

REPORT OF THE OIL PIPELINE REGULATION COMMITTEE

This report summarizes decisions and policy developments that occurred at the Federal Energy Regulatory Commission (FERC or Commission) and the U.S. Courts of Appeals in the area of oil pipeline regulation from June 1, 2007 through June 30, 2009.

I. Return On Equity – The Policy Statement and the Kern River Decision	730
A. Overview of FERC’s ROE Methodology	730
B. MLPs and The Policy Statement.....	731
C. Kern River.....	733
II. Major Rate Cases.....	735
A. Mid-America Initial Decision	735
1. Procedural Background.....	735
2. Major Holdings	736
a. Substantial Divergence.....	736
b. Locked-in Period.....	737
c. Capital Structure.....	737
d. Allocation Issues	737
e. Income Tax Allowance	738
f. Storage	738
g. Jurisdiction – Channahon to Morris, Illinois Movement	739
h. Throughput and Deficiency Agreement.....	739
i. Rate Design.....	739
j. Seminole	740
III. Trans Alaska Pipeline System (TAPS) Cases	740
A. Opinion No. 500	740
B. Opinion No. 502	741
C. Burden of Proof / Use of TAPS Settlement Methodology (TSM)...	742
D. Property Balances	742
E. Deferred returns	743
F. AFUDC and ADIT.....	744
G. Starting Rate Base (SRB) Write-up	744
H. Dismantlement, Removal, and Restoration (DR&R).....	744
I. Capital Structure	745
J. Return on Equity	746
K. Cost of Debt	746
L. Stand-Alone Cost (SAC) Presentation.....	746
M. Refunds	746
N. Individual Versus Uniform Rates	747
O. State’s Request For Refunds.....	747
P. TAPS Intrastate Rates and ICA Section 13(4).....	747
Q. Commission Orders	747
R. Rehearing of Opinion 502.....	748
S. TAPS Carriers’ Rates for 2007 and 2008	748
IV. Santa Fe Pacific Pipelines, L.P.	749
A. OR92-8 and OR96-2.....	749

B.	Watson Station (Docket No. OR92-8-025).....	751
C.	Docket Nos. OR03-5-000 & OR03-5-001	752
D.	East Line Expansions (Docket Nos. IS06-283 & IS08-28)	753
E.	2006 Index (Docket No. IS06-356).....	754
F.	2005 North Line Index Increase Complaints (Docket Nos. OR07-3 & OR07-6)	754
G.	2005 Index Rate Increase Complaint (Docket Nos. OR07-8 & OR07-11)	755
H.	2007 Index Filing (Docket No. IS07-229) and Complaint (Docket No. OR07-20).....	755
V.	Other Tariff and Rate Matters	757
A.	Belle Fourche Pipeline Company & Bridger Pipeline, L.L.C. (Docket Nos. IS09-92 & IS09-93)	757
B.	Bridger Pipeline, L.L.C. (Docket Nos. IS09-123 & IS09-124)	758
C.	Western Refining Pipeline Company (Docket No. IS08-131).....	758
D.	Big West Oil Company v. Frontier Pipeline Company (Docket No. OR01-2); Express Pipeline Partnership (Docket No. OR01- 4)	759
E.	Holly Refining and Marketing Company v. Plains All American Pipeline, L.P. and Rocky Mountain Pipeline System, L.L.C., 127 FERC ¶ 61,074 (2009); Rocky Mountain Pipeline System, L.L.C. (Docket No. IS09-157)	761

I. RETURN ON EQUITY – THE POLICY STATEMENT AND THE KERN RIVER DECISION

On April 17, 2008, the Commission issued the *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity* (Policy Statement) regarding inclusion of master limited partnerships (MLP) in the proxy groups used to determine the return on equity (ROE) for natural gas and oil pipelines.¹ The Policy Statement is the culmination of an extensive process that began with a proposed policy statement issued on July 19, 2007,² and included a technical conference and several rounds of comments from numerous parties. On January 15, 2009, the Commission issued *Kern River Gas Transmission Co.*,³ which applied the Policy Statement for the first time in a rate case. The Policy Statement and the *Kern River* decision are discussed further below.

A. Overview of FERC's ROE Methodology

The Commission's methodology for calculating ROE is generally the same for both oil and gas pipelines. The Supreme Court has held that a regulated entity's ROE should be "commensurate with the [return] on investments in other

1. *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 F.E.R.C. ¶ 61,048 (2008) [hereinafter, *Policy Statement*]; *reh'g denied*, 123 F.E.R.C. ¶ 61,259 (2008).

2. *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 120 F.E.R.C. ¶ 61,068 (2007).

3. *Kern River Gas Transmission Co.*, 126 F.E.R.C. ¶ 61,034 (2009).

enterprises having corresponding risks.”⁴ Accordingly, in each rate case, the Commission chooses a group of publicly-traded companies (known as a “proxy group”) based on the specific activities and risks of the regulated entity at issue. The returns investors expect from the companies in the proxy group are determined through the use of a discounted cash flow (DCF) methodology. The returns expected for each of the proxy companies provide a range that the Commission uses to assign a specific ROE to the regulated entity.⁵

The premise of the DCF method is that “a stock’s price is equal to the present value of the infinite stream of expected dividends discounted at a market rate commensurate with the stock’s risk.”⁶ The stock price, dividend yield and estimated growth rate of an individual company can therefore be used to determine the return that investors expect from an investment in that company. The basic DCF formula used by the Commission is written as follows (where “r” is the equity rate of return, “D” is the dividend yield, “P” is the stock price, and “g” is the estimated rate of growth in dividend income).⁷

$$r = (D / P) + g$$

The stock price and dividend yield of publicly-traded companies are publicly reported. The growth rate is based on a combination of short-term and long-term forecasts (weighted two-thirds and one-third, respectively). The short-term (*i.e.*, five year) growth rate is based on security analysts’ growth forecasts published in the Institutional Brokers Estimated Service (IBES). The long-term growth rate is based on an average of the gross domestic product (GDP) growth forecasts reported by Global Insight, the Energy Information Administration and the Social Security Administration.⁸

B. MLPs and The Policy Statement

Many gas pipelines and “virtually all” publicly traded oil pipelines are structured as MLPs.⁹ MLPs have also been used in oil pipeline proxy groups for at least a decade.¹⁰ Prior to the Policy Statement, however, there was significant controversy over whether the cash distributions of MLPs should be used as the equivalent of dividends in the DCF formula. Certain parties argued that MLP distributions often exceed book earnings and therefore cannot be expected to grow at the same rate as the dividends of a Subchapter-C corporation. Those parties argued that MLPs should therefore be excluded from the proxy group or, if they were included, that the level of MLP distributions used in the DCF formula should be capped at some level (*e.g.*, at the level of the MLP’s book earnings).¹¹

The Policy Statement addressed these issues, concluding that MLPs are appropriately included in proxy groups for both oil and gas pipelines and that the

4. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *see also* *Bluefield Water Works & Improvement Co. v. Public Servs. Comm’n*, 262 U.S. 679 (1923).

5. *CAPP v. FERC*, 254 F.3d 289, 294 (2001).

6. *Id.* at 293.

7. *Policy Statement*, *supra* note 1 at 4-5.

8. *Id.* at 6, note 7.

9. *Id.* at 9.

10. *See, e.g., SFPP, L.P.*, 86 F.E.R.C. ¶ 61,022 (1999).

11. *Policy Statement*, *supra* note 1, at 49.

full, uncapped amount of MLP distributions should be included in the DCF calculation.¹² The Commission found that “including MLPs in the gas and oil proxy groups will . . . make those proxy groups more representative of the business risks of the regulated firm whose rates are at issue.”¹³ The Commission further explained that if it

were to cap the distribution used to determine an MLP’s dividend yield at below the market determined level, but use the actual market price of the MLP’s publicly traded units and a growth projection reflecting the actual level of distributions, the DCF analysis would fail to achieve its intended purpose of determining the return the equity market requires in order to justify an investment in the pipeline . . . there would be a mismatch among the inputs . . . in the DCF formula.¹⁴

The Commission nevertheless concluded that the GDP forecast used for the long-term growth rate should be reduced by fifty percent for all MLPs included in the proxy group to account for the FERC’s assumption that MLPs are likely to grow more slowly over the long-term given its finding that MLPs often pay out distributions in excess of earnings and have less opportunity than Subchapter-C corporations to diversify their business activities due to existing income tax requirements.¹⁵ The Commission concluded, however, that the IBES forecasts should remain the basis for the short-term growth forecast,¹⁶ and that there should be no modification of the two-thirds and one-third weightings of the short- and long-term growth factors.¹⁷

The Commission made clear that it was not making any findings regarding particular MLPs and left the composition of specific proxy groups to each individual rate case.¹⁸ The Commission advised that in order to determine the most representative proxy group in each case, the parties “should provide as much information as possible regarding the business activities of each firm they propose to include in the proxy group, including their recent annual SEC filings and investor service analyses of the firms.”¹⁹ The Commission clarified that the Policy Statement would govern all gas and oil rate proceedings involving the establishment of ROE that were pending at hearing before an Administrative Law Judge or in a decisional phase at the Commission.²⁰ Finally, the

12. *Id.* at 2, 49-51, 57-63.

13. *Id.* at 49.

14. *Id.* at 61.

15. *Id.* at 93-94, 106.

16. *Id.* at 75-84.

17. *Id.* at 110-13.

18. *Id.* at 51.

19. *Id.*

20. *Id.* at 116. On May 2, 2008, the Commission established paper hearings in SFPP’s Sepulveda Line (IS98-1 & IS07-116) and North Line (IS05-230) proceedings solely on ROE issues pending on exceptions to the North Line Initial Decision and on rehearing as to an order on the Sepulveda Line Initial Decision. *Order on Exceptions and Establishing Paper Hearing*, 123 F.E.R.C. ¶ 61,116 (2008); *Order on Rehearing and Establishing Paper Hearing*, 123 F.E.R.C. ¶ 61,117 (2008). In July 2008, the parties to each of the proceedings submitted settlement agreements establishing ROEs for those pipelines, thus mooted the need for the paper hearings. Commission action remains pending on the settlements.

Commission indicated that it would “not explore other methods [for] determining [a pipeline’s] equity cost of capital at this time.”²¹

C. *Kern River*

As noted above, *Kern River* was the first Commission decision to apply the Policy Statement in an individual rate case.²² The decision resulted in an ROE of 11.55 percent, based on a 2004 test year.²³

Although various parties in *Kern River* challenged the Policy Statement, the Commission upheld it in all respects. The Commission reiterated its finding that MLPs are appropriate to include in the proxy group without capping their distributions.²⁴ The Commission also rejected the argument that MLP distributions should be adjusted to reflect differences in the taxation of corporations and MLPs.²⁵ The Commission found²⁶ the argument regarding MLP taxation to be “fundamentally inconsistent” with *ExxonMobil Oil Corp. v. FERC*.²⁷ The Commission explained that while MLP “investors invest on the basis of after-tax returns and price an instrument accordingly, they expect that the cash flow will be available to pay the taxes and thereby maintain a comparable after-tax return to that of a corporation.”²⁸ The Commission also rejected the contention that MLPs are “intrinsically less risky” than corporations because they purportedly return the investors’ capital more quickly.²⁹ The Commission explained that “within a range of enterprises of similar risk” any difference related to the timing of recovery of equity capital “should be reflected in the yield of the ownership instrument and . . . [thus] the returns generated by the DCF model.”³⁰ Finally, the Commission affirmed the use of IBES to calculate the short-term growth forecast, the fifty percent reduction in the long-term growth factor for MLPs and the calculation of the long-term growth forecast from the average of the three GDP forecasts referred to above.³¹

Having affirmed the Policy Statement, the rest of the *Kern River* decision involved the choice of an appropriate proxy group and Kern River’s placement within the range of proxy returns. The Commission held that “a proxy group should consist of at least four, and preferably . . . five members, if representative members can be found.”³² The Commission further explained that it prefers that

21. *Id.* at 53.

