135 FERC ¶ 61,172
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Five-Year Review of Oil Pricing Index Docket No. RM10-25-001

ORDER DENYING REQUEST FOR REHEARING

(Issued May 23, 2011)

1. On December 16, 2010, the Commission issued an order establishing an oil pipeline index level of the Producer Price Index for Finished Goods plus 2.65 percent (PPI-FG + 2.65) for the July 1, 2011- June 30, 2016 period.[1] Several parties have filed requests for rehearing. For the reasons discussed below, the Commission denies the rehearing requests.

Background

2. The 2010 Index Order resulted from the Commission's five-year review of the oil pipeline index level. In Order No. 561, the Commission established an indexing methodology for the purpose of allowing oil pipelines to change rates without making cost-of-service filings. The Commission developed the indexing methodology following the mandate from Congress in the Energy Policy Act of 1992 (EPAct 1992) to establish a "simplified and generally applicable" ratemaking methodology for oil pipelines[2] that was consistent with the just and reasonable standard of the Interstate Commerce Act (ICA).[3] Following Order No. 561, the Commission reviewed the index level every five years.

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[1] *Order Establishing Index for Oil Price Change Ceiling Levels*, 133 FERC ¶ 61,228 (2010) (2010 Index Order).

[2] Pub. L. No. 102-486 § 1801(a), 106 Stat. 3010 (Oct. 24, 1992). The EPAct 1992's mandate of establishing a simplified and generally applicable method of regulating oil transportation rates specifically excluded the Trans-Alaska Pipeline System (TAPS), or any pipeline delivering oil, directly or indirectly, into it. *Id.* § 1804(2)(B).

[3] 49 U.S.C. App. § 1 *et seq.* (1988).

During this time, the Commission adhered to the Kahn Methodology to determine the index level and set the index at PPI-FG plus or minus an adjustment factor.[4]

3. On December 16, 2010, the Commission conducted its third such five-year review of the oil pipeline index, establishing an oil pipeline index level of PPI-FG + 2.65 for the next five-year period of July 1, 2011- June 30, 2016.[5]

Request for Rehearing

4. On January 19, 2011, Valero Marketing and Supply (Valero), Air Transport Association of America (ATA), and Tesoro Refining and Market Company and Sinclair Oil Corporation (Sinclair/Tesoro) submitted requests for rehearing of the Index Order. National Propane Gas Association (NPGA), FLO-GAS Propane Services (FLO-GAS), and several individuals also filed comments.

A. Rate Based Screening Methodology

5. Valero and ATA claim in their requests for rehearing that the 2010 Index Order erred by rejecting the "rate base screening" methodology proposed by Valero's expert Matthew O'Loughlin. The "rate base screening" methodology modifies the data set used to determine the index adjustment factor in the Kahn Methodology. Under this rate base screening methodology, a pipeline is removed from the data set if a pipeline's rate base increased or decreased by more than 50 percent during the preceding five-year period of 2004-2009 period and if one of the following conditions are met: (a) the pipeline sought recovery of cost changes during the 2004-2009 period through means other than incremental rate increases via the index, such as a cost-of-service filing or a settlement agreement; (b) the pipeline experienced a major divestiture; or (c) the pipeline acquired another pipeline where the pipeline divesting the assets continued to exist after the divestiture.

6. On rehearing, Valero and ATA assert that the Commission erred by including pipelines in the data set that the rate base screening methodology would exclude. In its rehearing request, Valero claims the 2010 Index Order miscomprehended the proposed rate base screening methodology. Specifically, Valero contends that the 2010 Index Order erroneously concluded that the rate base screening methodology excluded pipelines solely due to large rate base changes. Valero states that although the methodology

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[4] The 2010 Index Order provides a more extensive discussion of the historical development of the Index and the Kahn Methodology. 133 FERC ¶ 61,228 at P 2-9.

[5] *Id.* P 1.

initially evaluates rate base changes, it does not remove pipelines based solely upon these rate base changes.

7. Valero and ATA also contend the rate base screening methodology is consistent with the Commission's prior treatment of anomalous data and extraordinary costs. Valero and ATA assert the Commission has routinely removed pipelines with erroneous, anomalous, or missing data. They add that the Commission has excluded the TAPS pipeline owners from the data sample because the TAPS pipeline rates are not subject to indexation. Valero and ATA further assert that the Commission's treatment of Ultra Low Sulfur Diesel (ULSD) surcharges is consistent with the rate base screening methodology. They state that the Commission allowed the pipelines to recover associated ULSD costs through a surcharge and explained that it would exclude these costs in determining the index levels.[6] Valero elaborates that ULSD costs are no more "extraordinary" than the expansion costs that result in large rate base changes, especially given that all pipelines that transport ULSD will incur the ULSD-related costs and that the ULSD costs were of a lower magnitude than those associated with expansions. Valero further contends the rate base screening method does not impose any additional material burden on the Commission and is within the limits of a "simplified and generally applicable ratemaking methodology" mandated by Congress in EPAct 1992.

8. Valero asserts the 2010 Index Order does not justify the inclusion of pipelines identified by Mr. O'Loughlin where acquisitions or divestitures could not be accounted for by merging or combining data resulting in cost comparisons between 2004 and 2009. For this group of pipelines, Valero contends the unit cost changes are inappropriate and unrepresentative. Accordingly, Valero submits the Commission should remove these pipelines from the index data set.

9. Valero states that failure to apply the rate base screening methodology causes an upward bias. Valero states this occurs because, once the pipelines with large rate base changes are removed from the data set: (a) these pipelines cannot be included in the middle 50; and (b) other pipelines with relatively large or small overall cost changes will be excluded from the middle 50 in place of the pipelines that were removed due to the rate base screening methodology. Valero states its analysis shows that application of the rate base screening methodology changes the range in the middle 50 percent from cost growth rates between 0.1 percent and 15.2 percent to -0.1 percent and 10.7 percent growth over the five-year period, or an overall downward movement of 4.3 percent.

