128 FERC ¶ 61,214
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

SFPP, L.P. Docket No. IS09-437-000

ORDER ACCEPTING AND SUSPENDING TARIFFS, SUBJECT TO REFUND AND CONDITIONS, AND ESTABLISHING A HEARING

(Issued August 31, 2009)

1. On July 31, 2009, SFPP, L.P. (SFPP) submitted a tariff filing with a cost-of-service (COS) justification that proposes rate increases for all petroleum products movements on SFPP's East Line from El Paso or Diamond Junction, Texas to Lordsburg, New Mexico, Tucson, Arizona, and Phoenix, Arizona. SFPP proposes an effective date of September 1, 2009 for FERC Tariff No. 182. The filing was protested. As detailed below, the Commission accepts and suspends SFPP's FERC Tariff No. 182, to become effective January 1, 2010, subject to refund, and sets this matter for hearing.

SFPP's Filing

2. SFPP states that it is filing FERC Tariff No. 182 to reflect a decline in demand for petroleum products in the Arizona market served by its East Line. It states that until recently it had experienced growing demand on its East Line and therefore expanded that line in two phases. SFPP completed Phase I on June 1, 2006, and resolved all rate issues regarding that Phase by settlement in November 2007. Phase II of the expansion entered service on December 1, 2007, and similarly, SFPP resolved all issues regarding that Phase by settlement in October 2008. Thus the currently effective rates on the East Line are the settlement rates from the October 2008 settlement.

3. SFPP further states that because petroleum products serving its Arizona market originate from both Southern California and Texas refineries any fluctuations in volume on either its West or East Lines affects the other line. Therefore, the October 2008 Settlement contained a volume adjustment clause that would decrease the East Line rates if annual average daily volumes exceeded 182,500 barrels per day. Conversely, if the

East Line annual average daily volumes dropped below 162,500 barrels per day (bpd), SFPP could either unilaterally terminate the settlement or replace those settlement rates with certain specific Replacement Rates also established in the October 2008 Settlement. SFPP asserts the decline in economic activity in Arizona since the third quarter of 2008 resulted in a decline in the demand for transportation on the East Line. As of May 31, 2009, the end of the first measurement period under the October 2008 Settlement, average annual daily volumes had dropped to 157,000 bpd, significantly below the termination level. Therefore, SFPP gave notice to its shippers that it would terminate the October 2008 Settlement on August 31, 2009.

4. SFPP asserts the average daily volume on the East Line from January through June 2009 was 143,731 bpd. SFPP anticipates volumes will remain depressed so it adopted adjusted test period East Line volumes of 150,932 bpd in its filing. It asserts this is actually 2.6 percent below the prior base period volumes used to design the current East Line rates from the October 2008 Settlement, but some 5 percent above the 143,731 bpd average daily volume. Further, SFPP calculated a cost of service for a twelve month test period ended June 30, 2009 of $95,845,000 and projects test period revenues of approximately $70,095,000. SFPP asserts this under-recover is approximately $25,749,000, or 26.8 percent. It concludes this meets the standard of section 342.4(a) of the Commission's regulations,[1] which requires SFPP to show the divergence between its ceiling rates and its actual costs precludes SFPP from charging just and reasonable rates because its ceiling rates are too low. SFPP also asserts it has prepared a COS consistent with the Commission's filing regulations, calculated its income tax allowance consistently with Commission precedent,[2] and made certain adjustments to reflect its current operating conditions, local real estate taxes, wage rates, and right-of-way costs. SFPP requests a one day suspension and permission for its new rates to become effective September 1, 2009.

Interventions, Protests, and Answers

5. Timely interventions and protests were filed by several shippers of petroleum products over SFPP's East Line, including: ExxonMobil Oil Corporation and Navajo Refining Company, L.L.C., filing jointly, ConocoPhillips Company, BP West Coast Products LLC (BP), Western Refining Company, L.P. (Western), and the Joint Protestors, consisting of Valero Marketing and Supply Company, Chevron Products Company, and Southwest Airlines Co, hereinafter the Protesting Parties. The Protesting Parties contend SFPP has not adequately supported the proposed rate increases and

[1] 18 C.F.R. § 342.4(a) (2009).

