

111 FERC ¶ 61,334
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

SFPP, L.P.	Docket Nos.	OR92-8-024 OR93-5-015 OR94-3-014 OR94-4-016
Mobil Oil Corporation v. SFPP, L.P.	Docket No.	OR95-5-013
Tosco Corporation v. SFPP, L.P.	Docket No.	OR95-34-012
AROC Products Co. a Division of Atlantic Richfield Company, Texaco Refining and Marketing Inc., and Mobil Oil Corporation v. SFPP, L.P.	Docket Nos.	OR96-2-010 OR96-2-011 OR96-10-007 OR96-10-009 OR98-1-009 OR98-1-011 OR00-4-002 OR00-4-004
Ultramar Diamond Shamrock Corporation, Ultramar, Inc. v. SFPP, L.P.	Docket Nos.	OR96-2-003 OR06-2-004 OR96-10-008 OR96-10-009 OR96-17-004 OR96-17-006 OR97-2-004 OR97-2-005 OR98-2-005 OR98-2-007 OR00-8-005 OR00-8-007

Docket No. OR92-8-024, *et al.*

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Tosco Corporation v. SFPP, L.P.	Docket Nos. OR98-13-005 OR98-13-007 OR00-9-005 OR00-9-007
Navajo Refining Corporation v. SFPP, L.P.	Docket No. OR00-7-005 OR00-7-006
Refinery Holding Company	Docket No. OR00-10-005 OR00-10-006
SFPP, L.P.	Docket No. IS98-1-001 IS98-1-002

ORDER ON REMAND AND REHEARING

(Issued June 1, 2005)

1. This order addresses three proceedings involving SFPP, L.P. (SFPP) now pending before the Commission. One is the remand by the D. C. Circuit¹ in Docket No. OR92-8-000, *et al.*, and involves Opinion Nos. 435, 435-A, 435-B, and a related order on rehearing and compliance.² The second is the Phase I proceeding in Docket No. OR96-2-000, *et al.*, and involves the issues raised by the Commission's March 26, 2004 Order in that proceeding.³ Many of these are similar to the issues raised by the remand opinion in Docket No. OR92-8-000, *et al.* The third proceeding is a compliance filing by SFPP to the March 2004 order. With the exception of the so-called *Lakehead* income tax allowance issue and the recovery of SFPP's reconditioning costs, the Commission adopts most the court's conclusions regarding the remanded issues. The Commission denies rehearing of the March 2004 Order and accepts the compliance filing for that order. The

¹ *BP West Coast Products, L.L.C. v. FERC*, 374 F.3d 1263 (D. C. Cir. 2004) (*BP West Coast* or "the remand opinion").

² *Opinion No. 435* (86 FERC ¶ 61,022 (1999)), *Opinion No. 435-A* (91 FERC ¶ 61,135 (2000)), *Opinion No. 435-B* (96 FERC ¶ 61,281 (2000)), and an *Order on Clarification and Rehearing* (97 FERC ¶ 61,138 (2001)) (collectively the Opinion No. 435 orders.)

³ *SFPP*, 106 FERC ¶ 61,300 (2004) (the March 2004 Order).

Commission also establishes further proceedings in certain issues involved in the remand.

I. Background

2. All three of these proceedings stem from the complex litigation between SFPP and several of its shippers that started in November of 1992. In this order the Commission addresses issues that are raised by the court's remand opinion and integrates its response to that remand with certain actions taken by the Commission while the Opinion No. 435 orders were on appeal. There are three discreet major proceedings involving SFPP now pending for decision before the Commission, each including a number of consolidated dockets.⁴ The first proceeding, Docket No. OR92-8-000, *et al.*, began in December 1992 and addressed complaints against SFPP's rates filed through August 5, 1995. This docket culminated in Opinion Nos. 435, 435-A, 435-B, a subsequent order that clarified certain aspects of those orders, and related compliance filings.⁵ In those orders the Commission determined that, with one exception, SFPP's West Line rates were grandfathered under section 1803(b) of the EPCA.⁶ As such those rates could not be reviewed for reasonableness for the period covered by the relevant complaints,⁷ which were filed between November 1992 and August 1995. The one exception involved rates for turbine fuel shipped over the West Line, which were not grandfathered. However, the Commission concluded that the turbine fuel rate was just and reasonable. The Commission also concluded that charges for the Watson Station drain dry facilities⁸ were

⁴ There were also a number of rate compliance filings involved in the Opinion No. 435 orders that require filings in separately captioned dockets that are not consolidated with the proceedings that established the rate design principles for those rates.

⁵ Some of these were rate filings submitted in separate IS dockets to comply with the Commission's directions in the Opinion No. 435 orders.

⁶ Section 1803(b) of the Energy Policy Act, Pub. L. 102-486, 106 Stat. 2772 (1992). Section 1803(b)(1) provides that no person may file a complaint against a rate that is deemed to be just and reasonable under section 1803(a) of the EPCA [a grandfathered rate] unless evidence is presented to the Commission which establishes that a substantial change has occurred after the date of the enactment of the Act in the economic circumstances of the oil pipeline which were a basis for the rate; or in the nature of the services provided which were a basis for the rate.

⁷ The West Line operates from Watson Station and East Hynes in greater Los Angeles transporting petroleum products to points to the east with ultimate destinations in Tucson and Phoenix, Arizona. The West Line has a connection to the CalNev Pipeline at Colton, California. CalNev transports the petroleum to the Las Vegas, Nevada area.

⁸ The Watson Station drain dry facilities are located at Watson Station and are
(Continued)

also grandfathered. Therefore the Commission dismissed the complaints against the West Line rates and the Watson Station drain dry facility charges.

3. The Commission also determined in Docket No. OR92-8-000, *et al.* that SFPP's then existing East Line rates were not grandfathered and that those rates were not just and reasonable as of 1994.⁹ In reviewing those rates, the Commission made numerous cost-of-service determinations. These included holding that the so-called *Lakehead* income tax allowance policy applied in setting the East Line rates, allocating legal costs between the West and East Lines, and finding that SFPP had not justified its proposed charges for the reconditioning of the East Lines. The Commission also made certain findings related to the Commission's oil pipeline cost-of-service rate making methodology, such as the starting rate base, capital structure, amortization rates, and the calculation of the allowance for deferred income taxes.

4. The Commission therefore required SFPP to file new rates for transportation over the East Lines, to be effective August 1, 2000. After several rehearing requests and twice requiring SFPP to file revised East Line rates, the Commission ordered SFPP to make a final East Line rate filing to be effective August 1, 2000.¹⁰ In response, SFPP filed Tariff 18 on February 13, 2003, which indexed the August 1, 2000 rates forward to that date. The Commission's June 5, 2003 order accepted Tariff 18 effective on February 13, 2003, and established the final terms for calculating reparations through that date.¹¹

5. SFPP and certain shipper parties then filed petitions in the Court of Appeals for review of the Commission's Opinion No. 435 orders challenging many of those jurisdictional and cost determinations. While the appeals were pending, the Commission issued an order on March 26, 2004 addressing a second series of complaints filed in 1996, 1997, 1998, and 2000, all of which had been consolidated in Docket No. OR96-2-000, *et al.* Those complaints alleged that SFPP's rates on its West, East, North, and Oregon Lines, and the charges for its Watson Station drain dry facilities, were unjust and unreasonable. The principal issue addressed by that March 2004 order was whether the

used in part to increase the pumping pressure of petroleum products tendered to SFPP at that point to a level that complies with its tariff.

⁹ See 49 App. U.S.C. 15(1) (1988) governing the determinations of whether oil pipeline rates are just and reasonable.

¹⁰ The Commission had made the rates contained in the earlier filings effective on an interim basis.

¹¹ SFPP, L.P., 103 FERC ¶ 61,287 (2003).

rates for the West, North, and Oregon Lines, and the Watson Station drain dry facilities, were grandfathered, or were subject to the Commission's rate jurisdiction. The central

matter in each instance was whether under section 1803(b) of the EPAct there had been substantial changes to the economic circumstances that were the basis for those rates.

6. The Commission concluded that there had been a substantial change in the economic circumstances underlying the West Line rates to Yuma and Tucson, Arizona and to the CalNev interchange at Colton¹² as of 1995 and for the rates to Phoenix, Arizona, as of 1997.¹³ Therefore those rates were deemed to no longer be just and reasonable as of those years. The Commission also found that SFPP's Sepulveda Line rates were not grandfathered as of the dates on which the complaints against those rates were filed. The Commission remanded the rates for the West Line to the Administrative Law Judge (ALJ) for a Phase II determination of the just and reasonableness of those rates and, as well as for those of the Sepulveda Line for the complaint years.¹⁴ The Phase II proceedings in Docket No. OR96-2-000, *et al.* for the West Line rates are now before the Commission on an initial decision that will be addressed in a subsequent order.¹⁵ The Sepulveda Line rates are at hearing before an administrative law judge and are in the post-hearing briefing phase of that proceeding. The March 2004 order held that there were no substantially changed circumstances on the North and Oregon Lines for the years at issue. Thus the Commission dismissed the complaints against the North and Oregon lines filed against SFPP in Docket No. OR96-2-000 *et al.*¹⁶

7. On July 20, 2004, the Court of Appeals for the D.C. Circuit issued its opinion on the Opinion No. 435 orders in *BP West Coast Products, supra*. The court stated it could

¹² The March 2004 Order refers to these rates as the CalNev rates. Colton is the interconnection point between SFPP and the CalNev pipeline going to Las Vegas, NV.

¹³ March 24 Order at PP 62, 66, and 84.

¹⁴ *Id.*, PP 25, 31.

¹⁵ The ALJ issued an initial decision (ID) in the Phase II proceedings on September 4, 2004. *See SFPP, L.P.*, 108 FERC ¶ 63,036 (2004). The rulings here will affect certain issues raised by the ID, and to that extent will be controlling in the Commission's review of the ID in Phase II.

¹⁶ Additional complaints are pending against the North and Oregon Lines in Docket Nos. OR05-4-000 and OR05-5-000. Those complaints have been held in abeyance pending the completion of Phase II of Docket No. OR96-2-000, *et al.*

affirm many of the Commission's decisions on specific issues but because it found error in several fundamental areas, it ordered the decisions vacated and remanded the matter for further proceedings consistent with its opinion.¹⁷ The court divided its opinion into three parts dealing with the West Line, the East Line, and Reparations. The first part addressed jurisdictional issues, the second, cost determinations, and the third, reparations.

8. Regarding the West Line, the court affirmed the Commission's determinations of (1) the jurisdictional status of the East Hynes origination point, (2) whether certain of the complaints addressed a tariff or a rate, (3) whether certain of the complaints were directed at the West Line rates or only the East Line rates, and (4) the relevance of investigations by the Oil Pipeline Board.¹⁸ The court also upheld the certain of the Commission's determinations of what factors should be used to determine substantially changed circumstances, including (1) the base time to be used for determining whether there were substantially changed circumstances, (2) the time frame in which to submit evidence on that matter, and (3) the scope of the contractual prohibition exemption contained in section 1803(b) (2).¹⁹ The court also held that the Commission did not improperly deny certain shippers a chance to amend their complaints.²⁰ The court rejected the Commission's conclusions that (1) the charges for the Watson Station facilities were grandfathered, (2) the West Line turbine fuel rates were just and reasonable, and (3) a cost change from implementing the *Lakehead* tax allowance policy by itself could be a factor that would result in substantially changed circumstances.²¹ These latter three issues are analyzed below in the sections dealing with substantially changed circumstances and the *Lakehead* income tax allowance issues.

9. Regarding the East Line, the court upheld the Commission's cost-of-service determinations regarding (1) SFPP's starting rate base, (2) the method for recovering SFPP's regulatory litigation expenses, and (3) the denial of SFPP's civil litigation costs

¹⁷ *BP West Coast* at 1271.

¹⁸ *Id.*, 1273 and 1276-79.

¹⁹ *BP West Coast* at 1278-81. Section 1803(b) (2) of the EPAct permits the filing of a complaint against a grandfathered rate by a person who was under a contractual prohibition against the filing of a complaint which was in effect on the date of enactment of the EPAct and had been in effect prior to January 1, 1991, provided the complaint is filed within 30 days after the expiration of the prohibition.

²⁰ *BP West Coast* at 1279 and 1280-81.

²¹ *Id.* 1273-76.

regarding its prior termination of service over the East Line.²² The court remanded the Commission's conclusions regarding (1) income tax allowances, (2) the allocation of legal costs between the East and West Lines, (3) and the denial of SFPP's proposed reconditioning costs.²³ These issues are addressed below in the sections dealing with cost issues and the *Lakehead* income tax allowance issue.

10. Regarding reparations, the court affirmed all of the Commission's conclusions, including (1) the relevance of the *Arizona Grocery* rule to the proceedings,²⁴ (2) whether pre-complaint reparations were allowed, (3) the application of a specific test period for SFPP's rate design, (4) the use of reasoned decision making related to SFPP's litigation status, (5) whether Navajo Refining Corporation (Navajo) was barred from collecting refunds for the period before its complaint, (6) the eligibility of Valero Marketing and Supply Company (Valero) for reparations in the context of the Order No. 435 opinions, (7) the failure of ARCO Products Company (ARCO) and Texaco Refining and Marketing, Inc. (Texaco) to challenge the East Line rates, and (8) that Chevron Products Company's (Chevron) September 23, 1992 complaint did not entitle it to reparations because it did not address rate issues.²⁵ The import of these rulings for some rehearing requests of the March 2004 Order is discussed below in the reparations section.

11. While the remand was pending, on November 2, 2004 the Interstate Natural Gas Association of America (INGAA) sent a letter to the Commissioners discussing certain policy issues involving the income tax allowance portion of the remand. On November 12, 2004, counsel to BP West Coast Products, LLC and ExxonMobil Oil (ARCO Group) Corporation filed a notice of illegal *ex parte* communication by INGAA based on the latter's November 2, 2004 letter.²⁶ Counsel asserted that the INGAA letter improperly addressed the tax allowance issues in litigation in the instant dockets and

²² *Id.* 1282-84, 1293-94, and 1294-97.

²³ *Id.* 1285-93, 1297-98, and 1298-1302.

²⁴ *Arizona Grocery Co v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370 (1932) (*Arizona Grocery*). *Arizona Grocery* bars reparations for changes to a final rate that has been approved by the Commission. The court held that the Commission properly found that *Arizona Grocery* did not bar reparations on the East Line as of August 1, 2000, because the East Line rates as of the date were not final, Commission approved rates.

²⁵ *BP West Coast*, Part III.

²⁶ Counsel to the ARCO Group also directed a letter to the Commissioners on November 12, 2004, making the same arguments but omitting the litigation material.

requested that the letter be placed in the non-decisional file. The ARCO Group filing also included copies of testimony from the Phase II proceedings in Docket No. OR96-2 addressing the income tax allowance issue. On November 12, 2004, SFPP filed comments requesting that the Commission hold a hearing on the remanded issues as the

most efficient way of resolving those issues. In its filing SFPP presented arguments on how each of five remand issues it summarized in its filing should be resolved.²⁷

12. On November 17, 2004, INGAA filed a reply to ARCO Group's notice asserting that it had inadvertently failed to file a copy of its November 2, 2004 letter with the Commission's Secretary and subsequently did so. INGAA further argued that its letter was not an *ex parte* communication because it addressed only generic issues and did not speak to the tax allowance issues in any specific proceeding. INGAA also noted that it represents gas pipelines and was careful not to address the issues of the oil proceedings at issue here. The Commission subsequently placed the November 2 letter in the non-decisional file and has not relied on that letter in making its decisions here.²⁸ On November 17, 2004, the ARCO Group filed a preliminary answer to SFPP's comments on the remand arguing certain of the income tax allowance issues. On November 29, 2004, Tosco Corporation and ChevronTexaco Products Company (Tosco/CT) also filed an answer to SFPP's comments, as did the ARCO Group. On December 6, 2004, SFPP filed a motion for leave to file and made a limited response to the November 29 filing by the ARCO Group. SFPP's December 6 motion included analysis and arguments related to the structure and operation of partnership tax law intended to rebut assertions made by the ARCO Group. On December 7, 2004, Navajo Refining Company also filed an answer to SFPP's comments on the remanded issues.

13. On December 2, 2004, the Commission issued a Notice of Inquiry Regarding Income Tax Allowances in Docket No. PL05-5-000. The Commission asked interested parties to comment when, if ever, it is appropriate to provide an income tax allowance for partnerships or similar pass-through entities that hold interests in a regulated public utility. Some forty-one comments were submitted by interested parties representing most

²⁷ These were the decisions regarding the Watson Station and turbine fuel rates, the role of the *Lakehead* doctrine in determining substantially changed circumstances, the proper amount of the income tax allowance, the allocation of litigation costs between the West and East Line shippers, and the recovery by SFPP of reconditioning costs.

²⁸ It should be noted that Counsel to the ARCO Group included a copy of the November 2 INGAA letter in his November 12 filing, and therefore that copy of the letter is included in the official decisional file because it was part of his duly filed pleading.

interests involved in the jurisdictional activities regulated by the Commission. These included gas and oil pipelines and their shipper, refinery, and local distribution customers, gas and oil producers, public electric utilities, municipal electric utilities, and state regulatory commissions. On December 16, 2004, the ARCO Group filed additional comments on the income tax allowance issue. On May 4, 2004, the Commission concluded that such an allowance should be permitted on all partnership interests, or similar legal interests, if the owner of that interest has an actual or potential income tax liability on the public utility income earned through the interest.²⁹ On April 19, 2005, the ARCO Group filed an offer of proof containing additional evidence it had elicited in the Sepulveda phase of Docket No. OR96-2-000 regarding the income tax allowance issues.

14. The Commission has concluded that given the unusually complex nature of these proceedings it will accept the various filings regarding the remanded proceeding. While some of the filings are repetitious, they contain sufficient useful information to warrant their inclusion in the record. All parties have been afforded an opportunity to reply to the various assertions raised. However, the Commission will decide the generic income tax allowance issues involved in the court's remand only on the basis of the record and decision in Docket No. PL05-5-000. Income tax and remand issues specific to the instant dockets will be decided only on the factual record before the Commission in Docket Nos. OR92-8-000, *et al.* and OR96-2-000, *et al.*, and if relevant, the more generic arguments presented in the supplemental materials in those dockets regarding the structure and operation of partnership income tax law.

II. Discussion

15. The discussion part of this order is divided into six sections. The first, section A, addresses issues raised by the court's remand of the *Lakehead* income tax allowance issue. This matter is discussed in a separate section because of its importance to the Commission's rulings on substantially changed circumstances in the Opinion No. 435 orders and the March 2004 Order as well as rate determinations in the Opinion No. 435 orders. The second, section B, addresses the other remanded issues involving substantially changed circumstances. The third, section C, addresses cost-of-service determinations contained the Opinion No. 435 orders. The fourth, section D, addresses reparation issues on rehearing of the March 2004 Order. The fifth, section E, addresses SFPP's compliance filing to the March 2004 Order. The sixth, section F, details the filings that SFPP must make in response to this order and sets certain additional matters for hearing. Finally, because the Opinion No. 435 orders were vacated and remanded, the Commission adopts and affirms here the conclusions of those orders otherwise affirmed by the court.

²⁹ *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005) (*Policy Statement*).

A. The Lakehead Tax Allowance Issue

16. The remanded *Lakehead* income tax allowance issue is important because it affects a major component of the cost-of-service calculations for the East Line rates developed under the Commission's prior orders and directly impacts further proceedings to develop just and reasonable rates for the transportation of turbine fuel over the West Line, the Watson Station drain dry facilities, the Sepulveda line, and the determination of just and reasonable rates for the West Line rates now before the Commission in Phase II of Docket No. OR96-2-000. Moreover, the March 2004 Order relied in part on a full Opinion No. 154-B cost-of-service analysis in making its determination whether there were substantially changed circumstances to the rates for two of the three lines at issue in Docket No. OR96-2-000, namely the North and Oregon Lines. The Commission concludes that given the Commission's ruling in Docket No. PL05-5-000, it will no longer apply its former *Lakehead* income tax allowance policy. Thus several of those issues must be revisited in this order.

1. Background

17. As was discussed in the Commission's May 5 decision in Docket No. PL05-5-000, the *Lakehead* income tax allowance issue is at bottom a finance issue that turned on the pipeline's ownership structure. As discussed in the court's remand opinion, partnerships, or other pass-through entities, pay no actual federal income taxes.³⁰ However, as the Commission determined in the *Policy Statement*, income of such entities is attributed to the partners through an information partnership tax return. The partnership income is then reported on, and any actual tax liability is paid by means of, the returns of the partners.

18. In *Lakehead*, the Commission concluded it would permit partnerships to have a federal income tax allowance in proportion to the partnership interests owned by a subchapter C corporation or other taxable entity. However, those cases denied the partnership a tax allowance in proportion to the partnership interests owned by individual partners.³¹ In its 1995 *Lakehead* decision, the Commission concluded that *Lakehead* "is entitled to an income tax allowance with respect to income attributable to its corporate partners."³² The Commission then further stated that the partnership is entitled to a tax

³⁰ See *BP West Coast*, at 1288-70 for the court's discussion.

³¹ *Lakehead Pipe Line Company, L.P.*, 71 FERC ¶ 61,388 (1995), *reh'g denied*, 75 FERC ¶ 61,181 (1998) (*Lakehead*).

³² 71 FERC at 62,314, *citing* at footnote 54 *Pelican Interstate Pipeline Gas*
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allowance for its corporate interests because the tax cost is passed on to the corporate shareholder who then pay corporate income taxes on their allocated share of the income, resulting in double taxation.

19. However, the Commission also stated that Lakehead should not receive an income tax allowance with respect to income attributable to limited partnership interests held by individuals because there is no corporate income tax paid on income distributed to individual partner. The Commission stated that this comports with the principle that there should not be a cost element in the cost-of-service to cover costs that are not incurred.³³ As a second rationale for denying an income tax allowance on the individual partnership interests, the Commission first stated that the individual partners are entitled to an after-tax return commensurate with returns on investments in other enterprises having similar risks. It concluded that if Lakehead were to receive a corporate tax allowance with respect to the individual partnership interests, Lakehead and those individual investors would earn an after-tax return on equity in excess of that to which they are entitled for Lakehead's risks.³⁴ Therefore that partnership was denied an income tax allowance in proportion to the partnership interests that were held by individual partners.

