

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



**FILED**  
07-19-10  
04:59 PM

Application of San Pablo Bay Pipeline  
Company LLC for Approval of Tariffs for the  
San Joaquin Valley Crude Oil Pipeline

A.08-09-024  
(Filed September 30, 2008)

Chevron Products Company,  
Complainant,

vs.

Equilon Enterprises LLC, doing business as  
Shell Oil Products US; and Shell Trading  
(US) Company,

C.08-03-021  
(Filed March 27, 2008)

Defendants.

Tesoro Refining and Marketing Company,  
Complainant,

vs.

Equilon Enterprises, L.L.C., doing business  
as Shell Oil Products (US); Shell Trading  
(US) Company; and San Pablo Bay Pipeline  
Company LLC,

C.09-02-007  
(Filed February 13, 2009)

Defendants.

Valero Marketing and Supply Company,  
Complainant,

vs.

Equilon Enterprises, LLC, doing business as  
Shell Oil Products (US); Shell Trading (US)  
Company; and San Pablo Bay Pipeline  
Company LLC,

C.09-03-027  
(Filed March 23, 2009)

Defendants.

**REPLY BRIEF OF TESORO REFINING AND MARKETING COMPANY**

BARRON DOWLING  
Associate General Counsel  
Tesoro Companies  
300 Concord Plaza Drive  
San Antonio, TX 78216  
Tel: (210) 283-2415  
Email: BDowling@tsocorp.com

DAVID L. HUARD  
TARA S. KAUSHIK  
Manatt, Phelps & Phillips, LLP  
One Embarcadero Center, 30th Floor  
San Francisco, CA 94111  
Telephone: (415) 291-7400  
Facsimile: (415) 291-7474  
Email: DHuard@manatt.com  
Email: TKaushik@manatt.com

*Attorneys for Tesoro Refining and Marketing  
Company*

Dated: July 19, 2010

## TABLE OF CONTENTS

	Page
I. INTRODUCTION .....	1
II. BACKGROUND .....	2
III. SUMMARY OF ARGUMENTS.....	3
A. The Shell Entities.....	3
B. The Independent Shippers .....	4
IV. ARGUMENT.....	5
A. Shell Pipeline Has Utterly Failed To Meet Its Legal And Factual Burden Of Proof For Its Request For Market-Based Rates.....	7
1. As A Matter Of Law, Shell Pipeline Bears The Burden Of Proof As A Utility Applicant.....	7
2. Shell Pipeline Has Previously Conceded That It Bears The Burden Of Proof As To All Issues Related To Its Application.....	8
3. Shell Pipeline Has Failed To Meet Its Burden Of Proof By Clear And Convincing Evidence.....	9
B. This Matter Clearly Affects The Public Interest .....	10
1. California Law And Commission Precedent Recognize That Regulation Of Oil Pipelines Serves The Public Interest.....	10
2. The California Economy Would Suffer Should Refineries Lose Access to SJVH .....	12
C. Shell Pipeline Has Failed To Meet Its Burden By Relying On Critically Flawed Analysis And Unsupported Conclusions .....	13
1. Shell Pipeline Relies Solely On Inapplicable Precedent To Support Its Application .....	14
2. Shell Pipeline's Critical Information Source Is Totally Unreliable .....	14
3. As A Matter Of Law, Shell Pipeline Has Market Power And Is Thus Ineligible For Market-Based Rates.....	20
a. Shell Has Failed To Conduct A Proper HHI Analysis Of Its Market Power .....	21
b. Shell Pipeline Has Failed To Prove That There Are Reasonably Available Supply Alternatives .....	22

