UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

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| Trans Alaska Pipeline System | Docket No. OR89-2-018 |
| Exxon Company, U.S.A. | |
| v. | Docket No. OR96-14-007 |
| Amerada Hess Pipeline Corporation | |
| Tesoro Alaska Petroleum Company | |
| v. | Docket No. OR98-24-003 |
| Amerada Hess Pipeline Corporation | |
| BP Pipelines (Alaska), Inc. | Docket No. IS03-137-002 |
| ExxonMobil Pipeline Company | Docket No. IS03-141-002 |
| Phillips Transportation Alaska, Inc. | Docket No. IS03-142-002 |
| Unocal Pipeline Company | Docket No. IS03-143-002 |
| Williams Alaska Pipeline Company, L.L.C. | Docket No. IS03-144-002 |

OPINION NO. 481-A, ORDER ON REHEARING

(Issued March 29, 2006)

1. On October 20, 2005, the Commission issued Opinion No. 481,[1] an order on the exceptions to the Initial Decision (ID), issued by Administrative Law Judge Edward Silverstein (ALJ).[2] At issue in this proceeding is the method of making monetary

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[1] *Trans Alaska Pipeline System*, 113 FERC ¶ 61,062 (2005).

[2] *Trans Alaska Pipeline System*, 108 FERC ¶ 63,030 (2004).

adjustments among shippers of Alaska North Slope (ANS) oil on the Trans Alaska Pipeline System (TAPS). The adjustments, based upon the value of the "cuts" in the crude oil tendered, are made through a "Quality Bank," which either compensates or charges a shipper for the difference in quality between the crude oil tendered by that shipper and the crude oil received by that shipper. Shippers with lower quality oil pay into the Quality Bank, and shippers with higher quality oil receive payments from the Quality Bank.

2. The hearing resulted from remands of certain issues by the United States Court of Appeals for the District of Columbia Circuit in *Exxon Co. U.S.A. v. FERC*[3] and *Tesoro Alaska Petroleum Co. v. FERC*.[4] The Commission set the remand issues, as well as other issues, for hearing, by order issued November 7, 2001.[5] The ID required certain changes in calculating the adjustments, with varying effective dates for these changes. Opinion No. 481 affirmed the ID, but required certain modifications in calculating the valuation of certain cuts, and, as required by recent Congressional action, limited any retroactive refunds resulting from the new valuations to February 1, 2000, rather than December 1, 1993, as the ID had directed. Requests for rehearing were filed by Flint Hills Resources Alaska LLC (Flint Hills), Petro Star, Inc., BP Exploration (Alaska), Inc. and BP American Production Company (BP), Williams Alaska Petroleum Inc. (Williams), and Union Oil Company of California and OXY USA, Inc. (Union Oil and OXY). The TAPS Carriers[6] filed for clarification or rehearing. This order grants rehearing in part, denies rehearing in part, and grants clarification as to certain issues.

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[3] 182 F.3d 30 (D.C. Cir. 1999) (*Exxon*).

[4] 234 F.3d 1286 (D.C. Cir. 2000) (*Tesoro*).

[5] *Trans Alaska Pipeline System*, 97 FERC ¶ 61,150 (2001). The order provided for concurrent hearing with the Regulatory Commission of Alaska (RCA), which has jurisdiction over intrastate shipments on TAPS. On August 31, 2004, the RCA ALJ issued a decision adopting Judge Silverstein's ID, and on October 20, 2005, the RCA adopted Opinion No. 481 and applied its findings to intrastate quality adjustments, RCA Order P-89-1 (104).

[6] At present, the TAPS Carriers consist of Amerada Hess Pipeline Corporation, BP Pipelines (Alaska), Inc., ExxonMobil Pipeline Company, ConocoPhillips Transportation Alaska (formerly Phillips Transportation Alaska, Inc.), Inc., Koch Alaska Pipeline Company, L.L.C. (formerly Williams Alaska Pipeline Company, L.L.C.) and Unocal Pipeline Company.

**Background**

3. This order will only set forth the background necessary to understand the issues presented in the rehearing requests since the extensive background to this proceeding is described in great detail in the ID and in Opinion No. 481.

4. TAPS is a 48-inch diameter common carrier crude oil pipeline owned and operated by the TAPS Carriers, extending approximately 800 miles from Alaska's North Slope to Valdez, Alaska, on Alaska's south central coast. The TAPS Carriers are affiliated with major oil companies that own producing interests in the North Slope, and as such these major oil producers are shippers on the system they control. However, there are other shippers on TAPS who are not affiliated with the owners of the system.

5. Oil produced on the North Slope originates from several fields, each of which contains crude oil of differing characteristics. The crude oil produced from these fields is transported to Pump Station No. 1, where all of the production streams are commingled. The resulting common stream is then transported to Valdez. Along the system there are refineries, where a portion of the crude is removed from the TAPS common stream, and the unused portion is re-injected into the TAPS common stream. As a result of this commingling, a shipper will not necessarily receive at Valdez the same quality of crude which it tendered for transportation.

6. In 1984, the Commission approved a Quality Bank using the gravity methodology[7] which put a higher value on crudes with a higher specific gravity.[8] In 1993, after producers constructed and put into operation a facility to process natural gas liquids (NGLs) found in ANS crude, the Commission held that a change in the methodology for valuing the crude oil was required because the presence of substantial amounts of NGLs in the TAPS stream had skewed the relationship between the "gravity" of the stream and its value. To replace the gravity methodology, the Commission approved, as modified, a contested settlement that used a distillation method for valuing the streams, which would be applied prospectively.[9] Under this methodology the crude oil stream is separated into its component parts, or “cuts” of petroleum products, such as Propane and Naphtha, then market values are assigned to each cut, and each shipper’s delivery is valued in accordance with the volume-weighted price of its component parts.

[7] *Trans Alaska Pipeline System*, 29 FERC ¶ 61,123 (1984). The Quality Bank is administered by the Quality Bank Administrator (QBA). Administration costs are covered from the payments into the Quality Bank.

[8] The specific gravity of a substance is a comparison of its density to water.

[9] *Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 (1993).

Where no market price for a cut was available, the cut was valued using the price of a kindred product, subject to adjustment for the differences between that product and that cut.[10]

7. In *OXY U.S.A., Inc. v. FERC*, (*OXY*)[11] the Court affirmed the Commission's finding that a change in the methodology was required and that no refunds were due, but remanded the valuation of the Distillate and the Resid cuts. Following the Court's decision in *OXY*, Exxon Company, U.S.A. (Exxon) filed a complaint, in Docket No. OR96-14-000, challenging the distillation methodology. The Commission consolidated Exxon's complaint with the *OXY* remand proceeding, and set the matters for hearing.[12] The Commission subsequently approved a contested settlement submitted by nine parties (the Nine Party Settlement) as a satisfactory resolution only of the valuation issues on remand of *OXY*.[13] The order held that the changes required by the Nine Party Settlement would take effect prospectively. The order did not resolve Exxon's complaint in Docket No. OR96-14-000, which remained before the ALJ.

8. In *Exxon*, the Court generally affirmed the 1997 Remand Order, but nonetheless held that the method of valuing the Resid cut did not bear a rational relationship to the actual value of Resid. The Court also found the decision to apply the settlement prospectively to be an abuse of discretion. The Court, therefore, vacated those portions of the order and remanded them to the Commission.

9. While the appeal in *Exxon* was pending, the hearing on Exxon's complaint in Docket No. OR96-14-000 proceeded before the ALJ, who then terminated the proceeding on the grounds that the arguments raised in the testimony were resolved in prior proceedings, and that there were no changed circumstances requiring a new Commission determination as to the reasonableness of the distillation methodology.[14] Further, the

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[10] The cuts under the distillation method are the following in the order in which they are distilled: Propane, Isobutane, Normal butane, Light Straight Run (natural gasoline, or light Naphtha), Naphtha (175°F - 350°F), Distillate (350°F - 650°F), Vacuum Gas Oil (VGO) (650°F - 1050°F), and Resid (over 1050°F). During the course of the proceedings there were slight changes in the temperature ranges of certain of the cuts.

[11] 64 F.3d 679 (D.C. Cir. 1995).

[12] *Trans Alaska Pipeline System*, 76 FERC ¶ 61,119 (1996).

[13] 81 FERC ¶ 61,319 (1997) (the 1997 Remand Order).

[14] *Exxon Co., U.S.A. v. Amerada Hess Pipeline Corp.*, 83 FERC ¶ 63,011 (1998).

ALJ found that the arguments raised by Tesoro Alaska Petroleum Company (Tesoro), an intervener in the complaint proceeding, were moot as a result of the dismissal of the complaint, but that Tesoro could file its own complaint, which Tesoro did in Docket No. OR98-24-000, challenging the valuation of the Naphtha and the VGO cuts.

10. On April 30, 1999, the Commission issued two orders. In one, the Commission affirmed the ALJ's dismissal of the Exxon complaint, and in the second, the Commission granted a motion to dismiss Tesoro's complaint.[15] Exxon and Tesoro appealed. In *Tesoro* the Court reversed the Commission, concluding that Exxon and Tesoro had presented sufficient evidence of changed circumstances as to the continued reasonableness of the distillation methodology and the valuation of the Naphtha and VGO cuts, and remanded those issues to the Commission for further proceedings.

11. The Commission's November 7, 2001 hearing order set these issues for hearing. The order also included the issue as to the valuation of the West Coast Heavy Distillate cut, as a result of the TAPS' QBA decision to use a new proxy for that cut. During the course of the hearing, the Commission set for hearing two changes in the Naphtha valuation that had subsequently been proposed by the TAPS' QBA, since the issues were related to the issues in the hearing.[16]

12. The ID decided six issues.[17] The Commission's order affirmed the ALJ's rulings on all the issues, but made certain modifications as to some of the issues. The requests

[15] *Exxon Co., U.S.A. v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,133 (1999), and *Tesoro Alaska Petroleum Co. v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,132 (1999).

[16] *See Trans Alaska Pipeline System*, 102 FERC ¶ 61,345 (2003), and 104 FERC ¶ 61,201 (2003).

[17] Prior to the hearing the parties entered into a stipulation, the October 3, 2002 Stipulation, which impacted a number of these issues. In addition to the six issues discussed, three other issues were to be determined at the hearing. However, the ID deferred ruling on these three issues. After issuance of the ID, the parties filed a motion to withdraw these issues. The ALJ granted the motion on June 16, 2005. S*ee* 111 FERC ¶ 63,068 (2005).

for rehearing are directed at four of the issues, but not as to the other two, which were Issue No. 2, valuation of the West Coast Heavy Distillate cut,[18] and Issue No. 6, whether reparations were an issue in the proceeding.