20. In contrast to its corporate general partner, SFPP, Inc. a subchapter C corporation, SFPP, L.P. was organized as a limited partnership. Its equity structure consisted of 99 percent limited partnership interests and a 1 percent general partnership interest. At the time of the Opinion No. 435 orders, SFPP, L.P. was controlled by SFPP, Inc., which owned 42.7 percent of the limited partnership interests and the 1 percent general partnership interest.³⁵ The remaining 56.30 percent of the limited partnership interests

System, 29 ERC ¶ 61,062 at p. 61,135 (1984). Other cases that permitted partnerships to have an income tax allowance were *Highland Offshore System*, 55 F.P.C. 2674 at 2688 (1976); *Sea Robin Pipeline Co.*, 28 FERC ¶ 61,092 at 61,173 (1984). However, none of these cases analyzed why such an allowance was appropriate. The first effort to establish why it was appropriate to continue such an allowance for the corporate partner, and not the individual partner, was in the two *Lakehead* orders, *supra*.

³³ 71 FERC at 62,315.

³⁴ *Id.*

³⁵ SFPP, Inc. was acquired by Kinder Morgan Energy Partners (KEMP) on March 6, 1998. KEMP is a master limited partnership with 99 percent limited partnership interests and a one percent general partner, KMEP Inc. A master limited partnership is one that controls other limited partnerships. This does not change the

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was held by the public and traded on national exchanges. Thus, in applying *Lakehead* in the Opinion No. 435 orders, the Commission only allowed SFPP an income tax allowance equal to the limited partnership interests held by SFPP, Inc., or 43.7 percent.

2. The Remand

21. As discussed above and in the *Policy Statement*, the focus in the *Lakehead* orders was on the income tax allowance to be denied the partnership in proportion to its individual partnership interests rather than the income tax allowance allowed in proportion to the partnership interests held by the corporate investor. However, it was the income tax allowance attributed to the corporate partnership interests, and the absence of a corresponding that was the focus of the recent appeal, and it was that income tax allowance scheme that the court determined was not adequately justified. While the court left open to the Commission the option of developing a superior rationale to support a continued federal income tax allowance solely for corporate partners, the Commission concluded in the *Policy Statement* that this was not possible. The Commission further concluded that all entities providing jurisdictional services should be permitted an income tax allowance, including partnerships and other forms of pass-through entities. The Commission did qualify this decision, however, by stating that partnerships and other pass-through entities would be permitted an income tax allowance only in proportion to those that have an actual or potential income tax liability.³⁶ To the extent that a partner or other owner of a pass-through interest did not have an actual or potential income tax liability, the tax allowance would be reduced.³⁷

22. In reaching this conclusion, the Commission expressly reversed the income tax allowance holdings of its earlier *Lakehead* orders. As was stated in Edison Electric Institute's (EEI) comments in Docket No. PL05-5-000, *Lakehead* mistakenly focused on who pays the taxes rather than on the more fundamental cost allocation principle of what costs, including tax costs, are attributable to regulated service, and therefore properly

analysis here as a corporate general partner during the time frame of the Opinion No. 435 proceedings.

³⁶ *Policy Statement*, PP 32 and 40-42

³⁷ The Commission recognized that, as with the consolidated corporate returns, this might require review of several layers of pass-through ownership to determine where the ultimate, if any, actual or potential tax liability lies. *Id.* P 42.

included in a regulated cost of service.³⁸ Relying on *BP West Coast*, some commenters in that docket asserted that because a pass-through entity pays no cash taxes itself, this results in a phantom tax on fictional public utility income. However, the comments summarized in sections A and D of Part II of the *Policy Statement* demonstrated that this assumption was incorrect.

23. Thus, while the pass-through entity does not itself pay income taxes, the owners of a pass-through entity pay income taxes on the utility income generated by the assets they own via the device of the pass-through entity.³⁹ As such, the taxes paid by the owners of the pass-through entity are just as much a cost of acquiring and operating the assets of that entity as if the utility assets were owned by a corporation. The numerical examples discussed in sections A and D of Part II of the *Policy Statement* also established that the return to the owners of pass-through entities would be reduced below that of a corporation investing in the same asset if such entities are not afforded an income tax allowance on their public utility income.

24. As several commentors in Docket No. PL05-5-000 pointed out, a detailed discussion of the realities of partnership tax practice was not before the court when it reviewed the Opinion No. 435 orders. Because public utility income of pass-through entities is attributed directly to the owners of such entities and the owners have an actual or potential income tax liability on that income, the Commission concluded that its rationale in the *Policy Statement* did not violate the court's concern that the Commission had created a tax allowance to compensate for an income tax cost that is not actually paid by the regulated utility.

25. As explained in detail by the comments summarized in sections A and D of Part II of the *Policy Statement*, just as a corporation has an actual or potential income tax liability on income from the public utility assets it controls, so do the owners of a partnership or limited liability corporation (LLC) on the assets and income that they

³⁸ EEI comments at 8. In support of this point commentors in Docket No. PL05-5-000 cited to *City of Charlottesville v. FERC*, 774 F.2d 1205 (D.C. Cir. 1985) for the proposition that a tax cost involves real taxes but does not necessarily require that cash taxes be paid by the regulated entity. See EEI at 11-13; INGAA at 12-13; Interested Gas Pipeline Partnerships at 10-12; Association of Oil Pipe Lines (AOPL) at 8-9.

³⁹ The comments and numerical examples submitted by the EEI, INGAA, and Northern Border Pipe Line Company (Northern Border) in Docket No. PL05-5-000 demonstrate that under partnership law the partners, or members, of pass-through entities pay taxes on the public utility income of the operating entities that they control through the partnership or other pass-through entity. See EEI at 13-15; INGAA at 15-17; and Northern Border at 5-8.

control by means of the pass-through entity. Moreover, it should be noted that if such first tier assets are owned only by Subchapter C corporations, their rates would include an income tax allowance designed to recover the 35 percent maximum corporate marginal tax rate.⁴⁰ Thus, the same rate result obtains if the assets are owned by a partnership or

an LLC that is in turn owned either by Subchapter C corporations or by individual investors in the maximum individual tax bracket.

26. Thus, the *Policy Statement* the Commission adopted in Docket No. PL05-5-000 should not result in increased costs to public utility ratepayers beyond those which would result from use of the corporate form. The Commission therefore concluded that, as is argued by the commentors urging an income tax allowance for all public utility entities, providing an income tax allowance to partnerships in proportion to the interests owned by entities or individuals with an actual or potential income tax liability does not create a phantom income tax liability. The Commission also concluded that the fact that some partnerships or LLCs may be used for financial investments rather than for making infrastructure investments does not warrant a different policy result here.⁴¹ Moreover, the Commission emphasized that the primary rationale for reaching the conclusion in the *Policy Statement* is to recognize in rates the actual or potential income tax liability attributable to regulated utility income. Finally, since it had concluded that such an income tax allowance does not result in phantom income taxes, the Commission further concluded that permitting partnerships an income tax allowance will facilitate important public utility investments.⁴²

⁴⁰ This analysis suggests that if partnerships and limited liability companies are not permitted to have an income tax allowance, there are incentives to shift to the taxable corporate ownership form. This might be done by converting a partnership to an LLC and then electing to have it taxed as a Subchapter C corporation. Once this is done, the newly taxable entity, which would be operating the same assets as it did as a pass-through entity, would be entitled to a 35 percent income tax allowance. *Cf.* AOPL at 9.

⁴¹ The partners of master limited partnerships have tax liability for any income recognized by the partnership. As the supplemental comments filed in this proceeding establish, distributions may substantially exceed partnership book income. Such distributions have an ultimate income tax liability depending on the status of the capital account of the individual partners. However, these matters can present complex allocation and timing issues that would be addressed in this proceeding once SFPP files a revised cost of service to comply with this order

⁴² *See, e.g., Trans-Elect NTS Path 15, LLC*, 109 FERC ¶ 61,249 (2004), *order denying rehearing*, 111 FERC ¶ 61,140 (2005).

27. Given the Commission's *Policy Statement* and the application of its policy in this opinion, the Commission concludes that SFPP, L.P. should be afforded an income tax allowance on all of its partnership interests to the extent that the owners of those interests had an actual or potential income tax liability during the periods at issue here. In the Opinion No. 435 orders the Commission significantly reduced the income tax allowance permitted SFPP by excluding those ownership interests that were not subject to double taxation. Thus, when SFPP develops its revised cost-of-service for the East Lines and new rates once all the relevant cost factors have been established, it will permitted to include a full income tax allowance in its cost of service if 100 percent of the interests in the relevant test years are owned by individuals or entities that had an actual or potential

income tax liability in those years. The procedures for doing so are discussed below in the section F of this order dealing with further proceedings.⁴³

3. The Lakehead Doctrine and Substantially Changed Circumstances.

28. In the Opinion No. 435 orders the Commission concluded that a change in policy, such as the adoption of the *Lakehead* income tax allowance policy in 1995, could be grounds for concluding that there were substantially changed circumstances provided that a complainant established the impact stemming from that change. The Commission therefore concluded that a change in policy could not establish substantially changed circumstances in and of itself absent evidence of the actual impact of the policy change.⁴⁴ In the March 2004 Order the Commission concluded that the application of the *Lakehead* policy, and the cost changes that would result, would not be used as a stand-alone criterion in determining if substantially changed circumstances had occurred. The Commission stated that application of the *Lakehead* policy could lead to anomalous results, citing to the example of the North and Oregon Lines. In both cases, the statistical tables analyzing those lines showed an extensive decline in the amount of the permitted tax allowance, as much as 25 percent in the case of the North Line, in a time frame when the total costs of operating that line were increasing.⁴⁵ Since substantially changed

⁴³ Several parties made supplemental filings in this docket asserting that the income tax allowance issue was raised through improper *ex parte* proceedings. As explained in Docket No. PL05-5-000, the fact that all parties had an opportunity to comment in that docket on this generic policy issue renders such arguments moot.

⁴⁴ *Opinion No. 435*, 86 FERC at 61,070-71.

⁴⁵ March 2004 order, P 35.

circumstances turns on improvements to the pipeline's return, this was an anomalous result. This was in contrast to other factors such as changes in rate base, allowed return, and volume which proved in the March 2004 Order to be more reliable indicators of the trends in the pipeline's return because they are tied more directly to pipeline operations.⁴⁶

29. As has been discussed above, on appeal, the court vacated that portion of Opinion No. 435 that suggested that the implementation of the *Lakehead* policy could be a basis for substantially changed circumstances.⁴⁷ Thus the court's remand was congruent with the Commission's revised position in its March 2004 order. On remand, the Commission is adopting the position established in Docket No. PL05-5-000 reversing the *Lakehead* doctrine. Since that doctrine is no longer applicable to any aspect of oil pipeline rate making, there is no basis at this point for including the *Lakehead* tax allowance factor in determining substantially changed circumstances either as a stand-alone factor or as an element in a full cost-of-service determination. This does not change the result in the Opinion No. 435 orders regarding the West Line rates since the Commission did not rely on a cost-of-service including the *Lakehead* adjustment in making its determination that there were no substantially changed circumstances to the economic basis of SFPP's West Line rates.

30. In the March 2004 Order the Commission utilized a standard Opinion No. 154-B cost-of-service analysis as a factor in its determination of whether there were substantially changed circumstances for SFPP's North and Oregon lines, and as a control for its determination that there were substantially changed circumstances for the West Line rates for the years stated earlier in this order. Those calculations included the *Lakehead* adjustment in developing the tax allowance to be included in that cost-of-service analysis. Since the Commission is no longer applying the *Lakehead* income tax allowance doctrine, it is necessary here to adjust the cost-of-service used in developing the substantially changed circumstances determinations in the March 2004 order. That adjustment increases the relevant costs and thereby decreases any improvements in the SFPP's return that were contained in the March 2004 analysis. Since it is the relative improvement to the pipeline's return that underpins the analysis of substantially changed circumstances, there would be no change in the determinations in the March 2004 Order regarding the North and Oregon Lines. This is because the Commission found that there were actual cost increases rather than a decrease in costs. As such, this did not warrant a determination that there were substantially changed circumstances to the economic basis of the rates on those two lines. An adjustment to the income tax allowance serves to increase costs further. As was previously discussed, the determination that there were

⁴⁶ *Id.* at PP 29-30.

⁴⁷ *BP West Coast* at 1280.

substantially changed circumstances to West Line rates did not turn primarily on the cost-of-service analysis, but rather on increases in volume and decreases in two stand-alone cost factors. However, as discussed below, the change in the income tax allowance is such that the Commission has revised the cost-of-service calculations for the West Line rates in the March 2004 Order to assure consistency with the analyses made in that order.

B. Determinations of Substantially Changed Circumstances

31. The remand opinion also requires further review of the Commission's prior conclusions regarding the jurisdictional status of the Watson Station drain dry facility charges. The remand opinion and the Commission's conclusions regarding the *Lakehead* policy also require that the prior rulings on substantially changed circumstances regarding the North and Oregon Lines in the March 24 Order be revisited here. There are no changes in the determinations regarding the North, Oregon, and West Lines.

1. The Watson Station Drain Dry Facilities.

32. The Commission determined in the Opinion No. 435 orders that charges that are included in private contracts and are effective for 365 days before the enactment of the EAct were grandfathered even though not on file with the Commission. The Commission further concluded that the contractual charges for the Watson Station drain dry facilities met this standard and therefore were grandfathered.⁴⁸ The same issue arose in the Docket No. OR96-2-000 proceedings, but the Commission deferred ruling on the matter until completion of judicial review of the Opinion No. 435 orders. On review the court held that neither conclusion was adequately justified and vacated those rulings. In doing so, the court noted that its ruling was based on the Commission's reasoning and not necessarily on its conclusion. The court held that the first conclusion addressing contractual but unfiled rates was inadequately grounded in the filed rate doctrine, and that the second regarding the length of time the rates were in effect was not supported by record evidence. The court left open for reconsideration by the Commission on remand (1) whether the EAct requires that rates or charges be filed with the Commission for the grandfathering provisions of the EAct to apply, and (2) if relevant, the date the charges were effective for the Watson Station drain dry facilities.⁴⁹

33. On remand, the Commission concludes that the charges for the Watson Station drain dry facilities can not be grandfathered because they were not effective for the required 365 day period before the enactment of the EAct. In its Opinion No. 435

⁴⁸ *Opinion No. 435*, 86 ERC at 61,007-76.

⁴⁹ *BP West Coast* at 1273-74.

orders the Commission focused on the execution date of the various Watson Station contracts. However, the statute does not speak in terms of the execution date of contracts, but when the rates (or charges) were effective. These dates are not necessarily the same. Based on the additional evidence submitted in Docket No. OR96-2-000, *et al.*, the Commission finds that SFPP executed a series of contracts under which it would build the Watson Station drain dry facilities to enhance the pressure of its system at the Watson Station receipt point. The contracts were in lieu of shippers providing their own pumping facilities to assure that petroleum products were tendered to SFPP at pressures that met the pipeline's tariff requirements. Some of these contracts were executed before October 25, 1991, and some thereafter.⁵⁰

34. However, the actual charge could not be determined and set until the facilities were completed and SFPP knew what the total volume would be. On October 18, 1991, SFPP sent all shippers that had signed contracts a letter stating that the charge had been temporarily reduced to 3.2 cents a barrel and would likely increase to 4 cents on January 1, 1993. The same letter stated that the "letter served as official notice that the facilities will be operational by November 1, 1991, and thus billing will commence on that date."⁵¹ It is clear that no final charge was determined before October 18, 1991, and thus the various contract dates are not controlling. The question then is when the 3.2 cent charge was in effect.

35. As a common carrier SFPP may not bill for any services before it is in a position to hold itself out as able to provide the service on demand.⁵² Thus any charges for service may not become effective until such time the carrier can actually provide the service on demand and bill for it. According to SFPP's letter, this date was November 1, 1991. Thus, for purposes of the EAct, this date was less than 365 days before the

⁵⁰ See Prepared Answering Testimony of Mary F. Morgan dated May 15, 2001, Ex. MFM-1 at Tab D. The execution dates were: Union Oil Company of California (Unical), July 26, 1991; Mobil Oil Corporation, August 20, 1991; ARCO Products Company, October 3, 1991; Chevron Oil Company, October 28, 1991 (based on letter to which there is attached an unexecuted contract); and Shell Oil Company, April 9, 1992. The date of enactment of the EAct was October 24, 1992.

⁵¹ *Id.*, Tab E.

⁵² The Commission's regulations treat rates and charges equally in all regards. See 18 *F.F.R.* §§ 340.1(a), (b), and (c). The regulations also require no rate can become effective before shippers are advised of the effective date of rate or charge with a minimum of 30 days notice. See 18 *C.F.R.* §341.2(b) and (c). While SFPP did not provide 30 days notice, it did follow the common carrier protocol embedded in the Commission's regulations by advising the shippers when the charges would be in effect.

enactment of the EPAct. Therefore, the charges for the Watson Station drain dry facilities were not in effect for 365 days before the enactment of the EPAct and cannot be considered as grandfathered. As with the case of a rate that becomes effective for all shippers when the service commences, this assures that the rate paying status of all shippers will be the same regardless of when their contracts were executed.⁵³

36. The court also remanded the issue of whether charges in private contracts could be grandfathered under the EPAct even though not on file with the Commission. Because the Commission has concluded that the charges for the Watson Station drain dry facilities were not in effect for more than 365 days prior to the effective date of the EPAct, and therefore could not be grandfathered, there is no need to address this later point. Similarly, there is no need to address the ALJ's conclusion in his June 24, 2003 initial decision in Docket No. OR96-2-000, *et al.* that there were substantially changed circumstances to those rates because SFPP had recovered all the capital costs of those facilities.⁵⁴ The structure for further proceedings with regard to the charges for the Watson Station drain facilities is outlined in section F of this order.

2. The West, North and Oregon Lines.

37. As discussed, the Commission concluded in its March 2004 Order that there had been a substantial change to the economic circumstances that were the basis of the rates for the West Line, but no such change for SFPP's North and Oregon Lines. While the Commission's March 2004 Order did not contain a precise definition of the phrase "substantially changed circumstances," the March 2004 Order was grounded in the analysis contained in Opinion No. 435. There the Commission concluded that the degree of change could not be 10 percent or other similarly low number.⁵⁵

38. In its subsequent March 2004 Order the Commission focused on three elements used in pipeline rate design, volume, rate base, and allowed return, in determining whether there were substantially changed circumstances on the West, North, and Oregon

⁵³ The contracts are similar to condition precedent contracts for the construction of gas pipeline facilities. The rates for these contracts are not in effect until (1) a final determination of the projects costs and volumes enables the pipeline to calculate the rate and (2) the pipeline notifies the Commission of the in-service date. The rates become effective on the in-service date.

⁵⁴ See 103 FERC ¶ 63,055 (2003) at PP 180-195, pp. 65,160-61.

⁵⁵ *SFPP*, 86 FERC at 61,065-67. This conclusion was not appealed and therefore is not addressed by the remand opinion.

Lines. The March 2004 Order used volume as proxy for revenue, and changes to rate base and allowed return as major indicia of changes in total expense.⁵⁶ In analyzing whether there were substantially changed circumstances, the Commission summed the increase in volume with a decrease in an expense factor (or total expenses) because an increase in volumes (revenues) coupled with a decrease in expenses increases the pipeline's net, and hence, its return compared to that in the base year.⁵⁷ For example, an increase in revenues of 13 percent combined with a decrease in rate base or allowed return of 12 percent, when measured against the same factors for the base year, would imply an overall increase in the pipeline's return of some 25 percent compared to the

⁵⁶ The rationale for the use of these three factors is explained in the March 2004 order at PP 16 and 29-31. The Commission utilized the full Opinion No. 154-B cost-of-service without a full income tax allowance as a check on those three narrower elements and concluded that there was a relatively close correlation between the stand-alone factors, rate base and rate of return allowance, and of the change in SFPP's cost-of-service. The Commission did not adopt the latter as standard protocol to be used in determining substantially changed circumstances. Tables 1, 2, and 3 to this order indicate that inclusion of a full income tax allowance significantly reduces or eliminates any correlation between the two stand-alone factors and a full Opinion No. 154-B cost of service. As discussed in the text, *infra*, this has required the Commission to rely more heavily on the cost-of-service comparisons in making its determinations here.

Because the correlation in the March 2004 order has weakened, this suggests that a full cost-of-service and revenue comparison should be used in making any determination of whether there are substantially changed circumstances to the economic basis of a rate. Since this may only be possible after discovery and preparation of such an analysis by a complainant, complainants at a minimum should make some showing of a substantial change in return when filing the initial complaint utilizing the information on revenues and expenses contained in the pipeline's Form-6. While SFPP complained about the preparation of the full cost of services for the complaint years in the instant proceeding, its position on the merits of the substantially changed circumstances issue was clearly improved by it doing so. As noted, given the novel issues involved here, the Commission concludes that the ALJ did not abuse his discretion by so requiring.

⁵⁷ The base year is the year in which the rate was created and reflects the economic circumstances that were the basis for the rate. The changes must occur after the effective date of the EPAct and before the complaint. *See Opinion No. 435*, 86 FERC at 61,065-67, as affirmed by *BP West Coast* at 1279-80. This results in the formula discussed in detail at PP 22-26 of the March 2004 Order, and incorporated herein.

base year.⁵⁸ The Commission reiterates here that it is changes in return, and hence a pipeline's profit expectations, that ultimately determines whether there had been a change in the economic basis of the rate.⁵⁹

39. Tables 1 and 2 recalculate the results contained in the March 2004 Order for the West Line, as do the related charts in the appendix.⁶⁰ Given the display of the net change in the West Line return reflected in Table 2 when the improvement in volumes is combined with any of the cost factors, even when a full income tax allowance is included, the Commission affirms the findings regarding the West Line in the March 2004 Order.⁶¹ In the aggregate there is an improvement of over 25 percent for the West Line rates in any of the years in dispute when comparing the percentage improvement in volumes and that of the overall cost of service. In the case of the analysis for the delivery points on the West Line reflected in Table 3 of the appendix the gain is at least 20 percent for each year in which the Commission found substantially changed circumstances to the economic basis for a rate to a specific West Line delivery point in the March 2004 Order.⁶² Thus the Commission again concludes there were substantially changed

⁵⁸ The percentage change for each of the three elements for the five years 1995-1999 for all three lines is contained in Table 1 of the appendix. The net percent change of volumes and three cost factors (following the example in the text) is contained in Table 2 of the Appendix. Both tables use the same volumes as in the March 2004 Order, but use cost factors and a cost-of-service that includes a full income tax allowance. This permits the reader to review the impact of a full the income tax allowance. For a detailed comparison with the March 2004 order, compare the line graphs and the charts contained in the appendix to this order with those contained in the appendix of the March 2004 Order.

⁵⁹ March 2004 Order at PP 16, 29, 45-46, 50, and 74 (particularly footnote 61).