10. Moreover, Valero continues to argue that including pipelines with alternative rate change mechanisms in the index adjustment calculation causes double-counting. Valero

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[6] Valero Request for Rehearing at 35-36 (citing *Magellan Pipeline Co.*, 115 FERC ¶ 61,276 (2006); *SFPP, L.P.*, 118 FERC ¶ 61,267 (2007)).

posits that if the index is based on cost-change data that includes the cost increases already being recovered using an alternative rate change mechanism, these costs will be double-counted, once in the alternate rate change mechanism and a second time in the cost change that is the basis for the index.

11. Valero and ATA also challenge the 2010 Index Order's distinction between "normal" and "extraordinary" costs. Valero and ATA argue the 2010 Index Order suggests the term "extraordinary" only has a numerical meaning as a statistical outlier that is excluded when using the middle 50 percent. However, Valero and ATA contend the Commission has used the terms "extraordinary" when identifying the types of costs that the Commission should exclude from the index.

Commission Determination

12. The Commission denies Valero and ATA's request for rehearing of its decision not to adopt the rate base screening methodology. The rehearing requests fail to undermine the conclusions of the 2010 Index Order that the rate base screening methodology selectively emphasizes one factor that may cause a substantial change in pipeline costs per barrel-mile while ignoring other factors.[7] On rehearing, Valero argues the Commission erred by characterizing the rate base screening methodology as emphasizing one cost factor. Rather, Valero states that the rate base screening methodology only excluded from the data set pipelines that both experienced a rate base change exceeding 50 percent and also satisfied additional criteria, such as seeking alternative cost recovery mechanisms, undergoing an acquisition or divestiture, or reporting materially erroneous data. Thus, Valero argues that the Commission "miscomprehended" the rate base screening methodology.

13. Contrary to Valero's assertions, the 2010 Index Order fully described the steps necessary to perform the rate base screening methodology.[8] Despite this rather extensive discussion, to support the argument that the Commission miscomprehended the proposed rate base screening methodology, Valero quotes one sentence from the 2010 Index Order which states, "By selectively modifying the data set based upon one potential cause for cost changes, Mr. O'Loughlin risks distorting the index calculation."[9] However, when read in the context of the entire 2010 Index Order, this sentence merely presents the uncontestable fact that the application of the rate base screening methodology required as

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[7] 2010 Index Order, 133 FERC ¶ 61,228 at P 49.

[8] *Id.* P 34, 50 n.29.

[9] Valero Request for Rehearing at 34 (quoting 2010 Index Order, 133 FERC ¶ 61,228 at P 49).

a first step the presence of a rate base change and ignored pipelines experiencing changes in per barrel-mile costs due to other factors (such as shifting customer demand, increased competition, economic changes, or changing product supplies). A hypothetical illustrates the point. Consider pipeline A and pipeline B which both experienced the same level of total cost changes and both of which filed for cost-of-service increases. However, pipeline A experienced a rate base change of 50 percent or more during 2004-2009 and pipeline B did not. In this hypothetical, the rate base screening methodology would remove pipeline A from the data set (due to the rate base change) while retaining pipeline B in the data set despite the fact that the two pipelines experienced the same level of total cost changes. In the 2010 Index Order, the Commission properly construed the proposed rate base screening methodology as emphasizing one potential cause for cost changes (rate base increases or decreases) while ignoring others.

14. The rate base screening methodology also represents a departure from the Commission's practices under the Kahn Methodology. On rehearing, Valero and ATA claim that the rate base screening methodology is analogous to other data set trimming methods used by the Commission in the past. Specifically, they compare the rate base screening methodology to: (1) the removal of pipelines with incomplete or inaccurate data; (2) the exclusion of the TAPS pipelines from the data set; and (3) the exclusion of the costs related to the ULSD surcharge from the data used to calculate the index. They state that these prior practices demonstrate that the Commission considers factors other than cost change to trim the data set and that the rate base screening process is consistent with the prior practices under the Kahn Methodology.

15. The comparisons are inapposite. First, although the Kahn Methodology removes from the data set those pipelines that reported erroneous or incomplete data, erroneous or incomplete data differ from the accurately reported actual costs Valero and ATA seek to remove using the rate base screening methodology. As an initial matter, if data for a particular year is missing, then it may be impossible to perform the calculations required by the Kahn Methodology. Thus, pipelines with missing data must be removed from the data set. More fundamentally, erroneous and incomplete data do not reflect actual pipeline cost changes. In contrast, Valero's rate base screening methodology seeks to exclude pipelines based upon costs that were actually incurred, accurately reported, and that are part of the costs that the pipeline may recover.[10] For these actual and accurately reported costs as opposed to erroneous data, the Kahn Methodology has relied upon data trimming using the middle 50, not an assessment of the particular underlying causes for the relatively large increase or decrease in pipeline costs.

16. Second, regarding the examples of the TAPS pipelines, the TAPS pipelines are easily identifiable and not subject to the index adjustment due to the provisions of the

[10] 2010 Index Order, 133 FERC ¶ 61,228 at P 51-52.

EPAct.[11] In contrast, the pipelines excluded by the rate base screening methodology have rates that are subject to the index.

17. Third, Valero and ATA's analogy to the ULSD surcharge is also misplaced. The ULSD surcharge is a special surcharge outside the normal indexed rates. The surcharge applies to costs incurred due to Environmental Protection Agency (EPA) regulations that affected a subset of pipelines transporting certain diesel products. For the pipelines that requested it, the ULSD costs were recovered in an entirely separate rate that was not subject to increases pursuant to the index.[12] The ULSD surcharge was assessed on shippers of ULSD only, and not shippers of other distillates. Because these charges were recovered in a separate surcharge and not the base transportation rates, the Commission concluded that these should be excluded from the data used to calculate the indexed rates.[13]

18. The rate base screening methodology differs from the ULSD surcharge in several respects. The Commission is not persuaded by Valero's argument that rate base changes, like the ULSD costs, only benefit some shippers. Although, any capital expenditure or operational cost incurred by a particular pipeline will generally only benefit the group of shippers on that pipeline, Valero disregards the more fundamental distinction between rate base and the ULSD costs. Rate base costs apply to all industry participants because all pipelines incur investment costs related to building and maintaining rate base and the very existence of the pipeline depends upon these expenditures. In contrast, only a limited subset of pipelines transporting particular diesel products incurred the ULSD charges. Moreover, unlike the ULSD surcharge, rate base related costs are to be recovered through the primary transportation rates. In contrast, for those pipelines with a ULSD surcharge, the ULSD related costs are recovered via means other than the primary transportation rates. Thus, when a pipeline seeks a cost-of-service filing to change the primary transportation rates, the pipeline is still seeking to recover the type of costs that are subject to the index.

