Opinion No. 435-B

<u>SFPP, L.P.</u>
Opinion on Rehearing and Directing Revised Compliance Filing
96 FERC ¶ 61,281 (2001)

This order addressed requests for rehearing on starting rate base issues, the recovery of civil litigation and settlement costs, the eligibility and calculation of reparations, and regulatory expenses.

On rehearing, SFPP argued that the Commission's determination that a 1988 settlement involving SFPP's predecessor did not bar investigation of SFPP's starting rate base for the period before 1988 (since the settlement was silent on that point) was inconsistent with Opinion 154-B, <u>Williams Pipe Line Company</u>, 31 FERC ¶ 61,377 (1985), which established a "strong presumption that the parent company's capital structure should control if the pipeline had no independent capital structure of its own." The Commission denied rehearing. (at 62,065). The Commission also affirmed its finding that the ALJ's determination that the use of SFPP's parent's capital structure to establish the starting rate base, led to an anomalous result that was inconsistent with the Commission's rate making methodology. (at 62,068).

Opinion 435-A denied SFPP litigation and settlement costs for anti-trust litigation brought by two of its shippers. On rehearing, SFPP argued that the costs incurred were proper regulatory expenses and were not extraordinary. SFPP alleged that under <u>Iroquois Gas Transmission System, L.P. v FERC</u>, 145 F.3d 398 (D.C. Cir. 1998), its civil action costs were recoverable as prudent business expenses that should be recoverable through its jurisdictional rates. (at 62,069). The Commission affirmed its conclusion that the civil litigation involved issues that were beyond the prudence issues governed by the Commission's tariff based regulatory authority. The Commission stated that in <u>Iroquois</u>, the issue was whether the underlying act, which was clearly within the Commission's province, was prudent. With SFPP, that was not the case. (at 62,070).

Opinion 435-A held that only one of the East Line shippers, Navajo Refining Company, was eligible to receive reparations. Chevron and RFC filed requests for rehearing of this determination. The Commission granted rehearing and concluded that both Chevron and RFC were entitled to reparations. In addition, the Commission also determined that Tosco and Mobil were eligible. The Commission also clarified Opinion 435-A to ensure that any shipper that prevailed in any subsequent proceeding would not be prevented from receiving the appropriate reparations. In calculating reparations, SFPP must "determine what the just and reasonable rate would be in each year between 1994 and August 1, 2000 (as well as two years back from the date of the earliest complaint), and then calculate what the appropriate gross revenues would have been from that rate. The difference between what SFPP actually earned and its appropriate gross revenues would be the total reparations pool. Once reparations are paid to eligible recipients, the remainder of the pool is to be used to offset certain post-test year expenses, then only the remaining costs could be recovered through a five-year surcharge. (at 62,073-74).

Opinion No. 435-A allowed SFPP to recover its post-test year (1995-1998) regulatory expenses through a combination of offsets against unpaid reparations and a surcharge to be amortized over five years. The Commission affirmed this result. (at 62,074-75).

The order also addressed miscellaneous issues raised by SFPP's compliance filing pursuant to Opinion No. 435-A. Notably, it reversed an earlier determination and found that SFPP could not include post-test year environmental, reconditioning, or litigation expenses in its surcharge. (at 62,078-79).

COMM-OPINION-ORDER, 96 FERC ¶61,281, SFPP, L.P., Docket Nos. OR92-8-000, OR92-8-010, OR93-5-000, OR93-5-007, OR94-3-000, OR94-4-000 and OR94-4-007, Mobil Oil Corporation v. SFPP, L.P., Docket Nos. OR95-5-000 and OR95-5-006, Tosco Corporation v. SFPP, L.P.,. . ., (Sep. 13, 2001)

SFPP, L.P., Docket Nos. OR92-8-000, OR92-8-010, OR93-5-000, OR93-5-007, OR94-3-000, OR94-4-000 and OR94-4-007, Mobil Oil Corporation v. SFPP, L.P., Docket Nos. OR95-5-000 and OR95-5-006, Tosco Corporation v. SFPP, L.P., Docket No. OR95-34-000, SFPP, L.P., Docket Nos. IS99-144-000, IS99-144-001 and IS99-144-002, SFPP, L.P., Docket No. IS00-379-000

[62,063]

[¶61,281]

SFPP, L.P., Docket Nos. OR92-8-000, OR92-8-010, OR93-5-000, OR93-5-007, OR94-3-000, OR94-4-000 and OR94-4-007

Mobil Oil Corporation v. SFPP, L.P., Docket Nos. OR95-5-000 and OR95-5-006

Tosco Corporation v. SFPP, L.P., Docket No. OR95-34-000

SFPP, L.P., Docket Nos. IS99-144-000, IS99-144-001 and IS99-144-002

SFPP, L.P., Docket No. IS00-379-000

Opinion No. 435-B; Opinion on Rehearing and Directing Revised Compliance Filing

(Issued September 13, 2001)

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, Linda Breathitt, and Nora Mead Brownell.

Appearances

Stephen H. Brose, *Timothy H. Walsh*, *Amy W. Lustig*, *R. Gregory Cunningham*, *J. Patrick Kennedy*, *Steven G. T. Reed* and *Kelly C. Maynard* for SFPP, L.P.

Thomas B. Magee, *Michael Lobue* and *John B. Merritt* for Arco Products Company

R. Gordon Gooch, *Mark R. Haskell*, *Glenn S. Benson* and *Jonya Walker* for Arco Products Company, Texaco Refining and Marketing, Inc., Mobil Oil Corporation and Tosco Corporation

J. Wade Linsday and *Joel L. Greene* for Arizona Public Service Company, Salt River Project and Phelps Dodge Corporation

D. Jane Drennan, *Andrew S. Katz*, *David L. Hunt* and *Ruth A. Bosek* for Chevron USA Products Company

Patrick J. Keeley and *Franklin R. Bay* for El Paso Refinery, L.P.

Stephen L. Teichler, *Charles M. Darling* and *Jennifer S. Leete* for Navajo Refining Corporation

Jeron L. Stevens, *Charles M. Butler, III*, *Michael Hamric* and *David Stevens* for Refinery Holding Company

Robert L. Woods, *Arnold H. Meltz*, *Warren C. Wood*, *Dennis H. Melvin* and *John P. Roddy* for the Staff of the Federal Energy Regulatory Commission

[Opinion No. 435-B Text]

On May 17, 2000, the Commission issued Opinion No. 435-A , [1] an order on rehearing in the captioned proceeding that modified and clarified certain portions of its prior order in Opinion No. 435 . [2] Both orders addressed the method for establishing just and reasonable rates for SFPP Inc.'s (SFPP) east and west lines serving Arizona and New Mexico based on a 1994 cost of service. In response to Opinion No. 435-A , SFPP filed a revised compliance filing in Docket No. OR98-010, *et al.*, on July 17, 2000. On the same date SFPP also filed proposed FERC Tariff Number 60 in Docket No.

