

127 FERC ¶ 61,039  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
and Philip D. Moeller.

|  |             |                               |
|--|-------------|-------------------------------|
| BP Pipelines (Alaska) Inc.                 | Docket Nos. | IS06-466-005,<br>IS06-466-006 |
| ConocoPhillips Transportation Alaska, Inc. |             | IS06-467-005,<br>IS06-467-006 |
| ExxonMobil Pipeline Company                |             | IS06-468-005,<br>IS06-468-006 |
| Koch Alaska Pipeline Company, LLC          |             | IS06-469-005,<br>IS06-469-006 |
| Unocal Pipeline Company                    |             | IS06-470-005,<br>IS06-470-006 |

ORDER ON REHEARING AND MOTION FOR CLARIFICATION

(Issued April 14, 2009)

1. In two prior orders in this proceeding,<sup>1</sup> the Commission accepted protested tariff sheets<sup>2</sup> filed by the TAPS Carriers,<sup>3</sup> to comply with Commission orders involving the

---

<sup>1</sup> *BP Pipelines (Alaska) Inc.*, 116 FERC ¶ 61,208 (2006) (Compliance Order), *order on reh'g*, 118 FERC ¶ 61,056 (2007) (Rehearing Order), *appeal pending sub nom. Flint Hills Resources Alaska, LLC v. FERC*, D.C. Cir. Nos. 06-1361, *et al.*

<sup>2</sup> Flint Hills Resources Alaska, LLC (Flint Hills) and Petro Star, Inc. (Petro Star) are referred to jointly as protesters.

<sup>3</sup> The TAPS Carriers are the owners of the Trans Alaska Pipeline System (TAPS). They consist of BP Pipelines (Alaska) Inc., ConocoPhillips Transportation Alaska, Inc., ExxonMobil Pipeline Company, Koch Alaska Pipeline Company, LLC, and Unocal Pipeline Company.

TAPS Quality Bank.<sup>4</sup> After appeal of those two orders was filed, this proceeding came before the Commission on voluntary remand from the United States Court of Appeals for the District of Columbia Circuit.<sup>5</sup> The remand was requested to address arguments concerning the consistency standard of *OXY USA, Inc. v. FERC*, 64 F.3d 679 (D.C. Cir. 1995) (*OXY*). On August 8, 2008, the Commission issued an order, *BP Pipelines (Alaska) Inc.*, 124 FERC ¶ 61,153 (2008) (Remand Order), which reversed the two orders and directed the TAPS Carriers to make a compliance filing consistent with the Remand Order. On August 27, 2008, the TAPS Carriers filed a Motion for Clarification of the Remand Order.<sup>6</sup>

2. On September 8, 2008, ConocoPhillips Alaska, Inc. (Conoco) and ExxonMobil Corporation (ExxonMobil) filed requests for rehearing and reinstatement of the Compliance Order. Chevron USA, Inc. and Union Oil Corporation (Chevron) jointly filed notice for leave to answer and answer to the request for rehearing. Conoco and ExxonMobil filed answers to the motion and answer. On September 8, 2008, the TAPS Carriers filed the compliance filing directed by the Remand Order. In this order, the Commission grants rehearing.

3. The issue addressed in the Remand Order concerns how to apply the Nelson-Farrar Inflation Adjustment Index to the processing costs for the Heavy Distillate and Resid cuts of the TAPS Quality Bank for the period 1996 to 2000. The Remand Order reversed the Commission's previous approval in the Compliance Order of the two-step method used by the TAPS Carriers in the protested tariff sheets (hereafter the "N-F Index" method). The Remand Order directed that in calculating the cost adjustment for the Heavy Distillate and Resid cuts the TAPS Carriers must use the same annual inflation adjustment method used for calculating the adjustment of the Light distillate cut, stating that "to be consistent with *OXY*, the Resid and Heavy Distillate cost adjustments in 1996

---

<sup>4</sup> *Trans Alaska Pipeline System*, 113 FERC ¶ 61,062 (2005) (Opinion No. 481), *order on reh'g*, 114 FERC ¶ 61,323 (2006) (Opinion No. 481-A), *order on reh'g*, 115 FERC ¶ 61,287 (2006) (Opinion No. 481-B) (collectively, Opinion No. 481), *aff'd sub nom. Petro Star Inc. v. FERC*, No. 06-1166, 2008 U.S. App. LEXIS 5328 (D.C. Cir. Mar. 6, 2008) (*Petro Star*), *cert. denied*, January 12, 2009.

<sup>5</sup> *Flint Hills*, D.C. Cir. No. 06-1361 (Jan. 22, 2008).

<sup>6</sup> Chevron, Flint Hills, Conoco, Exxon/Mobil, BP Exploration (Alaska), Inc., and Petro Star filed answers to the TAPS Carriers' motion for clarification.

must be escalated to 2000 using the same annual revisions applied to the Light Distillate, i.e., the tariff methodology.”<sup>7</sup>

4. In their requests for rehearing, ExxonMobil and Conoco argue, among other things, that *OXY* does not require the result in the Remand Order and in fact the Remand Order violates *OXY* because it would result in overvaluing of the Heavy Distillate and Resid cuts. Both also requested that the Remand Order be stayed pending resolution of all requests for rehearing of the Remand Order and the TAPS Carriers’ Clarification Motion.

### **Background**

5. In *OXY*, the Court affirmed the Commission’s order<sup>8</sup> adopting the “distillation” methodology of valuation for the Quality Bank. That methodology divides each petroleum stream entering TAPS into eight components or “cuts” based on the temperature at which particular petroleum products boil out of the stream. Each of the eight cuts are individually valued, and then those values are combined to determine the stream’s value.

6. The lighter cuts in the crude oil and those with the lowest boiling point, such as propane, are valued at published market prices for those products. Because there are no readily available market prices for the heaviest cuts, namely distillate and residual fuel oil (Resid), one must use as proxies for these cuts market prices of similar products adjusted to account for product differences.

7. The orders under review in *OXY* required the Quality Bank to value light distillate at the market price of jet fuel and heavy distillate at the market price of No. 2 fuel oil, the finished products into which those cuts are often refined. Since there is no market price for Resid, the heaviest Resid with a boiling point higher than 1050 degrees was valued at the price of fuel oil 380 (FO-380), while the lighter Resid, with a boiling point between 1000 and 1050 degrees, was valued at the more expensive No. 6 fuel oil.