**TABLE OF CONTENTS**  
(continued)

	<b>Page</b>
c.    There Are No Available Transportation Alternatives .....	26
4.    The Commission Should Adopt The Reasonable And Well-Supported Cost-Of-Service Rate Proposed By Tesoro.....	29
a.    The Commission Has Held That The Appropriate In-Service Date For Utility Service Is 1996.....	29
b.    Shell Pipeline Fails To Support Its Proposed Rate of Return.....	31
c.    Use of Shell Pipeline's Proposed Capital Structures Results In Unjust And Unreasonable Returns.....	33
d.    Shell Pipeline's Operating Expense Adjustments And Overhead Cost Allocations Are Totally Unsupported.....	34
e.    Shell Pipeline Duplicates Its Charges For Pipeline Losses .....	35
f.    The Rates Calculated By Tesoro Are Just And Reasonable Unlike Shell Pipeline's Cost-Based Rate Proposal .....	36
g.    Throughput And Crude Oil Production Decline.....	38
5.    The Commission Should Order Refunds To Tesoro For Shell Pipeline's Unreasonable Charges .....	41
a.    Tesoro's Analysis of Refunds Owed Should Be Adopted .....	41
b.    Tesoro Should Be Paid Refunds As A Matter Of Law And Equity.....	44
c.    The Rule Against Retroactive Application Of Rates Is Inapplicable With Respect To Refunds.....	46
V.    CONCLUSION AND REQUEST FOR RELIEF .....	49

# TABLE OF AUTHORITIES

Page

## FEDERAL CASES

<i>Cartwright v. Viking Industries, Inc.</i> , 249 F.R.D. (2008).....	45
---	----

## STATE STATUTES

Civ. Code § 1559 .....	44
Evid. Code § 115 .....	8
Evid. Code § 500 .....	8
Evid. Code § 520 .....	8
Pub. Resources Code § 25350(a).....	10
Pub. Util. Code § 451 .....	7, 10, 49
Pub. Util. Code § 453.5 .....	45
Pub. Util. Code § 453(d).....	48
Pub. Util. Code § 701 .....	11
Pub. Util. Code § 728 .....	47
Pub. Util. Code § 734 .....	47, 49
Pub. Util. Code § 735 .....	42

## STATE CASES

<i>Bleecher v. Conte</i> (1981) 29 Cal. 3d 345 .....	45
<i>Fireman's Fund Ins. Co. v. Maryland Caulaty Co.</i> (1998) 65 Cal.App.4th 1279 .....	30
<i>Kaiser Engineers, Inc. v. Grinnell Fire Protection Systems Co.</i> (1985) 173 Cal.App.3d 1050 .....	45
<i>Pacific Telephone and Telegraph Company v. Public Utilities Commission</i> (1965) 62 Cal.2d 634.....	47
<i>People v. Ranscht</i> (2009) 173 Cal.App.4th 1369 .....	30
<i>Southern California Edison Co. v. Public Utilities Commission</i> (1978) 20 Cal.3d 813 .....	47, 48

## CALIFORNIA PUBLIC UTILITIES COMMISSION DECISIONS

D.01-06-085, <i>Order Instituting Rulemaking into the Operation of Interruptible Load Programs Offered by Pacific Gas &amp; Electric Company, San Diego Gas &amp; Electric Company, and Southern California Edison Company and the Effect of These Programs on Energy Prices, Other Demand Responsiveness Programs, and the Reliability of the Electric System</i> , 2001 Cal. PUC LEXIS 593 .....	11
--	----

**TABLE OF AUTHORITIES**

(continued)

**Page**

D.01-07-035, *Order Instituting Rulemaking into the Operation of Interruptible Load Programs Offered by Pacific Gas & Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company and the Effect of These Programs on Energy Prices, Other Demand Responsiveness Programs, and the Reliability of the Electric System*, 2001 Cal. PUC LEXIS 538 ..... 11

D.02-02-051, *Application of Southern California Edison Company (E 3338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs. Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E) Petition of The Utility Reform Network for Modification of Resolution E-3527*, 2002 Cal. PUC LEXIS 170 ..... 45

D.05-07-016, *Application of Pacific Gas and Electric Company to Establish Market Values for and Sell its Richmond-to-Pittsburg Fuel Oil Pipeline*, 2005 Cal. PUC LEXIS 292 ..... 11, 12