[2] *Citing SFPP, L.P.*, 121 FERC ¶ 61,240 (2007).

therefore request the Commission to reject the tariff filing as unsupported or suspend those increases for the maximum seven month suspension period afforded by statute.[3]

6. The Protesting Parties concerns, while not identical in all regards, are quite similar and therefore most of the arguments or concerns will not be summarized by the name of the intervening party. Many of the protests raise the same concerns these parties have pursued in other SFPP rate cases, including whether SFPP is entitled to an income tax allowance, the method SFPP used to calculate its income tax allowance (including the role of incentive distributions and presumed marginal tax rates), the appropriateness of the return of equity, the calculation of debt, whether the Commission should disallow and remove a purchase accounting adjustment from SFPP's capital structure, the allocation of overhead costs to SFPP, the proposed level of operating and maintenance expenses, particularly proposed litigation expenses, and the relationship of the Commission's annual indexing methodology to the calculation of the deferred return of the Opinion No. 154-B[4] method for determining oil pipeline rates. The Protesting Parties request the Commission to address all these issues at a hearing, after a maximum seven-month suspension period.

7. The Protesting Parties also assert certain points that reflect the immediate context of this rate filing and appear to be of particular concern. First, they believe the tariff filings here represent increases in excess of 40 percent above the currently effective East Line settlement rates. They argue this usually large increase will have serious negative impact on existing commercial relationships of businesses shipping petroleum products over SFPP's East Line, and thereby on consumers. The Protesting Parties further assert this large rate increase comes from a confluence of three important factors. The first is the decline in volumes, which stems in part from short term shut downs of some of the refineries shipping over the East Line. The Protesting Parties also maintain that a portion of the decline in volumes may have resulted from unanticipated shifts between the East and West lines and as a result, the projected East Line volumes included in the filing may be understated. Continuing, they forecast that the rate increases proposed here will discourage shipments on the East Line and serve to further depress the volumes. The Protesting Parties also assert Commission precedent holds that volumes should not be adjusted down for cyclical reasons given that revised rates are in effect beyond the end of down turn.[5] Finally, they raise the issue of whether SFPP should base

[3] *See* Interstate Commerce Act, 49 U.S.C. § 15(7) (1988).

[4] *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985).

[5] *Citing Texaco Refining and Marketing Inc. v. SFPP, L.P.*, 117 FERC ¶ 61,285, at P 69 (2006).

its East Line rates on design capacity of the East Line facilities or on the projected throughput.

8. Second, the Protesting Parties state the cost of equity capital may be overstated. The return on equity contained in the instant filing includes a negative rather than a positive inflation rate, which increases, rather than decreases, the real equity cost of capital. They also assert the increase in ROE is unsupported by any detail, but increased from the 9.06 percent used in the October 2008 Settlement rates to the 14.88 percent in the instant filing. The Protesting Parties contend many other major cost of service factors have been relatively stable by comparison when compared to those in the October 2008 Settlement rate proceeding. These include rate base of $368.6 million in the current docket compared $391.3 million in the settlement dockets, depreciation of $41.7million in the current docket compared to $41.4 million, and an income tax rate of 36.12 percent in the current docket compared to 36.10 percent. They assert the 14.88 percent rate of return proposed here results in a $38.2 million overall return in the current docket compared to $30.1 million overall return in the October 2008 Settlement proceeding.

9. The third factor the Protesting Parties address is the large increase in the income tax allowance from $10.2 million to $14.8 million. They assert this is a direct function of sharp increase in the equity cost of capital contained in this filing. The Protesting Parties therefore conclude that a substantial portion of the proposed rate increase is caused by the significant increase in the overall return and related income tax allowance and that this increase is inadequately justified in the materials included in the filing. They again request a maximum suspension given what they conclude is incomplete documentation and analysis for a rate increase of the magnitude here.

10. SFPP filed a lengthy answer to the protests on August 20, 2009. As with the protests, SFPP's answer falls into two general areas. The first addresses the concerns and arguments that appear in most recent SFPP rate proceedings. SFPP thus asserts that it has fully complied with the Commission's income tax allowance and equity cost of capital policies and therefore no investigation of these issues is warranted. These include such matters as the role of incentive distributions, the so-called double recovery of certain return elements, the role of tax-deferred distributions, and the method for calculating the weighted marginal tax rate used to develop the proposed allowance. SFFP similarly asserts that it complied with Commission policy regarding purchase accounting adjustments, the proper method for calculating long term debt, its capital structure, cost of equity calculations, including the use of a negative inflation rate, overhead allocation, operating costs, regulatory litigation costs, and proposed indexing to the extent relevant. SFPP argues those matters have frequently been addressed in the past and involve regulatory policy issues, many of which have been decided by the Commission, and that such concerns should not prevent acceptance of its filing.