⁶⁰ In all the charts the heavy black bar reflects the figure used in making the decisions here. The formula used is the same as in the March 2004 Order and is the one upheld by the court in *BP West Coast*. See the March 2004 order at PP 22-26 and *BP West Coast* at 1278-81.

⁶¹ The March 2004 Order text incorrectly states that volume increased by 16.61 percent. The correct figure from Table 2 of the March 2004 appendix is 16.40 percent.

⁶² The analysis for the individual delivery points in the March 2004 Order relied on volumes plus the average cost decline for the West Line since individual cost figures for each point were not available. However, as Table 3 to this order shows, the results are the same here. These revised cost figures do not modify the conclusions contained in the March 2004 Order for the individual destinations in the year for which the

(Continued)

circumstances on the West Line for the years stated in the March 2004 Order. This includes its prior determination that there were substantially changed circumstances at the Phoenix West delivery point in 1997, the year in which the cost-of-service analysis, and all calculations, shows an improvement over the base year of at least 20 percent.⁶³

40. In its March 2004 Order the Commission also found that there had been no change in the economic circumstances of the North and Oregon Lines. In the case of both lines the cost-of-service increased in most years compared to the base year even as volume also increased. As is also reflected in Tables 1 and 2 of this order, with the use of a full income tax allowance, the North Line the resulting change still falls below the 10 percent line contained in Opinion No. 435. This is also true for the rate base factor and for all but two years for the allowed return factor, both of which are less than 15 percent.⁶⁴ In the case of the Oregon Line, with or without a full income tax allowance, the results here reflect a negative return. For the other cost factors, the combination of the percentage change in volumes and those cost factors is negative or less than ten percent. The Commission affirms its prior conclusion in the March 2004 Order that there were no substantially changed circumstances to the rates of the North and Oregon Lines.⁶⁵

C. Cost-of-Service Determinations

41. The court affirmed the cost-of-service determinations in the Opinion No. 435 orders with two exceptions, the allocation of regulatory litigation costs between the East and West Lines, and the Commission's denial of East Line reconditioning costs for the period 1993 through 1998. The Commission modifies its prior ruling on the allocation regulatory litigation costs, but affirms its prior holding regarding the reconditioning costs.

Commission determined that there were substantially changed circumstances for that delivery point.

⁶³ As Table 3 shows, this is consistent with the determination for the other West Line delivery points, all of which also show changes in excess of 20 percent.

⁶⁴ The results here thus show even less of a change in the pipeline's economic circumstances in the March 2004 Order.

⁶⁵ The Commission reaches its conclusions for these two lines recognizing, as the court stated, "Section 1803' overarching purpose of limiting litigation over pre-EPA rates,"⁶⁵ and that the dictionary definition of the word "substantial" suggests a change that is considerable in quantity or significantly large. A change of less than 15 percent does not meet this standard given the Commission's prior rejection in Opinion No. 435 of a threshold of 10 percent or some other similarly low number.

1. Allocation of Regulatory Litigation Costs

42. The Commission's Opinion No. 435-B allocated 50 percent of SFPP's regulatory litigation costs to each of the East and West Lines.⁶⁶ In reviewing the Commission's allocation of regulatory litigation costs between the East and West Lines, the court stated that allocating such costs to the parties that benefited could be appropriate. However, the court concluded that the record did not support an allocation of 50 percent each to the West and East Lines based on the ALJ's observation of the flow of litigation.⁶⁷ On remand, the Commission concludes that it should adopt the volumetric allocation initially used in Opinion No. 435. The Opinion No. 435 orders stemmed from extensive litigation on four groups of issues: the jurisdictional status of the West Line rates, the reasonableness of the East Line rates, the legal and economic consequences of reversing portions of the West Line, and general regulatory issues relating to pro-rationing and tariff publication. Of these, matters of general regulatory policy applied to all parties, while issues relating to the reversal of the West Line were relevant mainly to East Line shippers and were relatively narrow in scope and the extent of argument. Thus, neither of these issues is determinative of the allocation matter at issue here.

43. The jurisdictional issues affected only the West Line rates. Nevertheless, most shipper parties addressed those issues as well. A principal factor underlying the Commission's prior determination that 50 percent of legal fees should be allocated to each line was the extensive cost-of-service litigation to establish the just and reasonableness of the East Line rates. At the time it did not appear equitable to allocate these costs on the basis of volume given that the West Line had 83 percent of the volumes on the SFPP South Lines (the West and East Line combined), and the East Lines only 17 percent.⁶⁸ While a number of cost issues unique to the West Line were not addressed at that time,⁶⁹ the Commission has determined in its March 2004 Order that the West Line rates are no longer deemed just and reasonable for certain years.

44. Thus, the Commission's prior rulings on such basic issues as starting rate base, rate base allocation, capital structure, amortization, the deferred equity component, accumulated deferred income taxes, allowance for funds during construction, accumulated depreciation, cost of capital, the use of a rate cap, allocation of costs

⁶⁶ See 96 FERC at 61,080.

⁶⁷ *BP West Coast* at 1297-98.

⁶⁸ Footnote 56, *supra*.

⁶⁹ *Id.* at 61,078.

between jurisdictional and non-jurisdictional service, military services and costs, and some aspects of the rulings on litigation costs, power costs, reconditioning costs, and environmental costs are directly relevant to West Line rates, and in many cases, beneficial. Given this and the continued participation by West Line shippers on those issues during the Opinion No. 435 orders litigation, allocation of legal costs on the basis of volumes is appropriate and the result that is most adequately grounded in the record.

2. Reconditioning Costs

45. In the Opinion No. 435 orders the Commission concluded that SFPP had not justified the inclusion of any reconditioning costs for the East Line under the Commission's rate making procedures. The Commission found that SFPP had no reconditioning costs during the 1994 test year used to establish rates in the Opinion No. 435 order proceedings, and that no such costs were established during the additional nine month period for adjustments for costs that will be know and measurable during that period. The court remanded, stating that the Commission had departed from the strict test period concept in permitting SFPP to recover non-recurring legal costs it incurred in the years 1995 through 1998, which were outside the 1994 test year, and thus appeared to be inconsistent in denying the non-recurring reconditioning costs. The court instructed the Commission to review its prior conclusion in light its departure from the test period method in allowing recovery of legal costs and to further explain why recovery of reconditioning costs incurred outside the test year the those expenses might violate the filed rate doctrine.⁷⁰

46. The test period methodology works as follows. If a pipeline's regular costs increase from the amount embedded in a pipeline's existing rates, the pipeline can file a rate case to adjust its rates to recover those cost changes, based on a test year that reflects its current rather than historical cost profile. This procedure permits an orderly review of the pipeline's entire cost structure and prevents an over-recovery of the pipeline's cost-of-service by assuring that both positive and negative changes in revenue and expenses are included in the evaluation. Even if costs increase during the period that the rate case is pending, the normal procedure is for the pipeline to file another case and to establish a new test year which reflects those additional costs.

47. Here the Commission has permitted SFPP to recover unusually large, non-recurring legal expenses through the use of prospective surcharges that expire once the expenses are recovered. This has been done to allow recovery of costs that resulted from litigation that SFPP did not commence, and to that extent did not have control over the

⁷⁰ *BP West Coast* at 1299-1302.

timing of when the expenses would be incurred.⁷¹ The procedure adopted in the Opinion No. 435 orders recognizes this fact but serves to prevent these non-recurring costs from becoming embedded in the pipeline's rates. Filing a new rate case to recover legal costs based on the expenses for the years 1995-1998 would have gained SFPP nothing because these additional costs also could not have been included in SFPP's rates because they were also non-recurring costs. In contrast to the non-recurring legal costs, in the Opinion No. 435 proceedings, SFPP projected reconditioning expenses to be a 15 year program beginning in 1995 after adoption of the reconditioning program by SFPP's Board of Directors in 1994. SFPP sought an annual charge of three million dollars to be included in its cost-of-service to fund what it represented would be a systematic reconditioning program. Alternatively, SFPP suggested an annual surcharge that varied with the amount of the expenditures actually made. However, SFPP did not contend that the expenditures would be non-recurring, and in fact took the opposite position. It was the regularity of the program that distinguished it in the Commission's analysis from the non-recurring legal costs allowed in the Opinion No. 435 orders.⁷² Therefore the Commission excluded the reconditioning expenses from SFPP's rates.

48. On remand the Commission concludes that it should affirm its previous conclusion excluding the reconditioning costs for the period 1994 to 1998. While it is true that the costs are now more know and measurable based on SFPP's compliance filings, this does not change the fact that the reconditioning costs were intended to have some regularity and were to be incurred over an extended period of time. When the costs would be incurred, and the amount, was under SFPP's control. As such, those costs should have been established as a known and measurable item during the test period. SFPP elected to follow a more general procedure by establishing a reserve against future earnings. This might well be proper based on generally accepted accounting principles, but is not in keeping with the Commission's well established regulatory procedures regarding costs that are to be recovered over a long period and expected to be recurring in their nature.

49. The recovery of non-recurring costs is limited to narrow situations where the cost involved is both recognized as a legitimate cost-of-service expense and it is difficult to incorporate the cost into the pipeline's cost-of-service as recurring operating expenses. Otherwise, when facing a cost increase oil pipelines are required by the Commission's regulations to establish that any increase in costs cannot be recovered through the annual

⁷¹ SFPP did have some control over the amount of the costs that would be incurred and the Commission has expressed its concerns in this regard. This does not change the fact that SFPP did not have control over the timing of the litigation.

⁷² In this regard, the Commission never stated that the proposed reconditioning costs would be non-recurring. As noted, SFPP's representations were to the contrary.

increase permitted by the Commission's indexing methodology. If a pipeline believes the increase permitted under the annual index is inadequate, it may file to further increase its rates by establishing that a substantial divergence exists between costs actually incurred by the carrier and the rate allowed by the indexing methodology such that the resulting rate would not may then file a rate case consistent with the information required to justify a new cost-based rate or a general rate increase.⁷³

50. In the instant case SFPP itself proposed the use of a surcharge procedure as an alternative to eliminate the need for addressing the issue in a rate design context. The Commission has accepted such surcharges when the cost to be incurred is a legitimate cost-of-service expense but is likely to vary in its application. This is particularly true if the expense is of a type that is not expected to be continuously incurred over the life of the pipeline and is not of the type that would be periodically adjusted as part of a general rate case. Here SFPP could have made a limited rate filing justifying the surcharge on the grounds that the reconditioning costs resulted in an indexed rate that would not enable SFPP to recover its costs, *i.e.*, the rate would be too low to be a just and reasonable rate. Such a filing would have also enabled SFPP to develop a rate that could have been trued-up on an annual basis and would have avoided the difficulty of embedding the costs in SFPP overall cost-of-service.

51. As the Court noted, by the time SFPP made the compliance filing addressed by Opinion No. 435-B (issued September 13, 2001), the Commission had before it the actual reconditioning costs for the East Line incurred through 1998. The record shows that while the reconditioning costs were not as high as SFPP had predicted, they were substantial and essential for the safe operation of the pipeline. However, the knowledge of the cost specifics reflects the benefit of hindsight for a cost-of-service element that should have more appropriately been included in rate filing that was consistent with the Commission's indexing regulations. For this type of normalized operating expense, which SFPP had projected in Docket No. OR96-2-000, *et al.*, the annual indexing regulations apply to all oil pipelines whether or not they are in litigation about the reasonableness of their rates. SFPP may have been reluctant to apply for a surcharge out of concern that such a filing would open all of its cost-of-service rates to review without regard to whether they were grandfathered because SFPP would have to file information consistent with that required to establish a new rate.⁷⁴ But such litigation concerns

⁷³ This assures that the pipeline establishes that costs it claims have increased are not offset by other changes that benefit it, such as increases in revenues or reductions in other costs. As such, the indexing methodology is consistent with the general test period rate design methodology discussed above.

⁷⁴ See 18 C.F.R Part 346, Oil Pipeline Cost-of-Service Filing Requirements (2004).

should not compromise the Commission's oil pipeline rate making procedures through an accommodation that allows SFPP to justify higher costs midstream in a rate case when those costs (unlike its regulatory costs) were not engendered by the proceeding itself. The Commission notes that SFPP had to prepare cost of service studies for the each of the years at issue (1996-1999) in Phase II of Docket No. OR96-8-000, *et al.*, and will have an opportunity to justify much of its long-term reconditioning expenses in those dockets. For these reasons the Commission affirms its original decision to deny SFPP reconditioning expenses in Docket No. OR92-8-000, *et al.*

D. Reparation Issues

52. The court affirmed the Commission's rulings regarding all the reparation issues addressed by the Opinion No. 435 orders.⁷⁵ The reparation issues addressed by this order are raised by rehearing requests of the Commission's March 2004 Order in Docket No. OR96-2-000, *et al.* That order included a short discussion of whether the *Arizona Grocery* doctrine⁷⁶ precluded East Line shippers from obtaining reparations during the Phase II litigation of Docket No. OR96-2-000, *et al.* The Commission concluded that doctrine did not preclude reparations for most East Line shippers under the circumstances of that docket.⁷⁷ However, two parties, the Western Refining Company, L.P. and Navajo Refining Company, L.P. (the rehearing parties) filed requests for rehearing of one sentence in the background section of the March 2004 Order, which stated that reparations would not be available to complaints filed by East Line shippers after August 1, 2000.⁷⁸

53. The rehearing parties state that the cited comment misapplies the *Arizona Grocery* doctrine by barring reparations for complaints filed against the East Line rates after August 1, 2000. They cite numerous passages from the Opinion No. 435 orders stating (1) that the Commission did not intend that any Commission determination of a just and reasonable rate for the period November 1992 through August 1, 2000 bar reparations for complaints filed after August 1, 1995, and (2) that the rate established as of August 1, 2000 was not intended to be a final, lawful rate. They thus claim that the August 1, 2000 East Line rates were always intended to be interim rates, that the related compliance filings were nothing more than proposed rates filed by SFPP, and were accepted and

⁷⁵ *BP West Coast*, Part III.

⁷⁶ March 2004 Order PP 81-82

⁷⁷ *Id.*

⁷⁸ *Id.*, P 11.

suspended by the Commission on that basis. They argue that this interpretation of the Commission's prior orders is consistent with the Commission's numerous statements that its Opinion No. 435 orders were not intended to prejudice the right to reparations of East Line shippers filing complaints after August 5, 1995.

54. The rehearing parties further argue that it was arbitrary and capricious to establish a cutoff date of August 1, 2000, and thereby exclude from a claim for reparations two complaints that were filed on August 4, 2000 and August 8, 2000. They also claim that the cited comment deprives them of the right that all shippers have to file a complaint and to obtain reparations for a two year period before the complaint if the challenged rate is shown to be unjust and unreasonable. Finally, they assert that the cited statement is an incentive for protracted litigation because the pipeline has an incentive to prolong litigation in order to delay the effective date of any rate that will be applied prospectively.

55. The Commission denies rehearing. The first step in explaining this issue is a summary of what the Commission actually did in the Opinion No. 435 orders regarding the East Line rates. Because those rates were not grandfathered under EPAct, the Opinion No. 435 orders made numerous rulings on cost-of-service factors and required SFPP to make a series of compliance filings conforming to those orders. In each case SFPP was required to prepare a filing that explained how a rate would be determined based on the rulings and to actually make a rate filing that conformed to those calculations. When SFPP filed new East Line rates in response to the Opinion No. 435-A, the Commission accepted and suspended that rate, effective August 1, 2000. The Commission required SFPP to make additional compliance filings that required modification of the August 1, 2000 rates, but any changes were effective on that date. The effect of the Commission's action was to provide some relief to all of SFPP's East Line shippers as of August 1, 2000, not just to those who would be entitled to reparations if the Commission had delayed setting new rates for the East Line until all cost issues had been resolved.

56. In fact, it was not until February 15, 2002, that an order issued finalizing new rates for the East Line, effective on August 1, 2000.⁷⁹ Thus, for over one and half years all shippers had the benefit of lower East Line rates while the Commission worked out the nuances of SFPP's compliance filing. During this period, and on appeal, SFPP argued that the Commission had violated the *Arizona Grocery* doctrine by modifying the new East Line rates after they first became effective on August 1, 2000, and continuing to make those rates effective on that date. The court rejected this argument, stating (1) that the *Arizona Grocery* doctrine applies only to final Commission rates, and (2) that the Commission clearly did not intend the August 1, 2000 rates to be final rates when they

⁷⁹ See *SFPP, L.P.*, 98 FERC ¶ 61,177 at 61,657 (2002).

were first filed with the Commission.⁸⁰ Therefore the Commission was free to require that any modifications of the East Line rates be effective on August 1, 2000. Because of the rulings on certain issues in this remand order SFPP will have to file revised rates for its East Line. The Commission will also require those rates to be effective on August 1, 2000, with the intent of eventually taking final action on the new East Line rates on that date. When there is no more Commission action on those revised East Line rates, the rates will become final rates under the *Arizona Grocery* doctrine.

57. Since any final lawful East Line rates will be effective as of August 1, 2000, they may only be changed prospectively. The rehearing parties assert that it is arbitrary and capricious for the Commission to choose August 1, 2000 as a date that the new East Line rates will become lawful rates. There is no merit in this argument. The Commission chose August 1, 2000 as the effective date in the normal course of its proceedings, and clearly could not have known that the rehearing parties intended to file additional challenges to the East Line rates. In any event, the Commission has afforded complaining parties adequate time to file complaints before that date. When the Commission issued Opinion No. 435 in January 1999, it afforded all parties that had filed complaints between August 5, 1995 and that date to refile their complaints in light of the Commission's rulings. Numerous parties did so in January 2000, which included additional challenges to the East Line rates. Thus, the rehearing parties had ample time to review the Commission's rulings Opinion No. 435, and the related modifications in 435-A, issued May 17, 2000, and to determine what action they wished to take. In any event, while it may be true that there is some incentive to prolong litigation if a rate may only be changed prospectively, this is true for all lawful rates under the statutory scheme.

58. Finally, given the rehearing parties' arguments that the Commission is departing from the statements in its prior orders, it may be helpful to reiterate how the August 1, 2000 rate was designed and the implications for the complaints now before the Commission in Phase II of Docket No. OR96-2-000, *et al.* In the Opinion No. 435 orders the Commission found that SFPP's East Line rates were unjust and unreasonable. In establishing new prospective rates, the Commission first determined what the just and reasonable rates should be for the year 1994 using a cost-of-service for that year. The rates were then indexed forward under the Commission's index regulations to the August 1, 2000 effective date. This determined what the just and reasonable East Line rates should have been for each of the years 1994 through August 1, 2000. To the extent that any complainant paid rates that were higher than the rates so determined, the complainant would be awarded reparations for the relevant years and for two years before the date of the complaint. If a shipper was not a complainant in the Opinion No. 435 proceedings, that shipper would receive lower rates but would not receive reparations for those years. This dichotomy was affirmed on appeal.

⁸⁰ *BP West Coast* at 1304-05.

59. Thus, as of August 1, 2000, there were several categories of shippers on SFPP's East Line. All shippers paid the same rates as of August 1, 2000, because those rates were set prospectively and applied to all shippers. Shippers who were complainants in the Opinion No. 435 proceedings had their rates reduced for the period between the date of their complaint and August 1, 2000. Shippers who were not complainants did not have their rates reduced for the period before August 1, 2000. Any complaint filed against the East Line rates after August 1, 2000 will be constrained by the lawful rate the Commission establishes as of August 1, 2000.

E. The Compliance Filing to the March 2004 Order

60. The Commission's March 2004 Order stated two concerns regarding KMFP's December 31, 1998 acquisition of SFPP, L.P. The order noted that SFPP had used the purchase method of accounting to reflect that acquisition. Under the method, SFPP's balance sheet was adjusted to reflect the difference between its book value in prior years and the value of the transaction. The Commission's first concern was that SFPP did not obtain Commission permission to restate its accounts as of December 31, 1998. Second, the Commission stated that SFPP wrote up its rate base, thus potentially increasing the amount of depreciation and return used to determine its rates in Phase II of Docket No. OR96-2-000, *et al.* The Commission therefore directed SFPP to seek permission from the Chief Accountant within 30 days to restate its accounts as of December 31, 1998. The Commission further stated that SFPP could not use any increase in its accounts from the December 31, 1998 write-up to design its rates.⁸¹

61. On April 26, 2004, SFPP made a compliance filing to the March 2004 Order. SFPP stated that on November 18, 1999, it submitted to the Chief Accountant's office a request for confirmation it had complied with the Commission's regulations regarding the restatement of its accounts. SFPP attached a copy of that letter to its filing and stated that it included pages in the Form 6 format reflecting the implementation of the proposed adjustments as of the acquisition date. It further stated that the adjustments were well known to the Commission and the shipper parties because they were utilized to develop the record in Docket No. OR96-2-000. SFPP further stated that the Commission's accounting regulations, Instruction for Carrier Property Accounts No. 3-11(b), require that SFPP must record the assets at costs as of the date of acquisition, and that the write-up did just that.

⁸¹ March 2004 Order at PP 79-80.

62. Indicated Shippers and ConocoPhillips filed protests on May 11 to SFPP's compliance filing. They address seven main points.⁸² First, they contend that SFPP made no filing since there was no formal notice or acknowledgement by the Chief Accountant's office. Second, the Commission's accounting regulations do not apply to SFPP nor does the regulation require SFPP to write-up its accounts. Third, SFPP did not comply with the Commission's requirement that SFPP submit the evidence of value required to support the valuation. Fourth, that SFPP was inconsistent in its use of the purchase method. Fifth, that SFPP did not comply with the regulation requiring that a purchase price in excess of net assets acquired not be booked to tangible assets, from which rate base is taken. Sixth, SFPP wrote up the equity component of its rate base, which distorts Page 700 of its Form 6 used to set the annual increase under the Commission index procedures and that this page should be restated. Seventh, the accounting treatment will result in distortions in the allocation of overhead costs between KMEG and SFPP, SFPP's capital structure, income taxes, and the amount of Arizona property taxes to be included in its costs, thus distorting the rates to be established in Phase II of Docket No. OR96-2-000, *et al.* Indicated Shippers also included a lengthy argument as to why a write-up should not be permitted and its probable impact on rate payers by changes to various accounts. On May 25, 2004, SFPP filed an answer contesting these assertions, which was opposed by several shippers.⁸³ This was followed by more comments by Indicated Shippers.⁸⁴

63. The Commission will first address some procedural matters. Indicated Shippers' protest to the compliance filing is filed as a matter of right. SFPP's May 25 answer to the protest addresses a series of assertions not previously stated by the parties, contains useful information, and is accepted. Beyond this, none of the subsequent comments filed provide any meaningful or helpful information and in the main only reargue positions stated in the initial protests. Therefore they are rejected and SFPP's proposed reply is unnecessary. In addition, on June 9, 2004, a motion to intervene was filed out-of-time and protest was filed by America West Airlines, followed by similar motions on June 14, by Northwest Airlines and on June 16 by the Air Transport Association of America. SFPP filed a timely objection to these motions. It is far too late for interventions in this docket and the late filed motions to intervene are denied.

