

153 FERC ¶ 61,118
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Philip D. Moeller, Cheryl A. LaFleur,
Tony Clark, and Colette D. Honorable.

Tesoro Logistics Northwest Pipelines LLC

Docket No. IS15-644-000

ORDER REJECTING TARIFFS

(Issued October 30, 2015)

1. On September 22, 2015, Tesoro Logistics Northwest Pipelines LLC (Tesoro) filed FERC Tariff Nos. 2.3.0, 3.4.0, 4.3.0, and 5.2.0,¹ to be effective November 1, 2015. Tesoro is seeking to implement a surcharge for what it asserts are one-time, non-recurring environmental expenses that Tesoro incurred following its acquisition of the Northwest Products Pipeline System (Northwest Pipeline) from Chevron Pipe Line Company (Chevron Pipe Line) on June 19, 2013. For the reasons discussed below, Tesoro's tariffs are rejected.

Background

2. Tesoro states that its proposed surcharge will recover environmental expenses that first occurred on March 18, 2013, during Chevron Pipe Line's operation of the pipeline system. Following Tesoro's acquisition of the pipeline it assumed certain obligations established under a March 27, 2013 Pipeline and Hazardous Materials Safety Administration (PHMSA) Corrective Action Order. In order to comply with the Corrective Action Order as well as to ensure the safe continued operation of the Northwest Pipeline, Tesoro undertook a comprehensive environmental review of the pipeline including inline inspection, hydrostatic testing, pipeline repair, cathodic protection, pipeline coating, and capping and cutting, as well as other types of work.

3. Tesoro expects that its total environmental expenses to remediate and repair the Northwest Pipeline and comply with the Corrective Action Order and complete other inspection and repair will be \$32.2 million. Tesoro states those expenses consist of both incurred and expected amounts of \$11.6 million to comply with the Corrective Action

¹ Tesoro also states that it made several clerical changes to FERC Tariff No. 5.2.0.

Order and \$20.6 million for additional inspection work, repair and protection in a category referred to as non-Corrective Action Order work. In order to recover these costs, Tesoro is proposing an initial per-barrel surcharge of \$0.120. The surcharge will apply to each barrel of petroleum product tendered to Tesoro for shipment on the pipeline beginning on November 1, 2015. The surcharge will recover environmental remediation expenses over a ten-year period and be terminated when Northwest Pipeline has recovered those expenses. Tesoro anticipates the surcharge to complete recovery of the remediation expenses in November 2025. Tesoro's environmental remediation program is projected to be completed in 2017.

4. The environmental surcharge was calculated by taking the total volume that Tesoro anticipates will be transported on the Northwest Pipeline each year and implementing a uniform per-barrel surcharge that will recover those costs over a ten-year period. Tesoro submits a uniform volume-based surcharge is appropriate because its environmental review and repair affects and benefits all shippers on the Northwest Pipeline equally. Tesoro states its surcharge implements a transparent, cost-based recovery that will be trued up annually to actual costs and throughput and will not be subject to upward or downward adjustment under indexing.

5. Tesoro asserts that its environmental surcharge is consistent in both purpose and scope with surcharges the Commission has permitted in the past. Specifically, Tesoro contends that the costs Tesoro seeks to recover are consistent with the extraordinary and nonrecurring type of expenditures that the Commission has stated may be recovered through a surcharge.² Tesoro submits that the costs it seeks to recover through its surcharge are not covered by insurance and are not subject to any double recovery, which the Commission has consistently denied.³ Tesoro asserts that in accordance with Commission precedent regarding the recovery of expenses through surcharges, Tesoro's environmental surcharge recovers only environmental costs that are extraordinary in nature, unlikely to reoccur, and atypical from the routine and expected costs of operating the pipeline.

² Citing, *Magellan Pipe Line Company*, 115 FERC ¶ 61,276 (2006); *Extraordinary Expenditures Necessary to Safeguard National Energy Supplies*, 96 FERC ¶ 61,299 (2001); *SFPP, L.P.*, 118 FERC ¶ 61,267 at P 6, *reh'g denied*, 121 FERC ¶ 61,162 (2007); *Chevron Pipe Line Company*, 115 FERC ¶ 61,117, at P 31 (2006).

³ Citing, *Chevron Pipe Line Company*, 115 FERC ¶ 61,117 at P 24; *Sea Robin Pipe Line Company, LLC*, 128 FERC ¶ 61,286, at P 14 (2009).

