112 FERC ¶ 63,020
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Texaco Refining and Marketing Inc. (Complainant) v. SFPP, L.P. (Respondent)	**Docket Nos. OR96-2-012 OR98-1-010**
ARCO Products Company; Mobil Oil Corporation (Complainants) v. SFPP, L.P. (Respondent)	**Docket Nos. OR96-10-008 OR98-1-010**
Ultramar Inc. (Complainant) v. SFPP, L.P. (Respondent)	**Docket Nos. OR96-2-012 OR96-17-005**
SFPP, L.P.	**Docket No. IS98-1-000**

INITIAL DECISION FINDING SEPULVEDA REPLACEMENT RATE UNJUST AND UNREASONABLE

(Issued August 24, 2005)

APPEARANCES

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RAYMOND M. ZIMMET, Presiding Administrative Law Judge:

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1. The lawfulness of all but one of SFPP's interstate oil-pipeline rates has been determined in Docket Nos. OR96-2 et al. by two initial decisions -- Phase One (103 FERC ¶ 63,055 (2003)) and Phase Two (108 FERC ¶ 63,036 (2004)) -- subject to further review by the Federal Energy Regulatory Commission.[1] The present proceeding deals with the remaining Sepulveda rate, which involves some of the same complaint-dockets germane to phases one and two, together with another docket, IS98-1, pertaining to a rate tariff that the Commission ordered SFPP to file in early October 1997.[2] The tariffed rate went into effect in early November 1997, following the agency's suspension of the rate subject to refund and further investigation upon determining that the rate had not been shown to be just and reasonable. 81 FERC ¶ 61,177 (1997).

2. The ultimate question presented in this final phase is whether the $0.05/bbl Sepulveda replacement rate is just and reasonable under two distinct procedural tracks set forth in the Interstate Commerce Act: one, Sections 13(1) and 15(1) with regard to complaints initiated against the unfiled replacement rate which started at the beginning of January 1993 without notice to the Commission; and, two, Section 15(7) concerning the filed proposed replacement rate which took effect in early November 1997, subject to refund, by order of the Commission. 49 U.S.C. app. §§ 13(1), 15(1), and 15(7). Phase One at P 6 and n.4. The $0.05/bbl price of the filed proposed replacement rate is identical to the $0.05/bbl price of the unfiled existing replacement rate being challenged by complaint.

3. It is found that SFPP has failed to prove the proposed replacement rate is just and reasonable, and conversely that the complainants have shown the existing replacement rate to be unjust and unreasonable. Consequently, the rate is to be reduced in accordance with the findings below. SFPP also is to pay, with interest, refunds to all persons in whose behalf such excessive amounts were paid in conformity with § 15(7) and damages to the complainants consistent with §§ 8 and 16 of the Act, 49 U.S.C. app. §§ 8 and 16.

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[1] The Commission has reviewed portions of the phase one decision. 106 FERC ¶ 61,300 (2004), consolidated order on remand and rehearing, 111 FERC ¶ 61,334 (2005). The rehearing relates to parts of the phase one decision (and possibly parts of the phase two decision, which otherwise has not been reviewed), while the remand concerns the agency's action following judicial review of the Opinion 435-series of decisions in Docket Nos. OR92-8 et al., an interrelated prior proceeding to OR96-2 et al. BP West Coast Products, LLC v. FERC, 374 F.3d 1263 (D.C. Cir. 2004), cert. denied, 125 S. Ct. 2245 (2005).

[2] The October 1997 filing was made reluctantly: years after the rate, actually a changed or replacement rate, already had started without notice to the Commission, and only after SFPP had lost its fight with complainants as to whether Sepulveda interstate service is jurisdictional, leading the Commission to order the pipeline to file a rate tariff. 80 FERC ¶ 61,200, reh'g denied, 81 FERC ¶ 61,388 (1997).

I

4. The Sepulveda pipeline, No. 109, located in the Los Angeles, California area, is slightly less than four miles in length. It extends from Sepulveda Junction downstream to Watson station, an origin point on SFPP's West Line, transporting into Watson petroleum products destined for further interstate transportation downstream of the station. Exhibits SEP SFPP-72; SEP ARCO-77; and SEP ARCO-78. Phase One at P 20-24.

5. The $0.05/bbl Sepulveda replacement rate began in January 1993, but was not filed in a tariff with the Commission for almost another five years, toward the end of 1997. After complaints were brought against the rate in 1995 and 1996 and hearings were held on the question of jurisdiction, the Commission reversed an ALJ's initial decision (78 FERC ¶ 63,017 (1997)) and ordered a tariff to be filed on the ground that rates for interstate service over the line are subject to the agency's legal authority. 80 FERC ¶ 61,200, reh'g denied, 81 FERC ¶ 61,388 (1997).

6. Initial Sepulveda charges had preceded the replacement rate and lasted for ten years, from 1983 (when the line first began to operate) through 1992. These charges never were filed in a tariff with the Commission, SFPP or its predecessors[3] having elected to bypass the agency.

7. The Commission's 1997 jurisdictional order described the initial charges (80 FERC, at 61,803), but did not rule upon their lawfulness. When the order was issued, the initial charges already had expired and been supplanted by the replacement rate nearly five years earlier.

8. Despite the expiration, the former initial charges remain relevant today. The charges were not set at a single fixed amount (in comparison to the replacement rate), but rather were variable in nature. The charges could differ among the three parties that were permitted to contract with SFPP, depending upon the volumes tendered for transportation, with rebates given to these parties once the pipeline received annual revenues of $860,000. Exhibit SEP U/TR/T-7 at pp. 1-2 of 42 (contract with Texaco Inc.); pp. 9-10 of 42 (contract with Champlin Petroleum Co., predecessor to Ultramar Inc.); and pp. 20-21 of 42 (contract with GATX Tank Storage Terminals Corp.).

9. Reaching the annual revenue cap was a sure thing: two of the contracting parties (Texaco and Champlin/Ultramar) had guaranteed to pay the total, divided equally among them, every year for ten years. While these former charges have been depicted as $0.15/bbl, subject to the guaranteed annual revenue cap, the actual effective prices after rebates were around $0.035/bbl. 93 FERC ¶ 63,023, at 65,095 (2000) (initial decision).

[3] For ease of discussion, future references will be to SFPP alone even though its predecessors may have been the actual pipeline involved. Phase One at P 78-82.

10. The $0.05/bbl replacement rate, with no guaranteed payments compared with the former charges, was in fact an increase. The Commission's suspension and refund order, allowing the rate to take effect in early November 1997, called for further investigation. Shortly thereafter, however, the Commission postponed the investigation for years despite the fact that the rate never had been adjudged just and reasonable by the standards of the ICA. The Commission elected to pursue another path instead, in view of the pipeline's acceptance of the agency's invitation to apply for market-based rate authority regarding Sepulveda. 80 FERC, at 61,808.

11. But the other path, setting for hearing SFPP's market-based rate application (Docket No. OR98-11), did not promise to be a complete or adequate alternative to the §§ 13(1) and 15(1) complaints or the § 15(7) filing concerning the Sepulveda replacement rate. No matter what determination was finally reached in the market-based rate proceeding, even a ruling that the rate could be set without regard to costs at whatever level the market would bear, such a determination would have been prospective only, from the date of a final agency order. It would not have covered the past period: extending back to at least January 1993 when the replacement rate began without notice to the Commission, or to December 1995/January 1996 and August 1996 when complaints against the rate first were filed under §§ 13(1) and 15(1), or to November 1997 when the filed rate was allowed to start subject to refund under § 15(7). 104 FERC ¶ 63,022 at P 11-15 and 17-22 (2003); 104 FERC ¶ 63,045 (2003).

12. Eventually, almost five years later, a divided Commission affirmed an ALJ's initial decision (93 FERC ¶ 63,023 (2000)) denying the market-based rate application. 102 FERC ¶ 61,240, reh'g denied, 104 FERC ¶ 61,136 (2003). The agency also revived the complaint and proposed rate-tariff proceedings concerning Sepulveda, calling for hearings and consolidating the proceedings quite late with the ongoing proceedings in Docket Nos. OR96-2 et al.[4]

13. The rejuvenated Sepulveda questions did not proceed to hearings until after the two initial decisions were issued in Docket Nos. OR96-2 et al. While the two decisions discussed the replacement rate, including its ineligibility to be grandfathered under the EP Act of 1992 (Phase One at P 20-24; 34-35; and Phase Two at P 574; 584; 593; 630; and nn. 78 & 79), neither decision tried to determine whether the rate is just and reasonable owing to the absence of a complete factual record.

[4] The consolidation did not occur until after extensive, months-long hearings ended on all of SFPP's other rates, and the case was awaiting decision -- ultimately handled in two stages. Phase One at n.19; Phase Two at P 593.

14. Hearings have now been held, addressing factual matters peculiar to Sepulveda, along with two related topics that apply to Sepulveda as well as SFPP's other rates that were dealt with already in phases one and two of Docket Nos. OR96-2 et al. The two subjects -- a return on equity and an income tax allowance -- have been examined in certain ways at the recent Sepulveda hearings in a more comprehensive fashion than the previous hearings held in Docket Nos. OR96-2 et al. Thus, these two topics can help determine whether the Sepulveda replacement rate is just and reasonable, while also playing an important role in the Commission's review of the Phase Two decision concerning SFPP's rates other than Sepulveda. 108 FERC ¶ 63,036 at P 328-384.

II

15. SFPP chose to flout the ICA and ignore the Commission for nearly 15 years while assessing charges for interstate service over the Sepulveda Line. All of this came to light only after complaints had been filed, drawing the Commission's attention to the pipeline's conduct. SFPP asserts that it acted in good faith circumventing the Commission because it viewed the Sepulveda service as being outside the agency's jurisdiction under the ICA. Reply brief at 25. The argument is bogus.

16. If the pipeline believed that the service was non-jurisdictional, the proper course before ever commencing service would have been to file a proposed tariff with the Commission and to couple that with a motion to dismiss. The motion would have presented the reasons why SFPP considered the agency not to have jurisdiction. That would have put the Commission on notice and given it the opportunity to address the question, without placing the pipeline at risk for operating illegally and incurring penalties. See Schenley Distillers Corp. v. United States, 326 U.S. 432, 436 (1946).

17. SFPP elected at its peril not to follow that procedure. The regulatory process simply would collapse if every public utility, whose actions might otherwise be subject to regulation, could decide on its own volition whether to submit to the ICA and the Commission's jurisdiction without notifying the agency of its views. 104 FERC ¶ 63,022, at P 6 (2003).

18. Even now at this stage, after hearings, SFPP is asking the Presiding Judge to blink reality at its prior actions, and to grant relief from the ICA by disregarding the statute's ratemaking and liability provisions, which would enable the pipeline to escape the economic consequences of its unlawful behavior charging unjust and unreasonable rates. These matters will be considered below in the following sequence: (A) deciding why the pipeline has failed to carry its burden under § 15(7) to show the justness and reasonableness of the filed proposed $0.05/bbl replacement rate which took effect in early November 1997, subject to refund; and (B) deciding why the complainants have shown under §§ 13(1) and 15(1) that the unfiled $0.05/bbl replacement rate which started in 1993 without notice to the Commission is unjust and unreasonable.

A. The § 15(7) Proposal

19. In October 1997, when SFPP filed the proposed rate as directed by the Commission, the pipeline submitted data trying to support the $0.05/bbl charge. After the lengthy hiatus of the investigation that next ensued before the Commission finally revived the matter and ordered hearings to be held (P 10-13, supra), that data still forms the foundation currently for SFPP's attempted justification of the rate. In brief, the written evidence that SFPP presented in late 2004 and early 2005 for the Sepulveda hearings held in February and March 2005 rests upon the data submitted by the pipeline in October 1997. Exhibit SEP SFPP-3.

