

150 FERC ¶ 61,096  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

SFPP, L.P.

Docket Nos. IS08-390-004  
IS08-390-006  
IS08-390-007

OPINION NO. 511-B

ORDER ON REHEARING AND COMPLIANCE FILING

(Issued February 19, 2015)

1. On January 17, 2012, SFPP, L.P. (SFPP) filed for rehearing of Opinion No. 511-A, which addressed ongoing issues in this proceeding related to SFPP's proposed West Line rates.<sup>1</sup> On January 30, 2012, SFPP submitted its compliance filing pursuant to the directives of Opinion No. 511-A. As discussed below, the Commission grants SFPP's rehearing request related to issues involving Accumulated Deferred Income Taxes (ADIT) and denies rehearing regarding all other issues. The Commission also finds that parts of SFPP's compliance filing require modification. The Commission directs SFPP to make a revised compliance filing within 45 days consistent with this order and, as appropriate, to recalculate the refunds due its shippers.

**I. Background**

2. On June 30, 2008, SFPP submitted, pursuant to 18 C.F.R. § 342.4(a), revised FERC Tariff Nos. 171 and 172 to reflect proposed cost of service rates which increased rates for all shipments on SFPP's West Line between Watson Station, Los Angeles County, California, and Phoenix, Arizona. Several protesting parties raised issues of material fact regarding SFPP's cost-of-service and the proposed rate levels.

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<sup>1</sup> *SFPP, L.P.*, 137 FERC ¶ 61,220 (2011) (Opinion No. 511-A).

3. On July 29, 2008, the Commission accepted and suspended SFPP's proposed rates for the West Line to become effective August 1, 2008, subject to refund and hearing procedures.<sup>2</sup> Following hearing, the Presiding Administrative Law Judge (ALJ) issued the Initial Decision on December 2, 2009 (2009 ID).<sup>3</sup> Several parties filed briefs on exceptions and briefs opposing exceptions to the 2009 ID. In Opinion No. 511, the Commission generally affirmed the ALJ's determinations, but also reversed on certain issues.<sup>4</sup> On April 25, 2011, SFPP submitted its Compliance Filing in response to Opinion No. 511 in Docket No. IS08-390-006. Several parties requested rehearing of Opinion No. 511.

4. In Opinion No. 511-A, the Commission affirmed its prior findings regarding most issues. However, the Commission granted rehearing related to the calculation of allowance for deferred income taxes (ADIT) and overhead cost allocation, among others. Upon review of SFPP's April 2011 compliance filing, the Commission also required SFPP to modify its indexing calculations. The Commission required SFPP to make a revised compliance filing consistent with these rulings and to recalculate the refunds due to its shippers.

5. On January 17, 2012, SFPP filed for rehearing of Opinion No. 511-A related to issues involving (a) ADIT and (b) the Commission's indexing policies. No other party sought rehearing. On January 30, 2012, SFPP filed the Compliance Filing to pursuant to Opinion No. 511-A. The January 2012 Compliance Filing sets forth SFPP's computation of revised rates to apply to its West Line service from August 1, 2008, through January 31, 2012, as well as its computation of estimated refunds.<sup>5</sup> On February 29, 2012, the ACV Shippers<sup>6</sup> filed a protest and comments addressing the

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<sup>2</sup> *SFPP, L.P.*, 124 FERC ¶ 61,103 (2008).

<sup>3</sup> *SFPP, L.P.*, 129 FERC ¶ 63,020 (2009) (2009 ID).

<sup>4</sup> *SFPP, L.P.*, 134 FERC ¶ 61,121 (2011) (Opinion No. 511).

<sup>5</sup> In Docket No. IS12-145-000, SFPP filed tariffs setting forth prospective rates from February 1, 2012 forward. The Commission accepted and suspended the proposed tariff records, to be effective February 1, 2012, subject to refund and pending the outcome of the ongoing proceedings in Docket Nos. IS08-390-000, *et al.*, and IS11-444-000, *et al.* *SFPP, L.P.*, 138 FERC ¶ 61,144 (2012).

<sup>6</sup> The ACV Shippers include: Chevron Products Company; ConocoPhillips Company; Valero Marketing and Supply Company; Continental Airlines, Inc.; Delta Air Lines, Inc.; Southwest Airlines Co.; and US Airways, Inc.

January 2012 Compliance Filing. ExxonMobil Oil Corporation and BP West Coast Products LLC (collectively, ExxonMobil/BP) also filed joint comments addressing SFPP's compliance filing. On March 15, 2012, SFPP filed its reply comments.

## **II. Rehearing of Opinion No. 511-A**

### **A. ADIT**

#### **1. Background**

6. ADIT records the cumulative tax deferrals resulting from (a) the use of accelerated depreciation for determining annual federal and state income tax liability as opposed to (b) the use of straight-line depreciation. In this proceeding, the parties have disputed how the tax rate for calculating ADIT should be determined. In its original rate filing, SFPP calculated the annual changes to its ADIT balances between 1992 and 2008 based upon the weighted average marginal tax rates of its owning partners in the applicable year.<sup>7</sup> The 2009 ID upheld this calculation as consistent with Commission policy.