D.05-08-039, *Application of Southern California Edison (U 338-E) for Authorization to Recover Costs Recorded in the Catastrophic Events Memorandum Account*, 2005 Cal. PUC LEXIS 561 ..... 7, 8

D.07-01-003, *Joint Application of Southern California Edison Company and San Diego Gas & Electric Company for the 2005 Nuclear Decommissioning Cost Triennial Proceeding to Set Contribution Levels for the Companies' Nuclear Decommissioning Trust Funds and Address Other Related Decommissioning Issues, Application of Pacific Gas and Electric Company in Its 2005 Nuclear Decommissioning Cost Triennial Proceeding*, 2007 Cal. PUC LEXIS 3 ..... 7

D.07-01-027, *Bee Sweet Citrus, Inc., v. Southern California Edison Company (U 338-E)*, 2007 Cal. PUC LEXIS 73 ..... 8

D.07-07-040, *Chevron Products Company, Complainant, vs. Equilon Enterprises LLC, dba Shell Oil Products US, and Shell Trading (US) Company, Defendants*, 2007 Cal. PUC LEXIS 331 ..... 30

D.07-12-021, *Chevron Products Company, Complainant, vs. Equilon Enterprises LLC, dba Shell Oil Products US, and Shell Trading (US) Company, Defendants*, 2007 Cal. PUC LEXIS 631 ..... 29

D.08-01-020, *In the Matter of the Application of Golden State Water Company (U133W) for an Order Authorizing it to Increase Rates for Water Service by \$ 14,926,200 or 15.77% in 2007; by \$ 4,476,000 or 4.31% in 2008; and by \$ 6,909,300 or 6.02% in 2009 in its Region II Service Area.*, 2008 Cal. PUC LEXIS 5 ..... 9, 10

D.09-03-025, *Application of Southern California Edison Company (U338E) for Authority to, Among Other Things, Increase Its Authorized Revenues For Electric Service in 2009, and to Reflect That Increase in Rates and Related Matters*, 2009 Cal. PUC LEXIS 165 ..... 7

D.10-01-024, *Order Instituting Rulemaking Adopting Rules to Account for the Consideration Allocated to California Core Natural Gas Ratepayers Under Settlements of Natural Gas Antitrust Cases I-IV*, 2010 Cal. PUC LEXIS 9 ..... 46

## TABLE OF AUTHORITIES

(continued)

Page

D.94-03-040, <i>Application of Pacific Gas And Electric Company for authority to Adjust its Electric Rates Effective November 1, 1991; and to Adjust its Gas Rates Effective January 1, 1992; and for Commission Order Finding that PG&amp;E's Gas and Electric Operations During the Reasonableness Review Period from January 1, 1990 to December 31, 1990 were Prudent</i> , 1994 Cal. PUC LEXIS 159 .....	45
D.94-04-088, <i>Order Instituting Rulemaking into Natural Gas Procurement and System Reliability Issues; And Related Matters</i> , 1994 Cal. PUC LEXIS 347 .....	46
D.94-05-022, <i>The City of Long Beach in its Proprietary Capacity and as Trustee for the State of California, Complainant, vs. Unocal California Pipeline Company, a Unocal Company, Defendant</i> , 1994 Cal. PUC Lexis 380 .....	14, 22
D.96-04-056, <i>Application of Pacific Pipeline System, Inc., for Authorization to Issue 1,000 Shares of \$ 0.01 Par Value Capital Stock, To Incur Indebtedness and For Approval of Rates and Conditions of Service</i> , 1996 Cal. PUC Lexis 285 .....	14
D.98-10-023, <i>Ortega v. AT&amp;T Communications of California, Inc.</i> , 1998 Cal. PUC LEXIS 673 .....	48
D.99-12-022, <i>Independent Energy Producers Association, California Manufacturers Association, Toward Utility Rate Normalization, Complainants, vs. Pacific Gas and Electric Company, Defendant</i> .....	48

## OTHER AUTHORITIES

American Bar Association Of Antitrust Law, <i>Energy Antitrust Handbook</i> (2009) .....	10
Chambers Group, Inc., <i>Finalizing Addendum to the Draft Environmental Impact Report for the Chevron Richmond Long Wharf Marine Terminal Lease Consideration</i> (February 2007) .....	12, 13
Garfield and Lovejoy, <i>Public Utility Economics</i> (1964).....	10

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Application of San Pablo Bay Pipeline  
Company LLC for Approval of Tariffs for  
the San Joaquin Valley Crude Oil Pipeline

A.08-09-024  
(Filed September 30, 2008)

Chevron Products Company,  
Complainant,

vs.

