

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

MarkWest Michigan Pipeline Company, L.L.C.

Docket Nos. IS06-41-000
and DO06-2-000

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

(Issued December 29, 2005)

1. On November 18, 2005, MarkWest Michigan Pipeline Company, L.L.C. (MarkWest) submitted a tariff filing in Docket No. IS06-41-000 proposing rates for the transportation of crude oil on its pipeline system¹ to become effective January 1, 2006. MarkWest provided a cost-of-service justification for its proposed rates and a separate request in Docket No. DO06-2-000 for approval of initial depreciation rates. Sunoco Partners Marketing & Terminals (Sunoco), GulfMark Energy, Inc. (GulfMark), and Merit Energy Company (Merit) (jointly, Protestants) filed a joint motion for leave to intervene and a protest to MarkWest's filing. MarkWest filed an answer.
2. As discussed below, the Commission accepts and suspends the tariffs,² to become effective January 1, 2006, subject to refund, and sets this matter, as well as the proposed initial depreciation rates in Docket No. DO06-2-000, for hearing and settlement judge procedures. The hearing will be held in abeyance pending the outcome of the settlement process.

¹ MarkWest transports crude oil gathered in central Michigan along its pipeline system and delivers it to storage tanks connected to Enbridge Energy, Limited Partnership (Enbridge) at Lewiston, Michigan.

² FERC Tariff No. 1 is a rules and regulations tariff, and FERC Tariff No. 2 proposes rates for the transportation of crude oil gathered in central Michigan.

MarkWest's Filings

3. In Docket No. IS06-41-000, MarkWest proposes initial interstate rates based on a cost-of-service showing for its crude oil pipeline system (Gathering System), which is approximately 130 miles long, and which is part of a total of approximately 250 miles of gathering and trunk facilities. The facilities also include four truck unloading stations, associated terminals, and tank facilities. MarkWest states that, in accordance with 18 C.F.R. Part 346 of the Commission's regulations, it is submitting cost and revenue data supporting the rates proposed in FERC Tariff No. 2. The Gathering System, which MarkWest acquired from Shell Pipeline Company, LP (Shell), has been operated in the past as an intrastate pipeline. However, MarkWest states that, following its acquisition of the Shell facilities and its adoption of Shell's Michigan state tariffs, one of its shippers alleged that its shipments originating on the Gathering System move in interstate commerce. Following discussions with the Commission's Enforcement Staff that were initiated by Sunoco, and at the suggestion of the Enforcement Staff, MarkWest makes the instant tariff filing to request initial interstate transportation rates.³

4. MarkWest states that, in accordance with section 346.2(a)(1)(ii) of the Commission's regulations,⁴ its base period is September 1, 2004, through August 31, 2005, as adjusted for known and measurable changes for the nine-month test period ending May 31, 2006. MarkWest calculates a cost of service of \$5,231,000 for the test period. MarkWest also projects test period revenue under the current ceiling rates⁵ of approximately \$4,190,000, reflecting a six-percent test period volume decline from base period volumes. MarkWest contends that this represents the average annual decrease in volumes transported from 2000 to 2004. Under the proposed rates, MarkWest projects test period revenue of approximately \$4,833,000, which MarkWest states would represent an under-recovery of \$398,000 less than its test period cost of service.

5. MarkWest maintains that its proposed rate design addresses competitive constraints affecting the delivery of crude petroleum to the Gathering System by truck

³ See Answer of MarkWest Michigan Pipeline Company, L.L.C. to Motion for Leave to Intervene and Protest of Sunoco Partners Marketing & Terminals, L.P., GulfMark Energy, Inc. and Merit Energy Company at 6 (December 12, 2005).

⁴ 18 C.F.R. § 346.2(a)(1)(ii) (2005).