8. The Court agreed with petitioners’ arguments in *OXY* that the valuation of the distillate cuts was flawed because the market proxies used to value the cuts are refined product prices that require refiners to process the cuts. Since the products refined from the lighter cuts require little or no processing, the court held that the Commission

---

<sup>7</sup> Remand Order at P 28.

<sup>8</sup> *Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 (1993).

overvalued the distillate cuts relative to other cuts in the common stream because it failed to reduce the proxy prices for these cuts to account for these processing costs.

9. The Court stated that it would not hold the Commission to an impossibly high standard when valuing different quality of oils, especially in the case of products without a readily ascertainable market price, “[b]ut if the agency chooses to value some cuts of petroleum at the prices they command in the market without the benefit of processing, as it appears to have done, it must attempt, to the extent possible, to value all cuts at the price they would command without processing. It cannot, consistent with the requirement of reasoned decision-making, value some cuts precisely and other haphazardly.”<sup>9</sup> As the Court explained, “[t]he goal of the Quality Bank valuation methodology . . . is to assign accurate relative values to the petroleum stream that is delivered to TAPS and becomes part of the common stream. In order to achieve this goal, FERC must accurately value all cuts – not merely some or most of them – or it must overvalue all cuts to approximately the same degree.”<sup>10</sup>

10. In *OXY* the Court also rejected the Resid cut proxies the Commission had adopted. Specifically, the Court rejected use of FO-380 as the proxy for the Heavy Resid because there was no evidence to suggest that the proxy of the cut “have equal or even near-equal market values,”<sup>11</sup> and rejected the No. 6 fuel as the proxy for the Light Resid because there was no evidence to show that its proxy price bore a close relationship to that cut. The Court remanded the valuation of the distillate and resid cuts for further consideration by the Commission.

11. In response to *OXY*, in December 1997, the Commission accepted a contested settlement on the remanded cuts. The Parties had submitted three different settlement proposals to an Administrative Law Judge (ALJ). The ALJ certified one settlement based upon the evidence submitted in support of the settlement. The settlement established, prospectively, the value for the West Coast Light Distillate cut as the Waterborne Jet Fuel price less 0.5 cents per gallon (cpg) to reflect processing costs, and established the value of the West Coast Heavy Distillate cut as the West Coast Waterborne Gasoil price less

---

<sup>9</sup> *OXY*, 64 F.3d at 694.

<sup>10</sup> *Id.* at 693.

<sup>11</sup> *Id.*

1 cpg for processing costs. For the West Coast Resid cut, the value included a 4.5 cpg processing cost.<sup>12</sup>

12. Since the amount of the processing cost adjustment in the Settlement reflected the cost to process the cut to the proxy's specification at a specific time, the Settlement provided that the Quality Bank Administrator (QBA)<sup>13</sup> would revise the agreed upon cost adjustment each year by projecting the inflation of those costs for the year in question based upon the average inflation trend during the preceding two years. Thus, to account for annual inflation, the Settlement provided that each year, beginning January 1, 1998, regardless of when the Settlement becomes effective:

the adjustments to the specified prices . . . shall be revised in accordance with changes in the Nelson Farrar Index Operating Cost Index for Refineries<sup>14</sup>] by multiplying the adjustments provided hereunder for the previous year by the ratio of (a) the average of the monthly indices that are then available for the most recent 12 consecutive months to (b) the average of the monthly indices for the previous (i.e., one year earlier) 12 consecutive months.<sup>15</sup>

13. Since there is a lag in computing the actual Index Number, the calculation for January 1 of each year would include the 12-month period from September 1 to August 30. The TAPS Carriers incorporated this method into their tariffs and for purposes of this order, this method shall be called the "Tariff Method or "Tariff Methodology."

---

<sup>12</sup> *Trans Alaska Pipeline System*, 81 FERC ¶ 61,319, at 62,460 (1997).

<sup>13</sup> The QBA is an independent expert who administers the Quality Bank.

<sup>14</sup> The *Oil & Gas Journal* publishes the Nelson-Farrar Index monthly. It tracks, compares and reflects overall refinery operating costs rather than those costs' individual components. It is regularly corrected for the productivity of labor, changes in the amounts of fuel used, productivity in the design and construction of refineries and the amounts of chemicals and catalysts employed. See Gerald L. Farrar, *How Nelson Cost Indexes are Compiled*, *Oil & Gas J.*, December 30, 1985 at 145.

<sup>15</sup> See Explanatory Statement on Settlement Agreement dated January 13, 1997 in Docket No. OR89-2-007 at III B, Exhibit A to Conoco's Request for Rehearing.

14. In *Exxon Co. U.S.A. v. FERC*, 182 F.3d 30 (D.C. Cir. 1999) (*Exxon*), the Court affirmed the Commission's order accepting the settlement provisions relating to the Light and Heavy Distillate cuts. However, the Court again found fault with the valuation of the Resid cut because it had not been shown that "the chosen proxy [bore] a rational relationship to the actual market value of resid,"<sup>16</sup> and remanded the valuation of the Resid cut to the Commission.

15. In January 1998, the TAPS Carriers, who file the Quality Bank tariff yearly, filed their first Quality Bank tariff after the 1997 Commission order, which reflected the revisions in the remanded cuts. Applying the Tariff Method, the Light Distillate cut's 0.5 cpg processing cost adjustment was revised to 0.5082 cpg. Subsequent tariffs revised the cost adjustments to 0.4987 cpg in 1999, and then to 0.4906 cpg in 2000. The QBA then revised the adjustment annually using the Tariff Method so that by 2006 the adjustment had risen to 0.6287 cpg. The valuation of the Light Distillate cut was not an issue in the Opinion No. 481 proceeding.

16. On November 24, 1999, the QBA notified the Commission of a change in the published proxy price used to value the West Coast Heavy Distillate cut. On February 9, 2000, the Commission issued an order accepting Platt's West Coast LA Pipeline LS No. 2 (0.05 percent) as the appropriate proxy for the West Coast Heavy Distillate cut. However, since the parties could not agree on the amount of the processing cost adjustment, it became an issue in the Opinion No. 481 proceeding where the valuation of the Resid cut was also at issue.