20. SFPP used a 1996 test period, which was supposed to be composed of actual data for calendar-year 1996 (the base period), as adjusted for known and measurable changes in costs and revenues that were to become effective or were likely to occur within the first nine months of 1997. 18 C.F.R. § 346.2; cf. Phase Two at P 311-314. Among its costs, SFPP claimed a rather sizable depreciation expense. The alleged expense was based upon an assumption that after 15 years (reaching back to 1983 when the Sepulveda Line began operating) the pipeline had recovered less than half of the original investment of $2.3 million, and that it would take future decades to recoup the remainder. The assumption has the effect of enlarging two annual costs: depreciation, which is based on jurisdictional investment facilities (plant), and an overall return allowance, which is also based on jurisdictional plant that is included in rate base. Exhibits SEP SFPP-1 at 15-16; SEP SFPP-3 at 2-8.

21. In addition, SFPP asserted a higher income tax allowance by refusing to apply the Commission's then-applicable Lakehead policy,[5] and insisting instead on a full income tax allowance. Id. SEP SFPP-1, at 22-23; SEP SFPP-3, at 3 and 6.

22. Then, too, among its operating expenses, SFPP claimed higher administrative litigation costs. It did so by ignoring the Commission's regulations, thereby discarding the pipeline's actual costs incurred in 1996 as adjusted for known and measurable changes during the first nine months of 1997. Instead, SFPP substituted a projection of future costs, through the creation of a multi-year reserve, which would remain in its rates indefinitely, without end. Id. SEP SFPP-1, at 22 and 27; SEP SFPP-3, at 4.

23. By taking the steps above to justify the $0.05/bbl rate, SFPP reflected costs that were substantially higher, sometimes at least 4-5 times greater, than the costs estimated by its opponents which were protesting the proposed rate. Each of these subjects will be considered in turn.

[5] Lakehead Pipe Line Co., Limited Partnership, 71 FERC ¶ 61,338 (1995), order denying reh'g and clarifying, 75 FERC ¶ 61,181 (1996). Phase One at P 117 and n.28.

(1) Recovery of Original Capital Investment

24. The Sepulveda Line began operating in 1983, after being constructed the same year for about $2.3 million. Exhibit SEP U/TR/T-1, at 7-11. Not included in the capital costs were pumping power and equipment needed to move petroleum products through the line. The duty to provide that materiel was left to the contracting parties permitted to use the line, rather than being imposed upon SFPP. SEP Tr. 2056-57; Exhibit SEP U/TR/T-55, at 8-9.

25. The transportation contracts spelled out the terms and conditions for service, together with the charges which included a 15% return. Exhibit SEP U/TR/T-7, at 3-4 of 42; 11-12 of 42; 21-23 of 42. The objective was to have SFPP enjoy and maintain a "15% Discounted Rate of Return:" Id. (emphasis added).

26. By using the word "Discounted", the contracts intended to provide future cash flows (net revenues after deducting operating expenses, taxes, and any later capital additions) that would equal or exceed the original 1983 capital investment. The cash flows were to be calculated on a present value basis to 1983 at a 15% discount. Exhibit SEP U/TR/T-1, at 9. In short, the contracts called for full recovery of the original capital costs, plus operating expenses, taxes and any subsequent capital additions, along with a return of no less than 15%.

27. An adjustment clause was inserted into the contracts allowing the charges to be modified upward or downward to remain fair and equitable to all participants. In part, to preserve the specified return, the clause gave the pipeline a right to try to alter the charges upward if there were signs that the return was not being achieved. The pipeline has acknowledged that it never had to invoke the clause. SEP Tr. 2248-49.

28. Various discounted cash flow (DCF) analyses were performed by Mr. O'Loughlin, the witness for three opponents of SFPP: Ultramar, Chevron, and Tosco. Using some conservative premises more favorable to SFPP, the analyses confirmed the full recovery of the original investment within ten years by the end of 1992, corroborating the language of the Sepulveda contracts. Exhibits SEP U/TR/T-7, at 8-12; SEP U/TR/T-8; SEP U/TR/T-20, at 7-12; SEP U/TR/T-24; SEP U/TR/T-32, at 5-15; and SEP U/TR/T-63. SFPP has tried to cast doubt upon these analyses, mostly by fly-specking inconsequential points (SEP Tr. 2249-55), and by emitting crocodile tears about the analyses' estimates of the Sepulveda direct operating expenses for 1983-1992. The pipeline, custodian of the actual expenses, elected not to submit written evidence containing data or commentary of its own costs to rebut the estimates. SFPP has done nothing to prove that it fell short recovering the entire investment in a timely manner.

29. The successor contracts, stipulating an increased $0.05/bbl replacement rate starting in 1993 with no guaranteed payments (P 10, supra), also support the conclusion that SFPP already had recovered the original investment by the end of 1992. Guarantees became an

unnecessary part of these contracts for the plain reason that none of the investment remained to be recouped. SFPP has not refuted this simple fact.

30. Instead, the pipeline has taken a different tack, alleging that it was compelled to follow and did, in fact, faithfully apply the Commission's cost-of-service ratemaking standards -- especially the Opinion 154-B methodology for depreciation purposes, among other costs. Phase One at P 107 and 141, n.33.[6] According to SFPP, these standards outweigh and neutralize the original and successor contracts.

31. The major problem with the argument is that it covers the many years when SFPP had no rate tariff on file with the Commission. Thus, the argument is too incredible to be ratified. SFPP thumbed its nose at the ICA and the Commission for many years until being forced to file a Sepulveda tariff in 1997. Consequently, the pipeline is in no position to assert that its nonfeasance is immaterial because during that time it supposedly complied with the agency's ratemaking standards, even keeping books and records in accordance with the Commission's uniform system of accounts. At best, that would merely show the pipeline keeps more than one set of books. It would not prove that the pipeline failed to recover the entire original Sepulveda investment well before 1997.

32. Moreover, the argument is another illustration of the pipeline's trying to ride two horses simultaneously. Phase One at P 127; 190; and 237; Phase Two at P 384; 488; and 579. While claiming that it was constrained to follow the Commission's precepts for recovering its investment, SFPP has chosen not to follow other agency standards when it suits the pipeline's purpose to justify the $0.05/bbl replacement rate. For example, SFPP refused to apply the Commission's then-applicable Lakehead policy, and insisted instead on a full income tax allowance. P 21, supra. With regard to administrative litigation costs, SFPP chose to ignore the Commission's test-year regulations, ditching the actual 1996 costs, as adjusted, and substituting instead the pipeline's own improvised methodology. P 22, supra.[7]

33. This selective approach, picking and choosing which Commission standards to use or to reject, has a common theme: each action inflates the pipeline's costs to support the $0.05/bbl charge. There is no merit to SFPP's argument trying to include in its rate (through rate base calculations and depreciation expense) some of the original Sepulveda

[6] 31 FERC ¶ 61,377 (1985), reh'g denied in part, 33 FERC ¶ 61,327 (1985) (Opinion 154-C).

[7] Part III, infra, will discuss another example of SFPP's cavalier attempts to ride two horses simultaneously. Trying to avoid having to pay damages, and to reduce the amount of refunds owed, the pipeline relies upon the very contracts, original or successor (initial brief, at 53-59), that it otherwise claims cannot be used to determine whether the original investment was fully recovered prior to 1997.

capital investment incurred prior to 1993. Exhibit SEP ARCO-9, at 14-15. To hold otherwise would impermissibly allow the pipeline to recover these costs twice. As for capital additions starting in 1993 through the end of 1996, they are part of rate base and are subject to depreciation.

34. Undaunted, SFPP casts another argument into the fray, contending that to remove the original investment might violate the rule against retroactive ratemaking. But the rule stems from the filed rate doctrine, Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246, 251 (1951); Associated Gas Distributors v. FERC, 898 F.2d 809, 810-11 (D.C. Cir. 1990) (Williams, J., concurring), which SFPP cannot invoke for the period 1983-1997 given its choice not to file a Sepulveda rate tariff with the Commission until ordered to do so in 1997.

35. The rule against retroactive ratemaking has its proper place only when a rate has been on file with an administrative agency. In that circumstance, the rule bars an after-the-fact attempt to deal with past events which produced over- or underrecoveries of costs pursuant to a filed rate. That has nothing to do with the current case. Having elected to disobey the ICA and to ignore the Commission for so many years, SFPP cannot try now to treat the past period in some different fashion by pretending that it was in compliance and wrapping itself in judicial or administrative rules and standards emanating from the Act.[8]

36. For tactical reasons looking to force SFPP to pay reparations back to 1983, the ARCO Group on one point has broken ranks with the other parties protesting and complaining about the $0.05/bbl replacement rate. Through an eleventh-hour conversion, the Group has expressed a willingness under certain conditions to acquiesce in the pipeline's claim that it did not completely recover the original Sepulveda investment at the time of the § 15(7) filing in October 1997. Initial brief at 7-9.

37. The matter will be addressed more fully below in Part III. At this juncture, it is sufficient to say that the unfiled initial Sepulveda charges running from 1983-1992 were unlawful under § 6(7) of the ICA, and were not converted into lawful/legal grandfathered rates by the EP Act of 1992. The unfiled replacement rate that started in 1993 also was unlawful under § 6(7), and in all events was ineligible for grandfathered status under the EP Act. P 13, supra.

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[8] SFPP has moved to lodge a rather recent federal district court opinion, In Re: Western States Wholesale Natural Gas Antitrust Litigation, (District of Nevada, CV-S-03-1431-PMP (PAL) 2005). The motion is granted, but the decision is irrelevant finding in part that a market-based rate authorized by the Commission can satisfy the filed rate doctrine. The current case does not deal with such facts, but rather concerns SFPP's longtime circumvention of the ICA and the Commission regarding Sepulveda.

38. That, however, does not call for overlooking the original and successor contracts as though they are irrelevant. They, along with the various DCF analyses (P 28, supra), are solid evidence that SFPP recovered the entire original Sepulveda investment prior to 1997. The ARCO Group's tactical acquiescence carries no weight in deciding that SFPP is prohibited from including any of the original investment in the filed replacement rate.

(2) Capital Structure, Return Allowance Including Rate of Return, and Income Taxes

a. Capital Structure

39. As explained in Phase Two at P 328-345, determining an appropriate capital structure (i.e., a debt/equity ratio) is a necessary step to set a prospective, just and reasonable cost-of-service rate. To justify the proposed Sepulveda replacement rate, SFPP looked to the structure on its books at the end of 1996 (the conclusion of the base period) to find a ratio of 57.45% debt/42.55% common equity. It did not stop there, however, choosing to revise the ratio sharply by introducing deferred earnings into the equation to increase the equity to 58.04%, while reducing the debt to 41.96%. Exhibit SEP SFPP-3, at 5, lines 4, 6, 7, 10, 11, 12 and 13. By taking this step, SFPP greatly increased by nearly 67% one of its costs, overall return on rate base. Phase Two at P 328-331.

40. Ultramar, Chevron, and Tosco (P 28, supra), on the other hand, selected as the starting point the capital structure on SFPP's books at the end of September 1997 (the termination of the test period). They urged adjusting the ratio by removing a 1988 purchase accounting adjustment (PAA), thereby increasing the debt-portion and reducing the equity-portion. Exhibit SEP U/TR/T- 20, at 15-19.

41. The three opponents are correct seeking to remove the PAA of almost $123 million (Exhibit SEP U/TR/T-1, at 19), subject to possible offsets, if any. Cf. Phase Two at P 341-343. However, there is no compelling reason to start the process as these parties have done by selecting the end of the test period. It is adequate to use SFPP's approach starting at the conclusion of the base period given the absence of significant changes in the Sepulveda capital structure after December 1996 to the end of September 1997. Exhibits SEP SFPP-3, at 5 lines 6-7; SEP U/TR/T-20, at 16, Table 1. The approach needs to be modified, however, to remove the 1988 PAA and deferred earnings which SFPP also has included of almost $0.6 million. Exhibit SEP SFPP-3, at 5 (lines 1 and 3) and 8 (lines 6 and 8) and 5 again (lines 4, 10 and 11 regarding almost $0.420 million, a portion of the total $0.6 million, factored into other calculations).