7. On exceptions, the ACV Shippers argued that for the 1992-1996 period, SFPP's annual modifications to its ADIT account should reflect the maximum corporate tax rate of 35 percent, not the weighted average partnership income tax rate. In Opinion No. 511, the Commission reversed the 2009 ID, and held that each year's change to SFPP's ADIT totals for the entire 1992 to 2007 should be calculated using the top marginal income tax rate for corporations from 1992.<sup>8</sup>

8. SFPP sought rehearing, and in Opinion No. 511-A, the Commission modified its holding in Opinion No. 511. Opinion No. 511-A held that the proper weighted marginal tax rate for calculating ADIT is the weighted marginal tax rate embedded in SFPP's rates in any given year. Accordingly, for the period between May 1, 1996, and August 1, 2008 (the effective date of the West Line rates in this proceeding), Opinion No. 511-A stated that the weighted marginal tax rate used to determine ADIT must be fixed as a matter of

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<sup>7</sup> Thus, to determine the changes to its ADIT balances in 2001, SFPP used its 2001 weighted average marginal tax rate of its partners. The weighted average marginal income tax rate of a partnership is based upon (a) tax rates applicable to each type of partner (e.g. individuals, corporations) (b) weighted by the aggregate actual or potential income tax liability attributed to the partners of each type (e.g. individuals, corporations).

<sup>8</sup> Opinion No. 511, 134 FERC ¶ 61,121 at P 320.

“rate design” at the May 1, 1996 level.<sup>9</sup> Opinion No. 511-A selected May 1, 1996 because this was the date that the rates in SFPP’s most recent fully litigated West Line rate case became effective. However, citing prior Commission orders which previously addressed SFPP’s annual ADIT accumulations for 1992 through 1996, Opinion No. 511-A held that annual change to the ADIT for the 1992-1996 period should be calculated based upon the weighted marginal income tax rates in effect during those particular years.<sup>10</sup> Opinion No. 511-A held that although these earlier orders erred in the calculation of annual additions to ADIT, it would be improper to revisit the 1992-1996 period at this time.

9. In making these holdings the Commission also characterized ADIT as the difference between a pipeline’s actual income tax liability and “the dollar amount of taxes generated by the income tax allowance component of the pipeline’s cost of service.”<sup>11</sup>

## 2. SFPP’s Rehearing Request

10. SFPP asserts that Opinion No. 511-A erred and that the annual changes to its ADIT balances between 1992 and 2008 should be based upon the weighted average marginal tax rates of its owning partners for each applicable year.

11. SFPP argues that the reasoning in Opinion No. 511-A is internally inconsistent. SFPP states that the annual additions to ADIT depend on a variety of factors such as carrier property and depreciation rates. SFPP emphasizes that Opinion No. 511-A did not prohibit the use of actual carrier property and actual depreciation rates for each year. Given that the other data affecting the calculation of ADIT is permitted to change from year to year, SFPP states that it is inconsistent for Opinion No. 511-A to disregard changes to the weighted marginal income tax rates occurring after May 1996.

12. SFPP also contends that because pipeline rates change via indexing even without a cost-of-service filing, it is not correct for the Commission to view SFPP’s rates as embedding a particular weighted marginal tax rate from over a decade ago. SFPP also states that, even if the ADIT should only be adjusted between cost-of-service rate cases

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<sup>9</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 391 n.655.

<sup>10</sup> *Id.* P 385 (citing *SFPP, L.P.*, 121 FERC ¶ 61,240 at PP 143-144 (December 2007 Order)).

<sup>11</sup> *Id.* P 383.

as held by Opinion 511-A, SFPP's West Line rates (and the related ADIT levels) have been subject to multiple cost-of-service proceedings since 1997.

13. In its rehearing request, SFPP claims that the Commission's holdings regarding ADIT were procedurally improper. SFPP states that no participant in the hearing presented evidence justifying Opinion No. 511-A's approach for modifying SFPP's calculations of ADIT between 1997 and 2008. SFPP further emphasizes that ACV Shippers only challenged SFPP's ADIT calculations for the 1992-1996 period as opposed to the different 1997-2008 period addressed by Opinion Nos. 511 and 511-A.

14. SFPP also adds that the description of ADIT in Opinion No. 511-A is confused. SFPP states that Opinion No. 511-A describes ADIT as though it consists of the difference between (a) income taxes "actually" paid based upon the fixed weighted marginal income tax rate established during SFPP's most recent rate case and (b) the dollar amount of the income tax allowance in SFPP's most recent cost of service rate case. SFPP asserts that this is incorrect, and the dollar amount of the income tax allowance used in SFPP's most recent rate case has no role in determining ADIT for subsequent years.