22. Although *Kern River* involved a natural gas pipeline, it remains instructive for oil pipelines since FERC’s basic ROE methodology is the same in both contexts. The *Kern River* decision remains subject to Commission review of a pending request for rehearing as well as judicial review.

23. 126 F.E.R.C. ¶61,034 at 30, 57.

24. *Id.* at 109-112.

25. *Id.* at 114-116.

26. *Id.* at 114.

27. 487 F.3d 945, 955 (D.C. Cir. 2007) (holding that “the Commission reasonably relied upon evidence that a full income tax allowance is necessary to ensure that corporations and partnerships of like risk will earn comparable after-tax returns.”).

28. 126 F.E.R.C. ¶ 61,034, at 114.

29. *Id.* at 117-18.

30. *Id.* at 118.

31. *Id.* at 119-130.

32. *Id.* at 104.

the natural gas pipeline proxy group include companies whose businesses consist of at least fifty percent natural gas pipeline activities.³³

The Commission indicated, however, that it would permit diversified oil and gas pipeline companies to be included in the proxy group provided pipeline activities account for over fifty percent of the company's business and the oil pipeline activities do not predominate.³⁴ The FERC explained that "the oil pipeline component of a diversified natural gas company will increase somewhat the firm's overall risk, primarily due to the oil pipeline industry's overall greater exposure to competition."³⁵ As a result, if a company's oil pipeline activities were to predominate, it would not be risk-appropriate for inclusion in a natural gas pipeline proxy group.³⁶

The Commission also indicated that it may include other diversified natural gas companies in the proxy group, even where pipeline activities account for less than fifty percent of the company's business, provided the company's overall risks are comparable to those of a natural gas pipeline. The Commission explained that "gathering and processing, exploration and production, and trading and marketing" are riskier than "gas transmission, oil transmission, or gas distribution" whereas, local distribution company (LDC) activities are generally less risky than transmission activities.³⁷ Thus, in the FERC's view, a diversified natural gas company might still be appropriate to include in a gas pipeline proxy group if its riskier exploration and production functions are offset by less risky LDC activities.³⁸

The Commission also excluded Enterprise due in part to concern that Enterprise's merger with GulfTerra at the end of the test year may have caused short-term distortions in share price.³⁹ Southern Union Company was not included, because it failed to pay a cash dividend during the test year and instead issued a stock dividend. The Commission explained that

[i]n order to justify including a firm that paid a stock dividend in the proxy group, the record must establish that the stock dividend can be considered an equivalent of [a] cash dividend, for example by showing that the investor could convert the stock to a cash value with minimal risk.⁴⁰

The *Kern River* proxy group thus consisted of the following companies, three of which are MLPs: Kinder Morgan, Inc.; Kinder Morgan Energy Partners, L.P.; Northern Border Partners, L.P.; TC Pipelines, L.P.; and National Fuel Gas Corporation.

33. *Id.* at 59, 61 (approving inclusion of Kinder Morgan, Inc., Northern Border Partners, L.P., and TC Pipelines, L.P. on this basis).

34. *Id.* at 74 (approving Kinder Morgan Energy Partners, L.P. on this basis).

35. *Id.* at 75.

36. *Id.* at 78 (excluding Enterprise Products Partners, L.P. (Enterprise) in part because during the test period Enterprise "was primarily a natural gas liquids pipeline regulated under the [Interstate Commerce Act], not a gas transmission firm.").

37. *Id.* at 86-89.

38. *Id.* at 94 (including National Fuel Gas Company in the proxy group where it was engaged in 28 percent distribution, 28 percent natural gas transportation, 32 percent exploration and production and 8 percent other); *compare, id.* at 97 (excluding Questar Corporation from the proxy group where 51 percent of its business involved exploration and production and only 20 percent involved gas transmission).

39. *Id.* at 76-81.

40. *Id.* at 101.

As noted above, the median ROE for the proxy group for the 2004 test year was 11.55 percent (the ROE of Northern Border).⁴¹ The Commission then reviewed the credit rating and business risk profiles of Kern River and the proxy companies to determine Kern River's relative risk.⁴² The Commission reiterated its "traditional assumption" that "pipelines generally fall into a broad range of average risk absent highly unusual circumstances that indicate . . . anomalous[ly] [high] or low risk as compared to other pipelines."⁴³ "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."⁴⁴ Here, the Commission concluded that Kern River "is of a similar risk to the overall risk of the proxy group" and there were "no reasonable grounds" to adjust Kern River's ROE above or below the median ROE of the proxy group.⁴⁵

II. MAJOR RATE CASES

A. *Mid-America Initial Decision*

On September 3, 2008, an Initial Decision was issued by Presiding Administrative Law Judge Edward M. Silverstein in the rate case involving Mid-America Pipe Line Company, L.L.C. (Mid-America) and Seminole Pipeline Company (Seminole).⁴⁶ Commission review of the Initial Decision remains pending. The major holdings of the Initial Decision are set forth below.

1. Procedural Background

On March 31, 2005, Mid-America filed three new cost-of-service tariffs to increase most of its general commodity rates for movements of natural gas liquids on its three systems (Rocky Mountain, Northern, and Central) effective May 1, 2005. Protests were filed by Williams Power Company, Inc. and Williams Energy Services, L.L.C. (collectively Williams), Burlington Resources Trading, Inc. (Burlington), Navajo Refining Company, L.P. (Navajo), and a group of propane shippers (the Propane Group). The Commission suspended the tariffs subject to refund and investigation in Docket No. IS05-216-000.⁴⁷ Mid-America thereafter filed new rates for certain Rocky Mountain System movements, which were also protested, suspended subject to refund, and consolidated with the ongoing proceeding.⁴⁸

On March 6, 2006, Williams filed a complaint against the rates of Mid-America and Seminole. A similar complaint, later withdrawn, was also filed by Burlington. (Burlington also withdrew its protest on May 2, 2006.) On August 24, 2006, the Commission dismissed Williams' complaint against Mid-America,

41. *Id.* at 131.

42. *Id.* at 133-37, 149-52.

43. *Id.* at 138, 140.

44. *Id.* at 140.

45. *Id.* at 153.

46. *Mid-America Pipeline Co.*, 124 F.E.R.C. ¶ 63,016 (2008). Seminole is principally owned by Enterprise, the same company that owns Mid-America. As discussed below, Mid-America and Seminole also maintain certain joint rates.

47. *Mid-America Pipeline Co.*, 111 F.E.R.C. ¶ 61,128 (2005).

48. *Mid-America Pipeline Co.*, 111 F.E.R.C. ¶ 61,483 (2005).

but permitted the complaint against Seminole to go forward and consolidated it with the ongoing rate case.⁴⁹

On March 31, 2006, Mid-America filed a new tariff further increasing most of the general commodity rates on its Northern System, effective May 1, 2006. The Propane Group and Williams protested, and the Commission suspended the rates subject to refund and consolidated the investigation with the ongoing rate case.⁵⁰

As a result of withdrawals of rate changes and protests, the Presiding Judge ruled that the only Mid-America rates at issue were those on the Northern System.⁵¹

On August 18, 2006, Mid-America submitted a new tariff on its Rocky Mountain System, which among other things, proposed to increase certain Mid-America/Seminole joint rates and eliminate certain discounts. Williams protested and the Commission suspended the tariff subject to refund and consolidated it with the ongoing rate case.⁵² The Presiding Judge determined that, although the Mid-America/Seminole joint rates were subject to investigation, the Rocky Mountain System local rates remained outside the scope of the hearing.⁵³ He ruled that, in light of the Commission's dismissal of Williams' complaint against the Rocky Mountain System local rates, the justness and reasonableness of the joint rate would be determined by adding the existing Rocky Mountain System local rates and the Seminole rate determined as a result of the hearing. A hearing was held from October 2 through December 6, 2007.⁵⁴

2. Major Holdings

a. Substantial Divergence

The Commission's regulations require a carrier filing a cost-of-service rate change to show "a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index such that the rate at the ceiling level would preclude the carrier from being able to charge a just and reasonable rate."⁵⁵ The Initial Decision found that substantial divergence was a "threshold [procedural matter] to be determined at an oil pipeline carrier's initial rate filing, not after a full hearing on the merits."⁵⁶ The Initial Decision concluded that the Commission "impliedly and necessarily found a showing of substantial divergence" when it accepted Mid-America's rate filings and set them for hearing.⁵⁷

49. *Williams Energy Services v. Mid-America Pipeline Co., L.L.C.*, 115 F.E.R.C. ¶ 61,124 (2006).

50. *Mid-America Pipeline Co.*, 115 F.E.R.C. ¶ 61,124 (2006).

51. *Order Clarifying Scope of Proceeding*, Docket Nos. IS05-216-003, *et al.* (September 7, 2006).

52. *Mid-America Pipeline Co.*, 116 F.E.R.C. ¶ 61,249 (2006).

53. *Mid-America Pipeline Co.*, 117 F.E.R.C. ¶ 63,013 (2006).

54. *Id.* at 22.

55. 18 C.F.R. § 342.4(a) (2009).

56. 124 F.E.R.C. ¶ 63,016, at 500.

57. *Id.* at 504-05.

b. Locked-in Period

When Mid-America increased its Northern System rates effective May 1, 2006 (Tariff No. 41), the prior rate increases that took effect on May 1, 2005 (Tariff No. 38), became “locked-in.” Mid-America proposed to use the actual costs from the twelve-month period that Tariff No. 38 was in effect to assess the justness and reasonableness of the Tariff No. 38 rates. The Initial Decision, however, found no “unique or compelling circumstances” permitting deviation from the Commission’s traditional base and test period rules and therefore found it “more appropriate” to use a 2004 base period with a test period ending September 2005.⁵⁸

c. Capital Structure

Mid-America proposed to use its own capital structure for the period 1987 through 2001, when it issued long-term debt without any parent guarantee. Mid-America relied on *Williams Pipe Line Co.* (Opinion 154-B), which held that “a pipeline which issues long-term debt to outside investors without any parent guarantee should use its (the pipeline’s) own capital structure.”⁵⁹ The Initial Decision ruled that Mid-America should instead use the capital structure of its parent companies (MAPCO from 1987-1997 and The Williams Companies from 1998-2001). The Initial Decision found that Mid-America “is not an independent financial entity,” and that while it “issued long-term debt to outside investors without any parent guarantee . . . it did not have its own bond rating.”⁶⁰ The Initial Decision also found the Mid-America equity ratios, which averaged seventy-five percent during the 1987-2001 period, to be “excessive.”⁶¹

d. Allocation Issues

Mid-America owns certain facilities at Conway, Kansas (*e.g.*, pumps, meters, and dehydration equipment) that serve both the Central and Northern Systems. It owns similar facilities at Hobbs, Texas that serve both the Central and Rocky Mountain Systems. The Initial Decision approved Mid-America’s allocation of the operating expenses and rate base associated with the Conway and Hobbs facilities between the relevant systems using the Kansas-Nebraska (KN) method, a formula which allocates costs using two factors: labor and gross plant.⁶² The Initial Decision rejected Staff’s proposal to allocate rate base at Conway and Hobbs using the volumes that moved through each facility.⁶³ The Initial Decision, however, required Mid-America to adjust its KN calculation to remove labor costs associated with an ammonia pipeline operated by Mid-America for another company.⁶⁴

With respect to overhead, the Initial Decision approved Mid-America’s use of the Distrigas method (or “Modified Massachusetts formula”), which allocates

58. *Id.* at 536.

59. *Williams Pipeline Co.*, 31 F.E.R.C. ¶ 61,377, at 61,836 (1985) [hereinafter, *Opinion 154-B*].