6. Tesoro assert that the costs it intends to recover through the environmental surcharge are similar to the costs that were recoverable through a surcharge in *Magellan Pipeline Company, L.P.*,⁴ where the Commission permitted Magellan to implement a ten-year surcharge to recover costs incurred in complying with Environmental Protection Agency (EPA) regulations regarding ultra-low sulfur diesel (ULSD) petroleum products. Tesoro states that the Commission found that Magellan's costs were not industry-wide in nature since only certain pipelines transported ULSD. Tesoro states that the Commission further found that costs associated with the EPA's ULSD standards were not the type of cost properly recovered through the Commission's rate changing methods.

Interventions and Protests

7. A motion to intervene was filed by HollyFrontier Refining & Marketing LLC. Motions to intervene and protests were filed by Chevron Products Company (Chevron Products) and Sinclair Oil Corporation (Sinclair). The Commission grants all unopposed motions to intervene filed before the issuance date of this order. Both Chevron Products and Sinclair assert they have standing to protest because they have a substantial economic interest in Tesoro's proposed tariffs as past, present and/or potential future shippers on Tesoro's pipeline system. Chevron Products and Sinclair assert that Tesoro's tariffs should be rejected or, at a minimum, suspended for the maximum statutory period subject to refund and set for hearing or technical conference.

8. Chevron Products asserts that in accordance with section 342.4(a) of the Commission's regulations, a pipeline seeking to charge a rate in excess of the ceiling established by the Commission's indexing methodology must demonstrate that there is a substantial divergence between its actual costs and the indexed rate such that the indexed rate is not just and reasonable. Chevron Products contends that Tesoro has not provided the required justification. Chevron Products argues that while Tesoro has provided some extremely limited cost-of-service justification for its proposed surcharge, Tesoro improperly focused on the surcharge only, rather than examining its system-wide cost-of-service and revenues as required by Commission regulations. Chevron Products submits that because Tesoro has not justified its requested surcharge through a showing of substantial divergence between actual costs and revenues provided by its indexed rate, its requested surcharge is contrary to the Commission's oil pipeline regulations, and should be rejected on that basis alone. Chevron Products asserts there is no justification for imposing a surcharge in addition to the indexed rate if the pipeline can already profitably bear the costs it seeks to recover from the surcharge.

⁴ *Magellan Pipe Line Company*, 115 FERC ¶ 61,276 (2006) (*Magellan*).

9. Chevron Products states that the index was specifically designed to account for increasing regulatory costs. Chevron Products contends that Tesoro has not demonstrated that all of the costs it seeks to recover through the surcharge are extraordinary and non-recurring, and thus appropriate for recovery through a surcharge. Chevron Products submits that PHMSA Corrective Action Orders are not an unusual occurrence for pipelines, and pipelines regularly incur expenses associated with environmental remediation, and testing and inspection of their lines that are included and recovered in base rates.

10. Chevron Products asserts that the Corrective Action Order costs Tesoro seeks to recover are fundamentally different from the costs the Commission permitted carriers to recover to comply with new ULSD requirements. Chevron Products argues that in *Magellan*, the Commission determined that since the costs to comply with the ULSD regulations were not industry-wide and resulted from federally mandated requirements, they were not the kinds of costs to be recovered through the index. Chevron Products asserts that requirements imposed by PHMSA are both longstanding and industry-wide. Chevron Products submits that while the specific Corrective Action Order may apply only to Tesoro, this type of order is regularly issued throughout the industry, and costs incurred by pipelines complying with such orders are properly included in the periodic oil pipeline index rate adjustments, and should not be included for recovery in an additional surcharge as well.

11. Chevron Products argues that the risk of double recovery appears heightened in this case as Tesoro is requesting that the surcharge recover more than just costs directly stemming from the Corrective Action Order. Chevron Products contends that Tesoro does not explain why non-Corrective Action Order costs are extraordinary, non-recurring, or distinguishable at all from normal operation and maintenance expenses, despite the fact that these non-Corrective Action Order costs make up the bulk of the costs Tesoro seeks to recover through a surcharge.

12. Chevron Products states that costs Tesoro is seeking to recover are largely made up of purported environmental and safety costs incurred in 2013 and 2014 as well as unnamed and unidentified costs not associated with any particular time period. Chevron Products asserts that Tesoro's attempt to recover past period costs in a current going forward rate conflicts directly with the Commission's established rule against retroactive ratemaking.

13. Sinclair submits that the Commission has previously approved surcharges in only limited instances for costs related to extraordinary events outside a pipeline's control, but Tesoro's filing bears no similarity to those situations. Rather, Sinclair asserts that Tesoro seeks to recover through a surcharge the cost of a pipeline failure that may have resulted from improper maintenance, as well as other costs that Tesoro concedes are unrelated to

that event. Sinclair contends these costs are neither extraordinary nor beyond a pipeline's control, and the Commission should reject Tesoro's attempt to recover them outside normal ratemaking procedures.

