

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Trans Alaska Pipeline System, <i>et al.</i>	Docket No. OR89-2-016
Exxon Company, U.S.A. v. Amerada Hess Pipeline Corporation, <i>et al.</i>	Docket No. OR96-14-005
Tesoro Alaska Petroleum Company v. Amerada Hess Pipeline Corporation, <i>et al.</i>	Docket No. OR98-24-000
BP Pipelines (Alaska), Inc.	Docket No. IS03-137-000
ExxonMobil Pipeline Company	Docket No. IS03-141-000
Phillips Transportation Alaska, Inc.	Docket No. IS03-142-000
Unocal Pipeline Company	Docket No. IS03-143-000
Williams Alaska Pipeline Company, L.L.C.	Docket No. IS03-144-000

OPINION No. 484; OPINION and ORDER ON INITIAL DECISION

(Issued May 2, 2006)

APPEARANCES

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1. This matter is before the Commission on the exceptions to the Supplemental Initial Decision issued June 16, 2005, by the Presiding Administrative Law Judge (ALJ) in this proceeding.¹ The proceeding involves the Trans Alaska Pipeline System (TAPS) Quality Bank, which is the method of making monetary adjustments among shippers on TAPS of Alaska North Slope (ANS) crude that is necessary because different qualities of oil are commingled on TAPS.² The Quality Bank either compensates or charges a shipper for the difference in quality between the crude oil tendered by that shipper and the crude oil received by that shipper. Under the existing distillation methodology the crude oil stream is separated into its component parts, or “cuts” of petroleum products such as Propane and Naphtha, then market values are assigned to each cut, and each shipper’s delivery is valued in accordance with the volume-weighted price of its component parts. At issue

¹ 111 FERC ¶ 63,068 (2005) (Supplemental ID).

² The extensive history of Quality Bank litigation is set forth in an August 31, 2004 Initial Decision in this proceeding, 108 FERC ¶ 63,030 (2004) (TAPS ID), and Opinion No. 481,113 FERC ¶ 61,062 (2005), Order on Rehearing, 114 FERC ¶ 61,323 (2006).

before the ALJ was a proposed adjustment to the valuation of the Gulf Coast Naphtha cut. When that adjustment was proposed, the Gulf Coast Naphtha cut value was used to value the West Coast Naphtha cut. The ALJ rejected the proposed adjustment. This order affirms the ALJ.

Background

2. In an order issued November 7, 2001,³ the Commission set for hearing a number of issues relating to the valuation of certain Quality Bank cuts. Before the hearing the parties agreed that nine issues should be litigated. Issue Number 3 related to the valuation of the West Coast Naphtha cut. Since there was no published Naphtha price on the West Coast, the Commission had directed that Platts Gulf Coast (full range) published Naphtha price should be used to value the TAPS Quality Bank Naphtha cuts on both the Gulf Coast and West Coast. However, parties challenged this claiming circumstances had changed, and Issue No. 3 was “Whether the current method for valuing the West Coast Naphtha Cut is just and reasonable, and if not, what is the appropriate method for valuing the Naphtha cut”?⁴

3. In addition, the TAPS Quality Bank Administrator (QBA) had proposed, and the TAPS Carriers implemented his proposal in tariff filings, that the Gulf Coast Naphtha cut should use a new Platts Gulf Coast price assessment for “heavy” Naphtha, which Platts began publishing in February 2003, instead of the Platts Gulf Coast price assessment for full range Naphtha. The reason for the change was that the Naphtha produced from ANS crude was much closer to the product specifications used by Platts for its heavy Naphtha price assessment. When some parties protested the filings, the Commission accepted and suspended the tariff filings, and set that issue for hearing in the ongoing TAPS proceeding.⁵ In the TAPS ID the ALJ approved the proposal as just and reasonable.⁶

³ 97 FERC ¶ 61,150 (2001).

⁴ After the hearing commenced it became clear that the issues Numbers, 6, 7, and 8, “the intra-cut quality” issues, could not be properly addressed until an Initial Decision was issued on all the other issues. Accordingly, the parties filed a joint stipulation wherein the parties agreed to hold claims relating to those issues in abeyance until after the Initial Decision, but preserved their right to raise them again at a later date, and offer further evidence on the intra-cut issues on a limited basis.