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[11] The EPAct 1992 specifically excluded the TAPS pipelines from the simplified and generally applicable method of regulating oil transportation rates. Pub. L. No. 102-486 § 1804(2)(B) (1992).

[12] *Magellan Pipeline Co.*, 115 FERC ¶ 61,276, at P 8 (2006).

[13] *Id.* P 13 ("Since Magellan will be recovering its investment in plant and operation and maintenance expenses to comply with the ULSD requirements through a separate surcharge, it would not be proper to also include Magellan's ULSD surcharge costs in determining the industry wide oil pipeline price index. Otherwise, the data used to calculate the oil pipeline index that is intended to permit pipelines to recover normal oil pipeline industry wide costs, would be skewed.").

19. On rehearing Valero argues that failure to apply the rate base screening methodology will cause double counting of increased costs, "once in the alternate rate change mechanism and a second time in the cost change that is the basis for the Index…."[14] Valero's double-recovery argument incorrectly equates: (a) the data set used to determine the index adjustment factor pursuant to the five-year review; and (b) the annual indexation of each individual pipeline's transportation rates. Regarding the data set used in the five-year review, to exclude from the data set pipelines that sought cost-of-service rate changes in the base transportation rate distorts the index because "[t]he changing costs that compelled the pipeline to seek recovery outside the indexing methodology nonetheless reflect industry cost experience."[15] The Commission allows pipelines to file annual rate changes pursuant to the index to account for cost changes;[16] excluding pipelines experiencing these divergent costs from the data set would mean that the index does not reflect the evolving nature of pipeline costs. A pipeline is not recovering its costs twice when it seeks an increase via cost-of-service filing in one year and then in later years applies an index rate increase that is derived primarily to compensate carriers for industry-wide annual cost changes.

20. Moreover, Valero's argument regarding double-recovery is internally inconsistent. As noted previously in this order, Valero does not propose to remove all pipelines that experienced cost changes leading to cost-of-service rate increases. To be excluded by Valero, the pipeline must also have experienced a rate base change of at least 50 percent. Thus, pipelines that filed cost-of-service increases and that did not have a change in rate base of 50 percent remain in the data set used by Valero. Yet Valero makes no effort to address "double-recovery" for these pipelines that did not experience rate base changes of 50 percent. This inconsistent treatment of pipelines filing new cost-of-service rates further demonstrates that the rate base screening methodology attaches undue significance to one particular kind of cost change and undermines the double-recovery argument.[17]

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[14] Valero Request for Rehearing at 49.

[15] 2010 Index Order, 133 FERC ¶ 61,228 at P 53.

[16] 18 C.F.R. § 346.3 (2011).

[17] Valero's witness, Mr. O'Loughlin, explained that he only limited his analysis to pipelines with 50 percent changes in rate base and not all pipelines filing cost-of-service changes because identifying all pipelines that filed cost-of-service was too cumbersome. O'Loughlin October 9, 2010 Aff. ¶ 13. However, regardless of the proffered rationale, this inconsistent treatment of cost-of-service filings undermines the double-recovery argument.

21. On rehearing, Valero also objects that the 2010 Index Order did not specifically address acquisitions and divestitures. The 2010 Index Order did not specifically address the treatment of acquisitions and divestitures in the rate base screening methodology because Valero only addressed such acquisitions and divestitures in a manner that was inseparable from the rate base screening methodology itself. This is because the rate base screening methodology proposed by Mr. O'Loughlin only excludes mergers and divestitures that result in a rate base change of 50 percent or more, while including other pipelines affected by merger and acquisition activity. In the context of mergers and acquisitions, the 50 percent rate base change threshold can lead to arbitrary results that distort the index.[18] Moreover, to the extent Valero seeks to sever acquisitions and divestitures from the main body of its rate base screening proposal, Valero provided no economic basis to justify distinguishing between one method for obtaining new assets (purchasing them) and another method (constructing them). Further, acquisition or divestiture activity shows the changing per barrel-mile costs for that particular pipeline, including the cost of capital in the pipeline industry. Finally, to the extent that merger and divestiture activity caused certain pipelines to experience anomalous cost changes, trimming the data set to the middle 50 percent removes those pipelines.

22. Valero continues that applying the rate base screening rational results in a lower index level than the Kahn Methodology used here. Valero asserts this demonstrates that despite data trimming to the middle 50, the pipelines with rate base changes continue to distort the index factor calculation.[19] The Commission rejects such a results based argument. Whether the screening methodology causes the allowed indexation rate adjustment to increases or decrease cannot form the basis for the Commission's decision.[20]

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[18] Valero's proposal creates the potential for skewing the computation of the index. For example, consider the hypothetical where pipeline A acquires subsidiary company X from pipeline B. Suppose company X causes pipeline A's rate base to increase by 51 percent, this would exclude pipeline A from the data set. However, if the divestiture of subsidiary company X only causes pipeline B's rate base to decline by 49 percent, pipeline B remains in the data set. This incongruity can have arbitrary effects on the calculation of the appropriate index adjustment factor.

[19] The change occurs because if certain pipelines with costs that are either in the top 25 percent of total costs changes or in the bottom 25 percent of total cost changes are removed using the rate base screening methodology, then other, additional pipelines are excluded when the Commission applies the middle 50 to the remaining data set.

[20] *Association of Oil Pipelines v. FERC*, 281 F.3d 239, 246 (D.C. Cir. 2002) (*AOPL II*).

