFI for September 1994 through August 1995 to convert 1996 values to 2000 values. We find no merit in this. As stated in the September Order, the goal of the calculation is to convert cost data for 1996 to a year 2000 basis. But Petro Star's proposed method would use no data from either 1996 or 2000, even though the average indices for both years are known.

21. Petro Star's other argument concerns the inconsistency between the inflation factor applied to the Resid and Heavy Distillate cuts under the QBA's calculations, and the inflation factor applied to the Light Distillate cut. However, Petro Star's argument is flawed because it ignores the fact that processing cost adjustment for Light Distillate was set at 0.5 cpg by the 1997 Settlement. Thus, the escalation in the Light Distillate cut processing costs would not include any inflation prior to that time, while the escalation in the costs for the Resid and Heavy Distillate cuts covers the period from 1996 on.

22. In short, the Commission cannot find any error in the QBA's methodology to implement the parties' agreements on how to treat the inflation factor when calculating the costs assigned to certain crude petroleum cuts. Whether there might exist a different method of applying the parties' agreement is not an issue which the Commission need address. The Commission finds the QBA implemented the parties' agreements in a just and reasonable manner and accepts the QBA calculations.

<u>The Commission orders:</u>

Petro Star's request for rehearing of the September Order is denied.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.