



GRANDFATHERED RATES

*How the Recent Calnev Order
Impacts the Oil Pipeline Industry*



AGENDA

Review statutory framework and major issues

Review key FERC orders

Review 2011 *Calnev* order and its impact and open questions




EPAct Background

- Section 1803(a) of the Energy Policy Act of 1992 (“*EPAct*”) deems just and reasonable
 - any rate in effect for the 365-day period ending on the date of the enactment of this Act ... if the rate in effect ... has not been subject to protest, investigation or complaint during such period.
- Grandfathered rates are insulated from cost-based challenges unless a complaint meets specific requirements.

Challenges Under EPAct

- Grandfathered rate can be challenged if:
 - (1) “a substantial change has occurred after” October 24, 1992, “in the economic circumstances of the oil pipeline which were a basis for the rate” or
 - (2) “a substantial change has occurred after” October 24, 1992, “in the nature of the services provided which were the basis of the rates
- All challenges have focused on item (1).



Navigating Substantially Changed Economic Circumstances

- We will review:
 - Two SFPP cases (West Line and North/Oregon cases)
 - Calnev Orders on Complaint (December 2007)
 - Order Consolidating 2007 and 2009 Calnev Complaints (March 2011)
- Chart evolution of SCC standard from broad comparison of costs and volumes to a narrower measure of achieved ROE

SFPP West Line

- Major issues:
 - Formula to compute Substantial Change in Economic Circumstances (“SCC”)
 - Economic basis of a settlement rate
 - Measurement metric (contemporaneous or uniform COS methodology)
 - Broad vs. Narrow measures of change
 - System-wide vs. individual rate determination

SFPP West Line: Formula to Calculate SCC

- EPAAct established grandfathered floor unless SCC in economic basis and SCC occurs after passage of EPAAct
- SCC evaluation based on “A B C” test:
 - “A”: basis when rate was filed
 - “B”: basis the year prior to passage of EPAAct (1992)
 - “C”: basis prior to Complaint period

SFPP West Line:

- Commission adopted $(C-B)/A$ formula with corollaries to address anomalies:
 - In measuring volumes, if $B < A$ then the Commission uses $(C-A)/A$
 - In measuring costs, if $B > A$ then the Commission uses $(C-A)/A$

SFPP West Line: Issues Considered

- Economic Basis for Settlement Rate
 - FERC upheld I.D.'s reliance on top sheets submitted to the Oil Pipeline Board, rather than settlement terms (*March 2004 Order*, ¶ 44)
 - DC Circuit affirmed: "It is certainly reasonable for FERC to use a cost-of-service computation as an approximation for a pipeline's economic circumstance." (*D.C. Circuit Decision, ExxonMobil v. FERC*, ¶ 29)
- Consistent vs. Contemporaneous Yardstick
 - I.D. used contemporaneous yardsticks
 - e.g. a 1989 COS calculated "Pre-Arco" compared to a 1995 COS calculated using Opinion No. 435
 - FERC upheld
 - Not raised to DC Circuit on appeal

SFPP West Line: Issues Considered

- Broad vs. narrow measures of SCC; “substantial.”
 - ALJ adopted narrow (i.e., single rate component) measure for SCC with “substantial” being as low as 14%
 - Commission reversed I.D.’s reliance on single COS elements outside of full COS context (*March 2004 Order*, ¶ 35)
 - Commission measures change in COS and Volumes to determine overall change in economic circumstances
 - DC Circuit upholds the Commission use of broad measure
 - Offsetting changes (e.g. increase in volume offset by cost increase) are relevant

SFPP West Line: Issues Considered

- System vs. Point-to-Point Measures of Change
 - Evaluate change for entire systems (e.g. change in total West Line volumes) or by individual rate/movement?
 - FERC (March 2004) Order at ¶ 55:
 - Employ the individual rate test if data provided
 - Accepts use of total segment change in COS where rates were justified on segment basis.
 - *Possible implications:*
 - Failure of Complainant to provide that data carries no consequences
 - Failure of the Carrier to provide historical data may infer a negative consequence (*regardless of whether the Carrier has the data or not*)
 - Will revisit this in *Calnev* context

SFPP West Line: Reviewing Commission Decision

- Formula: $(C-B)/A$ *usually*
- Basis Economic Circumstances: COS
- Yardstick: Contemporaneous
- Broad vs. Narrow: Broad
- System vs. Point-to-Point: Point-to-Point, if available



SFPP West Line: Commission Application of Rulings

- Commission calculated change in system cost
- It also calculated change in point-to-point volume and *added* these changes to system cost
- For example, a 10% decrease in cost and a 10% increase in volume is a 20% improvement in pipeline circumstances
- A 10% increase in costs and a 10% increase in volume is a 0% improvement, because the 10% increase in volume is offset by the cost increase

December 2007 Orders

- Adding Percentages derived from Unlike Bases
- Grandfathered Revenues
- Starting from a Negative Earnings Base
- Broad v. Narrow Economic Measures & Regulatory Change