60. 124 F.E.R.C. ¶ 63016, at 580 (explaining that *Opinion 154-B* relied on general gas pipeline precedent with respect to capital structure issues).

61. *Id.* at 581.

62. *Id.* at 605, 623-24, 736-50.

63. *Id.* at 623-24.

64. *Id.* at 750-52.

costs using three factors: labor, plant, and net revenue.⁶⁵ The Initial Decision, however, required Mid-America to re-calculate its overhead allocation using end-of-period rather than monthly balances and to include the Gulf Terra entities that were acquired by Enterprise during the test year.⁶⁶

e. Income Tax Allowance

The Initial Decision held that Mid-America had generally calculated its federal income tax allowance correctly.⁶⁷ The Initial Decision rejected Mid-America's state income tax calculations, however, on the ground that they were based on the states in which the pipeline operates instead of the states in which the partners of the parent company pay taxes.⁶⁸

f. Storage

Mid-America's Northern System includes storage facilities at Iowa City and Greenwood used by the pipeline for operational purposes (operational storage).⁶⁹ At Conway, there is both operational storage as well as certain storage made available for individual shipper use for an additional fee (merchant storage).⁷⁰ The Initial Decision found the operational storage to be jurisdictional because it is "a necessary part of transportation," and found the merchant storage not to be jurisdictional, "because it is offered only for the convenience of shippers."⁷¹ All parties agreed that it was not necessary for Mid-America to charge separate rates for operational storage,⁷² and the Initial Decision determined that, since the merchant storage was non-jurisdictional, Mid-America was also not required to include rates for merchant storage in its tariff.⁷³ The Initial Decision required the costs and revenues related to the operational storage to be included in Mid-America's transportation rates.⁷⁴ The Initial Decision found that all of the costs and revenues related to the Conway storage should be reflected in Mid-America's transportation rates, because the Initial Decision found insufficient evidence in the record to determine what percentage was operational and what percentage was merchant.⁷⁵ The Initial Decision allowed Mid-America to recover the cost of leasing the operational storage at Greenwood and Iowa City from an affiliated storage provider, because the costs were not shown to be imprudent and Mid-America proved that the costs equaled the fair market price through the use of a market study.⁷⁶

65. *Id.* at 780-84 (rejecting the Propane Group's argument that the traditional Massachusetts formula's use of gross revenue was more appropriate).

66. *Id.* at 785-87.

67. *Id.* at 685.

68. *Id.* at 685, 709.

69. *Id.* at 312.

70. *Id.* at 944.

71. *Id.* at 923.

72. *Id.* at 938.

73. *Id.* at 942.

74. *Id.* at 943.

75. *Id.* at 944.

76. *Id.* at 975-82.

g. Jurisdiction – Channahon to Morris, Illinois Movement

Mid-America moves ethane/propane mix from Channahon, Illinois (where raw natural gas from Canada is processed to remove the natural gas liquids and the combined natural gas liquids are fractionated into individual natural gas liquid products) to a petrochemical plant at Morris, Illinois (where the ethane/propane mix is used as a feedstock to create other petrochemical products).⁷⁷ Mid-America treated the movement as intrastate, because the ethane/propane mix was created and used in Illinois and the movement occurred solely within that state.⁷⁸ The Initial Decision, however, found the movement to be interstate transportation.⁷⁹ The Initial Decision found that the pipeline that brought the raw natural gas from Canada to Channahon could “be characterized as a natural gas liquid pipeline because it moves wet gas, which is raw natural gas that has not had any of the natural gas liquids inherent in it stripped out.”⁸⁰ The Initial Decision found that the ethane/propane mix was not manufactured at Channahon, but was “already in existence and being injected in Canada.”⁸¹ The Initial Decision further found that the entity that operated the processing and fractionation facility at Channahon was the only entity that could inject natural gas liquids in Canada and extract them at Channahon.⁸² The Initial Decision concluded that “the fixed and persisting intent of the shipper owning or having the exclusive rights to all of the ethane/propane mix separated from the [raw natural gas stream] is to continue the transportation of the ethane/propane mix in interstate commerce.”⁸³

h. Throughput and Deficiency Agreement

Mid-America’s Northern System tariff provides a volume incentive rate under which, if a shipper fails to move the required volumes, it is required to make a deficiency payment of \$2.9 million.⁸⁴ During the period at issue, one shipper failed to move the required volumes and made the deficiency payment. Mid-America treated it as non-jurisdictional revenue since it was not for transportation service.⁸⁵ The Initial Decision disagreed, finding the payment to be jurisdictional trunk revenue, requiring a revenue credit against Mid-America’s cost of service.⁸⁶

i. Rate Design

In designing rates, Mid-America proposed to use an iterative discounting methodology sometimes used by the Commission in the natural gas context to account for certain discounts on its Northern System.⁸⁷ Mid-America explained

77. *Id.* at 1009.

78. *Id.* at 985.

79. *Id.* at 1008.

80. *Id.* at 1009.

81. *Id.* at 1010.

82. *Id.* at 1009.

83. *Id.* at 1011.

84. *Id.* at 1035.

85. *Id.* at 1036.

86. *Id.* at 1047.

87. *Id.* at 1081.

that since competition required it to discount certain rates, Mid-America would not be able to recover its full cost of service if it was required to design rates on a fully allocated cost basis (*i.e.*, using a strictly barrel/barrel-mile allocation formula).⁸⁸ The Initial Decision rejected Mid-America's rate design approach and required use of the fully allocated cost method.⁸⁹ The Initial Decision found that Mid-America had not shown that competition existed.⁹⁰ It further held that Mid-America's incentive rates were "negotiated rates" and not discounted rates that would justify use of the iterative discounting methodology.⁹¹ The Initial Decision also found that, even if an adjustment for discounted rates was appropriate, Mid-America had not correctly calculated the iterative discounting methodology.⁹²

j. Seminole

The remaining sections of the Initial Decision dealt with Williams' complaint against Seminole. The Initial Decision first found that Seminole is a FERC-jurisdictional pipeline.⁹³ While Seminole is located solely within the state of Texas, many of the shipments on Seminole begin outside of Texas and are nominated for continuous movement from the non-Texas origins to Mont Belvieu, Texas.⁹⁴

In assessing rates, the Initial Decision found Seminole's existing local FERC rate to be too high, and required the rate to be recalculated using the Commission's Opinion 154-B methodology, an end-of-test-year rate base and the same capital structure as Mid-America.⁹⁵ The Initial Decision upheld Seminole's use of actual base period volumes, finding them to be "the best representative of [Seminole's] future throughput levels."⁹⁶ No refunds or reparations were owed on Seminole's local rate, because no volumes were shipped on that rate during the period at issue.⁹⁷ The Initial Decision, however, found that Williams may be entitled to reparations for shipments on the Mid-America/Seminole joint rates depending on the difference between the joint rates on file and just and reasonable joint rates equal to the sum of the existing Mid-America local rates and the new Seminole local rate.⁹⁸

III. TRANS ALASKA PIPELINE SYSTEM (TAPS) CASES

A. *Opinion No. 500*

Opinion No. 500, issued in Docket No. OR06-10-000 on March 20, 2008, affirmed an Initial Decision involving the TAPS Quality Bank.⁹⁹ "This

88. *Id.* at 1080-81.

89. *Id.* at 1177-79.

90. *Id.* at 1112-19, 1124-26.

91. *Id.* at 1120-23, 1127-28.

92. *Id.* at 1150-57.

93. *Id.* at 1291-1301.

94. *Id.* at 1296.

95. *Id.* at 1342-58.

96. *Id.* at 1322.

97. *Id.* at 1370.

98. *Id.* at 1387-88.

99. *BP Pipelines (Alaska) Inc.*, 122 F.E.R.C. ¶ 61,236 (2008) [hereinafter, *March 20 Order*].

proceeding addressed the “cost adjustment to the West Coast Heavy Distillate cut under the . . . methodology for valuing the TAPS crude oil [established] in Opinion No. 481.¹⁰⁰” The Commission relied on the Nelson-Farrar Operating Cost Index (NFOCI) that tracks numerous refining costs, and rejected challenges to the use of the NFOCI, citing to the fact that FERC has used the index for more than a decade to adjust processing costs used by the Quality Bank.¹⁰¹ The Commission used 2000 as a base year and then adjusted the processing cost using the NFOCI, holding that continuing its longstanding use of the NFOCI was appropriate to “adjust total processing costs, given that the index applies to total refinery costs, and is the standard used by the industry for this very purpose.”¹⁰²

The FERC directed the TAPS Carriers to file compliance documents at the Commission establishing the processing costs adjustment for the West Coast heavy distillate cut within thirty days of the March 20 Order.¹⁰³ The compliance filing was made on April 2, 2008.¹⁰⁴ Flint Hills Resources Alaska, L.L.C. (FHR) protested the proposed June 1, 2006 effective date of the compliance filing, but the Commission accepted the compliance filing and rejected FHR’s protest in an order issued December 2, 2008.¹⁰⁵ FHR and Petro Star, Inc. filed requests for rehearing in December 2008 arguing that the Commission improperly accepted June 1, 2006 as the effective date of the compliance filing.¹⁰⁶

B. *Opinion No. 502*

Opinion No. 502,¹⁰⁷ issued on June 20, 2008, affirmed an Initial Decision¹⁰⁸ by the Administrative Law Judge (ALJ) involving the TAPS Carriers’ 2005 and 2006 interstate rate filings. The ALJ found that the “TAPS Carriers . . . failed to prove that the proposed rate increases in their 2005 and 2006 tariffs were just and reasonable,” and ordered limited refunds to all TAPS shippers under Interstate Commerce Act (ICA) section 15(7).¹⁰⁹ “The ALJ directed the TAPS Carriers to make a compliance filing after issuance of a Commission final order [to] establi[sh] rates in conformance with the findings in the [Initial Decision].”¹¹⁰ The Commission affirmed the ALJ on all issues and clarified and modified the ALJ findings on certain issues, as summarized below.¹¹¹

100. *Id.* at 1.

101. *Id.* at 48.

102. *March 20 Order*, *supra* note 99, at 52.

103. *Id.* at ¶ (B).

104. *BP Pipelines (Alaska) Inc.* 125 F.E.R.C. ¶ 61,254, at 1-2 (2008).

105. *Id.* at 14.

106. 127 F.E.R.C. ¶ 61,317 (2009).

107. *BP Pipelines (Alaska) Inc.*, 123 F.E.R.C. ¶ 61,287 (2008) [hereinafter, *June 20 Order*].

108. *BP Pipelines (Alaska) Inc.*, 119 F.E.R.C. ¶ 63,007 (2007). On May 31, 2007, the ALJ issued an errata to the Initial Decision with changes to certain items. *BP Pipelines (Alaska) Inc.*, 119 F.E.R.C. ¶ 63,008 (2007).

109. *June 20 Order*, *supra* note 107, at 20.