### 3. Discussion

15. The Commission grants rehearing and holds that for the 1992-2008 period<sup>12</sup> each year's deferred taxes must be calculated based upon the pipeline's weighted average marginal income tax rate for the applicable year.

16. The Commission's decision to grant rehearing is based upon the purpose and function of ADIT. Under Commission policy, pipeline rates are designed to recover a normalized income tax cost based upon straight-line depreciation.<sup>13</sup> To reconcile this policy with the accelerated depreciation used by the tax code, ADIT records the cumulative annual tax deferrals resulting from (a) the use of accelerated depreciation for determining annual federal and state income tax liability as opposed to (b) straight-line depreciation applied for Commission regulatory purposes. In the early years of an asset's life, accelerated depreciation reduces taxable income more than straight-line depreciation,

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<sup>12</sup> SFPP only seeks rehearing related to the calculation of ADIT for 1992-2008. No party has raised any issues related to the calculation of ADIT prior to the 1992-2008 time period.

<sup>13</sup> *Arco Pipe Line Co.*, Opinion No. 351, 52 FERC ¶ 61,055, at 61,238 (1990) (citations omitted).

creating a tax deferral and causing increases to the ADIT balance. In an asset's later years, straight-line depreciation costs exceed accelerated depreciation costs, causing the deferred taxes to be collected and the ADIT balance to decline. The Commission's longstanding policy treats ADIT as "cost-free" capital because the pipeline may use the funds in ADIT without paying either a return to equity investors or interest on debt.<sup>14</sup> Accordingly, in a cost-of-service proceeding, the Commission requires the pipeline reduce its rate base by the sums in ADIT so the pipeline does not improperly earn a return related to the cost-free ADIT funds.

17. The dollar amount of the tax deferrals recorded in ADIT, and the associated "cost free capital," depends upon the weighted marginal income tax rate at the time that the taxes are deferred. Use of the tax rate applicable at the time of the pipeline's most recent rate case as required by Opinion No. 511-A would lead to an inaccurate calculation of the deferred taxes because the weighted average marginal income tax may have changed in the years following the rate case.<sup>15</sup>

18. The Commission also rejects Opinion No. 511-A's reasoning that the weighted marginal income tax rate is a "matter of rate design" which must be fixed at the level of the pipeline's most recent rate case. The annual changes to ADIT are affected by annual changes to rate base, depreciation rates, and other factors which influence the size of tax deferrals.<sup>16</sup> While allowing these other factors to vary, there is no reason to hold the weighted average marginal income tax rate constant and, as a result, to provide an inaccurate calculation of the tax deferrals and the cost free capital recorded in ADIT.<sup>17</sup> Thus, the Commission grants rehearing and holds that for the 1992-2008 period SFPP

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<sup>14</sup> Opinion No. 351, 52 FERC at 61,238.

<sup>15</sup> For example, if in Year X, the use of accelerated depreciation reduces taxable income more than straight-line depreciation cost, the dollar amount of the resulting tax deferral depends upon the pipeline's effective tax rate (i.e., the weighted average marginal income tax rate) in Year X, not some other period.

<sup>16</sup> Opinion No. 511-A further allowed that changes to the statutory tax rate could be reflected in ADIT. Opinion No. 511-A, 137 FERC ¶ 61,220 at P 387 n.650. Thus, when Opinion No. 511-A referred to holding constant the "weighted average marginal tax rate," it apparently was referring to how the tax rates of the different types of partners (i.e., individuals, corporations, etc.) would be weighted.

<sup>17</sup> Having considered all the arguments on rehearing, the Commission is persuaded that a more accurate calculation of ADIT trumps Opinion No. 511-A's analysis related to "rate design."

should calculate its ADIT based upon the weighted average marginal income tax rate applicable to the year in which each tax deferral occurred.

19. Further, to the extent Opinion No. 511-A may have been unclear, the Commission also clarifies that ADIT is not based upon the difference between taxes actually paid and the dollar amount of the pipeline's income tax allowance as calculated in the most recent rate case. As with other items in a pipeline's cost of service, the Commission does not "track" or "true-up" the difference between the pipeline's actual taxes and the "income tax allowance" used in a pipeline's most recent cost-of-service rate case.<sup>18</sup> Although a pipeline's costs may change in the years following a rate case, the pipeline is assumed to recover its costs (including its tax costs) via the rates in effect at the time the cost is incurred. There is no subsequent adjustment for under- or over-recoveries.<sup>19</sup>

20. ADIT serves a different purpose, i.e., accounting for the accumulated tax deferrals resulting from (a) the accelerated depreciation by federal and state tax authorities as opposed to (b) straight-line depreciation used by the Commission's normalized tax methodology. This comparison only captures the effect of the resulting tax deferral if both (a) the federal/state taxes and (b) the normalized taxes are calculated based upon the then-existing tax rates (for a partnership like SFPP, the weighted average marginal income tax rate), rate base, and depreciation rates.

