121 FERC ¶ 61,162
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

SFPP, L.P. Docket No. IS07-137-002

ORDER ON REHEARING

(Issued November 13, 2007)

1. On March 30, 2007, the Commission issued an order in the captioned docket authorizing SFPP, L.P. (SFPP) to implement a surcharge to recover Ultra Low Sulfur Diesel (ULSD) costs it would incur in complying with certain regulations of the Environmental Protection Agency.[1] Chevron Products Company and Tesoro Refining and Marketing Company (the Rehearing Parties) filed a request for rehearing, which is denied.

2. Briefly stated, the March 30 Order authorized SFPP to institute a five year surcharge to recover the capital costs of installing certain facilities to meet environmental standards regarding the transportation of ULSD by oil pipeline. The surcharge proposal included an annual true-up mechanism designed to adjust the level of the charge in each of the years. The Commission reasoned that the ULSD costs were related to the needs of a relatively narrow category of shippers and therefore a surcharge, rather than a more general charge, was appropriate. The Commission rejected SFPP's request to include a litigation component in the surcharge in light of the long history of litigation between SFPP and certain of its shippers. The Commission concluded that such a surcharge was unnecessary at this time because the Commission had held the proceeding in abeyance until certain broader regulatory issues could be resolved.

3. The Rehearing Parties advance four arguments. They first assert that a surcharge is inappropriate because the capital expenditures at issue are not emergency expenditures but are the type of capital expenditures that are made in the normal course of business. As such, these expenditures should be included in the pipeline's overall rate base and recovered under the indexing procedure available for the recovery of such costs. As discussed, the Commission held that the costs at issue would benefit a narrow group of shippers and should not fall on SFPP's shippers as a whole. The Commission also held

[1] *SFPP, L.P.*, 118 FERC ¶ 61,267 (2007) (March 30 Order).

that the index procedure is grounded on oil pipeline industry-wide costs applicable to shippers as a whole. As such, the ULSD costs should not be included in the industry-wide or pipeline wide determinations of cost increases that drive the level of the index increase. To do so would simply internalize within the index the cross-subsidization that the Commission sought to avoid by the use of a surcharge.

4. The Rehearing Parties also assert that the Commission erred in permitting SFPP to utilize a surcharge when it is already over-recovering its costs. More fundamentally, SFPP's alleged over-recovery is a system-wide issue more appropriately addressed through rate complaints or limitations in the increases it obtains through the indexing methodology. The reason for the surcharge is the matching of cost incurrence by a specific category of shippers and establishing the rates designed to recover those costs. This fundamental rate making concern that the Commission applies to all oil pipelines seeking to recover ULSD costs is separate from the issue of the appropriateness of the pipeline's overall return, an issue that applies to all shippers rather than to one category.

5. The Rehearing Parties also assert that the surcharge fails to provide rate certainty because it does not state a final amount that will be charged during any given year. As such, the surcharge does not comply with the filing and notice requirements of the Interstate Commerce Act (ICA). This contention is without merit. The Commission and the courts have previously authorized the use of a true-up mechanism as a type of formula rate.[2] The notice that is required is reflected in the provision of the tariff stating that the true-up mechanism will be used. As recently stated by U.S. Court of Appeals for the D.C. Circuit, "the file rate doctrine and the bar on retroactive ratemaking are satisfied, in keeping with their functions, 'when parties have notice that a rate is tentative and may be adjusted with retroactive effect ….'"[3] The court continued that "[o]ne very practical application of this principle is the acceptability of tariffs with a rate formula, under which

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[2] *See Transwestern Pipeline Company v. FERC*, 59 F.3d 222 (D.C. Cir. 1995), approving the Commission's purchase gas adjustment true-up provision once adequate notice was provided to the customers by means of the pipeline's revised tariff.

[3] *NSTAR Electric & Gas Corporation v. FERC*, No. 50-1363 (D.C. Cir. March 9, 2007) (*NSTAR*) slip. op. at 12. While this is an electric case, the basic principles of gas and electric (as well as oil cases) are construed similarly in light of their substantially similar provisions. *Id.* at 11-12. *Accord, BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (2004) at 1294-95, where a gas pipeline precedent relating to the recovery of regulatory litigation costs was applied in an oil pipeline proceeding. *See also Verizon Communications Inc., et al. v. FCC*, 535 U.S 467 (2002) at 478-7, which has an extensive discussion of the history of federal rate regulation and its antecedents under the ICA, in this case the Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56.

rates may constantly change (as long as they do so consistently with the formula) without prior notice to the Commission or the public and are thus not precisely knowable at the time of sale."[4]

6. These well established principles apply here. Moreover, in the instant case, the surcharge mechanism at issue here is subject to the Commission's review of the underlying costs. If the true-up mechanism needs to be clarified or the underlying costs justified, this can be done through the hearing mechanism created by the March 30 Order and the protection provided by the refund obligation in the order. *NSTAR* is particularly instructive on this point. The court was not troubled that the tariff at issue provided a true-up mechanism for adjustment of wholesale electric prices based on the notice provisions of the tariff. However, the court reversed the Commission for failing to examine whether the underlying costs were just and reasonable.[5] On this point, the March 30 Order states that the Commission will undertake such an examination given the protests against the surcharge at the time it was filed.[6]

7. Finally, the Rehearing Parties assert that the Commission erred in delaying the hearing that would review the merits of the costs underlying the ULSD surcharge. They assert that while the evaluation of more systemic rate issues is important, SFPP is required to establish that the surcharge is reasonable and that it has failed to do so. The Commission rejects this argument. First, section 15(7) of the ICA specifically provides for a suspension and investigation procedure to determine if a rate filed by the pipeline is just and reasonable,[7] which provides a vehicle to determine if the carrier correctly defines the cost components underlying the proposed rate. Second, the Commission established a refund obligation to protect shippers against the possibility that some cost components included in the surcharge are inappropriate or that the carrier applied incorrect regulatory principles. Third, the shippers involved here have engaged in extensive and costly litigation on such generic issues as income tax allowance, equity cost of capital determinations and the appropriateness of SFPP's capital structure, and overhead allocations costs. It would be an unreasonable waste of the Commission's, and SFPP's, resources to undertake duplicate and extensive litigation on these issues when the relevant principles will be decided in the relatively near future in other cases now before the Commission. The contention that SFPP must establish the reasonableness of the surcharge at issue during the suspension phase is without merit.

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[4] *NSTAR* at 12-13.

[5] *Id.* at 16-17.

[6] March 30 Order at P 7 noting certain meritorious points advanced by the protests.

[7] 49 U.S.C. app. § 15(7) (1988).

The Commission orders:

The requests for rehearing in the instant docket are denied.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.