13. However, before addressing the specific issues,[19] the Commission will address the TAPS Carriers' request for clarification as to the implementation date for the new methodology since it bears on the valuation of many of the cuts.

**The TAPS Carriers' Request**

14. The TAPS Carriers state that they have no financial interest in the TAPS Quality Bank and administer the Quality Bank in compliance with the Commission's orders. As such, they state that they take no position on the justness and reasonableness of the various proposals made by the parties, or on the justness and reasonableness of Opinion No. 481. However, with respect to the administration aspect, they seek a modification of the implementation date for the revised methodology, and clarification concerning the valuation of West Coast Naphtha, and coker capital costs for the Resid valuation. The latter part of the request will be considered *infra* in the sections devoted to those cuts.

15. TAPS Carriers state that the Commission's order directs changes in some of the valuations which are to be effective prospectively from the date of the order, October 20, 2005.[20] They state that Quality Bank adjustments are calculated on a calendar month basis, and therefore they request November 1, 2005, as the implementation date for the revised methodology. They note that the values of the various components of the petroleum streams are based on monthly averages of prices, and the volumes of each petroleum stream shipped by each shipper are reported as totals for the month. Using November 1, 2005, as the effective date would result in including the full month of October in the calculation of the adjustment.

[18] Opinion No. 481 affirmed the ruling that the new Heavy Distillate cut valuation would be effective February 1, 2000, with retroactive refunds back to that date, and denied, as moot, BP's motion for an order directing interim refunds for the Heavy Distillate cut back to that date, 113 FERC ¶ 61,062 at P 249. On March 6, 2006, BP renewed that motion on the grounds that the pending rehearing stayed implementation of Opinion No. 481. This order moots BP's renewed motion.

[19] The issues will have the same number as in Opinion No. 481.

[20] TAPS Carriers cite to the change in the valuation of West Coast Naphtha and West Coast VGO.

16. On the other hand, TAPS Carriers assert, if the October 20 date remains as the effective date, it would require calculating two separate adjustments for October for some of the cuts, one for the October 1 – October 19 period, and a second for the October 20 – October 31 period. This, they contend would create three separate problems. First, data on the volumes of each stream shipped by each shipper do not exist except on a monthly basis. Second, the only assays of the streams are taken on a monthly composite basis. Third, the new formula-based values for West Coast Naphtha and Resid are to be calculated at the end of the month using monthly averages of other component values or prices so it would be difficult to make the calculation. Given these factors, the TAPS Carriers question how the QBA could calculate the values if implementation was not at the beginning of a month.

17. The TAPS Carriers cite to the QBA's testimony at the hearing, where he urged that implementation of any new valuation should be at the beginning of a month. The QBA testified as follows:

> Fourth, with respect to any component valuation revisions to be applied only prospectively, I recommend that such revisions be put into effect beginning on the first day of the first month after approval by both Commissions.[21]

No party objected to this recommendation.

18. Accordingly, the TAPS Carriers request a November 1, 2005, effective date. This, they assert "will greatly simplify implementation of the new methodology and avoid the need to address implementation issues that otherwise would have to be resolved."[22]

19. ExxonMobil and Tesoro (EM/T), ConocoPhillips Alaska, Inc. (CPAI), and the State of Alaska (Alaska), filed in support of the TAPS Carriers' request. Petro Star and Flint Hills urge the Commission to reject the request.[23]

20. Petro Star argues that the effective date should not be changed because it will have negative financial consequences for refiners at both the Golden Valley Electric Association (GVEA) and Petro Star Valdez Refinery Connections. Petro Star states that

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[21] TC-1 at 8 (Testimony of QBA James T. Mitchell).

[22] Request at 2.

[23] Flint Hills states that if the Commission changes the effective date, it should be changed to October 1, 2005, not November 1, 2005.

an estimate of the impact on it from delaying implementation to November 1, 2005 is "approximately $500,000 in additional Quality Bank assessments."[24] Petro Star asserts that the three problems identified by the TAPS Carriers "are easily resolved."

21. In its request for rehearing, Flint Hills states that it was informed that the QBA might seek a November 1, 2005, effective date "based on alleged administrative convenience."[25] Flint Hills states there was no basis for such a request, and urges the Commission to reject it. Flint Hills' argument is similar to Petro Star's, namely that delay in the implementation would result in "hundreds of thousands of dollars in damage to Flint Hills."[26]

22. The resolution offered by Petro Star to the concerns raised by the TAPS Carriers basically consists of pro-rating as to each of the problems. The Commission is not in a position to make a judgment whether the solution urged by Petro Star sufficiently addresses the problems posed by a mid-month effective date. Some parties are hurt and some parties are benefited from the new valuations. However, the QBA testified at the hearing that the effective date for any changes should be at the beginning of a month. No party objected to that testimony.

23. In this proceeding there are issues relating to the effective date that will have far more serious financial consequences on the parties than the financial consequences from the ten day period at issue here, such as the effective date for both the new West Coast Naphtha and West Coast VGO cut valuations, and whether there should be retroactive refunds for the new Resid cut valuation. These issues are addressed *infra*. Moreover, the October 20, 2005 date is unrelated to any relevant consideration, such as a tariff effective date, or an agreed-upon date by the parties, or a Congressionally-established refund date. It is merely the date the Commission issued Opinion No. 481. That date could have been November 1, 2005, or January 1, 2006, or any other date. Under these circumstances, we will grant the request, and make the effective date November 1, 2005.

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[24] Petro Star submitted an affidavit from an officer. The affiant states, after conceding that it "was not possible to precisely calculate the impact of delaying implementation," that he estimated the impact on Petro Star from delaying implementation from October 20 to November 1 "would be approximately $500,000." Bolz affidavit at 3.

[25] Rehearing request at 7.

[26] *Id.* at 8. To show the effect from the delay Flint Hills submitted an affidavit setting forth the current price differential between Gulf Coast and West Coast VGO, and Flint Hills' volumes for the relevant period.

**<u>ISSUE No. 1 – Valuation of the Resid Cut</u>**

## I. <u>Resid Value Methodology</u>

### A. <u>Opinion No. 481</u>

24. Resid is the portion of the petroleum stream remaining after distillation of all other cuts at lower boiling points. Under the Quality Bank, Resid is any material that does not boil out until the temperature reaches or exceeds 1050°F. Before the hearing, the parties stipulated that Resid should be valued as a coker feedstock by valuing the coker products minus the cost of producing these products using the following formula: "Resid = Before-Cost Value of coker Products – (Coking Costs * Nelson Farrar Index)."[27] Further, the Coking Costs would be given a "single value," but the parties failed to agree on what that value should be. While not agreeing as to the "base year" the parties agreed that the Nelson Farrar Index to be used is a ratio of the Nelson Farrar Index (Operating Indexes Refinery) for the year in which the value is sought and the Nelson Farrar Index (Operating Indexes Refinery) for the base year. [28]

25. In Opinion No. 481, the Commission affirmed the ALJ's method for determining typical coking costs, which in turn, would be used to determine the value of Resid, subject to one modification.[29] First, the Commission agreed with the ALJ's determination of capital costs of a typical coker. The Commission agreed with the ALJ's finding that Mr. O'Brien (witness for Eight Parties) had omitted the costs of several items of equipment in his base cost curve approach that were included in Mr. Jenkins's (EM/T's witness) itemized approach for the direct costs, referred to as "Inside Battery Limits" (ISBL) costs,[30] of a typical coker's capital costs. In particular, the Commission

[27] Joint Stipulation of the Parties, filed October 3, 2002, at 1 (Joint Stipulation).

[28] The Stipulation provided that the Before-Cost Value is to be calculated using a 3-step process: (1) the product (Fuel Gas, Propane, Isobutane, Normal Butane, LSR, Naphtha, Heavy Distillate, VGO, and coke) yields are to be determined through the use of the Process Industry Modeling System, Version 11.0 (PIMS); (2) values are to be determined for each; and (3), the product yields are to be multiplied by the product prices and the resulting values are added together.

[29] Opinion No. 481 found that a typical coker would only have bottom automatic deheading equipment, instead of both top and bottom deheading equipment.

[30] ISBL costs include the costs of the coker itself and related downstream refinery units.

agreed that a typical delayed coker, *i.e.*, a coker capable of processing 40,000 barrels per stream day of Resid,[31] would be expected to have: (1) four coke drums rather than the two assumed by Mr. O'Brien;[32] (2) automatic deheading equipment for safety and efficiency,[33] albeit bottom systems and not top systems; (3) adequate coke handling equipment, *i.e.*, "coke pit and crane, chutes and conveyor system, and covered storage," rather than the concrete "pad" and front end loader assumed by Mr. O'Brien;[34] and a coker gas plant.[35] The Commission agreed with the ALJ's determination to use Mr. O'Brien's cost curve approach with these additional costs.

26. Second, the Commission agreed with the ALJ's determination to include appropriate storage costs for storing the Resid as a coker feedstock and for the storage associated with downstream units in determining the indirect costs, or "Outside Battery Limits" (OSBL) costs,[36] of capital costs of a typical coker. The Commission affirmed the ALJ's use of Mr. O'Brien's approach using an average estimate for OSBL costs equal to 35 percent of the ISBL costs.

27. The Commission also agreed with the ALJ's use of a location factor of 1.27 to determine the cost of a typical West Coast coker because the construction costs, labor costs, and permitting costs are generally higher on the West Coast than on the Gulf Coast.[37]

28. Finally, the Commission agreed with the ALJ's finding that the Resid value that would result from using Mr. O'Brien's modified cost-curve approach would be just and reasonable. The Commission stated that the ALJ was not required to calculate the precise

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[31] The parties adopted as the standard that the coker would have to be sized to be able to process 40,000 barrels per stream day of Resid with an 87 percent annual utilization rate. ID at P 957, 960.

[32] ID at P 1194.

[33] ID at P 1199.

[34] ID at P 1204.

[35] ID at P 1208.

[36] OSBL costs include costs for facilities necessary to support refinery processing units such as storage facilities, steam generation systems, etc., and finance costs.

[37] *See, e.g.*, EMT-116 at 7; EMT-169 at 6; EMT-146 at 13.

Resid value and that the TAPS Carriers must use O'Brien's cost curve approach along with O'Brien's cost figures unless the ALJ specifically referenced otherwise, *e.g.*, adopted Jenkins's estimate for a specific cost.