23. Contrary to Valero's objections on rehearing, the Commission's rejection of the rate base screening methodology follows naturally from the "Congressional mandate to develop a 'simplified and generally applicable ratemaking methodology….'"[21] As the 2010 Index Order explained, given the mandate of general applicability, the Commission is reluctant to exclude pipelines due to one particular cost factor.[22] The Commission also concludes that adding the additional complexity inherent to the rate base screening methodology would be inconsistent with the intent of EPAct 1992.

24. On rehearing, Valero and ATA allege the 2010 Index Order improperly distinguished between "normal" costs recoverable under indexation and "extraordinary" costs that are not subject to the index. Specifically, they aver the term "extraordinary" references the particular characteristics of the cost, not just the cost level as stated by the 2010 Index Order. Although Valero notes the Commission uses the term "extraordinary" in different contexts, this does not undermine the conclusion of the 2010 Index Order to reject the rate base screening methodology. Valero and ATA point out that the Commission uses the term "extraordinary" to describe the costs associated with the ULSD surcharge. As discussed above, the ULSD cases do not undermine the Commission's decision not to adopt the rate base screening methodology; the ULSD costs differ from rate base changes because the ULSD costs were recovered via a separate surcharge over a specified recovery period not from primary transportation rate subject to indexation.

25. Valero and ATA's claims regarding "extraordinary" costs in Order No. 561-A are equally unpersuasive. The meaning and importance that Valero and ATA attach to the word "extraordinary" ignores the operation of indexation. The regulations as explicitly modified by Order No. 561-A allow pipelines to seek cost-of-service recovery if there is a "substantial divergence" between the pipeline's recovery under the indexed rates and the pipeline's prudently incurred costs.[23] Although the Commission orders identified

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[21] 2010 Index Order, 133 FERC ¶ 61,228 at P 50 (quoting Energy Policy Act of 1992 Pub. L. No. 102-486 Sec. 1801(a), 106 Stat. 3010 (Oct. 24, 1992)).

[22] 2010 Index Order, 133 FERC ¶ 61,228 at P 50.

[23] 18 C.F.R. § 324.4. In Order No. 561-A, the Commission modified section 324.4 of the proposed regulations to provide that pipelines may seek recovery if they show a "substantial divergence" in costs rather than "uncontrollable circumstances." *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561-A, FERC Stats. & Regs. ¶ 31,000, at 31,106-07 (1994).

some of the circumstances that might cause a substantial divergence,[24] the Commission's regulations do not require a pipeline to demonstrate particular circumstances justifying a departure from the indexed rate levels. Second, regarding the data set used to calculate the index adjustment factor, Order No. 561-A established the current indexing methodology, which has not historically removed pipelines using a screening methodology based upon a particular cost component (such as rate base).[25]

26. The arguments advanced by Valero and ATA on rehearing regarding the rate base screening methodology are without merit and the Commission denies rehearing.

B. <u>FERC Form No. 6 - Page 700 Data</u>

27. In the 2010 Index Order, the Commission rejected a proposal advocated by Valero and other shipper interests for the use of page 700 data of Form No. 6 instead of information from pages 110-111, 114, 300-303, 600-601 of Form No. 6 that the Commission historically used to calculate the index level. The shippers proposed that page 700 contained only interstate data and was based upon the Commission's cost-of-service methodology, and was thus the preferable method for calculating the index level. In the 2010 Index Order, the Commission determined that instructions on page 700 may have lead companies to file costs that reflected only interstate data while also reporting throughput data that included both interstate and intrastate data.[26] Thus, the 2010 Index

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[24] *E.g.*, Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 at 31,107 ("Such cost changes may be the result of planned expansions or of upgrading or replacement of facilities for safety or environmental considerations.").

[25] Moreover, if the term "extraordinary" has the import that Valero and ATA assign to it, presumably the effect on the computation of index would not stop with rate base. The Commission would need to review every pipeline to see whether its Form No. 6 data reflected some sort of "extraordinary" cost and exclude it altogether from the index calculation. The prospect of such a process only further demonstrates the inconsistencies in the rationale advanced for the rate base screening methodology and the singular focus of the rate base screening methodology only on costs related to rate base changes.

[26] As the 2010 Index Order explained:

> [T]he barrel-mile information listed on page 700 provides that the barrel-mile figure should be the same as that reported on line 33a of page 600 of the Form No. 6. The instructions for page 600 refer to the inclusion of "all oils received" by the pipeline and makes no distinction between interstate and intrastate volumes.

2010 Index Order, 133 FERC ¶ 61,228 at P 84.

Order explained that to obtain an accurate measurement of changing per barrel-mile costs for purposes of establishing an index level, the methodology must match the barrel-miles to the costs incurred to transport the barrel-miles.

28. On rehearing, Valero ATA, and Sinclair contend the 2010 Index Order erroneously rejected the use of page 700 data as the basis for measuring historical cost changes and computing the new index level. Valero and ATA assert the history of page 700 illustrates the Commission has always intended page 700 to be an interstate-only compilation of data. Valero and ATA aver the intent of page 700, as established in Order Nos. 571 and 571-A, was to provide shippers with interstate only data, including changes in per barrel-mile costs. Furthermore, Valero also cites revisions to page 700 promulgated in Order Nos. 620 and 620-A which specified that pipelines should report only interstate revenues on page 700 and not include any intrastate revenues.

29. Furthermore, Valero and ATA assert the 2010 Index Order erred by not conducting an assessment to determine the extent the mismatches involving interstate and intrastate data on page 700 occur and what the impact this discrepancy may have on the index level. To assess pipeline reporting practices on page 700, Valero states it conducted its own analysis using the data in the record. Valero used revenue data on page 301, which separately lists interstate and intrastate revenues, to assess whether the pipeline earned revenue from only interstate operations or from both intrastate and interstate operations. For pipelines that only reported interstate revenue, Valero assumed that these pipelines' operations were entirely interstate in character.