14. Sinclair points out that Tesoro seeks to recover costs involving pipeline facilities constructed between 1949 to 1952 that have been involved in several failures dating back to 2002, including one that occurred just three years prior to the failure in 2013. Sinclair states that a history of pipeline failures and problems directly led to multiple PHMSA inspections and a PHMSA letter of concern identifying pipeline safety issues.⁵ Sinclair argues that the costs to rectify problems such as these cannot be compared to unique natural disasters and terrorists attacks for which surcharge recovery is permitted. Moreover, Sinclair states that Tesoro admits that more than \$20 million of the \$32 million it seeks to recover is traceable to additional inspection, repair and protection that is not even related to the 2013 pipeline failure event. Sinclair asserts that surcharges for these amounts are wholly unsupported under Commission precedent involving extraordinary expenses and catastrophic events.

15. Sinclair contends that Tesoro's situation is unlike the situation faced by pipelines complying with the EPA's ULSD requirements, inasmuch as Tesoro's filing does not seek to recover costs arising from new regulations. Sinclair submits that the PHMSA Corrective Action Order enforces legal obligations imposed under 49 U.S.C. § 60112, which have been in effect since 1994. Sinclair states that Tesoro (currently, and as the successor interest to Chevron Pipe Line) has been under a duty to comply with these long-standing pipeline safety regulations, and the costs of operation and maintenance activities associated with that ongoing compliance requirement are properly recoverable through traditional rate recovery processes available to oil pipelines, not through a surcharge mechanism. Sinclair asserts that the Commission has rejected analogous gas pipeline tariff filings where a pipeline improperly attempted surcharge recovery of amounts arising from pipeline failures that were not outside the pipeline's control.⁶

16. Sinclair argues that even if the cost of compliance with the PHMSA Corrective Action Order were considered extraordinary, Tesoro cannot properly surcharge for \$20.6 million in unrelated normal preventative maintenance costs. Sinclair submits that pipeline owners responsible for complying with pipeline safety regulations and the costs of maintaining their systems in accordance with those requirements are normal and routine. Sinclair asserts that to the extent Tesoro is facing unexpected or unusual costs

⁵ *Citing*, Exhibit A of Sinclair's Protest, PHMSA Corrective Action Order at 2-3.

⁶ *Citing*, *CenterPoint Energy Gas Transmission Co.*, 127 FERC ¶ 61,096 (2009) and *Colorado Interstate Gas Co.*, 123 FERC ¶ 61,183 (2008).

due to the condition of the Northwest Pipeline system Tesoro should seek recovery from Chevron Pipe Line, from whom it purchased the facilities, or initiate a general rate case.

17. Finally, Sinclair contends that if Tesoro's filing is not rejected, a hearing is necessary to determine whether the proposed costs were prudently incurred and to ensure that there will be no over-recoveries.

Tesoro's Answer

18. Pursuant to section 343.3(b) of the Commission's regulations, Tesoro filed an answer to the protests of Chevron Products and Sinclair on October 13, 2015. Tesoro asserts that in the course of meeting the requirements of the Corrective Action Order for extensive testing of the 760-mile system, Tesoro discovered additional integrity issues that needed to be addressed. Tesoro contends that the integrity issues were so urgent that they could not wait for normal schedule maintenance. Tesoro states that it concluded that it could not prudently operate its pipeline in the future without engaging in substantial additional environmental integrity work. Tesoro asserts that the environmental problems that it identified in the course of meeting the Corrective Action Order's stringent testing requirements could only have been discovered as a direct result of the operating restrictions placed on the Northwest Pipeline under the terms of the Corrective Action Order. Tesoro contends that in order to comply with the Corrective Action Order, it had to undertake a massive inspection program that cost more than \$32 million. Tesoro contends that the emergency corrective actions that it undertook for its entire pipeline system were anything but routine.

19. Tesoro asserts that since surcharges have been allowed for extraordinary events, the conditions giving rise to them necessarily involve unusual, unique, and different circumstances. However, Tesoro contends that the unifying core feature of each situation in which the Commission has approved a surcharge is the extraordinary non-recurring nature of the costs and the inability of a prudent pipeline to prepare for those extraordinary events. Tesoro asserts that its environmental costs are extraordinary, non-recurring, and non-industry-wide costs incurred over a three -year period as opposed to the normal 15-year period that is characteristic of industry-wide reconditioning programs. Tesoro argues that the condition of the pipeline that Tesoro acquired from Chevron Pipe Line in 2013 was so dire that extraordinary repairs had to be made along the entirety of the system in a highly compressed time period.