17. In the Opinion No. 481 proceedings, the parties presented competing Resid processing cost data, one set stated in 1996 dollars (the O'Brien calculations), the other in year 2000 dollars. The parties, except for the TAPS Carriers, stipulated that "Resid shall be valued as a Coker feedstock," and that, "The Coker feedstock value of Resid shall be determined in accordance with the following formula: Resid = Before-Cost Value of Coker Products - (Coking Costs \* Nelson Farrar Index)." The Nelson Farrar Index was defined as the ratio of: "(a) the Nelson Farrar Index (Operating Indexes Refinery) for the year in which the value is being determined to (b) the Nelson Farrar Index (Operating

---

<sup>16</sup> *Exxon*, 182 F.3d at 42.

Indexes Refinery) for the base year.”<sup>17</sup> The Eight Parties proposed a base year of 1996 and ExxonMobil/Tesoro proposed a base year of 2000.<sup>18</sup>

18. Opinion No. 481 affirmed the ALJ’s rulings in the Initial Decision (ID)<sup>19</sup> that determined that the processing cost adjustment for Heavy Distillate and the capital investment cost adjustment for Resid, based upon O’Brien’s 1996 costs, should be adjusted to a 2000 base year using the N-F indices, effective February 1, 2000.<sup>20</sup>

19. On July 3, 2006, the TAPS Carriers filed identical tariffs to comply with Opinion No. 481, which included a June 29, 2006 memorandum from the QBA explaining the process he used to convert 1996 based capital investments to a year 2000 basis for the Resid and Heavy Distillate cost adjustments.

20. The QBA revised the Light Distillate 1997 Settlement cost adjustment of 0.5 cpg for the entire period until 2006 using the Tariff Methodology. The QBA converted the 1996 cost adjustments for Resid and Heavy Distillate<sup>21</sup> to the year 2000 in a different manner. The QBA converted the cost adjustments for Resid and Heavy Distillate cuts from 1996 to 2000 by the ratio of the average of the N-F Index for calendar year 2000 to the average of the N-F Index for calendar year 1996 which resulted in 1.0742 increase.

---

<sup>17</sup> Joint Stipulation of the Parties in Docket No. OR89-2-007, filed October 3, 2002 at 3.

<sup>18</sup> *Id.*

<sup>19</sup> *Trans Alaska Pipeline System*, 108 FERC ¶ 63,030, at P 1254, 1256 and 1449 (2004).

<sup>20</sup> *Id.* P 1258 and 1450.

<sup>21</sup> The order noted that for the first years after the 1997 Commission order accepting the settlement, the QBA revised the cost adjustment for the Heavy Distillate and Light Distillate in the same manner. However, once the 1997 settlement amount no longer governed the Heavy Distillate cut, when Platts discontinued reporting the existing proxy in 1999, it was necessary to determine the amount of the processing cost to the new proxy, effective February 1, 2000, when that new proxy became effective.

21. The QBA explained in a memorandum sent to all interested parties<sup>22</sup> why he did not use the Tariff Methodology to convert the Heavy Distillate and Resid cuts to the year 2000. He stated that in the Opinion No. 481 proceeding, the ALJ accepted witness O'Brien's values for determining the cost adjustments, and O'Brien based the costs on the overall year 1996, not costs as of January 1, 1996, thus the costs could come from any part of the year. However, in the Opinion No. 481 proceeding the base year was to be the year 2000, and the 1996 costs required converting to 2000 costs using the N-F indices. The QBA stated that Opinion No. 481 gave no specific direction as to how to use these indices to make this conversion. The QBA concluded that since "Mr. O'Brien's values were based on the overall year 1996 and they were to be converted to the overall year 2000 basis, it seems logical to use a ratio of the annual average 2000 index to the annual average 1996 index."<sup>23</sup>

### **Protests of the Original Compliance Filing**

22. Protesters challenged the compliance filings on two bases. The first contention was that the QBA's two-step method results in double counting of inflation from September 1, 1999, through December 31, 2000, because the base year and annual adjustments both include inflation for that period. Protesters' second ground, the disparity claim, was that the method the QBA used to adjust the 1996 processing costs to 2000 costs for Heavy Distillate and Resid differed from the methodology the QBA applied to adjust the Light Distillate processing costs for that period. In that period the cost adjustments for the Heavy Distillate and Resid cuts were positively inflated by a factor of 1.0742. However, for the same period, the 1997 Settlement processing cost adjustment for Light Distillate was reduced by 0.9812. This resulted in adjustments to the processing costs for the Heavy Distillate and Resid cuts during that period that were ten percent above the adjustment for the Light Distillate cut processing cost.<sup>24</sup> Protesters

---

<sup>22</sup> July 5, 2006 Memorandum of QBA, Petro Star's July 18, 2006 Protest at Appendix I.

<sup>23</sup> *Id.* at 1.

<sup>24</sup> The reason for the difference is because the actual months included in the calculation of the escalation for the Heavy Distillate and Resid cuts are not the same as the months included in the calculation of the escalation for Light Distillate cut for the year 2000. The N-F indices for the months in 2000 were higher than the N-F indices for the comparable months in the previous year. These months were not included in calculating the year 2000 cost adjustment for Light Distillate, using the tariff methodology, effective February 1, 2000. Therefore, the Resid and Heavy Distillate cost

(continued)

argued that this violated the *OXY* requirement, that “FERC must accurately value all cuts – not merely some or most of them – or it must overvalue all cuts to approximately the same degree.”<sup>25</sup>

### **The Compliance and Rehearing Orders**

23. On September 1, 2006, the Commission issued the Compliance Order accepting the identical tariff sheets, effective November 1, 2005. Petro Star filed a request for rehearing of the Compliance Order. On January 26, 2007, the Commission issued the Rehearing Order denying rehearing.