30. However, for pipelines with both interstate and intrastate revenues, further analysis was necessary. Thus, Valero assessed the pipelines' practice for reporting other line items on page 700. For this group of pipelines, if the operating cost information on page 303[27] differed from the operating and maintenance cost on page 700, then Valero assumed the pipeline reported only interstate operating costs on page 700. If the operating expense data on page 303 equaled the operating expense data on page 700, then Valero assumed the pipeline was combining interstate and intrastate costs on page 700. Valero performed a similar assessment using pages 600 and 700 to determine pipeline reporting practices involving throughput.

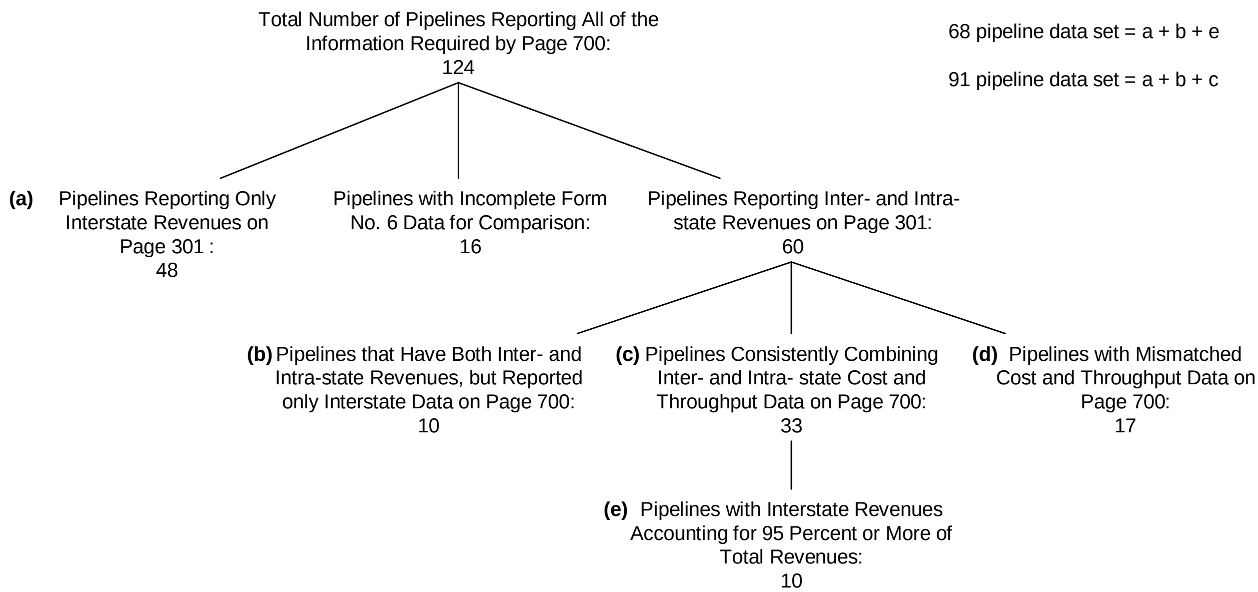
31. Based upon this analysis, Valero asserts that of the 124 pipelines that reported all of the information required by page 700, Valero excluded 16 pipelines which did not report the information elsewhere on Form No. 6 used by Valero in its analysis on rehearing. Valero states 48 pipelines were entirely interstate based upon the revenues reported on page 301. Of the remaining 60 pipelines that transported both interstate and

[27] Page 303 combines interstate and intrastate operating costs without distinguishing between the two.

intrastate throughput, Valero stated that 10 pipelines reported only interstate data on page 700. Valero identifies 33 pipelines that reported combined interstate and intrastate data for barrel-miles and operating cost on page 700. Valero states that another 17 pipelines reported a mismatch between operating cost and volume data by reporting interstate data for one and intrastate and interstate data for the other.

TABLE 1

Valero's Analysis of Page 700 Reporting



32. On rehearing, following the above analysis, Valero seeks to preserve the use of page 700 by altering the data set of 124 pipelines that it originally proposed. First, Valero suggests using a data set of 91 pipelines (the 91 pipeline data set). This data set removes the pipelines that Valero identifies as reporting mismatched data on page 700. Thus, Valero explains this data set includes: (a) the 33 pipelines that combined interstate and intrastate data for both the barrel-miles and operating costs on page 700; (b) the 10 pipelines that reported only interstate data for both barrel-miles and operating costs; and (c) the 48 pipelines that had only interstate throughput. Valero states that using page 700 data for the middle 50 percentage group of these 91 pipelines results in a cost change of 5.1 percent, or PPI-FG + 2.1 percent.

33. Second, Valero also proposes an evaluation of a second data set consisting of 68 pipelines (the 68 pipeline data set). Valero states this data set places emphasis on similar results. This second data set includes the 48 interstate only pipelines and the 10 pipelines that reported only interstate data for both barrel-miles and operating costs. Valero

removes most pipelines from the data set that reported combined intrastate and interstate operating costs and barrel-miles on page 700, but Valero did not exclude ten pipelines that obtained 95 percent or more of their revenues from interstate shipments. Valero determined this analysis provides an index level that is further reduced to PPI-FG + 1.8 percent.[28] Accordingly, Valero argues its analysis relying on page 700 data demonstrates the 2010 Index Order's adoption of a 2.65 percent index differential is excessive and unreasonable.

34. In addition, Valero's rehearing request reiterates the arguments advanced in its earlier comments to support the use of page 700 data, including that page 700 avoids using net plant as a proxy for changes in capital costs and that page 700 uses only interstate data.[29]

Commission Determination

35. The Commission denies rehearing and will continue to use data from elsewhere on Form No. 6[30] as opposed to data from Page 700.

36. The 2010 Index Order rejected the use of data from page 700 because "there is a mismatch between the page 700 total cost-of-service, which includes only interstate data, and the page 700 throughput data, which includes interstate and intrastate data."[31] Contrary to Valero's assertions on rehearing, the instructions on page 700 supported the findings in the 2010 Index Order that pipelines may be reporting on page 700 a combination of interstate and intrastate throughput. The instructions on page 700 direct pipelines to report the same barrel-mile figures as those reported on line 33a of page 600 of the Form No. 6. The instructions for page 600 make no distinction between interstate and intrastate volumes and direct pipelines to include "all oils received" by the pipeline. Consequently, the instructions ultimately direct pipelines to report on page 700 "all oils received" by the pipeline, which may include both interstate and intrastate barrel-miles.

