129 FERC ¶ 61,114
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Tesoro Refining and Marketing Company v. SFPP, L.P.	Docket No. OR09-18-000
Tesoro Refining and Marketing Company v. Calnev Pipe Line L.L.C.	Docket No. OR09-19-000
BP West Coast Products LLC v. SFPP, L.P.	Docket No. OR09-21-000
BP West Coast Products LLC v. Calnev Pipe Line L.L.C.	Docket No. OR09-23-000

ORDER ON COMPLAINTS AGAINST INDEX-BASED RATE FILINGS

(Issued November 9, 2009)

1. This order addresses four complaints challenging index-based rate increases filed by SFPP, L.P. (SFPP) and Calnev Pipe Line, LLC, (Calnev). Tesoro Refining and Marketing Company (Tesoro) filed complaints against SFPP's July 1, 2008 and 2009 index-based rate increases in Docket No. OR09-18-000 and against Calnev's July 1, 2009 index-based rate increase in Docket No. OR09-19-000.[1] BP West Coast Products LLC (BP West Coast) filed complaints against SFPP's July 1, 2009 index-based rate increases in Docket No. OR09-21-000 and against Calnev's July 1, 2009 index-based-rate increase in Docket No. OR09-23-

[1] Both complaints were filed on July 1, 2009.

000.[2] SFPP and Calnev filed answers. None of these complaints meets the standards contained 18 C.F.R. § 343.2(c)[3] or the protocols described in the December 14, 2007 order in *BP West Coast Products LLC v. SFPP, L.P.* and the related rehearing order dated May 5, 2008.[4] The Commission therefore dismisses the complaints except for Tesoro's complaint against SFPP's July 1, 2008 index-based rate increase, which is severed from this proceeding. That portion of Tesoro's complaint will be addressed in a separate order along with other pleadings addressing that July 1, 2008 increase.

The Pleadings

2. The four complaints at issue here generally argue that the rates resulting from SFPP's and Calnev's July 1, 2009 index-based rate increases are unjust and unreasonable. In this regard, Tesoro's complaints assert that Calnev and SFPP were substantially over-recovering their costs at the time they filed their increases under the Commission's indexing methodology. With regard to Calnev, Tesoro states that for the calendar year 2007 Calnev's cost of service was $39,010,324 and its operating revenues were $53,595,150. Tesoro argues that the difference of some $14 million is a substantial over-recovery that will be exacerbated by Calnev's July 1, 2009 index-based rate increases. Tesoro also states that Calnev's cost of service decreased by more than 2.8 percent between 2007 and 2008 on a per barrel basis.

3. With regard to SFPP, Tesoro states that SFPP's cost of service for calendar year 2008 was $183,406,724 and its interstate revenues for the same period equaled $153,871,946. Tesoro further claims that, despite this apparent under-recovery, it has demonstrated in other complaint and protested proceedings that SFPP has vastly overstated its costs of service, and thus SFPP is substantially over-recovering its costs. Tesoro claims that SFPP's index-based rate increases in 2008 and 2009 therefore exacerbate SFPP's over-recovery. Tesoro therefore requests the Commission to direct Calnev and SFPP to reset their respective rates at the July 1, 2009 level and provide reparations and damages accordingly.

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[2] Both complaints were filed on July 31, 2009.

[3] 18 C.F.R. § 343.2(c) (2009).

[4] *BP West Coast Products LLC v. SFPP, L.P.*, 121 FERC ¶ 61,243 (2007) (*BP West Coast v. SFPP I*), *reh'g denied*, *BP West Coast Products LLC v. SFPP, L.P.*, 123 FERC ¶ 61,121 (2008) (*BP West Coast v. SFPP II*), *appeal sub nom. ExxonMobil Oil Corporation and BP West Coast Products LLC v. FERC*, No. 07-1163, *et al.* (consolidated) (D.C. Cir.).

4. In its complaint against SFPP, BP West Coast first asserts that it is complying with the Commission's instructions that any shipper that wishes to challenge an index-based rate increase must file four complaints for every year in which the pipeline takes such an increase.[5] BP West Coast then asserts that SFPP was not entitled to any index-based rate increase in 2009 and therefore SFPP's indexed rates are not just and reasonable. BP West Coast further asserts that it has alleged reasonable grounds to believe that the rate increase is substantially in excess of SFPP's actual (or claimed) cost increase, so as to render the resulting rates not just and reasonable, and thus that all of SFPP's rates are not just and reasonable.