⁵ Such ceiling rates are based on presently-effective intrastate tariff rates filed with the Michigan Public Service Commission. MarkWest currently has no effective interstate FERC tariff rates on file.

and by direct connection. MarkWest contends that, in gathering and transporting crude petroleum in central Michigan, it faces greater competition from trucking, by which most of the crude petroleum is delivered to its pipeline, rather than from direct pipeline connections to producing wells. According to MarkWest, because of the proximity of its truck-unloading stations⁶ and its Enbridge pipeline interconnection, the level of its rates between these delivery points affects the producers' choices of delivery locations. Therefore, MarkWest states that it must limit the transportation cost differences between these stations to recover costs and capture overall throughput on the Gathering System, which continues to shrink because of the natural decline of area oil producing fields. MarkWest also hopes to encourage producers to deliver to the closest station. MarkWest further contends that, if its rates were set too high, shippers would have an incentive to build their own connections to Enbridge and completely bypass the Gathering System. Moreover, continues MarkWest, if the rates at the producers' pipeline receipt points become too high, producers would have an incentive to deliver to nearby truck stations. MarkWest emphasizes that it set its proposed rates at levels that will not create such inefficient incentives.

6. In evaluating the appropriate rates to set for trucking stations and directly-connected production, MarkWest states that it examined the methodology that the Commission employs in setting gas pipeline rates. According to MarkWest, under that methodology, if a pipeline charges a rate to a non-affiliated shipper that is below fully-allocated cost, the pipeline may reduce the rate determinants (*e.g.*, barrels and barrel-miles) for that movement in proportion to the discount.⁷ MarkWest asserts that the Commission has determined this rate design to be appropriate in a competitive market because it benefits all shippers by spreading fixed costs over a large number of shippers. Further, MarkWest claims its proposed rate design provides a reasonable balance between allowing the pipeline an opportunity to recover its costs and ensuring that its rates provide appropriate incentives for efficient transportation of oil in the region served by the Gathering System.

⁶ The unloading stations are located at Manistee, Kalkaska, Junction, and Lewiston, Michigan. Manistee, Kalkaska, and Junction are 130, 60, and 10 miles, respectively, from Lewiston.

⁷ MarkWest acknowledges that the Commission applies stricter scrutiny when the discount is offered to affiliated shippers, but states that it is not transporting any volumes for affiliates.

7. Because the proposed rate design reflected in FERC Tariff No. 2 results in higher rates to certain receipt points than the rates charged to truck stations involving longer hauls, MarkWest requests relief from the provisions of section 4 of the Interstate Commerce Act (ICA),⁸ as provided for in section 341.15 of the Commission's regulations,⁹ to permit these rates to be established in light of the competitive circumstances on its Gathering System. FERC Tariff No. 2 contains the proposed rates, which range from twelve to fifty cents more per barrel for a shorter haul. MarkWest states that, where it charges a lower rate for a longer haul, the lower rate is reasonably compensatory because the rate level is set in response to competition and will recoup MarkWest's variable costs and contribute to the recovery of its fixed costs. MarkWest reiterates that its rates will not fully recover the cost of service based on test period volumes.

8. In Docket No. DO06-2-000, MarkWest proposes initial depreciation rates for the Gathering System assets that are based on the remaining life of the crude oil reserves in MarkWest's supply region, which was determined in an independent study to be 20 years from the time when MarkWest acquired the assets from Shell on December 18, 2003. MarkWest states that, to comply with Commission regulations, it must maintain two sets of property and depreciation records, both based on the same 20-year remaining life: (1) book depreciation rates based on purchase price and used for FERC Form No. 6 reporting purposes; and (2) ratemaking depreciation rates based on the depreciated original cost amounts and used for ratemaking purposes.

9. MarkWest states that its filing is made pursuant to Part 347 of the Commission's regulations,¹⁰ and that certain information constitutes confidential business information, the release of which could harm the pipeline. Accordingly, MarkWest states that it filed the information supporting its proposed depreciation rates under confidential cover, pursuant to section 388.112(b) of the Commission's regulations.¹¹ MarkWest requests

⁸ 49 U.S.C. App. § 4 (1988). Section 4 in general provides that it is unlawful for any common carrier to charge a greater compensation for transportation for a shorter than for a longer distance. Section 4 also provides that, after investigation, the Commission in special cases may authorize the carrier to charge less for longer than for shorter distances so long as the Commission does not permit the establishment of any charge to or from the more distant point that is not reasonably compensatory for the service performed.