24. The Compliance Order rejected the double counting contention stating that “The methodology advocated by protestors results in converting 1996 costs into the year 1999 costs, not the year 2000 costs, as required by our orders.”<sup>26</sup> The Rehearing Order similarly rejected this contention. The order stated:

Petro Star argues that the QBA must calculate the conversion of the 1996 base year costs to a 2000 base year the same way as the “going forward” annual escalation. It urges the Commission to use the average NFI for September 1998 through August 1999 divided by the average NFI for September 1994 through August 1995 to convert 1996 values to 2000 values. We find no merit in this. As stated in the September Order, the goal of the calculation is to convert cost data for 1996 to a year 2000 basis. But Petro Star’s proposed method would use no data from either 1996 or 2000, even though the average indices for both years are known.<sup>27</sup>

---

(continued)

adjustments for 2000 would necessarily be higher than the Light Distillate cost adjustment for 2000, since calculating the processing cost adjustment for the Light Distillate cut, to be effective February 1, 2000, does not use year 2000 data.

<sup>25</sup> *OXY*, 64 F.3d at 693.

<sup>26</sup> Compliance Order P 12.

<sup>27</sup> Rehearing Order P 20.

25. The Rehearing Order rejected the disparity contention, stating:

Petro Star's other argument concerns the inconsistency between the inflation factor applied to the Resid and Heavy Distillate cuts under the [Quality Bank Administrator]'s calculations, and the inflation factor applied to the Light Distillate cut. However, Petro Star's argument is flawed because it ignores the fact that [the] processing cost adjustment for Light Distillate was set at 0.5 cpg by the 1997 Settlement. Thus, the escalation in the Light Distillate cut processing costs would not include any inflation prior to that time, while the escalation in the costs for the Resid and Heavy Distillate cuts covers the period from 1996 on.<sup>28</sup>

### **The Remand Order**

26. The Remand Order further addressed the disparity issue and found, for the reasons explained below, that the *OXY* consistency standard compelled granting rehearing and directed the QBA to recalculate the processing costs based on the Tariff Methodology. The order also stated that since the Commission was granting rehearing the double counting issue was moot.

27. The Remand Order found that unless there was some overriding reason why the Tariff Methodology used to escalate the adjustment for the Light Distillate cut could not be applied to the Heavy Distillate and Resid cuts, and none was shown, it would violate the *OXY* consistency requirement to use a different methodology to convert the 1996 processing cost adjustments for the Resid and Heavy Distillate cuts to a year 2000 basis. Since the Tariff Methodology would have resulted in a lower inflation factor for the Heavy Distillate and Resid cuts, this would reduce the process cost adjustment for these two cuts and increase their value. Therefore, the Remand Order concluded, to satisfy *OXY*, the Resid and Heavy Distillate cost adjustments in 1996 must be escalated to 2000 using the same methodology that was applied to the Light Distillate cut, i.e., the Tariff Methodology.

28. The order directed the QBA to recalculate the processing cost adjustments for Resid and Heavy Distillate using the Tariff Methodology, and directed the TAPS Carriers

---

<sup>28</sup> Rehearing Order P 21.

to make a compliance filing consistent with the QBA's recalculated processing costs and the Remand Order.

### **TAPS Carriers Clarification Motion and Compliance Filing**

29. The TAPS Carriers' motion states that they believe that the intent of the Remand Order is for the TAPS Carriers to file new processing cost adjustments for Resid and Heavy Distillate but not to issue new invoices within the thirty-day period. In the alternative, to the extent the Commission intended the TAPS Carriers also to recalculate the Quality Bank invoices within thirty days, the TAPS Carriers requested that the Commission grant the TAPS Carriers an extension of time until sixty days after resolution of any disputes regarding the recalculated processing cost adjustments to do so.

30. The Commission had not acted on the TAPS Carriers' motion when the TAPS Carriers made the compliance filing on September 8, 2008. The compliance filing included tables by the QBA, and a memorandum from the QBA explaining the enclosed tables. Pending clarification of the time period for which the processing cost adjustments should be recalculated, the QBA recalculated the processing cost adjustment for West Coast Heavy Distillate and Resid for all months from February 2000 through January 2009 and included Tables reflecting his calculations.<sup>29</sup>

### **Conoco's Request for Rehearing**

31. Conoco argues that the Commission erred in overturning the prior ruling regarding the method to be used to bring forward the 1996 processing costs for the Heavy Distillate and Resid cuts to a Year 2000 base year. Conoco contends the change ordered by the Commission in the Remand Order constitutes a *sub silentio* reversal of the ruling in Opinion No. 481 that a Year 2000 base year be adopted for the Heavy Distillate and Resid cuts.

32. Further, Conoco argues, that for a number of reasons, the Commission's reason for the change, namely to meet the OXY consistency standard, does not justify overruling the

---

<sup>29</sup> The new processing cost adjustments are set out in Table 1. Table 2 shows that consistent with the Remand Order, identical Nelson-Farrar escalation ratios have been used to calculate the annual processing cost adjustments for Light Distillate, Heavy Distillate and Resid. The remaining Tables 3 through 11 show the details of the new processing cost adjustments.

holding in Opinion No. 481 that a Year 2000 base year should be used for the Heavy Distillate and Resid cuts.

33. First, Conoco contends, the Commission did not consider the magnitude of the impact of applying the Tariff Methodology to convert Heavy Distillate and Resid processing costs to a 2000 base year. For the Light Distillate cut there is only a minimal difference in the amount of the processing cost adjustment between the two methods, because the processing cost that is adjusted by the N-F Index is only one-half a cent per gallon. The difference in the Light Distillate processing costs in 2006 dollars between using the existing Tariff Method 1.257 factor, which results in a processing cost adjustment of 0.6285 cpg, and using the N-F Index factor of 1.377, which results in a processing cost adjustment of .6885 cpg, is only six one-hundredth of a cent per gallon. Thus, Conoco argues, the value of the Light Distillate cut is basically the same, whichever method is used to adjust the processing cost.

34. This, Conoco asserts, is not true with respect to the Heavy Distillate and Resid cuts, which the Commission failed to recognize in the Remand Order. The processing costs for the Heavy Distillate and Resid cuts are approximately 7.5 cpg and 18 cpg respectively, in 1996 dollars. Thus, adjustments to these amounts have a significant impact on the value of these cuts for Quality Bank purposes. Reducing the processing cost adjustments for the Heavy Distillate and Resid cuts calculated under the QBA's method, accepted by the prior rulings, to the amount of these adjustment to these cuts under the Remand Order, results in overvaluing these cuts, since it cannot be disputed that the QBA's methodology accurately reflects the processing costs that were incurred in the years in question. Conoco argues that reducing the amount of these costs under the Remand Order approach bestows an illegal benefit on producers whose crude oil contained significant amounts of Heavy Distillate and Resid.