⁸²At that time Indicated Shippers consisted of BP West Coast Products LLC (formerly ARCO Products Company, A Division of Atlantic Richfield), ExxonMobil Oil Corporation ("ExxonMobil) (formerly Mobil Oil Corporation).

⁸³ Conoco Phillips Company, Ultramar Inc., and Valero Marketing and Supply Company, and Chevron Products Company.

⁸⁴ Indicated Shippers on June 9 and June 19, 2004.

64. Turning to the merits, in its April 26, 2004 compliance filing, SFPP states that it had previously requested approval of the purchase accounting adjustments in question and provided copies of a letter purportedly sent to the Commission's Chief Accountant dated November 18, 1999. There is no record of the Commission having received SFPP's letter and no indication that the Commission considered or acted on the accounting proposal contained in it. Regardless of these circumstances, a compliance filing detailing the accounting adjustments applied upon KMEP's acquisition of SFPP is now before the Commission. This resolves the issue of whether SFPP complied with the requirement to obtain Commission approval to modify its accounts to reflect the acquisition of SFPP by KMEP.

65. The second issue is whether SFPP properly modified its accounts and the potential impact of any such changes on the design of SFPP's rates. KMEP accounted for the transaction using the purchase method of accounting and used "push-down accounting"⁸⁵ to establish a new accounting and reporting basis for SFPP's assets and liabilities, reflecting KMEP's cost of acquisition. Through the use of "push-down" accounting KMEP restated SFPP's pipeline property to conform to the purchase accounting requirements of Instruction 3-11(b), Accounting Under a Purchase, of the Uniform System of Accounts Prescribed for Oil Pipeline Companies (USofA). Instruction No. 3-11(b) requires an entity to record purchased assets at their acquisition cost. As a result of the revaluation SFPP's net carrier property increased from \$468 million to \$1.2 billion.

66. Under push-down accounting the basis of accounting for purchased assets and liabilities is the same (acquisition cost) as if the acquired entity was merged into its parent's operation. Push-down accounting is an acceptable option under Generally Accepted Accounting Principles (GAAP). Although the Commission is not bound to follow GAAP, it generally does so provided that it does not conflict with sound regulatory principles.

67. Consistent with GAAP, the intent of Instruction No. 3-11 of the USofA is to record property acquired as a result of a merger or consolidation at its acquisition cost. Additionally, while push-down accounting is not specifically provided for in the USofA, the Commission has permitted its use for accounting and financial reporting purposes. Consequently, consistent with its past actions⁸⁶, the Commission will allow SFPP to use

⁸⁵ Under "push down" accounting, the difference between the purchase price and the book value of the company acquired is "pushed down" to the books of the acquired company.

⁸⁶ See letter order issued on June 18, 1992 in Docket No. AC91-17-000, TE Products Pipeline Company, L.P., approving the use of push down accounting.

push-down accounting to record the business combination for financial accounting purposes. However, the purchase accounting adjustment, regardless of which entity's books it may be recorded, on cannot be reflected in rates absent a showing of specific benefits to ratepayers. In order to ensure that this regulatory principle is adhered to, the Commission's approval is conditioned on SFPP maintaining full and complete information related to the business combination so that original cost records are available for use by the Commission for ratemaking purposes, and the amount of the original cost of carrier property, the amount of acquisition premium paid for such property, and related depreciation and amortization are disclosed in footnotes to the financial statements.

68. The protesting parties are correct that SFPP was required to provide supporting information on the fair market value of the acquired assets. Instruction 3-11(c) (2) further provides that the purchase price shall be equitably apportioned among the appropriate property or other accounts based upon the percentage relationship between the purchase price and the original cost or the fair market value of the properties. However, this instruction limits the amounts recorded for the properties and other assets acquired to the total purchase price. Instruction 3-11(c)(3)(a) also provides that where the purchase price is in excess of amounts recorded for the net assets acquired (e.g. goodwill), the excess shall be included in Account 40, Organization Costs and Other Intangibles. In addition, the portion of the total price assignable to the physical property is to be supported by independent appraisal or other such information as the Commission may consider appropriate.

69. SFPP filed as Exhibit 85 in Docket No. OR96-2-000 *et al.* an appraisal of SFPP's assets and liabilities, which SFPP asserts fully supports both the purchase price and its allocation to various accounts. Exhibit 85 supports the assignment of the purchase price to SFPP's property accounts. This is sufficient and accepted at this point. The Commission will not review the validity of the price paid because it was an arms length transaction and, as has been discussed, the increase in asset value that resulted may not be used to establish SFPP's rates.

70. Protesting parties also assert that KMEP did not apply the purchase method to its acquisition of the Calnev Pipeline. SFPP on the other hand asserts that it did in fact apply the purchase method to that acquisition. However, the point is irrelevant since, as discussed above, the Commission permits the use of push down accounting in these types of business combinations.

71. On the remaining issues, SFPP asserts that the net book value reflected on page 700 of its 1998 Form 6 does not reflect the purchase price adjustment and is consistent with the methodology used to develop the same page in its 1997 Form 6. SFPP's representation is correct on this point in the context of the questions raised by the Commission's March 2004 Order. Protesting parties have raised the issue regarding page 700 of Form in greater detail in Docket No. IS04-323-000 and thus the Commission will

explore issues underlying page 700 in that docket.⁸⁷ Finally, issues related to the pipeline's capital structure, overhead cost allocations, and Arizona property taxes are best addressed in Phase II of Docket No. OR96-2-000, *et al.*, since these are the specifics that are used to design SFPP's rate. Finally, any changes in rate levels required by Phase II of the Docket No. OR96-2-000, *et al.*, proceedings will result in refunds that return to the shippers a reduction in the base rates, and as such, a corresponding reduction in any increases to those rates under the index methodology.

F. Further Proceedings

72. The court remand and the rulings here require a number of further proceedings. These include determining just and reasonable rates for the East Line in light of the remanded dockets and determining whether further adjustments are to those rates are required based on the complaints in Docket No. OR96-2-000, *et al.* As noted, the West Line rates are now before the Commission in Phase II of that proceeding. The cost-of-service for both the East and West Lines is directly impacted by the *Policy Decision* and the proposed use of full income tax allowance in designing SFPP's rates. Separate proceedings are required to establish a just and reasonable charge for the Watson Station

drain dry facilities and the turbine fuel rates for the West Line that are now at issue in Docket No. OR92-8-000, *et al.* Each is discussed below.

1. The East Line

73. The East Line rates are presently before the Commission in two contexts. One is revisions that must be made to the 1994 test year in Docket OR92-8-000, *et al.* in light of the remand and the determinations here. The second is whether there should be further prospective changes to the East Line rates based on the 1999 test year (as it may be modified) in Docket No. OR96-2-000, *et al.* In both instances the most difficult issue at this point may well be the tax allowance issue since the record in both proceedings appears oriented to the *Lakehead* doctrine and the rulings in the court remand rather than the Commission's recent *Policy Statement*. While other issues should be able to be resolved on the existing record of these related proceedings, it may be necessary to supplement the record to determine whether SFPP meets the standards of the *Policy Statement* in the those two years.

⁸⁷ The docket involves SFPP's May 24, 2004 filing to adjust its rates pursuant to the Commission's indexing regulations. *See SFPP, L.P.*, 107 FERC ¶ 61,134 (2004). As such, it is more appropriate to address any issues related to the index calculation there.

2. The West Line.

74. In the March 2004 Order⁸⁸ and in this order the Commission has found that there were substantially changed circumstances beginning in 1995 to the West Line delivery points of Yuma, CalNev, and West Tucson and beginning in 1997 for the West Phoenix rates. Since complaints were pending against those rates in 1996 and 1997 or 1998, this suggests that it may be necessary to develop a record on tax allowances for the cost-of-service test years utilized for determining whether the rates to those points were just and reasonable in those test years.⁸⁹ After a new rate is established for any of the West Line complaint years, any further changes to the West Line rates would be on a prospective basis only. Thus, the next most logical year for determining whether the West Line rates are just and reasonable would be the calendar year 2000, the last year in which the amended complaints in these consolidated proceedings were filed.⁹⁰ Again, it is unclear whether the record for the years test year for the 1996 and 1997 or 1998 complaints, or the 2000 complaints, contains sufficient information to determine if SFPP's partnership structure met the standard contained in the *Policy Statement* in those years. Other issues have been briefed on the record before the Commission in Phase II.

3. The Watson Station drain dry facilities and the West Line turbine fuel rates.

75. The Commission has concluded here that the charges for the Watson Station drain dry facilities were not grandfathered in the years for which complaints were filed against those charges. Since there is no record before the Commission on the merits of whether those charges were and are just and reasonable, the Commission sets those charges for hearing. The West Line turbine fuel rates are a subset of the West Line rates that were involved in Docket No. OR92-8-000, *et al.* and are now before the Commission on remand from the court. Thus the Commission must make a reasonableness determination for the turbine fuel rates for the years in which those rates were at issue in those proceedings. The Commission will defer further proceedings on the turbine fuel rates until it completes its analysis of the initial decision before it in Phase II of Docket No. OR92-6-000 *et al.* The Commission will be making determinations on the reasonableness of the turbine fuel rates in that proceeding for the relevant complaint

⁸⁸ March 2004 order P 53.

⁸⁹ The test year and the complaint year are not necessarily the same because the calendar year prior to the complaint year may be used to determine the relevant costs since the prior year would provide a full 12 months data to support any determinations.

⁹⁰ An issue before the Commission in Phase II is whether 1999 or 2000 should be used as the test year for resolving those complaints.

years involved there since the West Line turbine fuel rates are a subset of the broader West Line rate issues discussed in the previous paragraph of this order. Any determination of the West Line turbine fuel rates in Phase II will not decide the reasonableness of those rates in the remanded proceeding in Docket No. OR92-8-000, *et al.*, but may establish basic principles that would facilitate the resolution of that docket.

4. Disposition of Further Proceedings on East and West Line Rates.

76. In subsections 1 and 2 of this section the Commission discussed, but did not resolve, the relationship between the *Policy Statement* and the rate proceedings before it on remand and Phase II of Docket No. OR96-2-000, *et al.* The change in the tax allowance policy involved in these proceedings creates sufficient uncertainty on how that issue should be addressed that the Commission will not rule on it with finality here. For example, some statements in the briefs on exception in Phase II and in procedural motions filed in the Sepulveda Line proceeding suggest that SFPP may have provided substantial information on the structure of the SFPP partnership and the status of its owning interests for the various years at issue in several of the proceedings now before the Commission. However, the Commission does not have that information clearly before it and it appears necessary to render an efficient and complete decision both in the remanded proceedings in Docket No. OR92-8-000, *et al.* and in Phase II. Therefore, in the interests of administrative efficiency, the Commission directs SFPP to file a brief within 15 days after this order issues describing, with supporting affidavits, the location and quantity of information regarding the tax allowance information with regard to the years at issue for the East and West Line rates. Reply briefs by other parties will be due 30 days after this order issues.

77. On brief, the parties shall explain, with examples and supporting analyses, whether such information is adequate to establish whether SFPP met the standard contained in the *Policy Statement* for any given year at issue and to what years that standard should apply and why. The parties should further explain whether the data is sufficient that it can be certified to the Commission and tax allowance matters resolved on brief, or if, alternatively, the issue of whether SFPP has met the standards of the *Policy Statement* should be set for hearing. The Commission wishes to resolve this narrow, if important, technical issue in sufficient time to utilize the results in a single final compliance order resolving most outstanding rates issues involving the East and West Line rates now before it for the years 1992 through 2000.⁹¹ As such, the Commission will look with disfavor on generalized statements that (1) detailed hearings are necessary to assure due process on the tax allowance issue, or (2) that a particular

⁹¹ This is unlikely to involve the Watson Station drain dry charges or the West Line turbine fuel rates discussed in subsection 3 of this section of the order. It may also not include a specialized rate such as the Sepulveda Line.

party has already met its burden of proof based on the overall content of the record. If any party believes either to be the case, that party should plead the point with specificity.

The Commission orders:

- (A) The remanded issues are decided as discussed in the body of this order.
- (B) The requests for rehearing of the March 2004 hearing are denied.
- (C) SFPP's compliance filing to the March 2004 order is accepted as discussed in the body of this order.
- (D) The issue of the just and reasonableness rates for the Watson Station drain dry facility charges is set for and hearing.
- (E) Further proceedings regarding the West Line turbine fuel rates are deferred pending the completion of Phase II of Docket No. OR96-2-000, *et al.*
- (F) Within 15 days after this order issues the SFPP shall file the brief required in the body of this order. Reply briefs are due 30 days after this order issues.
- (G) 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 (1996), shall convene a prehearing conference with regard to the charges for the Watson Station drain dry facilities, said conference 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.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

Appendix

1. Table 1 - Display of Percentage Change in Volumes and Three Cost Factors Discussed in the Text Compared to the Base Years Discussed in the March 2004 Order and this Order.
2. Table 2 - Estimated Percentage Change in Return When the Percentage Change in Volume is combined with the Percentage Change in the Three Cost Factors Displayed in Table 1.
3. Table 3 - Estimated Percentage Change in Return at Specific Delivery Points When the Percentage Change in Volume is Combined with the Percentage Change in the Three Cost Factors Displayed in Table 1
4. Table 4 - Change in Rate Base Analysis
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8. Chart 1 - West Line: Rate Base Analysis
9. Chart 2 - West Line: Percentage Rate Base Change
10. Chart 3 - West Line: Allowed Total Return Analysis
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12. Chart 5 - West Line: Income Tax Allowance Analysis
13. Chart 6 - West Line: Percentage Income Tax Allowance Change
14. Chart 7 - West Line: Cost of Service Analysis
15. Chart 8 - West Line: Percentage Cost of Service Change
16. Chart 9 - North Line: Rate Base Analysis
17. Chart 10 - North Line: Percentage Rate Base Change
18. Chart 11 - North Line: Allowed Total Return Analysis

19. Chart 12 - North Line: Percentage Allowed Total Return Change
20. Chart 13 - North Line: Income Tax Allowance Analysis
21. Chart 14 - North Line: Percentage Income Tax Allowance Change
22. Chart 15 - North Line: Cost of Service Analysis
23. Chart 16 - North Line: Percentage Cost of Service Change
24. Chart 17 - Oregon Line: Allowed Total Return Analysis
25. Chart 18 - Oregon Line: Percentage Allowed Total Return Change
26. Chart 19 - Oregon Line: Rate Base Analysis
27. Chart 20 - Oregon Line: Percentage Rate Base Change
28. Chart 21 - Oregon Line: Income Tax Allowance Analysis
29. Chart 22 - Oregon Line: Percentage Income Tax Allowance Change
30. Chart 23 - Oregon Line: Cost of Service Analysis
31. Chart 24 - Oregon Line: Percentage Cost of Service Change

Table 1

Display of the Percentage Change in Volumes and Three Cost Factors Discussed in the Text
Compared to the Base Years Discussed the March 2004 Order and this Order

West Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	16.40	-18.14	-21.55	-10.92
1996	21.84	-19.65	-29.10	-14.26
1997	26.31	-21.52	-29.49	-14.07
1998	26.65	-25.25	-33.14	-10.81
1999	28.47	-21.58	-25.43	-12.00
5 Year Average	23.93	-21.23	-27.74	-12.41

North Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	11.93	2.52	1.98	9.28
1996	10.73	3.52	-3.34	8.07
1997	10.89	4.42	-1.29	20.75
1998	14.97	3.82	-2.27	24.14
1999	11.53	-0.03	-0.82	13.59
5 Year Average	12.01	2.85	-1.15	15.17

Oregon Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	6.39	7.62	7.10	16.39
1996	7.05	6.09	-3.44	30.64
1997	1.82	4.84	-2.75	36.21
1998	13.67	8.21	-0.34	70.30
1999	21.00	10.28	8.82	36.38
5 Year Average	9.99	7.41	1.88	37.98

Note 1 - All figures are in percentages.

Note 2 - All figures are derived from the Appendices to
the March 2004 Order and to this Order.

Note 3 - A positive number is an improvement in the pipeline's return.
A negative number indicates a deterioration in the pipeline's return.

Table 2

Estimated Percentage Change in Return When the Percentage Change in Volumes is combined with the Percentage Change in the Three Cost Factors Displayed in Table 1

West Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	16.40	34.54	37.95	27.32
1996	21.84	41.49	50.94	36.10
1997	26.31	47.83	55.80	40.38
1998	26.65	51.90	59.79	37.46
1999	28.47	50.05	53.90	40.47
5 Year Average	23.93	45.16	51.68	36.35

North Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	11.93	9.41	9.95	2.65
1996	10.73	7.21	14.07	2.66
1997	10.89	6.47	12.18	-9.86
1998	14.97	11.15	17.24	-9.17
1999	11.53	11.56	12.35	-2.06
5 Year Average	12.01	9.16	13.16	-3.16

Oregon Line

Year	Volume	Rate Base	Allowed Return	Cost of Service
1995	6.39	-1.23	-0.71	-10.00
1996	7.05	0.96	10.49	-23.59
1997	1.82	-3.02	4.57	-34.39
1998	13.67	5.46	14.01	-56.63
1999	21.00	10.72	12.18	-15.38
5 Year Average	9.99	2.58	8.11	-28.00

Note 1 - All figures are in percentages.

Note 2 - All figures are derived from the Appendices to the March 2004 Order and to this Order.

Note 3 - A positive number is an improvement in the pipeline's return. A negative number indicates a deterioration in the pipeline's return.

Table 3

Estimated Percentage Change in Return at Specific Delivery Points When the Percentage Change in Volumes is combined with the Percentage Change in the Three Cost Factors Displayed in Table 1

Delivery Point	Year	Volume	Rate Base	Allowed Return	Cost of Service
Yuma	1995	9.44	27.58	30.99	20.36
CalNev	1995	25.62	43.76	47.17	36.54
Phoenix W	1996	0.68	20.33	29.78	14.94
Phoenix W	1997	7.56	29.08	37.05	21.63
Tucson W	1995	188.04	206.18	209.59	198.96
Luke AFB	N.A	N.A	N.A	N.A	N.A
William AFB	N.A	N.A	N.A	N.A	N.A

Note 1 - All figures are in percentages

Note 2 - All figures are derived from the Appendices to the March 2004 Order and to this Order

Table 4- Change Rate Analysis

VISLINE

	(a)	199	1249	Rate Difference		Rate Percentage		
				ca	cb	(ca)a	(cb)b	(cb)a
LogInUF1(Apr 3,2001); Sore UF4(Fcted)	(a)	199	1249					
LogInUF1(Apr 3,2001); CR62Ex 26 SFP287	(b)	192	1308	ca	cb	(ca)a	(cb)b	(cb)a
CanzSFP221(EG18)(July 31, 2001)	(c)	195	1353	-2886	-2940	-17.7%	-180%	-184%
CanzSFP222(EG19)(July 31, 2001)		196	1318	-3131	-3195	-19.8%	-195%	-198%
CanzSFP223(EG12)(July 31, 2001)		197	1208	-3451	-3495	-21.5%	-214%	-212%
CanzSFP224(EG12)(July 31, 2001)		198	1200	-4049	-4103	-24.8%	-25.5%	-25.3%
CanzSFP225(EG12)(July 31, 2001)		199	1297	-3452	-3536	-21.2%	-215%	-21.3%

NORLINE

	(a)	199	3625	Rate Difference		Rate Percentage		
				ca	cb	(ca)a	(cb)b	(cb)a
5P/tonintesaUF0; Shell no 1A(917200)	(a)	199	3625					
SFP231(EG13)(July 31, 2001)	(b)	192	2742	ca	cb	(ca)a	(cb)b	(cb)a
CanzSFP225(EG13)(July 31, 2001)	(c)	195	2852	-743	090	-20.8%	3.2%	25.2%
CanzSFP226(EG13)(July 31, 2001)		196	2904	-711	122	-19.6%	4.5%	35.2%
CanzSFP227(EG13)(July 31, 2001)		197	2930	-675	158	-18.7%	5.6%	42.2%
CanzSFP228(EG13)(July 31, 2001)		198	2912	-704	139	-19.9%	4.9%	38.2%
CanzSFP229(EG13)(July 31, 2001)		199	2732	-833	-000	-23.2%	-0.0%	-0.0%

ORGLINE

				Rate Difference	Rate Percentage Change
SFP26(EG14)(July 31, 2001)	(b)	192	73	cb	(cb)b
CanzSFP227(EG14)(July 31, 2001)	(c)	195	828	57	7.2%
CanzSFP228(EG14)(July 31, 2001)		196	838	47	6.9%
CanzSFP229(EG14)(July 31, 2001)		197	820	39	4.8%
CanzSFP230(EG14)(July 31, 2001)		198	814	63	8.2%
CanzSFP231(EG14)(July 31, 2001)		199	855	85	10.8%

Table 5- Change Total Return Analysis

VISLINE

	(a)	199	1994	Above Total Return		Above Total Return Percentage		
				Difference		Change		
Loggin UF1 (April 3, 2001); Source UF4 Rdetekd	(b)	192	1995	ca	cb	(ca)/a	(cb)/b	(cb)/a
Loggin UF1 (April 3, 2001); ORS 2 Ex 26 SFP 287	(c)	195	1476	-478	-429	-244%	-218%	-215%
Canz SFP 22 (GG18) (July 31, 2001)		196	1321	-623	-584	-319%	-298%	-210%
Canz SFP 22 (GG19) (July 31, 2001)		197	1325	-639	-576	-323%	-308%	-249%
Canz SFP 24 (GG12) (July 31, 2001)		198	1252	-732	-643	-360%	-311%	-314%
Canz SFP 25 (GG12) (July 31, 2001)		199	1408	-556	-487	-282%	-261%	-248%

NORLINE

	(a)	199	443	Above Total Return		Above Total Return Percentage		
				Difference		Change		
5P from intesae UF10; Shelle No 1A (9/7/2001)	(b)	192	309	ca	cb	(ca)/a	(cb)/b	(cb)/a
SFP 24 (GG13) (July 31, 2001)	(c)	195	316	-127	8	-278%	282%	198%
Canz SFP 25 (GG13) (July 31, 2001)		196	292	-141	-17	-319%	-47%	-33%
Canz SFP 27 (GG13) (July 31, 2001)		197	302	-137	-5	-314%	-18%	-129%
Canz SFP 28 (GG13) (July 31, 2001)		198	299	-144	-10	-322%	-32%	-22%
Canz SFP 29 (GG13) (July 31, 2001)		199	303	-130	-6	-367%	-17%	-62%