42. The 1988 PAA reflects additional costs due to the late December 1988 transformation by SFPP's predecessor from doing business as a corporation to a limited partnership. Phase One at P 79. The Presiding Judge has rejected SFPP's attempts to insert into the pipeline's rates the PAA either for 1998 when SFPP was sold to Kinder Morgan, Inc. through subsidiaries (Phase One at P 1, n.1; Phase Two at P 304-306;

336-341; 393; 407; 477-488; 625), or for the earlier 1988 transformation. Phase Two at P 603; 607; 625. In each instance, assets were transferred and costs were increased, but without significant change in the service being rendered. SFPP has failed to rebut the fact that each PAA did nothing more than unduly raise costs which ratepayers would have to bear, without their receiving substantial benefits from these business transactions.

43. There is no justification for including the 1988 PAA in the Sepulveda capital structure. It is to be removed.

44. The same result applies to the deferred earnings that SFPP has tried to include in the capital structure. The concept of deferred earnings arises from the Commission's Opinion 154-B methodology (P 30, supra) adopting "trended original cost" (TOC) as the means to calculate the equity-portion of a common-carrier oil pipeline's rate base. TOC achieves this by distinguishing a 'real" rate of return from a "nominal" rate of return (the latter consisting of the real rate, plus other costs including inflation). While the real rate determines the return to be earned or recovered currently, the inflation-factor of the nominal rate determines the earned return to be deferred by being added annually to the equity-portion of the rate base. Endicott Pipeline Co., 55 FERC ¶ 63,028, at pp. 65,141-43 (1991) (initial decision).

45. None of this, however, is relevant here until the Commission issues a final order prescribing a forward-looking, just and reasonable Sepulveda rate under § 15(7). It has no bearing at all during the 15 years from 1983 to 1997 when SFPP had no Sepulveda rate tariff on file with the Commission. Therefore, it is improper for the pipeline to include any theoretical, accumulated deferred earnings in the proposed replacement rate filed in 1997. They are to be removed from the capital-structure determinations as found above.

b. Return Allowance Including Rate of Return

46. Phase Two at P 346-365 explained how a total return allowance is included in a rate, reflecting profit after all other costs such as income taxes have been paid. The allowance is affected in part by the respective rates of return to be permitted on the long-term debt and common-equity capital.

47. For the long-term debt to be factored into the Sepulveda 1996 test period pursuant to § 15(7), there is no quarrel among the parties as to the interest rate. SFPP has used a debt cost of 9.96% for 1996. Exhibit SEP SFPP-3, at 5-6. Ultramar, Chevron, and Tosco agree with that cost (Exhibit SEP U/TR/T-1, at 15), which was previously adopted in Phase Two at P 610, following agreement among the parties.

48. There is, however, a dispute with regard to the cost of common equity for the 1996 test period. SFPP proposes a real rate of 11.78%, the same rate that it previously had recommended employing for a 1994 test period in Docket Nos. OR92-8 et al. Exhibits SEP SFPP-1, at 6 and 24; SEP SFPP-3, at 5. On the other hand, Ultramar, Chevron, and

Tosco, as well as the Commission's staff, urge using a real rate of 8.77% for 1996 based upon the findings in Phase Two at P 349, 356-357 and 615.

49. The 8.77% rate is to be used for the reasons stated in Phase Two and for other reasons arising from the Sepulveda hearing record. Stemming from a wide range of unduly inflated "dividend yields" caused by cash distributions, there is a need to keep the rate of return on equity as reasonably low as possible, toward the bottom of the range. The rationale applies when publicly traded master limited partnerships (MLPs) form the entire proxy group under a traditional DCF methodology, fashioned years ago for regulated corporations, to arrive at a rate of return for a regulated operating limited partnership like SFPP.

50. The findings above distinguish the present case from the Commission's orders in High Island Offshore System, L.L.C., 110 FERC ¶ 61,043 (2005), reh'g, 112 FERC ¶ 61,050 (2005) (HIOS). There, the agency refused to include MLPs in a proxy group unless it was shown that cash distributions reflected earnings alone and not a return of investment. 110 FERC at P 126. On rehearing, all such MLPs were excluded on the ground that they were not needed in any event because there were enough other types of entities, considered comparable, to form the proxy group. 112 FERC at P 63. In the end, HIOS effectively skirted the MLP-issue by kicking it down the road.

51. The facts of the case at bar, where the entire proxy group is composed of MLPs, do not permit such a deferral. They do, however, call for a solution other than banning MLPs without a showing that cash distributions come from earnings only.

52. To determine the rate on equity in Phase Two, the Commission's favored DCF model was applied to MLPs. P 348-360. The Presiding Judge expressed some misgivings about using that procedure in the future where there is a regulated operating limited partnership, rather than a corporation, and the partnership is a subsidiary under the control of an MLP. P 361-365. The present Sepulveda case, however, is not the future.

53. At the recent 2005 hearings, the ARCO Group in particular tried to address the concerns expressed in Phase Two, including related questions about income taxes. The presentation obliged SFPP to respond in part, thereby allowing each side to cross-examine the others' witnesses. All of this has helped to sharpen matters.

54. Nevertheless, it has left unanswered what reasonable methodology can be used in lieu of the customary DCF approach,[9] if that procedure is scrapped when MLPs are the

[9] As will be discussed, a traditional DCF analysis tries to determine the current cost of equity by adding the present market dividend yield on common stock of a particular company with the future growth rate in dividends as anticipated by investors. Phase Two at P 348.

only relevant entities to be considered.[10] Years could elapse before the question is resolved, perhaps through rulemaking. Phase Two at P 365.

55. But this is not the time for Phases One, Two, and Sepulveda to stop dead in their tracks awaiting resolution of such a question. For other reasons in the past, the Commission has held in abeyance for years both Docket Nos. OR96-2 et al. (Phase One at P 64-67) and IS98-1. P 10-12, supra. It would be terribly unfair for the Commission to go down that path again when there are parties entitled right now to damages and refunds from SFPP.

56. Consequently, it is better to go forward here and in the Commission's review of Phase Two by applying the traditional DCF methodology -- warts and all -- to MLPs. But in doing so, as noted (P 49, supra), it is essential to keep the rate on equity as reasonably low as possible for the reasons stated in Phase Two and for the reasons next explained arising from the recent Sepulveda hearing record.

57. The hearings, among other matters, explored the question whether a customary DCF analysis is capable of being performed where a regulated operating limited partnership like SFPP is involved, and it is controlled by a publicly traded MLP. In SFPP's case, the MLP was Santa Fe Pacific Pipeline Partners, L.P. (SFPPP) until early March 1998 when SFPP was sold to Kinder Morgan, Inc. (KMI) through subsidiaries. Since the sale, the MLP has been Kinder Morgan Energy Partners, L. P. (KMEP), a subsidiary of KMI.

58. Through its rate-of-return witness, Professor Williamson, who also was a key witness on the subject in HIOS (110 FERC at P 128; 112 FERC at P 66-67), SFPP takes the position that the DCF methodology used for corporations can just as readily be applied here. Its opponents, led by the ARCO Group, strongly disagree. The opponents are right, but the recommended solution of the ARCO Group does not cure the problem.

59. Where a regulated corporation is concerned, the DCF model tries to determine the current cost of equity by adding together (1) the present market dividend yield on common stock of a particular company -- calculated by dividing the numerator, Dividend (D), by the Price (P)[11]; and (2) the future Growth (G) rate in that dividend as anticipated by investors. A proxy group of corporations, selected for having qualities comparable to the regulated company, is used to arrive at the rate of return on equity.

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[10] Included in the discussion below is the ARCO Group's unworkable suggestion that the DCF model can be salvaged simply by substituting net income or net taxable income for cash distributions as the numerator to determine a "dividend yield."

[11] D/P (dividend yield) is averaged over a period of time.

60. An MLP, compared with a subchapter-C corporation, does not pay a dividend to its unitholders, but rather a cash distribution. SFPP contends that although the name is different, the payment still can be used in the DCF formula because investors treat a cash distribution as akin to a dividend. To support its assertion, SFPP points to the fact that, in the daily survey of stock exchanges, publications like the Wall Street Journal list together under the common heading "dividend yield", the rates both for corporations and MLPs.[12]

61. Though having a surface appeal, the argument is meaningless for ratemaking purposes to determine a rate of return on equity. To be sure, the name of the payment is not the critical factor. Instead, what counts particularly are the payment's origins (from earnings or some other source) and income-tax consequences. In that sense, to differentiate them, it helps to keep using the two discrete names.

62. To compare dividends and cash distributions, SFPP and the ARCO Group each presented a tax expert at the hearings: Mr. Hrdlicka, a lawyer, on behalf of SFPP (Exhibit SEP SFPP-30, at 1); and Mr. Sintetos, a certified public accountant (CPA), on behalf of the ARCO Group. Exhibit SEP ARCO-5, at 2. The two witnesses seem to be in agreement on the following fundamental points.

63. A dividend paid by a subchapter-C corporation to a stockholder comes from the company's profits (earnings), current or accumulated through the retention of earnings. SEP Tr. 1401. Generally, a dividend is a return on capital, deemed to be income subject to income taxes in the year paid.[13]

64. On the other hand, an MLP's cash distribution paid to a unitholder is a disbursement of cash, not an allocation of income. Exhibit SEP ARCO-32, Response 1; SEP Tr. 452-53; accord SEP ARCO-15, at 6553-54. Thus, with one exception,[14] such a distribution is deemed not to be income subject to income taxes in the year paid. SEP Tr.

[12] In the Journal's New York Stock Exchange notes, "**Dividend/Distribution**" (separated by a slash) implies possible differences between these payments. "**Yield**" is defined as "the dividends or other distributions paid by a company on its securities, expressed as a percentage of price." An MLP is not mentioned.

[13] In a special situation, a cash distribution in excess of earnings is made by a corporation as a return of capital, not subject to income taxes unless it exceeds a shareholder's basis triggering a capital-gains tax.

[14] The exception occurs only if a unitholder's tax basis has been reduced to zero, due to receiving previous cash distributions and/or tax losses -- each of which has the effect of reducing the basis. In that instance, another cash distribution triggers a capital-gains income tax to assure that the basis stays at zero, and not go below. SEP Tr. 1158-59.

356-57. The cash can come from any source, earnings or otherwise. In short, it need not come from earnings at all.[15]

65. SFPP acknowledges that MLPs often[16] pay distributions in excess of earnings. Initial brief at 50. This is an important reason why the "dividend yield" of an MLP's cash distribution can be significantly higher than a corporation's dividend. Thus, while a dividend is a return on capital, part or all of a cash distribution can well be a return of capital. Consequently, with the one exception already noted (P 64, n.14, supra), for income-tax purposes it is not by chance that a cash distribution avoids creating any tax liability in the year when the distribution is paid. Instead, the distribution simply reduces the tax basis of a unitholder in the year of the payment. SEP Tr. 356-57; 1169; 1443; 1780.

66. Despite SFPP's arguments and intimations to the contrary, the reduction in basis may never result in a future income tax obligation of a unitholder. SFPP states that, eventually, when a unit is sold an income tax will be due on the difference between the basis and the sales price. SEP Tr. 1441. But the pipeline has not shown and cannot show that such a tax will in fact materialize or, even if one does, that it will be anything other than a lower capital-gains tax assessed against not a current unitholder, but an erstwhile holder after disposing of the security.

67. There are too many possibilities that can preclude an eventual income tax, even a lower capital-gains tax. One is if the per-unit price decreases, even plummets if an MLP's business-fortunes collapse. Absent these circumstances, another possibility ruling out an eventual income tax is if an MLP flows through to a unitholder enough tax losses year-after-year. Cf. SEP Tr. 465-67; 477. In that event, upon sale of the security, the losses can be used to offset any type of income taxes (ordinary or capital gains) that may otherwise

[15] Without challenge, the ARCO Group has offered a list, not claimed to be complete, of possible sources of cash -- without considering earnings -- for a cash distribution: sale of new limited partnership units; borrowings; non-cash expenses, like depreciation and amortization, producing available cash; shifting money (i) owed to others, or (ii) which could be used to maintain a pipeline's reliability and safety, to pay it out to partners instead; and creating a reserve for future costs, then dipping into the reserve to pay cash to partners instead. SEP Tr. 1296-98; 1309; 1321-26; 1363; and 1373; Exhibits SEP SFPP-58, at 88 of 127; SEP ARCO-26 and -27; SEP ARCO-35, at lines 4 and 5, 9, 13, 61 and 73; SEP ARCO-35A.