35. Conoco argues that *OXY* does not require that the same method must be applied to these cuts in calculating their Quality Bank value. It asserts that in *OXY*, the court found that it might be reasonable to ignore minor processing costs and still comply with the consistency requirement, but held that the record in that proceeding provided no quantification of the processing costs at issue to determine whether the amounts involved were in fact minor. *OXY*, 64 F.3d at 693-94. Here, Conoco asserts, it is possible to quantify the impact of the difference in inflation factors and, as noted above, that difference as to the Light Distillate cut is immaterial. Clearly, Conoco continues, the holding in *OXY* does not require that the accurate Year 2000 base year values for Heavy Distillate and Resid cuts must be changed merely because the accurate inflation factor applied to them differs from the inflation factor applied to the Light Distillate cut under the Tariff Methodology.

36. Conoco states use of the Tariff Methodology would use no data from either 1996 or 2000. Thus, Conoco asserts, the change ordered by the Commission constitutes a *sub silentio* reversal of the Commission's ruling in Opinion No. 481 that a year 2000 base year should be used for valuing the Heavy Distillate and Resid cuts.

37. This is particularly egregious, asserts Conoco, because in the Remand Order at PP 17-20, the Commission noted that the prior orders had dealt with the protestors "double counting" arguments, but had only failed to adequately address their *OXY* consistency argument. However, Conoco argues, the Remand Order then commits the exact opposite mistake – it addresses the *OXY* consistency argument but ignores the issue of how a 2000 Base Year should be calculated, which was the crux of Protesters' double counting argument. By requiring that the QBA now must adopt a methodology that uses 1999 costs for the Year 2000, the Commission has, without any explanation, reversed its rulings in Opinion No. 481 requiring that a Year 2000 base year be adopted. Conoco contends that this *sub-silentio* reversal is arbitrary and capricious.

38. Conoco proposes that if the Commission nevertheless believed that the same method should be applied to all the cuts, the Commission could order that the processing costs for the Light Distillate cut also be placed on a Year 2000 basis. The calculation of the Year 2000 base year processing costs for Light Distillate then could be performed in exactly the same fashion as is done for the Heavy Distillate and Resid costs. This would allow the Commission to comply with the Year 2000 base year ruling in Opinion No. 481 and still maintain exact consistency in inflation factors for the Light Distillate, Heavy Distillate and Resid cuts, as the Remand Order required.

### **Exxon/Mobil Request for Rehearing**

39. Exxon asserts that *OXY* does not require that the Commission ignore actual inflation indexes for the period from 1996 and 2000 to convert 1996 processing costs to a 2000 year basis. Moreover, Exxon argues, since that ruling results in understating the processing costs for the Heavy Distillate and Resid cuts by about 9 percent, the ruling violates the *OXY* consistency standard because it results in overvaluing those cuts at the same time the Commission attempts to determine accurately the market values for all of the other Quality Bank cuts, not merely the three at issue here. Exxon also argues that by requiring use of the Tariff Method, which it asserts states costs in 1999 dollars, constitutes an unlawful collateral attack on Opinion No. 481's directive to calculate Heavy Distillate and Resid costs on a 2000 year basis.

40. Exxon contends that the Remand Order ignores that in the Opinion No. 481 proceeding, although the parties acknowledged the ongoing dispute regarding whether the QBA's Resid processing cost adjustment should be stated in 1996 or in 2000 dollars,

they stipulated that to convert processing costs between the competing 1996 and 2000 base years the N-F indices of the years in question would be used, as the QBA did here. The stipulation provided that the TAPS Carriers should use the “ratio of: (a) the Nelson Farrar Index (Operating Index Refinery) for the year in which the value is being determined to (b) the Nelson Farrar Index (Operating Index Refinery) for the base year.”<sup>30</sup> This, Exxon states is precisely the method the QBA used to adjust the 1996 costs to year 2000 costs. In fact Exxon asserts, the Protesters themselves used this NFI adjustment method in their testimony and briefs submitted in the Opinion No. 481 proceeding.

41. Exxon argues that the N-F Index adjustment method specified in the Joint Stipulation, which compared the indices of actual costs for the desired year to those of the given base year, was fully consistent with how the parties used cost indices in the evidence submitted in the ensuing hearing. Moreover, Exxon refers to Protesters’ witness, Mr. O’Brien, who, using the N-F adjustment method, testified that “[t]he operating cost index is 1.073 for the period ’96 to 2000.”<sup>31</sup> That, Exxon points out, is virtually identical to the adjustment factor of 1.0742 calculated by the QBA that he used to convert Heavy Distillate and Resid cuts’ processing cost to the 2000 base year.

42. Exxon argues that the Remand Order adopts a methodology that the Commission found places costs on a 1999-year basis in calendar year 2000, and thereby conflicts with the Initial Decision and Opinion No. 481. This, Exxon contends, represents an impermissible collateral attack on the Initial Decision and Opinion No. 481.

43. Exxon asserts that the Commission’s reliance on *OXY* to change the QBA’s approach is misplaced for a number of reasons. In *OXY*, the Court properly rejected the Commission’s valuation of cuts that required processing because the Commission had ignored the costs of processing, thereby significantly overvaluing those cuts in relation to the value of other cuts which did not incur processing costs to determine their Quality Bank value. Here, on the other hand, Exxon asserts, the Remand Order adopts a method that understates actual processing costs in 2000 by about 9 percent by disregarding the actual inflation that occurred during those years, and instead uses the Tariff Method.

---

<sup>30</sup> Exxon Rehearing Request at 6 (citing Initial Decision at P 25; *see* Compliance Order at P 3; Rehearing Order at P 3).

<sup>31</sup> Exxon cites to Protester’s witness testimony at the Opinion No. 481 hearing that he used the NFI adjustment method to convert 1996 processing costs to year 2000 processing costs. Tr. 1108:7-16 (Attachment A to Exxon/Mobil’s Answer).

This is particularly egregious for the Resid cut, where such costs represent nearly half of Resid’s adjusted cut value.