Equilon Enterprises LLC, doing business  
as Shell Oil Products US; and Shell  
Trading (US) Company,

C.08-03-021  
(Filed March 27, 2008)

Defendants.

Tesoro Refining and Marketing Company,  
Complainant,

vs.

Equilon Enterprises, L.L.C., doing business  
as Shell Oil Products (US); Shell Trading  
(US) Company; and San Pablo Bay  
Pipeline Company LLC,

C.09-02-007  
(Filed February 13, 2009)

Defendants.

Valero Marketing and Supply Company,  
Complainant,

vs.

Equilon Enterprises, LLC, doing business  
as Shell Oil Products (US); Shell Trading  
(US) Company; and San Pablo Bay  
Pipeline Company LLC,

C.09-03-027  
(Filed March 23, 2009)

Defendants.

**REPLY BRIEF OF TESORO REFINING AND MARKETING COMPANY**

**I. INTRODUCTION**

Pursuant to Rule 13.11 of the Commission's Rules of Practice and Procedure, the Scoping Memo and Ruling of Assigned Commissioner (John Bohn) issued on April 27, 2009, and the direction of Presiding Administrative Law Judge ("ALJ") Karl Bemederfer at the close

of hearings,<sup>1</sup> Tesoro Refining and Marketing Company (“Tesoro”) respectfully submits the following Reply Brief.

This brief addresses all issues not otherwise addressed in a Joint Independent Shippers' Reply Brief which has been submitted concurrently with this brief and which is herein adopted and incorporated by reference.

## **II. BACKGROUND**

As noted in the Opening Briefs of Tesoro, Chevron Products Company (“Chevron”), and Valero Marketing and Supply Company (“Valero”) (collectively, “Independent Shippers”), this proceeding concerns the application of a regulated, heated crude oil pipeline,<sup>2</sup> Shell Pipeline, which is owned and operated by two Royal Dutch Shell entities.<sup>3</sup> The application proposes to transfer ownership by Shell Pipeline of part of the SJV Pipeline assets to an inactive subsidiary, San Pablo Bay Pipeline Company, LLC (“San Pablo Bay”), retain certain assets as “proprietary” for use of a trading affiliate (Shell Trading (US) Company, “STUSCO”) and other affiliates, establish initial rates in the form of market-based rates, and establish a first tariff with rules and regulations for system operations. This matter is also consolidated with several complaints for refunds as to excessive charges for service provided by Shell Pipeline since 2005 until the date this Commission establishes just and reasonable rates.<sup>4</sup>

Tesoro has provided a full and detailed discussion of the background and procedural history of this matter in its Opening Brief, which is incorporated herein. Notably, a Joint Independent Shippers' Reply Brief has been filed herewith on behalf of Tesoro, Chevron Products Company (“Chevron”), and Valero Marketing and Supply Company (“Valero”). The Joint Independent Shippers' Reply Brief is directed exclusively to the form of an appropriate

---

<sup>1</sup> Reporter's Transcript (“RT”) 1504:10-22 (ALJ Bemserderfer).

<sup>2</sup> The pipeline itself that extends from the San Joaquin Valley to the San Francisco Bay Area is referred to herein as the “SJV Pipeline.” The pipeline company is referred to for ease of reference as “Shell Pipeline.”

<sup>3</sup> For ease of reference, the generic term “Shell” is used throughout herein to refer to multiple Shell entities, or where there is confusion about which of the numerous Shell entities may be most accurately referenced.