5. BP West Coast then incorporates its June 15, 2009 protest to Docket No. IS09-375-000, the docket in which SFPP filed for its July 1, 2009 index-based increase. Among the grounds BP West Coast argued in its protest, BP West Coast stated that on June 30, 2008, SFPP filed for an increase to its West Line rates in Docket No. IS08-390-000, which was effective August 1, 2008, and was based on a cost of service that SFPP has continuously updated since then. BP West Coast asserts that the July 1, 2009 index-based increase violates Commission policy because the new West Line rates effective August 1, 2008, were based on SFPP's actual costs for 2007, adjusted for known and measurable changes in the nine months that had already occurred at the time of its complaint filing in 2008. BP West Coast thus argues that SFPP may have a general rate increase for its West Line rates in 2008, or an index-based increase for the West Line rates in 2009, but not both.

6. BP West Coast further asserts that SFPP is estopped from obtaining a 7.6 percent rate increase based on the inflation rate in 2008 because SFPP projected a zero inflation rate in its projected equity cost of capital in Docket No. IS08-390-000. BP West Coast also asserts that the return component of SFPP's cost of service increased by $32,166,284 to $58,447,362 between 2007 and 2008, a sixty two percent increase in one year even though SFPP had included a zero inflation rate in its cost of capital in Docket No. IS08-390-000. It claims that SFPP did not comply with requirements of the Opinion No. 154-B[6] oil pipeline cost-of-service methodology, in part because SFPP did not explain the change in its income tax allowance, which increased from $11,973,316 to $22,155,578. BP West Coast further argues that SFPP claimed an increase in rate base by $65,772,340, or 13 percent. It argues that this increase in rate base has nothing to do with inflation that would act to increase operating expenses, maintenance costs, administrative

[5] *Citing BP West Coast v. SFPP I*, 121 FERC ¶ 61,243 at P 8-10.

[6] *Williams Pipe Line Company*, 31 FERC ¶ 61,377 (1985) (Opinion No. 154-B).

costs, and even depreciation, return, and taxes. BP West Coast states that this issue is now before the Commission on complaint in Docket No. OR08-15-000 and on rehearing in Docket No. IS08-302-001, the proceeding where SFPP filed for its July 2009 index-based rate increase. BP West Coast requests a hearing and investigation, with the burden of proof on SFPP to justify the index increase, the appointment of a settlement judge, and that SFPP's July 1, 2009 index-based increase be subject to refund.

7. BP West Coast's complaint against Calnev's July 1, 2009 index-based increase repeats many of the general assertions made in its complaint against SFPP in Docket No. OR09-21-000 regarding the regulatory framework for oil pipeline index-based increases. It asserts that Calnev is substantially over-recovering its costs and that application of an index-based increase would substantially exacerbate that over-recovery by adding $4.2 million to Calnev's existing over-recovery of $8.4 million. BP West Coast further asserts that Calnev is estopped from taking the additional increase because of the zero inflation rate that Calnev's affiliate SFPP included in its equity cost of capital in Docket No. IS08-390-000 and that like SFPP, Calnev failed to comply with the instructions to Page 700. In addition, BP West Coast states that in Docket No. OR09-11-000 it is challenging Calnev's cost claims and calculations for 2006 and 2007. BP West Coast thus challenges the claimed year-to-year changes to Calnev's rate of return, income tax allowance, and other claimed bases for Calnev's reported increase in its cost of service. BP West Coast thus requests a hearing and investigation, with the burden of proof on Calnev to justify the index increase, the appointment of settlement judge, and that Calnev's 2009 rate increase be made subject to refund.

8. Calnev and SFPP filed answers to the complaints. Turning first to the complaints filed by Tesoro, Calnev asserts that Tesoro failed to demonstrate that Calnev is substantially over-recovering its cost of service because Tesoro based its calculations on 2007 and not 2008 numbers. Given this and other alleged errors, Calnev states it cannot determine how Tesoro calculated an over-recovery of $11,191,836. It further asserts that much of the revenue used in the calculation reflects the indexing of grandfathered rates. Calnev thus concludes that Tesoro has not established that applying the index would substantially exacerbate any alleged over-recovery. Calnev states that the permitted index increase of 7.6025 percent would result in a revenue increase of approximately $4 million. However, Calnev states that Calnev's actual cost increase from 2007 to 2008 was $7,590,552, an increase of over 19 percent. As such, Calnev concludes that Tesoro could not show that Calnev's rate index adjustments so exceed Calnev's increase in costs that the resulting rate increases would substantially exacerbate an over-recovery of Calnev's costs.