44. Exxon contends that the N-F Index adjustment method is the most accurate way to adjust costs between 1996 and 2000 since it is based on the actual increase, or decrease, in costs that occurred during that period. Application of the Tariff Method to reflect the inflation of those costs during that period results in an understatement of processing costs by about 9 percent and thereby impermissibly increases the value of the cut. This substantial overstatement of the Heavy Distillate and Resid cut values violates the very rationale that the Court relied upon in *OXY*.

45. In fact, Exxon argues, the Remand Order violates *OXY* because the processing costs for the Light Distillate cut are minimal compared to Light Distillate’s adjusted price, since these costs are about one-half of 1 percent of the Light Distillate cut’s reference price, as shown in the table included at page 16 in Exxon’s Rehearing Request.<sup>32</sup> In contrast, Resid processing costs are nearly 50 percent of Resid’s adjusted cut value. Thus, Exxon argues, it is critical to accurately calculate Resid’s processing cost adjustments in order to meet the *OXY* consistency standard, which the Remand Order ignored.

46. There can be no doubt, Exxon states, that the most accurate method to adjust processing costs between 1996 and 2000 is to use the N-F Index adjustment method, which reflects actual inflation rates for those years.

---

<sup>32</sup> The table is based upon the September 8, 2008 affidavit of David I. Toof attached to the rehearing request. The processing costs are the amounts in the TAPS Carriers’ July 3, 2006 Tariff filing. The answer to the rehearing request did not challenge any data contained in the Toof affidavit.

(2000 Annual Average \$/BBL)

| CUT              | REFERENCE PRICE | PROCESSING COST | ADJUSTED PRICE | PROCESSING COST % OF ADJUSTED PRICE |
|------------------|-----------------|-----------------|----------------|-------------------------------------|
| LIGHT DISTILLATE | \$39.03         | \$0.21          | \$38.82        | 0.54%                               |
| RESID            | \$26.31         | \$8.24          | \$18.07        | 47.51%*                             |
| HEAVY DISTILLATE | \$38.95         | \$2.11          | \$36.84        | 5.87%*                              |

\*The correct percentage is 45.6% for Resid and 5.73% for Heavy Distillate.

47. Under these circumstances, Exxon asserts, *OXY* does not mandate requiring that Heavy Distillate and Resid cuts use the Tariff Method because that method was used to adjust the Light Distillate cut's processing costs. Both Court and Commission decisions have made clear that *OXY* does not require precisely identical treatment in the valuation of the Quality Bank cuts where there are differences in the cuts that reasonably justify treating them differently. Exxon cites to the Opinion No. 481 proceeding where the Commission required that in the valuation of Resid Coke product, there must be a deduction of the costs of shipping the Coke from the refinery gate to the waterborne point of sale, even though shipping costs were not deducted from the valuation of other coker products.<sup>33</sup> The reason for the different treatment was because Coke shipping and handling costs represented on average 61 percent of the value of Coke, while for all other coker products, such costs represented only 2 percent to 8 percent of product value. The ALJ rejected the argument that *OXY* required similar treatment, (*see* ID at P 1172 and 1175). The Court upheld the Commission's position stating:

Similarly without merit is petitioners' objection that FERC should have ignored the shipping and handling costs of the resid byproduct coke when estimating resid's value. Although FERC ignored the shipping and handling components of most oil components, it explained that the costs of shipping and handling are dramatically higher relative to its value than are those of any other oil product, making it perfectly reasonable for FERC to treat coke differently. (emphasis added)<sup>34</sup>

48. Exxon argues that the instant case presents a much stronger reason for treating the cuts differently, and the *OXY* consistency standard is not violated in doing so. Moreover, Exxon continues, not only does *OXY* not support the Commission's decision to ignore actual inflation indexes for 1996 and 2000 to adjust processing costs between those two years, but the Remand Order itself violated the *OXY* consistency standard by understating the processing costs for the Heavy Distillate and Resid cuts by about 9 percent in 2000 and subsequent years. Overvaluing the Heavy Distillate and Resid cuts is a clear departure from *OXY*'s requirement that the Commission "must accurately value all cuts—

---

<sup>33</sup> *See* Initial Decision P 1168-1177.

<sup>34</sup> *Petro Star Inc. v. FERC*, Docket Nos. 06-1166, *et al.*, 2008 U.S. App. LEXIS 5328 at 2 (D.C. Cir. March 6, 2008), *cert. denied*, No. 08-1212 (U.S. January 12, 2009).

not merely some or most of them—or it must overvalue or undervalue all cuts to approximately the same degree.”<sup>35</sup>

49. Exxon asserts that there is virtually no impact on Quality Bank payments regardless of whether the Light Distillate cut is valued on a 1999- or a 2000-year basis.<sup>36</sup> Accordingly, it argues that it is particularly objectionable that the Remand Order requires that the Heavy Distillate and Resid cuts’ processing cost adjustments be valued in the same fashion as the Light Distillate cut’s processing adjustment.

50. Exxon, proposes, as does Conoco, that to the extent the Commission believes that the difference between the Heavy Distillate/Resid and Light Distillate inflation factors is material, the Commission could order that the processing costs for the Light Distillate cut, on a prospective basis, should also be placed on a Year 2000 basis using the N-F Index Adjustment Method. This would allow the Commission to comply with the Year 2000 base year ruling in Opinion No. 481 and still maintain precise consistency in use of the inflation factors for the Light Distillate, Heavy Distillate and Resid cuts.

51. Finally, Exxon argues that the Remand Order erred in failing to hold that Flint Hills and Petro Star are estopped from challenging the N-F Index adjustment method because (a) the parties in the underlying Opinion No. 481 proceedings expressly agreed to use that method, and (b) the Protesters advocated the use of that same methodology in their witness’ testimony and their briefs in that proceeding.

### **Answer of Chevron**

52. Chevron asserts that contrary to Conoco and Exxon/Mobil’s contention, the Remand Order does not constitute a collateral attack of the Commission’s ruling in Opinion No. 481 that a Year 2000 base year be adopted for the Heavy Distillate and Resid because the Remand Order was issued in the compliance proceedings to implement Opinion No. 481. Petro Star raised and pursued the Nelson Farrar calculation issue in the compliance phase of the Opinion No. 481 proceedings. That issue was then determined in an order issued in the normal course of proceedings reviewing and implementing Opinion No. 481.