### B. Requests for Rehearing

29. BP argues that the Commission erred by affirming the ID to the extent that the ID established cost deduction factors, *i.e.*, coker costs, that exceed those proposed by EM/T at the hearing and resulting Resid values on the Gulf Coast and West Coast that were less than the Resid values proposed in the hearing by EM/T. In this connection BP argues that the Commission erred by (1) adopting a cost deduction factor which is higher than EM/T's proposed cost deduction factor for the West Coast and the Gulf Coast; and (2) establishing a West Coast Resid value that is lower than the West Coast Resid value proposed by EMT.

30. BP argues that both the ALJ and the Commission failed to calculate the end result of the Resid value resulting from the findings in the ID, and to compare that result to the overall zone of reasonableness for the actual value of Resid which is established by the record in this case. It argues that the ALJ and the Commission did not attempt to analyze the overall justness and reasonableness of that value. Instead, BP argues, the ALJ and the Commission have engaged in a form of analysis that is comparable to focusing the calculation of the rate of return on equity in a rate case on the components of the calculation, and not assessing at the end of that process whether the overall return on equity falls within the zone of reasonableness supported by the record. BP states that such an approach is too narrow and that the Commission may only adopt a method of valuation "so long as the end result of the ratemaking process is reasonable."[38] BP argues that the resulting Resid deduction, *i.e.*, coker costs, is higher than any proposed by any party to the proceeding, thus lowering the value of Resid below that proposed by any party. BP concludes that if the end result of the methodology adopted by the ALJ and the Commission is not within the zone of reasonableness supported by the record, then the end result is not just and reasonable.

31. Union Oil and OXY argue that the ALJ double counted the costs of the coker gas plant and the 4-drum coker. As to the gas plant, they argue that by enlarging O'Brien's ISBL costs, Opinion No. 481 had already increased the OSBL provision by an amount sufficient to cover the gas plant and all other OSBL items. Further, Union Oil and OXY argue that both Jenkins and O'Brien demonstrated that typical cokers use Resid tanks constructed for the base refinery, and that additional storage tanks would not be needed if

[38] *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1527 (D.C. Cir. 1984).

one were to add a coker to an existing refinery. They request that the Commission either remove the gas plant costs from ISBL or reduce the OSBL multiplier from 35 percent to 25 percent.

32. With regard to the 4-drum coker, Union Oil and OXY argue that costs do not have to be added to O'Brien's cost estimate for a 2-drum coker, but that it is a matter of design, and that designing a coker with 4 drums rather than 2 need not involve higher costs. They state that O'Brien's cost curve shows one curve for a 2-drum coker, and another curve for a 4-drum coker, and that while the 4-drum curve extends higher, the two curves overlap, such that the peak of the 2-drum curve is at the same cost level as the bottom of the 4-drum curve. Union Oil and OXY conclude that where the curves overlap, either a 2-drum or 4-drum configuration can be built for the same cost.

### C. Commission Determination

33. BP raises many of the same arguments regarding the justness and reasonableness of the methodology adopted by the ALJ to determine typical coker costs that the Commission addressed in Opinion No. 481. We are not persuaded to reverse our finding. Opinion No. 481 stated that the coker costs based on the ALJ's rulings may be higher than Jenkins's estimate,[39] but that no party demonstrated that the ALJ's methodology for calculating coker costs, except as to the automatic deheading equipment, was incorrect. The ALJ added equipment to Mr. O'Brien's cost estimate where Mr. O'Brien admitted to not accounting for such equipment in his cost estimate.[40] As we stated in Opinion No. 481, "[f]or Eight Parties to argue that regardless of the fact that O'Brien admits that he did not include certain equipment, the ALJ's methodology should be result-oriented and, therefore, should be modified so that it does not result in costs that exceed Jenkins's estimate would be to ignore the evidence and testimony presented in the hearing."[41]

34. We reject BP's argument that the zone of reasonableness ceiling should be Jenkins's estimate on behalf of EM/T. Jenkins's and O'Brien's cost estimates were not the only estimates presented during the hearing.[42] In fact, O'Brien presented evidence which suggests that the coker cost estimate would be substantially higher than O'Brien's

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[39] Eight Parties Appendix B to Brief on Exceptions.

[40] ID at P 1194 (2-drum coker instead of a 4-drum coker), P 1199 (automatic deheading equipment), P 1204 (coke handling equipment), and P 1208 (coker gas plant).

[41] Opinion No. 481 at P 47.

[42] *See* PAI-10.

cost estimate as modified by the ALJ.[43] Therefore, Jenkins's coker cost estimate did not establish the "just and reasonable" ceiling so coker costs could exceed his estimate of those costs.

35. We also find no merit in BP's argument that the Commission and ALJ failed to calculate the precise Resid value. Neither the ALJ nor the Commission was required to calculate the precise Resid value; much less that such an omission automatically results in an unjust and unreasonable decision. In this instance, the ALJ ruled on a methodology and the specific components thereto, and directed the TAPS Carriers to file revised tariff sheets in accordance with the rulings.[44] Because the ALJ ruled on all the issues that were disputed between the parties, there was no need to calculate the precise Resid value.

36. Union Oil and OXY's argument that the ALJ's methodology results in double counting of the coker gas plant costs, is contrary to the record evidence. As the evidence demonstrated, O'Brien only included in his cost estimate a "coke pad" and a "front end loader."[45] Jenkins, however, demonstrated that a typical coker, and particularly one on the West Coast, would include many more items such as coke handling equipment consisting of a coke pit and crane, appropriate chutes and conveyor system, and covered storage to move and store the coke at the refinery and meet environmental requirements.[46] In fact, O'Brien admitted that, though a coke pad and front-end loader might have been acceptable in 1996, he did not "think it would be today."[47] Furthermore, O'Brien specifically adjusted the coker cost estimates derived from treatises by removing such costs from those estimates in order to make those estimates comparable to his own coker cost estimate.[48] Consequently, adding these costs of these omitted items of coke handling equipment to O'Brien's coker cost estimate does not double count any costs.

37. The evidence also demonstrated that the costs of the coker gas plant should be included in ISBL and not in OSBL as Union Oil and OXY suggest. Both Jenkins and

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[43] *Id.*

[44] ID at P 3084.

[45] ID at P 1204 & n.454 (citing PAI-58 at 15).

[46] EMT-146 at 33-34; EMT-212 at 2-3.

[47] Transcript at 331-32.

[48] PAI-10, Transcript at 408.

Gary, author of the Gary and Handwerk Treatise,[49] presented testimony that the coker gas plant should be included in ISBL.[50] In addition, the evidence demonstrated that gas plants are physically inside the battery limits as they are normally located as close as possible to the fractionator of the coker so that that the heat from the fractionator can be used in the plant.[51] Therefore, the coker gas plant should be included in ISBL.

38. We also reject the argument that the OSBL multiplier of 35 percent should be reduced to 25 percent. O'Brien testified that he used a higher 35 percent OSBL factor because, unlike Gary & Handwerk, which Union Oil and OXY consider to be the standard, he did not include separate cost estimates for the steam and cooling water facilities that would be required for the coker in his ISBL costs, but chose instead to include those costs in his 35 percent OSBL cost factor.[52] We recognize, as did the ALJ and Opinion No. 481, that increasing the ISBL causes a concomitant increase to OSBL. However, this increase in OSBL accounts for appropriate storage costs for storing the Resid as a coker feedstock and for the storage associated with downstream units, which O'Brien did not account for in his OSBL estimate.

39. Union Oil and OXY contend that additional storage tanks would not be needed if a coker was added to an existing refinery. We disagree. The evidence demonstrated that the storage requirements of a refinery with a coker would be very different from the requirements of a refinery without a coker. A refinery without a coker would blend the Resid directly into fuel oil without any need for intermediate storage. On the other hand, a refinery with a coker would require intermediate storage for both the Resid and the coker output products to protect the coker from having to shut down due to a shutdown of any of the downstream processing units, and also to protect the downstream processing units by making product available in the event of a shutdown of the coker.[53] In addition, the storage tanks for Resid must be heated to around 500°F and insulated in order to keep the material in a liquid state, whereas tanks used for crude oil and other refinery products

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[49] James H. Gary & Glenn Handwerk, Petroleum Refining, Technology and Economics (4th ed. 2001).

[50] EMT-37 at 36; EMT-191 at 4.

[51] EMT-146 at 36-37; EMT-167 at 24-26; EMT-191 at 5-6; Transcript at 1327-28, 3493, 4084, 4093.

[52] PAI-1 at 24; Transcript at 445.

[53] ID at P 1039; Transcript at 625-26; EMT-37 at 48; Transcript at 3711-12.

must be maintained at a temperature below 212°F.[54] Also, because the heating process for Resid storage tanks involves the use of open flames, for safety reasons, coker feedstock tanks are not normally located in the tank farm that is used for other refinery products, but are segregated in a separate area of the refinery.[55] Accordingly, we affirm our decision that the increase in percentage of ISBL to estimate the OSBL costs, *i.e.*, 35 percent of ISBL instead of 20-25 percent of ISBL, coupled with the ALJ's decision to increase the ISBL costs, adequately provides for storage costs, as well as all other OSBL costs.

40. The record also contradicts Union Oil and OXY's argument that costs do not have to be added to O'Brien's cost estimate for a 2-drum coker in order to design a 4-drum coker. O'Brien himself testified at the hearing that if his coker cost estimate were based on a 4-drum coker rather than a 2-drum coker, his ISBL cost estimate would increase by $13.1 million. Moreover, the Eight Parties, of which Union Oil and OXY was a member, did not challenge the amount in their brief on exceptions.[56]

## II. <u>Exhibit PAI-10</u>

41. Williams argues that the Commission should withdraw from the record Exhibit PAI-10, which is Mr. O'Brien's comparison of his cost estimate to similar coker cost estimates, because the ALJ erred by admitting it into evidence. Williams states that although the Eight Parties presented the exhibit for the record, they attempted to withdraw it at the end of O'Brien's testimony, but the ALJ nevertheless admitted it. Williams essentially argues that if an exhibit is withdrawn from or not included in the record the ALJ may not rely upon the exhibit.

42. We find Williams' arguments unpersuasive. PAI-10 was presented by Eight Parties as part of O'Brien's direct testimony during the hearing, and was subject to approximately eight days of cross-examination. Based on these circumstances, the ALJ

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[54] ID at P 1040; Transcript at 807-09; EMT-37 at 48.