[62,064]

IS00-379-000 to provide revised rates reflecting the compliance filing, and included a surcharge on its East Line rates between El Paso, Texas, and Phoenix, Arizona, to recover certain additional costs the Commission stated SFPP might be eligible to amortize over a 5-year period. Both the July 17 compliance filing and the filing in Docket No. IS00-379-000 were protested. On August 16, 2000, the Commission accepted and suspended proposed Tariff Number 60, subject to refund, effective August 1, 2000. [3]

SFPP and two shipper parties, Chevron Products Company (Chevron), and Refining Holding Company (RHC) have filed requests for rehearing of Opinion No. 435-A . SFPP filed a rehearing request related to the August 16, 2000 suspension order. [4] The Commission denies SFPP's requests for rehearing, certain of those of the shipper parties, and clarifies a number of issues. In light of those decisions and upon review of the compliance filing, SFPP is directed to submit a revised compliance filing in Docket No. OR92-8-000 , *et al.* and to recalculate and refile the surcharge filed in Docket No. IS00-379-000 . SFPP is directed to make reparations consistent with this order.

Discussion

The background of this complex litigation is discussed in detail in Opinion Nos. 435 and 435-A and will not be repeated here except as necessary to resolve the issues presented. In summary, the litigation involves a protracted dispute between SFPP and its shippers regarding the reasonableness of SFPP's oil pipeline rates for shipments on its South Line system. That system consists of lines between the Los Angles basin and Phoenix, Arizona, and between El Paso, Texas, and Phoenix. In addition, the system has the capability to serve Tucson, Arizona from either of its end points. The rehearing and compliance issues now before the Commission turn primarily on rate base issues, the recovery of legal costs, and the eligibility for and calculation of reparations. A related point regards the extent to which SFPP can recover through a surcharge certain costs that the Commission did not permit SFPP to recover through its rate base but may be eligible for recovery through a five year surcharge under Opinion No. 435-A .

A. *The Requests for Rehearing*

1. *The Starting Rate Base*

Opinion No. 435-A concluded that the capital structure to be used by SFPP in calculating its starting rate base as of December 31, 1983, would be that adopted as a result of its initial public offering on December 19, 1988, or 60.74 percent debt and 39.26 percent equity. [5] In reaching this conclusion, the Commission adopted the prior conclusions by two ALJ's that SFPP's risks as a pipeline on June 28, 1985 were

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materially different than those of its former parent company as of the same date. [6] The Commission also concluded that a 60.74 percent debt capital structure is more consistent with that generally adopted by the oil pipeline industry (45 to 55 percent debt), [7] a debt level that SFPP has gradually approached over time. [8] In contrast, the 21.7 percent debt capital structure of SPPL's parent company in 1988 was less than one half that of the lower bound of the same oil pipeline industry range. The Commission reached this analytical conclusion after making a prior legal conclusion in Opinion No. 435-A that the terms of SFPP's 1988 Settlement with certain *customers did not preclude the revisiting of SFPP's starting rate base in this proceeding.*

SFPP argues on rehearing that Opinion No. 154-B established a strong presumption that the parent company's capital structure should control if the pipeline had no independent capital structure of its own. It further asserts that there is no basis in the record for concluding that SFPP's risks in 1985 were different or less than its former parent, as compared to 1988, and that in fact its regulatory risk was considerably greater because the legal standards for determining pipeline rates were unknown in 1983. It also argues that the debt-equity ratio of its former parent was within debt-equity ratios previously accepted by the Commission in gas decisions, [9] and that those precedents should control here. Finally, it asserts that it is inequitable and defeats investor expectations to impose the same starting rate base for the period 1983 to 1988 as the period thereafter, and that the Commission's prior determination that the 1988 Settlement prevents review of the starting rate base before December 19, 1988 should control.

The Commission will deny rehearing. The fundamental point here is that the Commission determined in Opinion No. 435-A that the 1988 Settlement involving SFPP's predecessor entity does not bar investigation of SFPP's starting rate base for the period before 1988 in light of the Settlement's silence on this point. Opinion 435-A quoted Section 5.3 of the 1988 Settlement:

> SPPL and Airline Intervener further expressly understand and agree that the provisions of this Stipulation and Agreement relate only to the matters specifically referred to in this Stipulation and Agreement, and that no party waives any claim or right which it otherwise may have with respect to any matters not expressly provided for in this Stipulation and Agreement. [10]

As stated in Opinion No. 435-A, the level of the pipeline's starting rate base was an issue in rate proceedings involving SFPP's predecessor pipeline, SPPL, and was not explicitly addressed in the 1988 settlement that resolved the litigation which began in 1985. The issue of SFPP's starting rate base is therefore properly at issue in this proceeding. That issue turns on the debt component of the capital structure to be used in this proceeding to calculate the starting rate base under the Commission's Opinion No. 154-B methodology. Since SPPL had no debt of its own on June 28, 1985, the threshold issue is what debt-equity ratio should be used here to determine the starting

[62,066]

rate base since no determination was made by the Commission in the rate proceeding that was terminated in 1988.

During the 1985-1988 proceeding regarding the reasonableness of its rates, SPPL argued that a 100 percent equity structure was the appropriate capital structure. In that proceeding, the ALJ rejected both SPPL's proposed 100 percent equity structure and an alternative theory that the debt-equity structure of SPPL's parent company should be adopted. After concluding that the risks of SPPL and its then parent were too different to warrant use of the same capital structure, the ALJ then cited the following concept from the appellate court opinion in *Farmers Union II*:

In the case of oil pipelines, the hypothetical capital structure would be approximated by estimating the capacity of the pipeline to support debt in the absence of the parent's guarantees. [11]

In the 1985-1988 proceeding, the ALJ also noted that if the debt-equity structure of SPPL's parent were to be adopted, the size of the resulting starting rate base would actually exceed the rate base that would have been calculated under the ICC's valuation methodology, which the Commission has disallowed. Thus the very purpose of changing the method of determining a pipeline's starting rate base would have been defeated if the ALJ had adopted SPPL's arguments in the 1985-1988 proceeding. [12] The ALJ in the current proceeding reached the same conclusion regarding both the starting rate base SFPP advanced for its entire system and that portion of the rate base that should be attributed to SFPP's South System lines between Los Angeles and El Paso. [13] In both cases the ALJs concluded that the starting rate base would have been severely overstated using the capital structure proposed by SFPP.