21. For the reasons stated above, the Commission grants rehearing and concludes that the annual tax deferrals added to ADIT for the 1992-2008 period should be based upon the weighted average marginal tax rate effective in the year the tax deferral occurred.<sup>20</sup>

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<sup>18</sup> *Lakehead Pipe Line Co. L.P.*, 75 FERC ¶ 61,181, at 61,594 (1996).

<sup>19</sup> If the tax burden dramatically increases, the remedy available to a pipeline for under-recoveries of its total costs is to file a new cost-of-service rate case. Likewise, if the tax burden declines, the remedy available to shippers for over-recoveries is to file a complaint. Furthermore, because SFPP's rates have changed pursuant to the Commission's indexing policies and settlements, it would be unreasonable to view SFPP's rates as embedding a dollar amount of the income tax allowance from its last fully litigated cost-of-service rate case.

<sup>20</sup> Although SFPP became a Master Limited Partnership in 1988, the Commission acknowledges that it has historically applied the corporate rate, not the "weighted marginal income tax" rate for the partnership, to calculate ADIT accumulations until the year 1992. The Commission has at times justified this policy on the basis of the timing of certain complaints against SFPP, which began in 1992 (e.g., *SFPP, L.P.*, Opinion No. 435, 86 FERC ¶ 61,022, at 61,094 (1999)), reasoning which we have

(continued...)

## B. Indexing

### 1. Background

22. Oil pipelines may file for an annual change to their rate ceiling levels every July 1 pursuant to the Commission's indexing regulations.<sup>21</sup> A pipeline may, at its discretion, also increase its rates pursuant to the Commission's indexing regulations up to these new ceiling levels.<sup>22</sup> A pipeline's index rate change can be challenged by a shipper if a rate change "is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable...."<sup>23</sup>

23. SFPP filed its new cost-of-service rates to be effective on August 1, 2008.<sup>24</sup> Pursuant to the indexing regulations, effective July 1, 2009, oil and petroleum products pipelines were allowed to request an index increase up to 7.6025 percent based upon industry cost changes during the prior 2008 year.<sup>25</sup> In its Opinion No. 511 compliance filing, SFPP calculated its refunds and going forward rates implementing the full 7.6025 percent index increase.<sup>26</sup> ExxonMobil/BP, ACV Shippers, and Trial Staff raised concerns about SFPP's proposed application of the full index increase.

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repudiated here. However, the Commission has also justified this policy on the basis that 1992 was the earliest year in which the Commission recognized that a different tax rate should be applied to partnerships than the marginal corporate rate. *SFPP, L.P.*, 121 FERC ¶ 61,240, at PP 142-144 (December 2007 Order) (citing *Lakehead Pipe Line Co. L.P.*, 75 FERC ¶ 61,181, at 61,594 (1996) and *SFPP, L.P.*, Opinion No. 435, 86 FERC ¶ 61,022, at 61,094 (1999)). Given that the 1988-1992 period has not been challenged on rehearing, we do not revisit issues related to that particular time period here.

<sup>21</sup> 18 C.F.R. § 342.3 (2014).

<sup>22</sup> *Id.* § 342.3(a).

<sup>23</sup> *Id.* § 343.2(c).

<sup>24</sup> These new cost of service rates became the ceiling rate for the July 1, 2008-July 1, 2009 index year. 18 C.F.R. § 342.3(d)(5).

<sup>25</sup> *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, 127 FERC ¶ 61,184 (2009).

<sup>26</sup> SFPP has also filed West Line indexing rate changes in subsequent years.



24. Opinion No. 511-A denied SFPP's claim that it was entitled to the full 7.6025 percent increase. Opinion No. 511-A observed that the 7.6025 percent increase was based on changing costs in 2008, and that the cost-of-service rates adopted in this proceeding included significant costs from the January 1, 2008-September 30, 2008 period. Accordingly, Opinion No. 511 held that SFPP's cost of service rates already incorporated a portion of the January 1 – December 31, 2008 cost increases which formed the basis for the 7.6025 percent index increase to be effective July 1, 2009. However, Opinion No. 511 explained that the cost increases in the last quarter of 2008 (October 1-December 31) are not reflected in the cost of service used to establish the rates in this proceeding. Thus, Opinion No. 511-A permitted SFPP to increase its West Line rates by 1.9006 percent, which is one-fourth of the July 1, 2009 rate indexing adjustment of 7.6025 percent.<sup>27</sup>

## 2. SFPP Rehearing Request

25. On rehearing, SFPP asserts that Opinion 511-A should have permitted the full July 1, 2009 index increase of 7.6025 percent. SFPP asserts that the data incorporated into its cost of service support application of the full index. SFPP argues that out of \$21,215,756 total expenses, only \$7,481,242 consists of annualized 2008 expenses. In addition, SFPP asserts that the Commission's practice of using cost of capital data for later periods has not been a basis for denying rate indexing adjustments in the past.<sup>28</sup>

26. SFPP also contends that Opinion No. 511-A's denial of the full July 1, 2009 index increase is inconsistent with the "simplifying" objectives of the Commission's indexing mechanism. Furthermore, SFPP asserts that the index exists to enable pipelines to adjust their rates to reflect "inflation-driven cost changes."<sup>29</sup> SFPP states that the cost-of-service adjustments using 2008 adjustment period data were designed to create just and reasonable rates for 2008. SFPP states that the purpose of the index adjustment is to convert 2008 just and reasonable rates into 2009 just and reasonable rates. SFPP states if the Commission continues to hold that some reduction of the 2009 rate index adjustment is necessary, a 25 percent reduction would be more appropriate.