[55] Transcript at 806-09; EMT-45.

[56] Eight Parties Brief on Exceptions at 39 & n.35.

decided to admit the exhibit into evidence on his own motion even though the Eight Parties did not move to have it admitted after the initial proffer.[57] The Eight Parties did not object to the Exhibit being in the record.[58]

43. Simply because the Eight Parties had the opportunity to choose whether to present a document to the ALJ does not give the Eight Parties the right to decide, once it has been presented, whether that particular document should be considered as evidence. Having chosen to submit the document at the hearing, how it will be treated is the role reserved for the ALJ.[59]

## III. Coke Handling Equipment

### A. Request for Clarification and Responses

43. TAPS Carriers request that the Commission specify the costs to be used for coke handling in the calculation of coker capital costs. In response to that request Williams argues that the Commission can only use the coke handling equipment cost that Jenkins calculated in Exhibit EMT-287 of $6.922 million for the Gulf Coast, and $8.8 million for the West Coast. Williams argues that Jenkins had the opportunity to include in his cost estimate whatever coke handling equipment he thought appropriate. Williams adds that the only other coke handling equipment costs are found in Exhibit PAI-10, which amount to $35.1 million. Williams argues, however, that that figure was not intended to be used in any of the cost figures that would determine the costs of a coker in calculating the value of the Resid component of the TAPS Quality Bank.

44. In their response to the TAPS Carriers' request, EM/T argue that Opinion No. 481 requires the use of O'Brien's estimates of the coke handling equipment in Exhibit PAI-10. They contend that the ID did not adopt Jenkins's cost estimate, which did not include cost estimates for all three categories of equipment Jenkins had specified, *i.e.*, a

[57] Transcript at 1412-13.

[58] Transcript at 1412.

[59] 18 C.F.R § 385.504(b)(4) (2005).

coke pit and crane, appropriate chutes and conveyor system, and covered storage. EM/T argue that O'Brien did determine the costs of the three pieces of equipment,[60] and thus the estimate in Exhibit PAI-10 must be used.

### B. Commission Determination

45. We agree with EM/T. Opinion No. 481 states that: "[A]s the ALJ found that O'Brien's cost curve should be used to value Resid, we clarify that the TAPS Carriers must use this approach *along with O'Brien's cost figures* unless the ALJ specifically referenced otherwise, *e.g.*, adopted Jenkins's estimate for a specific cost."[61] In Exhibit PAI-10, O'Brien specifically estimates the costs of each of the three coke handling equipment components. The ALJ did not adopt Jenkins's estimate for any of these costs. Therefore, consistent with our language in Opinion No. 481, O'Brien's cost figures in Exhibit PAI-10 must be used.

## IV. West Coast Valuations for VGO and Naphtha in the Resid Valuation

### A. Request For Rehearing

46. Petro Star argues that the Commission erred by not requiring the new West Coast valuations for VGO and Naphtha to be used within the coker feedstock methodology for calculating retroactive values for West Coast Resid. It contends that under Opinion No. 481, Resid will be valued as a coker feedstock from February 1, 2000, onward, and that the processing costs for West Coast Resid will be determined based on the costs of operating a coker physically located on the West Coast (which would have higher capital costs than Gulf Coast refineries). However, Petro Star states that Opinion No. 481 leaves intact past Gulf Coast-based valuations for straight-run VGO and Naphtha, and fails to specify that when the coker feedstock methodology is implemented to value West Coast Resid retroactively, West Coast-based values must be used for coker VGO and coker Naphtha. It contends that in order for the valuation of West Coast Resid to meet the *OXY* standard, West Coast valuations for VGO and Naphtha must be used within the coker feedstock methodology retroactively so that Resid will not be undervalued relative to other cuts.

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[60] O'Brien's estimates included: (1) \$11.5 million for coke crushing and screening; (2) \$10.0 million for covered storage; and, (3) \$13.6 million for coke pit and crane.

[61] Opinion No. 481 at P 50 (emphasis added).

47. In addition, Petro Star argues that the West Coast-based valuations for coker VGO and Coker Naphtha can be used for retroactive valuation of West Coast Resid even if West Coast valuations are only applied prospectively to straight-run VGO and Naphtha. Petro Star argues that there will be no rationale for using Gulf Coast valuations for coker VGO and Naphtha to calculate retroactive values for Resid if the Commission adheres to its decision to implement new valuations for straight-run West Coast VGO and Naphtha prospectively. Petro-star divides the valuations into "coker VGO and coker Naphtha," and "straight-run VGO and straight-run Naphtha." Petro Star reasons that when the "straight run" products are used in the distillation methodology, *OXY* requires them to be valued consistently with other cuts that are separated from the crude stream. Their values relative to other streams will determine whether their owners receive a windfall of profits or not. Distillates that are overvalued while other cuts are not will induce such a windfall. Petro Star asserts that the *OXY* consistency is a means to accomplish the end of accurate relative stream valuations. It continues that "coker" products do not factor into the calculation of relative stream values, but instead operate solely as tools used in calculating the value of Resid. Petro-Star concludes that if straight-run VGO and Naphtha valuations are incorrect, as it argues they are, the evidence shows they have been incorrect since at least October 3, 2002, and extending them to coker VGO and Naphtha compounds the error by making Resid valuations incorrect too.

48. Petro Star also states that West Coast valuations for coker VGO and coker Naphtha must still be used to calculate Resid values, and therefore should be used to determine retroactive values of West Coast Resid, at least as of the Parties October 3, 2002 Stipulation. Further, Petro Star argues that here, the Commission is prescribing rates that will alter the past status quo, and that therefore, nothing in the filed rate doctrine either requires or authorizes it to prescribe Gulf Coast-based valuations for the coker VGO and coker Naphtha components that the record evidence demonstrates are inaccurate and that would render the Resid valuation unjust and unreasonable.

### B. <u>Commission Determination</u>

49. The Commission affirms the ruling that the new valuations for the West Coast Naphtha and VGO cuts will be applied on a prospective basis. However, we find merit in Petro Star's request that the new valuations for these cuts as coker products should be used when calculating the retroactive value for West Coast Resid from October 3, 2002, the date the parties stipulated the value of these cuts. There is no inconsistency in using the two different valuations for the West Coast Naphtha and VGO cut valuations because the valuations serve two different purposes, as Petro Star explains above, and using the new valuations more accurately reflect the value of Resid. Accordingly, we grant Petro Star's request for rehearing with respect to calculating the retroactive value for West Coast Resid from October 3, 2002.

**Issue No. 3. – Naphtha**

## I. Which Naphtha prices should be used for updating the Tallett regression analysis used for valuing West Coast Naphtha?

### A. Opinion No. 481

50. Opinion No. 481 affirmed the ALJ's ruling to use the Tallett Methodology to value West Coast Naphtha effective prospectively. Opinion No. 481 also affirmed the ALJ's rulings to use the Heavy Naphtha price to value Gulf Coast Naphtha effective March 1, 2003, and to use the arithmetic average of Heavy Naphtha Cargo and Heavy Naphtha Barge prices to value Gulf Coast Naphtha effective August 17, 2003.

### B. Request for Clarification

51. TAPS Carriers request that the Commission clarify which Naphtha prices should be used for updating the Tallett regression analysis to value West Coast Naphtha, because the issue has arisen as to how to recompute the constants in the regression equation in that methodology. TAPS Carriers submit that since Mr. Tallett originally computed the constants from a dual variable regression analysis using Gulf Coast prices for gasoline, jet fuel and Naphtha over a ten-year period from January 1992 through December 2001,[62] the QBA would update the regression analysis using Gulf Coast prices for the ten-year period 1995-2004. TAPS Carriers further submit that the constants obtained from that regression analysis would be used in the formula for the November and December 2005 Quality Bank calculations and then in January 2006, the QBA would again update the formula using data from the period 1996-2005.

52. TAPS Carriers submit that, prior to February 2003, Platts published a single Gulf Coast waterborne price for Naphtha, and then in February 2003, Platts began publishing a quotation for waterborne Heavy Naphtha and the Quality Bank began to use that quotation effective March 1, 2003. TAPS Carriers state that in May 2003, Platts began publishing four waterborne Gulf Coast Naphtha prices: (1) Naphtha, (2) Naphtha Barge, (3) Heavy Naphtha, and (4) Heavy Naphtha Barge, and effective August 17, 2003, the Quality Bank began using an arithmetic average of the Heavy Naphtha and Heavy Naphtha Barge prices, both of which changes the Commission upheld in Opinion No. 481.[63]

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[62] EMT-18.

[63] 113 FERC ¶ 61,062 at P 156, 164. The averaging issue is discussed *infra*, Part D.

53. TAPS Carriers assert that there is a question of which Gulf Coast Naphtha price should be used in the regression analysis for periods after March 1, 2003: the Heavy Naphtha price effective March 1, 2003, the arithmetic average effective August 17, 2003, or the full-range Naphtha since Tallett used it in his original analysis.

54. EM/T, CPAI, and Alaska filed in response answers to the TAPS Carriers' request. EM/T believes that the QBA should use the same Gulf Coast Naphtha prices that were used for Quality Bank valuation purposes. They state that prior to March 1, 2003, the Quality Bank would use the single Platts' "Naphtha" price which was then in effect; for periods after March 1, 2003, the Quality Bank would use the Platts prices that were approved for use by the Commission during those subsequent periods. CPAI agrees that the Heavy Naphtha prices should be used for those months in which published Heavy Naphtha prices are available. CPAI states that since the Commission ordered the use of the Heavy Naphtha price data to value Gulf Coast Naphtha because the Heavy Naphtha specifications most closely approximate ANS Naphtha, there is no justification for using a different published Gulf Coast price in the methodology. Alaska agrees with and supports EM/T and CPAI's positions.

### C. Commission Determination

55. We find merit in the position set forth in the responses. Accordingly, the Commission clarifies that the QBA should use the following prices which were approved in Opinion No. 481 to update the regression analysis: (1) prior to February 2003, a single Gulf Coast waterborne price for Naphtha; (2) the Heavy Naphtha price effective March 1, 2003; and, (2) the arithmetic average of the Heavy Naphtha Cargo and Heavy Naphtha Barge prices effective August 17, 2003.