53. Moreover, Chevron contends that the Remand Order did not reverse any ruling in Opinion No. 481. The Initial Decision description of the base year, in P 1258 and 1450,

---

<sup>35</sup> *OXY*, 64 F.3d at 693.

<sup>36</sup> *Toof Aff.* (9/8/08) P 19-23 and Exh. DIT-9.

focused primarily on a dispute over whether to use the Nelson Farrar Construction Cost Index or the Nelson Farrar Operating Cost Index to inflate the processing costs for the Heavy Distillate and Resid cuts. Chevron contends that neither the Initial Decision nor Opinion No. 481 ruled on how to establish a 2000 Base Year for Heavy Distillate and Resid processing costs. Thus, Chevron asserts, requiring use of the Tariff Method to establish Year 2000 costs is not inconsistent with Opinion No. 481 because Opinion No. 481 did not determine how to derive Year 2000 costs.

54. Chevron states that Exxon/Mobil's argument that the Remand Order violates a Joint Stipulation among the parties entered into at the Opinion No. 481 hearing regarding how to change 1996 processing costs to 2000 processing costs is not correct. Chevron asserts that the Joint Stipulation can be interpreted as an agreement among the parties limited to the matters in litigation, not as an agreement on how to set the Base Year costs or how to inflate processing costs on a going-forward basis.

55. Moreover, Chevron contends that if the Commission changes its ruling does not make the decision arbitrary provided the Commission explains the reason for doing so. Chevron asserts that the Remand Order fully meets that test since the Commission found the change was necessary to satisfy the *OXY* consistency requirement.

56. Chevron states that contentions that putting Heavy Distillate and Resid on the same inflation adjustment basis as Light Distillate has a disproportionate impact on Heavy Distillate and Resid which counteracts the *OXY* goal of treating all cuts equally ignores the fact that only three out of seven cuts require processing cost adjustments, so that whatever alleged disparity is caused by changing the inflation factors for processing costs can impact only three, not all seven cuts. Furthermore, Chevron states, "the disparate impact alleged as between Light Distillate on the one hand and Resid and Heavy Distillate on the other is due, as Exxon Mobil's data show, not to any discriminatory treatment among cuts but to factual differences between and among the three cuts. Different treatment caused by such factual differences does not reflect unjust discrimination or preference."<sup>37</sup>

57. In response to the proposal that the Commission change how the Light Distillate adjustment would be calculated, Chevron states there is no authority to make such a change in the tariff method of determining the adjustment for the Light Distillate cut. However, if the Commission were inclined to address the impact argument, Chevron proposes that the Commission make a one-time change to the tariff inflation adjustment

---

<sup>37</sup> Chevron Answer at 12.

for the Heavy Distillate and Resid cuts for 2001 by simply eliminating the 2001 tariff adjustment for that year. Chevron asserts that this proposal is consistent with the Tariff Forecast Methodology, which has a one-year lag, meaning that the Year 2000 tariff-adjusted value is in actuality a Year 1999 value.

### **Exxon/Mobil and Conoco's Replies**

58. Both Exxon/Mobil and Conoco assert that Chevron's alternative proposal for establishing a Year 2000 base year has no merit. That proposal would be to basically apply a one-year freeze on the inflation adjustment for the Heavy Distillate and Resid cuts, but apply the adjustment in that year to the Light Distillate cut. They argue that Chevron's proposal, however, addresses the wrong problem. The Commission's reasons in the Remand Order for changing the methodology for the annual adjustments to the Heavy Distillate and Resid processing costs was not due to a concern about "double counting." This argument had been considered and rejected by the Commission and was not reversed in the Remand Order. By adjusting **only** the Light Distillate processing costs but not the Heavy Distillate and Resid processing costs, from 2000 to 2001, Chevron's proposal would treat the Heavy Distillate and Resid cut valuations differently from the Light Distillate cut valuation. Thus, Chevron's proposal violates the *OXY* consistency standard, and creates the very problem that the Commission attempted to avoid when it reversed its course in the Remand Order.

59. Exxon asserts that Chevron's claim that the N-F Index issue first arose during the compliance phase is incorrect and misstates the real issue of how to apply the N-F Index to convert Heavy Distillate and Resid processing costs adjustments from a 1996 base year to a 2000 base year. This issue arose in 2002, in the underlying Opinion No. 481 proceeding, five years before the instant proceeding. Exxon asserts it was because of this issue that the parties entered into the Joint Stipulation in 2002 at the hearing. Moreover, Chevron's argument that the Joint Stipulation was meant to govern solely the submission of evidence is not supported by any language in the stipulation. The provisions of the Joint Stipulation were cited and applied throughout the Initial Decision and Opinion No. 481.<sup>38</sup>

60. Exxon requests the Commission reverse the Remand Order and affirm the conclusions reached in the prior orders, or reverse the Remand Order and order a hearing to determine the proper processing cost adjustment for the Heavy Distillate and Resid cuts.

---

<sup>38</sup> Exxon cites to Initial Decision P 25, 1135, 1168; Opinion No. 481 P 13, 19, 53.

## **Discussion**

61. The Remand Order found that there was no overriding reason shown why the methodology used to escalate Light Distillate cut's processing costs (the Tariff Method) could not also be applied to the Heavy Distillate and Resid cuts. Accordingly, to satisfy the *OXY* consistency standard, the Remand Order required that the Heavy Distillate and Resid cuts' 1996 processing cost adjustments be escalated to 2000 using the same methodology that was applied to the Light Distillate cut, i.e., the Tariff Method.

62. However, the rehearing applicants have provided good reason why the Tariff Method should not be applied to the Heavy Distillate and Resid cuts. The data presented on rehearing shows that, unlike the Light Distillate cut, whose processing cost is only about one half cent per gallon, equal to 0.54 percent of its adjusted value, processing costs for Heavy Distillate and Resid represent a significant portion of the value of those cuts, 5 cents and 19 cents, respectively.<sup>39</sup> Thus, while the value of the Light Distillate cut is basically the same whether the Tariff Method or the N-F Index methodology is used to escalate processing costs (the difference in results between the two methodologies is six-one-hundredths of a cent, an immaterial amount), because the processing costs for the Heavy Distillate and Resid cuts are much higher (Resid's processing costs account for nearly 50 percent of its adjusted value; the processing costs for Heavy Distillate represent almost 6 percent of that cut's adjusted value), there is a substantial difference in the values of these two cuts depending on which escalation methodology is used.