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<sup>27</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 405.

<sup>28</sup> SFPP Rehearing at 17 (citing *Portland Natural Gas Transp. Sys.*, 134 FERC ¶ 61,129, at P 242 (2011)).

<sup>29</sup> SFPP Rehearing at 18 (citing *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act*, Order No. 561, FERC Stats. & Regs. ¶ 30,985, at 30,948 (1993)).

### 3. Commission Decision

27. The Commission denies rehearing and rejects SFPP's assertions that it is entitled to the full 7.6025 percent July 1, 2009 increase to SFPP's ceiling levels and rates. The Commission affirms the holding in Opinion No. 511-A that SFPP may increase its West Line ceiling levels and rates by 1.9006 percent for the July 1, 2009 index increase.

28. Commission regulations permit challenges to a proposed index increase if the challenging party demonstrates that the proposed increase "is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable...."<sup>30</sup> The Commission has denied index increases proposed by the pipeline in the past in which the cost-of-service data in the pipeline's rate increase was for the same period covered by the index's measurement of industry-wide changes.<sup>31</sup> The 7.6025 percent increase sought by SFPP is based upon industry-wide cost changes during the year 2008. However, significant January 1, 2008-September 30, 2008 costs have been incorporated into the cost-of-service rates adopted in this proceeding. Thus, Opinion No. 511-A properly denied SFPP's request for a full index increase. The one quarter of the index increase corresponds to the three months of 2008 cost changes that are outside the January 1, 2008-September 30, 2008 adjustment period<sup>32</sup> and thus are not incorporated into SFPP's cost-of-service rates approved in this proceeding.

29. SFPP's attempts on rehearing to minimize the significance of 2008 costs and other data in its cost-of-service are not persuasive. The cost summary provided in SFPP's rehearing request demonstrates that \$12,676,611 of \$21,215,745 cost-of-service operating expenses<sup>33</sup> is either based upon annualized 2008 costs or the normalization of an across the board wage increase which became effective in October 1, 2007. Annualized 2008

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<sup>30</sup> 18 C.F.R. § 343.2(c) (2014).

<sup>31</sup> *SFPP, L.P.*, 117 FERC ¶ 61,271 (2006), *reh'g denied*, 120 FERC ¶ 61,245 (2007).

<sup>32</sup> This proceeding has adjudicated SFPP's proposal for new rates, to be effective August 30, 2008, determined using base period (January 1, 2007-December 31, 2007) and adjustment period data (January 1, 2008-September 30, 2008).

<sup>33</sup> The \$21,215,745 in operating expenses excludes litigation costs related to this proceeding, which are recovered via a surcharge and which incorporate costs incurred during 2008 and later.

expenses are responsible for \$7,481,242.<sup>34</sup> Another \$5,195,369 results from a wage increase, which as Opinion No. 511's explained, because it "became effective in late 2007, [the wage increase] is more fully reflected in SFPP's costs for the January 1, 2008, through the September 30, 2008 period than for SFPP's unadjusted 2007 costs."<sup>35</sup> To the extent that SFPP's cost-of-service rates are derived from unadjusted 2007 base period costs,<sup>36</sup> SFPP makes no argument that these costs were significantly higher during the January 1, 2008-September 30, 2008 period. SFPP's rehearing arguments do not alter the conclusion that its cost-of-service rates will incorporate expense levels largely commensurate with its January 1-September 30, 2008 expenses.

30. Other parts of SFPP's cost-of-service offer support for Opinion No. 511-A's decision to deny SFPP the full index increase. SFPP's capital costs are based upon September 30, 2008 data, not 2007 base period data.<sup>37</sup> SFPP states that the Commission's frequent use of post base period capital costs has not previously been a basis for denying an index rate increase.<sup>38</sup> However, SFPP cites to no circumstance in which the Commission has been required to address this issue, and, in any case, the use of September 30, 2008 capital costs must be considered alongside the other significant post base period costs which have been incorporated into SFPP's cost of service in this proceeding.

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<sup>34</sup> SFPP January 17, 2012 Rehearing at 16. Even this \$7,481,242 figure, which was derived by adding the expenses in each account, somewhat underestimates the significance of 2008 data in the cost-of-service rates. When using simple addition, the negative balance for annualized oil losses and shortages (specifically, -\$1,290,603), serves to lower the total of expenses attributed to annualized 2008 data. However, it is not reasonable to assert that the use of 2008 annualized oil losses and shortages *reduces* the relative importance of 2008 operating expenses in the determination of SFPP's cost-of-service rates.