ORGNLINE

	(b)	192	83	Above Total Return		Above Total Return Percentage	
				Difference		Change	
SFP 26 (GG14) (July 31, 2001)	(c)	195	95	62		71%	
Canz SFP 27 (GG14) (July 31, 2001)		196	88	-3		-34%	
Canz SFP 28 (GG14) (July 31, 2001)		197	89	-24		-27%	
Canz SFP 29 (GG14) (July 31, 2001)		198	80	-3		-3%	
Canz SFP 31 (GG14) (July 31, 2001)		199	90	77		88%	

Table 6 - Oregon Income Tax Analysis

VISLINE

	YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change			
			ca	cb	(ca)/a	(cb)/b	(cb)/a	
Loghin UF1 (April 3, 2001); UF4 Federal Material	(a) 1999	10734						
Loghin UF1 (April 3, 2001); SFP287, UF-11	(b) 1992	9124	ca	cb	(ca)/a	(cb)/b	(cb)/a	
Canz SFP221 (FG18) (July 31, 2001)	(c)	1995	5980	-4824	-3194	-488%	-350%	-297%
Canz SFP222 (FG19) (July 31, 2001)		1996	5187	-5567	-3987	-517%	-431%	-368%
Canz SFP223 (FG12) (July 31, 2001)		1997	5488	-5281	-3631	-492%	-398%	-378%
Canz SFP224 (FG12) (July 31, 2001)		1998	7318	-3436	-1816	-319%	-197%	-167%
Canz SFP225 (FG12) (July 31, 2001)		1999	8223	-2531	-901	-254%	-98%	-83%

NORLINE

	YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change			
			ca	cb	(ca)/a	(cb)/b	(cb)/a	
5P/ironintestae UF10, Straddle No 1A	(a) 1999	3150						
SFP234 (FG13) (July 31, 2001)	(b) 1992	1161	ca	cb	(ca)/a	(cb)/b	(cb)/a	
Canz SFP235 (FG13) (July 31, 2001)	(c)	1995	1310	-1840	149	-584%	128%	47%
Canz SFP236 (FG13) (July 31, 2001)		1996	1176	-1974	15	-626%	129%	04%
Canz SFP237 (FG13) (July 31, 2001)		1997	1270	-1880	109	-596%	93%	34%
Canz SFP238 (FG13) (July 31, 2001)		1998	1748	-1402	587	-445%	506%	186%
Canz SFP239 (FG13) (July 31, 2001)		1999	1804	-1346	683	-427%	553%	244%

OREGONLINE

	YEAR	Income Tax Allowance	Income Tax Allowance Difference		Income Tax Allowance Percentage Change		
			ca	cb	(ca)/a	(cb)/b	(cb)/a
SFP226 (FG14) (July 31, 2001)	(b) 1992	35					
Canz SFP247 (FG14) (July 31, 2001)	(c)	1995	33	58			178%
Canz SFP248 (FG14) (July 31, 2001)		1996	38	13			40%
Canz SFP249 (FG14) (July 31, 2001)		1997	32	37			113%
Canz SFP250 (FG14) (July 31, 2001)		1998	55	18			553%
Canz SFP251 (FG14) (July 31, 2001)		1999	50	25			692%

Table 7 - Change in Cost of Service Analysis

VISLINE

UF4 Retailed Market

Canz SFP 23 (FG13) (July 31, 2001)

Canz SFP 21 (FG18) (July 31, 2001)

Canz SFP 22 (FG19) (July 31, 2001)

Canz SFP 23 (FG12) (July 31, 2001)

Canz SFP 24 (FG12) (July 31, 2001)

Canz SFP 25 (FG12) (July 31, 2001)

	YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
			ca	cb	(ca)/a	(cb)/b	(cb)/a
(a)	199	5,998					
(b)	1992	5,880	ca	cb	(ca)/a	(cb)/b	(cb)/a
(c)	1995	4,767	-921	-623	-162%	-115%	-109%
	1996	4,743	-11,175	-8,117	-196%	-150%	-142%
	1997	4,553	-11,055	-8,007	-194%	-148%	-140%
	1998	4,770	-9,238	-6,150	-161%	-114%	-108%
	1999	4,731	-9,887	-6,829	-173%	-128%	-120%

NORLINE

5P from retail UF-10, Street No 1A (91701)

SFP 24 (FG13) (July 31, 2001)

Canz SFP 25 (FG13) (July 31, 2001)

Canz SFP 26 (FG13) (July 31, 2001)

Canz SFP 27 (FG14) (July 31, 2001)

Canz SFP 28 (FG15) (July 31, 2001)

Canz SFP 29 (FG16) (July 31, 2001)

	YEAR	Cost of Service	Cost of Service Difference		Cost of Service Percentage Change		
			ca	cb	(ca)/a	(cb)/b	(cb)/a
(a)	199	17,457					
(b)	1992	11,539	ca	cb	(ca)/a	(cb)/b	(cb)/a
(c)	1995	13,179	-428	1,620	-245%	142%	92%
	1996	12,967	-440	1,48	-252%	121%	80%
	1997	15,182	-225	3,623	-130%	313%	273%
	1998	15,74	-1,683	425	-96%	364%	244%
	1999	13,92	-3,55	2,33	-201%	203%	133%

OREGONLINE

SFP 26 (FG14) (July 31, 2001)

Canz SFP 27 (FG14) (July 31, 2001)

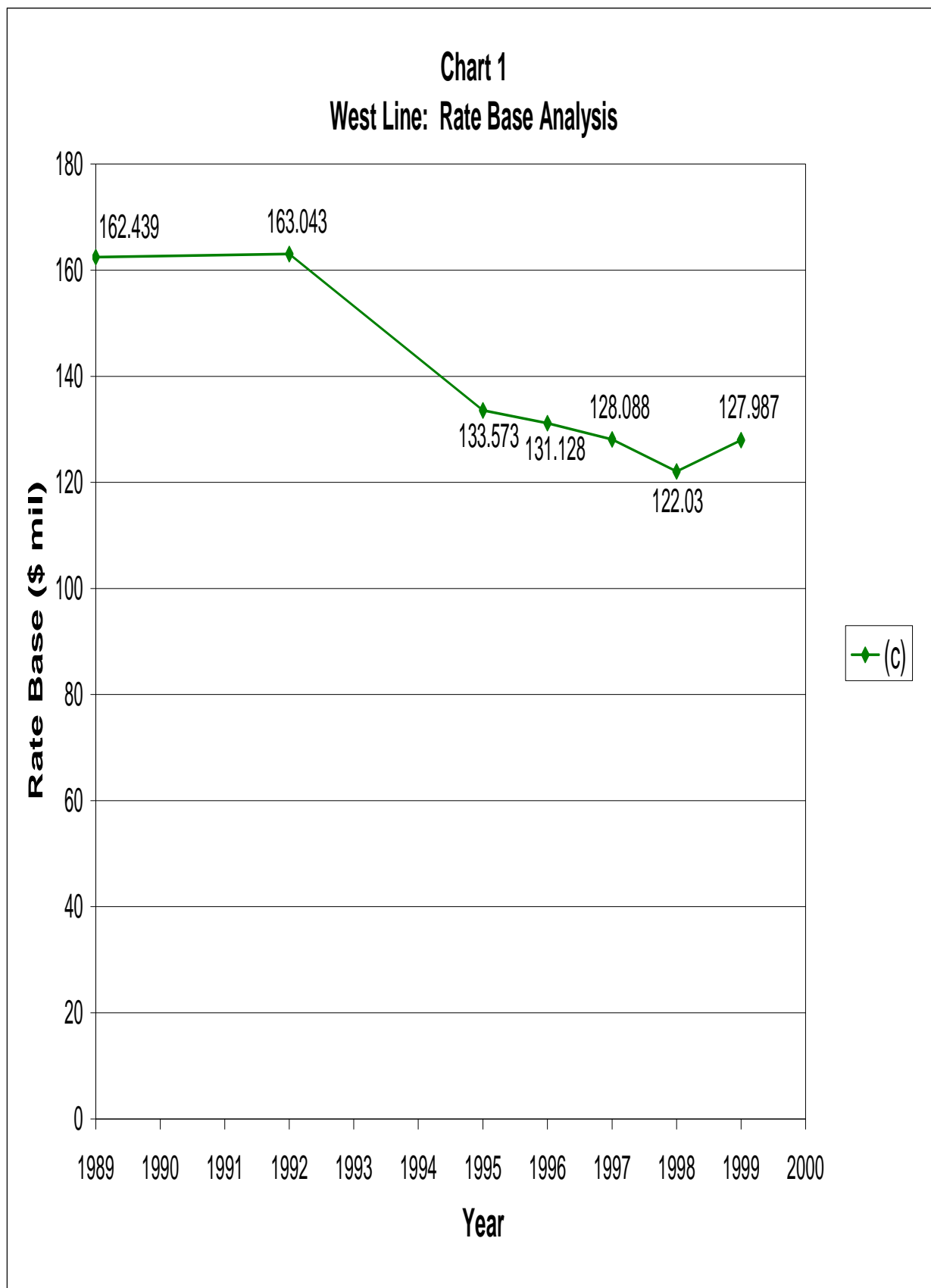
Canz SFP 28 (FG14) (July 31, 2001)

Canz SFP 29 (FG14) (July 31, 2001)

Canz SFP 20 (FG14) (July 31, 2001)

Canz SFP 21 (FG14) (July 31, 2001)

	YEAR	Cost of Service	Cost of Service Difference	Cost of Service Percentage Change
(b)	1992	4,697	cb	(cb)/b
(c)	1995	5,467	70	163%
	1996	6,136	1,49	306%
	1997	6,338	1,701	362%
	1998	7,999	3,32	703%
	1999	6,406	1,70	363%



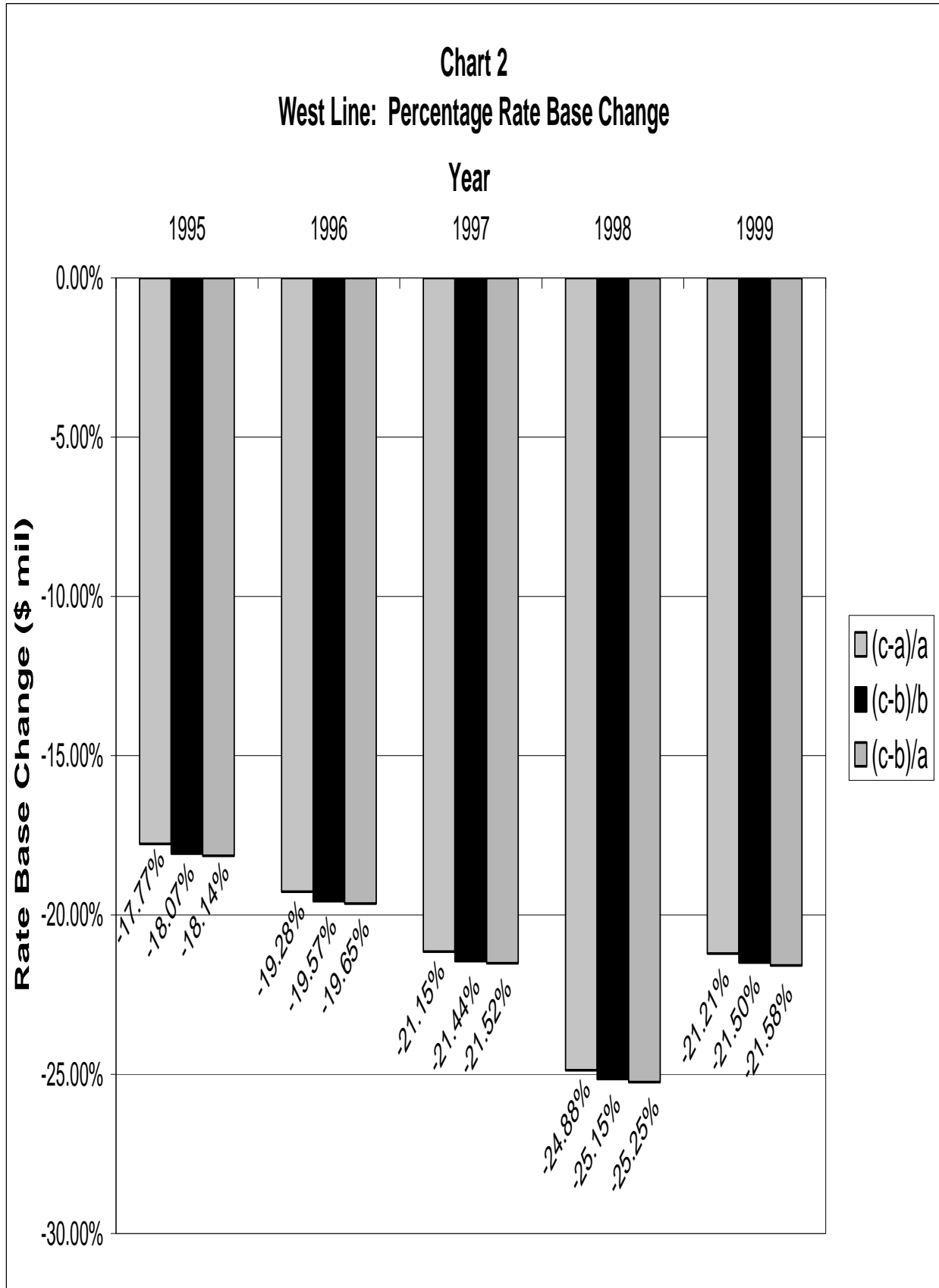
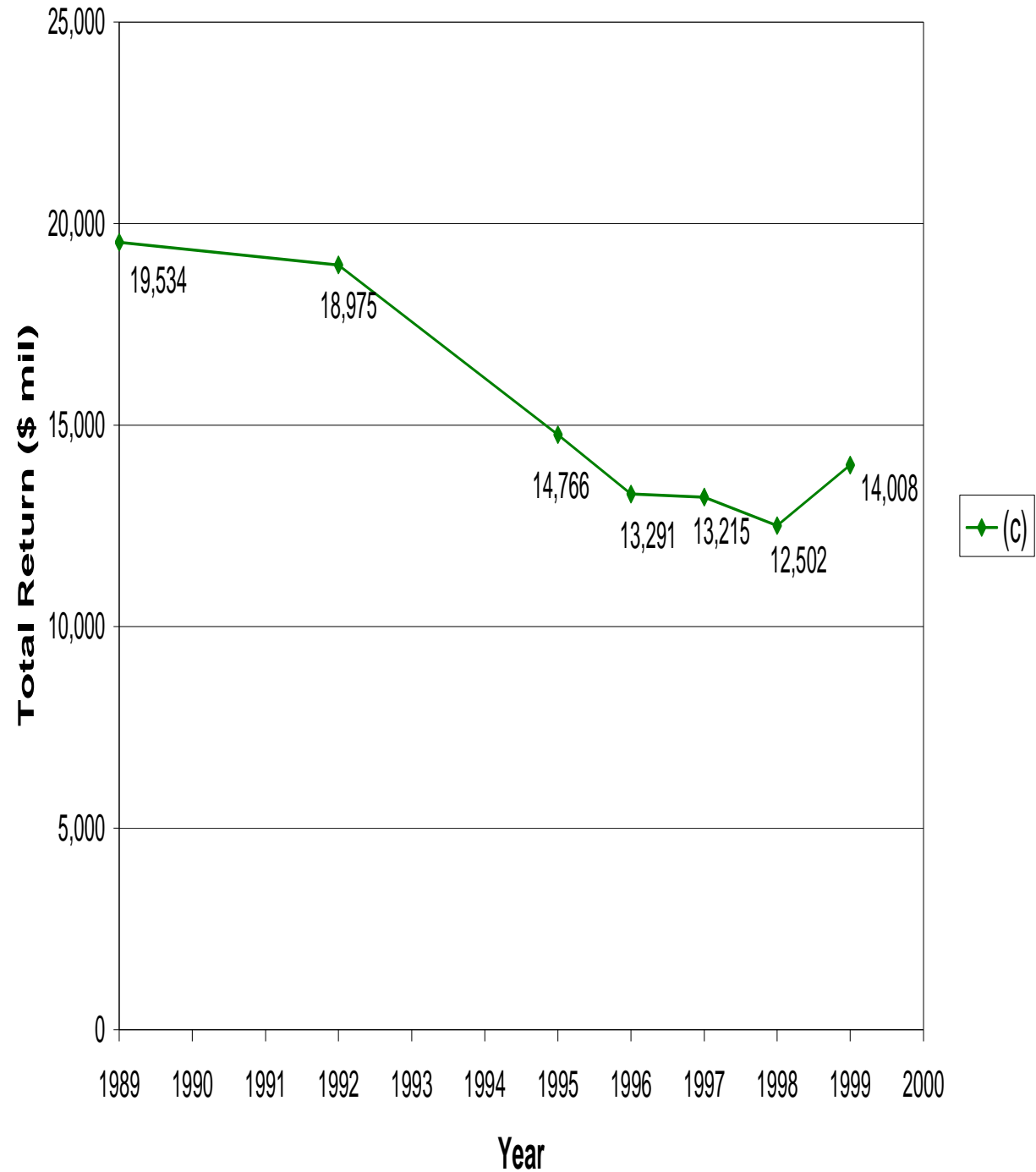