Because the Commission is rejecting the use of SPPL's historical rate structure for the period 1985-1988 in this proceeding, and that of its former parent, the next issue to be resolved is the standard for determining the debt-equity structure to be adopted when the pipeline has no debt of its own. The issue then becomes whether the parent's capital structure is appropriate. Thus, in Opinion No. 435-A , the Commission acknowledged that there is a strong presumption in favor of the parent company's capital structure, but concluded that this was not necessarily controlling. *Citing Arco Pipeline Company* (Opinion No. 351), the Commission stated:

Of course the Commission is concerned about whether a capital structure is abnormal. But the correct yardstick is not whether the pipeline's capital structure

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is in tune with historical capital structures. Rather, it is whether the capital structure is representative of the pipeline's risks. [14]

The Commission first concludes that there is adequate evidence within this record to conclude that SPPL's risk in 1985 was materially different from that of its railroad parent at that time. The record here is also confirmed by a publically available authoritative source, Moody's Transportation Manuel, involving the rail industry for the same period. The shipper parties squarely raised the issue of the relative risk of SFPP and its parents on this record. The shipper parties noted that the pipeline's South System has possessed an oil transportation monopoly for the entire period at dispute here, as well as during the period of the prior rate litigation, and has succeeded in defeating all efforts at entry by competitive pipelines into the long haul markets served by the South System. In fact, its position was sufficiently secure that it proposed to undertake a major expansion beginning in 1985. [15] Moreover, SPPL, the predecessor pipeline, had a 100 percent equity structure in 1985, and by definition faced minimal financial risk. [16] Based on the stability of its capital structure and a lack of meaningful competition, there is no rational grounds here to believe that SPPL's operations or business substantially changed between June 28, 1985 and December 19, 1988. In fact, the record reflects that it had a strong commercial position and that, if anything, its prospects were improving. SPPL's business risk and financial risk was sufficiently low that it was able to make a major limited partnership public offering of both debt and equity interests the raised resulted in a 60 percent debt component.

In contrast, the shipper parties submitted evidence regarding the business profile of its parent that strongly suggests that SPPL's parent company was operating in a substantially riskier environment in the same four year period, 1985 to 1988. [17] Based on these evidence, the ALJs in both rate proceedings concluded that the parent company was operating in a much more competitive environment than its pipeline affiliate given its predominate emphasis on rail and trucking operations. Moreover, a review of Moody's Transportation Manual for the same period discloses that the Southern Pacific Railroad, the parent company's principal asset, had cumulative losses on rail operations between 1983 and 1988 of $481,417,000, that its rail revenues were flat in this same period, and its general bond obligations were rated at Ba1, a rating grade containing clear speculative risk elements. In fact, most of the net cash from operations was derived from real estate sales and financial transactions that would cease to be a source of support once the assets were exhausted. [18] Thus, the financial position of the parent railroad, and its attendant risk, for the entire period 1984 to 1988 differed dramatically from that of its pipeline affiliate, and this is reflected in their different prospects in the same time frame. At the time the pipeline was contemplating expansion and a public offering, the Southern Pacific Railroad was experiencing serious operating losses and was the subject of a merger by the Santa Fe Railroad in a proceeding before the Interstate Commerce Commission [19] Besides, SPPL itself argued in the earlier rate proceeding that the use of its parent's capital structure to establish the starting rate base was inappropriate because of its different risk. [20]

[62,068]

On rehearing, the Commission also affirms its prior conclusion that the ALJ's finding that the use of SFPP's parent's capital structure as of June 28, 1985 to establish the starting rate base leads to an anomalous result that is inconsistent with the Commission's current rate making methodology. The Commission found in Opinion No. 435 that Staff had used the proper method for allocating SFPP's rate base between its South System Lines and its other divisions, and within the South System, between the East and the West Lines. [21] Given this result, it does not make sense, as the ALJ in both proceedings concluded, to adopt a capital structure that results in a starting rate base that is higher than the ICC valuation method that the Commission has previously rejected. Moreover, SFPP's argument that it faced unknown regulatory risk in 1983 is irrelevant since the capital structure and the related operating and financial risks are normally determined as of June 28, 1985, the date the Opinion 154-B methodology was adopted. Thus, the parent company was aware of the regulatory climate well before it decided to spin off SPPL into a separate, independently capitalized affiliate in 1988, thereby creating SFPP.

The Commission reviews a pipeline's capital structure to assure that it is not contrived, or that the parent company's capital structure is not unrepresentative of the pipeline's risks. The previous discussion demonstrates that SPPL's capital structure was 100 percent equity in 1995, which was clearly contrived, and that its financial risk was clearly different from that of its parents. Under these circumstances, in most cases the Commission would design a hypothetical capital structure. In the instant case, however, there is no need for the Commission to design a hypothetical structure because the private capital markets have provided the answer. That answer was the 61.74 percent debt--39.26 percent equity capital structure that SFPP raised in the financial markets in December 1998. To propose a different structure would be invite speculation when an arm lengths public offering provided a far better one than one that could be constructed by the Commission. Because that capital structure was derived in a public offering, that capital structure reflects the financial market's perceptions of the pipeline's risk, thus eliminating the need to establish a proxy capital structure as suggested by Opinion No. 154-B. Accordingly, SFPP's actual capitalization as of December 19, 1988, should be used to establish its debt-equity ratio for the period June 28, 1985 to December 19, 1988 as this most accurately reflects the pipeline's risk.

Moreover, given the status of SPPL's rate case litigation beginning in 1985 and the ALJ's initial decision in the proceeding in 1987, there is no inequity to SFPP's current equity investors from the decision here. First, they obtain the benefits of the Opinion No. 154-B methodology designed to protect existing investor expectations, such as the starting rate base write-up premium to be amortized over the remaining useful life of the pipeline. They obtain all of these benefits even though by definition they had no equity interest in the pipeline before 1988 because the predecessor pipeline entity, SPPL, changed its ownership form in that year. The prospective investors in the current SFPP pipeline limited partnership were also on notice that there had been litigation on the matter of the pipeline's starting rate base before the limited partnership was formed on December 19, 1988, and that the matter was not resolved with finality under the 1988 Settlement. Thus, if the matter were to be resolved in a manner that affected their long term returns, this risk was assumed at the time they purchased their interests.

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Under these circumstances, SFPP's argument that the Commission is engaged in the type of retrospective ratemaking that is appropriate only in a locked-in rate period determination is inapposite. Because the determination of capital structure is essential to determine the starting rate base that applies to the rates at issue here, the ruling here is grounded in the fact that those rates are in dispute in this proceeding. If the issue had been resolved with finality in the prior proceeding, then SFPP's argument would have merit and the Commission would be bound by its prior determination. But as has been discussed, this is simply not the case. SFPP also argues that the capital structure adopted here is less generous than that permitted other oil pipelines. This does not change the fact that the ratio here is within the bounds of normal Commission practice, and in any event, it was actually established by the financial markets. It was also the one adopted by SFPP as a market based solution to its own financial and managerial concerns in an effort to maximize the return to the former parent company. As such, SFPP can hardly be heard to complain because that structure is relatively favorable to the rate payers. Finally, SFPP's arguments on rehearing that the other capital structures are within gas precedents are not relevant here. [22]

2. *Recovery of Certain Civil Litigation and Settlement Costs*

The recovery of litigation costs occurs in two distinctly different contexts in this proceeding. At issue are both civil litigation cost and settlement costs, which SFPP incurred in litigation in the state and federal judicial system, and the regulatory costs that are related to administrative litigation before this Commission. The issue of the civil litigation and settlement costs is addressed in this portion of the order.