⁹ 18 C.F.R. § 341.15 (2005).

¹⁰ 18 C.F.R. Part 347 (2005).

¹¹ 18 C.F.R. § 388.112(b) (2005).

approval to use the proposed depreciation rates as of the date it acquired the Gathering System.

Intervention, Protest, and Answer

10. Protestants filed a timely joint motion to intervene and protest, asking the Commission to consolidate the two dockets for hearing and suspend the proposed rates, subject to refund.

11. Protestants claim that MarkWest developed the rate base underlying its tariff by inappropriately using a combination of claimed purchase or acquisition prices, a write-up of certain property, trending, and other irrelevant concepts, all of which would combine to require Protestants to overpay for the use of the assets.¹² Protestants state that MarkWest added an unwarranted component for the amortization of deferred return and an allowance for funds used during construction, thereby overstating its cost of service¹³ and resulting in rates that are substantially above Shell's previous rates, which violates the fundamental principle established in Opinion 154, that "[A] mere change in ownership should not result in an increase in the rate charged for a service *if the basic service rendered itself remains unchanged.*"¹⁴ Protestants claim that MarkWest improperly used the trended original cost (TOC) methodology set forth in Opinion 154-B to inflate its cost of service and various schedules that pertained to Shell's operations, because Shell never subjected itself to Commission jurisdiction and accordingly had no reason to use TOC.¹⁵ Further, Protestants state that, because Shell never filed interstate tariffs with the Commission, but nonetheless established charges (similar to SFPP's Sepulveda line where the pipeline entered into contracts instead of filing tariffs),¹⁶ Shell and its predecessors may have recovered their investment during the 30-plus years of

¹² Protestants cite *Williams Pipe Line Co.*, 21 FERC ¶ 61,120 at 61,635 (1982); *SFPP, L.P.*, 112 FERC ¶ 63,020 at P 24-33 (2005); and *Farmers Union Cent. Exchange v. FERC*, 734 F.2d 1486 (D.C. Cir. 1984).

¹³ Protestants cite *SFPP, L.P.*, 112 FERC ¶ 63,020 (2005).

¹⁴ Protestants cite *Williams Pipe Line Co.*, 21 FERC ¶ 61,120 at 61,635 (1982) (emphasis in the original).

¹⁵ Protestants cite *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985).

¹⁶ Protestants cite *SFPP, L.P.*, 112 FERC ¶ 63,020 at P 29 (2005).

operation of the Gathering System. Thus, argue Protestants, MarkWest's net investment base (\$9.169 million remaining as of the end of 1983) may be overstated.¹⁷

12. Protestants further assert that MarkWest appears to have improperly increased its purported cost of capital from a claimed hypothetical 50-percent equity/50-percent debt to an effective 66-percent equity/34-percent debt by recalculating the capital structure to reflect an unjustified deferred return. Protestants contend that MarkWest's use of a 9.78-percent equity rate of return is likely excessive and not consistent with the cost of equity to a limited partnership in the oil pipeline industry.¹⁸

13. According to Protestants, as a limited partnership, MarkWest should not add an income tax allowance into its current cost of service at the full federal and state income tax rate unless it is able to demonstrate that its investors will actually have a tax liability arising from the operations of the pipeline.¹⁹ Protestants question whether the claimed expenses for outside services, which comprise approximately 42 percent of MarkWest's total operating expenses (excluding depreciation) for the pipeline, have been properly determined.