Chart 3
West Line: Allowed Total Return Analysis



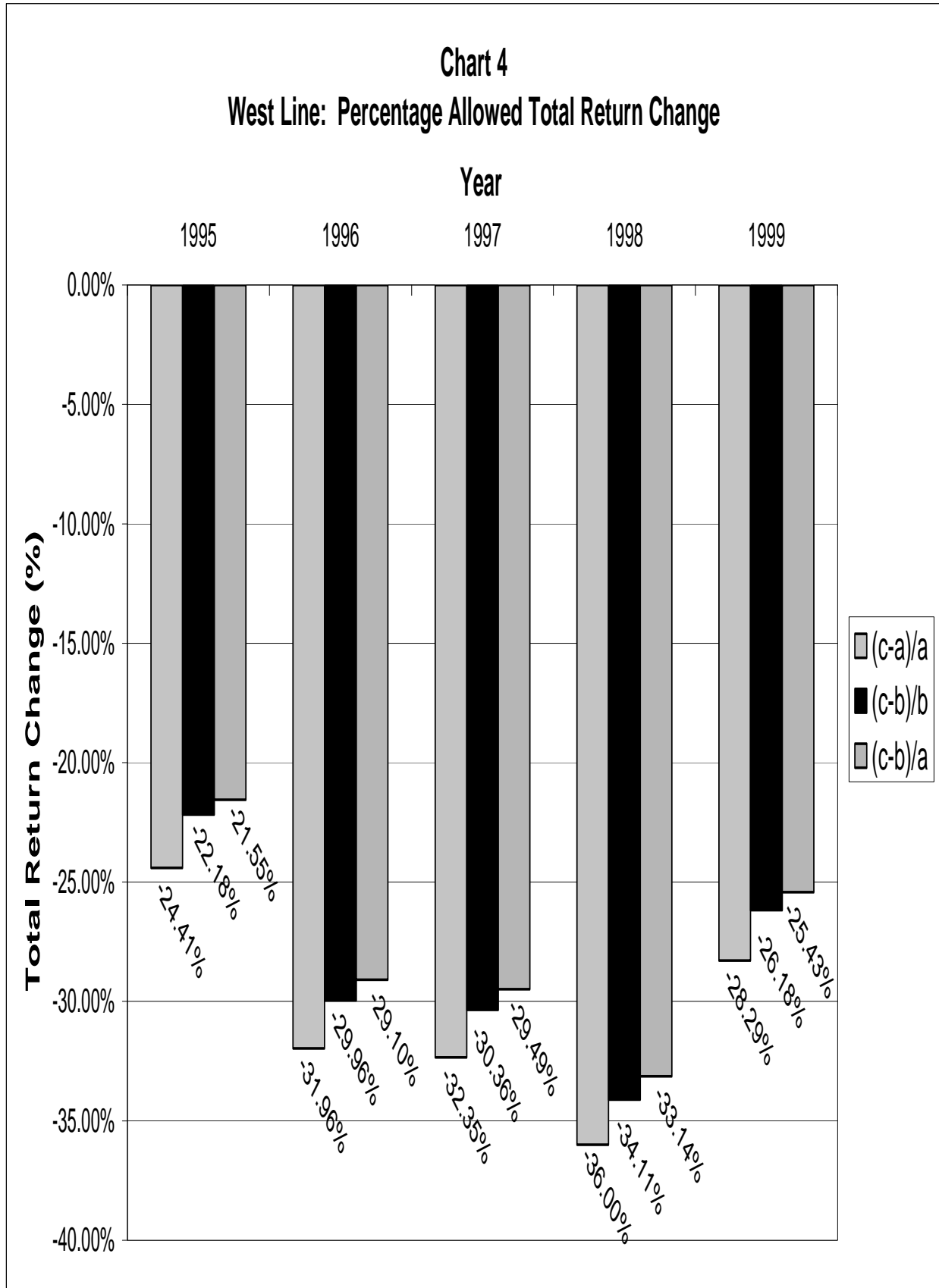
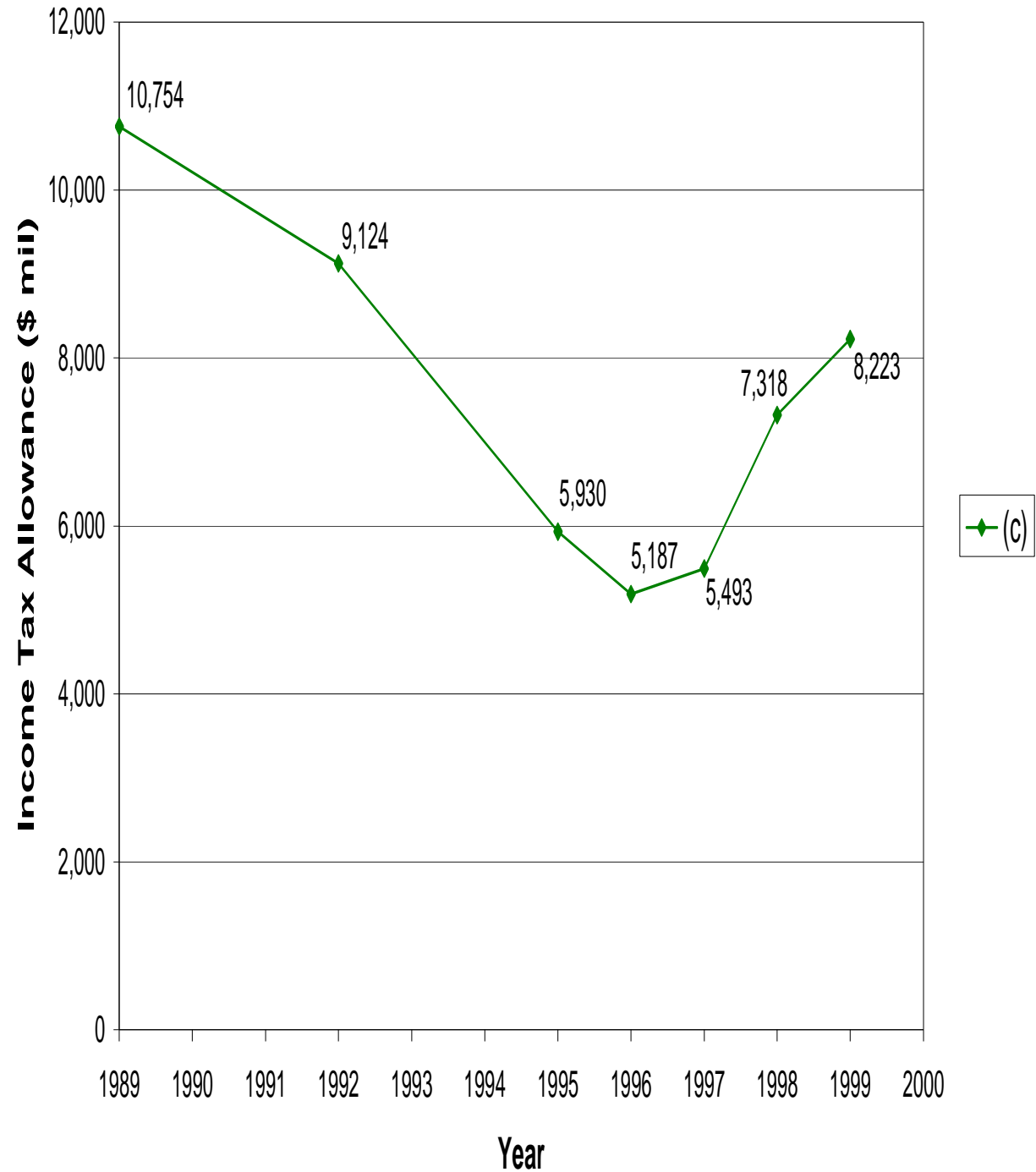
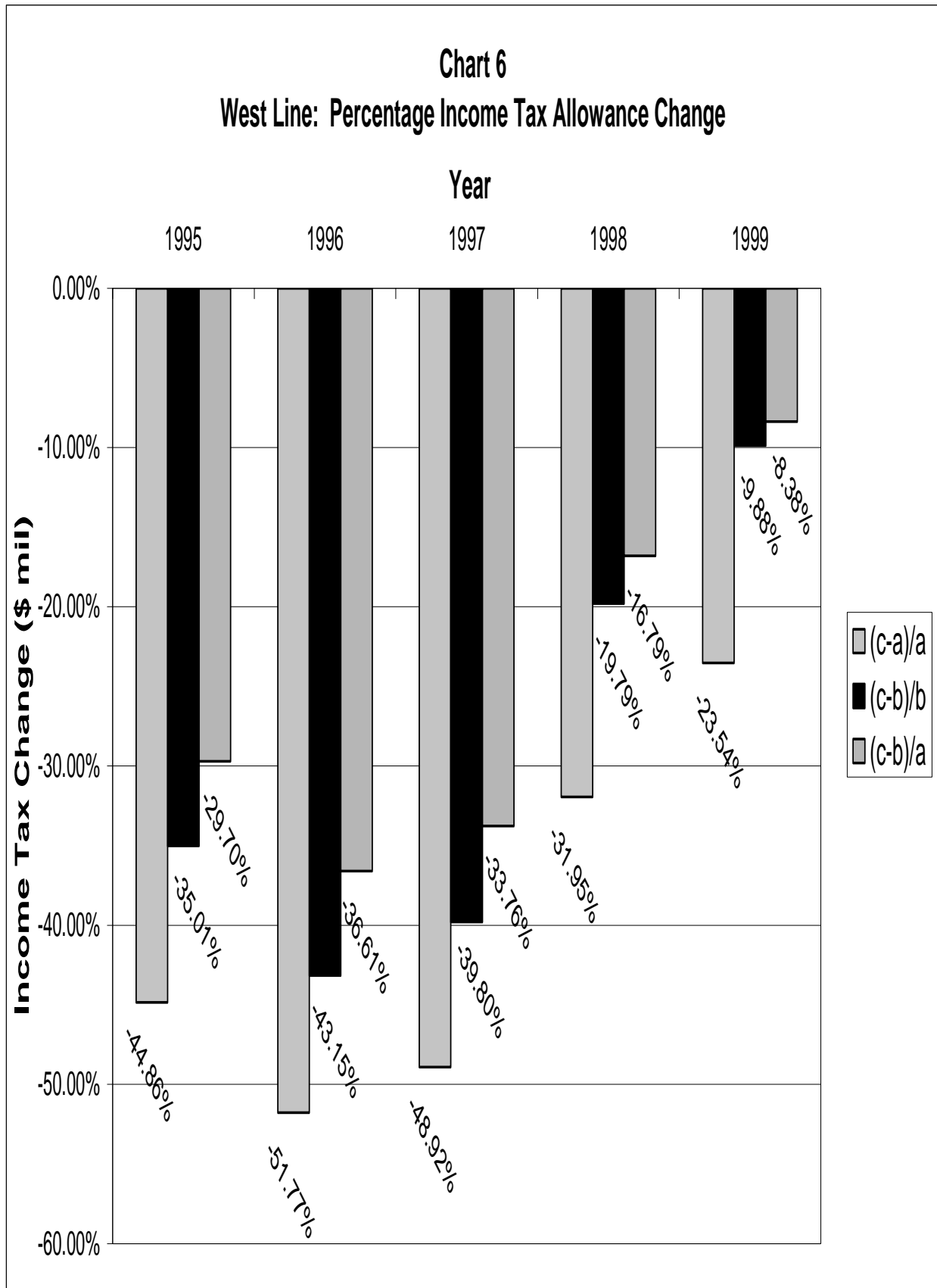


Chart 5
West Line: Income Tax Allowance Analysis





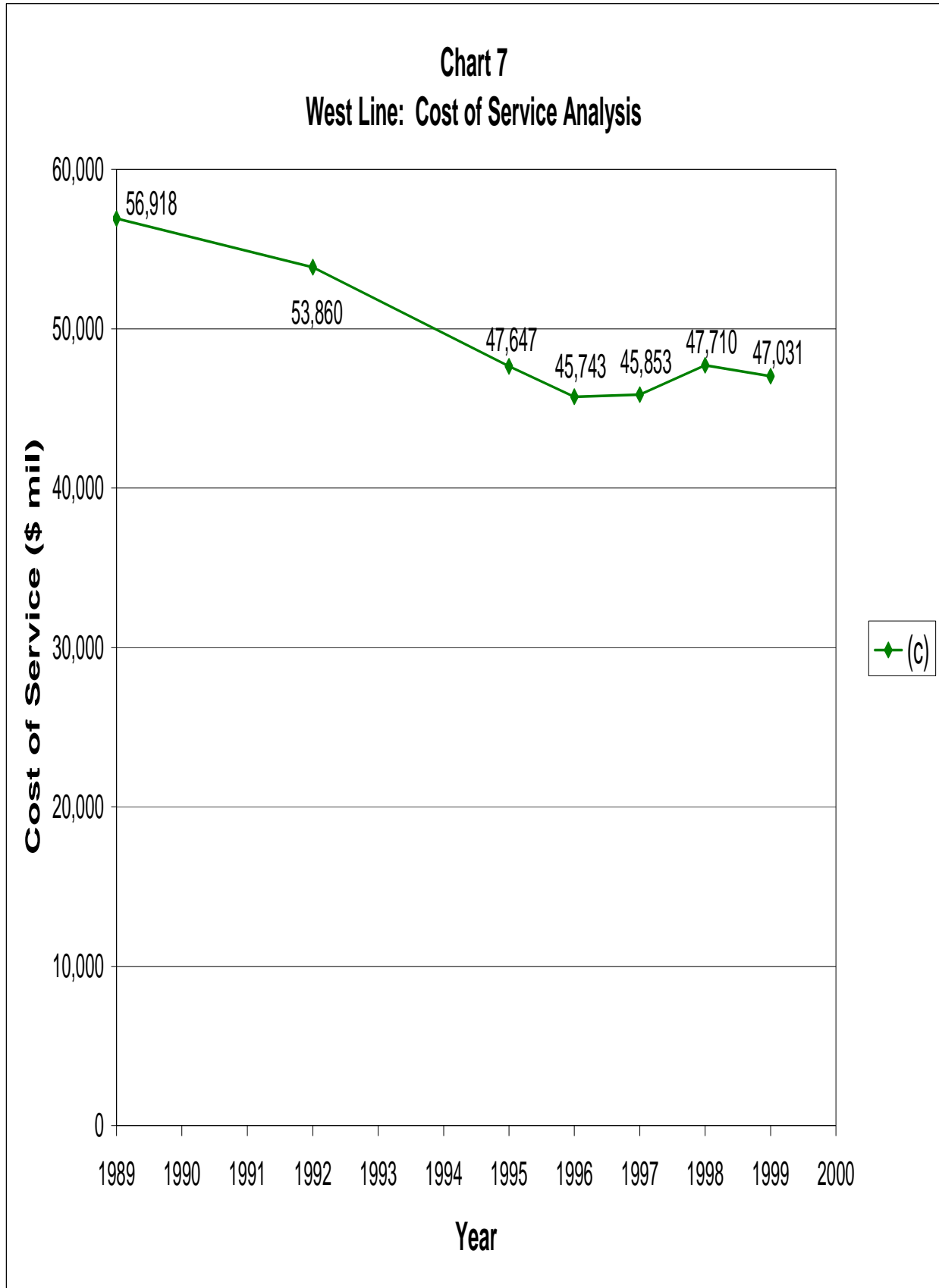
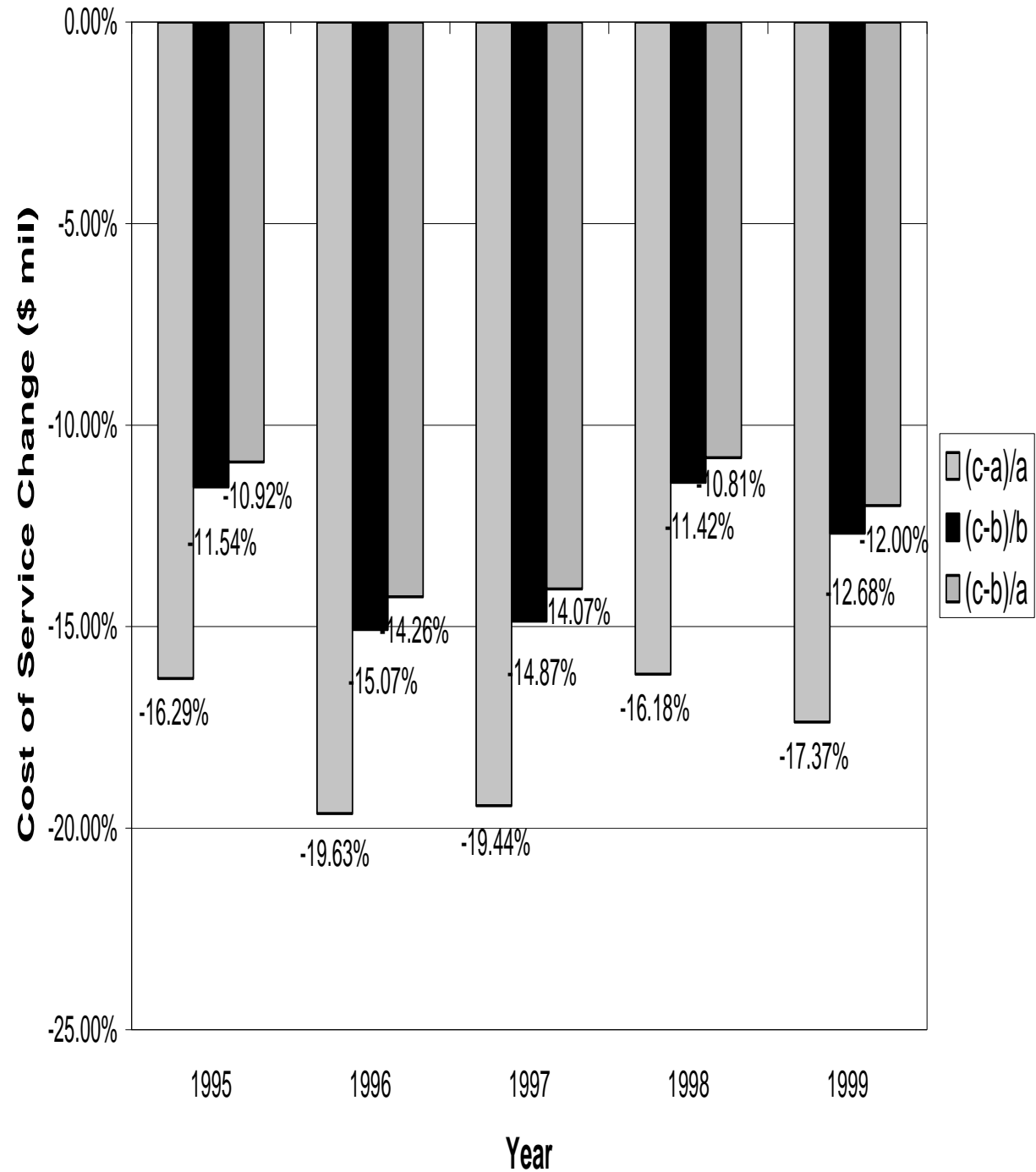


Chart 8
West Line: Percentage Cost of Service Change



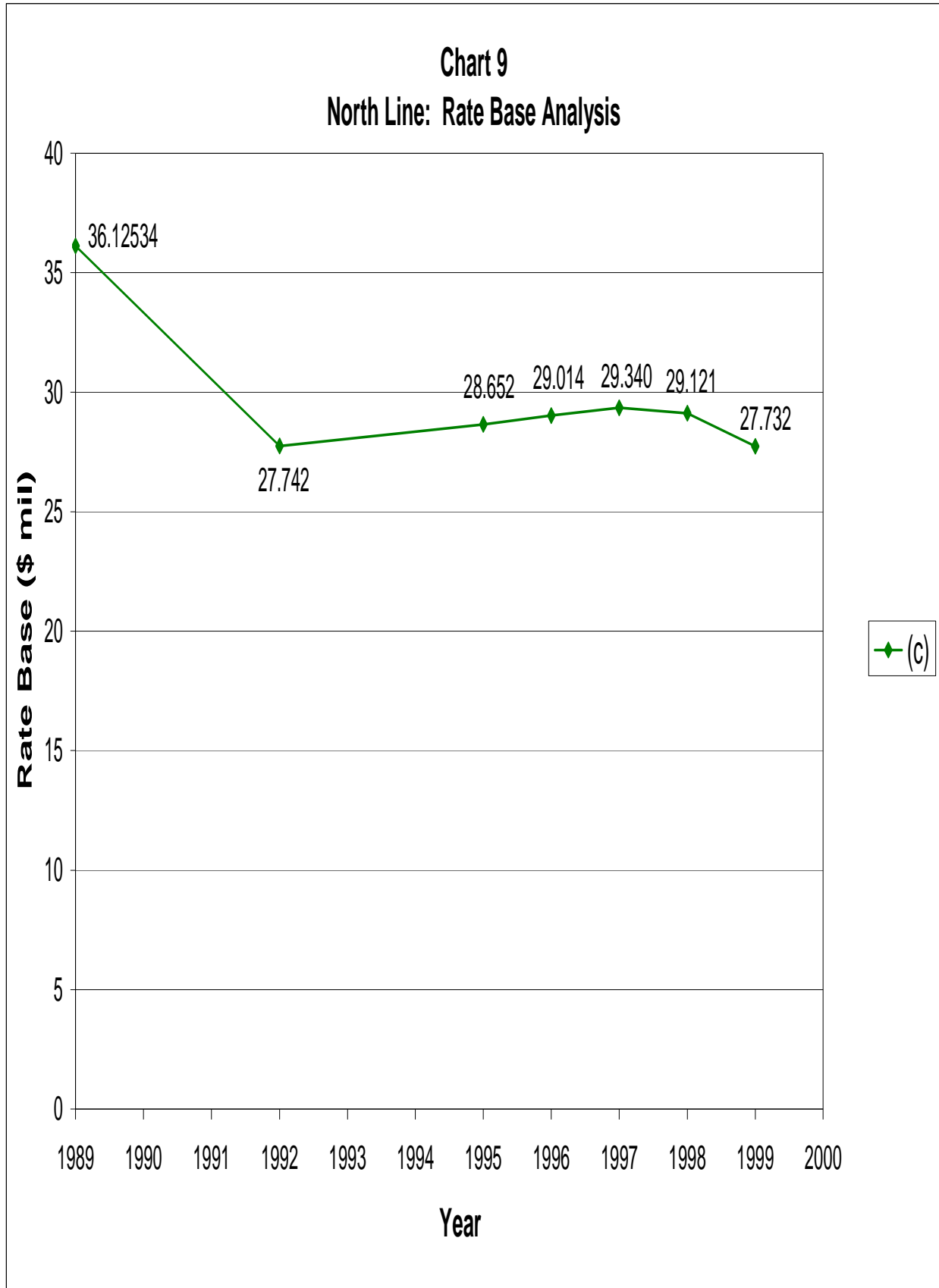
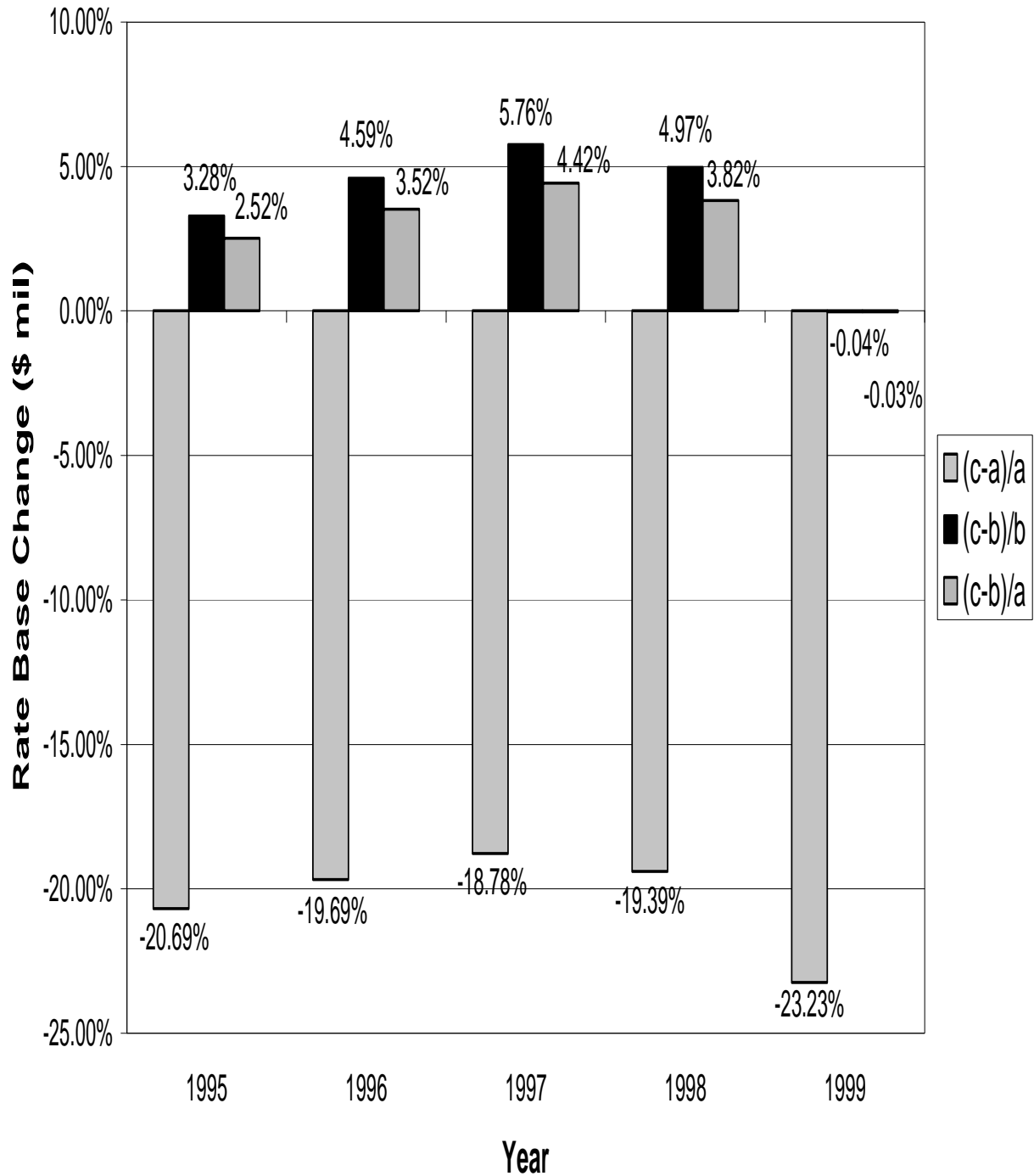
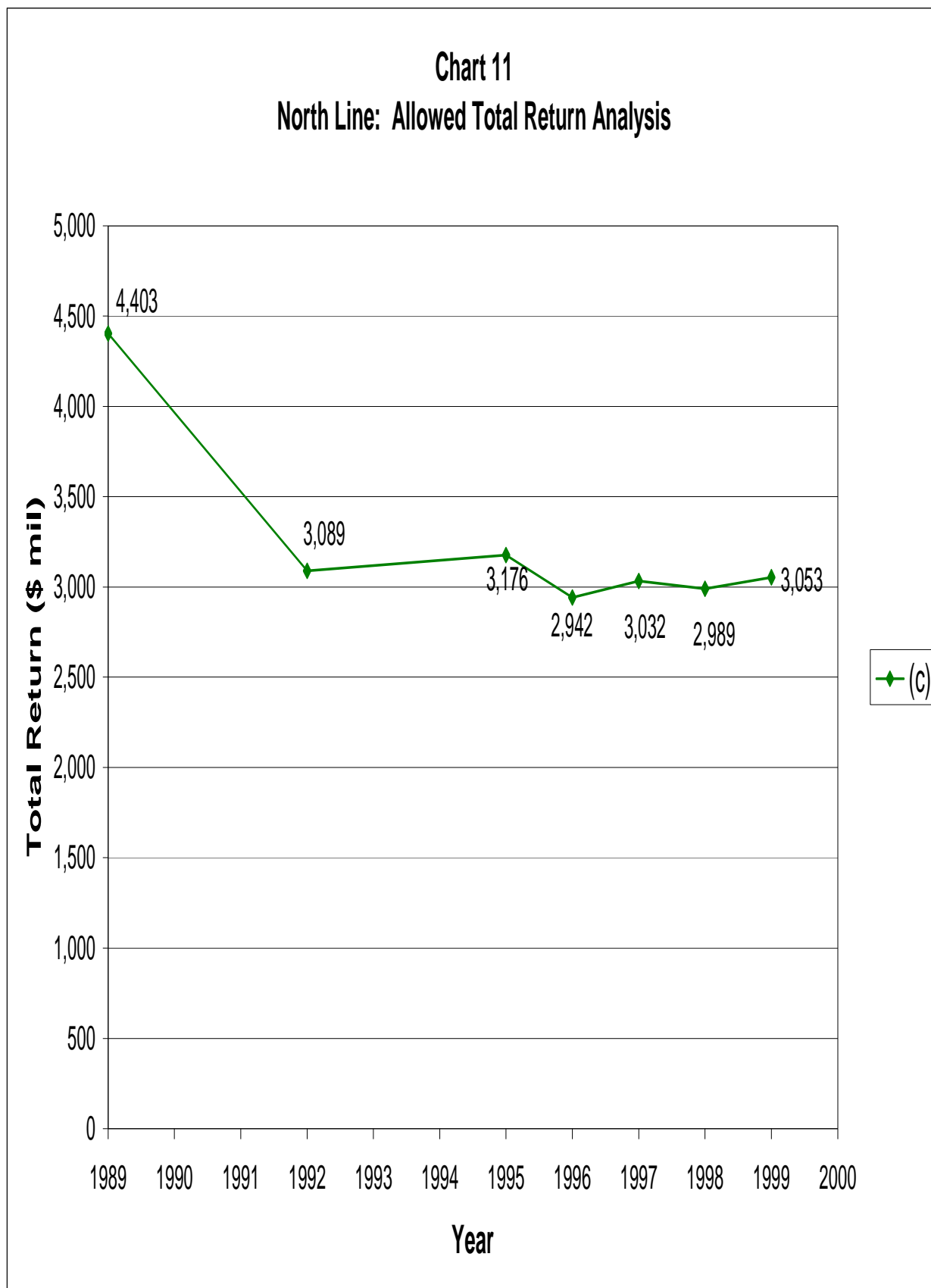
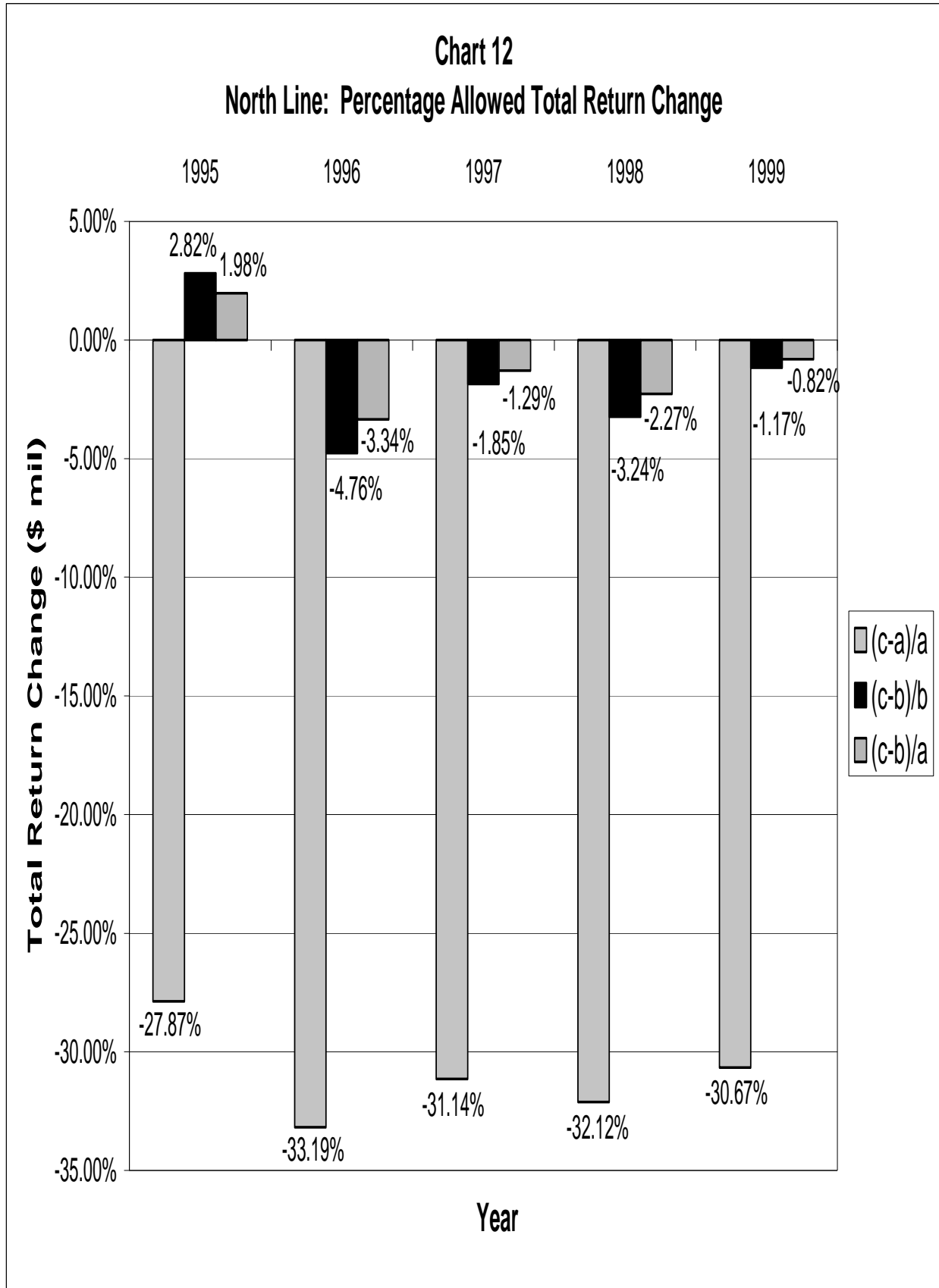