## II. Is the Existing Method for Valuing West Coast Naphtha Still Just and Reasonable?

### A. Opinion No. 481

56. Opinion No. 481 affirmed the ALJ's finding that circumstances had changed materially since 1993 when the Commission determined that West Coast Naphtha should be valued on a Gulf Coast basis, and that "there is substantial evidence that continuing to base the value of West Coast Naphtha on the basis of Platts Gulf Coast Naphtha assessment no longer is just and reasonable."[64] Thus, continuing to value West Coast

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[64] ID at P 2679; *see also* ID at P 2664.

Naphtha on the basis of Gulf Coast prices would violate the D.C. Circuit's internal consistency requirement.[65] Accordingly, Opinion No. 481 affirmed the ALJ's finding that continued use of the Gulf Coast Naphtha price to value the West Coast Naphtha cut was no longer just and reasonable, and should be replaced with a viable, appropriate West Coast methodology.

### B. Rehearing Requests

57. Union Oil and OXY present the same arguments that they urged in their Briefs on Exceptions to the ID concerning whether the existing method for valuing West Coast Naphtha is just and reasonable. Union Oil and OXY assert that the Commissions erred in concluding that continued use of the Gulf Coast Naphtha price to value West Coast Naphtha is no longer just and reasonable.

58. Union Oil and OXY maintain that even though circumstances have changed materially since 1993 when the use of Gulf Coast pricing was first approved, the Gulf Coast Naphtha price assessment remains the most reliable value for West Coast Naphtha. Union Oil and OXY further state that the reasons cited in Opinion No. 481 for abandoning the Gulf Coast price assessment to value West Coast Naphtha are not compelling. Union Oil and OXY claim that since the value of West Coast Naphtha is unknown it is necessary to draw conclusions about West Coast Naphtha based on refined products, and the witnesses' conclusions were split. Union Oil and OXY further argue that it is error for the Commissions to conclude that "there is no basis for a Gulf Coast Naphtha assessment that can be said to represent the value of West Coast Naphtha."[66] Union Oil and OXY argue that the ALJ and the Commission ignored a test of the reasonableness for continuing to use Gulf Coast prices as described in the affidavit of Mr. Sanderson, a witness for Williams. Union Oil and OXY also reject the conclusion that abandonment of Gulf Coast pricing is required by the Court of Appeals' internal consistency ruling because the replacement methodology the Commission approved is inconsistent with the way that any other cut is valued.

### C. Commission Determination

59. In his analysis, the ALJ stated that "the Commission has changed its policy and no longer refuses to consider adjusted proxy prices for ANS cuts. Moreover, virtually no ANS is being shipped to the Gulf Coast any longer; in fact, on the whole, ANS

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[65] *See OXY*, 64 F.3d at 693.

[66] Opinion No. 481 at P 94.

production has greatly diminished since 1993."[67] Furthermore, West Coast Naphtha would be the only ANS cut still valued on a Gulf Coast basis, and would violate the *OXY* ruling.[68] Accordingly, we affirm Opinion No. 481's finding that circumstances had changed materially since 1993. Continuing to value West Coast Naphtha on the basis of Gulf Coast prices would violate the D.C. Circuit's internal consistency requirement. Thus, its continued use is no longer just and reasonable, and it must be replaced on a prospective basis with a viable West Coast methodology, such as the Tallett methodology, adopted by the ALJ.

## III. Tallett Methodology

### A. Opinion No. 481

60. Opinion No. 481 found that the Tallett methodology is objective because it determines the value of West Coast Naphtha based directly on published West Coast prices for regular unleaded gasoline and jet fuel.[69] Moreover, the standard statistical formula in the Tallett methodology is portable, can run on any computer, and no judgment is required to calculate the formula. Thus, anyone running the same analysis will come up with the same result.

61. Opinion No. 481 agreed with the ALJ that the evidence shows that higher West Coast gasoline prices lead directly to higher West Coast Naphtha values and that the value of Naphtha on the Gulf Coast more closely tracks the price of Gulf Coast gasoline than tracking Naphtha's value by the price of crude oil.[70] Opinion No. 481 further found that Tallett's regression formula properly reflects the major change in the West Coast market caused by the advent of California Air Resources Board (CARB) gasoline requirements and that the record evidence shows that CARB requirements make Naphtha more valuable. Opinion No. 481 stated that the additional costs that California refineries have to incur to produce CARB gasoline have resulted in significantly higher prices for CARB gasoline than for conventional gasoline.[71] Opinion No. 481 also stated that

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[67] ID at P 2664.

[68] *See OXY*, 64 F.3d at 693.

[69] ID at P 2713.

[70] ID at P 2710.

[71] 113 FERC ¶ 61,062 at P 125.

Tallett's regression formula compensates for any potential impact on Naphtha's West Coast value by the introduction of CARB gasoline by using both West Coast jet fuel prices, and West Coast prices for regular unleaded gasoline.

62. Opinion No. 481 affirmed the ALJ's finding that Tallett's regression analysis confirms that, as Naphtha's value as a gasoline and jet fuel feedstock is higher than its value as a petrochemical feedstock, the former use creates a ceiling on its use for the latter.[72] Opinion No. 481 also affirmed the ALJ's decision that the evidence shows that the Naphtha used on the Gulf Coast as a petrochemical feedstock is a different, lighter Naphtha than the heavier reformer-grade of Naphtha that is used on the West Coast.[73]

### B. <u>Rehearing Requests</u>

63. Flint Hills asserts that, for the reasons previously stated in the prior briefings on this issue by a number of parties, the Tallett formula does not generate a just and reasonable value for Naphtha on the West Coast. Flint Hills contends that the markets on the Gulf Coast and the West Coast are simply too different to allow the use of this type of regression formula, and it argues that this part of the Commission's decision, at paragraphs122-128, should be reversed on rehearing.

64. Union Oil and OXY state that in affirming the ALJ's approval of the Tallett methodology as the replacement for valuing the West Coast Naphtha cut, the Commissions erred, and they argue that the Tallett methodology should be rejected and Gulf Coast pricing should be reinstituted as the proxy for valuing the West Coast Naphtha cut.

65. Union Oil and OXY state that the Commission did not understand that their argument is that the Tallett methodology uses Gulf Coast *price relationships*, not Gulf Coast prices, to value West Coast Naphtha.[74] Union Oil and OXY argue that the Commission's reasons for rejecting Williams's evidence on the margins between the price of crude oil and the value of Naphtha, on the ground that such evidence would "indicate nothing about the relative value of Naphtha," was erroneous.[75]

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[72] ID at P 2715.

[73] *Id.*

[74] 113 FERC ¶ 61,062 at P 122.

[75] *Id.* at P 123.

66. Next, Union Oil and OXY note that the Commission's holding that higher West Coast gasoline prices "led directly to higher West Coast Naphtha values," is a conclusion unsupported by factual evidence.[76] Union Oil and OXY also contend that the Commission erred in concluding that the Tallett methodology properly reflects changes caused by the advent of CARB gasoline, and that CARB requirements make Naphtha more valuable. Union Oil and OXY also argue that the Commission, in affirming the ALJ, erroneously concluded that "the value of Naphtha more closely tracks the price of Gulf Coast gasoline than the price of crude oil."[77] Finally, Union Oil and OXY claim that the Commission erred in rejecting the contention that petrochemical demand on the Gulf Coast undermines the Tallett method.

### C. Commission Determination

67. All the arguments urged on rehearing are similar to the arguments raised by those parties in their Brief on Exceptions. Opinion No. 481 discussed each, and found no merit in them. The ID and Opinion No. 481 also addressed arguments that the Tallett methodology, using Gulf Coast price relationships, is erroneous. The ID and Opinion No. 481 found that the Tallett methodology, using the Gulf Coast price relationships between gasoline, jet fuel, and Naphtha to determine West Coast prices for Naphtha, was a just and reasonable method for determining West Coast Naphtha because the relationships were then applicable to objective West Coast prices.[78] We see no need to repeat that discussion since there is nothing new in the requests for rehearing. Accordingly, we deny rehearing and affirm that the Tallett methodology is an appropriate methodology to value West Coast Naphtha.

## IV. Averaging Two Heavy Naphtha Published Prices.

### A. Opinion No. 481

68. In May 2003, Platts began publishing Heavy Naphtha price assessments in two categories, barge and ship cargo transactions. The QBA proposed to use the arithmetic average of the two Heavy Naphtha prices to value Gulf Coast Naphtha effective August 17, 2003. When certain parties protested, the Commission accepted the QBA's

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[76] *Id.* at P 124.

[77] *Id.*

[78] ID at PP 2705-2708; 113 FERC ¶ 61,062 at PP 122-123.

proposal, but set it for hearing as an issue in this proceeding.[79] The ALJ accepted the QBA's proposal, effective the date the Commission had accepted it.[80] Opinion No. 481 stated that the evidence in the record establishes that there are two reliable Platts price assessments for Heavy Naphtha, that both are supported by "numerous transactions," and that "[b]oth markets are therefore representative of the market for Heavy Naphtha on the Gulf Coast."[81]

### B. Rehearing Requests

69. Williams states that Platts's addition of the new Gulf Coast Heavy Naphtha Barge price quote does not constitute a "radical alteration" of the pre-existing price quote used to value the Naphtha cut, and the prior valuation should not have been changed. Williams submits that the QBA's recommendation to average the prices, which the ALJ accepted, is inconsistent with the valuation of the other Quality Bank cuts. Williams contends that this approach introduces a valuation that does not reflect Platts' assessment of the Gulf Coast Naphtha market.[82]

### C. Commission Determination

70. We affirm Opinion No. 481's ruling accepting the ALJ's ruling. It is a matter of record that as of May 1, 2003, Platts began publishing two waterborne Heavy Naphtha prices. Since May 1, 2003, Platts' Heavy Naphtha price is an assessment of cargo transactions only, and it is not an overall assessment of the market as it was originally. Since both cargo and barge transactions are more representative of how the market actually flows, it is more appropriate to use the two assessments, namely Heavy Naphtha and Heavy Naphtha barge. (Exhibit TC-21) The QBA has the authority to make recommendations in situations where there are unanticipated implementation issues.

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[79] 104 FERC ¶ 61,201 (2003).

[80] 113 FERC ¶ 61,062 at P 164.

[81] *Id.* at n.161.

[82] Williams submitted a 12 page affidavit of Mr. Sanderson to support its argument regarding the price averaging issue.

71. Williams presents the same arguments relating to this issue concerning the averaging of the two Heavy Naphtha prices that it presented in its Briefs and Reply Briefs on Exceptions of the Initial Decision, with the exception of a 12 page affidavit by Mr. Sanderson which it claims is new evidence. The Commission has already considered these arguments, and found no merit in them. As the hearing phase of this proceeding is concluded, we reject Williams's proffered affidavit as inadmissible at this stage of the proceeding.[83] Accordingly, we deny rehearing, and affirm the ALJ's ruling.