<sup>35</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 409 n.683. Notably, SFPP does not refer to a similar wage increase becoming effective during the January 1, 2008-September 30, 2008 period.

<sup>36</sup> The data summarized in SFPP's rehearing request states that unadjusted base year 2007 data provided \$8,539,134 out of \$21,215,745 of the operation and maintenance costs reflected in SFPP's cost of service.

<sup>37</sup> Opinion No. 511, 134 FERC ¶ 61,121 at P 151.

<sup>38</sup> SFPP January 17, 2012 Rehearing at 17.

31. Opinion No. 511 also determined the cost-of-service throughput using annualized January 1, 2008 through September 30, 2008 volume data, which was significantly lower than the 2007 unadjusted base period volume level. The resulting reduction to throughput significantly increased SFPP's rates above the rates which would have been calculating using the 2007 base period throughput. Although SFPP argues that it adjusted expenses (such as fuel and power) to account for the declining throughput levels, the throughput adjustment most significantly affected cost-of-service by reducing the throughput billing determinant from the 2007 base period levels. Under these circumstances, it seems equitable to consider the extent to which January 1-September 30, 2008 adjustment period data determined SFPP's cost of service rates. SFPP should not be able to take advantage of cost-of-service adjustments from the January 1-September 30, 2008 adjustment period while simultaneously seeking an index increase covering the same time frame.

32. The Commission also dismisses SFPP's assertions on rehearing that denial of the full index increase is contrary to the purpose of the indexing regulations to provide a simplified ratemaking methodology. Although the Commission generally does not consider specific company costs when evaluating an index increase, such limits do not pertain to the base and adjustment period of a prolonged rate case in which these very costs have been litigated before the Commission and integrated into a pipeline's rates.<sup>39</sup> Once the Commission has already proceeded through extensive rate case litigation, there is very little "simplification" to be achieved by ignoring the evidence already presented in the record.<sup>40</sup> The evaluation of this data is straightforward. Given the substantial presence of January 1-September 30, 2008 data in SFPP's cost of service, Opinion No. 511-A properly denied SFPP the full application of the July 1, 2009 Index increase for industry-wide cost changes during 2008.

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<sup>39</sup> *SFPP, L.P.*, 117 FERC ¶ 61,271 (2006), *reh'g denied*, 120 FERC ¶ 61,245 (2007).

<sup>40</sup> The Commission established the indexing mechanism in response to the mandate in the Energy Policy Act of 1992 to establish a simplified ratemaking methodology. *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act*, Order No. 561, FERC Stats. & Regs. ¶ 30,985, at 30,942 (1993) (cross-referenced at 65 FERC ¶ 61,109), *order on reh'g*, Order No. 561-A, FERC Stats. & Regs. ¶ 31,000 (1994) (cross-referenced at 68 FERC ¶ 61,138), *aff'd*, *Assoc. of Oil Pipe Lines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

33. In its rehearing request, SFPP suggests that the Commission consider allowing SFPP to recover three quarters of the index increase. However, SFPP does not persuasively justify why the application of three quarters of the July 1, 2009 index increase is appropriate. As described above, the cost-of-service rates accepted by Opinion Nos. 511 and 511-A include significant data from the first nine months of 2008, but not the last three months of that year. Accordingly, the Commission affirms that for calculating refunds and going-forward rates, SFPP may apply an index increase effective July 1, 2009, corresponding to the last three months of 2008 and equivalent to one quarter of the increase otherwise permitted under the indexing methodology.

### **III. Compliance Filing**

34. Both the ACV Shippers and ExxonMobil/BP state that SFPP's compliance filing is generally consistent with the directives of Opinion No. 511-A. However, they raise issues related to (a) the allocation of certain overhead costs, (b) the calculation of the litigation surcharge, and (c) ensuring that SFPP's index rate adjustments are modified as appropriate in other ongoing proceedings.<sup>41</sup> In its reply comments, SFPP also identified certain errors that it discovered in its compliance filing.

#### **A. Overhead Costs**

##### **1. KM Canada**

###### **a. Background**

35. Both the ACV Shippers and ExxonMobil/BP state that SFPP's compliance filing is generally consistent with the directives of Opinion No. 511-A. However, they raise issues related to (a) the allocation of certain overhead costs and (b) the calculation of the litigation surcharge.<sup>42</sup> In its reply comments, SFPP also identified certain errors that it discovered in its compliance filing.

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<sup>41</sup> ExxonMobil/BP state that they have filed a petition for review of Opinion No. 511-A with the United States Court of Appeals for the D.C. Circuit. They emphasize that SFPP's compliance filing should only be made subject to further refund and further reduction to the extent that SFPP's cost of service is decreased as a result of judicial review.