11. SFPP also replies to arguments that it is not entitled to file for a cost-based increase to its East Line rates. It asserts the projected 26.8 percent under-recovery between its test period and projected revenues for its current rates is sufficient to establish a substantial divergence between its actual costs and its current rates and to support its entitlement to file a cost-based rate increase under 18 C.F.R. § 342.4(a). It maintains the termination of the October 2008 Settlement is irrelevant to any analysis of whether the instant tariff filing meets the Commission's standards for substantial divergence. It further argues that any history of cumulative increases in its East Line rates, or the size of the proposed increase, is not relevant to that issue since the standard is based on current data and the carrier's needs, not its historical rate levels or returns.

12. SFPP also addresses two matters that are of particular relevance to the instant filing. The first is the volumetric data contained in the filing. SFPP reiterates the information contained in its filing regarding the recent decline in throughput on its East Line and supports that information by the affidavit of Mr. James B. Kehlet, a vice president of marketing for Kinder Morgan Energy Partners. SFPP asserts that East Line volumes declined to the extent that it would not recover its costs even if it were to adopt the Replacement Rates set forth in the October 2008 Settlement. Thus, the Commission should reject any implication that it manipulated its volumes to support its termination of the aforementioned settlement. SFPP claims it accounted for the short term closure of Navajo's refineries and in fact increased its projected volumes to reflect this turnaround and other market conditions.

13. SFPP also asserts the decline in East Line volumes occurred well before the current rates became effective and in fact, it reduced its East Line rates to $1.435 per barrel in October 2008 and throughput continued to decline. It notes that at a rate of $1.99 a barrel its East Line Phoenix rate represents only 4.6 cents of a total cost of gasoline in Phoenix, which currently averages $2.663 per gallon. It concludes the decline of the East Line volumes was independent of any actions on the West Line and urges the Commission to reject arguments that it should base its East Line rates on the design capacity of the East Line rather than projected throughput.

14. SFPP also addresses in detail the Protesting Parties' request for a seven month suspension. It asserts the request for the seven month suspension is contrary to the Commission's established policy regarding the suspension of oil pipeline rate filings, which allows rates to go into effect subject to refund.[6] SFFP argues that since *Buckeye* the Commission has applied a minimum suspension period to oil pipeline rates except in extraordinary circumstances where (1) the rate at issue will have significant anti-competitive effects or impose undue hardship on the shipper, or (2) the suspension for

[6] *Citing Buckeye Pipe Line Co.*, 13 FERC ¶ 61,267, at 61,595-96 (1980) (*Buckeye*); *Pioneer Pipe Line Co.*, 94 FERC ¶ 61,138, at p. 61,257 (2001).

seven months would have a sufficient mitigating effect. It asserts the Protesting Parties have not satisfied this standard with regard to the East Line rate filing at issue here. For example, SFPP argues that BP fails to make a rudimentary statement of harm and that Western relies only on the magnitude of the increase. SFPP further asserts that reliance on the large increase in the rate of return and the income tax allowance is also inadequate to support suspension since the decline in throughput on the East Line has contributed significantly to its projected under-recovery.

15. SFPP also asserts that speculative concerns that increased rates would shift volumes to the less expensive West Line are insufficient to meet the standard. For example, SFPP states that when it added capacity to the East Line and rates increased, volumes still shifted to the East Line for reasons other than SFPP's rate levels. It again notes it adjusted its projected East Line volumes to reflect short term decreases in East Line shipments and therefore there is no injury in this regard. Finally, it reiterates that the East Line shippers will be protected by the refund obligation. Rather, it is SFPP that will suffer irreparable injury from a suspension period because it will lose revenue that it cannot recover due to the deferral of the rate increase. As the shippers have not met an irreparable injury standard, there should not be a seven month suspension.