[16] Engaging in more doublespeak (Phase One at P 139 and 190), SFPP seems to regard the words "sometimes" (initial brief at 44) and "often" (initial brief at 50) as synonymous while describing cash distributions exceeding earnings. Either word suffices to make the point that a cash distribution need not come from earnings, and can well exceed earnings.

be due on the sale, and may even be used to offset other unrelated income for tax purposes. SEP Tr. 383-84; 402-05.

68. This is not mere speculation. An MLP often touts itself as a tax shelter, a technique allowing its unitholders legally to reduce or avoid income-tax liabilities. A number of MLPs that control interstate oil and natural gas pipelines, operating or treated as limited partnerships, state in their Schedule K-1s[17] (Part I, line E) that they are in fact tax shelters. See, e.g., Exhibits SEP ARCO-72 (KMEP); SEP ARCO-73 (GulfTerra Energy Partners, L.P.); SEP ARCO-74 (Buckeye Partners, L.P.); SEP ARCO-75 (Teppco Partners, L.P.); and SEP ARCO-76 (Enterprise Products Partners L.P.).

69. As tax shelters, the MLPs' game plan seems to be to flow through to their unitholders little or no net taxable income, and perhaps even tax losses, to shield them from income-tax liabilities. Id. and Exhibit SEP ARCO-21, at 2. KMEP, in particular, has been quite successful in these efforts, producing tax losses for five consecutive years from 2000 through 2004. Exhibits SEP ARCO-7 (2000); SEP ARCO-60 (2001); SEP ARCO-37 (2002); SEP ARCO-38 (2003); and SEP ARCO-72 (2004).

70. Professor Williamson soldiers on in the face of this compelling evidence showing major differences between the dividends paid by a C-corporation, on the one hand, and cash distributions paid by an MLP, on the other. In his quest to treat the payments alike, the Professor insists that (a) in a financial and economic sense, cash distributions and dividends are equivalent (SFPP reply brief at 40); (b) MLP distributions do not include a return of capital, especially from the viewpoint of knowledgeable investors in the financial markets (id. at 41-44); and (c) thus, MLP cash distributions are properly used in the Commission's DCF model to calculate a rate of return on equity (id. at 44-46).

71. The Professor's focus on cash is far too narrow, concentrating entirely on investors' expectations and desires. True, investors need to be considered, but their hopes cannot be the sole criterion or final word to determine the equity-rate questions presented here. If cash received, without regard to its origins, is all that matters to investors and, therefore, should be all that counts in this case, the income-tax consequences would be overlooked, and the door would be open to all sorts of mischief contrary to the public interest.

72. For ratemaking purposes, income taxes are an important component in deciding a just and reasonable, cost-of-service rate. The Professor's approach would shrug that off if the origins of the cash did not matter. Then, too, being consumed entirely with the cash received, no matter its source, could lead to endorsing illicit conduct, including highway robbery such as a Ponzi scheme. SEP Tr. 1294-98. Whether far-fetched or not, the

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[17] These are annual forms issued to unitholders for income-tax reporting purposes.

Professor has never explained why his cash-is-king approach should be adopted if it could possibly lead the Commission down such a treacherous course.

73. As for his assertion that MLP distributions are never a return of capital, in whole or in part, the Professor seems to stand alone on the point, even clashing with others who represent SFPP (including Mr. Hrdlicka), an MLP trade group, or various MLPs unrelated to SFPP. SEP Tr. 358-60; Exhibits SEP ARCO-15, at 6553-54; SEP ARCO-58, at 2; SEP ARCO-21, at 2; SEP ARCO-39; SEP ARCO-41; SEP ARCO-73; SEP ARCO-75; SEP ARCO-76. Also disagreeing with the Professor's allegation are the ARCO Group's witnesses. Exhibit SEP ARCO-1, at 5-7; SEP Tr. 1763-64; Exhibits SEP ARCO-5, at 6; SEP ARCO-28, at 6; SEP Tr. 1808-09; Exhibit SEP ARCO-9, at 6-10; SEP Tr. 1826-27; Exhibit SEP ARCO-84, at 6-7 and 12-14.

74. Nor did the Professor help himself by his answers on cross-examination to a series of hypothetical questions regarding his assertion that a cash distribution always results in a return on capital, never a return of capital. The questions assumed that after investing in a partnership, a limited partner had no net taxable income flowed through[18] to him for five years, but did receive annual cash distributions spread evenly over that time period: with the total distributions equaling the original investment. Each distribution reduced the partner's basis[19] so that when the fifth and final distribution was received, the basis had been reduced to zero.

75. The Professor called each year's distribution a return on capital, even though all that the partner received was his own money back. SEP Tr. 1118-27. The Professor's answers -- which are at odds with SFPP's tax expert, Mr. Hrdlicka, who was asked somewhat similar questions (SEP Tr. 476-77) -- are quite preposterous. There had merely been a return of capital, analogous to someone withdrawing money from his own bank account -- as another ARCO Group witness, Ms. Jennings (a CPA in the same firm as Mr. Sintetos) aptly described. SEP Tr. 1760 and 1800-01; 1809.[20]

[18] A flow through, when it occurs, is a bookkeeping entry. Thus, if net taxable income were flowed through, a partner would not receive cash (in comparison to a cash distribution), but would have to report the income for tax purposes. SEP Tr. 454-55.

[19] The basis may differ, to some extent, from a partner's "capital account" set forth on line J of a Schedule K-1. SEP Tr. 454.

[20] SFPP quarrels with the analogy of a bank account (reply brief, at 37-38), but ignores the fundamental point made by Ms. Jennings and Mr. Sintetos. Notwithstanding Professor Williamson's unsupported assertions to the contrary, a cash distribution from an MLP to a unitholder may well be, in whole or in part, a return of capital, akin to a withdrawal of money from a bank account.

76. The Professor also has attempted to distinguish the considerable evidence showing that a cash distribution can be a return of capital. He has done so by calling the evidence, among other things, an anomaly, misleading, an isolated instance, or merely a "sort of shorthand." SEP Tr. 1442; SFPP initial brief, at 45-47. At bottom, the Professor's unwavering stance is not unlike a hoary punch line from vaudeville and the movies. With strong evidence contradicting a character's assertions, his final retort is "Well, who you gonna believe, me or your own eyes?"[21] As to return of capital, the Presiding Judge believes his own eyes based upon the myriad, convincing evidence presented, not Professor Williamson's unsupported assertions to the contrary.

77. With regard to the dividend-yield[22] factor in a DCF model, the substitution of an MLP's cash distribution for the usual C-corporation's dividend is very disquieting. Nevertheless, there is no reasonable alternative at this time to that approach to calculate a rate of return on equity for SFPP. The ARCO Group suggests that where an MLP is involved the DCF model can be salvaged simply by substituting net income or net taxable income for cash distributions as the numerator to determine a dividend yield. That, however, is unworkable and is rejected.

78. As noted, in a customary DCF methodology the numerator is the dividend issued by a C-corporation. P 59, supra. Dividends tend to be fairly stable, not subject to major variations on a quarterly or yearly basis. Net income, on the other hand, may fluctuate greatly from year-to-year depending upon gross-income levels and costs. The different types of costs do not march in lockstep with each other, and can vary considerably among themselves from one year to the next. If net income were the standard, with possible sharp annual swings, the results could be too unreliable and unpredictable for ratemaking purposes.

79. Furthermore, a dividend usually represents only a portion of a corporation's earnings, with the rest of the earnings retained. In comparison, the ARCO Group's unexplained proposal seems to be to use the entire amount of net income, if there is any, with nothing retained. The results, again, could vary substantially from year-to-year, injecting unreliability and unpredictability into the mix to set rates.

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[21] See, e.g., Chico Marx and Mrs. Teasdale in the movie "Duck Soup" (1933).

[22] SFPP -- as it has done on other issues (cf. Phase Two at P 577) -- also has tried through another argument of Professor Williamson to change the subject at hand, dividend yield. It does so by raising the irrelevant point (Exhibit SEP SFPP-54) that in the end a higher dividend yield may not matter if it causes the future growth rate to be lower. (P 59, supra). But it is the unduly inflated dividend yields caused by cash distributions that are the source of the problem here, and will not be erased by an argument about growth.

80. As a final point, given the fact that an MLP can well be a tax shelter, there is a greater likelihood that its net taxable income would be zero. In that instance, the so-called dividend yield also would be zero, leaving no rate of return on equity. That would hardly be the proper solution for all situations. Sometimes, despite its intentions, a regulated business goes awry for years, producing no net income and possibly forcing it eventually into reorganization or bankruptcy. In that circumstance, the answer would not be to punish the business further by preventing it from earning any return on equity.

81. There are too many unanswered questions concerning the ARCO Group's quick fix to use net income in lieu of cash distributions as the means to rescue the DCF model when MLPs are involved. It cannot be adopted.

82. Therefore, as stated, a real rate of return on equity of 8.77% is to be used for the Sepulveda 1996 test period under § 15(7), based upon the findings in Phase Two and the findings above resting upon the recent Sepulveda hearing record. Despite the recognized problems using cash distributions to apply the DCF methodology to MLPs, that is the only adequate solution at hand to bring Phase One, Phase Two, and Sepulveda to a close without further delay. These proceedings call for repose, not further hearings. P 49; 54-56, supra.

c. Income Taxes

83. As an operating limited partnership, SFPP does not pay income taxes or incur an income tax liability. As a trading limited partnership, SFPP's parent, an MLP, also does not pay income taxes or incur an income tax liability. The possibility exists, however, that those who own an interest in SFPP through the MLP (each a pass-through entity) may have to pay income taxes or otherwise incur a tax liability insofar as net taxable income is flowed through to them from SFPP's regulatory operations. It has been a source of major controversy at the Commission whether SFPP's rates should include an income tax allowance to reflect these possible costs of the owners.

84. In its § 15(7) October 1997 tariff filing, SFPP included a full income tax allowance to try to justify the proposed $0.05/bbl Sepulveda replacement rate. By taking that step, the pipeline was refusing to comply with the Commission's then-applicable Lakehead policy (P 21, supra), which policy would have produced a smaller tax allowance for SFPP. Lakehead had found that for ratemaking purposes a regulated operating limited partnership is to be granted an income tax allowance only with respect to income attributable to its corporate partners, provided these partners are subject to an income tax liability regarding their respective shares of the partnership's income. Phase One at P 117, n.28.

85. Within a short time after the tariff filing, which was allowed to take effect in early November 1997, subject to refund, the Commission put on the shelf for years the investigation concerning the lawfulness of the Sepulveda replacement rate under § 15(7) as well as §§ 13(1) and 15(1). P 10-13, supra. During the hiatus, judicial review finally

was accomplished of the Commission's Opinion 435-series of decisions affecting SFPP in the earlier Docket Nos. OR92-8 et al. -- including Lakehead's application. BP West Coast Products, LLC v. FERC, 374 F.3d 1263 (D.C. Cir. 2004), cert. denied, 125 S. Ct. 2245 (2005).

86. As to the income-tax allowance question, BP (1) vacated and remanded Opinion 435's application of the Lakehead rationale granting a tax allowance for corporations; (2) rejected SFPP's argument that the Commission should have included a full income tax allowance covering not only corporations, but also individuals and others that own interests in a regulated operating limited partnership; and (3) upheld shippers' arguments that SFPP was entitled to no allowance at all for the phantom income taxes it did not pay. 374 F.3d at 1288-93 and 1312.

87. Subsequent to BP, the rejuvenated Sepulveda questions went forward to hearings held in February and March 2005, after most written testimony and supporting exhibits had been submitted in late 2004 and early 2005.[23] P 13 and 19, supra.

88. Significantly, though still seeking a full income tax allowance, just as it had in October 1997 -- Exhibits SEP SFPP-1, at 22-23; SEP SFPP-3, at 3 and 6 -- SFPP made no serious attempt to prove why it should be granted such an allowance. Under § 15(7), the burden to justify the allowance rested upon the pipeline. For all purposes, SFPP was treating the matter as though it were a regulated corporation, not a limited partnership, automatically entitled to a full tax allowance.