110. *Id.*

111. *Id.*

C. *Burden of Proof / Use of TAPS Settlement Methodology*¹¹² (TSM)

The burden of proof falls on the proponent of an increase in rates, in this case the TAPS Carriers since each of their filings for 2005 and 2006 proposed an increase over the existing rates.¹¹³ The TAPS Carriers were found to have the “burden of supporting each component of the cost of service, the unchanged as well as the changed components. . . demonstrat[ing] the justness and reasonableness of the overall proposed rates, not merely the increases related to the changed components of those rates.”¹¹⁴

The TSM, which was approved by the Commission in a settlement agreement between the State of Alaska and six of the eight original TAPS owners (Settlement Agreement), has been used to determine the maximum interstate tariffs for TAPS for each year since January 1, 1986.¹¹⁵ The TSM established an original and new rate base which is adjusted annually for inflation, with annual depreciation subtracted before the inflation adjustment is made, and the TSM also had provisions for certain expenses to be recovered, income tax, and net carryover.¹¹⁶ The TSM merely set maximum tariffs and did not preclude lower future tariffs.¹¹⁷ In approving the Settlement Agreement, the “Commission did not rule that either the settlement rate or the TSM rate methodology were just and reasonable.” Rather, the settlement was uncontested and the Commission evaluated the settlement under the uncontested settlement regulations.¹¹⁸ Therefore, the methodology cannot be used to determine just and reasonable rates for TAPS, and “cannot be imposed on non-settling parties unless it meets the just and reasonable standard.”¹¹⁹

Opinion No. 154-B provides the ratemaking standard for this ratemaking proceeding, and it creates an obligation on all TAPS Carriers to “support each of the individual rate elements of their filed rates, and cannot simply support the [overall] rate level of their filed rates.”¹²⁰ The Commission found, however, that the TAPS Carriers did not justify “any of the elements that determine the TSM rate,” and the Commission rejected “the TSM as an inappropriate method for setting the TAPS rates.”¹²¹ The remainder of Opinion No. 502 focuses on the proper inputs under the Opinion No. 154-B guidelines.

D. *Property Balances*

The TAPS Carriers argued that the Commission should rely on the depreciation rates prescribed by the Commission in 1982 (1982 Stipulation).¹²²

112. *Trans Alaska Pipeline Sys.*, 33 F.E.R.C. ¶ 61,064 (1985) (approving the TSM as “a comprehensive cost-based methodology that provides a rational and predictable tariff profile over time which is economically efficient”) (hereinafter, *October 23 Order*); *reh'g denied*, 33 F.E.R.C. ¶ 61,392, 61,757 (1985).

113. *Id.* at P 45.

114. *June 20 Order*, *supra* note 107, at 46.

115. *October 23 Order*, *supra* note 112, at 61,138.

116. *Id.* at 61,139.

117. *June 20 Order*, *supra* note 107, at 46.

118. *Id.* at 49.

119. *Id.* at 51.

120. *Id.* at 53.

121. *Id.* at 59.

122. *Trans Alaska Pipeline Sys.*, 20 F.E.R.C. ¶ 61,352, at 61,730 (1982) (defining how depreciation rates would be calculated for 1982 and then each year subsequent to 1982 until December 31, 2011).

The Commission determined that the appropriate balances for accumulated depreciation in the Opinion No. 154-B methodology are contained in the TAPS Carriers' annual rate filings.¹²³ The Commission found that the "\$450 million of original investment [was] properly excluded from the TAPS Carriers' rate base," and that the "TAPS Carriers' arguments for use of the 1982 Stipulation [was] without merit."¹²⁴ Likewise, the Commission rejected the TAPS Carriers' Form 6 arguments because "Form 6 property balances reflect . . . the straight-line accounting convention required in the Commission's regulations for general reporting purposes, not ratemaking purposes."¹²⁵ The TAPS Carriers' other arguments were also rejected including those "pertaining to FERC Form 73 and [the argument] that book depreciation rates, such as those in Form 6, are used for cost of service purposes."¹²⁶ The Commission affirmed the ALJ's conclusion that the "\$450 million of rate base previously amortized and recovered, as well as all other costs recovered in rates before and after 1985 . . . must be recognized in future rates."¹²⁷ "[T]here [was] record evidence that [the] exclusion and subsequent amortization of the \$450 million represent[ed] the resolution of the imprudence claims made against the TAPS Carriers," and the Commission found that the arguments "to ignore the \$450 million recovered investment [were] inconsistent, irrelevant and misleading."¹²⁸ Therefore, the Commission determined that the "TAPS Carriers already received the benefits of the amortization in the form of forgiven and reduced refunds and [that] cost-based, just and reasonable ratemaking requires that these benefits be recognized in future rates."¹²⁹

E. Deferred returns

Anadarko/Tesoro's Opinion No. 154-B cost of service presentation reflected the appropriate adjustment and amounts for deferred returns for 2005 and 2006 (\$198.31 million and \$175.283 million, respectively).¹³⁰ The argument against allowing for deferred return from prior periods based on the TSM's actual operation includes the fact that the "TSM formula for deferred return on remaining investment was calculated using a 100 percent equity structure, which incorrectly assumes that the pipeline was constructed with all equity and therefore, overstates the deferred return, and ultimately violates the principle of Opinion No. 154-B that deferred returns are not allowed on a debt-financed rate base."¹³¹ The Commission also rejected the argument that TAPS Carriers should have been "entitled to more deferred return balances if the TSM recognized post-1985 additions with a return that included an inflation component."¹³² The TSM method provided for deferred returns on these additions, and thus the suggested deferred return calculation using some other method would have amounted to

123. *June 20 Order, supra* note 107, at 21.

124. *Id.* at 76-77.

125. *Id.* at 79

126. *Id.*

127. *Id.* at 86.

128. *Id.*

129. *Id.*

130. *Id.* at 95.

131. *Id.* at 97.

132. *Id.* at 98.

forbidden retroactive ratemaking.¹³³ The Commission further found that since the allowance in the TSM formula already reflected an adjustment to return that incorporated inflation from 1983 forward, “there [was] no need to allow an additional adjustment for inflation already recognized and collected in rates.”¹³⁴ It did not matter how the “deferred returns were calculated under the TSM, or whether they represent[ed] more or less than deferred returns typically calculated under Opinion No. 154-B.”¹³⁵

F. AFUDC and ADIT

The Commission found that Anadarko/Tesoro’s filing reflected the appropriate allowance for funds used during construction (AFUDC).¹³⁶ The Commission also agreed with Anadarko/Tesoro’s accumulated deferred income tax (ADIT) was amounts of “\$46.20 million for 2005 and \$43.00 million for 2006.”¹³⁷

G. Starting Rate Base (SRB) Write-up

The Commission held that the TAPS Carriers were not entitled to an SRB write-up. Based on Opinion No. 154-B, an SRB cannot be calculated without a valuation report.¹³⁸ The SRB write-up was “intended to bridge the transition from valuation rate base to [trended original cost] rate base” and was irrelevant because “the TAPS Carriers never had rates approved on the valuation methodology.”¹³⁹ The “TAPS Carriers did not rely on the valuation methodology, and never had an approved rate calculated under a valuation formula.”¹⁴⁰ The “TAPS Carriers’ rates . . . were never going to be regulated under the ICC valuation methodology,” so there was no reason to issue a valuation order,¹⁴¹ and “the TAPS Carriers never petitioned the Commission to issue [such] report.”¹⁴² Since the “Commission has not allowed an SRB write-up for any oil pipeline whose rates have not been established under the valuation methodology,” the Commission held it was not appropriate to allow an SRB write-up for the TAPS Carriers.¹⁴³

H. Dismantlement, Removal, and Restoration (DR&R)

The Commission affirmed that the “use of Moody’s Aa bond rate to calculate the TAPS Carriers’ after tax accumulated balance for the years 1977 through 2005” was appropriate, because it was the “most reasonable approach, was consistent with the approach used in the TSA, and was equitable under the circumstances.”¹⁴⁴ The Commission also stated that basing the TAPS Carriers’

133. *Id.* at 98.

134. *Id.* at 100.

135. *Id.* at 102.

136. *Id.* at 103.

137. *Id.* at 103-104.

138. *Id.* at 114.

139. *Id.*

140. *Id.*

141. *Id.* at 115.

142. *Id.* at 117.

143. *Id.* at 116.

144. *Id.* at 138.

earnings rates on their parents' earning rates would be too high, because the parents' capital structures did not have a debt component so they were based on 100 percent equity.¹⁴⁵ Likewise, the Commission rejected the TAPS Carriers' proposed risk-free interest rate as "too low because it fail[ed] to take into account that the TAPS Carriers had free rein to use the DR&R funds as they pleased."¹⁴⁶ "The correct amounts for the DR&R allowance for 1977-1981 are the TSM-6 amounts."¹⁴⁷ The TAPS Carriers "have not cost justified additional collections of DR&R expense through future rates and . . . the DR&R expense should not be collected in the 2005 and 2006 Carriers' cost-based rates."¹⁴⁸ Finally, the Commission affirmed that "at this time the TAPS Carriers are not required to credit rate base or refund any amounts," noting that the "concern[s] regarding DR&R expense [are] what earnings these funds have accrued and what the ultimate DR&R costs will be at the end of the useful life of the pipeline."¹⁴⁹

The Commission held that refunds regarding the DR&R collections were premature at the time, but noted that this did not "preclude the possibility of refunds being issued when such collections of DR&R are realized and quantified."¹⁵⁰ Therefore, if the refund is granted, it will not be until the final costs are known because DR&R expenses will not be realized and quantified until the end of the life of the pipeline.¹⁵¹ The Commission rejected arguments that this is retroactive ratemaking and found that accounting for DR&R collections and earnings is consistent with Commission precedent "since the remedy only concerns the 2005 rates forward, the money was collected in jurisdictional rates related to a jurisdictional service and the DR&R collections and earnings are prepayments."¹⁵²

I. Capital Structure

"[S]ince TAPS does not provide its own debt financing, the ALJ appropriately looked to an alternative capital structure."¹⁵³ The equity ratios of the TAPS Carriers' parent companies are anomalous and do not appropriately represent the Carrier's risk profile, and they fall outside the forty-five percent to fifty-five percent equity range normally approved by the Commission for oil pipelines' capital structures.¹⁵⁴ Therefore, the Commission determined that the "appropriate capital structure is that of a hypothetical proxy group that mirrors a typical oil pipeline."¹⁵⁵ The proxy group selected was the same proxy group the parties agreed to use to calculate return on equity, which consisted of oil pipeline companies previously approved as acceptable by the Commission.¹⁵⁶ Also, the Commission noted that the distinction between MLP distributions and corporate

145. *Id.* at 139.

146. *Id.* at 140.

147. *Id.* at 141.

148. *Id.* at 142.

149. *Id.* at 148.

150. *Id.* at 161.

151. *Id.* at 162.

152. *Id.* at 163.

153. *Id.* at 175.

154. *Id.* at 176.

155. *Id.* at 178.

156. *Id.* at 179.

dividends is not a relevant consideration in the determination of an entity's capital structure.¹⁵⁷ Therefore, the Commission affirmed the ALJ's capital structure of "55 percent debt and 45 percent equity for 2005, and 58 percent debt and 42 percent equity for 2006."¹⁵⁸

J. Return on Equity

The Commission determined that the ALJ based the TAPS' return on equity on a proxy group that was both risk-appropriate and representative, but found that the ALJ failed to make adjustments to account for differences for the lower growth prospects due to distributions in excess of earnings.¹⁵⁹ Therefore, the Commission required that the return on equity amounts be modified for the long-term growth projection for Master Limited Partnerships to fifty percent of the projected growth of gross domestic product.¹⁶⁰ Finally, the Commission affirmed the ALJ's decision not to add a two percent risk premium to the TAPS Carriers' return on equity, because the TAPS Carriers failed to rebut the presumption that TAPS faces average risks.¹⁶¹ The risk premium inquiry is forward-looking, and TAPS's current business and financial risks are average.¹⁶²

K. Cost of Debt

The ALJ determined, and the Commission affirmed, that the cost of debt would be calculated in accordance with the findings concerning capital structure.¹⁶³ "[T]he real weighted cost of capital in this case [was] 7.20 percent in 2005 and 7.16 percent in 2006."¹⁶⁴

L. Stand-Alone Cost (SAC) Presentation

The Commission found that it had "never used SAC to establish an overall revenue requirement, nor [had] it ever [been] suggested that it be used in such a manner."¹⁶⁵ The Designated Carriers' attempt to use SAC as a test revenue adequacy was therefore without merit.¹⁶⁶ The Commission also found that the Designated Carriers' SAC proxy did not serve as adequate, credible, acceptable evidence, and cannot justify the filed rates.¹⁶⁷

M. Refunds

The rate determined in this case became effective on January 1, 2005, "but the refund [was] limited to the amount of the increase in the filed 2005 and 2006 rates over the existing rate in the 2004 filing, which filing was not protested."¹⁶⁸

157. *Id.* at 181.