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[28] Valero explains that if the rate base screening methodology is also performed, including pipelines that are predominantly interstate carriers, use of page 700 results in an index level of PPI-FG + 0.3 percent.

[29] Valero Request for Rehearing at 5.

[30] The Commission historically has used data from pages 110-111, 114, 300-303, 600-601 of Form No. 6 in the Kahn Methodology to establish the index level since Order Nos. 561 and 561-A in 1993 and 1994, including two five-year reviews of the index level before this proceeding.

[31] 2010 Index Order, 133 FERC ¶ 61,228 at P 83.

37. Valero's citations to the orders establishing and amending Form No. 6 do not undermine the conclusions of the 2010 Index Order. The Commission had previously amended Form No. 6 to clarify that total costs and revenues reported on page 700 must be interstate,[32] but these changes did not affect the instructions for reporting barrel-miles on page 700. Moreover, although the Commission envisioned that the throughput on page 700 could be used with this interstate data to calculate costs on a barrel-mile basis,[33] such intentions do not negate the practical effect of the explicit instructions on page 700 and page 600.

38. Valero's examination of the record supports the concerns expressed by the 2010 Index Order that the throughput reported on page 700 could contain both interstate and intrastate data.[34] Analyzing the page 700 data presented by Valero, of the 60 pipelines that reported revenue related to both interstate and intrastate shipments,[35] a mere 10 pipelines reported only interstate barrel-miles on page 700. The remaining 50 pipelines reported barrel-miles on page 700 that apparently combined both interstate and intrastate barrel-miles.[36] These results are fully consistent with the concerns expressed by the 2010 Index Order that pipelines were reporting throughput that combined interstate and intrastate data.

39. Valero provided no justification that undermines the conclusions of the 2010 Index Order. The additional analysis presented by Valero supports rather than undermines the findings of the 2010 Index Order that page 700 data used by Valero

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[32] *Revisions to and Electronic Filing of the FERC Form No. 6 and Related Uniform Systems of Accounts*, Order No. 620, FERC Stats. & Regs. ¶ 31,115 at 31,959, *order on reh'g,* Order No. 620-A, 94 FERC ¶ 61,130 (2001).

[33] *Revisions to and Electronic Filing of the FERC Form No. 6 and Related Uniform Systems of Accounts*, Order No. 620, FERC Stats. & Regs. ¶ 31,115, at 31,958-59 (2000), *order on reh'g*, 94 FERC ¶ 61,130 (2001).

[34] 2010 Index Order, 133 FERC ¶ 61,228 at P 83-85.

[35] From Table 1, of the total 124 pipelines, 16 reported incomplete data and 48 reported that they only transported interstate shipments. Thus, of the 124 pipelines, 60 pipelines (60=124 - 16 - 48) both reported complete data and revenues related to both interstate and intrastate volumes.

[36] Of the other pipelines with interstate and intrastate volumes, 33 pipelines reported interstate and intrastate data for both their operating costs and throughput. Another 17 pipelines reported interstate operating costs, but used both interstate and intrastate data to formulate throughput.

include mismatching of data. Rather than defend the validity of its original proposal, Valero now on rehearing suggests two alternative modifications to the page 700 data set.

40. The two alternatives advanced by Valero on rehearing further demonstrate the difficulty of resuscitating Valero's proposal to use page 700. Both the 91 pipeline data set and the 68 pipeline data sets are significantly affected by pipelines following varied practices for reporting data on page 700, including pipelines that reported only interstate data as well as pipelines that combined interstate and intrastate data. The Commission is reluctant to adopt data sets containing such internal inconsistencies. Moreover, even on rehearing, one of the shipper parties' principle arguments for changing Commission policy has been that page 700 data incorporates only interstate costs and barrel-miles;[37] thus, the inclusion of pipelines reporting intrastate data on page 700 undermines Valero's case for adopting page 700.

41. In particular, the 68 pipeline data set raises other concerns. This data set includes a much smaller number of pipelines[38] and a smaller percentage of the barrel-miles than the data set relied upon by the 2010 Index Order.[39] The Commission did previously use data sets with smaller sample sizes (prior to trimming for the middle 50) than that adopted in the 2010 Index Order, but it is preferable to apply the larger data set when the additional data is available using the current Kahn Methodology. Moreover, Valero represents that this data set is "predominantly," interstate, but this data set obtains over 75 percent of its barrel-miles from 10 pipelines that reported both intrastate and interstate data on page 700. This step raises methodological questions. For example, Valero justifies the inclusion of these pipelines because, according to Valero, they reported at 95 percent of their revenue from jurisdictional activities. However, Valero does little to explain why it used a 95 percent threshold; furthermore, whereas Valero's test relies upon revenues, the index uses barrel-miles and costs. Thus, it is not clear in the 68 pipeline data set how intrastate and interstate data are being combined together.

42. Additionally, because Valero only raises these proposals on rehearing, other parties have not had an opportunity to comment regarding these proposals to alter the

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[37] Valero Request for Rehearing at 6.

[38] The middle 50 in this data set contains only 34 pipelines, significantly fewer than the 54 pipelines contained within the middle 50 of the date set relied upon by the 2010 Index Order.