20. Tesoro contends that it has provided sufficient data to demonstrate that the costs Tesoro proposes to recover through the environmental surcharge are extraordinary and non-recurring expenses. Tesoro reiterates its argument that the Commission has determined that the substantial divergence and cost-of service ratemaking methodologies do not apply to extraordinary non-recurring cost recovery surcharges such as Tesoro's environmental surcharge. Finally, Tesoro asserts that the costs it seeks to recover through the environmental surcharge are not barred by the filed rate doctrine or the rule

against retroactive ratemaking because the environmental review conducted in order to comply with the PHMSA Corrective Action Order and the associated expenses were crucial to ensure future operations of the Northwest Pipeline system. Accordingly, Tesoro requests that its tariffs be accepted.

Discussion

21. The issue presented by the instant filing is whether Tesoro should be permitted to recover \$32.2 million in environmental costs through a per-barrel surcharge over a ten-year period. Tesoro classifies the costs as those arising from a PHMSA Corrective Action Order issued to its predecessor in interest, Chevron Pipe Line, as well as non-Corrective Action Order related costs. Tesoro asserts that the costs it seeks to recover are extraordinary, non-recurring costs that it should be permitted to recover through a surcharge, consistent with Commission precedent. On the other hand, the protesters, Chevron Products and Sinclair, assert that the environmental costs Tesoro seeks to recover are not extraordinary or non-recurring, but are the type of customary inspection, maintenance, and repair costs expected of every oil pipeline, and recoverable through traditional cost recovery methods.

22. Based upon a review of the pleadings and applicable precedent, the Commission finds that the environmental costs Tesoro seeks to recover through its proposed surcharge are not the type of extraordinary, non-recurring costs beyond a pipeline's control that the Commission has permitted to be recovered through surcharges. While Tesoro goes to great lengths to classify its environmental costs as extraordinary and non-recurring, Tesoro freely assumed certain obligations that were imposed on Chevron Pipe Line by the PHMSA Corrective Action Order. The fact that obligations imposed by the corrective action order resulted in Tesoro incurring more costs over a shorter time period may make those costs unanticipated or underestimated, but does not make them extraordinary.

23. As the protesters point out, the Northwest Pipeline is over 60 years old, has had several failures and was the subject of a PHMSA letter of concern prior to the subject Corrective Action Order. This naturally leads to the question of whether the pipeline was being adequately maintained or repaired by Tesoro's predecessor-in-interest, Chevron Pipe Line, and whether such maintenance or repair, could have avoided the environmental costs Tesoro faces today. In fact, Tesoro itself states that the condition of the pipeline "was so dire that extraordinary repairs had to be made *along the entirety of the system* in a highly compressed time period."⁷ Tesoro uses that fact as a justification for the surcharge. The Commission disagrees. The ongoing maintenance, repair, and safety of a pipeline as well as compliance with PHMSA orders and regulations are the

⁷ Tesoro Answer at 9.

type of ongoing and routine expenses that are appropriately recovered through the normal ratemaking process. The fact that Tesoro may have made an improvident bargain, and thus inherited costly unexpected problems as a result of its acquisition of the Northwest Pipeline system from Chevron Pipe Line does not render Tesoro's environmental costs extraordinary or make it just and reasonable to impose those costs on shippers through a surcharge. The fact that Tesoro incurred costs due to the acquisition of a pipeline in a state of extreme disrepair cannot compare to costs imposed on pipelines due to extraordinary events like Hurricane Katrina or post-September 11 security costs, or even pipelines' compliance with new EPA ULSD requirements. The operating condition of the Northwest Pipeline was always in the control of Chevron Pipe Line and was not due to external events. Nor were there any new regulations involved. Tesoro stepped into Chevron Pipe Line's shoes with its purchase, and cannot recover costs arising from that purchase through a surcharge, simply because it may have entered into a bad deal.

24. The Commission's decision here is without prejudice to Tesoro recovering the environmental costs through the normal ratemaking process. To the extent that Tesoro believes it cannot recover the subject costs through its indexed rates, it has the opportunity to show through a cost of service filing pursuant to section 342.4(a) of the Commission's regulations that there is a substantial divergence between the costs incurred by the pipeline and the indexed rate that would prevent the pipeline from charging a just and reasonable rate.

The Commission orders:

Tesoro's FERC Tariff Nos. 2.3.0, 3.4.0, 4.3.0, and 5.2.0 are rejected.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.