9. With regard to SFPP's July 2009 index-based rate increase, SFPP similarly asserts that Tesoro could not meet the complaint standard with regard to SFPP. According to SFFP, this is because SFPP actually under-recovered its cost of service by approximately 16 percent in 2008, having a cost of service of $183,406,724 compared to revenues of $153,871,946. SFPP further states that in 2008 its costs increased by $40,207,918 compared to a potential revenue increase of $11,698,114 based on the tariffs in effect in 2008. It concludes that it is impossible for Tesoro to show that SFPP's rate index adjustments so exceed SFPP's increase in costs that the resulting rate increases would substantially exacerbate any over-recovery.

10. Regarding the complaints filed by BP West Coast, SFPP again states that it was under-recovering its cost of service in 2008 and therefore its rates are not unjust and unreasonable. As with its response to Tesoro, SFPP asserts that BP West Coast cannot establish that the rates resulting from an index-based increase are so substantially in excess of the actual cost increases when in fact its actual cost increases exceeded the amount of revenue that would be generated from application of the index. SFPP also responded to BP West Coast's more specific arguments regarding the application of the index. The first issue SFPP addresses is whether it filed a full cost of service in the calendar year to which the index is applied. SFPP asserts that regardless of what may have been the case for the calendar year 2007, as of June 2009 SFPP had made no rate filing that utilized a calendar year 2008 test period. Thus, under Commission policy, SFPP argues there was no double recovery of cost increases it incurred in calendar 2008. SFPP similarly argues that regardless of any significant increases to its East Line rate base that it made in 2007, this increase was fully integrated into its system during calendar year 2008, and therefore its July 1, 2009 index-based increase properly reflected the impact of inflation on all of its assets. [7]

11. SFPP further asserts that BP West Coast's estoppel argument has no merit because the inflation rate used to calculate the index is based on the actual inflation rate for 2008, whereas the regulatory cost of service used in a general rate case is the projected inflation rate at the time the case is filed, which in this case of SFPP's current East Line rate case in Docket No. IS09-437-000 happens to be zero. SFPP also states that if the inflation rate is negative in 2009, this will be reflected in the index factor to be applied to its 2009 costs and included in the index adjustment effective July 1, 2010. SFPP further asserts that the increases to its rate base in 2008 reflect standard accounting procedures and that in fact its net rate base declined in 2008 compared to 2007 due to retirements of plant.

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[7] SFPP answer at 9-10 (citing *SFPP, L.P.*, 117 FERC ¶ 61,271 (2006) as the grounds for the distinction between the two calendar years SFPP discusses).

12. SFPP also argues that BP West Coast's other challenges to its cost of service, such as rate base, rate of return, and income tax allowance are issues that must be addressed through a rate complaint against the base rates or the accumulated index based increases. Finally, SFPP states that BP West Coast's compliant against the East Line rates is inconsistent with a settlement governing new rates that were established for its East Line service in 2008.[8]

13. Calnev makes similar general arguments in response to BP West Coast's complaint, and states specifically that the permitted percentage index-based rate increase was 7.6025 percent compared to an approximately 19.5 percent increase in its cost of service during 2008 (i.e. from $39,010,324 to $46,600,876). Calnev also argues that BP West Coast cannot simply add the <u>projected</u> $4 million for its July 1, 2009 index-based increase to Calnev's December 31, 2009 over-recovery because that makes no allowance for an additional costs that may be incurred during the calendar year 2009. SFPP and Calnev therefore request the Commission to dismiss all four index-based complaints.

<u>Discussion</u>

14. The Commission concludes that the four complaints at issue are inadequate under the Commission's regulations and the precedent established by *BP West Coast v. SFPP I* and *BP West Coast v. SFPP II*. 18 C.F.R. § 343.2(c), the regulation regarding oil pipeline index-based rate increases, states in part:

> A protest or a complaint filed against a rate proposed or established pursuant to § 342.3 of this chapter must allege <u>reasonable</u> grounds for asserting that … the rate increase is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable. . . .[9] (emphasis added).

On the face of this language the standard cannot be met if the carrier's cost increases in a given calendar year exceed the authorized percentage index-based rate increase based on the inflation rate established by the Commission for the same year.[10] In the instant case, both Calnev and SFPP's actual cost increases in dollar and percentage terms exceeded the 7.6025 percent index-based rate increase authorized for the year 2008,[11] and thus the complaints fail based on the language

[8] SFPP answer at 10-11 (*citing SFPP, L.P.*, 126 FERC ¶ 61,076 (2009)).