⁵ *BP Pipeline (Alaska), Inc., et al.*, 102 FERC ¶ 61,345 (2003).

⁶ 108 FERC at 65,607 P 2739.

4. At the hearing, certain parties also contended that an N+A adjustment to the Gulf Coast Heavy Naphtha price was required which would apply to the value of the West Coast Naphtha cut as well. N+A refers to the volume percent of Naphthenes plus the volume percent of Aromatics. When a material is referred to as having a 40 N+A, it means that 40 percent of the material is Naphthenes and/or Aromatics.⁷ The effect of the adjustment would be 1.5 cents per gallon increase in the value of the Gulf Coast Naphtha cut. In support of their proposed adjustment, the parties argued that the TAPS QBA had been told by a Platts employee that Platts bases its published Gulf Coast Naphtha price assessments on the assumption that the Naphtha has an N+A of 40. The employee stated that Platts adjusts for higher values of N+A by adjusting the price by 0.15 cents per gallon per percent N+A above 40, up to an N+A of 50, for an overall adjustment of 1.5 cents per gallon. They asserted that since the undisputed evidence was that the Naphtha produced from ANS crude has an N+A greater than 55, it follows that the QBA should add 1.5 cents per gallon to the Platts Gulf Coast price assessment for heavy Naphtha to reflect the higher N+A content of the Quality Bank Naphtha cut.

5. In the TAPS ID the ALJ found that the Quality Bank's use of the Platts Gulf Coast Naphtha price assessment to value the Naphtha cut on the West Coast was not just and reasonable, and concluded that the Tallett methodology should be used to value West Coast Naphtha.⁸ The ALJ also held that the proposed N+A adjustment was sufficiently similar to the intra-cut quality issues that it should be deferred until the next phase of the TAPS proceeding when those other issues would be considered. However, he also stated there was not substantial evidence in the record to support the conclusion that an N+A adjustment should be made, and therefore he rejected the proposed adjustment.⁹

6. After issuance of the TAPS ID the parties filed a joint motion requesting the ALJ to "confirm the tentative ruling in the Initial Decision on the issue of the proposed N + A

⁷ The most fundamental of the Naphthenes are benzene, toluene and xylene, 108 FERC ¶ 63,030 at P 749 n.309.

⁸ *See* 108 FERC at 65,606 P 2730. Tallett's regression formula establishes relationships between Gulf Coast Naphtha's value as a feedstock and the prices of end-products derived from it, namely gasoline and jet fuel. Those relationships and West Coast prices are then used for those same end-products to calculate the value of West Coast Naphtha. *Id.* at P 459-531.

⁹ 108 FERC at P 2750-51.

adjustment,” enabling the parties to file exceptions to that ruling.¹⁰ The ALJ granted the motion in the Supplemental ID, and issued a merits ruling on the proposed N+A adjustment based upon the record in the TAPS ID proceeding.

The ALJ’s Ruling

7. The ALJ determined that “all of the evidence relating to whether Platts makes an N+A adjustment and, if so, what the amount of that adjustment is and how it is applied, consists of hearsay reports of comments made by one employee of Platts, whose comments have been interpreted differently by the witnesses.”¹¹ The ALJ therefore held that the proponents of the N+A adjustment failed to carry their burden of proof, since there was insufficient evidence regarding the practices used by Platts to adjust Gulf Coast Naphtha prices to reflect differences in N+A content.