89. While BP had rejected SFPP's argument with regard to the earlier Docket Nos. OR92-8 et al., the pipeline did not try when presented with the later opportunity in Sepulveda to clear up any misconceptions by offering hard, specific evidence that might establish its entitlement as an operating limited partnership to a full allowance.[24] Instead,

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[23] SFPP, through Professor Williamson, was allowed to file two additional rounds of testimony: the first, in February 2005, dealt with the then-recently issued HIOS decision (110 FERC ¶ 61,043) and Mr. Sintetos's rebuttal testimony (Exhibits SEP ARCO-28 and 28A) concerning a number of 1996 K-1s (Exhibit SEP SFPP-50) issued by SFPP's then-parent MLP, SFPPP (P 57, supra), that the Professor had introduced a week earlier; the second, in March 2005, dealt with Exhibits SEP ARCO-72 through -76 that ARCO's counsel had introduced into the record during the hearings.

[24] SFPP did introduce some 1996 K-1s issued by its then-parent MLP, SFPPP, showing that net taxable income had been flowed though to partners. Exhibit SEP SFPP-50. But the data was not compelling to justify an allowance. The taxable income was very small (see, e.g., Exhibit SEP ARCO-34; SEP Tr. 402), especially when compared to the cash distributions that had been disbursed (Exhibits SEP ARCO-28 and (con't next page)

through Mr. Hrdlicka, SFPP simply offered a primer -- a basic discussion of partnership-tax law theory -- as to why partners of a hypothetical partnership may be subject to income taxes, if not today then perhaps sometime in the future. Exhibit SEP SFPP-30.

90. Even the theory was shown by the ARCO Group to be wanting. The theory (id. at 4) starts with the assumption that taxable income -- which is discrete and different from a cash distribution (P 64 and n.18, supra; SEP Tr. 452-53) -- will be generated by a partnership and then allocated (flowed through) to the partners who, as a group or individually, will be subject to tax on such income. But the assumption is faulty and can crumble upon closer examination.

91. For example, an allocation of taxable income may not occur at all, especially when a regulated, operating limited partnership like SFPP is under the control of an MLP which is a tax shelter, trying to shield unitholders from income-tax liabilities. P 67-69, supra. Thus, if no taxable income is flowed through, the rest of the theory's statement is irrelevant. In addition, even if some taxable income were flowed through, that does not ipso facto mean a tax obligation will result. Evidence must be presented to establish a tax liability. Indeed, "subject to tax" does not necessarily denote a tax liability. Rather, it may cause the income to be reported on tax returns, yet not be taxable due to offsetting carryovers of MLP passive-activity deductions or credits.[25] SEP Tr. 437-39.

92. The theory then shifts away from taxable income, concentrating instead on cash received in excess of the amount paid for a partnership interest. The theory's assumption is that when an excess amount of cash is received, each partner will be taxed on the excess. Exhibit SEP SFPP-30, at 4. However, the assumption fails to discuss what such a tax would represent, and why that type of tax for ratemaking purposes should be eligible for an income tax allowance. The whole matter deals with a cash distribution, which has been discussed above at P 64-69; 90.

93. An excess amount of cash possibly may arise in two situations. One is the single exception to the principle that a cash distribution is a disbursement of cash, not an

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28A), indicating that partners were being protected from income-tax liabilities. Most important, SFPP made no effort to show that the taxable income actually would lead to tax obligations.

[25] There can be a major difference between "net ordinary income", on the one hand, and "total net reportable ordinary income," on the other. The latter can be a very small fraction of the former. Exhibit SEP ARCO-34; SEP Tr. 402. Yet a third term is "net taxable income", which may or may not be synonymous with total net reportable ordinary income. When not synonymous, it is net taxable income that specifies the amount that possibly may be taxed, subject to proof.

allocation of income subject to income taxes in the year paid. P 64, supra. The exception occurs only if a partner's tax basis has reached zero, due to previous cash distributions and/or tax losses -- each of which has the effect of reducing the basis. In that instance, another cash distribution triggers a capital-gains tax to assure that the basis stays at zero, and not go below. See n.14, supra.

94. Such a tax, however, would have nothing at all to do with previous net taxable income, if any, that had been flowed through to partners. For ratemaking purposes, it is only net taxable income, provided it actually leads to a tax liability, which can form the foundation for an income tax allowance. A capital-gains tax resulting from another cash distribution after a partner's tax basis had reached zero, due to previous cash distributions and/or tax losses, would not qualify for such an allowance.

95. Subject to the single exception mentioned, cash distributions, after all, are simply disbursements of cash from any source, and are not allocations of income subject to income taxes. The previous distributions, not being income, never will be taxed, and it would be baseless to consider them as potential candidates in the future for income taxes, ordinary or capital gains. As for tax losses which also reduce basis (P 67, supra), they serve to benefit a partner in the future, including upon sale of the security, to offset income taxes (ordinary or capital gains) which may otherwise be due on the sale, and may even be used to offset other unrelated income for tax purposes. SEP Tr. 383-84; 402-05. These losses do not somehow get transformed into taxable income when -- in the single exception described -- another cash distribution triggers a capital-gains tax after a partner's tax basis has reached zero.

96. SFPP has presented nothing in the record to show how often, if ever, the exception may arise. Nor has it explained in any event why -- in order to create an income tax allowance that otherwise would be barred -- the exception should swallow the rule that a cash distribution is not an allocation of income subject to income taxes in the year paid or thereafter.

97. The second situation where an excess amount of cash possibly may arise is at the time of the sale of an owner's interest in a partnership like an MLP. Given the fact that cash distributions generally reduce the tax basis of an owner, SFPP's theory assumes that, eventually, when a unit is sold an income tax will be due on the difference between the basis and the sales price.

98. But the theory assumes without supporting proof from SFPP that an income tax will in fact materialize. As discussed, too many possibilities can preclude an eventual income tax, including a lower capital-gains tax. P 66-69, supra. Even if such a tax did occur, it would not be assessed against a current owner, but an erstwhile owner after disposing of the security. The latter point is quite important for a reason that SFPP has not attempted to address in its theoretical effort to create an income tax allowance.

99. Stockholders in a regulated corporation do not and cannot expect ratepayers to bear their tax costs, whether a gain or a loss, when they sell their securities. SFPP has offered no reason why owners (unitholders) in an MLP should be treated differently when they sell their securities. It would be contrary to the public interest to force such costs on ratepayers through an income tax allowance.

100. In ratemaking, the purpose of a tax allowance is to ensure that a regulated pipeline has the opportunity to earn its allowed return on equity. That objective cannot be twisted into a contrivance to protect owners of a limited partnership from the vicissitudes of the stock market. Ratepayers never should have to backstop investors (ex-owners, to boot) when their securities are sold.

101. SFPP's presentation of partnership-tax law theory does not satisfy the pipeline's burden under § 15(7) to prove that it should be granted an income tax allowance.

102. After the Sepulveda hearings had ended, as the parties were in the process of filing post-hearing briefs, in early May 2005 the Commission issued a policy statement on income tax allowances. 111 FERC ¶ 61,139 (2005). Issued in response to the BP remand, the statement found that a regulated operating limited partnership is to be permitted a full income tax allowance insofar as the partnership establishes that its owners (corporations, individuals or others) have an actual or potential income tax liability on the public utility income earned. Id. at P 1; 32; and 37.[26] Concluding that these matters should be resolved in individual rate proceedings, the statement emphasized that the burden was upon a regulated operating partnership "to establish the tax status of its owners, or if there is more than one level of pass-through entities, where the ultimate tax liability lies and the character of the tax incurred." Id. at P 42.

103. With regard to SFPP and particularly the Sepulveda replacement rate, there is less to the policy statement than meets the eye. Since October 1997, SFPP has been seeking a full income tax allowance for the replacement rate. P 19; 21; 84, supra. The May 2005 policy statement did not change the pipeline's proposal at all. As to the burden of proof upon SFPP, the statement added nothing that was not already imposed upon the pipeline by § 15(7). P 88, supra.

104. A post-hearing conference was held in Sepulveda shortly after the policy statement was issued. It explored various questions, including whether the parties believed that in

[26] The finding was in conflict with what the Commission already had won in BP when SFPP's argument seeking a full income tax allowance was rejected. 374 F.3d at 1288, 1291-92. Of course, a policy statement is neither a rule nor a precedent establishing a binding norm. Pacific Gas & Elec. Co. v. FPC, 506 F.2d 33, 38-39 (D.C. Cir. 1974); American Hosp. Ass'n v. Bowen, 834 F.2d 1037, 1046-47 (D.C. Cir. 1987).

view of the statement there was a need to reopen the record to hold further hearings on particular points. Neither SFPP nor any of the other parties expressed such a need. SEP Tr. 3114; 3119; 3120-21; 3122; 3123; and 3124.

105. Thereafter, the parties' post-hearing reply briefs, which were next filed, discussed the policy statement and addressed questions that the Presiding Judge had posed during the conference regarding the statement. Within a short time after all of the briefs were submitted and taken under advisement by the Presiding Judge, on June 1, 2005 the Commission issued a consolidated order on remand and rehearing in Docket Nos. OR92-8 et al., OR96-2 et al., and IS98-1. 111 FERC ¶ 61,334. Repeating and applying the findings from the recently issued policy statement, the order concluded that SFPP should be granted "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." Id. at P 27.

106. On the record developed in the Sepulveda hearings, SFPP has failed to carry its burden under § 15(7) to prove that it should be granted an income tax allowance. Essentially, the pipeline has advanced partnership-tax theory, which it contends is sufficient to be given a full income tax allowance. But SFPP previously argued tax theory in BP while urging a full allowance. Its argument was rejected. P 86, supra.

107. Therefore, if the pipeline was serious about being granted such an allowance in Sepulveda, something different than discussing more theory had to be advanced. This is true even if the theory itself in the current case was presented in a different fashion from what had been argued previously in BP. The "new" theory, if it is that, is still unsatisfactory and wanting. P 90-101, supra.

108. To be sure, SFPP made a token effort during the hearings to introduce a very small random sample (less than 1%) of some 1996 K-1s which its then-parent MLP, SFPPP, had issued showing that a minuscule amount of net taxable income had been flowed through to owners. Exhibits SEP SFPP-50; SEP ARCO-28 and 28A; SEP ARCO-34; SEP Tr. 402 and 1475-76. But aside from the presentation being meager, SFPP made no attempt whatever to follow up and try to prove that the taxable income actually would lead to any tax liabilities. See n.24, supra. The sparse material offered by SFPP has no significance here, as the pipeline knows. SFPP has not discussed or cited the material in either of its post-hearing briefs.

109. There may be yet another reason why the pipeline has not pressed the point. For ratemaking test-period purposes, it is appropriate to examine whether a regulated entity's costs, actual as well as projected, are reasonably representative of what the costs are likely to be in the future while a rate is in effect. Within a relatively short time after 1996, in early March 1998, SFPP was sold to Kinder Morgan, Inc. and placed under the control of KMI's subsidiary-MLP, KMEP. P 42 and 57, supra. KMEP is a tax shelter, which keeps on producing tax losses for its owners. P 68-69, supra.

110. Tax losses, year-after-year, hardly square with a regulated operating partnership's efforts to be granted an income tax allowance. If no tax is generated by the regulated partnership or its parent-MLP, a publicly traded partnership, the reasons for such an allowance vanish, particularly when the owners (unitholders) already are reaping the benefits of tax losses.

111. This information, which became part of the record in the Sepulveda hearings, was not available at the time that the Phase Two initial decision was issued. The decision dealt with the rest of SFPP's rates on the East Line and the West Line, including the Watson drain-dry charge. Though Lakehead was tottering at that point in the aftermath of BP, there was still some life in it pending further consideration by the Commission following the remand. Consequently, the decision continued to handle the income tax question from the perspective of Lakehead. Phase Two at P 366-384.