[9] 18 C.F.R. § 343.2(c) (2009).

[10] *See BP West Coast v. SFPP II*, 123 FERC ¶ 61,121 at P 7-8.

[11] *See* 18 C.F.R. § 342.3 for the indexing methodology.

of the regulations. Moreover, while both the complainants and SFPP speak to whether the increases at issue here would substantially exacerbate any alleged over-recoveries by the pipelines, it is not necessary to reach that point. The "substantially exacerbate" standard, as discussed in *BP West Coast Products LLC v. SFPP L.P.*, is satisfied if (1) the pipeline is substantially over-recovering its cost of service, and (2) an indexed based increase so exceeds the actual increase in the pipeline's cost that the resulting rate increase would substantially exacerbate that over-recovery.[12]

15. In *BP West Coast Products LLC v. SFPP L.P.*, the substantially exacerbate standard was met and the complaint was accepted.[13] However, given the facts here, the standard is not satisfied because neither pipeline increased the amount of any alleged or actual over-recovery because the revenues generated by the index-based increase were less than the actual increase in the pipeline's cost, as reflected on its Page 700. This is most clearly reflected on Page 700 of SFPP's 2008 FERC Form No. 6. SFPP's operating revenues increased by slightly more than $5.6 million in 2008, but based on Page 700 of SFPP's 2008 FERC Form No. 6 its costs increased from $143,198,806 to $183,406,724. Thus, the increase in the costs exceeded the increase in revenue by approximately $35 million.[14] In the case of Calnev, Calnev's costs increased by $7,590,552 from 2007 through 2008, but its revenue increased only by approximately $4 million.[15] Thus, the Commission finds that the complainants have failed "to allege reasonable grounds for asserting that … the rate increase is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable" as required under 18 C.F.R. § 343.2(c). As discussed, the substantially exacerbate standard is not satisfied in these dockets.

16. BP West Coast also raises four points arguing that the indexing methodology was not appropriately applied to SFPP's and Calnev's 2008 cost of service. Because these arguments have already been raised in another proceeding

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[12] *BP West Coast Products LLC v. SFPP II*, 123 FERC ¶ 61,141 at P 8-10.

[13] *Id.*; *see BP West Coast Products LLC v. SFPP, L.P.*, 125 FERC ¶ 61,138 (2008) for the settlement order in that proceeding.

[14] *See* Complaint of Tesoro Refining and Marketing Company Against Index Rate Increases of SFPP, L.P., Exhibit A, at reproduced Page 700.

[15] Under 18 C.F.R. § 343.2(c) the fact that the pipeline has an over-recovery is not in itself sufficient grounds to deny an indexed-based increase. A complaint must meet the cited standard. *See BP West Coast v. SFPP I,* 121 FERC ¶ 61,243.

and rejected, the Commission will only touch on the more significant points.[16] BP West Coast's first argument is that SFPP made a large increase to its East Line rate base in 2007 and that this disproportionately influences the July 1, 2008 index-based increase applicable to SFPP's other rates. SFPP is correct that the large increase in its rate base in 2007 has nothing to do with the application of the index methodology to its rate base in calendar year 2008. Once the increased costs are embedded in its rate base for a full calendar year, in this case calendar year 2008, the investment made in a prior year incurs maintenance and administrative expenses, real estate tax increases or decreases, an equity return, and depreciation, just like the rest of SFPP's historical rate base. The enumerated costs are all included in the carriers' total cost of service to which the index applies each year because the Commission uses fully allocated costs in the indexing methodology.[17]

17. Second, BP West Coast's argument that SFPP has improperly used different inflation rates used in different proceedings is without merit. The indexing method looks backward to the prior year, in this case calendar year 2008, and is based on the actual costs recorded in the carrier's accounts, because the indexing methodology compares the difference between industry-wide costs in 2007 and 2008. Thus, a complaint must address the actual increase in the carrier's costs with the increase resulting from the application of the indexing methodology, which is based on annualized cost changes between two calendar years.[18] In contrast, in a general rate case the cost of equity capital included the cost of service rate filing looks forward based on the inflation rate that occurred during the twelve month base case. Thus, if the base case is filed after the end of the calendar year and the inflation rate drops during the twelve month period for a base case covering a later period, it is possible for the inflation rate in the twelve month base case to be lower than a prior calendar year used in the indexing

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[16] *See SFPP, L.P.*, 127 FERC ¶ 61,132 (2009), which addressed the complainants' protests to SFPP's July 1, 2009 index-based rate increase.