8. In the Supplemental ID the ALJ also stated that “[a]lthough there are certain cost-based adjustments to finished market-priced products used to value their intermediate product TAPS stream counterparts, none of these adjustments are currently made for the purpose of representing intra-cut differential qualities (such as N+A) of any of the nine cuts that constitute the TAPS combined crude stream.”¹² The ALJ further stated that the cost-based adjustments provide consistent cut values across the Quality Bank, whereas, the N+A “quality cut differential” forces an inconsistency in the valuing of the products or cuts. The ALJ also found that adjusting the West Coast Naphtha value for N+A content would add an additional level of analysis only to the Naphtha cut resulting in an inappropriate valuation of the Naphtha cut relative to the methods used to calculate the other cuts. Finally, he stated that even if an N+A adjustment was appropriate the evidence had not established “that refineries on the West Coast, namely California, would pay more for ANS crude with an N+A of 55 than crude with an N+A of 40.”¹³

¹⁰ May 10, 2005 Joint Motion of All Parties For resolution of remaining Issues, at 3. The motion also provided for the withdrawal of pending Issues Nos. 6, 7, and 8, see n. 4, *supra*.

¹¹ 111 FERC ¶ 63,068 at 65,384 P 21. Two witnesses testified what the Platts employee told each what his practice was with respect to adjusting the Naphtha price for the N+A content.

¹² *Id.* at 65,385 P 31.

¹³ *Id.* at 65,386 P 33.

Exceptions and Subsequent Matters

9. Exxon Mobil Corporation (Exxon) and Tesoro Alaska Company (Tesoro) (jointly EM/T) and ConocoPhillips Alaska, Inc. (Conoco) filed Brief on Exceptions. Both assert that there was substantial evidence that established the need for an N+A adjustment. Moreover, they argue that such an adjustment is not an “intra-cut” adjustment, and providing for that adjustment is consistent with other Commission-approved adjustments. In fact, they contend, rejecting the proposed adjustment conflicts with the decision of the Court of Appeals in *OXY USA, Inc. v. FERC*, 64 F.3d 679, 693-94 (D.C. Cir. 1995) (*OXY*). They argue that *OXY* held that the Quality Bank must adjust the reported price assessments that are used to value Quality Bank cuts where there is a difference between the quality specified for the product being valued by the reported price assessment and the quality of the Quality Bank cut. That, they contend, is the very situation present here with the higher N+A content of ANS crude.

10. Briefs Opposing Exceptions were filed by BP Exploration (Alaska) Inc. and BP America Production Company (BP), Petro Star, Inc., Union Oil Company of California and OXY USA, Inc., Williams Alaska Petroleum, Inc., and Flint Hills Resources Alaska.

11. Subsequently, in Opinion No. 481, *supra* n.2, the Commission affirmed the ALJ’s ruling that the valuation of the West Coast Naphtha cut should not be based on the Gulf Coast Naphtha price, and accepted the Tallett methodology for valuing the West Coast Naphtha cut, and in Opinion No. 481-A, the Commission denied rehearing on these rulings.¹⁴ As a result, the proposed N+A adjustment would only have application to the Gulf Coast Naphtha cut, and would only be effective prospectively. Proponents of the N+A adjustment state in their exceptions that “there currently are no deliveries of ANS to the Gulf Coast.”¹⁵ Accordingly, since there now is a separate West Coast Naphtha cut value unrelated to the valuation of the Gulf Coast Naphtha cut, they recognize that the issue of whether there should be an N+A adjustment for Gulf Coast Naphtha “will not have any impact on Quality Bank payments and receipts.”¹⁶ While we could dismiss the

¹⁴ 113 FERC at 61,189 P 96 and 61,192 P 133, and 114 FERC 61,323 (2006). Neither EM/T nor Conoco propose any N+A adjustment to the Tallett methodology in valuing the West Coast Naphtha cut. *See* EM/T Exceptions at 13, Conoco Exceptions at 11.

¹⁵ Conoco Exceptions at 5.

¹⁶ *Id.* at 6.

exceptions as moot, we will address the issue on the merits in case circumstances change and there were deliveries of ANS crude to the Gulf Coast.¹⁷

Discussion

1. Did Evidence Establish That an N+A Adjustment Was Required?

12. Both EM/T and Conoco contend that the ALJ erred when he rejected the N+A adjustment for the reason that there was no agreement as to what the Platts employee said he did with respect to making an N +A adjustment, or what Platts policy was with respect to such an adjustment. They argue that given this alleged conflict, the ALJ had erroneously concluded that “though hearsay is admissible in these proceedings, it cannot be construed to constitute substantial evidence in the circumstance presented here.”¹⁸

13. The proponents of the N+A adjustment had relied on what the QBA stated he had been told by a Platts employee as to what Platts did to adjust for differences in N+A content of the Gulf Coast Naphtha. Those opposed to the proposed adjustment introduced testimony of another person, who testified to what he had been told by that Platts employee. There were differences between what each recounted of their conversation with the Platts employee.