<sup>42</sup> The protests also observe that aspects of SFPP's compliance filing incorporate the 2011 index adjustment which remained, at the time of the comments, subject to ongoing proceedings in Docket No. IS11-444-000, and they urge that this filing only be

(continued...)

36. Kinder Morgan Energy Partners L.P. (KMEP), a master limited partnership, owns SFPP. Neither SFPP nor KMEP have any employees. Rather, all operating and administrative services and related overhead functions are provided by either Kinder Morgan, Inc. (KMI) or Kinder Morgan General Partner Services (GP Services). Opinion Nos. 511 and 511-A addressed several issues related to the allocation of overhead costs between SFPP and the numerous KMEP subsidiaries. One class of KMEP subsidiaries are the KM Canada entities. In its filings, SFPP sought to directly assign costs from KMI and GP services to KM Canada and to exclude KM Canada from the Massachusetts Formula application which allocated the remaining KMI and GP service costs among KMEP's other subsidiaries (including SFPP). SFPP's direct assignments are based on so-called responsibility centers (RCs) which are coded by employees and used to assign costs to particular subsidiaries based upon the level of service an RC ostensibly provides to each KMEP subsidiary.

37. Opinion No. 511 required SFPP to provide additional information and documentation to support its proposal to directly assign costs to KM Canada costs as opposed to allocating these costs using the Massachusetts Formula allocation.<sup>43</sup> SFPP's compliance filing included Tab D, Exhibit 9, which listed the (a) labor and (b) non-labor costs from GP Services or KMI RCs which SFPP claimed were incurred on behalf of KM Canada. The non-labor costs include employee related costs such as materials and supplies, cellular phones, and general employee expenses.

38. In Order No. 511-A, the Commission determined that SFPP had failed to provide adequate documentation regarding the direct assignment of costs from GP Services or KMI-shared services to KM Canada.<sup>44</sup> Accordingly, the Commission concluded, "[T]he KM Canada Entities must be included in KMEP's Massachusetts formula allocation with respect to any GP Services or KMI-shared RC that SFPP has identified in this proceeding as providing any amount of services to the KM Canada entities in 2007."<sup>45</sup> The Commission further stated, "[t]o implement this directive, the KM Canada Entities must be included in the Massachusetts formula for allocating the costs from each RC listed in Tab D, Exhibit 9 of SFPP's [Opinion No. 511] Compliance Filing." SFPP did not seek rehearing of Opinion No. 511-A's holdings on this issue.

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accepted subject to the outcome of those proceedings. The Commission will address, in due course, the effect of other ongoing proceedings on SFPP's West Line rates.

<sup>43</sup> Opinion No. 511, 134 FERC ¶ 61,121 at P 120.

<sup>44</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 139.

<sup>45</sup> *Id.* P 140.

**b. SFPP's Compliance Filing**

39. In its Opinion No. 511-A Compliance filing, SFPP included KM Canada in the Massachusetts Formula Allocation of the labor costs in GP Services or KMI-shared RCs that SFPP identified as providing any amount of services to KM Canada. Furthermore, SFPP included KM Canada in the Massachusetts Formula allocation of non-labor costs in those RCs that identified as incurring some amount of non-labor costs on behalf of KM Canada Entities. However, Tab D, Exhibit 9 of SFPP's Opinion No. 511 Compliance Filing listed some RCs which incurred only "labor costs" and no "non-labor costs" on behalf of KM Canada. In these situations, SFPP excluded KM Canada from the Massachusetts Formula allocation of "non-labor costs" associated with the RC.

**c. Protests**

40. The ACV Shippers assert that SFPP failed to comply with Opinion No. 511-A. The ACV Shippers state that Opinion No. 511-A directed SFPP to include the KM Canada in the allocation of Kinder Morgan overhead costs for each RC which was identified as incurring costs on behalf of the KM Canada Entities. By completely excluding KM Canada from the allocation of certain non-labor costs, ACV Shippers state that SFPP violated the requirement of Opinion No. 511-A. The ACV Shippers further add that SFPP improperly relies upon its rejected 2011 survey data to determine whether an RC incurred any non-labor costs on behalf of KN Canada. The ACV Shippers contend that Opinion No. 511-A determined that this survey data was not reliable.<sup>46</sup> The ACV Shippers also emphasize that it is implausible that if an RC incurred labor costs on behalf of KM Canada that that there would be no non-labor costs (i.e., general employee expenses) which benefited KM Canada. The ACV Shippers' protest includes an Affidavit from Daniel Arthur which supports their analysis and indicates which non-labor costs ACV Shippers assert should be allocated to KM Canada. ExxonMobil/BP state they support and adopt ACV Shippers position on this issue.

**d. Reply Comments**

41. In its reply comments, SFPP concedes that Opinion No. 511-A "did not distinguish between labor and non-labor costs."<sup>47</sup> However, SFPP argues that its compliance filing is consistent with the Commission's goal of "matching costs and cost

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<sup>46</sup> ACV Shippers Protest at 4 (citing Opinion No. 511-A, 137 FERC ¶ 61,220 at P 139).