14. Protestants maintain that MarkWest may have inappropriately selected the period of September 1, 2004, through August 31, 2005, as the base period for purposes of calculating its operating costs, throughput, and revenues. Further, continues MarkWest, after an investigation, the Commission likely will require adjustments so that the requested base period properly reflects a representative test period. Similarly, Protestants believe that MarkWest's reduction of test period volumes and revenues by six percent is inaccurate in light of existing trends and projections of oil production in the areas served by the pipeline.²⁰

15. Protestants argue that MarkWest's publication of a flat, across-the-board pipeline allowance on all shippers, regardless of the volumes or distances involved, is

¹⁷ Protestants cite *Boston Edison Co.*, 61 FERC ¶ 61,026 (1992); *Tarpon Transmission Co.*, 57 FERC ¶ 61,371 (1991).

¹⁸ Protestants cite *High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043 at P 126 (2005).

¹⁹ Protestants cite *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005).

²⁰ Protestants cite *Exxon Mobil Pipeline Co.*, 91 FERC ¶ 61,182 (2000).

unreasonable and inappropriately overcompensates the pipeline for losses it will not experience. Protestants also state that, from a rate design perspective, MarkWest has shifted an inappropriately high percentage of its cost-of-service recovery to parties that ship the shortest distances and thus have the least use of the pipeline assets and services. Accordingly, Protestants claim the proposed rate structure is unrelated to the cost of providing service, creates an inappropriate system of cross subsidies, and is otherwise inconsistent with competitive conditions in the industry, as well as Commission policy and precedent. Protestants claim that MarkWest's rate design reflects its market power over them and omits any discussion of the cost of operating the Gathering System or how those costs should be apportioned fairly among the customers.

16. Protestants also ask the Commission to reject MarkWest's filing in Docket No. DO06-2-000, which is its request for approval of depreciation rates. Protestants maintain that MarkWest has based these rates on overstated gross plant balances. Protestants also claim that it is inconsistent with the public interest and Commission policy and precedent²¹ for the proposed depreciation rates to become effective on the date of acquisition, rather than the date of the filing.

17. On December 12, 2005, MarkWest filed its answer, contending that it correctly applied Commission policies in developing its cost-of-service calculations and rate design. MarkWest asks the Commission to reject the protest or, at a minimum, to deny the request to suspend FERC Tariff No. 2 for seven months.

18. MarkWest challenges Protestants' assertion that it has conceded that the Gathering System is subject to ICA jurisdiction. MarkWest contends that Protestants did not raise this issue until they became unhappy with a proposed increase in intrastate rates for the Gathering System. According to MarkWest, Protestants have failed to present facts that support their position on jurisdiction. MarkWest argues that the intent of the shipper is important in determining whether a shipment is interstate or intrastate, even though the movement may be wholly within a single state.²²

19. Addressing Protestants' challenges to its proposed cost of service, MarkWest states that it has appropriately determined its rate base on historical original costs and then applied trending, one of the core principles of the Commission's oil pipeline

²¹ Protestants cite *SFPP, L.P.*, 112 FERC ¶ 63,020 at P 138-39 (2005).

²² MarkWest cites *Northville Dock Pipe Line Corp.*, 14 FERC ¶ 61,111 at 61,207 (1981); *see also Baltimore & Ohio S.W. R.R. Co. v. Settle*, 260 U.S. 166, 170 (1992).

ratemaking approach. Indeed, MarkWest contends that Protestants are proposing retroactive ratemaking. Further, continues MarkWest, the cases Protestants cite do not support their position on the issues in this case. MarkWest emphasizes its rate base is supported by Shell's records that reflect the application of straight-line depreciation, consistent with Commission precedent.

20. MarkWest maintains that it properly included deferred return and an allowance for funds used during construction, properly determined its capital structure, is entitled to a full income tax allowance, and properly determined its rate of return on equity. Likewise, MarkWest argues that it correctly determined its overhead expenses and applied the Commission's test period policies. MarkWest further refutes Protestants' challenges to its rate design, claiming that its rate design is consistent with Commission practice. Finally, continues MarkWest, Protestants' attack on its application to adjust its depreciation rates is conclusory and without substance and their requests for relief are inconsistent with long-standing Commission practice.