158. *Id.* at 183.

159. *Id.* at 186.

160. *Id.* at 194.

161. *Id.* at 195-96.

162. *Id.* at 196.

163. *Id.* at 197.

164. *Id.* at 197-98.

165. *Id.* at 205.

166. *Id.* at 206.

167. *Id.* at 207.

168. *Id.* at 226.

The Commission found no merit in the argument “that no refunds should be required and that any change in rates must be prospective only.”¹⁶⁹ The Commission held that the State of Alaska (State) did not show discrimination based on the difference between interstate and intrastate rates, and the discrimination claim provided no basis for ordering refunds below the refund floor.¹⁷⁰

N. Individual Versus Uniform Rates

The Commission agreed with the ALJ that there should be a uniform interstate rate, and “that nothing in the ICA prevents the Commission from setting a uniform rate for the identical service, as long as the uniform rate is just and reasonable.”¹⁷¹ But, the Commission also found “there was nothing that precluded it from requiring that, as part of the process of establishing just and reasonable rates, the TAPS Carriers continue to make revenue adjustments based on actual usage.”¹⁷²

O. State’s Request For Refunds

The State requested that the Commission modify the ALJ’s decision by requiring a reduction in the interstate rates to the level of the intrastate rate to eliminate the unlawful discrimination.¹⁷³ The Commission found that nothing in the ICA or decisions thereunder support the State’s contention that because it is seeking equitable relief against discriminatory rates, it did not need to prove actual damages.¹⁷⁴ Finally, the Commission noted that the Intrastate Settlement Agreement (ISA) provides that in the event unjust discrimination or undue preference occurs, the maximum intrastate rate will be adjusted to equal the maximum interstate rate.¹⁷⁵ Therefore, even if the State’s discrimination claim were upheld, the result would be to increase the intrastate rate to match the interstate rate.¹⁷⁶

P. TAPS Intrastate Rates and ICA Section 13(4)

After the new interstate rates are implemented, the difference between the interstate and intrastate rates will be so minimal that the TAPS Carriers’ ICA Section 13(4) claim will be effectively rendered moot.¹⁷⁷

Q. Commission Orders

The Commission ordered the TAPS Carriers “to make a compliance filing establishing rates in conformance with the Initial Decision and [the] order within thirty days. . . .”¹⁷⁸ The TAPS Carriers were also directed to file a refund report

169. *Id.* at 227.

170. *Id.* at 233.

171. *Id.* at 242-44.

172. *Id.* at 248.

173. *Id.* at 265.

174. *Id.* at 266.

175. *Id.*

176. *Id.* at 269.

177. *Id.* at 279.

178. *Id.* at ¶ (B).

and refund shippers in accordance with the Initial Decision and the Order within thirty days of the order establishing rates in the proceeding.¹⁷⁹

R. Rehearing of Opinion 502

On November 20, 2008, the Commission issued an order generally denying rehearing, but granting rehearing, in part, of Opinion No. 502, on the pooling issue and directed the TAPS Carriers to amend their operating agreement to include a pooling mechanism as discussed in the rehearing order.¹⁸⁰ The Order also accepted the TAPS Carriers' compliance filing which established rates for 2005 and 2006 applying the Opinion No. 154-B methodology.¹⁸¹

S. TAPS Carriers' Rates for 2007 and 2008

The TAPS Carriers filed interstate rates for 2007 and 2008 on or about December 1, 2006 and November 30, 2007, respectively.¹⁸² On July 22, 2008, Shippers filed a motion requesting that the Commission summarily dispose of the TAPS Carriers' 2007 and 2008 rate filings because they were legally deficient and contrary to the ratemaking methodology approved in Opinion No. 502.¹⁸³ Alternatively, they requested that the Commission require TAPS Carriers to file reduced 2007 and 2008 rates to conform to the cost-based ratemaking principles established for TAPS in Opinion No. 502.¹⁸⁴

In the Order on Motion for Summary Disposition and Directing TAPS Carriers to Submit Compliance Filing Establishing Rates for 2007 and 2008 Consistent with Opinion No. 502, issued on December 29, 2008, the Commission found that summary disposition was appropriate since Opinion No. 502 equally applies to setting the rates for 2007 and 2008.¹⁸⁵ The Commission denied the request to immediately reduce the rates, holding that such action would deny the TAPS Carriers an opportunity to set just and reasonable rates for 2007 and 2008 based on circumstances in those years. Therefore, the Commission granted the alternative request and ordered the TAPS Carriers to submit compliance filings calculating 2007 and 2008 rates in conformity with the ratemaking methodology established in Opinion No. 502.¹⁸⁶

The TAPS Carriers filed their compliance filing on January 28, 2009 calculating rates for 2007 and 2008 consistent with Opinion No. 502, and on April 16, 2009 the Commission issued an order addressing rehearing requests of the December 29 Order and the compliance filing.¹⁸⁷ In the April 16 Order, "the Commission resolv[ed] on a summary basis the issues of the useful life of the pipeline [(2034)] and the appropriate refund floor for 2007 and 2008."¹⁸⁸ The Commission found that the 2007 compliance filing rate fell below the 2004

179. *Id.* at ¶ (C).

180. *BP Pipelines (Alaska) Inc.*, 125 F.E.R.C. ¶ 61,215, at 55 (2008).

181. *Id.* at 2.

182. *BP Pipelines (Alaska) Inc.*, 125 F.E.R.C. ¶ 61,367, at 1 (2008).

183. *Id.* at 4.

184. *Id.* at 4.

185. *Id.* at 19.

186. *Id.*

187. *BP Pipelines (Alaska) Inc.*, 127 F.E.R.C. ¶ 61,047 (2009).

188. *Id.* at 36.

refund floor, so no further proceedings regarding the 2007 rates were necessary.¹⁸⁹ “[T]he Commission order[ed] the TAPS Carriers to issue refunds for 2007 limited to the difference between the charged 2007 TSM rate and the 2004 refund floor.”¹⁹⁰ The 2008 proposed uniform rate, on the other hand, was higher than the 2004 refund floor. The Commission needs to determine whether the TAPS Carriers’ proposed rate is just and reasonable, and if not, to set the just and reasonable rate.¹⁹¹ Since the compliance filing raised a number of issues of material fact, the Commission felt these issues were more appropriately addressed in a hearing.¹⁹² The following issues were set to be resolved through hearing and settlement judge procedures:

[W]hether (1) the ROE and capital structure were properly determined; (2) test-period or actual data should be used to calculate the rate; (3) DR&R expenses were improperly included in the rate; (4) the correct rate base, operating expenses, and throughput were used in calculating the rate; and (5) the rates improperly included imprudent costs related to the SR Project.¹⁹³

A formal settlement conference was held on May 15, 2009, and the participants agreed to provide a status report to the Settlement Judge on June 15, 2009.¹⁹⁴

IV. SANTA FE PACIFIC PIPELINES, L.P.

As relevant to this report, Santa Fe Pacific Pipelines, L.P. (SFPP) operates four principal pipelines that transport petroleum products in Texas, New Mexico, Arizona, California, Nevada, and Oregon, known as the East Line, North Line, Oregon Line, and West Line (respectively). SFPP also operates a short pipeline in the Los Angeles area called the “Sepulveda Line.”

Beginning in 1992, the SFPP litigation encompasses three main periods: (1) various complaints in Docket Nos. OR92-8-000, *et al.* against the East and West Line rates and Watson Station drain-dry charge; (2) the proceedings in OR96-2-000 *et al.* against all SFPP rates through 2000; and (3) complaints filed against those rates after 2000.

A. *OR92-8 and OR96-2*

On May 29, 2007, the U.S. Court of Appeals for the D.C. Circuit upheld the FERC’s Policy Statement on Income Tax Allowances,¹⁹⁵ and affirmed that the FERC could apply the Policy Statement to SFPP.¹⁹⁶ The court held that “SFPP will be eligible for a tax allowance only to the extent it can demonstrate—in a

189. *Id.*

190. *Id.* at 42.

191. *Id.* at 43.

192. *Id.*

193. *Id.*

194. *Settlement Judge Report to the Commission and Chief Judge*, Docket No. IS07-75-001, *et al.* (May 18, 2009).

195. *Inquiry Regarding Income Tax Allowances*, 111 F.E.R.C. ¶ 61,139 (2005).

196. *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 951-53 (D.C. Cir. 2007).

rate proceeding—that its partners incur ‘actual or potential’ income tax liability on their respective shares of the partnership income.”¹⁹⁷

The court also upheld FERC’s interpretation of EPAct Section 1803 governing “grandfathered” rates.¹⁹⁸ In adopting a new test for “substantially changed circumstances,” the FERC had “de-grandfathered” SFPP’s West Line rates as of 1995 and 1997.¹⁹⁹ On appeal, the court found that the FERC’s interpretation of Section 1803 to require a showing of a substantial change in a pipeline’s overall achieved return was reasonable.²⁰⁰

Finally, the court held that shippers on SFPP’s East Line were entitled to reparations for the rates that went into effect on August 1, 2000, and that the FERC’s denial of their claim was contrary to law.²⁰¹ On August 20, 2007, the court denied SFPP’s petition for rehearing of the May 29, 2007 decision.

On December 26, 2007, the Commission issued its “Order on Rehearing, Remand, Compliance, and Tariff Filings”²⁰² in this proceeding and multiple other dockets. The order addressed SFPP’s March 7, 2006 compliance filing in Docket Nos. OR92-8 and OR96-2 and related tariff filings in light of the D.C. Circuit decision, as well as that court’s remand on the reparations issue. The primary issues addressed by the Commission include income tax allowances, changed circumstances, reparations, the use of master limited partnerships in the proxy group,²⁰³ and specific cost-of-service issues in OR92-8 and OR96-2.

Regarding income tax allowance issues, the Commission “affirm[ed] its prior conclusion that SFPP can establish that a partner has an ‘actual or potential’ income tax liability if the partner is obligated to file a return that recognizes either taxable gain or a loss.”²⁰⁴ The FERC also affirmed its earlier holding that the marginal tax rate for corporate partners would be presumed to be thirty-four percent unless the partnership can demonstrate that a corporate partner has a higher marginal rate, and that the marginal tax rate for non-corporate investors would be twenty-eight percent.²⁰⁵ The Commission reaffirmed its earlier assumption that partnership income will be distributed in proportion to the partnership interests, and that it is the partner’s distributive income that is used to determine the weighted marginal tax rate.²⁰⁶ The weighted income tax rate is then applied to the pipeline’s jurisdictional income. Finally, the Commission rejected arguments challenging the inclusion of incentive distribution payments made to the general partner in the determination of the income tax allowance, noting that these are “permitted under limited partnership law and are part of the structure authorized by Congress.”²⁰⁷

197. *Id.* at 954.

198. *Id.* at 956.

199. *Id.* at 958.

200. *Id.* at 961.

201. *Id.* at 963.

202. *SFPF, L.P.*, 121 F.E.R.C. ¶ 61,240 (2007).

203. Regarding the use of MLPs in the proxy group, the Commission held that the analysis of that issue was not appropriate for these proceedings, now in their compliance phase, as it would require a remand to develop a record on that issue. *Id.* at 92.

204. *Id.* at 27.

205. *Id.* at 35-37.

206. *Id.* at 35.

207. *Id.* at 55.