[17] Order No. 561, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, 58 FR 58753 (Nov. 4, 1993), FERC Stats. & Regs., Regs. Preambles January 1991-June 1996 ¶ 30,985 at 30,948 (1993), *order on reh'g,* Order 561-A, 59 FR 40242 (Aug. 8, 1994), FERC Stats. & Regs., Regs. Preambles, January 1991-June 1996 ¶ 31,000 (1994), at 31,107; *aff'd, Association of Oil Pipe Lines v.* FERC, 83 F.3d 1424 (D.C. Cir. 1996); *aff'd Association of Oil Pipe Lines v.* FERC, 281 F.3d 239 (D.C. Cir. 2002), *order on remand,* Five-Year Review of Oil Pipeline *Pricing Index,* 102 FERC ¶ 61,195 (2003).

[18] *See* 18 C.F.R. § 343.2(b)(2) (2009).

methodology. Because the inflation rate is rolling twelve month average and the indexing methodology is a rigid calendar year requirement, there is no necessary correlation between the two.[19] In any event, even if SFPP calculated the inflation rate in a general rate case filing incorrectly, the place to contest that error is in the general rate case proceeding.

18. Third, BP West Coast asserts that SFPP should not obtain an inflation increase for its West Line rates because it filed a general rate case regarding those rates in Docket No. IS08-390-000 based on a 2007 cost of service, as updated by SFPP. SFPP states that the updates were in response to criticism and concerns of the parties opposing the rate increase, and as such are simply not relevant to this case.[20] Regardless, the West Line cost of service at issue was for 2007 and not 2008, and as such there is no bar to SFPP taking an index-based rate increase on July 1, 2009 for cost increases incurred in 2008. Under these circumstances there is no double recovery as a full cost recovery general rate case based on the calendar year 2007 is distinct from the costs thereafter incurred in calendar year 2008. The indexing methodology relies on actual historical costs, not those that may be projected or updated in a general rate case.[21]

19. Fourth, BP West Coast argues that the $4 million projected to be raised by Calnev's July 1, 2009 index-based rate increase will exacerbate Calnev's December 31, 2008 over-recovery. BP West Coast's argument reflects projected revenue to be generated beginning July 1, 2009 for the next twelve months and assumes that the volumes underlying the projection materialize. If that does not occur, the revenue will not be realized. In addition, BP West Coast's argument does not allow for any increase in costs that may occur between January 1 and December 31, 2009. Such cost increases might offset the entire revenue increase, as was the case for both Calnev and SFPP in calendar year 2008.

20. Finally, the complainants attempt to challenge the various cost-of-service factors underpinning Calnev's and SFPP's cost of service, including the derivation of their rate bases, income tax allowances, return factors, and the method by overhead costs were assigned to these two pipelines. However *BP West Coast v.*

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[19] *See, e.g.*, SFPP, L.P. March 7, 2006 Compliance Filing in Docket No. 92-8-024, *et al.*, Schedule 11, Line 9 (citing Opinion No. 435-A, 91 FERC ¶ 61,135, at p. 61,250 (2000)). *See also*, Exh. No. SFP-5 dated October 16, 2008, at p. 9 of 9, filed in *SFPP, L.P.*, Docket No. IS08-309-002, which uses a twelve month inflation rate of the period to August 2008.

[20] SFPP answer at 9-10.

[21] *BP West Coast v. SFPP II*, 123 FERC ¶ 61,121 at P 6.

SFPP I and *BP West Coast v. SFPP II* makes clear that such issues must be raised through a complaint against the pipeline's base rates, the accumulated index-based increases, or both.[22] For the reasons stated all four complaints are dismissed.

The Commission orders:

(A) With the exception of Tesoro's complaint against SFPP's 2008 index-based rate increase, the complaints listed in the caption are dismissed.

(B) Tesoro's complaint against SFPP's 2008 index-based rate increase in Docket No. OR09-18-000 is severed for review together with other pleadings addressing SFPP's July 1, 2008 index-based increase.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[22] *BP West Coast v. SFPP I*, 121 FERC ¶ 61,243 at P 9-10, and *BP West Coast v. SFPP II*, 123 FERC ¶ 61,121 at P 4.