<sup>4</sup> See *Opening Brief of Tesoro Refining and Marketing Company*, filed June 21, 2010 (“Tesoro Opening Brief”), pp. 2-6.

tariff for the San Pablo Bay system and how the pipeline assets and operations are managed within the context of the tariff.

### III. SUMMARY OF ARGUMENTS

#### A. The Shell Entities

Throughout this proceeding, Shell Pipeline and its affiliate, STUSCO, have demonstrated an *utter disregard for regulation* by this Commission and its previous orders in its false belief that there is no public interest in regulation of crude oil pipelines. In effect, Shell Pipeline has attempted to create its own alternate reality where it is free to exercise its market power and operate on its own terms, without any regard for the regulation of this Commission or the input of its ratepayers, through a Shell-designed form of “light-handed” regulation.

Shell Pipeline and its affiliate have dismissively delayed this application proceeding with numerous extensions since 2007. In this application, Shell Pipeline has turned the concept of utility regulation on its head, as it requests market-based rates that are designed to recover from its ratepayers the *maximum* each can absorb before they are forced to elect an alternative form of service or shut down their operations. This is hardly the regulatory standard or basis for the establishment of any rate for service by a public utility or common carrier—in fact, it is an outline for how to perfect the benefits of market power.

The record evidence conclusively shows that Shell Pipeline possesses and has exercised this market power, as it has more than doubled its rates in the last five years, has failed to provide any interim tariff for service, has resisted this Commission’s previous orders to file a tariff since 2007, has filed an unusual application for “market-based” rates instead of the expected cost-of-service rate filing, and proposed a tariff that aims to preserve affiliate preferences and pipeline “discretion” over reliable and useful utility services to its customers. Indeed, Shell Pipeline has failed to adopt or even refer to a code of conduct as to its transactions and communications with its marketing affiliate.

As a matter of law, Shell Pipeline bears the *full* burden of proof by clear and convincing evidence to support its application for market-based rates, but Shell Pipeline has provided no

more than a threadbare, unsupported application that proposes to effectively maintain the *status quo* without any regulation—*i.e.*, an application that includes discriminatory terms of service, significantly higher rates, and denial of access to numerous utility assets regularly and historically used for pipeline services. Indeed, Shell Pipeline’s case is riddled with errors and manipulated data used to drive up the rates to be charged, presumably for maximum profits or possible sale of the pipeline.

In effect, Shell Pipeline has created its own reality where its rates and terms of service appear reasonable to no one other than itself and its affiliate. In this regard, Shell Pipeline is dismissive of its burden of proof or support of its ratepayers. It is opposed aggressively by all of its unaffiliated customers and parties in this proceeding, and as stated more fully herein, Shell Pipeline bases its case on erroneous assumptions, mischaracterizations of facts, blatant manipulation of data, and unsupported misinterpretations of Commission policy.

Shell Pipeline has thus presented a case that rests on bald assertions, self-serving and speculative data, and misrepresentations of industry practice that have no grounding in the facts of this case or applicable law. Indeed, Shell Pipeline can point to no Commission precedent that supports the request of a vertically-integrated crude oil pipeline, which provides the *only* means of crude oil transportation to refineries in the Bay Area, to charge market-based rates. Further, Shell’s marketing and trading arm, STUSCO, filed no evidence whatsoever to support its various claims.

**B. The Independent Shippers**

In contrast, the Independent Shippers have provided the only detailed studies and analyses by experts in the industry on which the Commission can rely to make its decision in this matter. Shell Pipeline’s demand for market-based rates and draconian tariff provisions remains unsupported, without any studies, analyses, or formal evaluations to show that its rate request and proposed terms of service are just and reasonable. However, the Independent Shippers have provided detailed cost-of service analyses, market power analyses, extensive crude oil market

information, a tariff with equal treatment of all shippers and the pipeline, and an entire panel of witnesses who have presented this new tariff.