Discussion

16. The Commission finds that SFPP has made an adequate initial showing that its filing meets the requirements of a cost of service filing, under 18 C.F.R. § 346.1 of the Commission's regulations based on the cost figures provided in its filing. The issues in this case pertain to the data and rate design methodology that SFPP uses to determine its proposed rate, and the resolution of these factual disputes will have a rate impact on shippers using SFPP's East Line. There is insufficient data to resolve these rate design disputes at this time. In particular, the Commission is concerned that SFPP's proposed COS may not be representative of certain costs that SFPP can reasonably be expected to incur in the near term that the proposed tariffs would be in effect. These costs include whether recent declines in volumes due to the current recession are likely to be sustained and a proposed debt and equity cost of capital that may reflect unusual volatility during a substantial portion of the test period.

17. In addition, the proposed equity cost of capital includes the unusual feature of a negative inflation rate with its attendant impact of the real cost of capital. The increase in the equity cost of capital over the base rates also significantly increases the income tax allowance. While these matters are a serious concern given the size and breadth of the increases proposed here, they do not warrant rejection of the tariff filing as proposed by some of the Protesting Parties. Therefore, the Commission will establish hearing procedures to examine all the issues raised by the filing. However, any reservations here regarding the cost of service contained in the instant filing are not, as SFPP correctly asserts, relevant to its termination of the October 2008 Settlement.

Suspension

18. Based upon a review of the filing, the Commission finds that SFPP's tariff filing has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. The Commission further concludes that immediate implementation of the large rate increase proposed here will have an undue short term impact on the shippers transporting petroleum products over SFPP's East Line. These include significant impacts on existing contracts for the sale and delivery of petroleum products, particularly with the approach of the winter season and the likely short term impact on consumers. While the Commission normally holds that the refund obligation is adequate to protect the interest of shippers such as the Protesting Parties, in this particular case the Commission concludes that the many shippers or consignees shipping over the East Line may not be able to adjust their operations or commercial patterns in the short term given the size of the increases here. These firms should be given a short period in which to adjust their positions in anticipation of the rate increases.

19. The Commission's broader concern is based on the depressed state of the national economy. This broader concern reflects circumstances that transcend the normal requirement that shippers show undue hardship to specific interests before the Commission will adopt more than a one day suspension of an oil pipeline tariff filing. The Commission finds that a four month suspension will sufficiently mitigate the affects of the proposed increase and avoid undue hardship given the current status of the national economy. The Commission therefore rejects SFPP's argument that suspension for more than one day is inappropriate.

20. The Commission is also concerned that SFPP's test period ending June 30, 2009, may not be representative for the reasons discussed above in this order. This expression of concern is not a conclusion that SFPP failed to adequately conform to the mechanics of the requirements for an oil pipeline filing or failed to reasonably apply current Commission policies in developing the COS included in the instant filing. Given the magnitude of the increase here and the breadth of its impact, the Commission finds that a delay in the effective date will provide time to determine if a test period ending December 31, 2009, is more representative and would result in a proposed rate increase that appropriately limits its impact on all parties. The delay required here will allow exploration of this matter prior to the effective date of the proposed rate increases.

21. Therefore, in this case the Commission will not follow its normal practice of using a short suspension in oil pipeline proceedings, but will require a four month suspension. Accordingly, pursuant to section 15(7) of the Interstate Commerce Act, the Commission will accept FERC Tariff No. 182 filing and suspend it, to be effective January 1, 2010, subject to refund and subject to the conditions set forth in the body of this order and in the ordering paragraphs below.

<u>The Commission orders</u>**:**

(A) Pursuant to the authority contained in the Interstate Commerce Act, particularly section 15(7) thereof, SFPP's FERC Tariff No. 182 is accepted for filing and suspended, to become effective January 1, 2010, subject to refund and to further order of the Commission.

(B) Pursuant to the authority contained in the Interstate Commerce Act, particularly sections 15(1) and 15(7) thereof, and the Commission's regulations, a hearing is established to address the issues raised by SFPP's filing.

(C) A Presiding Administrative Law Judge (ALJ), to be designated by the Chief Administrative Law Judge, for the purpose pursuant to 18 C.F.R. § 375.302 (2009), shall convene a prehearing conference in this proceeding to be held within 20 days of the issuance this order in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. The prehearing conference shall be held to clarify the positions of the participants, and for the ALJ to establish any procedural dates for the hearing. The ALJ is authorized to conduct further proceedings pursuant to this order and the Commission's Rules of Practice and Procedure.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.