112. There may still be a reason to do so in part today, notwithstanding the policy statement's finding that the Commission was expressly reversing the income tax allowance holdings of Lakehead. P 33. In stating that a full income tax allowance is theoretically available to a regulated operating limited partnership, the policy statement actually has expanded the owners to be considered for possible income tax liability: not only corporations (as in Lakehead) but individuals or others as well. This can be called "Lakehead Plus."

113. When Phase Two was issued, there was an assumption that net taxable income had been flowed through. One of the principal income-tax questions that was addressed was, assuming there was such income, whether SFPP had carried its burden to show that corporate unitholders themselves have a tax liability concerning that income. It was found that the pipeline had failed. Phase Two at P 367-374.

114. However, in view of the Sepulveda record showing that for at least 5 straight years, 2000 through 2004, KMEP has been flowing through tax losses, not taxable income, to its owners, there would have been no need to reach the question that was considered.[27] SFPP would not have been entitled to any income tax allowance for the plain reason that its parent-MLP, KMEP, did not even generate taxable income.

115. Accordingly, it is found that SFPP has failed to justify an income tax allowance not only for Sepulveda, but for all of the other rates dealt with in Phase Two. They were

[27] If, however, there had been a situation where the pipeline had carried its first burden to show that net taxable income was flowed through, the pipeline's second burden then would have come into play: to establish that the flow-through actually led to tax liabilities. At that putative stage, the findings in Phase Two (P 366-374) would be relevant to corporations.

based upon a 1999 test period, and there is enough that has been presented here that shows the pipeline should get a zero income tax allowance.

116. No matter what arguments SFPP tries to advance now, the pipeline has had an unrestricted bite at the apple regarding an income tax allowance for Sepulveda. Since October 1997 SFPP has been seeking a full income tax allowance for Sepulveda. It had every opportunity during the hearings held in 2005 to try to make its case. There is no reason for the Commission to give the pipeline a second bite through additional hearings, which would unfairly delay matters to the pipeline's advantage.

117. Nor is there any reason to hold further hearings on an income tax allowance as to the rest of the rates discussed above, East Line and West Line including Watson. SFPP possesses all of the relevant tax information concerning KMEP, and the pipeline has done nothing to show that it warrants a tax allowance of any kind when its parent is a tax shelter generating annual tax losses regularly.

118. There is one final point. In its initial brief, at 40-41, SFPP asserts that a full income tax allowance is good public policy to ensure that funds from an allowance are available to maintain, upgrade and expand oil pipeline infrastructure. Though it has a lofty sound, the assertion is spurious so long as the pipeline is under the control of an MLP like KMEP. Not only is it a tax shelter, KMEP keeps looking to pay investors greater non-taxable cash distributions. That could well clash with a purported goal of maintaining, upgrading and expanding oil pipeline infrastructure.

(3) Operating and Maintenance Costs

a. Regulatory Litigation Costs

119. For the 1996 test period, SFPP claimed high regulatory litigation costs. It did so by ignoring the Commission's regulations, thereby discarding the pipeline's actual costs incurred in 1996 as adjusted for known and measurable changes during the first nine months of 1997. The actual costs for the 1996 base period were slightly under $110,000. Exhibits SEP SFPP-1, at 28; SEP SFPP-45, at 5. Instead of using these costs, SFPP substituted a projection of future costs, $1.2 million, amortized over three years to reflect a $400,000 per-year expense to remain in the Sepulveda replacement rate in perpetuity: from 1996 onward, without end. Id. SEP SFPP-1, at 22 and 27; and SEP SFPP-3, at 4.

120. SFPP's proposal is unacceptable. It fails to follow the Commission's test-period regulations, and produces an amount that is disproportionate compared to all of the pipeline's other Sepulveda costs. The unending recovery of this excessive amount also is unjust and unreasonable.

121. The more reasonable solution is to take the actual base period costs and amortize them over five years: ending at the conclusion of calendar-year 2000. The yearly amount,

$22,000, is then to be removed from the Sepulveda replacement rate starting in the year 2001. Cf. Phase Two, at P 423.

b. California Property Taxes

122. The costs pertaining to this question are quite small, but still need to be considered. SFPP's California property taxes are a component of its ad valorem taxes. Sepulveda is a small fraction of these overall state taxes, which primarily relate to the West Line and the North Line.

123. In 1996, the Sepulveda fraction was 0.50% resulting in a property tax of slightly more than $12,000. Exhibits SEP U/TR/T-20, at 26; SEP U/TR/T-21, Schedule 15 at p.14, Account 580 California Property Tax, Cols. (o) and (p). SFPP, however, has proposed adjusting the fraction by increasing it to 0.67%, resulting in a tax of almost $19,000: an increase of nearly 60%. According to the pipeline, the increase reflects a 1997 allocation of Sepulveda's share of "an annualized accrual" for the taxes. Exhibits SEP SFPP-1, at 22; SEP SFPP-11, at 2; SEP SFPP-13, at 3.

124. Ultramar, Chevron, and Tosco challenge the adjustment, alleging that it is essentially an estimate by the pipeline, subject to change. Therefore, they contend, it is more appropriate to stick with the actual amount for 1996, rather than the estimated amount for 1997. The staff supports the argument of these opponents.

125. SFPP has failed to show that the 1997 adjustment is anything more than an estimate, a cyclical change, which is far from certain to remain in effect. Having never adequately explained why the 1997 allocation occurred, or whether it was simply temporary rather than a steadfast change, SFPP has not justified the proposed increase.

(4) Volumes

126. With the cost questions decided (collectively, the numerator), the remaining issue concerns the volumes, also known as the throughput, to be transported through the Sepulveda Line (the denominator) in order to prescribe, on a per-unit basis, a just and reasonable replacement rate prospectively. Cf. Phase Two at P 513. The subject boils down to one question: whether SFPP was justified in its § 15(7) rate proposal to adjust downward sharply the volumes tendered by Ultramar, one of the three parties that had been allowed to contract with the pipeline to transport petroleum products through Sepulveda.[28] P 8; 9, supra.

[28] The number of contracting parties stayed at three until SFPP's tariff filing in October 1997 when, as a common carrier, the pipeline was compelled by the Commission's jurisdictional decision to open the line to the general public. P 5; 19, supra.

127. Starting in July 1996, Ultramar decreased dramatically the volumes to be moved through Sepulveda. The company shifted a lot of its business by using lines other than Sepulveda to reach Watson station, a West Line origin point. Exhibits SEP SFPP-5, at 1; SEP SFPP-21. To adjust for the marked reduction, SFPP has proposed using 12-months of data that mixes together parts of the base period and adjustment period: the last 4 months of 1996, and the first 8 months of 1997. Exhibits SEP SFPP-1, at 11-15; SEP SFPP-5, at 1. The Commission's staff supports the pipeline's proposal.

128. Ultramar opposes the proposal, suggesting a different approach. It argues that rather than singling out Ultramar alone, the better course would be to use SFPP's proposed mix of 12-months of data, but for all three of the contracting parties. Ultramar points out that, compared to its decreases, the other two parties showed increases in volumes during that time. Exhibits SEP U/TR/T-20, at 26-28; SEP U/TR/T-30, at 1-2.

129. SFPP's proposal is adopted. The three contracting parties were never the three musketeers synchronizing their actions. Ultramar's reduction was a significant, lasting sea change -- perhaps due to the elevated Sepulveda replacement rate, but nevertheless a sea change. There is no indication that the other two parties' increases in volumes were of the same nature, to continue indefinitely into the future.

130. Based upon the findings above, the just and reasonable rate for the 1996 test period is less than one penny per barrel: around $0.0093/bbl, or somewhat lower. Compare P 41-45, supra, with Exhibits SEP U/TR/T-23, at 1 (for costs) and SEP SFPP-1, at 12 (for volumes) and staff's initial brief, at 39.

B. The §§ 13(1) and 15(1) Complaints

131. Apart from SFPP's unpersuasive efforts under § 15(7) to prove that the belatedly filed $0.05/bbl Sepulveda replacement rate is just and reasonable (P 19-130, supra), there are also the §§ 13(1) and 15(1) complaints that were brought against the unfiled replacement rate. As noted, the rate started at the beginning of January 1993, without SFPP's filing a tariff with the Commission. P 2; 3; 15-17, supra. The unfiled rate was challenged by complaints for the first time at the agency three years later, commencing in December 1995/January 1996.

132. An unfiled rate is unlawful under § 6(7) of the ICA, 49 U.S.C. app. § 6(7).[29] In these circumstances, the question arises as to what burden the complainants have if they consider the rate to be excessive and are seeking damages. Traditionally, where a rate is in

[29] As relevant here, the statute prohibits a common carrier like SFPP from transporting refined petroleum products in interstate commerce unless its rates have been filed and published with the Commission in accordance with the provisions of the Act.

a tariff on file with the Commission, the settled rule is that the burden is upon a complainant to prove that the rate is unjust and unreasonable. See, e.g., Swift & Co. v. United States, 343 U.S. 373, 376, 382-83 (1952); Louisville & N. R.R., 238 U.S. 1, 11 (1915). Whether the general rule applies when the rate already is unlawful is another matter.

133. The solution seems to be found in Section 7(c) of the Administrative Procedure Act, 5 U.S.C. § 556(d). It provides that, in a rulemaking or an adjudication, when hearings are required to be conducted in accordance with the Section, "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof." As the parties seeking an order under §§ 13(1) and 15(1) that the unfiled Sepulveda replacement rate was unjust and unreasonable, the complainants certainly appear to have a burden. However, on the face of the statute, it is less clear what type of burden it is: an ultimate burden of persuasion, or a burden of going forward.

134. The Attorney General's Manual on the Administrative Procedure Act [p. 75 and n.3] (1947) suggests that, rather than being an ultimate burden of persuasion, "[t]here is some indication that the term 'burden of proof' was not employed in any strict sense, but rather as synonymous with the 'burden of going forward.'" The Manual cites the legislative history, which bears out the point "That the proponent of a rule or order has the burden of proof means not only that the party initiating the proceeding has the general burden of coming forward with a prima facie case but that other parties, who are proponents of some different result, also for that purpose have a burden to maintain." Sen. Doc. No. 245, 79th Cong., 2d Sess. 208, 270 (1946) (emphasis added). See NLRB v. Mastro Plastics Corp., 354 F.2d 170, 176 (2d Cir. 1965) (emphasis added); Minnesota Power & Light Co., 23 FERC ¶ 61,393, at p. 61,835 (1983).

135. For purposes here, it is enough to find that the complainants have come forward to make a prima facie case by a preponderance of the evidence, showing that the unfiled $0.05/bbl Sepulveda replacement rate was unjust and unreasonable. On the other hand, SFPP has failed to maintain its own burden to rebut their showing through convincing evidence. The pipeline chose not to present a full affirmative case to counter the complainants' showing under §§ 13(1) and 15(1) concerning the unfiled rate covering the period from January 1, 1993 through November 5, 1997. See Steadman v. SEC, 490 U.S. 91, 98-102 (1981); Smith v. United States, 557 F. Supp. 42, 51 (W.D. Ark. 1982), aff'd, 726 F.2d 428 (8th Cir. 1984).

136. Instead, SFPP mainly raised inconsequential criticisms, including the inapposite Opinion 154-B methodology given the pipeline's flouting of the ICA during the many years at issue here. P 28; 30-35, supra. Nor did the pipeline help itself for §§ 13(1) and 15(1) purposes by echoing in any way its inadequate § 15(7) presentation which applies to a different period, from November 6, 1997 forward.

137. The first complaint against the unfiled $0.05/bbl replacement rate was brought in December 1995. Other complaints followed, beginning in 1996. Consequently, trying to use a 12-month base period ending during this time frame, the complainants selected a 1995 test period as the means to demonstrate that the rate was unjust and unreasonable.[30] Exhibit SEP U/TR/T-1, at 6.

(1) Recovery of Original Capital Investment

138. Most of the important questions raised by the complaints parallel those decided above where SFPP's § 15(7) proposal was considered.[31] P 19-130, supra. Mr. O'Loughlin has been the principal witness for the complainants regarding the costs at issue. P 28, supra. The first major question that he addressed concerned the original capital investment in Sepulveda. He showed that SFPP had recovered the entire original investment prior to 1995, and therefore none of that capital could be included for depreciation purposes or to calculate an overall return allowance, which is also based on jurisdictional plant that is part of rate base.[32] Exhibits SEP U/TR/T-1, at 7-12; SEP U/TR/T-20, at 6-12 and 22-23.