On the issue of changed circumstances, the Commission “confirmed” the status of the various SFPP lines and rates as follows: SFPP’s West Line rates were no longer grandfathered as of 1995 and 1997, but SFPP’s North and Oregon Line rates remain grandfathered.²⁰⁸

In response to the *ExxonMobil* court’s remand of the reparations issue, the Commission directed SFPP to develop an East Line cost of service for 1997, and recalculated the period for which reparations for the West Line rates would be owed.²⁰⁹ The Commission also made certain re-determinations as to the eligibility of certain shippers for reparations, based on a *sua sponte* review of the underlying complaints.²¹⁰ The Commission directed SFPP to make a compliance filing within forty-five days of the Commission’s order.²¹¹

On January 25, 2008, SFPP and a number of shippers filed for rehearing of various aspects of the December 26 Order, and the Commission thus issued an “Order on Rehearing” on February 15, 2008,²¹² granting rehearing in part on certain of the reparations and cost-of-service issues in light of SFPP’s anticipated compliance filing, and deferring other issues. On February 26, 2008, SFPP submitted its compliance filing, lowering its rates significantly and re-calculating total West Line reparations for shippers in the millions of dollars.²¹³ Parties protested and filed comments on SFPP’s compliance filing.²¹⁴

On October 27, 2008, several shippers filed a “Motion for Resolution on the Merits” in these dockets and twenty other SFPP proceedings. These shippers requested that the Commission resolve the procedure and process issues regarding the backlog of cases involving SFPP’s rates. On November 12, 2008, SFPP, L.P. and Calnev Pipe Line, L.L.C. filed a joint answer, which disputed various aspects of the shippers’ motion. On the same day, Western Refining Company, L.P. also filed an answer in opposition to shippers’ motion.

B. *Watson Station (Docket No. OR92-8-025)*

In 1993, shippers filed a series of complaints with the Commission asserting the jurisdictional nature and challenging the justness and reasonableness of the incremental fee charged at SFPP’s Watson Station in connection with its drain-dry facilities (otherwise known as vapor recovery facilities). From November 1, 1991 through March 31, 1999, SFPP did not have a tariff on file with the Commission for the charge associated with the Watson Station facilities.

On August 2, 2006, the Commission approved a Settlement Agreement between SFPP and Shippers,²¹⁵ which resolved by stipulation all of the factual issues involved in the docket, with the exception of two legal issues reserved for hearing and decision: (1) whether SFPP’s contracts with individual shippers established a rate level that limited reparations for drain-dry services provided by

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.*

212. *SFPP, L.P.*, 122 F.E.R.C. ¶ 61,133 (2008).

213. *Id.*

214. *Id.*

215. *SFPP, L.P.*, 116 F.E.R.C. ¶ 61,116, at 6 (2006).

SFPP prior to April 1, 1999; and (2) whether the payment of any reparations may start on November 1, 1991, or are limited to the dates two years before the filing of each individual complaint.²¹⁶

On March 28, 2007, Judge Johnson issued her Initial Decision, which concluded that SFPP's contracts with individual shippers did not establish a rate level or preclude reparations during the period before April 1, 1999, and that no reparations would be available for more than two years prior to the filing of a complaint, pursuant to section 16(3)(b) of the ICA, which established an absolute bar on claims that are more than two years old from the date of the complaint.²¹⁷ On February 12, 2008, the Commission affirmed the Initial Decision and directed SFPP to make reparations.²¹⁸ The Commission held that "SFPP's contracts with individual shippers do not establish the rate level or limit reparations for drain-dry services provided prior to April 1, 1999, at its Watson Station storage and pumping facility."²¹⁹ Under the ICA, the carrier must file all jurisdictional rates and it may recover only those rates on file with the Commission.²²⁰

SFPP paid reparations to the shippers in March 2008; however, SFPP appealed the Commission order on March 10, 2008, to the United States Court of Appeals for the District of Columbia Circuit, challenging FERC's determination that SFPP's unfiled contracts with its customers for the installation of "drain-dry" facilities in Watson, California, were not enforceable. The case is now in the briefing stage at the U.S. Court of Appeals for the D.C. Circuit in Case No. 08-1110. Oral argument has not yet been scheduled.

C. Docket Nos. OR03-5-000 & OR03-5-001

This "third round" of shipper complaints filed in 2003 and 2004 against SFPP is bifurcated into two proceedings, one involving the East and West Lines, the other involving the North and Oregon Lines.

In the North Line and Oregon Line proceeding, Judge Edward Silverstein issued an Initial Decision on November 18, 2008.²²¹ Judge Silverstein deferred ruling on the issue of "grandfathering" until after a compliance filing following a ruling on the remaining issues.²²² Specifically, Judge Silverstein framed the grandfathering issue as "[w]hether there was a substantial change, exceeding 15%, in the economic circumstances that served as the basis for either of the grandfathered rates at issue."²²³ Judge Silverstein also deferred on ruling on rate base, rate of return on equity, and capital structure issues. Because no party had calculated rate base for either line for either 2003 or 2004 "using both the correct rate of return on equity and the correct capital structure in this proceeding," Judge Silverstein held that "SFPP must include the appropriate data in its compliance filing following a final ruling on the merits in this matter."²²⁴ With

216. *Id.*

217. *SFPP, L.P.*, 118 F.E.R.C. ¶ 63,033 (2007).

218. *SFPP, L.P.*, 122 F.E.R.C. ¶ 61,126 (2008).

219. *Id.* at 6.

220. *Id.*

221. *Chevron Products Co. v. SFPP, L.P.*, 125 F.E.R.C. ¶ 63,018 (2008).

222. *Id.*

223. *Id.*

224. *Id.* at 479.

respect to the issue of an income tax allowance, Judge Silverstein adopted the income tax rates used by SFPP as “appropriate for purposes of determining its income tax allowance.”²²⁵ Judge Silverstein ruled that “to allocate 2003 and 2004 corporate overhead costs to Kinder Morgan’s subsidiaries . . . the Commission’s traditional one-tier Massachusetts formula should be used . . .”²²⁶ On January 16, 2009, the parties filed Briefs on Exceptions. BP West Coast Products, L.L.C. (BP WCP) also filed an offer of proof with respect to rulings on the policy statements on return on equity and income tax allowances. Commission action is pending on exceptions to Judge Silverstein’s Initial Decision.

With respect to the East Line and West Line portion of these complaints, Judge Bobbie McCartney issued an Initial Decision on June 9, 2009.²²⁷ On the use of indexing, the Initial Decision ruled in favor of the carrier, finding that the 2003 and 2004 test year rates can be indexed forward and backwards for reparations purposes.²²⁸ Trial Staff’s efforts to change SFPP’s depreciation rates were rejected.²²⁹ The carrier’s calculation of its income tax allowance and ADIT were upheld.²³⁰ Judge McCartney found that purchase accounting adjustments should be removed from the equity component of SFPP’s parent’s capital structure, but goodwill should not be removed.²³¹ The Initial Decision applies the ROE Policy Statement, adopting the carrier’s MLP proxy group and finding the carrier of average risk.²³² On overhead allocations, the carrier’s allocation was largely adopted, including findings that certain affiliates were properly excluded from the allocations.²³³

D. East Line Expansions (Docket Nos. IS06-283 & IS08-28)

Following issuance of the D.C. Circuit’s opinion in *ExxonMobil Oil Corp. v. FERC*, the parties in the East Line Phase I expansion case requested that the procedural schedule, which had been held in abeyance pending the court’s opinion, be reinstated after a 120-day pause for settlement negotiations. The parties reached a settlement in principle on September 11, 2007.

On November 6, 2007, SFPP and the shippers filed an uncontested offer of settlement in this and other dockets, which was approved in a letter order issued February 7, 2008.²³⁴ The settlement resolved all protests and complaints related to the East Line Phase I Expansion Tariff and the East Line 2006 and 2007 index rate filings in Docket Nos. IS06-283, IS06-356, IS07-229, and OR07-20, respectively, for a locked-in rate period of June 2006 through November 2007.

On October 31, 2007, SFPP filed its East Line Phase II Expansion Tariff proposing to increase its rates to reflect costs and litigation expenses expected to

225. *Id.* at 697.

226. *Id.* at 783.

227. *Chevron Products Co. v. SFPP, L.P.*, 127 F.E.R.C. ¶ 63,024 (2009).

228. *Id.* at 27, 524.

229. *Id.* at 35, 105, 440.

230. *Id.* at 65, 203.

231. *Id.* at 78, 80, 103-105.

232. *Id.* at 149, 164, 175.

233. *Id.* at 370

234. *SFPP, L.P. et al.*, 122 F.E.R.C. ¶ 61,107, at 9 (2008).

be incurred to expand the East Line for a second time.²³⁵ On November 29, 2007, the Commission set the proceeding for hearing and settlement procedures.²³⁶

On October 22, 2008, the parties filed a settlement resolving SFPP's East Line rates and establishing a rate moratorium through November 30, 2010. On November 12, 2008, Judge Birchman certified the settlement to the Commission, and on January 29, 2009, the Commission issued an order approving the settlement.²³⁷ The settlement resolved all pending issues in Docket Nos. IS08-28-000 and IS08-389-000 and the portions of the complaints filed by BP WCP and ExxonMobil against SFPP's East Line rates in Docket Nos. OR08-13-000 and OR08-15-000.

E. 2006 Index (Docket No. IS06-356)

In SFPP's 2006 index rate increase proceeding, SFPP sought rehearing of the December 6, 2006 order in which the Commission reversed its prior approval of an index rate increase for the East Line.²³⁸ On September 20, 2007 the Commission issued an order denying rehearing.²³⁹ The Commission rejected SFPP's claims that the order had effectively amended the regulations and thereby undercut the indexing regulations for all new rate filings. First, the Commission stated that recent Commission decisions proved that the argument was false, and that the assertion was "inconsistent with basic math."²⁴⁰ Second, the Commission found that the result of its decision is administrative efficiency. In response to SFPP's allegation that the Commission had improperly ordered refunds, the Commission held that it is not precluded from ordering refunds when the underlying rate is under investigation and subject to refund. In that event, any increase to the base rate under an index filing is also subject to refund.

F. 2005 North Line Index Increase Complaints (Docket Nos. OR07-3 & OR07-6)

On December 20, 2006 and January 9, 2007, various shippers filed a complaint and motion for summary disposition in Docket No. OR07-3-000, challenging the application of SFPP's index rate filing in Docket No. IS05-327 to the North Line. The complaint relied upon the Commission's December 6, 2006 order involving SFPP's East Line in Docket No. IS06-356, described above, in asserting that the application of the index rate increase to the North Line would result in unjust and unreasonable rates. Shippers argued that, as with the East Line, the then-current North Line rates were based upon actual costs in the relevant test year, such that an index rate increase for the same year would result in an over-recovery to the pipeline.

The Commission issued an order on March 29, 2007, dismissing the complaints.²⁴¹ The Commission stated that SFPP's 2005 index rate increase did

235. *SFPP, L.P.*, 121 F.E.R.C. ¶ 61,211, 1 (2007).

236. *Id.*

237. *SFPP, L.P.*, 126 F.E.R.C. ¶ 61,076, 2 (2009).

238. *SFPP, L.P.*, 117 F.E.R.C. ¶ 61,271 (2006).

239. *SFPP, L.P.*, 120 F.E.R.C. ¶ 61,245 (2007).

240. *Id.* at 9

241. *BP West Coast Products, L.L.C., v. SFPP, L.P.*, 118 F.E.R.C. ¶ 61,261 (2007).

not result in revenues so substantially in excess of SFPP's actual costs that the resulting North Line rates were unjust and unreasonable. Chevron, Tesoro, and Valero filed a request for rehearing of the March 29 order, challenging, among other things, FERC's acceptance of SFPP's claims that its North Line revenues were under recovering its cost of service; and the inconsistency of the order with the FERC's order denying an East Line index increase in Docket No. IS06-356-000. The Commission denied rehearing on November 20, 2007, distinguishing the East Line case on the basis of SFPP's claim that even with the North Line rate increase SFPP would still not be recovering its cost of service.²⁴²

BP WCP and ExxonMobil filed petitions for review of the orders in the D.C. Circuit, Case Nos. 07-1163 & 08-1237, and the appeals are now in the briefing stage.