Chart 10
North Line: Percentage Rate Base Change







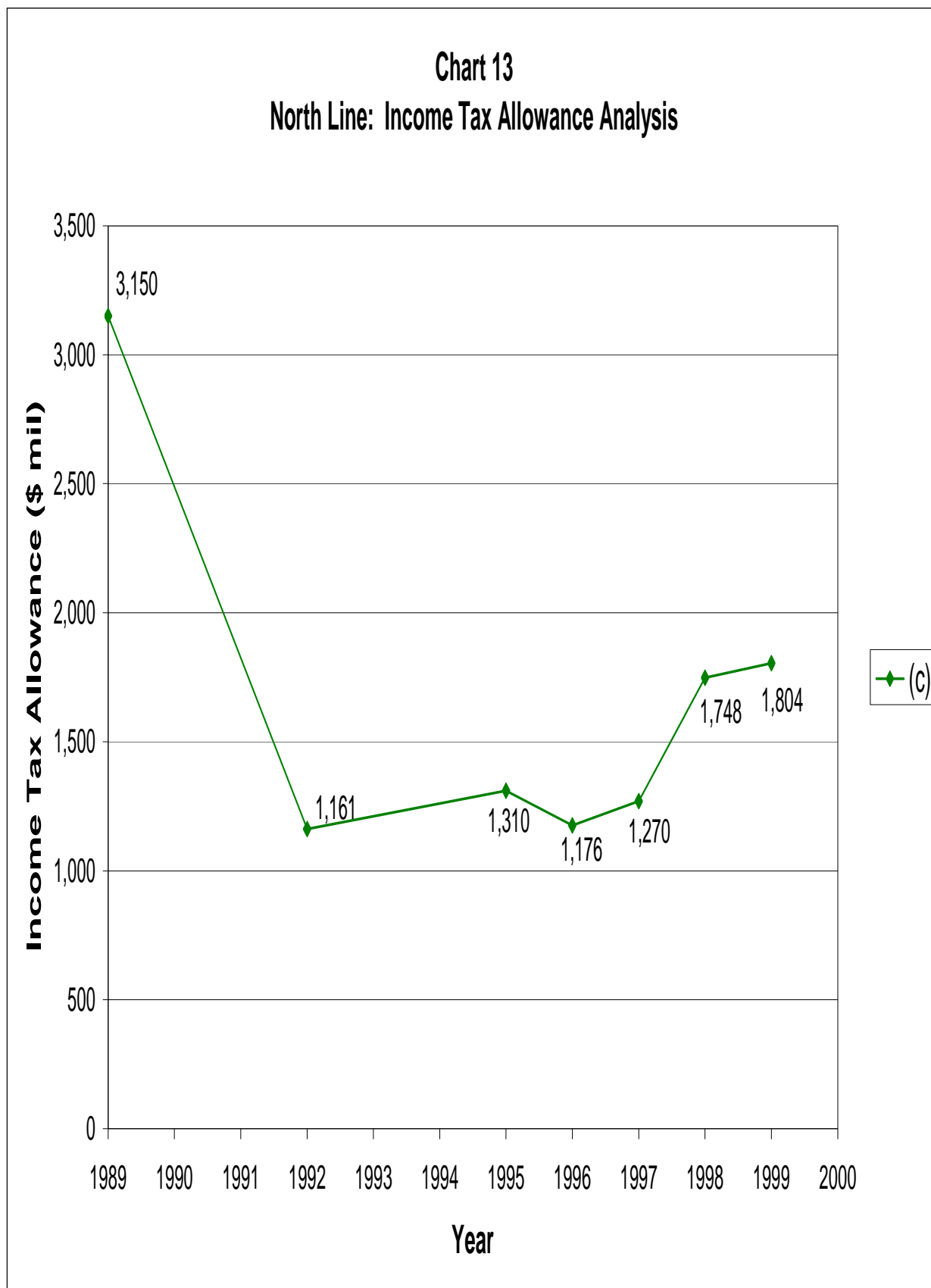
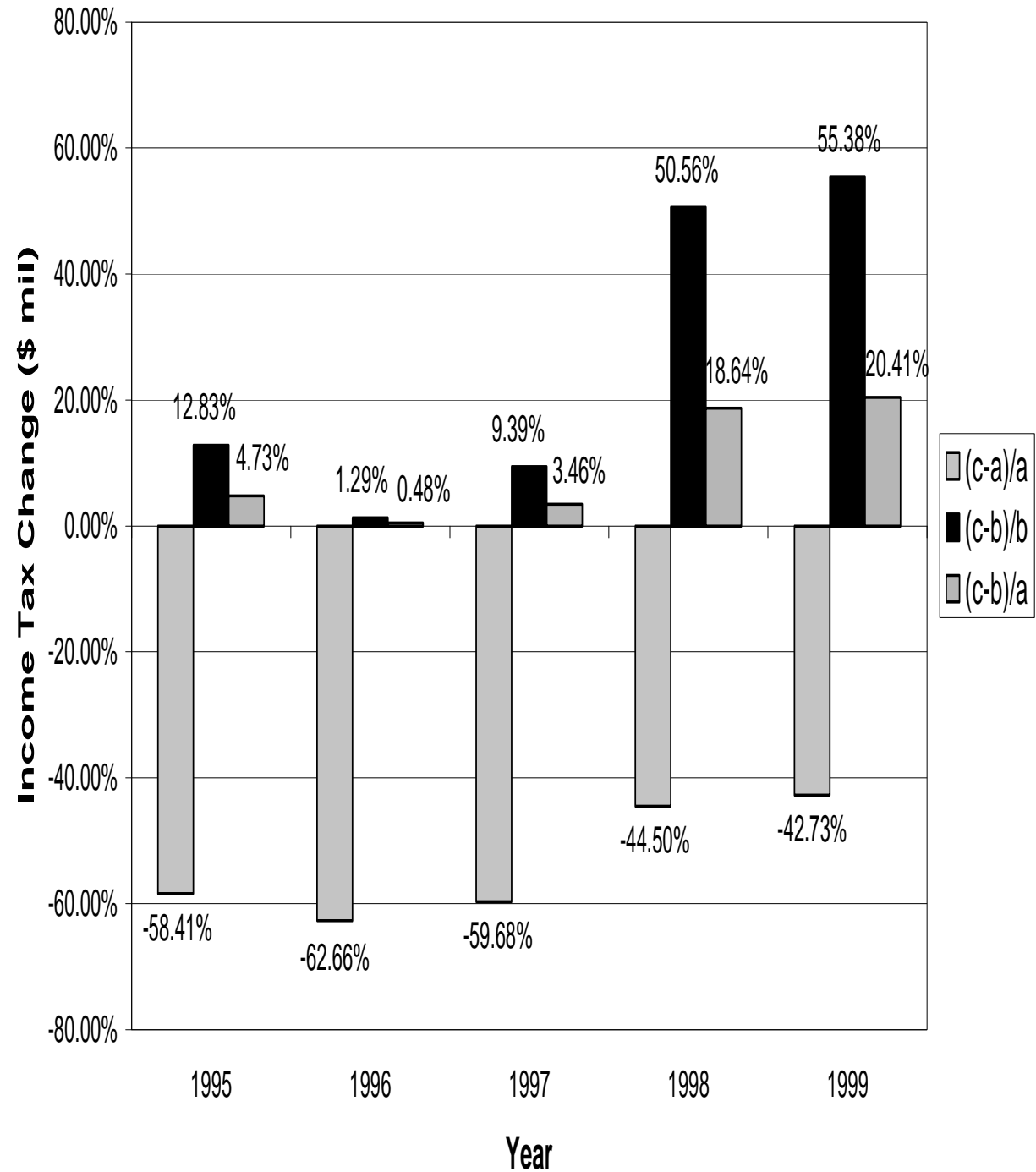


Chart 14
North Line: Percentage Income Tax Allowance Change



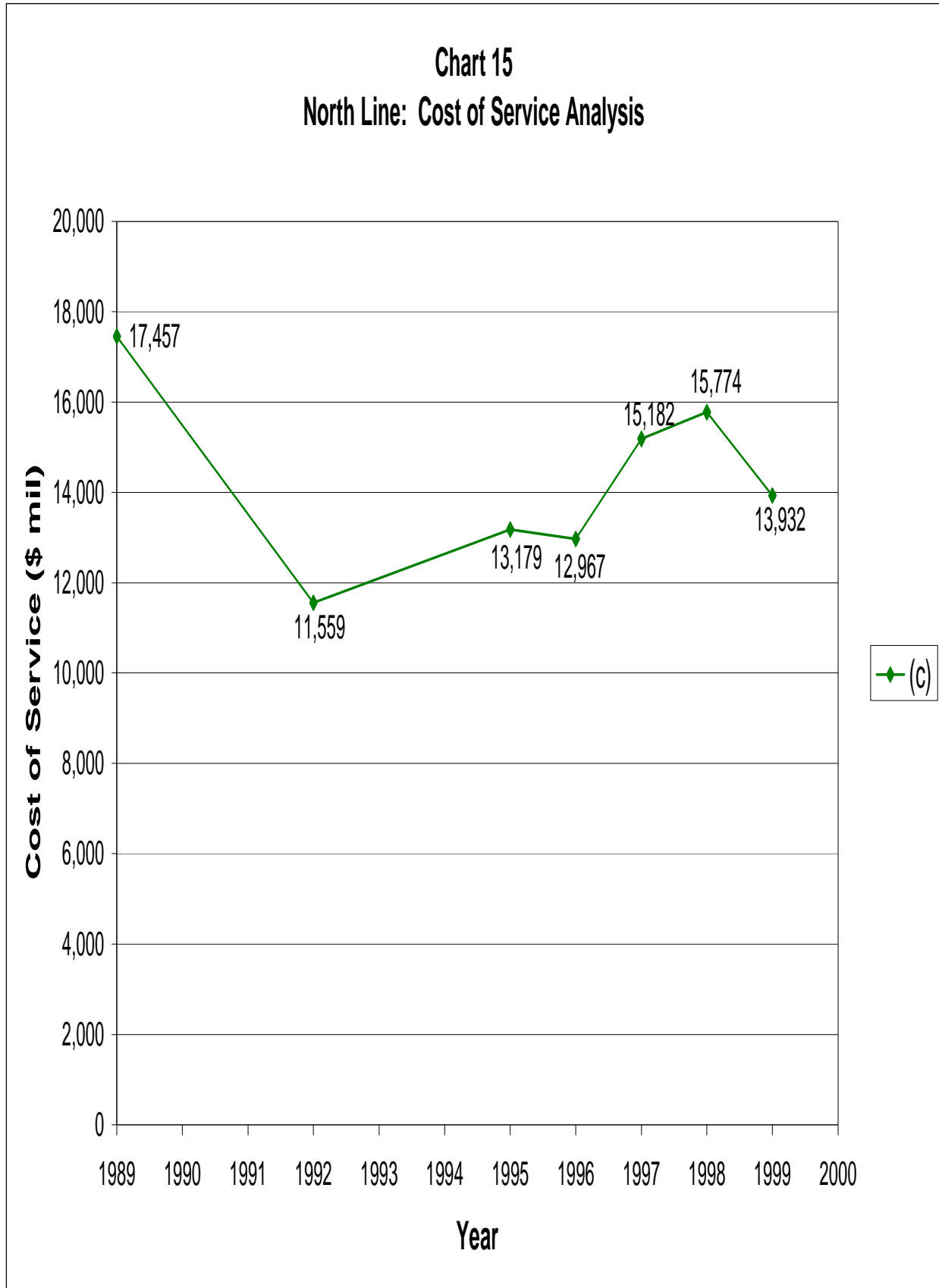
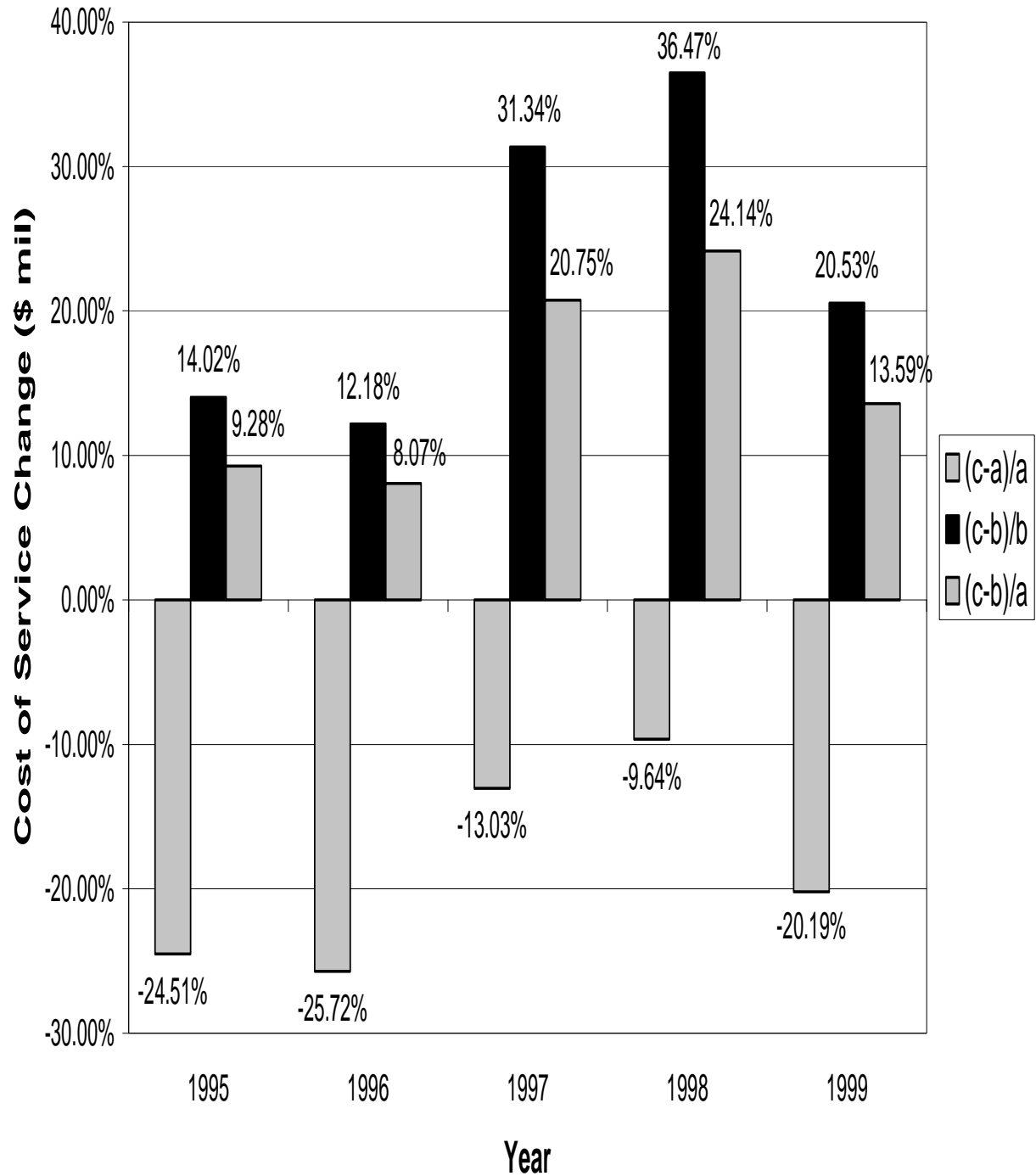
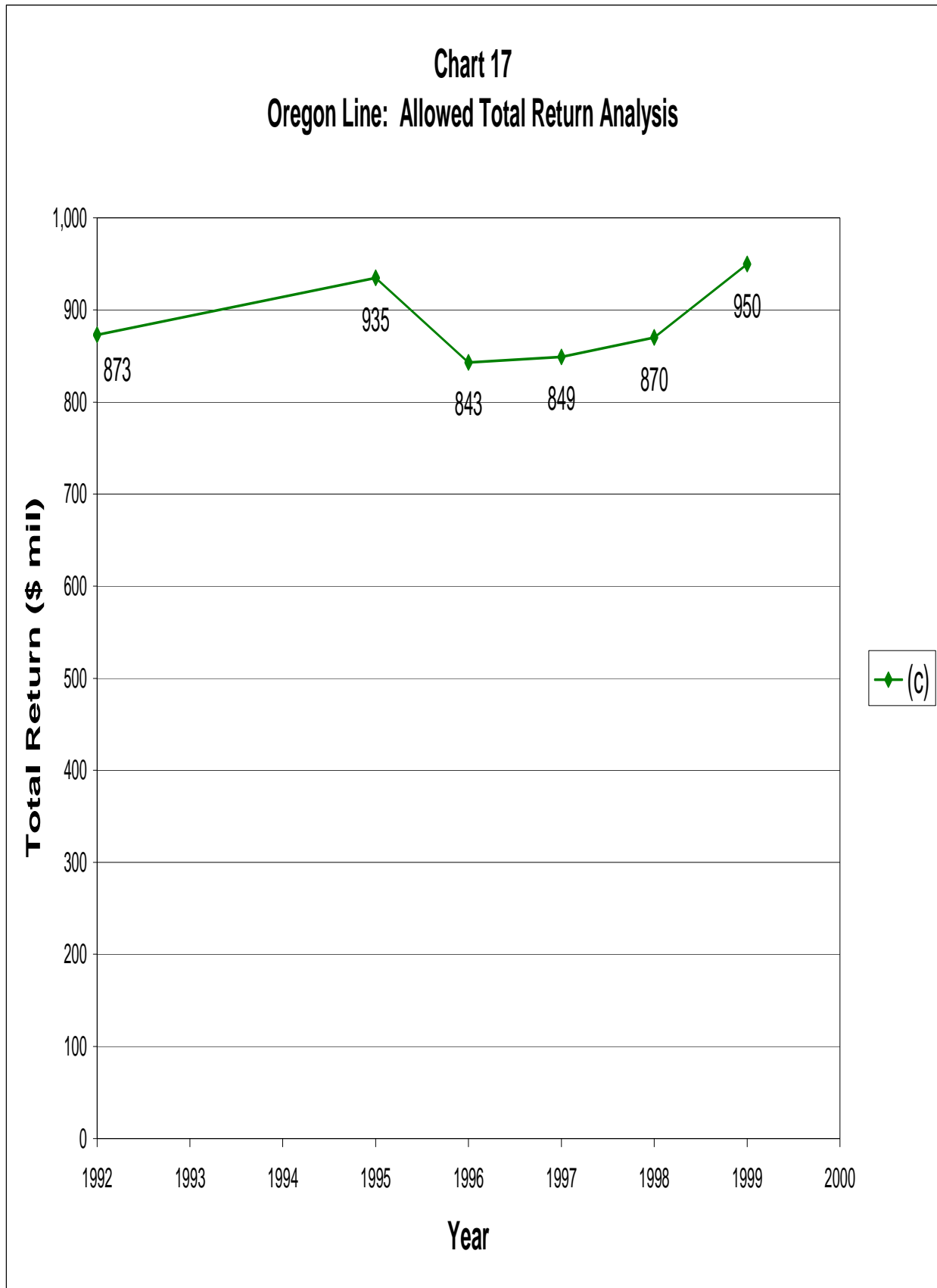