[39] This second alternative data set includes only 58 percent of the barrel miles reported on page 700. In contrast, the middle 50 of the data set used in the 2010 Index Order contained 76 percent of the barrel-miles reported by pipelines subject to the index on page 600.

composition of the data set.[40] Because Valero presents these proposals at the rehearing stage, the changes are not supported by expert testimony. Similarly, Valero did not provide work-papers demonstrating how it calculated the data sets, or, for example, identifying all 10 pipelines that passed the 95 percent revenue screening test used to derive the 68 pipeline data set. Moreover, the effect of using the page 700 data varies significantly whether Valero uses the 124 pipeline data set proposed in its comments (which produce an Index level of PPI-FG+1.6 percent) or one of the data sets it now advocates on rehearing (for example, the 91 pipeline data set leads to an Index level of PPI-FG+2.1 percent). Thus, in addition to being methodologically flawed, the new analysis and the two alternative data sets advanced by Valero on rehearing involve significant methodological assumptions that are beyond the scope of rehearing.[41]

43. Given that an established methodology using data from elsewhere on Form No. 6 already exists, it is not necessary to adopt innovative methodologies to salvage the shipper proposal to use the Page 700 data. In contrast to the uncertain and late-modifications proposed by Valero on rehearing, here the Commission used Form No. 6 data and the Kahn Methodology to establish the index level since Order Nos. 561 and 561-A in 1993 and 1994, including two five-year reviews of the index level before this proceeding. Although the Commission is acting to ensure that pipelines only report interstate data on page 700, the inconsistent instructions and practices involving the inclusion of intrastate data on page 700 support the Commission's continued use of other data from Form No. 6 as approved in Order No. 561 and subsequent proceedings. Accordingly, we deny rehearing on this issue.

C. <u>Separate Indices for Crude and Product Pipelines</u>

44. The 2010 Index Order rejected the proposal from ATA and some other shipper parties that the Commission establish separate indices for crude and product pipelines. The 2010 Index Order noted that ATA relied upon the testimony of Mr. O'Loughlin, but that Mr. O'Loughlin recommends using one index for all pipelines.[42] The 2010 Index Order determined that the parties requesting separate indices failed to explain why the "cost disparity between crude and product pipelines exists."[43]

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[40] In preparing its comments proposing to depart from the data that has historically been used in the Kahn Methodology, Valero could have compared the data reported on page 700 to the data elsewhere in Form No. 6, all of which was publically available, and modified its original proposal accordingly.

[41] *See, e.g., Nevada Power Co.*, 111 FERC ¶ 61,111, at P 10 (2005).

[42] O'Loughlin August 20 Aff. ¶ 61.

[43] 2010 Index Order, 133 FERC ¶ 61,228 at P 105.

45. On rehearing, ATA asserts the 2010 Index Order erred by not establishing separate indices for crude oil and product pipelines. ATA avers that the D.C. Circuit has recognized that the oil pipeline industry is divided between relatively high-cost crude oil pipelines and relatively low-cost product pipelines;[44] but acknowledges that the Court did not address whether separate indices were appropriate. ATA contends the use of a single index forces the products-based portion of the industry to subsidize the crude-based portion. Using Mr. O'Loughlin's analysis presented in Valero's comments, ATA asserts the annual cost change from 2004 to 2009 for crude pipelines is nearly twice that of products pipelines (4.3 percent for crude and 2.3 percent for products). Furthermore, ATA contends that the data to construct separate indices is readily available and in sufficient numbers of each type to construct representative samples. Accordingly, ATA recommends adopting separate indices for crude and products pipelines.

Commission Determination

46. The Commission denies rehearing and will continue the prior practice under the Kahn Methodology of using one index level for both crude and product pipelines. The mere identification of a potential disparity in per barrel-mile cost changes[45] between two categories of pipelines over the prior five-year period used to calculate the index is not sufficient to justify a separate index for each group. On rehearing, ATA failed to identify any evidence in this record explaining why a disparity between crude and product pipelines existed during the 2004-2009 period.

47. Confronted with the absence of evidence in this proceeding, ATA now attempts on rehearing to rely upon 10-year old evidence submitted in the first index five-year review conducted in 2000.[46] ATA states that in assessing the record in that proceeding, the D.C. Circuit "highlighted" evidence that the oil pipeline industry was divided between relatively high cost crude oil pipelines and relatively low cost product pipelines.[47] However, in the Kahn Methodology, it is the change in per barrel-mile costs on

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[44] ATA Request for Rehearing at 26 (citing *AOPL II*, 281 F.3d at 243).

[45] The only cost comparison that ATA provides is a comparison using the original data sample of page 700 data from Mr. O'Loughlin's August 20, 2010 Affidavit (which included mismatching data) and the rate base screening methodology, both of which have been rejected by the Commission. ATA has performed no analysis demonstrating that a disparity would exist under the methodology used by the Commission in the 2010 Index Order.

[46] ATA Request for Rehearing at 26 (citing *AOPL II*, 281 F.3d at 243).

[47] *Id*.

percentage basis that affects the index adjustment factor.[48] Thus, even though crude oil pipelines may have higher transportation costs than product pipelines, this does not demonstrate that the cost *changes* for crude oil pipelines are unrelated to the cost *changes* for product pipelines. The Court's reasoning based upon ten-year old testimony does not address the changes in costs per barrel-mile over the current period. In addition, the Court's reasoning refers to conditions that may no longer exist or be as significant.[49] The Commission denies rehearing on this issue and will continue its existing policy of using one index for both crude and product pipelines.

D. <u>Possible Pipeline Over-recoveries</u>

48. On rehearing, ATA reiterates its claims that the index has diverged from actual pipeline costs, resulting in substantial over-recoveries for some pipelines. ATA repeats that over 30 of the 103 pipelines with data it reviewed reported over-recoveries for some or all of the years from 2002 to 2009, accumulating to approximately $1.9 billion over the period. ATA notes that while some pipelines over-recover, others under-recover, yet states this does not absolve the Commission of its duty to ensure that all rates are just and reasonable. ATA argues that rather than addressing the inconsistencies, the Commission instead concludes that the disparity between pipelines' earnings is an inherent aspect of an industry-wide index. ATA asserts the wide discrepancy in pipelines' over- and under-recovery highlights the fact that the index does not reflect actual pipeline costs. ATA also reiterates its claim that the continued increase in pipeline rates could lead to the situation where pipelines defer needed capital expenditure because the returns they are receiving on fully depreciated assets are more than what they could earn on new investments. ATA concludes that investment in new infrastructure, including efforts to expand capacity and improve pipeline safety and integrity, could be hindered if appropriate incentives are not provided.