December 2007 Orders

- Adding Percentages Derived from Unlike Bases
 - Adding percentages from unlike bases is mathematically incorrect (*America West*, ¶ 8)
 - (e.g., Correct SCC analysis should take account of different earnings base. A 20% increase from \$100,000 has a different dollar impact than a 50% reduction from \$50,000)
- Grandfathered Revenues
 - Threshold Requirements:
 - GF Portion: Energy Policy Act §1803
 - Non GF Portion: 18 C.F.R. §343.2(c)
 - Addressed in *America West*, ¶¶ 3, 8, 12
 - GF Revenue as proxy for GF Volume: “Moreover, the Complainants note that a comparison of the change in dollar margins might be more appropriate” (*America West*, ¶ 8)
 - Including non-GF portion of revenue in SCC analysis would:
 - Conflate rate level changes with economic improvement
 - Penalize pipeline for applying indexing methodology

December 2007 Orders

- Starting from a Negative Earnings Base
 - Commission finds that starting from a negative earnings base overstates change in economic circumstances (*America West*, ¶ 9)
- Broad vs. Narrow Measures
 - Commission continues to support broad measures
 - Rejected reliance on changes to one of a number of COS factors since changes to individual factors might be offsetting
 - Change to ITA methodology not sufficient for SCC (*SFPP December 2007 Order*, ¶ 14)

SFPP North and Oregon Lines: Docket No. OR03-5-001

- All issues discussed in December 2007 Orders with respect to SCC were also addressed in OR03-5-001 hearing
- Additional SCC issues addressed:
 - SCC Threshold
 - Application of (C-B)/A methodology
 - Possible cost-based rate adjustment if SCC not found

SFPP North and Oregon Lines

- Positions of the Parties

Party	SCC Measure	Weighting	Revenues	Threshold
SFPP	$(C-B)/A$	Yes	Grandfathered	>20%
Trial Staff	Revenue-Cost Index	No	Total	15%
Shippers	Achieved Return	No	Grandfathered	15%

SFPP North and Oregon Lines: Initial Decision

- Endorsed Staff's SCC methodology
- Supported comparing percentage changes in revenues with percentage changes in costs, computed using dollars
- Compare *total* cost of service and *total* revenue when determining SCC (both systems only served one destination)
- Use $(C-B)/B$ instead of $(C-B)/A$ when credible SCC evidence is lacking
- Rates cannot be lowered from grandfathered rate without a complainants showing of SCC
- Minimum change of 15% is required for showing of SCC



Calnev Order

- Issued: 17 March 2011
- Consolidates 2007 and 2009 complaint proceedings, and
- Sets new framework for analyzing SCC
- Commission looks to record in OR03-5-001 case

Calnev Order: SCC Formula

- Achieved Return on Equity is the measure for determining whether SCC has occurred (¶ 53)
 - A narrow measure
 - Order anticipates this will be computed based on achieved return percentages (i.e., percentage change in ROE percentage)
- Retains **(C-B)/A** formula to compute percentage change return on equity (¶¶ 17-18, 23)

Calnev Order: Measuring Change

- Revenues

- Must use total jurisdictional revenues in calculation, including indexing revenue (§ 41)

- Economic Basis of Rate

- Period A will be based on actual achieved return proposed if the Carrier made a COS filing (§ 69)
- Eliminates the assumption in *America West* that management would have expected to earn the J&R ROE
- Absent a filing, it is presumed that a carrier's actual achieved return at period A will be used

Calnev Order: Measuring Change

- Regulatory Methodology
 - Must apply the current regulatory methodology that was in place during each period (¶ 68)
- Threshold for SCC
 - 25% Change in ROE
 - This is not a bright line threshold as change must be sustained, not based on anomalous circumstances (¶ 61)
 - Review period may be limited by the complaint filing date

Calnev Order: Additional Notes

- Exceeding SCC 25% threshold is not enough – Prospective cost-based rate must be substantially below grandfathered rate and current achieved ROE must be substantially greater than the just and reasonable ROE (¶ 62)
- New standard may find SCC more easily
- Carriers found to have SCC may be subject to rates being reset to COS

Evolution of Methodology

SFPP Global Case

Calnev (March 2011)

SCC Measure:

- Combined change in COS and volumes

- Change in Equity Return

Formula:

- C-B/A (usually)

- C-B/A ?

Scope:

- Broad Measure

- Narrow Measure

Evaluation:

- Point to Point

- Unclear

Threshold:

- Uncertain (15-20%)

- Sustained 25%



- Open issues:

- How is achieved ROE to be measured?
- Base rate challenges vs. whole rate challenges?
- How will we determine ROE on systems with multiple delivery points?
- Did Congress deem rates or ROE as J&R?
- What time period should be evaluated when determining if SCC is sustained?

Questions

Case Cites

- Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992)
- March 2004 Order: *ARCO Prods. Co., et al. v. SFPP, L.P.*, 106 FERC ¶ 61,300 (2004)
- D.C. Circuit Decision, *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007)
- *America West Airlines, Inc. v. Calnev Pipe Line, L.L.C.*, 121 FERC ¶ 61,241 (2007)
- SFPP December 2007 Order: *SFPP, L.P.*, 121 FERC ¶ 61,240 (2007)
- OR03-5-001 ID: *Chevron Prods.Co.*, 125 FERC ¶ 63,018 (2008)
- March 2011 Order in OR07-7 (consolidating proceedings and setting for hearing): *Tesoro Refining and Marketing Co. v. Calnev Pipe Line LLC*, 134 FERC ¶ 61,214 (2011)