**Issue No. 4 – The Effective Date for the New Valuation of West Coast Vacuum Gas Oil Cut**

**I. History of Opinion No. 481 Ruling**

72. In its May 1994 Order,[84] the Commission modified the reference price for valuing the VGO cut under the newly adopted distillation methodology. The Commission held that the Gulf Coast price for high sulfur VGO would be the reference price for both the Gulf Coast and the West Coast. The Commission rejected use of the West Coast price because of concern that the West Coast price was thinly traded, and was thus subject to manipulation. The reference price for VGO was not an issue in the *OXY* case. Thus, the Court's approval of the Commission's action in adopting the distillation methodology necessarily approved the Commission's action on the valuation of the VGO cut.

73. In August, 1998, Tesoro filed its complaint in Docket No. OR98-24-000 in which it objected to continued use of the existing VGO valuation and proposed that the West Coast VGO be valued using the West Coast VGO published price. The Commission dismissed the complaint finding that Tesoro's proposal had been previously considered and rejected by the Commission.[85]

74. In *Tesoro*, the Court held that the Commission should have addressed Tesoro's claim that the Commission's reason for not using the West Coast VGO price in the May 1994 Order was no longer valid.

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[83] *See, e.g.*, *Trans Alaska Pipeline System*, 87 FERC ¶ 61,133 at 61,529 n. 73 (1999); *Ocean State Power II*, 69 FERC ¶ 61,146 at 61,548 (1994); *Philadelphia Electric Co.*, 58 FERC ¶ 61,060 at 61,133 (1992). This practice has been upheld by the Courts, *Exxon Corp. v. FERC*, 114 F.3d 1252, 1260 (D.C. Cir. 1997).

[84] 67 FERC ¶ 61,175.

[85] 87 FERC ¶ 61,133 at 61,520.

75. At the hearing in this proceeding, the parties, in an October 3, 2002 Stipulation,[86] stipulated that the West Coast VGO should be valued on the basis of the OPIS West Coast High Sulfur VGO weekly price, but disagreed as to the effective date. The Eight Parties argued that the new price should be put into effect on a prospective basis. EM/T argued that the effective date for the new price should be March 1, 2003.

76. The ALJ held that there was no evidence in the record which supports making the agreed-upon West Coast VGO price effective on a retroactive basis. Accordingly, he held that the West Coast VGO would be valued using the OPIS West Coast High Sulfur VGO weekly price on a prospective basis.[87] He added that since he had determined that the new valuation for the West Coast Naphtha cut value should also be made effective on a prospective basis, his ruling on the West Coast VGO valuation coincided with the parties' October 3, 2002, Stipulation. EM/T and Flint Hills filed exceptions to this ruling, asserting that the effective date should be October 3, 2002, the date of the stipulation.

77. Opinion No. 481 found no merit in the exceptions. The Opinion stated that in *Tesoro* the Court made no finding as to the justness or reasonableness of the existing VGO valuation. Rather, the Court required the Commission to consider Tesoro's contention that the reason for not using the published West Coast VGO reference price was no longer valid. The issue of whether continued use of the Gulf Coast price was just and reasonable was not addressed at the hearing because the parties stipulated what that price should be. The Commission recognized, as had the ALJ, that nothing in the October 3, 2002 stipulation provided for any retroactive application of that price, or that it should apply from the date of the stipulation. However, the stipulation did provide that if a new West Coast Naphtha price was established, the effective date of both that price and the new West Coast VGO price should be the same. Since the ALJ's ruling on the

[86] The stipulation provided:

Stipulation to Issue No. 4 – West Coast VGO Valuation

1. West Coast VGO shall be valued based on the published OPIS West Coast High Sulfur VGO weekly price.

2. The Parties disagree as to the effective date of the new West Coast VGO value. However, the Parties agree that if a different West Coast Naphtha valuation methodology is adopted in this proceeding, it and the new West Coast VGO value should have the same effective date.

[87] ID at P 2770.

Naphtha valuation, accepted by the Commission, was that it would be on a prospective basis, the prospective application of the new West Coast VGO price was consistent with the stipulation.

78. In addressing EM/T's exceptions, the Commission stated that the existing West Coast VGO reference price was approved by the Commission's May 1994 Order and was not an issue in *OXY*. Thus, it is the lawful rate until replaced by another rate. Even though the parties stipulated as to a new reference price, until the Commission issued an order adopting that price, the existing reference price continued as the lawful rate and could not be changed retroactively. Accordingly, the Commission affirmed the ALJ's ruling that the new reference price for West Coast VGO would be applied on a prospective basis, with an October 20, 2005 effective date, the date the Commission's order issued.

### A. Requests for Rehearing as to the Effective Date

79. Williams, Flint Hills, and Petro Star filed requests for rehearing as to the effective date for the new valuation. Williams asserts that in Opinion No. 481, the Commission approved averaging the two Gulf Coast Heavy Naphtha published price quotations, and used valuations during the period August 17, 2003 – October 20, 2003. Williams argues that the same August 17, 2003 date should be used for the effective date for the West Coast Naphtha under the second part of the October 3, 2002 Joint Stipulation.

80. Flint Hills asserts that the Commission's ruling that the new West Coast VGO value should be implemented on a prospective-only basis relying on the filed rate doctrine, "ignores the fundamental reality that all parties stipulated and agreed in October 2002 and that the OPIS West Coast High sulfur VGO weekly price was the just and reasonable value for VGO on the West Coast."[88]

81. Petro Star asserts that because the Commission determined to apply the new valuation of the Resid cut retroactively, the Commission erred in applying the new valuation for the West Coast VGO and Naphtha cuts prospectively. Petro Star contends that since the Quality Bank must use the valuations of all nine Quality Bank cuts to calculate the stream values used to determine the Quality Bank's actual monetary assessments, all nine of the Quality Bank cuts must be valued uniformly and consistently. Thus, it argues, it is error for the Commission to implement some of the new valuations

[88] Rehearing request at 3.

prospectively, and other new valuations on a retroactive basis, which is the result here. Petro Star argues that all the relevant court decisions, *OXY*, *Tesoro,* and *Exxon,* support its position.

### B. Commission Ruling

82. There is no merit to Williams' contention because the issue addressed here is the valuation of the West Coast VGO cut. The Naphtha valuation referred to in the stipulation also related to the "valuation of the West Coast Naphtha Cut." The ALJ ruled, and Opinion No. 481 affirmed, that the new valuation for the West Coast Naphtha cut would be implemented on a prospective basis. Thus, implementing the new valuation for the West Coast VGO cut prospectively is consistent with the October 3, 2002 stipulation. Implementation of the new valuation on a retroactive basis, as Williams argues for, would be contrary to the October 3, 2002 Joint Stipulation.

83. Flint Hills' argument ignores the fact that while the parties stipulated what the new valuation should be, there was no agreement when the new valuation would be implemented, one of the signatory parties to the stipulation arguing it should be on a prospective basis.

84. In Opinion No. 481, in discussing another party's exceptions to the ALJ's ruling on the effective date, the Commission stated that the existing valuation for the West Coast VGO cut was "the lawful just and reasonable rate until replaced by another rate." Thus, even if the parties stipulated what the new reference price should be for that cut "until the Commission issues an order adopting that price, the existing reference price continues as the lawful rate."[89]

85. Flint Hills takes issue with this analysis in a number of ways, none of which has any merit. First, it asserts that because it is the shippers who are affected by the Quality Bank valuation the filed rate doctrine is inapplicable. It is not clear how the conclusion follows from that premise. Regardless, this proceeding is based upon the fact that the distillation methodology, and the amounts resulting from the valuations, are considered a rate. Accordingly, as the Court stated in *OXY*, 64 F.3d at 699, "the filed rate applies to changes in [the Quality Bank] methodology." Thus, until changed by a Commission order, an existing Quality Bank valuation applies unless there is a basis on which the Commission can order a retroactive implementation date. Opinion No. 481 explained that there is no basis for ordering a retroactive effective date as to the new valuation for the West Coast VGO cut. The order stated that there was no merit finding that the

[89] 113 FERC ¶ 61,062 at P 174.

existing West Coast VGO valuation was no longer just and reasonable. The fact that the parties stipulated as to a new valuation is not a finding that the existing valuation was not just and reasonable.

86. Flint Hills argues that while it may be true that nothing in the stipulation provided for retroactive application, or that it should be the date of the stipulation "nothing in the stipulation precluded any party from making the argument that the agreed-upon VGO price should be made effective as of the date of the parties' agreement on that price. The stipulation simply left the parties free to make whatever arguments they wished on the effective date for the new price."[90]

87. However, contrary to Flint Hills' argument, there is something in the stipulation that does preclude the result Flint Hills seeks. The stipulation provides that if there are new valuations for the West Coast Naphtha cut, and for the West Coast VGO cut, the effective date for both should be the same. As stated above, the Commission has affirmed that the new valuation of the West Coast Naphtha cut will be implemented on a prospective basis, so under the stipulation any new West Coast VGO valuation should have the same prospective application.

88. Contrary to Petro Star's contention, there is a valid reason why there are different implementation dates for the new valuations adopted in Opinion No. 481. As the Commission explained in the order, since the valuation of the Resid cut under the Distillate methodology was challenged from the outset, and the Court upheld that challenge in *OXY*, there has not been a legal rate for the Resid cut until now. Thus, retroactive application of the new valuation for the Resid cut was not barred by the filed rate doctrine. This is not true for valuation of the West Coast VGO cut. The valuation of that cut was not challenged when the Commission adopted the Distillate methodology, which change the Court approved in *OXY* so the valuation of the West Coast VGO cut was the legal rate. Until the Commission adopted another valuation, that valuation continued. Thus, while the parties may have stipulated what would be an appropriate valuation for the West coast VGO cut, that did not become the legal rate until so ordered by the Commission.

89. Petro Star argues that continued use of the Gulf Coast VGO proxy for the West Coast VGO cut results in a lower valuation of the West Coast VGO and thus retroactive

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[90] Rehearing request at 6, n.9.

application is required.[91] The fact that the existing valuation resulted in some shippers being impacted negatively is not a basis for applying the new valuation on a retroactive basis. While the parties stipulated to a new valuation, that did not affect the existing rate on file. Moreover, the stipulation states that there was disagreement as to the effective date of the new West Coast VGO value, so the stipulation did not establish an effective date for the new valuation.