14. In their exceptions proponents assert that while there was some disagreement as to what the Platts employee said, these were only minor differences, differences which did not undermine the evidence that Platts makes an adjustment for higher than 40 N+A content. They assert that while there were differences in the testimony, the record establishes that: (1) Platts bases its Gulf Coast Naphtha price assessments on an N+A that is much lower than the N+A of the Quality Bank Naphtha cut; (2) the N+A differential of more than 15 percentage points makes the Naphtha produced from ANS crude significantly more valuable than the Naphtha on which the Platts Naphtha price assessments are based; and (3) the proposed N+A adjustment of 1.5 cents per gallon is a reasonable way to reflect that difference in value.

¹⁷ We will not address any issue relating to the West Coast Naphtha cut since the Commission approved the Tallett methodology for valuing that cut, and that valuation is no longer related to the valuation of the Gulf Coast Naphtha cut.

¹⁸ 111 FERC at 65,386 n.13.

15. We find no error in the ALJ's ruling that there was not substantial evidence to establish that Platts made an N+A adjustment to the Gulf Coast Naphtha price that would justify the 1.5 cent adjustment that the proponents seek. The evidence consisted of hearsay statements of a Platts employee as reported by two different witnesses at the hearing, and the ALJ did not discount the evidence because it was hearsay, but discounted it because it was in conflict.

16. The most compelling evidence for proponents of the N+A adjustment was that a Platts employee stated that he makes some adjustment to the Platts reference price for N+A content. This is not comparable to the type of price quotation information that is used to value other Quality Bank cuts.

17. Platts publishes a guide to its specifications that describes quality parameters for its price quotes. There is no dispute that the current ANS naphtha cut meets the quality specifications actually published for the heavy naphtha reference product.¹⁹ If the N+A adjustment was an adjustment that was consistently applied by Platts, it would be mentioned in the Platts Guide to Specifications (Guide). However, there is no N+A adjustment mentioned in the Guide. In fact, unlike its (full range) Naphtha quote, for the Heavy Naphtha quote, Platts does not even document that the base N+A level for Heavy Naphtha is 40; there simply is no mention of N+A whatsoever.

18. Moreover, the proponents of adopting the proposed change did not produce the Platts employee whose statements were the basis of the proposal so that his practice of an unpublished adjustment could be clarified and subjected to cross examination. The failure to produce the key witness on whom the proponents rely, supports the ALJ's decision that the proponents did not carry their burden of proof.

19. Objectors also point out that there could be other adjustments that are made to other cuts which are not reflected in the published guide. They note that there are dozens of quality adjustments that could be made but are not in the current methodology. Thus, in addition to N+A one witness listed 26 other properties affecting six of the eight Quality Bank cuts that could be measured and taken into account in the methodology. These include four or five quality parameters that can be measured for each of the following cuts: LSR, Naphtha Light Distillate, Heavy Distillate, VGO, and Resid.²⁰ In fact, even with respect to Naphtha, one could measure, in addition to N+A, Octane Value, Sulfur Level and Mercaptans. It follows that if the Commission approved an N+A

¹⁹ See Ex. WAP-262.

²⁰ See Ex. UNO-7.

adjustment for the Naphtha cut, then credible arguments could be made for secondary quality adjustments to *all* the liquid cuts in the Quality Bank, which could lead to further rounds of litigation.

2. Is the N+A Adjustment Similar to an Intra-Cut Matter or Similar to Other Price Adjustments the Commission Permits?

20. A second reason why the ALJ rejected the proposed N+A adjustment was because he held it is an “intra-cut differential” in quality that “would add an additional level of analysis only to the Naphtha cut.”²¹ Proponents assert that there is no logical basis for this contention. They argue that the so-called “intra-cut” adjustments which the ALJ referred to involved the assignment of different values to the same cut based on differences in the crude oils produced from the different ANS fields. They contend that here no such “intra-cut” quality issues are presented by the proposed N+A adjustment, which would apply equally to all the streams that make up the common TAPS stream.