Opinion No. 435-A denied SFPP any litigation or settlement costs for anti-trust litigation brought by two shippers, Navajo and RHC, related to SFPP's reversal of flows on portions of the East Lines. The Commission concluded that the civil litigation costs and settlement costs involved in the anti-trust litigation between SFPP as defendant, and Navajo and RFC as plaintiffs, were incurred with respect to an issue that did not arise from SFPP's performance of its common carrier obligation. [23]

On rehearing, SFPP asserts that the litigation and settlement costs related to its anti-trust litigation were proper regulatory expenses, that the costs are not extraordinary, and that even if they were, they would be properly recovered through its rates. SFPP asserts that since the litigation related to its contractual obligations to serve its customers, the costs of this anti-trust litigation are part of its common carrier obligation and were part of its normal operating expenses. It claims that the civil action costs were therefore recoverable under *Iroquois Gas Transmission System, L.P. v FERC* [24] as prudent business expenses that should be recoverable through its jurisdictional rates. It further asserts that the litigation arose because SFPP decided to expand its system to meet the demands of certain customers and that reversal, and then re-reversal, of a portion of its East Lines was the most efficient way to do this. It further argues that the litigation was brought by certain East Line customers who were attempting to preserve certain competitive advantages by opposing SFPP's efforts to serve all its customers through its line reversals. It also asserts that anti-trust allegations are inadequate to overcome the presumption of prudence that attaches to its commercial

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decisions, and that unproven allegations of wrong are insufficient to support the exclusion of civil litigation and settlement costs from its rates.

The Commission affirms its initial conclusion that the disputed civil litigation involved issues beyond the oil pipeline prudence issues governed by the Commission's tariff based regulatory authority. The merits of the civil litigation between SFPP and its east line shippers over the reversal and re-reversal of portions of the East Line were never litigated before the Commission, nor would one expect them to be. Given that the Commission has no jurisdiction over whether a pipeline enters or exits a market, in contrast to the efficiency of its ongoing operations, the Commission is not the proper venue for reviewing the prudence of SFPP's actions in making the line reversals or the costs that were incurred in litigation on that matter.

Through its regulation of pipeline rates and tariffs the Commission seeks to assure that the rates are just and reasonable and not unduly discriminatory. In doing so, it examines the cost of assets used in the common carrier service, and related expenses that are incurred in providing common carrier service under the tariff. In *Iroquois*, the challenged criminal costs arose directly from the determination that the pipeline had willfully violated an environmental regulation imposed pursuant to the Commission's certificate authority over gas pipeline entry and construction, and the criminal litigation stemmed directly from the exercise of that authority. In the case of ordinary operations, the Commission has the ability to exclude the related costs from the pipeline's cost of service as a sanction if operations were imprudently or inefficiently incurred Under Iroquois, *supra*, the issue was whether the underlying act, over which the Commission clearly had jurisdiction, was prudent. If the underlying action was prudent, then the litigation costs were also prudent and could be recovered. If the underlying action was not prudent, recovery would not be permitted. In contrast, as the prior orders establish, the behavior complained about in the civil actions at issue here is beyond the Commission's remedial authority.

It would be anomalous if the Commission were to assume jurisdiction over the prudence of costs incurred in civil litigation concerning a subject matter over which the Commission has no jurisdiction and where the litigation did not arise from day to day operations under the pipeline's tariff obligations. The instant dispute turns on a commercial dispute between SFPP and its customers involving *both entry and exit by the pipeline*, an action that would not arise in the normal course of the pipeline's operations under its tariff. [25] In contrast, tort actions or environmental matters arising from day to day operations, right-of-way disputes, labor costs and contracts, disputes with supplier, contract disputes with suppliers, rate matters, and shipper disputes about the provision of service over existing facilities are the type of matters that arise with regularity under daily pipeline common carrier operations. These types of costs can be expected to borne by shippers across the whole system *once the carrier has entered a market*, and all shippers will bear both the benefits and burdens of those costs. [26]

Legal costs arising from such matters, including whether they were prudently incurred, are regulated under the known and measurable standard of the Commission's

[62,071]

test year, and the efficient and economical management standards applicable to day to day public utility operations in the markets that the carrier is serving. As such, while the types of disputes listed in the previous paragraph may be resolved in forums other than the Commission, the related litigation costs are jurisdictional costs since they arise from litigation related to risks and expenses of regulated operations provided to the pipeline's shippers under its tariff. In contrast, just as the Commission does not permit environmental costs that are incurred by the pipeline's non-jurisdictional operations to be included in its FERC tariff rates, the Commission will not permit civil litigation and settlement costs concerning a non-jurisdictional commercial decision to be included in SFPP's common carrier rates. [27] The reasonableness of this position is re-enforced by the common sense observation by the East Line shippers that the costs and awards relating to their litigation will be borne primarily by themselves if the litigation and settlement costs are included in the East Line rates, rather than being distributed over a large number of East Line rate payers. [28] The Commission also affirms its prior conclusion that the costs involved here were non-recurring under the Commission's cost of service regulations.

3. *Reparation Issues*

In the prior orders the Commission established the just and reasonable rates for SFPP's East Lines for the calender year 1994 based on a 1994 costs of service. Because those rates were established pursuant to complaints, the rates established by the prior orders became effective on August 1, 2000, the date that the Commission accepted SFPP's compliance filing. The East Line rate levels as of August 1, 2000 were developed by determining what the rates would be on that date after applying the oil pipeline cost adjustment factors under the Commission's oil pipeline regulations to the 1994 cost of service. To the extent that certain of SFPP's costs could not be recovered by the offset against possible reparations that were not actually paid in years after 1995, the Commission also stated that those costs could be recovered through a five year surcharge effective on August 1, 2000. [29]

Reparations are due when complainant shippers paid more for East Line transportation service between January 1, 1994 and August 1, 2000 than the just and reasonable rate the Commission established for the calender year 1994, beginning with the dates of their complaints. The difference between the 1994 rate level and the level actually paid by those shippers in the intervening period through August 1, 2000 represents the amount that SFPP earned above the just and reasonable rate established for the calender year 1994. Since the 1994 cost of service is being indexed, this results in a different rate level for the prevailing East Line shippers for each year between 1994 and August 1, 2000, and a different level of reparations in each such year based on the date of their complaints. The large number of potential calculations materially complicates the issues to be decided here. In addition, the ICA also provides that reparations are available for up to two years before the filing of a complaint if the rates paid in those two prior years exceed the just and reasonable rate established in this proceeding. Because indexing was not in effect prior to 1995, the 1994 rates cannot be indexed retrospectively.

[62,072]

As a threshold matter, Opinion No. 435-A held that only those East Line shippers who had filed complaints could receive any reparations that might be due under that order, [30] a basic ruling not challenged here, and that only Navajo Refining Company met the standard. Chevron and RFC filed requests for rehearing asserting that they have had complainant status since the early part of this proceeding. A review of the record establishes that the Commission's order in these proceedings dated October 5, 1993, accepted Chevron's complaint in Docket No. OR93-5-000 and consolidated it with this proceeding, Docket No. OR92-8-002 . [31] The same order granted RFC complainant status as a successor in interest to El Paso Refinery Company in the same dockets. [32] SFPP did not contest these conclusions. The Commission will grant rehearing.