<sup>47</sup> SFPP Reply Comments at 2.

incurrence.” SFPP, using RC 0031 (Legal) as an example states that (a) there were no non-labor costs in this account which were assigned to KM Canada, (b) that SFPP produced the transaction-level detail supporting this position, and (c) that no shipper pointed to evidence suggesting these non-labor costs should have been assigned to KM Canada. SFPP claims that the Commission should accept the allocations in its Opinion No. 511-A Compliance Filing because they appropriately match the costs with the entities that caused such costs to be incurred.

**e. Commission Determination**

42. The Commission finds that SFPP has not complied with its order, and directs SFPP to comply with Opinion No. 511-A’s directive to include KM Canada in the Massachusetts Formula allocation for all costs (labor and non-labor) associated with the RCs in Tab D, Exhibit 9 of SFPP’s Opinion No. 511 Compliance Filing. Opinion No. 511-A made clear that SFPP failed “to provide adequate documentation with respect to any of the relevant RCs” associated with the KM Canada Entities. Accordingly, Opinion No. 511-A held:

[T]he KM Canada Entities must be included in KMEP’s Massachusetts formula allocation with respect to any GP Services or KMI-shared RC that SFPP has identified in this proceeding as providing any amount of services to the KM Canada entities in 2007. To implement this directive, the KM Canada Entities must be included in the Massachusetts formula for allocating the costs from each RC listed in Tab D, Exhibit 9 of SFPP’s [Opinion No. 511] Compliance Filing.<sup>48</sup>

SFPP acknowledges Opinion No. 511-A “did not distinguish between labor and non-labor costs.”<sup>49</sup> SFPP did not seek rehearing of this issue, and the only issue with respect to SFPP’s compliance filing is whether SFPP complied with Opinion No. 511-A.<sup>50</sup> It has not. In its Opinion No. 511-A Compliance Filing, SFPP only includes KM Canada Entities in the allocation of a specific RC’s non-labor costs if the rejected survey data in Tab D Exhibit 9 of its Opinion No. 511 Compliance Filing provided that the RC incurred

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<sup>48</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 140.

<sup>49</sup> SFPP Reply Comments at 2.

<sup>50</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 57 (a challenge to an underlying order on compliance as opposed to rehearing is untimely).



non-labor costs for the benefit of the KM Canada Entities. This was not the approach directed by Opinion No. 511-A.

43. Not only is SFPP inappropriately re-litigating this issue in its compliance filing, but in doing so, SFPP still fails to support its position. The “non-labor” costs at issue in this proceeding include employee related costs such as material and supplies, cellular phones, accounting and audit fees, and general employee expenses.<sup>51</sup> SFPP’s Opinion No. 511-A compliance filing and its reply comments have not explained how, if labor costs present in a particular RC benefit KM Canada, there could be no non-labor costs (i.e., material and supplies, general employee expenses, etc.) in the same RC which similarly benefit KM Canada.

44. Accordingly, SFPP’s treatment of non-labor costs involving KM Canada is hereby rejected on both a procedural and a substantive basis. SFPP is directed to comply with the terms of Opinion No. 511-A, which requires that “the KM Canada Entities must be included in the Massachusetts formula for allocating the costs from each RC listed in Tab D, Exhibit 9 of SFPP’s [Opinion No. 511] Compliance Filing.”<sup>52</sup>

## **2. Other Cost Allocation Issues**

45. In its answer, SFPP states that in the cost allocation model in Exhibit 1 of Tab D of the Opinion No. 511-A Compliance Filing, SFPP inadvertently included Trans Mountain not only in the KMP Tier (i.e., the tier encompassing all of the KMEP Operated Entities) but also in the Products Pipeline Tier. SFPP states this was a mistake. The Commission accepts SFPP’s proposal to correct this error in its subsequent compliance filing.

### **B. Litigation Surcharge**

46. In its reply comments, SFPP concedes that the calculation of its litigation surcharge failed to account for 5,090,432 barrels. SFPP states that when recalculated to include the additional five million barrels, the resulting litigation surcharge is \$0.0357/bbl instead of \$0.0365/bbl. SFPP states that correcting this error will increase the refunds SFPP will pay for periods the surcharge applied. SFPP states that it will correct this error in its next compliance filing, and the Commission directs SFPP to make this unopposed correction.

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<sup>51</sup> ACV Shippers Protest, Affidavit of Daniel Arthur at p. 4 n.11, Attachment A.

<sup>52</sup> Opinion No. 511-A, 137 FERC ¶ 61,220 at P 140.

The Commission orders:

(A) The requests for rehearing are granted in part and denied in part for the reasons stated in the body of this order.

(B) SFPP shall file revised West Line rates consistent with this order within 45 days after this order issues, including a supporting cost of service, workpapers, explanatory statements, and any other necessary documentation.

(C) Comments on the compliance filing directed in ordering paragraph (B) are due 60 days after this order issues, and reply comments are due 75 days after this order issues.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.

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