Chart 16
North Line: Percentage Cost of Service Change





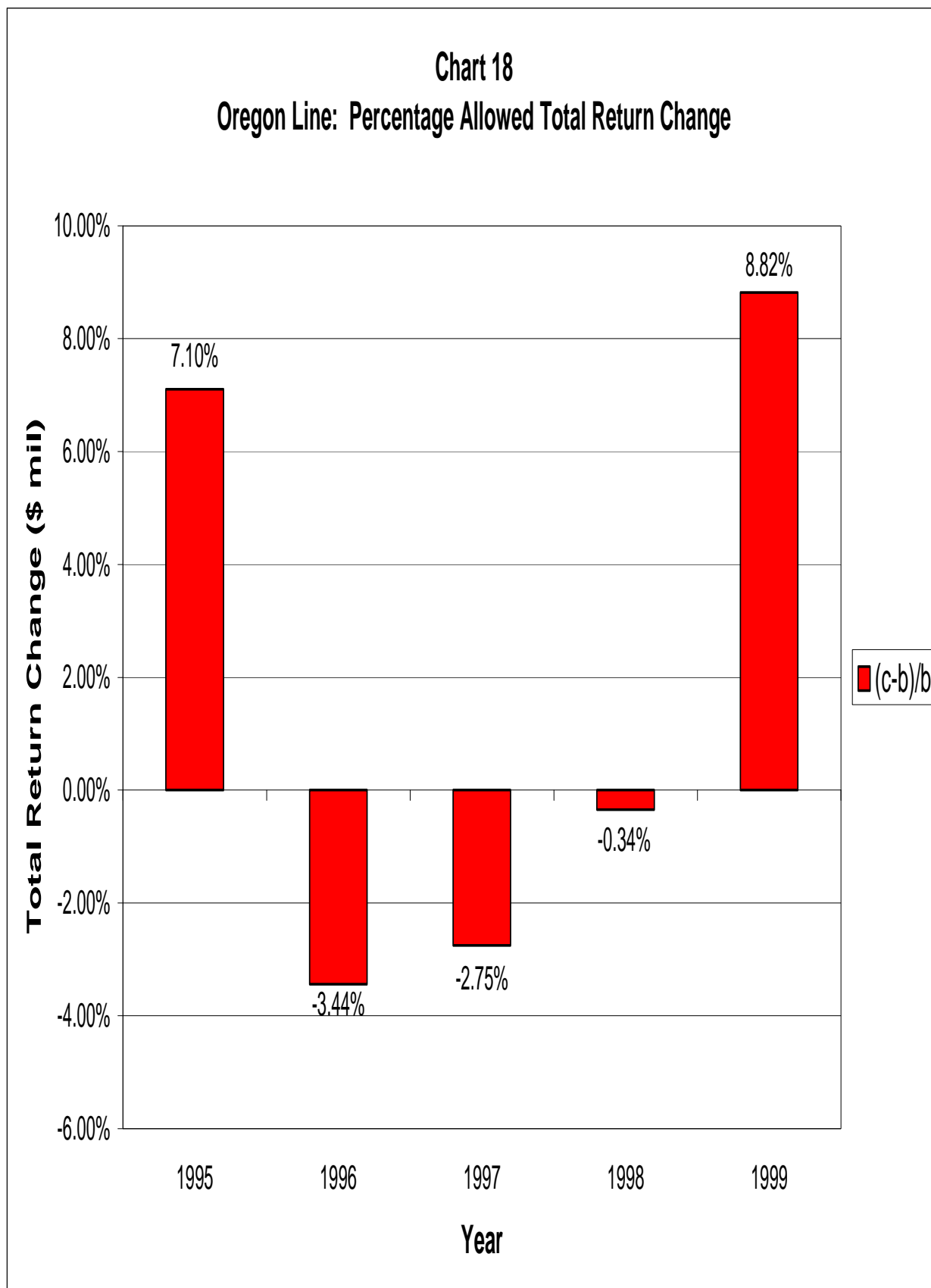


Chart 19
Oregon Line: Rate Base Analysis

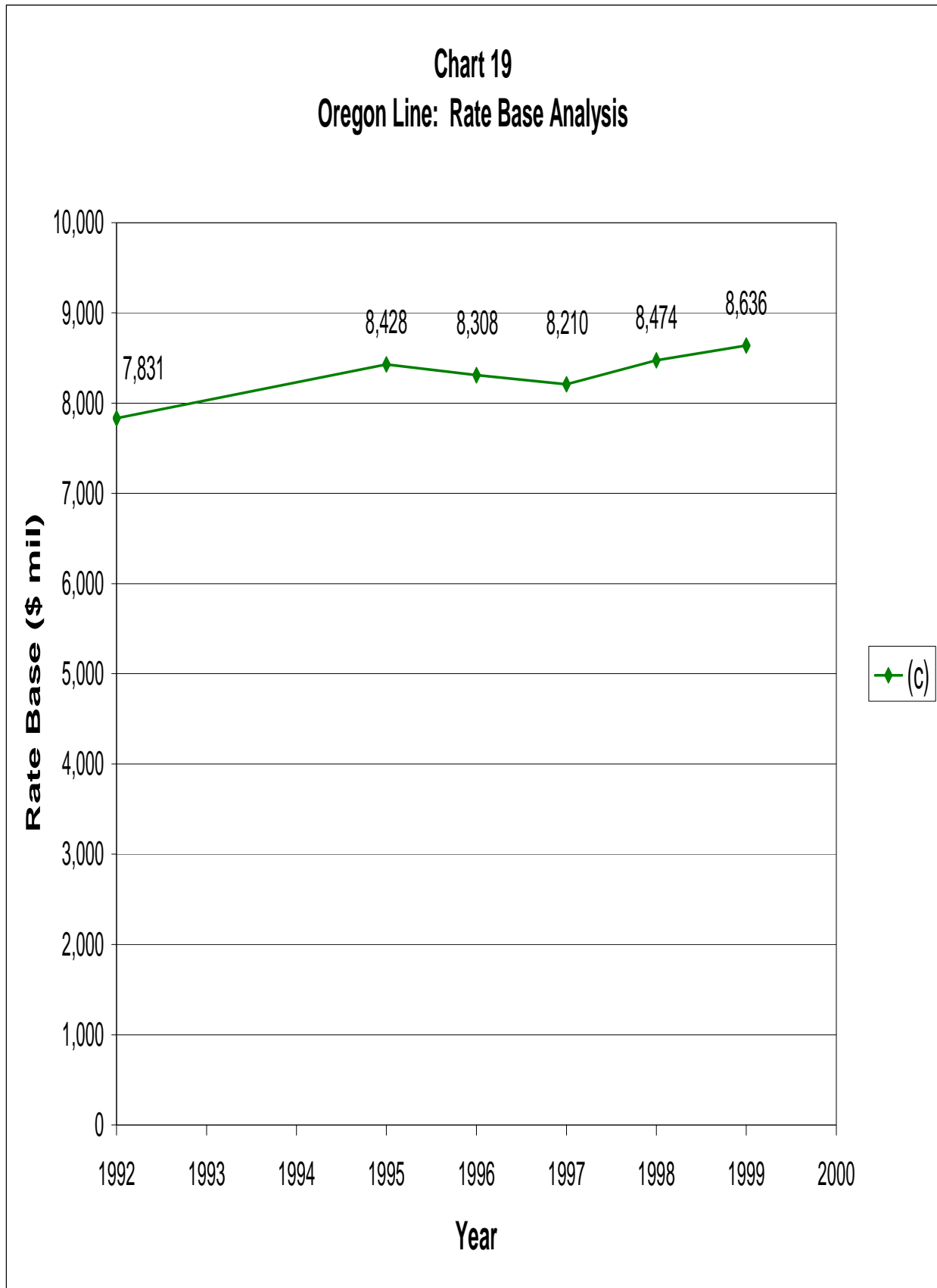
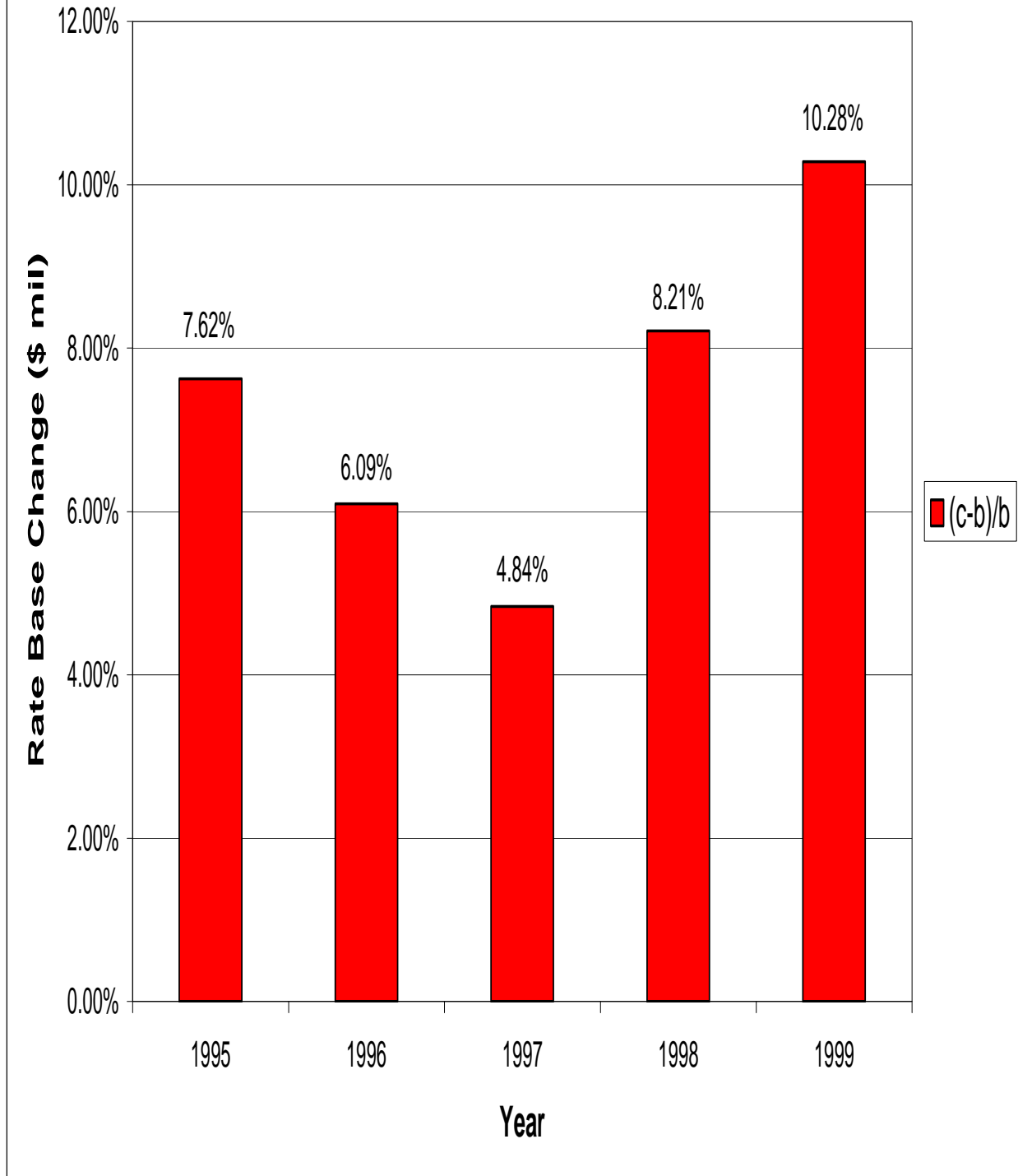
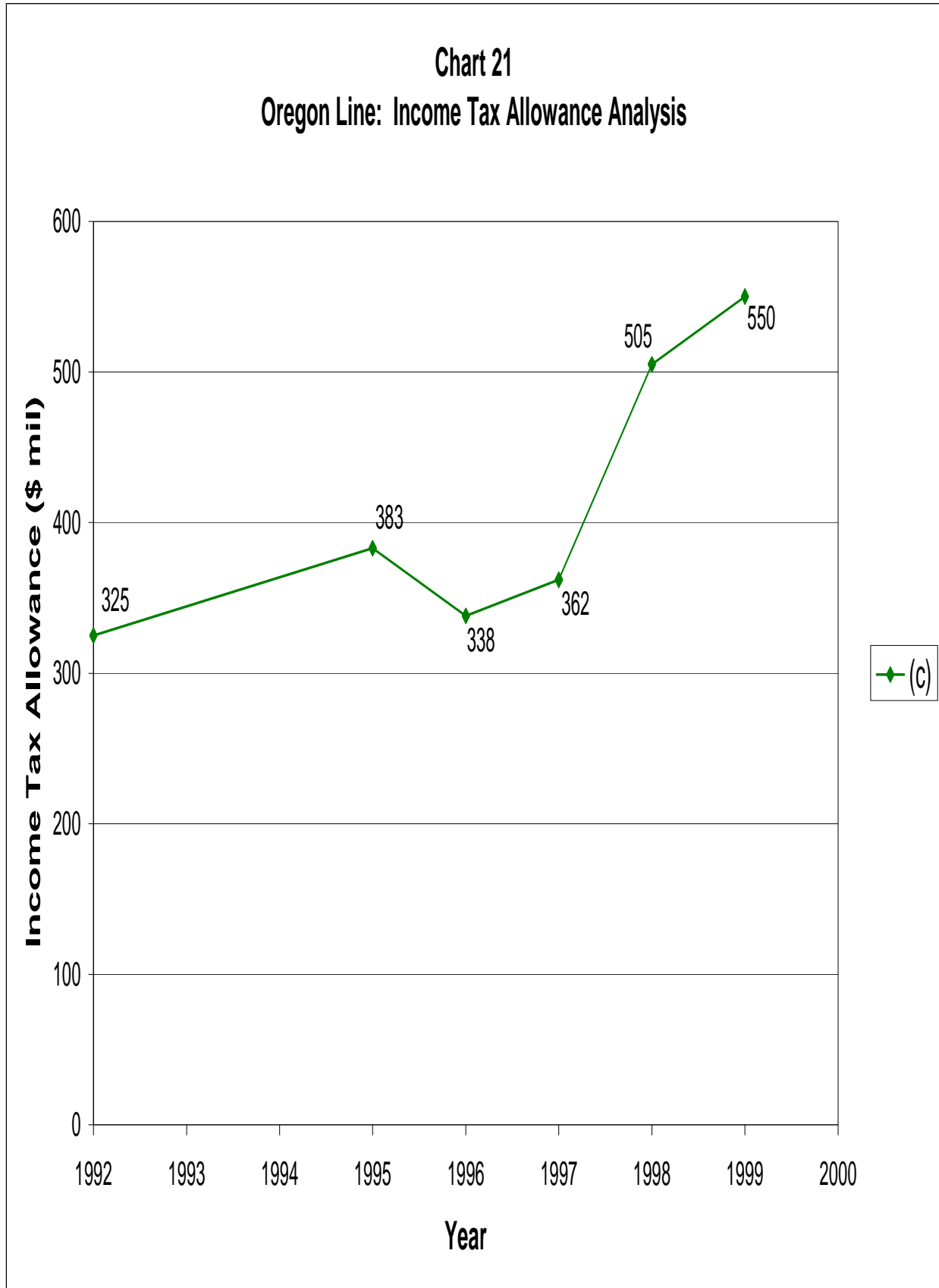


Chart 20
Oregon Line: Percentage Rate Base Change





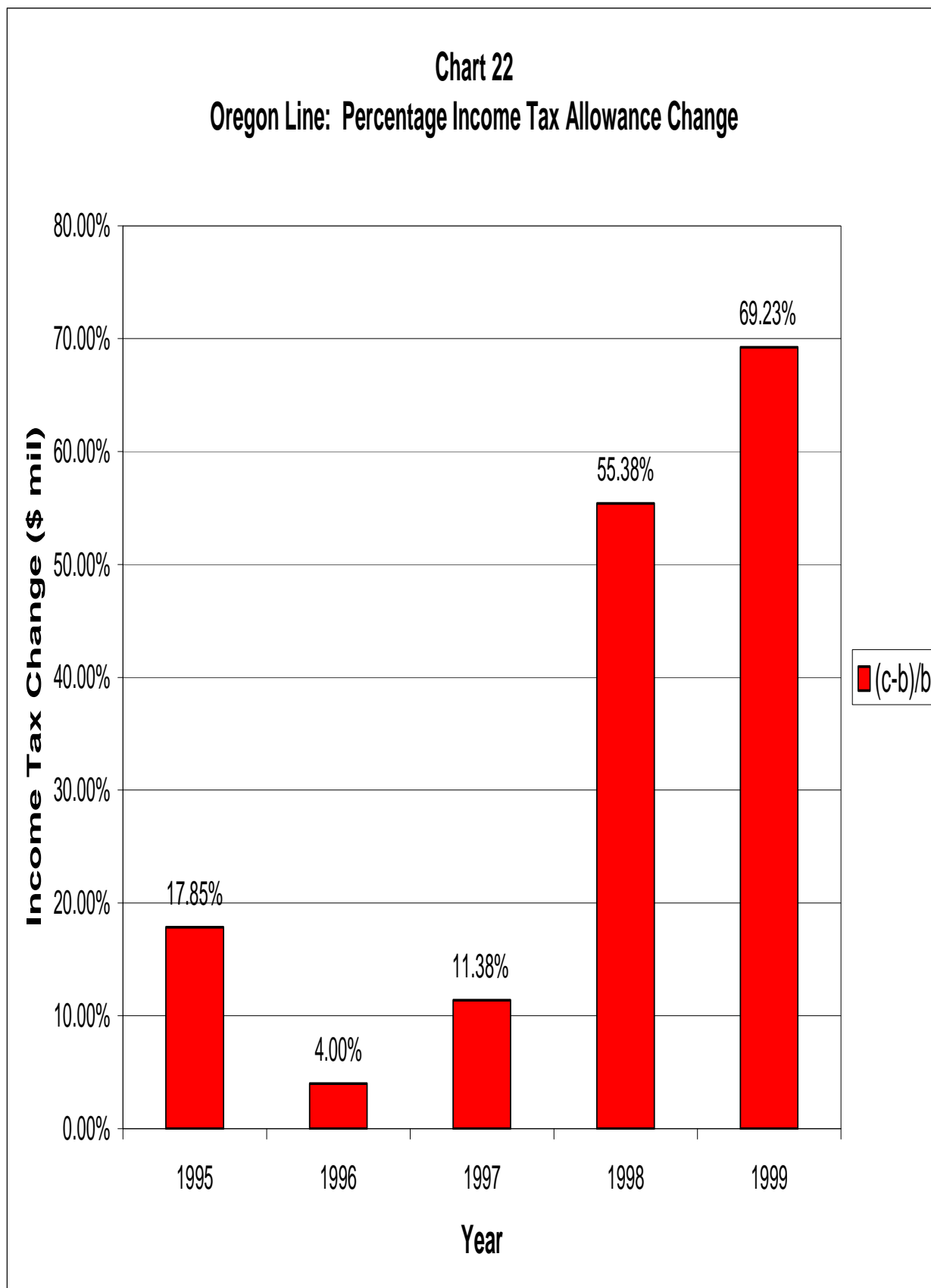


Chart 23
Oregon Line: Cost of Service Analysis