Moreover, as the case caption indicates, Tosco was a complainant in the instant proceeding on that date and a review of the underlying pleadings indicates that Tosco clearly complained against the reasonableness of SFPP's East Line rates. [33] Tosco raised this point in its comment on the compliance filing, and the Commission concludes that Tosco is entitled to reparations of any shipments on SFPP's East Lines between August 7, 1995, the date of its complaint, and the August 1, 2000, and for a two year period before August 7, 1995. Similarly, Mobil filed a complaint dated April 3, 1995, as amended on June 12, 1995, that also challenged the reasonableness of SFPP's East Line rates. [34] While SFPP questioned whether the Tosco and Mobil complaints were adequate under the EPA, the Commission accepted the complaints and set them for hearing. [35] The Commission concludes that these two complainants are also entitled to reparations.

One additional party, Ultramar, asserts in its comments on the compliance filing that it is also entitled to reparations for its shipments on the East Line after 1994 because it filed complaints against the East Line rates in 1997 and subsequent years. Because the rates it paid in 1997 exceeded the rate levels ultimately determined to be reasonable for 1994, Ultramar concludes that reparations are due it for the years between 1994 and the date SFPP's new East Line rates became effective on August 1, 2000.

Ultramar's argument for reparations fails because its November 1997 complaint against the East Line rates was filed after August 7, 1995, the last date that complaints were consolidated into this proceeding. Therefore, Ultramar is not a complainant in this proceeding and is not eligible for reparations here. The complaints filed for the period after August 7, 1995 are currently before an ALJ, and the reasonableness of those rates, and any reparations that may be due, will be established in those proceedings. As is explained in greater detail below, the parties filing complaints after August 7, 1995, will not be precluded from obtaining an award, including reparations, pursuant to another timely filed proceeding. Ultramar may not receive reparations at this time.

On rehearing and in the compliance filings, Tosco, Ultramar, and Navajo again question whether SFPP should be permitted to recover certain supplemental costs for

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the years 1994 through 1998 by means of an offset against reparations that might otherwise have been available in those years. They assert that this prejudices their rights to refunds for the periods after August 7, 1995, and that the Commission should not have ruled in the SFPP rate proceeding now before it that shippers filing complaints after August 7, 1995 are not eligible for reparations in the years that they filed complaints.

Upon further review, the Commission concludes that there is some merit to these arguments. Therefore the Commission will clarify Opinion No. 435-A to assure that its prior ruling does not prejudice the ability of complaining shippers to recover reparations if they prevail in the subsequent proceedings. As has been previously discussed, Opinion No. 435-A established the just and reasonable rate for the years 1994 and subsequent years, as indexed through August 1, 2000, for the complaints at issue here. However, the Commission has not determined a cost of service for the East Line for the years after 1994 based on the cost factors that were actually involved in those subsequent years. [36] Therefore the Commission has made no merits decision regarding what the just and reasonable rate level should be in each of the subsequent years for shipments that are subject to the complaints after August 7, 1995. As the cost and revenue factors that would be used for determining a just and reasonable rate could be different in each of these later years, there is no record basis here for determining the level of the just and reasonable rates for subsequent years based on a cost of service for those years. The Commission therefore concludes that it would be inequitable to preclude parties filing timely complaints against the East Line rates after August 7, 1995 from litigating the cost of service of each of the subsequent years, and therefore complaints may lie against the East Line rates for the years after August 7, 1995. [37]

The protesting parties also assert that any reparations that might otherwise have been due shippers in the years 1994 through August 1, 2000 should not be used as an offset against certain costs that the Commission did not permit SFPP to include in its embedded cost of service. In the preceding paragraphs the Commission has ruled that complainants who filed against the East Line rates after August 7, 1995 should not be precluded from obtaining relief under those complaints. This means that if the complainants should prevail, they could be awarded reparations from the date of their complaints to the date of any subsequent Commission order, and for a period two years back from the date of the complaint. The Commission clarifies that the fact that SFPP must use any revenues that flow from rates that exceed the just and reasonable level to offset certain other costs will also not prejudice the rights to reparations under complaints filed in the subsequent years.

Thus, in calculating reparations, as explained in Opinion No. 435-A , SFPP must determine what the just and reasonable rate would be in each year between 1994 and August 1, 2000 (as well as two years back from the date of the earliest complaint), and then calculate what the appropriate gross revenues would have been from that rate. The difference between the gross revenue under the new just and reasonable rate creates the total reparations pool. SFPP would then calculate the reparations due each

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eligible shipper (including interest), leaving a residual in the pool of funds that could not be distributed because certain shippers had not filed a complaint within the time frame of this proceeding. The residual pool would then be credited against the total supplemental costs permitted under Opinion No. 435-A between 1995 and 1998. Any remaining allowable costs would then be recovered through a five year surcharge beginning on August 1, 2000.

As noted, the ruling here is without prejudice to the rights of the complainants filing against the East Line rates after August 7, 1995 to receive reparations under the subsequent complaints. If reparations should be due, they would be awarded in due course in the additional proceedings now at hearing before the Commission. The Commission is adopting this solution because its does not deem it equitable to both permit SFPP to keep refund amounts that are not paid pursuant to Opinion No. 435-A , and also file for a five year surcharge for certain costs that were not included in its 1984 cost of service. This solution prevents that inequity while preserving the rights of subsequent complainants.

4. *FERC Regulatory Costs Excluded from SFPP's 1994 Cost of Service*

In Opinion No. 435-A , the Commission did not permit SFPP to include in its East Line rates certain FERC regulatory costs SFPP estimated it would incur after the 1994 test year because those estimated costs were not known and measurable within the time frame ordinarily permitted by the Commission's regulations. [38] On rehearing, SFPP asserts that its FERC regulatory costs have been so high that it should be permitted to include at least some FERC regulatory costs in its embedded East Line rates. In the prior order the Commission followed its traditional practice of limiting the inclusion of high FERC regulatory costs in embedded rates to ensure that those costs do not artificially inflate the level of rates between rate cases. The Commission did recognize that SFPP's litigation costs are ongoing, but in light of their exceptional size and the unusual time frames, permitted SFPP to recover its FERC litigation costs for the years 1995 through 1998 attributable to the East Line rates through a combination of: (a) a surcharge to be amortized over five years; and (b) an offset against reparations that might be due to shippers that had not filed complaints against the East Line rates in the instant proceeding. The Commission will deny rehearing of SFPP's request that it be permitted to include a higher level of regulatory and general legal costs as an embedded cost in its East Line common carrier rates, and will affirm its prior ruling that these costs may be recovered through a combination of an offset against reparations (without prejudice to the pending complaints) and a five year surcharge.