63. We find it appropriate, in this limited, locked-in period scenario, to apply a different inflation adjustment methodology to the Resid/Heavy Distillate cuts than the methodology applied to the Light Distillate cut because, while the value of the Light Distillate cut is basically the same whether its processing costs are escalated using the Tariff Method or the N-F Index methodology, the values of the Heavy Distillate and Resid cuts are substantially different depending on which escalation methodology is used, and are far more accurate if the N-F Index methodology is used. As noted in *OXY*, where one cut's processing costs are minimal and other cuts' processing costs are not, it might be appropriate to apply different valuation methodologies to those cuts. *See OXY*, 64 F.3d at 693-94.

64. It is undisputed that the N-F Index adjustment method is the more accurate method to adjust 1996 processing costs to year 2000 costs because it reflects the actual inflation

---

<sup>39</sup> *See* table in note 32, *supra*. That table refers to cost per barrel. That cost is converted to costs per gallon by dividing by 42, the number of gallons in a barrel.

for those years. Using the Tariff Method in the circumstances here (where, in contrast to the usual circumstance when the Tariff Method is applied to forecast inflation, we have, at the time the inflation adjustment is being made, the actual inflation experienced during the period in question) would unnecessarily greatly overvalue Heavy Distillate and Resid (by about 9 percent) relative to other cuts. Reducing the amount of these costs for these cuts bestows an unreasonable and unjustifiable benefit on producers whose oil contained significant amounts of Heavy Distillate and Resid. Since Light Distillate's value is virtually unaffected by the choice of valuation methodology, *OXY's* consistency requirement is met.

65. Under the circumstances here, the Commission finds it appropriate and consistent with *OXY's* requirement that the Commission “must accurately value all cuts—not merely some or most of them— or it must overvalue or undervalue all cuts to the same degree,”<sup>40</sup> to apply the N-F Index methodology to escalate Heavy Distillate and Resid's processing costs to 2000 while applying the Tariff Method to escalate Light Distillate's processing costs.

66. Exxon contends that not only is it wrong to require use of the Tariff Methodology to convert costs from 1996 to year 2000 given the cost impact on the cuts in question, but in addition, another independent reason to uphold the QBA's approach is that he followed the stipulation that all parties agreed to in the Opinion No. 481 proceeding which set forth how to make that type of conversion. That stipulation provided that to convert processing costs between the competing 1996 and 2000 base years the ratio of the N-F indices of the years in question would be used, exactly what the QBA did here.<sup>41</sup> While the Stipulation seems to support the QBA's approach, in and of itself it is not a sufficient basis to reject applying the Tariff Methodology. The Stipulation was limited to valuation of the Resid cut, and did not apply to the Heavy Distillate cut. Moreover, the QBA himself did not refer to the Stipulation in explaining why he converted the Heavy Distillate and Resid cuts 1996 costs to the year 2000 in the manner he did. In any event, here, where one cut's processing costs are minimal whatever valuation methodology is used, and other cuts' processing costs are substantially affected by the choice of methodology, it is appropriate to apply different valuation methodologies.

---

<sup>40</sup> *OXY*, 64 F.3d at 693.

<sup>41</sup> The stipulation provided that the TAPS Carriers should use the “ratio of: (a) the Nelson Farrar Index (Operating Index Refinery) for the year in which the value is being determined to (b) the Nelson Farrar Index (Operating Index Refinery) for the base year.” Initial Decision P 25.

67. In summary, the rehearing requests set forth data and argument showing the impact of the different methodologies on the cuts at issue, which was not evident previously. These data were not challenged in the answer to the rehearing requests. In view of this additional information the Commission finds merit in the rehearing requests. The QBA applied the N-F Index numbers to the Heavy Distillate and Resid cuts to convert their 1996 costs to the year 2000, but for the Light Distillate cut those numbers were used to forecast the inflation amount for that year under the Tariff Method. The N-F Index is the more accurate method of determining the processing costs for the base year 2000. Moreover, the processing cost adjustment for the Heavy Distillate and Resid cuts represent a significant amount of the value of these cuts. Accordingly, the more accurate method for calculating those costs should be used (in this limited locked-in period) even if it differs from the methodology applied to the Light Distillate cut, where the processing cost adjustment is minimal, whichever method is used. To treat the cuts differently here does not violate *OXY* because there is good reason for the different treatment.

68. As the Rehearing Requests point out, it is permissible to treat different Quality Bank cuts differently where there is a valid reason for doing so since the goal is to assure that a Quality Bank cut is not being overvalued in relation to other Quality Bank cuts. For example, in the Opinion No. 481 proceeding, in valuing Coke, the Commission required the cost of shipping Coke from the refinery gate to the waterborne point of sale to be deducted even though it did not require shipping costs to be deducted from the value of other coker products. The Commission's reason for the different treatment was that Coke shipping and handling costs represented on average 61 percent of the value of Coke, while for all other coker products such costs represented only 2 percent to 8 percent of product value. The court upheld the Commission's position stating:

Although FERC ignored the shipping and handling components of most oil components, it explained that the costs of shipping and handling are dramatically higher relative to its value than are those of any other oil product, making it perfectly reasonable for FERC to treat coke differently (emphasis added).<sup>42</sup>

---

<sup>42</sup> *Petro Star Inc. v. FERC*, Docket Nos. 06-1106, *et al.*, 2008 U.S. App. LEXIS 5328 at 2 (D.C. Cir. March 6, 2008).

69. Accordingly, we grant rehearing and accept the tariff sheet originally filed, and reject the September 8, 2008 compliance filing.<sup>43</sup> We affirm the ruling in the Compliance Order and Rehearing Order on the double-counting issue.

The Commission orders:

(A) The requests for rehearing are granted and the Remand Order is reversed.

(B) The TAPS Carriers' tariff filings of July 3, 2006 are accepted, effective November 1, 2005, the date directed in Opinion No. 481-A, P 23.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.

---

<sup>43</sup> The ruling moots TAPS Carriers' Motion for Clarification filed in Docket Nos. IS06-466-004, IS06-467-004, IS06-468-004, IS06-469-004, and IS06-470-004.