G. 2005 Index Rate Increase Complaint (Docket Nos. OR07-8 & OR07-11)

On February 13, 2008, the Commission issued an order setting complaints of BP WCP and ExxonMobil filed in 2007 against SFPP's 2005 index rates for hearing and establishing settlement procedures.²⁴³ On August 29, 2008, the parties submitted a settlement agreement to the Commission. On November 3, 2008, the Commission approved the settlement.²⁴⁴

H. 2007 Index Filing (Docket No. IS07-229) and Complaint (Docket No. OR07-20)

On May 25, 2007, SFPP proposed rate increases incorporating the inflation index established pursuant to the Commission's oil pipeline indexing regulations. BP WCP and ExxonMobil protested the tariff filing, and asserted that SFPP was substantially over recovering its cost of service, and the application of the index would only further exacerbate SFPP's existing "excess profits." Relying on the Commission's June 6, 2007 order in *BP West Coast, L.L.C. v. SFPP, L.P.*,²⁴⁵ BP WCP and ExxonMobil requested that the Commission reject SFPP's filing, or at least suspend and investigate it.

On June 28, 2007, the Commission accepted and suspended the tariffs, subject to refund, effective July 1, 2007.²⁴⁶ The Commission explained that Indicated Shippers arguments "must be advanced by means of a separate complaint, not a protest filed in the suspension phase."²⁴⁷

In accordance with that order, BP WCP filed a complaint challenging SFPP's 2007 index rate increase (Docket No. OR07-20) on August 22, 2007. On November 9, 2007, the Commission issued orders in Docket Nos. OR07-8, OR07-11, and OR07-16 substantially narrowing the holding in the June 6 order in BP WCP's 2005 index complaint against SFPP.²⁴⁸

242. *BP West Coast Products, L.L.C. v. SFPP, L.P.*, 121 F.E.R.C. ¶ 61,195 (2007).

243. *ExxonMobil Oil Corp. v. SFPP, L.P.*, 122 F.E.R.C. ¶ 61,129 (2008).

244. *BP West Coast Products, L.L.C. v. SFPP, L.P.*, 125 F.E.R.C. ¶ 61,138 (2008).

245. *BP West Coast, L.L.C. v. SFPP, L.P.*, 119 F.E.R.C. ¶ 61,241, at 11 (2007) ("complaint will meet the standards of section 343.2(c) if it establishes that the pipeline appears to substantially over-recover its costs at the time it files tariffs to increase rates under our indexation methodology.").

246. *SFPP, L.P.*, 119 F.E.R.C. ¶ 61,330 (2007).

247. *Id.* at 7.

248. *BP West Coast Products, L.L.C. v. SFPP, L.P.*, 121 F.E.R.C. ¶ 61,141 (2007) (dismissing BP's complaint in Docket No. OR07-8); *Tesoro Refining & Marketing Co. v. Calnev Pipe Line, L.L.C.*, 121 F.E.R.C.

On December 14, 2007, the Commission dismissed BP WCP's August 22, 2007, complaint against SFPP's 2007 index rate increase, citing the complaint's failure to meet the standards announced later in the November 9 orders.²⁴⁹ On January 14, 2008, BP WCP requested rehearing, asserting that its complaint was based on the standard then in effect – *i.e.*, the standard set forth in the June 6 order. BP WCP also asserted that the Commission erred in reversing its June 6 order, and that a shipper does meet the burden of alleging reasonable grounds to believe that the rate increase will not be just and reasonable when the pipeline's Form 6, Page 700 shows that it is collecting substantial revenues in excess of its claimed cost of service. BP WCP asserted that, in any event, its complaint did meet the narrowed standard promulgated after the complaint was filed: whether the amount of the excess profits was substantially exacerbated by the rate increase.

In an order issued May 5, 2008, the Commission denied BP WCP's rehearing request.²⁵⁰ The Commission held that Section 343.2(c)(1) of the Commission's regulations requires that the rate increase that results from the index increase be compared to the cost increases actually incurred by the carrier, a year-to-year comparison, and the increase must substantially exacerbate the over-recovery.²⁵¹ The Commission explained that it normally makes this comparison by applying a percentage test, not a dollar test.²⁵² The Commission also explained that an index rate increase may be proper even if the pipeline is over-recovering its cost of service, because the over-recovery may be from the base rate, which must be challenged in a separate complaint.²⁵³ The Commission also rejected the assertion that it was precluding challenges against index-based increases.²⁵⁴

On July 3, 2008, BP WCP filed a petition for review of the December 2007 and May 2008 orders with the United States Court of Appeals for the District of Columbia Circuit. The appeal was docketed as Case No. 08-1237. On August 7, 2008, FERC filed an unopposed motion to hold the appeal in abeyance pending the outcome of a similar appeal by Tesoro in Case No. 07-1461.

On January 23, 2009, the U.S. Court of Appeals for the D.C. Circuit issued an order dismissing Tesoro's petition for review in Case No. 07-1461 for failure to exhaust administrative remedies. On March 23, 2009, the D.C. Circuit issued an order returning the cases to the active docket. The appeals are now in the briefing stage.

¶ 61,142 (2007) (dismissing Tesoro's complaint in Docket No. OR07-16 for failure to meet the standard enunciated in the BP order.).

249. *BP West Coast Products, L.L.C. v. SFPP, L.P.*, 121 F.E.R.C. ¶ 61,243 (2007).

250. *BP West Coast Products, L.L.C. v. SFPP, L.P.*, 123 F.E.R.C. ¶ 61,121 (2008).

251. *Id.*

252. *Id.*

253. *Id.*

254. *Id.*

V. OTHER TARIFF AND RATE MATTERS

A. *Belle Fourche Pipeline Company & Bridger Pipeline, L.L.C. (Docket Nos. IS09-92 & IS09-93)*

In related filings, Belle Fourche Pipeline Company (Belle Fourche) and Bridger Pipeline, L.L.C. (Bridger) filed initial rates to establish new service due to the construction of the new Bridger pipeline, known as the Heart River Line, between the Belle Fourche pipeline system at Skunk Hill Junction, North Dakota and the Bridger Little Missouri Line at Fryburg Station, North Dakota.²⁵⁵ Pursuant to section 342.2(b) of the Commission's regulations, both Belle Fourche and Bridger "filed affidavits stating that the initial rates had been agreed to at least one non-affiliated shipper who intended to use the services."²⁵⁶ The filings were protested by Enserco Energy, Inc. (Enserco) and Nexen Marketing U.S.A., Inc. (Nexen). The protesters alleged, among other things, that the tariffs were an integral part of an arrangement through which the True Companies, which own Belle Fourche and Bridger, were able to discriminate against any shipper other than its own crude oil marketing affiliate, Eighty-Eight Oil, L.L.C.²⁵⁷ Enserco also requested cost justification for Bridger's proposed rate because the rate for the new fifteen mile segment was approximately nine cents per barrel higher than transportation on the existing ninety-three mile segment of the Little Missouri Line.²⁵⁸

On January 16, 2009, the Commission issued an order on tariffs and establishing investigation.²⁵⁹ Since the only rate challenge was filed by Enserco, and only to the initial rate proposed by Bridger, the Commission accepted and suspended Bridger's tariff to be effective December 22, 2008, subject to refund and subject to Bridger providing cost, revenue, and throughput data pursuant to Part 346 of the Commission's regulations.²⁶⁰ "Belle Fourche's rate was accepted to be effective December 22, 2008."²⁶¹ The Commission found that alleged coordination of the activities and prorationing policies of these commonly-owned pipelines for the benefit of their marketing affiliate merited further review.²⁶² Accordingly, "pursuant to sections 15(1) and 15(7) of the [Interstate Commerce Act], the Commission [established] an investigation into the practices of Belle Fourche, Bridger, and their affiliated entities to determine if their practices [were] just and reasonable."²⁶³ Bridger's cost justification and the supplemental pleadings required by the January 16, 2009 order are pending before the Commission.

255. *Belle Fourche Pipeline Co.*, 126 F.E.R.C. ¶ 61,454 (2009).

256. *Belle Fourche Pipeline Co.*, 126 F.E.R.C. ¶ 61,054 (2009).

257. *Id.*

258. *Id.*

259. *Id.*

260. 18 C.F.R. pt. 346 (2008).

261. 126 F.E.R.C. ¶ 61,454, at 61,455 (2009).

262. *Id.* at 24.

263. *Id.*

B. Bridger Pipeline, L.L.C. (Docket Nos. IS09-123 & IS09-124)

In Docket Nos. IS09-123-000 and IS09-124-000, “Bridger request[ed] that the Commission accept two proposed tariffs to provide displacement services between non-contiguous pipeline segments of Bridger’s pipeline” in Montana and North Dakota.²⁶⁴ Enserco protested the filings asserting that Bridger’s proposed new, so-called “displacement” services were inconsistent with the Interstate Commerce Act (ICA) because they were not transportation service at all. Enserco contended that the services constituted an exchange of commodity involving no transportation that were simply part of Bridger’s ongoing efforts to provide preferences to its marketing affiliate, Eighty-Eight Oil, L.L.C.

On February 27, 2009, the Commission issued an order rejecting Bridger’s tariff filings.²⁶⁵ The “Commission recognize[d] that an oil pipeline may provide displacement services, and displacement services by backhaul or counterflow occur on natural gas pipelines and electric transmission systems.”²⁶⁶ The Commission stated that, in such cases, “while the movement of the commodity [goes] against the flow of the system, the commodity itself is received into and transported on one contiguous system.”²⁶⁷ The Commission found that the “only physical transportation path would be through other pipelines and Bridger ha[d] not filed any joint tariff with these other pipelines that would make such proposed displacement services physically possible.”²⁶⁸ The Commission found that the “so-called displacement services proposed by Bridger did not involve the transportation of oil in interstate commerce, and therefore, did not require a Commission tariff.”²⁶⁹ The Commission, citing *Western Refining Pipeline Company*,²⁷⁰ determined that “the service proposed by Bridger can be accomplished in the market without the involvement of a pipeline.”²⁷¹

C. Western Refining Pipeline Company (Docket No. IS08-131)

On February 8, 2008, Western Refining Pipeline Company (Western) filed tariffs establishing initial rates, and rules and regulations governing the interstate movement of crude petroleum from points in New Mexico and Texas to certain points in New Mexico. The filing was protested by Resolute Natural Resources Company and Resolute Aneth, L.L.C. (Resolute); and the Navajo Nation and the Navajo Nation Oil and Gas Company (Navajo Nation). The protesters argued that the filing was an attempt to secure Commission validation of Western’s exercise of market power by illegally preferring its affiliates and discriminating against third parties who seek access to competitive markets for their crude oil. On March 7, 2008, the Commission issued an order accepting Western’s tariffs.²⁷²

264. *Bridger Pipeline, L.L.C.*, 126 F.E.R.C. ¶ 61,182 (2009).

265. *Id.*

266. *Id.* at 15.

267. *Id.*

268. *Id.*

269. *Id.* at 16

270. *Western Refining Pipeline Co.*, 122 F.E.R.C. 61,210 (2008).

271. *Bridger Pipeline, L.L.C.*, 126 F.E.R.C. ¶ 61,182 (2009).

272. *Western Refining Pipeline Co.*, 122 F.E.R.C. ¶ 61,210 (2008); *reh’g denied*, *Western Refining Pipeline Co.*, 123 F.E.R.C. ¶ 61,271 (2008); *appeal pending sub nom.*, *Resolute Natural Res. Co. and Resolute Aneth, L.L.C. v. F.E.R.C.*, No. 08-1268 (D.C. Cir. Aug. 15, 2008).