The expenses have been high for all parties, and the issue here is how those costs can be most equitably allocated. At the outset, SFPP is entitled to recover its legitimate FERC regulatory costs through its jurisdictional rates. The 1994 costs were some $2,914,114, of which 50 percent is allocated to the East Line figures under Opinion No. 435-A . [39] By comparison, the accumulated unrecovered FERC litigation cost for the remaining years addressed by Opinion No. 435-A cover 5 years: 1993 (because reparations are retroactive to that year), and the years 1995-1998 was $14,354,165, or an average of $2,870,833 per year. This is somewhat less than the $2,914,114 that SFPP suggests should be included in SFPP's embedded rates on the grounds that the 1994 costs were representative of SFPP's FERC related litigation

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costs over a several year period. [40] However, the numbers are quite close and indicates the consistency of SFPP's FERC related regulatory costs in this time frame. [41]

The problem with including $2,914,114 in SFPP's 1994 just and reasonable rates is that cost would be included in those rates until such time as SFPP filed a new rate case, or the Commission issued an order changing SFPP's cost of service and rates on a prospective basis. [42] Even with the ongoing litigation now before the Commission, there is no assurance that SFPP's litigation costs would exceed $2,914,114 a year for the several years that the 1994 rates are likely to remain in effect. In light of these facts, the Commission will affirm its decision to include 50 percent of the 1994 FERC regulatory costs in the East Line rates amortized over five years beginning in that year. The Commission will also affirm its decision that the 50 percent of the FERC regulatory costs incurred in the years 1993 and 1995 through 1998 (some $7.17 million) can be included in the East Line rates as a five year surcharge beginning on August 1, 2000. While these costs were similar to the those incurred in 1994, this will ensure that the FERC regulatory costs are not embedded in SFPP's just and reasonable rates beyond the period of the surcharge. Since those rates became effective after the completion of the five year amortization period for the 1994 FERC regulatory costs, the impact of remaining costs after that year will be further mitigated.

While the Commission has permitted SFPP to recover its FERC regulatory costs for several years in keeping with the *Iroquois* doctrine, the Commission is concerned about the very high level of regulatory costs SFPP incurred between 1995 and 1998, even allowing for the complex and novel nature of the proceeding. For example, page 1 of Schedule 2 contained in SFPP's July 17, 2000 compliance filing shows a total 1994 cost of service of $15,546,000. Allowing for the fact that the some $2.9 million in FERC regulatory costs incurred in 1994 is spread over 5 years, some $600,000 of this cost of service reflects FERC regulatory costs. If all of the FERC regulatory costs were included in the 1994 cost of service, the total 1994 cost of service would have been approximately $18,460,000 and the FERC regulatory costs would have exceed 15 percent of the total cost of service. While the Commission does not have before it FERC regulatory costs SFPP has incurred after 1998, the past costs approach any reasonable limit as a percentage of total operating costs and could reasonably be considered excessive. The overall size of SFPP's regulatory costs after 1998 and the rate at which these might be recovered is an issue that may therefore be considered in ongoing litigation now before the Commission.

B. *The Compliance Filing*

SFPP made a filing on July 17, 2000 to comply with the provisions of Opnion No. 435-A. On the same date SFPP filed proposed FERC Tariff 60 in Docket No. IS00-379-000 . Tariff 60 contained rates designed to implement the compliance filing and also to institute a surcharge to recover certain additional costs the Commission stated SFPP might be able to recover under the terms of Opinion No. 435-A . Navajo filed a timely motion to intervene and protest on July 31, 2000. On August 16, 2000, the Commission issued an order accepting and suspending proposed Tariff 60 to be effective August 1, 2000, subject to refund, and requiring SFPP to submit certain

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supporting information that was not included in its July 17 filing. [43] In response, SFPP filed additional information with the Commission on August 31, 2000.

On August 7, 2000, Texaco Refining and Marketing, Inc. (Texaco) and ARCO Products Company, a Division of Atlanta Richfield Company, filed for late intervention. These two interventions are unopposed. On August 15, 2000, Ultramar Diamond Shamrock Corporation filed a late motion for intervention and a protest, and on August 21, 2000, Tosco Corporation did also. Both companies assert that they did not receive notice of SFPP's compliance filing and that they would be directly impacted by the rates contained in Tariff 60. On August 31 and September 5, 2000, SFPP filed objections to the late interventions of Ultramar and Tosco respectively. SFPP asserts that Opinion No. 435-A was a matter of common knowledge, that the interventions are long after the main docket was instituted, and that the intervening parties should not be permitting to relitigate issues that had already been addressed in Opinion No. 435-A .

The Commission will grant the four proposed late interventions. All four of these firms are shippers on SFPP's East Lines and will be directly affected by the rates proposed in Tariff 60. As such, they should be permitted an opportunity to comment on the compliance filing and surcharge calculations that underlie that tariff though they will lack standing to challenge the substance of Order No. 435-A .

1. *Rate Base Issues*

Navajo raises two issues in its protest regarding SFPP's amortization of its rate base. It first asserts that SFPP did not use the proper time frame for the amortization of its starting rate base. It further asserts that SFPP did not use the proper starting date for the amortization of part of its accumulated deferred income tax (ADIT) liability.

Navajo notes that the Commission held in Opinion No. 435-A that SFPP should amortize its starting rate base write up over "the composite useful life of the pipeline's assets as of December 31, 1983." [44] It asserts that SFPP did not apply this method but used the Commission's estimate of 20.6 years to amortize the rest of its rate base. Navajo argues that there was no basis in the record for this estimated useful life, and that in fact the remaining useful life is 16.8 years. It submits an affidavit of one Mr. Horst who notes that the ratio of net carrier property to gross carrier property on December 31, 1983 was 44.50 percent, *i.e.*, that some 55.50 percent of the property had already been depreciated, and that the composite depreciation rate for 1984 was 2.65 percent. Dividing the two numbers results in a remaining useful life of 16.8 years, or a completion of the amortization period of around October 16, 2000. It suggests first that SFPP should be required to make the proper calculation, and remove the starting rate base component from its rate case in this instance. The Commission concludes that Navajo has correctly calculated the amortization period for SFPP's starting rate base and that the rates should be recalculated accordingly. SFPP must use the 16.8 year time frame for the remaining amortization of its starting rate base.

A secondary issue is whether the starting rate base component should continued to be included in SFPP's costs for the rates that were effective August 1, 2000. The Commission finds that it is not appropriate to continue to include in SFPP East Line rates a rate component that will be obsolete under its own terms within some three

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months after the new rates became effective on August 1, 2000. The Commission therefore directs SFPP to remove the SRB cost from its base rates as of August 1, 2001, and to include that cost as a one time charge in the invoices that have been issued for the months in which it would have otherwise been effective. The current posture of this proceeding permits this to be done in an administratively efficient manner. Since the costs have already been billed under the rates that became effective, subject to refund, on August 1, 2000, SFPP must refund that portion of the rates that have already been collected for the months to which the SRB would no longer apply. SFPP must make an appropriate revised compliance filing.