139. This is the same question that was decided above in considering the § 15(7) proposal. Pursuant to three 10-year contracts that ran from 1983 through 1992, SFPP recouped the entire original investment no later than the end of 1992 through initial Sepulveda charges -- which were never filed in a tariff, and preceded the replacement rate. The point was corroborated by Mr. O'Loughlin's various DCF analyses. SFPP has presented nothing of merit that casts doubt upon this conclusion. P 6; 24-38, supra.

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[30] In comparison, as noted, SFPP used a 1996 test period to try to prove that its 1997 filed Sepulveda replacement rate is just and reasonable under § 15(7). P 20, supra.

[31] Procedurally, in the pre-hearing stage of the case when written testimony and proposed exhibits were submitted, subject to discovery, both sides filed their respective cases simultaneously. The first round, SFPP filed under § 15(7), while the complainants filed under §§ 13(1) and 15(1). The second round, SFPP replied to the complainants' initial presentation, while conversely the complainants (as protestants) replied to SFPP's initial presentation. The third round, each side filed its rebuttal: SFPP under § 15(7); the complainants under §§ 13(1) and 15(1).

[32] Any capital additions after 1992 through the end of 1995 are part of rate base and are subject to depreciation.

(2) Capital Structure, Return Allowance Including Rate of Return, and Income Taxes

140. After deducting the impermissible 1988 PAA (P 40-43, supra), Mr. O'Loughlin arrived at a capital structure of 68.33% debt/31.67% equity based upon SFPP's structure at the end of 1995 as reported in the pipeline's FERC Form No. 6. Exhibits SEP U/TR/T-1, at 16-18; SEP U/TR/T-14, at 1-2. There is no dispute about this structure. It is adopted.

141. The short answers to the cost of debt and the rate of return on common equity for the 1995 test period are found in the Phase Two initial decision. The undisputed debt cost is 10.23%. P 610. As for the real rate of return on equity, it is 10.29%. P 349; 611-615. Mr. O'Loughlin has based the debt cost and the equity return allowance upon these findings. Exhibit SEP U/TR/T-1, at 15-16. SFPP has offered no data to contradict these points.

142. It is recognized that the return-allowance determination stems from a DCF methodology involving a proxy group composed entirely of MLPs. That causes the dividend yield to be unduly inflated due to cash distributions. However, currently there is no adequate alternative to this approach. To try to counter the result, for the reasons explained there is a need to keep the rate of return on equity as reasonably low as possible toward the bottom of the range of rates developed from the proxy group. P 49-82, supra.

143. With regard to income taxes, Mr. O'Loughlin has concluded that no allowance should be permitted. Exhibit SEP U/TR/T-1, at 19-21. He is right. There is an additional element beyond the fact that SFPP pays no income taxes, as BP found when it concluded that the pipeline cannot be granted an allowance for phantom income taxes it does not pay.

144. The Sepulveda hearing record indisputably demonstrates that SFPP has not justified an income tax allowance under any circumstance. The pipeline was given an unrestricted opportunity to show why it should be granted an allowance. Yet it elected not to file specific evidence to prove its claim: neither for a § 15(7)-1996 test period, nor for a 1995 test period as to §§ 13(1) and 15(1). The pipeline's decision to rest upon partnership-tax theory has not sufficed. P 83-118, supra.

(3) Operating and Maintenance Costs and Volumes

145. Mr. O'Loughlin has used SFPP's actual 1995 O&M expenses of $184,000 (excluding depreciation), as reported by the pipeline in Docket Nos. OR96-2 et al. See Item by Reference B, Schedule 4A, page 1 of 6, line 13. Exhibits SEP U/TR/T-1, at 22; SEP U/TR/T-3, at 1, line 13. Without objection by any party, the amount is adopted.

146. As for the volumes (the denominator to be divided into the numerator, the entire cost of service), Mr. O'Loughlin has used the actual 1995 Sepulveda throughput as reported by SFPP in Docket Nos. OR96-2 et al. See Item by Reference B, Schedule 35,

page 5 of 6. Exhibits SEP U/TR/T-1, at 22; SEP U/TR/T-3, at 14. Without objection by any party, the figure is adopted.

147. Based upon the findings above, the just and reasonable rate for the 1995 test period is less than one penny per barrel: $0.0085/bbl. See Exhibit SEP U/TR/T-1, at 22-23.

III

148. As decided, the just and reasonable Sepulveda replacement rate under §§ 13(1) and 15(1) is less than one cent per barrel for the period January 1, 1993 through November 5, 1997. P 131-147, supra. The just and reasonable replacement rate under § 15(7) also is less than one cent per barrel, albeit somewhat different from the rate under §§ 13(1) and 15(1), for the period from November 6, 1997 forward. P 1-2; 19-130, supra. During all of this time, SFPP has charged and continues to charge a far higher rate, $0.05/bbl.

149. Thus, in addition to reducing the rate in accordance with the findings above, the pipeline is to pay money, with interest, for the higher charges assessed: the difference between the just and reasonable rate(s) and the rate collected by SFPP, multiplied by the respective volumes shipped. The payments under §§ 13(1) and 15(1) -- called damages -- are to be made to the complainants. The payments under § 15(7) -- called refunds -- are to be made to the persons in whose behalf the excessive amounts were paid.

150. SFPP contends that it owes nothing to the complainants for the excessive charges. As an apparent fallback-position, the pipeline seems to argue that even if it does owe some amount, there is an alleged “rate floor” (about 4 times higher than the just and reasonable rate) which cannot be breached, precluding the complainants from being made whole. As for the relief ordered under § 15(7), the pipeline asserts that the same alleged rate floor applies (about 3.5 times higher than the just and reasonable rate), stopping the calculation of the refunds from going below the “floor” and preventing the persons who paid the excessive charges from being made whole. Furthermore, SFPP argues that the same alleged rate floor shackles the Commission for years and perhaps forever from ordering the excessive $0.05/bbl charge to be reduced to the appropriate just and reasonable rate level -- unless and until additional hearings are held, and the injured parties have satisfied the requirements of the EP Act of 1992.

151. The parties opposing the pipeline strongly disagree with these assertions.

152. They are right. SFPP has fabricated an unfounded house of cards which collapses upon analysis. These arguments show that just as the pipeline disobeyed and violated the Interstate Commerce Act for 15 years (P 15-18, supra), it continues today trying to do so by brushing aside the Act and recasting the matter as though it were simply a private contractual quarrel where the Commission has no role to play enforcing the ratemaking and liability provisions of the Act. At bottom, the pipeline continues showing disdain

toward the Act and the Commission, while trying to hold on to its ill-gotten gains free of regulation.

153. The argument about an alleged rate floor starts by relying upon the initial, variable Sepulveda charges contained in the three contracts which ran from 1983 through 1992, but were never filed in a tariff with the Commission. In brief, the argument rests on the very contracts that the pipeline otherwise claims, erroneously, cannot be used to determine whether the original Sepulveda investment was fully recovered no later than the end of 1992. P 6-9; 24-32 and n.7; 138-139, supra. It is shameful how the pipeline keeps on with its supercilious behavior advancing contradictory arguments: the original contracts cannot be used for one purpose -- to determine whether the replacement rate is unduly inflated; but the contracts can be used for other purposes -- to deny financial relief to those bearing the costs of the excessive replacement rate, and to restrict the Commission from prescribing an appropriate just and reasonable rate level. It is yet another example of the repeated conduct, bordering on being unethical, by the pipeline's counsel trying to ride two horses simultaneously. P 31-32, supra; Phase One at P 127; 190; and 237; Phase Two at P 384; 488; and 579.

154. Building upon the unfiled initial charges in the original contracts, SFPP proceeds to argue that the charges became grandfathered by the EP Act of 1992. For support, the pipeline relies upon (1) findings from the Commission's Opinion 435-A issued in the prior, related proceedings in Docket Nos. OR92-8 et al. concerning the Watson drain-dry charge, which also had not been filed in a tariff with the Commission until the pipeline was ordered to do so; and (2) arguments defending the findings in the Commission's brief submitted to the United States Court of Appeals for the District of Columbia Circuit in BP.

155. BP found the reasoning on the point about an unfiled rate to be fundamentally flawed, and vacated and remanded subject to further consideration by the Commission. 374 F.3d at 1273-74; 1312. Upon remand, the Commission changed its conclusion previously reviewed in BP, finding the Watson charge ineligible to be grandfathered. Concurrently, the Commission decided not to address the question whether charges in private contracts can be grandfathered under the EP Act of 1992 when they are not on file in a tariff with the agency. June 1, 2005 order, supra, 111 FERC ¶ 61,334, at P 32-36.

156. At this stage, the 435-A findings are obiter dictum, and the previous arguments in the Commission's BP brief carry no weight. SFPP disagrees, asserting that the dicta and the arguments have enunciated an unalterable, controlling "principle" whereby the Commission enforces unfiled contract rates. Initial brief, at 64; reply brief, at 54.

157. The assertion is vacuous insofar as it suggests that contract rates trump the Interstate Commerce Act when questions arise as to whether the rates are just and reasonable. The Commission, not the courts, has primary jurisdiction to determine rate questions under the Act, and it is for the agency to decide whether contract rates are just and reasonable. United States v. Western Pac. R.R., 352 U.S. 59, 62-65 (1956); City of

New Orleans v. Texas & Pac. Ry., 195 F.2d 887, 889 (5th Cir. 1952). Notwithstanding SFPP's erroneous intimations, the Commission does not and cannot yield its ratemaking authority to private contracting parties when questions are presented about the justness and reasonableness of contract rates.

158. In addition to SFPP's unwarranted reliance upon the Commission's pre-BP findings and arguments, there are two critical errors that the pipeline commits asserting that the unfiled initial Sepulveda charges in the original contracts became grandfathered by the EP Act of 1992. The first is to focus solely on the EP Act, and to ignore altogether the Interstate Commerce Act. That is in keeping with the pipeline's modus operandi, trying to divert attention from the subject at hand. Cf. Phase Two at P 577; 582; 586.

159. The second crucial error is the pipeline's failure to recognize that under § 6(7) of the ICA an unfiled rate is unlawful. P 37;132, supra. The unfiled initial Sepulveda charges were about to expire anyway as the EP Act was beginning, and did expire well before the Commission became aware of them. In these circumstances, they did not magically get converted from being unlawful under § 6(7) into grandfathered status, whereby they would be deemed just and reasonable by the EP Act.

160. The EP Act did not repeal or otherwise expressly amend the ICA. Phase One at P 7. By not revoking § 6(7), Congress in enacting the EP Act must be presumed to have been fully cognizant of the longstanding statutory scheme of the ICA that was being left in place. Square D Co. v. Niagara Frontier Tariff Bureau, Inc., 476 U.S. 409, 420 (1986). SFPP has pointed to nothing that brings into question this essential fact.

161. Having not explicitly revoked § 6(7), Congress did not do so implicitly either. It is settled statutory construction that implied repeals of federal statutes are not favored. Where two statutes are capable of coexisting, each is to be regarded as effective, absent a clearly expressed congressional intention to the contrary. Traynor v. Turnage, 485 U.S. 535, 547-48 (1988). SFPP has not cited to any such intention.

162. It is also significant that when the Commission issued its 1997 Sepulveda jurisdictional order, the unfiled initial charges already had expired and been supplanted by the replacement rate nearly five years earlier. P 7, supra. SFPP is hardly in a position to argue that its "rate-floor" theory is credible when the Commission first learned about these charges after they had ceased to exist.

163. It is bad enough when SFPP tries to pretend, on the one hand, that the initial Sepulveda charges never happened so that the pipeline can inflate its replacement rate by arguing that the original capital investment has not yet been recovered. P 24-38; 138-139, supra. The charges were real. The fact that they had ended before the Commission ever learned about them should not work in the pipeline's favor.