The Commission addressed several jurisdictional and procedural issues in the proceeding. The Commission found that the protesters did not have standing because they did not demonstrate a substantial economic interest in the transportation of crude oil over Western's pipeline.²⁷³ The Commission stated that the protesters lacked standing because they were not shippers on Western, did not intend to ship on Western, and had not made a valid transportation request to Western for shipments.²⁷⁴ On rehearing, the Commission stated that while "Order No. 561"²⁷⁵ did not adopt specific classifications such as customer, customer of customer, or competitor for purposes of standing, that finding did not mean that such considerations were irrelevant in determining whether a party had a substantial economic stake in a tariff filing and the associated pipeline transportation.²⁷⁶

The Commission also rejected an argument that the Commission has its own enforcement authority under the Mineral Leasing Act (MLA).²⁷⁷ The Commission found that the MLA at 30 U.S.C. § 185(r)(5) "requires the Secretary of the Interior to request the Attorney General to prosecute a proceeding before the appropriate agency or court, including the Commission."²⁷⁸ The Commission concluded that the protesters did not point to any part of the MLA that conferred independent authority on this Commission.²⁷⁹

Finally, the Commission determined that the exchange service the protesters requested that Western provide was a private contractual arrangement that did not involve pipeline transportation. The Commission determined that "since there is no actual movement of oil, there is no transportation involved. The exchange is essentially a private contractual arrangement between the parties exchanging barrels, and thus there is no need to involve the pipeline at all, for there is nothing for the pipeline to do to make an exchange happen."²⁸⁰

D. Big West Oil Company v. Frontier Pipeline Company (Docket No. OR01-2); Express Pipeline Partnership (Docket No. OR01-4)

In *Big West Oil Company v. Frontier Pipeline Company* and *Express Pipeline Partnership*, a challenge regarding the lawfulness of Frontier's local rates and portion of joint rates filed by Frontier and Express, covering the transportation of crude oil and syncrude, was lodged. The carriers were transporting crude oil and syncrude from the Canadian border to Salt Lake City, and published their own rates.²⁸¹ In 1998, the carriers agreed to provide a

273. 122 F.E.R.C. ¶ 62,210 at 13.

274. *Id.*

275. *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, 58 Fed. Reg. 58,753 (1993) (to be codified at C.F.R. pts. 341, 342, 343, 344, 345, 347, 360, 361,375); Order No. 561-A, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, (to be codified at C.F.R. pts. 341, 342, 343).

276. 123 F.E.R.C. ¶ 61,271, at 10 (2008).

277. 30 U.S.C.185(r)(5) (1995).

278. 123 F.E.R.C. ¶ 61,271, at 13.

279. *Id.*

280. 122 FERC ¶ 61,210, at 16 (2008).

281. *Frontier Pipeline Co. v. FERC*, 425 F.3d 774, 779 (D.C. Cir. 2006).

discount to through shippers under joint tariffs published by Express.²⁸² However, the shippers protested, and as a result of settlement discussions, reparations were based on the filed local rates of three of the four carriers, with Frontier's applicable local rate stipulated as lower than what was on file during the period at issue.

The Commission's joint rate policy was identified as, "a joint rate is just and reasonable if it does not exceed the sum of the individual local rates on file for the individual movements covered by the joint rate."²⁸³ Frontier and Express disputed the Commission's methodology of calculating reparations for past overpayments under joint rates. The issue stemmed from whether or not the Commission could combine filed rate segments with a stipulated rate determined by a cost-of-service proceeding, and whether that violated the principle that "a through rate cannot be judged on the basis of a traditional cost inquiry into some segments unless the agency allows the carrier to be heard on costs for other segments."²⁸⁴

The Commission asserted that, "under its joint rates policy, reparations must be calculated based on the sum of the local rates on file with the Commission rather than on the sum of the applicable ceiling levels."²⁸⁵ Judicial review was sought in 2004, but on May 26, 2006, the Court remanded the case to the Commission for further explanation of the joint rates policy.²⁸⁶ Specifically, the court questioned whether Section 1(5) of the ICA precluded the Commission's acceptance of a joint rate without considering the reasonableness of the rate as an aggregate. In June 2007, the Commission affirmed the Commission's policy that "a joint rate is just and reasonable if it does not exceed the sum of the local rates on file with the Commission."²⁸⁷ The Commission further denied Frontier's motion to dismiss the proceedings, but allowed an additional evidentiary proceeding to allow Frontier an opportunity to demonstrate that the joint rate issues in this proceeding were not unreasonable, and that no reparations under the ICA were due.²⁸⁸

In July 2007, Frontier and Express filed requests for rehearing and clarification. The Commission reviewed its policy, and stated that it had "applied its policy consistently by measuring the justness and reasonableness of a joint rate by comparing it with the sum of the underlying local rates on file with the Commission."²⁸⁹ The Commission went on to say that "it never has allowed joint rates to be measured against the sum of the applicable ceiling levels if the ceiling levels were higher than the actual local rates on file."²⁹⁰ The Commission went on to point out that the most accurate measure of a just and reasonable rate is a full cost-of-service determination, which it had offered to Frontier.²⁹¹ Further, "Order No. 561 anticipates such proceedings, and the

282. *Id.*

283. *Big West Oil Co. v. Frontier Pipeline Co.*, 119 F.E.R.C. ¶ 61,249, at 11 (2007).

284. *Id.* at 13.

285. *Id.* at 2.

286. *Id.* at 4.

287. *Id.* at 5.

288. *Id.*

289. *Big West Oil Co. v. Frontier Pipeline Co.*, 122 F.E.R.C. ¶ 61,138, at 8 (2008).

290. *Id.*

291. *Id.* at 30.

Commission's action in providing for a hearing to examine the pipelines' cost-of-service is entirely consistent" with the ICA, regulations, and the court.²⁹² The Commission therefore denied rehearing in this case.²⁹³ The proceeding was terminated March 27, 2009.²⁹⁴

E. Holly Refining and Marketing Company v. Plains All American Pipeline, L.P. and Rocky Mountain Pipeline System, L.L.C., 127 FERC ¶ 61,074 (2009); Rocky Mountain Pipeline System, L.L.C. (Docket No. IS09-157)

On February 17, 2009, Holly Refining and Marketing Company (Holly) filed a complaint against Plains All American Pipeline, L.P. (PAAP) and Rocky Mountain Pipeline System, L.L.C. (RMPS), which challenged the lawfulness of RMPS' proposed flow reversal on an interstate pipeline segment that provided crude oil transportation service from Ft. Laramie, Wyoming westward to Wamsutter, Wyoming.²⁹⁵ Holly's complaint alleged that the flow reversal would result in undue and unjust preferential treatment of affiliates of PAAP and RMPS and "unduly and unjustly [prejudice] and [discriminate] against Holly in violation of the Interstate Commerce Act (ICA) sections 3(1) and 15(1)."²⁹⁶ Holly requested the Commission conduct an investigation, commence hearing procedures, and order a cease and desist to RMPS to stop the flow reversal. In addition, Holly sought damages under ICA section 16(1) in the event RMPS continued with the reversal.²⁹⁷

Holly's refinery at Salt Lake City processes approximately 26,000 barrels per day (bpd) of crude oil and Holly utilizes RMPS to supply its refinery with 2,000-4,000 bpd of crude oil from the Ft. Laramie/Guernsey market and to supply its refinery with 9,000-13,000 bpd of crude oil from the Wamsutter market.²⁹⁸ Holly argued that, as a shipper on RMPS, it had a substantial economic interest in the proposed reversal and that it had standing to bring the complaint.²⁹⁹ Holly alleged that the proposed flow reversal would cut off refineries in Salt Lake City from one of only two import supply options and refineries would have to import an additional 20,000 to 35,000 bpd of crude oil from Casper, Wyoming on Frontier Pipelines, L.L.C., RMPS' affiliate, which in turn would allow Frontier to utilize currently unused capacity. Holly contended that the reversal would allow Plains Marketing, L.P. (Plains), another affiliate of RMPS and a competitor of Holly, to purchase crude at Wamsutter for transportation, resale or blending at Ft. Laramie or more distant hubs, and then store this crude in its new storage tanks at Ft. Laramie, thereby enhancing the logistical and marketing capability of Plains. Holly averred that all of this would result in Holly acquiring lesser quality crude from distant markets, which would result in increased costs and decreased efficiency. Holly alleged that the reversal was not in the economic interest of RMPS, which evidenced other underlying

292. *Id.*

293. *Id.* at 2.

294. *Order Terminating Proceeding*, Docket No. OR01-4-004 (Mar. 27, 2009).

295. *Holly Refining & Mtkg. Co. v. Plains All American Pipeline*, 127 F.E.R.C. ¶ 61,074, at 1 (2009).

296. *Id.* at 4.

297. *Id.*

298. *Id.* at 5.

299. *Id.* at 6.

reasons for the flow reversal.³⁰⁰ Holly contended that the Commission can exercise jurisdiction over the reversal of flow by an oil pipeline where “there is evidence that the reversal would be unduly preferential to a party affiliated with the pipeline,” despite the fact that the Commission does not regulate the abandonment of services by oil pipelines.³⁰¹

BP America Production Co. (BP) protested the complaint arguing that contrary to the implications in Holly’s complaint there was a need for reversal of flow on RMPS.³⁰² BP argued that the reversal would provide producers in the region with access to alternative refining opportunities and would ensure adequate refining capability. BP noted that refining capability in Salt Lake City has remained static despite increased oil production in the region and that producers therefore need access to additional refineries. Suncor Energy Marketing, Inc. and Suncor Energy (U.S.A.) Pipeline Co. (Suncor) filed comments in support of the flow reversal.³⁰³ Suncor argued that the Commission lacks jurisdiction over flow reversal, and that, contrary to Holly’s assertion, the reversal would benefit non-affiliates. The Wyoming Pipeline Authority also intervened in support of RMPS’ flow reversal.

On March 9, 2009, PAAP and RMPS filed their answer, which argued that the Commission and the Court of Appeals for the District of Columbia Circuit have confirmed that the Commission does not have ICA jurisdiction over oil pipeline abandonments or flow reversals. PAAP and RMPS further argued that Holly provided no support for its claim that the reversal was intended to benefit RMPS’ affiliates, Holly had no standing to bring the complaint, and that Holly’s claims were speculative at best. PAAP and RMPS contended that, in effect, Holly requested the Commission to find that Holly had a legal right to be free of competition and to purchase crude from certain sources, rights which the ICA does not confer.

On April 23, 2009, the Commission dismissed Holly’s complaint on the basis that “[a]pplicable precedent makes it clear that the Commission does not have jurisdiction over the reversal of flow on a pipeline.”³⁰⁴

In a separate but related proceeding, on February 27, 2009, RMPS filed Supplement No. 4 to FERC No. 143 canceling service from Wyoming Stations to Rangely, Colorado effective April 1, 2009.³⁰⁵ RMPS stated that the reason for cancellation was the future reversal of flow of the pipeline. On March 16, 2009, Holly intervened and protested RMPS’ tariff filing alleging the same arguments made in Holly’s complaint. On March 23, 2009, RMPS responded to Holly’s protest. On March 31, 2009, the Commission accepted RMPS’ tariff finding that “because the Commission does not have jurisdiction over Rocky Mountain’s cancellation of the tariff and the prospective reversal of flow on the pipeline, the Commission will not address the other issues raised by the parties.”³⁰⁶

300. *Rocky Mountain Pipeline Sys.*, 126 F.E.R.C. ¶ 61,301, at 7 (2009).

301. 127 F.E.R.C. ¶ 61,074, at 6.

302. *Id.* at 11.

303. *Id.* at 10.

304. *Id.* at 12.

305. *Id.*

306. 126 F.E.R.C. ¶ 61,301, at 9 (2009).

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