The third rate base issue involves SFPP's proposed amortization of its deferred accumulated income tax liability. Navajo asserts that Opinion No. 435 held that under the Commission's *Lakehead* doctrine, [45] partnership pipelines are permitted to include an income tax allowance in their rates only for that portion of the enterprise that is owned by interests that incur a corporate income tax liability on their share of the partnership income. [46] Navajo asserts that this shift from a whole to a partial income tax allowance results in an excessive ADIT balance because the deferred taxes would have to be calculated against a lower amount of total income taxes. It notes that Opinion No. 435 required this ADIT balance to be amortized using the *South Georgia* method. Navajo states that SFPP did establish a line in its compliance filing to make the necessary adjustment (Schedule 13, line 5), but improperly began the amortization in 1988. Navajo asserts that since the Commission did not require SFPP to adjust its income tax allowance before 1992, the amortization of the excessive ADIT should not begin until that year. Navajo is correct and SFPP must modify its compliance filing accordingly.

2. *Application of the Lakehead Doctrine*

Opinion No 435-A affirmed on appeal that SFPP was subject to the *Lakehead* doctrine and that SFPP must modify its cost of service to eliminate any tax allowance related to non-corporate owners unless it could establish that such entities were subject to double taxation. In its compliance filing SFPP states that the tax allowance contained therein was based on the list of unit holders contained in Exhibits No. 477 and 478. It did not, however, specifically list in the compliance filing the unit holders upon which the compliance filing relies. It further states that the corporations listed in its unit holder list are not categorized by whether those corporations have Subchapter C or Subchapter S status. It asserts that the unit holder corporations listed in the cited exhibits are unlikely to be Subchapter S corporations because of the restrictions on such corporations for earning passive income.

The intervening parties assert that SFPP has not adequately established which units holders were the basis for the calculation of its income tax allowance and whether those unit holders were in fact subject to double taxation. The Commission agrees that in its revised compliance filing SFPP should list the corporate unit holders that were the basis for its compliance filing, and certify to the best of its knowledge that these are not Subchapter S corporations. The remaining unit holders are to be excluded from the calculation for the reasons stated in Opinion No. 435-A .

3. *Civil Litigation Fees and Settlement Costs*

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SFPP included in its compliance filing substantial litigation fees related to its FERC based litigation and to the civil litigation discussed earlier in this order. The protesting parties assert that these expenses are inadequately documented and that SFPP has incorrectly included in its compliance and tariff filing civil litigation and settlement costs. SFPP later provided documentation which separated the costs into FERC East Line, Civil East Line, and Other for the years 1995 through 1998 as well as a summary for the year 1999. In making its next compliance filing SFPP must clearly exclude any civil litigation costs from the claimed legal expenses used to develop any surcharges authorized under Opinion No. 435-A . It must also establish for all the years used in calculating its reparation obligations, including those prior to 1994, whether the fees and expenses permitted are FERC related expenses and the periods to which they apply. SFPP must include in its revised compliance filing an explanation of how it has done so.

4. *The Recovery of Certain Additional Costs*

Opinion No. 435-A stated that SFPP might be permitted to recover by means of a surcharge certain additional costs that were not included in its 1994 cost of service. These included FERC regulatory expenses, as has been discussed, and litigation, environmental, and line rehabilitation costs that were incurred in the years 1995 through 1998. This determination is again protested at the compliance phase, with the protesting parties again asserting that this ruling violates the filed rate doctrine. They assert that SFPP should have filed a rate increase to cover the additional costs during the years at issue. Upon further review, the Commission concludes that SFPP should not be permitted to recover any costs that were not incurred in the 1994 cost of service test period, other than the FERC regulatory costs previously discussed in this order.

Earlier in this order SFPP was directed to make reparations to certain of its East Line shippers based on a 1994 cost of service that does not include documented costs in later years. Reparations based on the 1994 cost of service will reduce the cash-flow that was generated in those years. The problems with the recovery of additional legal costs incurred outside the 1994 test year were addressed earlier in this order by permitting SFPP to recover those costs through a five year surcharge beginning with the effective date of its revised East Line rates. This was done to mitigate the impact of costs that might have otherwise been included in SFPP's just and reasonable rates for an indefinite period based on the amount of FERC regulatory costs that were actually incurred in the test period.

SFPP has claimed no extraordinary environmental costs for the years 1995-1998. It does claim to have incurred some $5.9 million in pipeline repair and rehabilitation costs that were expensed and not capitalized, or about $1 million per year in of costs in those four years that was not placed in its rate base. However, unlike the FERC regulatory costs, none of these were incurred in the test period.

The Commission does not believe that SFPP can be faulted for failing to file a new rate case to recover its costs during the course of this complex litigation. However, the Commission nevertheless concludes that it should not consider costs outside the test period when none of these costs were incurred in the test period or with any regularity thereafter. To allow a surcharge under these circumstances would permit SFPP to recover costs after the fact which were not eve present in the test year itself and which therefore could not be recovered in a cost of service rate filing. To do so after the fact raises serious questions under the filed rate doctrine. Moreover, the rates that were in effect in the years to 1994 were indexed rates under the provisions of the EPA. As such

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SFPP was required to demonstrate a substantial divergence between its actual cost of service and the rate resulting from application of the index in order to change the rate to one above the indexed ceiling level. SFPP failed to make this basic showing for the categories of costs that were not even present in the 1994 cost of service.

C. *Subsequent Filings*

SFPP is directed to make a revised compliance filing to be effective August 1, 2000, including revised tariff sheets that are necessary to implement this order, within 60 days after this order issues. The initial calculations of reparations for the years 1993 through 1999 for the eligible East Line shippers is to be extended to August 1, 2000, the point at which the reduced East Line rates became effective under Opinion No. 435-A . The cost of service of all of SFPP's lines is closed for the period before 1996, because all complaints against earlier years have been dismissed or resolved. The determinations here are controlling in the ongoing litigation in Docket No. OR96-2-000 , *et al.*

The Commission orders:

(A) Rehearing is granted and denied to the extent stated in the body of this order.

(B) SFPP must filed a revised compliance filing and revised tariffs, including revised estimates of reparations and refunds, complying with this order within 60 days after this order issues, the revised tariffs to be effective August 1, 2000.

– Footnotes –

[62,063]

[1] *SFPP, L.P.*, 91 FERC ¶61,135 (2000) (Opinion No. 435-A).

[2] *SFPP, L.P.*, 86 FERC ¶61,022 (1999) (Opinion No. 435).

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[3] *SFPP L.P.*, 92 FERC ¶61,166 (2000).

[4] The parties have since filed a number of procedural motions addressing the time frame and reparation issues addressed by this order. None of these merit further consideration than the merits discussion of reparations issues in the body of this order.