164. What would make a complete mockery of the regulatory process, however, would be to endorse the pipeline's about-face as it now asks that the initial charges be treated as though they were grandfathered. The effect would be to create an untenable shield and a sword for the pipeline. SFPP's obligation to pay damages and refunds would be excused, enabling the pipeline to be unjustly enriched. Moreover, the Commission would be effectively handcuffed discharging its ratemaking duties, preventing the agency from ordering the pipeline's excessive replacement rate to be reduced to a just and reasonable level. The grandfathered rate-floor argument is a sham. It is rejected.

165. SFPP advances other arguments trying to thwart the complainants from recovering damages for the unjust and unreasonable $0.05/bbl replacement rate that was in effect from 1993 through November 5, 1997. The pipeline concentrates this time upon the successor contracts to the original contracts, but there is a common theme with the rate-floor argument. The theme is just asserted more forcefully with regard to the successor contracts. According to the pipeline's syllogism, the contracts are valid and enforceable, therefore reparations are foreclosed.

166. The argument suffers from the same fatal flaw previously discussed. P 157, supra. By skipping over the Interstate Commerce Act and the Commission's primary jurisdiction to determine rate questions under the Act, the argument implicitly leaps to the false conclusion that contract rates trump the Act when questions arise as to whether the rates are just and reasonable.

167. SFPP cites irrelevant court opinions which enforced transportation contracts where regulated carriers had failed to comply with the requirements of the Act, including the filing of a tariff. Initial brief, at 55-56. The cases are inapposite because none addressed questions as to whether the contract rates were just and reasonable. See, e.g., Ets-Hokin & Galvan, Inc. v. Maas Transp., Inc., 380 F.2d 258 (8th Cir.), cert. denied, 389 U.S. 977 (1967). If such questions had been presented, the courts would have had to yield to the Commission for it alone has primary jurisdiction to decide these matters.

168. It is untrue and thus misleading for SFPP to argue and imply that valid and enforceable contracts foreclose reparations. The successor contract charge is $0.05/bbl. Exhibit SEP U/TR/T-7, at SFIS98 001226-27; from Docket Nos. OR96-2 et al. Exhibit SFPP-62, Tab F, at SF109885-89; SF109918-19. In accordance with the Interstate Commerce Act, this case is the first time that the contract charge has been examined to determine whether it is just and reasonable. The charge has now been determined to be far too high and is, therefore, unjust and unreasonable. The complainants are owed damages for this excessive charge. There is no valid reason to deny them such relief, while allowing the violator of the Act, SFPP, to be unjustly enriched.

169. SFPP, however, belabors the point that the complainants are sophisticated (initial brief, at 5; 56; 65; 73; reply brief, at 22; 25; 59) and freely entered into the successor contracts. Therefore, according to the pipeline, that is enough to turn down their claims

for reparations. Of course, the pipeline also argues that persons not having contracts with it are prohibited from being awarded reparations, in that case owing to the absence of privity. Under this classic Catch-22 argument, SFPP would free itself of ever having to pay reparations, and would effectively erase the liability provisions from the Act.

170. The liability provisions do not work this way. Contracts usually are the first requirement from the standpoint of a regulated interstate carrier before it will even provide service. Therefore, without rendering meaningless the Act's liability provisions, contracts do not suffice to disqualify a contracting party from being awarded reparations. Nor is the sophistication of a contracting party a disqualifying factor. Psychiatrists or other types of professionals are not needed in the process to determine whether damages have to be paid. Instead, what matters is whether a regulated oil pipeline like SFPP has charged an unjust and unreasonable rate, calling for the pipeline to disgorge its ill-gotten gains. On that basis, it is beyond dispute that the complainants are entitled to reparations.

171. SFPP's final argument of any note is that reparations should be foreclosed because the pipeline allegedly does not have market power regarding the Sepulveda Line. That is beside the point here, and is simply a variation of the argument that the complainants freely entered into the successor contracts with the pipeline. SFPP is seeking again to be excused from having to pay damages despite the fact that it charged unjust and unreasonable rates. The argument is rejected.

172. The ARCO Group alone seeks to force SFPP to pay reparations back to 1983 when the initial Sepulveda charges started, given the fact that the charges were unlawful under § 6(7). P 36-37, supra. The claim is denied. Despite being unlawful, there has never been an evaluation of the justness and reasonableness of the initial charges to know whether reparations would be due. The reason that reparations are due for the subsequent $0.05/bbl unlawful, unfiled Sepulveda replacement rate for the period from 1993 through November 5, 1997 is that hearings have been held here proving that the rate is excessive.

173. The ARCO Group should not rush into filing another complaint to test the justness and reasonableness of the initial charges. The charges had expired before the Commission ever learned of them, and the ensuing complaints in this case were directed at the existing replacement rate, not the former initial charges. Unless every SFPP charge has become sport, there seems to be little reason to initiate new complaints to pursue additional questions about the initial charges.

174. To summarize, SFPP is to pay damages and refunds, with interest, for the unjust and unreasonable $0.05/bbl Sepulveda replacement rate. The damages start January 1, 1993 and extend through November 5, 1997. Because the unfiled replacement rate was unlawful under § 6(7), the time limitations of § 16(3)(b) are not controlling here. Instead, §§ 8 and 16(1) are to be used for guidance. Section 8 provides that an oil pipeline like SFPP is liable "for the full amount of damages sustained" regarding any violation of the Act. Section 16(1) provides that the pipeline is "to pay to the complainant the sum to

which he is entitled…." Within 30 days after the Commission issues a final order in this matter, SFPP is to pay, with interest, the damages specified.

175. With regard to § 15(7), the refunds, with interest, start November 6, 1997 and will continue until the Commission issues a final order that is no longer judicially reviewable.

176. As to both damages and refunds, no payments are to be made to GATX, but rather to each of its customers to whom the Sepulveda charge has been flowed through. SEP Tr. 3076-77. GATX is now affiliated with SFPP under the control of Kinder Morgan. It will not suffice for KM to take money from one pocket and simply place it in the other pocket.

177. All of the remedies prescribed above are necessary to achieve the statutory goals of the Interstate Commerce Act. ICC v. American Trucking Ass'ns, Inc., 467 U.S. 354, 364-65 (1984); Trans Alaska Pipeline Rate Cases, 436 U.S. 631, 655 (1978); United States v. Chesapeake & Ohio Ry., 426 U.S. 500, 514-15 (1976); see also Mesa Petroleum Co. v. FPC, 441 F2d 182, 186-88 (5th Cir. 1967); Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153, 158 (D.C. Cir. 1967).

178. There is one last question in the case to be resolved. It concerns determining the party to be substituted for Texaco Refining and Marketing Inc. (TRMI) for purposes of receiving SFPP's payments of damages and refunds. TRMI has been one of the complainants and protesting parties in this case. Based upon a complaint filed in January 2000, Equilon Enterprises, LLC was described as the successor in interest to TRMI. Phase One, at P 71.

179. However, ChevronTexaco Products Company (which now appears to have restored its former name, Chevron Products Company) alleges that, insofar as claims against SFPP are involved, TRMI's interest was transferred to it, not to Equilon. Although notified of this proceeding, Equilon has not appeared to present its own views. SFPP has appointed itself to pinch hit for Equilon. The pipeline, however, has presented no witness or data to support its assertions. Alleging that Chevron has failed to make an adequate showing here, SFPP declines to regard the company as the proper substitute, deems Equilon to be the correct party in interest, and expresses a willingness to put in escrow any money due until the matter is finally resolved.

180. SFPP depicts the issue as "conflicting claims" and "dueling successors" (reply brief, at 60 and n.20). But it is the pipeline that is trying to create a conflict. Equilon, for its part, is not arguing sotto voce. Rather, it is not arguing at all, making no claim to be the transferee of TRMI's interest for purposes of receiving damages and refunds from SFPP. That is enough reason to be skeptical of SFPP's arguments regarding the subject.

181. Contrary to SFPP's unsupported assertions, Chevron has made a sufficient showing to find that it has stepped into the shoes of TRMI for purposes of claims against the pipeline. In reaching this conclusion, the Presiding Judge has revisited orders which he

issued over three years ago before the Phase One and Phase Two initial decisions were issued. The orders denied proposals to substitute parties or others as complainants resulting from corporate mergers or other types of combinations affecting these parties. Chevron, in particular, was among the parties, and held the unique status of being an intervenor only, not a complainant. 99 FERC ¶ 63, 009 (2002); 99 FERC ¶ 63,023 (2002).

182. The difference now is that -- after the Phase One and Phase Two initial decisions, together with the current initial decision -- SFPP's rates have been determined to be unjust and unreasonable, and damages and refunds are due to be paid by the pipeline. Of equal importance, Chevron presented a witness at the Sepulveda hearings, and exhibits were made part of the record, providing more information than was available three years ago as to the successor in interest of TRMI's claims against the pipeline. Based upon the information, it is reasonable to treat Chevron as the successor in order to be awarded damages and refunds.

183. Some background is necessary to understand the matter. TRMI was a subsidiary of Texaco Inc. Texaco was active on two fronts in the late 1990s extending into the year, 2001. First, through contracts executed in 1997, Texaco and Shell Oil Corporation formed a petroleum-marketing joint venture, Equilon, which started operating at the beginning of 1998. As its share in the joint venture, Texaco contributed most -- but not all -- of TRMI's assets or interests, including a Los Angeles refinery located very near the origin of the Sepulveda pipeline. Second, Texaco and Chevron Corporation agreed to merge -- subject to approval by the Federal Trade Commission. To satisfy a condition imposed by the FTC, Texaco surrendered its ownership interest in Equilon, which interest then passed to Shell (the latter becoming the full owner of Equilon), allowing the ChevronTexaco merger to be consummated in October 2001.

184. Chevron states that the 1997 Texaco-Shell contracts forming the then-joint venture did not include TRMI's interest in the FERC proceedings. Instead, according to Chevron, along with other "non-Equilon" assets or interests, TRMI's interest was passed to another Texaco subsidiary, Texaco Downstream, Inc. (TDI), which was subsequently acquired by Chevron through the ChevronTexaco merger. Exhibits SEP TR-2, at TRIS98-0011; SEP TR-2A, at TRIS98-0084; SEP TR-3; SEP TR-3 (Addendum); SEP TR-3A; SEP Tr. 2984-85; 2997; 3012. SFPP assails Chevron's explanation, arguing that Chevron has not proved the point beyond a reasonable doubt. The pipeline then proceeds to conclude that TRMI's interest in the FERC proceedings was in fact transferred to Equilon. SFPP's conclusion is deficient, however, not citing to a single document to back up its assertion.

185. Rather than having the matter get bogged down, as SFPP seeks, into the morass of contracts and alleged conflicts over contractual interpretations, there are more practical considerations that plainly favor Chevron's position. As the owner-operator of the Sepulveda pipeline billing shippers or so-called suppliers for using the line, SFPP knows full well that Equilon was never a shipper or a supplier on Sepulveda. The record bears

out the point. Exhibits SEP SFPP-24; 101, 101A, and 101B; SEP TR-6; from Docket Nos. OR96-2 et al. Tr. 12,711-12.

186. For another reason, it is incorrect to assume that TRMI's interest in the FERC proceedings was transferred to Equilon in 1997 at the same time that Texaco's Los Angeles refinery located near the Sepulveda Line was contributed to the then-joint venture. P 183, supra. Though it is counterintuitive given the proximity of the refinery to Sepulveda, TRMI did not transfer its rights to use the line to Equilon. The non-transfer caused Equilon Line 28 to be built in 1998 to transport products from the refinery to Watson station, often in lieu of using Sepulveda. Exhibit SEP SFPP-72; SFPP, L.P., 93 FERC ¶ 63,023, at 65,100-01 (2000) (initial decision).

187. To recap the final question, Equilon is the dog that has not barked in this matter. Having no reasonable basis to deputize itself to stand in for Equilon, SFPP has failed to show in any event that Equilon is the successor in interest to TRMI for purposes of being awarded damages and refunds in this case. The hearing record demonstrates that it is reasonable to find that Chevron is the proper successor in interest. For the money that is owed to TRMI, the pipeline is to pay Chevron directly just as it is to pay the other parties in the case.

Raymond M. Zimmet
Administrative Law Judge