Discussion

21. The Commission finds that MarkWest has made an adequate initial showing that its tariff 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 Commission also finds that MarkWest's depreciation filing meets the requirements of 18 C.F.R. § 347.1 of the Commission's regulations, but there are questions as to the lawfulness of the depreciation rates used since MarkWest's purchase of the Gathering System, as well as the justness of its acquisition price. The issues in this case include but are not limited to the data and methods that MarkWest used to determine its proposed rates. The resolution of these factual disputes will have a rate impact on shippers using MarkWest's pipeline system. There is also to be resolved the fundamental issue of whether the transportation involved here is in interstate commerce. Accordingly, the Commission will establish hearing procedures to examine all the issues raised by the filings, including the base issue of whether the movements are in interstate commerce.

22. The Commission has consistently encouraged parties to resolve disputes of this nature through settlement, and the Commission concludes that formal settlement procedures may lead to a resolution of this case.²³ Therefore, the Commission will hold the hearing in abeyance pending the outcome of formal settlement procedures in this

²³ See 18 C.F.R. § 343.5 (2005), which states that the Commission will refer all protested rate filings to a settlement judge pursuant to 18 C.F.R. § 385.603 (2005).

matter. To aid the parties in their settlement efforts, a settlement judge shall be appointed pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.²⁴ If the parties desire, they may, by mutual agreement, request a specific judge; otherwise, the Chief Judge will select a judge for this purpose.²⁵

Suspension

23. Based upon a review of the filing, the Commission finds that MarkWest's tariff filing has not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, pursuant to section 15(7) of the ICA, the Commission will accept the tariffs listed in footnote number 2 above for filing and suspend them, to become effective January 1, 2006, consistent with the Commission's policy established in *Buckeye Pipe Line Company*,²⁶ subject to refund and subject to the conditions set forth in the body of this order and in the ordering paragraphs below. The issues raised by the Protestants relating to MarkWest's depreciation filing in Docket No. DO06-2-000 are also set for hearing.

The Commission orders:

(A) Pursuant to the authority contained in the ICA, particularly section 15(7) thereof, MarkWest's instant tariffs, FERC Tariff Nos. 1 and 2 are accepted for filing and suspended, to become effective January 1, 2006, subject to refund and subject to further order of the Commission. MarkWest's depreciation filing in Docket No. DO06-2-000, including the gross balances, resulting rates, and proposed effective date is also set for investigation and hearing.

(B) Pursuant to the authority contained in the ICA, particularly section 15(1) thereof, and the Commission's regulations, a hearing is established to address the issues raised by MarkWest's instant filings in Docket Nos. IS06-41-000 and DO06-2-000.

²⁴ 18 C.F.R. § 385.603 (2005).

²⁵ If the parties decide to request a specific judge, they must make their joint request to the Chief Administrative Law Judge by telephone at (202) 219-2500 within five days of issuance of this order. The Commission's website contains a list of the Commission's judges and a summary of their background and experience at www.ferc.gov/legal/oalj/bio/judges.htm.

²⁶ 13 FERC ¶ 61,267 (1980).

(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 (2005), 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.

(D) The hearing established in Ordering Paragraph (B) above is hereby held in abeyance pending the outcome of the settlement proceedings described in the body of this order.

(E) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2005), the Chief Administrative Law Judge is directed to appoint a settlement judge in this proceeding within 10 days of the issuance of this order. To the extent consistent with this order, the designated settlement judge shall have all the powers and duties enumerated in Rule 603 and shall convene an initial settlement conference as soon as practicable.

(F) Within 60 days of the issuance of this order, the settlement judge shall file a report with the Chief Administrative Law Judge and the Commission on the status of the settlement discussions. Based on this report, the Chief Administrative Law Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to an ALJ for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every 30 days thereafter, informing the Chief Administrative Law Judge and the Commission of the parties' progress toward settlement.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.