[5] The starting rate base for all oil pipelines is the rate base to be depreciated beginning on December 31, 1983. Thereafter, all rate base additions are at the actual construction cost. The starting rate base reflects a weighted average of the historical book depreciated rate base of the pipeline and the depreciated Interstate Commerce Commission (ICC) valuation methodology, a form of reproduction cost that was rejected by this Commission as unduly high. The starting rate base is defined as the historical rate base plus a premium above that rate base that results from the weighted average. *See*, 80 FERC at pp. 65,125 -26 for the formula. This premium is amortized over the remaining useful life of the pipeline's assets as of December 31, 1983. The debt-equity ratio of the pipeline is used to develop the weighting factors used to determine the premium that will be amortized. While December 31, 1983 is the date on which the amortization begins, the Commission ordinarily has fixed the debt-equity structure at that in effect on June 28, 1985, the date of Opinion No. 154-B . *See*, 80 FERC at p. 65,126 ; 86 FERC at p. 61,088 ; 91 FERC at pp. 61,504 -05.

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[6] SFPP became an independent pipeline on December 19, 1988 after being offered to the public as a limited liability partnership. The references to SPPL for the period before December 19, 1988, refer to its predecessor incorporated pipeline, Southern Pacific Pipe Line (SPPL), which was owned by the SantaFe Southern Pacific Company.

[7] *Id.* at p. 65,128.

[8] *See* Exh. No. 529 at Schedule 8, page 3 of 4, lines 1 and 2 (years 1989-94).

[9] Citing the 85.96 percent equity structure in *Alabama–Tennessee Natural Gas Co*, 52 FERC ¶61,151 (1983), *modified*, 27 FERC ¶61,006, at p. 61,417 (1984).

[10] 1998 Settlement and Agreement between SPPL and Airline Intervenors: Article V, Section 5.3.

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11 21 FERC at p. 61,621 , *citing Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486 (D.C. Cir 1984), *cert. denied sub nom., Williams Pipeline Co. v. Farmers Union Central Exchange, Inc.*, 105 S. Ct. 507 (1984) (*Farmers Union II*) at 1513. The ALJ's citation is at 39 FERC at p. 65,087 . The Court summarized the language from *Williams Pipe Line Company*, 21 FERC ¶61,260 (Opinion No. 154) (1982) at p. 61,621. The Commission order under review had severely criticized the hypothetical rate base concept, a view that was not shared by the Court. *See* the text, *infra*, for the test adopted by the Commission in Opinion No. 351 , which focuses on the issue of whether the capital structure is representative of the pipeline's risks. Both concepts focus on the ability of the pipeline to raise capital in a private market using proxy tests to establish an appropriate capital structure. The two concepts have the same practical result since risk is a key component in determining the capacity the pipeline has to support debt in the absence of the parent's guarantees.

12 39 FERC at p. 65,086 .

13 80 FERC at p. 65,129 . The ALJ adopted Staff's estimate that the use of the parent's capital structure as of June 28, 1985 would result in a starting rate base for the South Lines of $70.7 million compared to a starting rate base of $61.5 million based on SFPP's actual capital structure as adopted on December 19, 1988.

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14 *Arco Pipeline Company*, Opinion No. 351 , 52 FERC ¶61,055 (1990), at p. 61,233.

15 *See* Ex. 910 at 76; *See*, 39 FERC at p. 65,080 , 65,084 , *citing Oil Pipeline Deregulation, Report of the U.S. Department of Justice*, issued May 29, 1986, at 75-76;

16 39 FERC at pp 65,083 -84.

17 *See* Ex. 911 and Ex. 101.

18 *See* Moody's Transportation Manuel, 1990 Edition at 341-43.

19 *Id.* 1990 Edition at 344.

20 *See* Ex. 909 at 24.

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21 86 FERC at pp. 61,086 -87.

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22 SFPP cited 85.96 percent equity structure in *Alabama–Tennessee Natural Gas Co.*, 52 FERC ¶61,151 (1983), *modified*, 27 FERC ¶61,006, at p. 61,417 (1984).

23 91 FERC at pp. 61,511 -13.

24 *Iroquois Gas Transmission System, L.P. v. FERC*, 145 F.3d 398, 403 (D.C. Cir. 1998).

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25 In fact, the Commission has no authority to require SFPP to expand its pipeline to meet additional demand. This is a matter for the pipeline' sole discretion.

26 While the environmental violations in Iroquois were site specific, the prudence of these actions arises under regulatory obligations that apply to the system as a whole and there is no doubt about the Commission's ability to review the prudence of an action that involved an area over which it has unquestioned, and primary jurisdiction.

[62,071]

27 The rationale expressed on rehearing makes it unnecessary to address SFPP's arguments that the costs involved in the Exxon Valdez oil spill litigation were defined as extraordinary costs because of the contractual relationship between the pipelines and shipping company involved in the spill, and as such reflected facts that were unique to that case.

28 The costs would be included only in the East Line rates since they involved the East Line shippers only and the Commission has required that costs attributable to the East and West Lines be allocated to the East and West Line rates respectively.

29 91 FERC at pp. 61,516 -17.

[62,072]

30 *Id.* at p. 61,154.

31 *SFFP, L.P.*, 65 FERC ¶61,028, at p. 61,379 (1998).

32 *Id.* 61,380.

33 *See* Tosco's August 7, 1995 complaint in Docket No. OR95-34-000 at 8-10.

34 *See* Mobil's June 12, 1995 amended complaint in Docket No. OR95-5-000 at 6.

35 *Mobil Oil Corporation v. SFPP*, 73 FERC ¶61,032 (1995).

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36 No additional complaints were filed until 1996, and thus 1996 is the first year for which SFPP's East Line cost of service can be challenged by complaint. The cost of service of the two prior years might have to be adjusted to calculate reparations.

37 This issue is also *pending on rehearing* of the Commission's September 26, 2000 decision in *ARCO Products, supra*. If an East Line shipper has received the benefit of the 1994 cost of service in the subsequent years, then that shipper must meet the Commission's standing requirement that there be a substantial divergence between in the cost of service and the change in the index in the subsequent years if a Commission established rate is to be reviewed.

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38 91 FERC at p. 61,518 , *citing*, 86 FERC at p. 61,113 in footnote 57.

39 *See* Schedule 30, page 1 of 3, of SFPP's July 17, 2000 Opinion No. 435-A Compliance Filing.

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40 *Id.*

41 The Commission has discretion to base the pipeline's rates on a review costs outside the standard 12 to 15 month cost of service period if this would result in a more rationale and equitable rate structure.

42 It would also materially increase the cost to the East Line shippers for the year 1993 and all subsequent years, and materially reduce their reparations as well for any of the years for which SFPP's cost of service is now a issue in these protracted proceedings.

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43 *SFPP, L.P.*, 92 FERC ¶61,166 (2000).

[44] 86 FERC at p. 61,090 .

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[45] *Lakehead Pipe Line Co.*, Opinion No. 397 , 71 FERC ¶61,338 (1995), *order on reh'g*, Opinion No. 397-A , 75 FERC ¶61,181 (1996), discussed at 91 FERC pp. 61,508 -10.

[46] *Citing*, 86 FERC at p. 61,093 .