90. Accordingly, we deny rehearing, and confirm that the new valuation of the West Coast VGO cut will be implemented on a prospective basis.

## **Issue No. 5 – The Resid Cut Refund Period**

### A. **Opinion No. 481 Ruling**

91. The new valuations of the remanded cuts other than the Resid cut have been in effect since February 1, 1998, pursuant to the 1997 settlement between the parties. The ID concluded that the revised values of the remanded cuts should be made effective on a retroactive basis, and the retroactive period would start December 1993. Thus, the retroactive period for the Resid cut would have been the entire period from December 1993 to the present, and for the other new valuations, the refund period would have been between December 1993 and February 1998. However, on August 10, 2005, after issuance of the ID, and after the parties filed exceptions, Congress passed legislation limiting the period of any retroactive refunds in a pending TAPS proceeding to February 1, 2000.[92] As a result of this legislation, only the new valuation of the Resid cut could result in retroactive refunds, and only for the period after February 1, 2000. Thus, the issue presented to the Commission was whether it should affirm the ID's determination that the new values should be applied on a retroactive basis, with the retroactivity period limited, by the Act of Congress, to the period after February 1, 2000.

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[91] Petro Star submitted an affidavit in support of its claim. The material set forth therein was available when Opinion No. 481 was issued. Thus, the affidavit does not satisfy the requirements of section 285.713(c)(3) of the Commission's Regulations which permits material to be submitted in a rehearing request if it is "based on matters not available for consideration by the Commission at the time of the final decision or final order." *See Southern Company Services*, Opinion No. 416-A, 82 FERC ¶ 61,168 at 61,612, n.14 (1998).

[92] Section 4412 (b)(1) of the Motor Carrier Safety Reauthorization Act of 2005, Pub.L. No. PL 109-59, 119 Stat. 1144, provides that for TAPS proceedings commenced before the date of enactment of that act, the Commission "may not order retroactive changes in TAPS quality bank adjustments for any period before February 1, 2000."

92. Before addressing the issue, the Commission stated that the arguments urging that the ALJ's ruling should not be accepted were addressed to the ID's conclusion that refunds were to be paid from December 1, 1993. Since that no longer is the period for the refunds, and those arguments must be considered in light of this change, those arguments no longer have the same validity that they might have had if the refund period started December 1, 1993. Moreover, another important factor to be considered was that as of the Congressionally mandated date of February 1, 2000, the Court had in 1999, in *Exxon*, again rejected the existing Resid cut valuation, and also had rejected the Commission's ruling that any new quality bank values would be applied prospectively. Thus, Opinion No. 481 stated that the vitality of the arguments against retroactive adjustments "has essentially been undermined by the Congressional action limiting the retroactive refund period to February 1, 2000."[93]

93. While the court in *Exxon* recognized that the Commission does have a measure of discretion whether there should be retroactive application of a rate ruling, nevertheless, in this case, the Commission was constrained by the Court's further statement in *Exxon* "that such discretion is not without its limits," and the Court's holding that the Commission had "abused that discretion" in applying the new valuation on a prospective basis.[94] The Court held that the equitable factors on which the Commission based its decision to apply the new valuations prospectively did not overcome the strong equitable presumption in favor of retroactivity which would make the parties whole.

94. The Court's concern was that the settling parties might have chosen prospective application of the settlement "to divvy up a windfall at the expense of the contesting parties."[95] The "windfall" referred to would be the inappropriate valuation of the Distillate and Resid cuts from 1993, the date the distillation method was adopted, until the implementation of revised valuation of these cuts. Given the strong presumption in favor of making injured parties whole, and the incentive that this creates for the parties to litigate regarding past errors and for the agency to correct those errors, the Court concluded that "on the record before us" the Commission "abused its discretion when it failed, without adequate explanation to make the revaluation and concomitant Quality

[93] 113 FERC ¶ 61,062 at P 177.

[94] 192 F.3d at 50.

[95] *Id.*

Bank adjustments retroactive to 1993, when the distillation method was adopted."[96] The Court remanded the issue of the effective date of the new valuation method for action consistent with the Court's opinion.

95. The Commission's 2001 Hearing Order permitted the parties to introduce evidence why it would be inequitable to require retroactive application of the revised valuations for the Distillate and Resid cuts.

96. The ALJ concluded that "As there never has been a Resid proxy since the Commission implemented the distillation method on December 1, 1993, it follows that the value of the Resid proxy established by this order should be made effective on that date as well. However, the Eight Parties strenuously argue in support of a prospective only implementation."[97]

97. The ALJ reviewed the equitable grounds urged by Eight Parties but held that none sufficed to overcome his reasoning why retroactive application was required. Thus, Opinion No. 481 stated "Given the Court's ruling in *Exxon*, the question presented now is whether there is anything in the present record that was not present before that provides a basis for not applying the new valuations on a retroactive basis, but limited to February 1, 2000."[98]

98. Opinion No. 481 found that the equitable arguments urged in the exceptions basically consisted of two grounds. The first was the inter-period one, that since the Commission did not require retroactive refunds when the Commission replaced the gravity methodology with the distillate methodology when the gravity methodology was found to be no longer just and reasonable, it would be inequitable to order retroactive application of the new valuation of the Resid cut, which would result in refunds which would benefit the very same parties who had benefited from the "no retroactive refunds" ruling as to the first period.

99. The second ground was that applying the new Resid valuation on a retroactive basis would not put the parties in the same position they would have been in had the Commission not made the legal error of adopting the wrong proxy for the remanded cuts. The argument contended that if the valuation of the remanded cuts had been different, the

[96] *Id.*

[97] ID at P 2941.

[98] 113 FERC ¶ 61,062 at P 217.

refiners would have operated their refineries differently to minimize their Quality Bank obligation. Accordingly, they argue it is inequitable to apply the new valuations retroactively.

100. Opinion No. 481 found no merit in these contentions. As to the inter-period inequity argument the order explained that there were legal differences between the two periods because the Distillate methodology was challenged from the outset of its adoption. This was not true for the gravity methodology, which was not immediately challenged after its adoption in 1984. Thus, until it was replaced by a new methodology, the rates under the gravity methodology were the rates on file, and the filed rate doctrine bars change to them on a retroactive basis.

101. As to the second ground, the Commission referred to the fact as of the February 1, 2000 date, the Court in 1999 in *Exxon* had rejected the existing Resid valuation, so refiners should have taken this into consideration in their operations after 1999. The Commission also explained that this case differed from those where the Commission did not require full retroactivity, such as *Panhandle,* where the Commission stated it did so because complete retroactivity "cannot restore the parties to the position they would have occupied in the absence of the Commission's error."[99]

## B. Requests for Rehearing

102. Petro Star, and Union Oil and OXY seek rehearing of the Commission's ruling requiring refunds, with interest, from the congressionally-mandated date of February 1, 2000. Both assert that the Commission erred in rejecting the request that the Commission should have adopted the position it had taken in other cases when it did not require complete retroactivity. They both rely on the equitable argument that complete retroactivity will not be ordered when, as Union Oil and OXY argue, "it is impossible or difficult to return the parties to the position they would have been in absent agency error."[100] Petro Star, in a slightly different manner asserts that where the Commission cannot determine what the parties' position would have been absent the Commission's error, "the Commission has discretion to order refunds without interest if the equities so require."[101]

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[99] *Panhandle Eastern Pipe Line Co.*, 70 FERC ¶ 61,167 at 61,521 (1995).

[100] Rehearing request at 18.

[101] Rehearing request at 22.

103. Union Oil and OXY assert that in Opinion No. 481 “the Commission recognized that refunds would *not* restore the parties to the position they would have been in but for the Commission’s legal error,”[102] citing P 227. They continue that refunds were nevertheless ordered “to put salve on the wounds of those who were injured.”[103] Union Oil argue that by so ruling, Opinion No. 481 conflicts with prior Court and Commission decisions.

104. Petro Star asserts that if the new Resid cut valuation “had been in place in 1993,” refiners would have optimized their operations differently and paid lower Quality Bank assessments at that time. Moreover, implementing new Quality Bank charges retroactively now, would deprive refiners of the possibility of passing those charges through to the customers who bought fuel which led to the increased charges.”[104]

105. Petro Star also contends that at a minimum, the Commission should have not required interest to be paid as it did in *Panhandle*. Petro Star asserts that the Commission’s effort in Opinion No. 481 to distinguish the circumstances in the *Panhandle* case from the circumstances in this proceeding here is unconvincing.

106. Petro Star finally argues that “when the Commission determines that it cannot put the parties in the positions they would have been in if there had been no Commission error, it can craft an equitable remedy or it can even deny retroactivity altogether,” citing cases.[105] Accordingly, Petro Star requests the Commission to grant rehearing and “consider intermediate remedies, including withholding an award of interest.”

107. Williams argues that it was error to extend the Resid valuation based on the cost of the delayed coker that was established in Opinion No. 481 back to February 1, 2000, because no refiner would have built a delayed coker costing that much before 2004 based on comparison of the resulting Resid coker feedstock value to the Resid fuel oil blend.

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[102] Rehearing request at 18.

[103] *Id.*

[104] Rehearing request at 23.

[105] Rehearing request at 22.

### C. **Commission Ruling**

108. We find no merit in the requests. Clearly, under the *Exxon* ruling, complete retroactivity is required, absent compelling equitable grounds not to require it. In this case the reason why retroactivity is appropriate is clear. The new valuation of the Resid cut accurately reflects the value of the Resid cut, whereas the prior valuation overvalued the cut. To the extent certain parties benefited from the overvaluation of the Resid cut, other parties were harmed by the overvaluation because the Quality Bank is a zero sum arrangement. The retroactive refunds are necessary because prospective application of the new valuation "leave[s] the parties without remedy for the years of unlawful valuations and grant[s] the settling parties a windfall."[106]

109. Both Union Oil and OXY's and Petro Star's argument is erroneously premised on the contention that the Commission conceded that the relief ordered would not put the parties back in the position they would have been in absent the Commission's legal error, which incorrectly valued the Resid cut. Both cite to P 227 in Opinion No. 481 where the Commission referred to "to the ALJ's 'supposed' recognition in n.880 that retroactive application of the new valuation would not put the parties back in the same position they would have been in had the new valuations been determined in 1993 . . . ."[107]

110. First, the ALJ's statement referred to 1993, not to the period beginning February 1, 2000, that Opinion No. 481 ordered. Moreover, the ALJ made that statement in light of the fact that "Inasmuch as about 15 years of litigation has passed since this matter first was initiated, and that over that period, there have been multiple changes in the circumstances involving the ANS field, the participants, and local, national and worldwide economic conditions."[108]

111. However, as Opinion No. 481 responded, the parties citing the ALJ's statement ignored the conclusion that regardless of these factors, "refunds, if warranted, must be paid to those who paid too much into the Quality Bank and those who put in too little must be billed for their overpayment."[109] That remedy is what the Court in *Exxon* stressed was necessary to prevent a "windfall" to some parties who benefited from the wrong valuation.