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[48] The Court only addressed the per barrel-mile costs (as opposed to cost changes) of crude and product pipelines in context of the "floated weighted average" that had been proposed as a departure from the Kahn Methodology used in Order Nos. 561 and 561-A. *AOPL II*, 281 F.3d at 243. The Court's acknowledgment did not affect the use of one index for both product and crude pipelines. On remand, the Commission continued to apply one index for both crude and petroleum pipelines and also used only one index level in the 2006 Index Order.

[49] For example, the Court cited testimony from the record in that proceeding asserting that there had been declining domestic crude production and conversion of crude pipelines into product pipelines. *AOPL II*, 281 F.3d at 243. However, no party has presented any evidence that such conditions have persisted in the same manner over the 2004-2009 period or are likely to be present during the prospective 2011-2016 period.

49. Moreover, ATA claims it is arbitrary and capricious and not reasoned decision-making for the Commission to permit a pipeline to increase rates where its Form No. 6 reflects that it may be over-recovering costs and where the Commission failed to perform any analysis of it. ATA states the Commission's actions are contrary to ICA's and EPAct 1992's requirement of just and reasonable pipeline rates in applying the automatic index adjustments to pipelines that the Form No. 6 indicates may be over-recovering.

50. Similar to ATA, Sinclair/Tesoro, NPGA, FLO-GAS, and several individuals filed comments expressing concerns about pipeline over-recoveries.

Commission Determination

51. On rehearing, ATA and some of the other rehearing requests allege that the Commission erred by failing to address or to conduct "an independent review" of specific evidence of over-recovery. However, as is inevitable under a "generally applicable ratemaking methodology" and as the Commission stated in the 2010 Index Order, because the index aggregates the cost experience of the pipeline industry as a whole, a particular pipeline's cost experience may deviate from the rates established pursuant to the index.[50] When this occurs, the Commission's regulations allow for shippers to file protests and complaints.[51]

52. On rehearing, ATA asserts the 2010 Index Order inappropriately relies upon shipper complaints to secure just and reasonable rates. ATA's assertions are the equivalent of a collateral attack on the EPAct 1992 and the Commission's indexing regulations. Under the EPAct 1992, Congress mandated a simplified and generally applicable scheme. Since the inception of the index, it has been understood that as a result of the application of any industry-wide pipeline index, a mere application of the index will cause some pipelines to over-earn while others will under-earn.[52] Thus, as established in Order Nos. 561 and 561-A and approved by the Court of Appeals, the Commission's regulations provide for protests and complaints to address over-recoveries by individual pipelines subject to this index scheme.[53] The 2010 Index Order adhered to

[50] 2010 Index Order, 133 FERC ¶ 61,228 at P 113.

[51] 18 C.F.R. pt. 343.

[52] *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,948-49 (1993); Second Five-Year Review, 114 FERC ¶ 61,293 at P 57 (2006).

[53] *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, at 1437 (D.C. Cir. 1996) (AOPL I) (finding that the Commission guards against an individual pipeline charging excessive rates via complaint and protest procedures).

this scheme when it emphasized that shippers may file a complaint against any pipeline that the shipper claims is over-recovering under the Index. ATA's attempt to criticize Form No. 6 and other Commission rate proceedings are beyond the scope of this proceeding, which is to establish a going forward index level. Similarly, ATA's claim on rehearing that over-recoveries for some pipelines under the index may cause a decrease in pipeline investment is speculative and not supported by record evidence.

53. Moreover, ATA and the other parties on rehearing have not shown that the index has been systematically inflated regarding the industry as a whole. On rehearing, ATA simply reiterates the arguments it raised in its initial and reply comments. Notwithstanding that some pipelines may have over-recovered according to ATA, ATA and the other rehearing requests have not refuted evidence presented by Dr. Shehadeh and cited by the 2010 Index Order that, in 2009, the oil pipeline industry as a whole was under-earning by approximately 17 percent.[54] The Commission denies rehearing on this issue.

E. <u>Appropriateness of PPI-FG as a Costs Tracker</u>

54. Sinclair/Tesoro state the Commission never adequately responded to their claim that PPI-FG is not an appropriate tool for setting the index because the behavior of the PPI-FG is not correlated with the costs pipelines actually incur. Sinclair/Tesoro contend because the rate ceiling index is reviewed only every five years, the Commission should undertake an investigation into index methodologies that reflect the actual cost being incurred by oil pipelines. Moreover, Sinclair/Tesoro assert the Commission has yet to produce a satisfactory set of studies and calculations illustrating the appropriateness and accuracy of the PPI-FG + 2.65 index to track pipeline cost increases.

<u>Commission Determination</u>

55. The Commission denies Sinclair/Tesoro's request for reconsideration on the issue of the appropriateness of using PPI-FG as a tool for estimating the appropriate index adjustment factor. The Commission has used PPI-FG as a cost tracker since Order Nos. 561 and 561-A.[55] Sincliar/Tesoro submitted data regarding the changing costs of various inputs, but this anecdotal evidence fails to support their larger assertion that PPI-FG does not reflect pipeline cost changes or provide an alternative for establishing the index adjustment factor. To the extent that pipeline costs deviated from the index

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[54] 2010 Index Order, 133 FERC ¶ 61,228 at P 113 (*citing* Shehadeh September 20 Decl. at 32-33).

[55] Order No. 561, FERC Stats. & Regs. ¶ 30,985 at 30,951-52, *order on reh'g*, Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 at 31,094-96.

using PPI-FG, evidence presented by Dr. Shehadeh and cited by the 2010 Index Order that, in 2009, the oil pipeline industry as a whole was under-earning by approximately 17 percent.[56] Accordingly, the Commission denies rehearing.

The Commission orders:

The requests for rehearing are hereby denied as discussed in the body of this order.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[56] 2010 Index Order, 133 FERC ¶ 61,228 at P 113 (*citing* Shehadeh September 20 Decl. at 32-33).