21. Moreover, they assert that in *OXY*, the D.C. Circuit held that the Commission is required to “accurately value all cuts,” and that this obligation requires the Commission to adjust a reported market price where that price does not accurately reflect the value of the Quality Bank cut.²² Since the Commission allows adjustments for other cuts, to not allow the N+A adjustment would run counter to the Court’s admonition in *OXY*.

22. Proponents assert that the N+A adjustment is necessary to value accurately the particular Quality Bank cut on the basis of a reported market price that reflects a product quality that is different from the quality of the Quality Bank cut. Such an adjustment, they assert, is required in order to put the Quality Bank Naphtha value on the same basis as the published reference price for Naphtha, similar to the sulfur processing cost adjustment that is applied by the Quality Bank to reflect the difference in the quality of the Heavy Distillate produced from ANS crude and the quality of the Heavy Distillate reflected in the reported Platts price assessment that is used to value the Heavy Distillate cut. Proponents argue that to not allow this adjustment would run counter to the Court’s admonition in *OXY*.

²¹ 111 FERC at 65,385-86 PP 31-32.

²² *OXY*, 64 F.3d at 693-94.

23. We find no merit in these contentions. Proponents' reliance on *OXY* is misplaced. There the Court addressed the straightforward question of whether a petroleum product can be sold at full price if it fails to meet specifications. Accordingly, with respect to the Heavy Distillate cut, the Commission required that the costs of bringing a product into conformance with appropriate specifications must be subtracted from a published reference price, and adopted the practice that expert testimony would be used to establish the magnitude of those costs.²³

24. The proposed N+A adjustment is a completely different type of adjustment. The proposal seeks to add to the published price because the product exceeds specifications. Nor is there any published guide that would determine how the adjustment would be made. The ALJ explained that under the current Quality Bank, certain cost-based adjustments are made to finished market-priced products in order to value the TAPS intermediate product counterparts. However, the N+A adjustment represents an intra-cut quality difference, designed to adjust the value of a single Quality Bank cut or stream based on differences other than cost-based differences. Thus, the ALJ correctly concluded that application of the N+A adjustment would result in an inconsistent valuation of the Quality Bank cuts.

25. Moreover, objectors note that other adjustments could be requested for other cuts where ANS product might exceed specifications. If the Commission approved the type of subjective, non-published, non-cost-based adjustment to the published Heavy Naphtha price proposed here, then the Commission would be required to evaluate whether any similar non-published, non-cost-based adjustments are made to any of the other reference prices relied upon by the Quality Bank and adopt those same adjustments to the value used for those cuts. Anything short of a full review of other specification-based adjustments that could be made to other Quality Bank cuts would fail the D.C. Circuit's consistency requirement. The ALJ correctly pointed out that *OXY* would not allow Naphtha to be singled out for a premium without considering all the other cuts.²⁴

26. *OXY* established a relative standard in its decision. Thus, the Commission must look to the valuation of all the Quality Bank cuts to determine if they are being overvalued or undervalued by approximately the same degree. Here, the proposed N+A adjustment is a non-cost-based, unpublished price adjustment that would modify the

²³ See *Trans Alaska Pipeline System*, 81 FERC 61,319 at 62,462-63 (1997) (issue concerning the level of adjustment necessary to bring Heavy Distillate into line with specifications for Platt's West Coast LA Pipeline Low Sulfur No. 2 fuel oil).

²⁴ 111 FERC at 65,386 P 32.

published price of a product which covers the quality of the corresponding ANS cut. Thus, an N+A adjustment would treat Naphtha differently than any other cut, and thus would lead to inconsistency in valuation among the cuts, contrary to *OXY*.

The Commission orders:

The Supplemental Initial Decision issued June 16, 2005, is hereby affirmed.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.