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[106] *Exxon*, 192 F.3d at 47.

[107] 113 FERC ¶ 61,062 at P 227.

[108] 108 FERC ¶ 63,030 n.880.

[109] 113 FERC ¶ 61,062 at P 227.

112. The requesters' argument also ignores the fact that by limiting the refund period to after February 1, 2000, the validity of their equitable argument has been undermined. The Court in 1999, in *Exxon,* made it clear that the valuation of the Resid cut would have to be changed, and the new valuation would undoubtedly benefit those challenging the existing valuation. Those refiners who opposed the change were on notice that they should modify their operations to reflect the probably reduction in value of the Resid cut. Moreover, after 1999, refiners could have protected themselves contractually to provide for reimbursement from customers if the refiners' costs increased from a change in the valuation of the Resid cut.

113. Petro Star asserts that in Opinion No. 481 the Commission rejected the contention that no interest should be required, as the Commission had done in *Panhandle* because the Commission misapprehended the argument being advanced. In Opinion No. 481 the Commission stated:

> There are striking differences between the two situations. In *Panhandle,* the pipeline could have recovered the disputed amounts from customers legally, but in a different manner. Thus, in *Panhandle*, the Commission in denying the interest basically awarded half the full amount so there was an equal sharing of the relief. Here there is no way of knowing what the refiners' refund obligation would have been if they knew the Resid cut valuation from 1993 on. Thus, there is no basis for denying interest because to do so has no relation to what is appropriate relief in this case."[110]

114. Petro Star contends that the argument was not that no refunds should be due. Rather it was "that if the new valuations had actually been in place in 1993, they could and would have optimized their operations differently and paid lower Quality Bank assessments at that time. Moreover, implementing new Quality Bank charges retroactively now would deprive them of the possibility of passing those changes through to the customers who bought the fuel which led to the increased charges."[111]

115. Petro Star's argument does not respond to the conclusion in Opinion No. 481 because Petro Star's premise is that refiners could have changed their operations with resulting lower Quality Bank assessment. Even if true, this does not mean that there

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[110] 113 FERC ¶ 61,062 at P 233.

[111] Rehearing request at 3.

would be no Quality Bank assessment owing by the refiners. However, even if this contention may have had some validity if refunds were ordered back to 1993, it has none as to the retroactive refunds that Opinion No. 481 requires refiners to pay, namely refunds back to 2000. As explained above, by the year 2000 refiners were on notice that they could not rely on the existing Resid cut valuation, and they should "optimize their operations" to reduce Quality Bank assessment from a lower-valued Resid cut. Moreover, they could have protected themselves contractually in all contracts entered into by them after the 1999 *Exxon* decision by providing that for the customer would be responsible for any additional costs imposed on the refiner from any new valuation of the Resid cut that was applied on a retroactive basis.

116. In Opinion No. 481, the Commission explained why the circumstances present in *Panhandle*, where no interest was required as part of the refund, were not present here. Petro Star asserts that here the Commission "refused to relieve the refiners from paying interest on refunds based on its view that, because the Commission cannot determine what positions the parties would have been in if the new Resid cut valuation had been in effect in 1993, there should be no attempt to balance the equities among the parties."[112]

117. Petro Star distorts the Commission's analysis in Opinion No. 481. In *Panhandle*, the pipeline was seeking to recover certain costs, and could have recovered them in the commodity sales rate to its customers. Instead, with Commission approval, it directly billed the customers for those amounts. However, the court held that direct billing of customers was illegal, and customers were entitled to refunds. In the remand order, the Commission held that since the pipeline could not now include the amount in the sales to customers that had already taken place, while it would require the pipeline to refund the directly-billed amount, it would not require the pipeline to also include interest on the refund because customers would have paid the refund amount to the pipeline but for the Commission's legal error. The Court approved the Commission's approach, since interest on refunds is to compensate a party for the time value of the illegally collected amount. In *Panhandle*, the customer would have had to pay the amount under the alternative method so there was no deprivation of the use of any money by the customer. In the present case, there was nothing to establish what different amount the refiners would have paid into the Quality Bank if the new Resid cut valuation was in effect starting in 2000.

118. Petro Star and Union Oil and OXY cite to other cases where because the parties would not be put back in the same position by retroactive application of the remedy, the Commission did not order complete retroactivity. None are similar to the instant case,

[112] Rehearing request at 25.

and none support their contention, especially since here the Court of Appeals has indicated that absent compelling reasons the remedy should "make whole parties who are clearly injured by undervaluation."[113] While in those cases, the Commission stated that it was taking its action because it was not possible to restore the *status quo ante*, the circumstances there differ completely from the present case.

119. In *Southern Natural Gas Co.* (S*outhern)*,[114] cited by both, the Commission first held a zone delivery rate design unjust and unreasonable and accepted an interim rate design, a zone matrix design. Then, on March 16, 1994, the Commission reversed its acceptance of the interim rate design, and required the pipeline to reinstate the zone of delivery rate design retroactive to November 1, 1993, the date the interim zone matrix rate design had become effective. In its compliance filing the pipeline proposed to reinstate the zone of delivery rate design and make those rates effective April 1, 1994, and proposed to defer collecting higher FT commodity and IT rates that it would be entitled to collect from November 1, 1993 through March 31, 1994, under the zone of delivery rate design pursuant to the March 16 Order.

120. After noting that shippers have already made their decisions to purchase transportation service in reliance on the rates in effect from November 1, 1993, through March 31, 1994, so it was not possible to restore the full *status quo ante*, the Commission concluded:

> In this case, the Commission will exercise the discretion described in these court cases to accept part of Southern's compliance filing proposal. The Commission views Southern's proposal to make the zone of delivery rate design effective on April 1, 1994, which no customer protests, as a practical and equitable compromise between the Commission's retroactive reinstatement of rates based on a zone of delivery rate design and Southern's (and the Commission's) desire to avoid, if possible, retroactive billings. No party has proposed a better alternative.[115]

[113] *Exxon*, 192 F.3d at 49.

[114] 67 FERC ¶ 61,262 (1994)

[115] 67 FERC ¶ 61,262 at 61,905.

121. In *Southern*, the pipeline, by asking for the April 1, 1994 effective date, chose not to recover the higher rate on a retroactive basis, and the Commission accepted its proposal. There was no issue as to interest on refunds, because no refunds were ordered.

122. In *New York ISO*,[116] the New York ISO, in a March 27, 2000 filing claimed that starting January 29, 2000, there were indications of the exercise of market power in the reserve markets in its control area. It proposed to suspend market-based bids, established bid caps, and it also sought to initiate an ADR settlement prior to determine the correct charges for the past period until the proposed bid caps became effective. The Commission denied the request. The Commission noted that the ADR procedures are voluntary and a number of parties indicated the ADR could not resolve the issue, particularly since "it would be very difficult … to simply recalculate the correct market-based rates."[117] Moreover, the Commission stated "such changes should be prospective. Customers cannot effectively revisit their economic decisions in these circumstances – there is no way for buyers and sellers to retroactively alter their conduct."[118] Given all these factors, there was no basis for retroactive billing. In this case, there are no such impediments. The remedy will require those who benefited from the overvaluation to disgorge that amount, an amount readily calculable.

123. In another lengthy Commission proceeding where the Commission first approved, and subsequently, after a court remand, denied natural gas producers the right to collect from customers certain charges, the Commission required refunds, with interest on the illegally collected amount. Producers sought to be relieved of the interest obligation, since the interest on the overcharge amounted to 160 percent of the principal. The Commission denied the request, and the Court of Appeals affirmed.[119]

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[116] 91 FERC ¶ 61,218 (2000).

[117] *Id.* at 61,804-05.

[118] *Id.* at 61,804.

[119] *Anadarko Petroleum v. FERC*, 196 F.3d 1264 (D.C. Cir. 1999).

124. The Court stated that "the Commission's general policy, in effect for many years, requires interest to be paid on various kinds of overcharges."[120] The fact that there was a long delay, the Court stated, was not a ground for altering the producers' interest obligation since "interest is simply a way of ensuring full compensation."[121]

125. In response to the argument that producers were being penalized for their reliance on the Commission's erroneous prior ruling, similar to that one made here that refiners relied on the prior Resid cut valuation, the Court stated producers "misapprehend[s] the purpose of awarding interest. Interest is not awarded against someone for conducting litigation in bad faith; it is, as the Commission knew, awarded to make the prevailing party whole."[122]

126. In short, the instant case involves two groups, one includes those who benefited from the prior illegal rate, and a second, consisting of those who were injured by the erroneous rate. The retroactive remedy, with interest, corrects the legal error from February 1, 2000 by awarding the injured party the funds they would have had absent the Commission's legal error. Accordingly, we deny rehearing on this issue.

127. We also disagree with Williams's argument that it was error to extend the Resid valuation based on the cost of the delayed coker that was established in Opinion No. 481 back to February 1, 2000, because no refiner would have built such a delayed coker before 2004. The evidence demonstrates that the coke handling equipment, which we addressed above, incorporated in the cost of the delayed coker, should be applied back to February 1, 2000. All of the 4-drum cokers located on the West Coast, for instance, were constructed prior to 1995.[123] In addition, it was demonstrated that all cokers built in the last ten years have been built with automatic deheading equipment.[124] Therefore, the equipment included in the cost of the delayed coker is representative of equipment installed in modern cokers during the period of retroactivity.

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[120] *Id.* at 1267.

[121] *Id.* at 1268.

[122] *Id.*

[123] *See* EMT-188; Transcript at 270-01.

[124] Transcript 3894, 4110; EMT-211 at 10-11

The Commission orders:

(A) The requests for rehearing are granted in part, and denied in part, and clarification is granted, as discussed in the body of this order.

(B) The new valuations applied on a prospective basis are effective November 1, 2005.

By the Commission.

( S E A L )

Magalie R. Salas,
Secretary.