In addition, the Independent Shippers have provided the Commission with precedent, regulatory policies, and law to support their position. The law, as cited by the Independent Shippers, makes clear that a pipeline with market power cannot and should not be permitted to charge market-based rates. Commission cited policy also makes clear that a utility pipeline must provide fair and equal access to its assets used for transportation to *all* shippers.

Further, the cited authority makes clear that Tesoro is owed refunds for past unreasonable charges since 2005, as Shell Pipeline was determined to be providing utility service. For the first time, Shell and its entities assert in their opening briefs that refunds are prohibited by the rule against retroactive ratemaking. As with most of Shell's assertions, this claim eclipses reality. A close reading of the law reveals that the Commission is authorized to order refunds to Tesoro, as there are no previously established and approved rates for Shell Pipeline that would retroactively change as a result.

For these reasons, Shell Pipeline's application for market-based rates should be denied as a matter of law. In addition, in light of the very serious concerns of market power which would have a devastating impact on ratepayers and the public, it is essential that this Commission adopt the cost-based rates proposed by Tesoro, adopt without modification the Joint Tariff (addressed concurrently in the Joint Independent Shippers' Reply Brief), and order Shell Pipeline to pay refunds to Tesoro for excessive charges imposed from April 2005 to the present.

#### **IV. ARGUMENT**

Consistent with Shell Pipeline's continued resistance to this Commission's regulation, the Opening Brief of Shell Pipeline is no more than a crude attempt to disguise its effort to provide its affiliate with a major competitive advantage over the other independent refiners and marketers connected to the pipeline. In a manner completely inconsistent with the evidence and the law, Shell Pipeline's Opening Brief contains outlandish assertions, which most notably include:

- Shell Pipeline concedes that it bears the burden of proof as to market power, competitive alternatives, and market-based rates,<sup>5</sup> but then asserts that the Independent Shippers have “failed to meet their burden” to prove that “San Pablo Bay is a monopoly provider of utility services” whose rates must be set on a cost-of-service basis,<sup>6</sup> which is inconsistent with Shell Pipeline’s own position and contrary to the law of this case as confirmed by the Presiding ALJ in this matter.<sup>7</sup>
- Shell Pipeline states that its application for market-based rates is not an effort to free itself from Commission regulation,<sup>8</sup> but then proposes, for example, that its rate for delivering San Joaquin Valley Heavy Blend (“SJVB”) and San Joaquin Valley Light (“SJVL”) crude oil would reflect “a market-based discount for shipping less viscous crude oil”.<sup>9</sup> Given that STUSCO is the *only* shipper that receives SJVL,<sup>10</sup> the proposed “discount” would maintain a competitive advantage for the pipeline’s affiliate—which is contrary to the very concept of regulation.
- Shell Pipeline relies on a throughput forecast with an alarming 14% decline rate of SJVH crude supply,<sup>11</sup> but its own witnesses have stated that it is not yet necessary for Shell Pipeline to conduct studies to address this issue, as the decline does not yet pose a problem.<sup>12</sup>
- Shell Pipeline insists that the Independent Shippers have crude oil supply and transportation alternatives,<sup>13</sup> when cross-examination revealed that such alternatives are not available, economic, and reasonable as required by law.<sup>14</sup>
- Shell Pipeline asserts that the “market adjustment” referenced in the buy/sell agreements is just a transportation adder that should be included in the competitive rate for transportation,<sup>15</sup> when its own witness reluctantly conceded in cross-examination that the adjustment is a modification to the price at which crude oil is posted to be purchased and that at which it is actually sold.<sup>16</sup>

---

<sup>5</sup> *Concurrent Opening Brief of San Pablo Bay Pipeline Company LLC [Public Version]*, filed June 21, 2010 (“San Pablo Bay Opening Brief”), p. 2.

<sup>6</sup> San Pablo Bay Opening Brief, p. 5.

<sup>7</sup> *Administrative Law Judge’s Ruling Denying Defendants’ Motion to Reject Response to Answers and Defendants’ Motion to Dismiss Complaint*, filed May 27, 2009 in C.09-02-007, p. 3.

<sup>8</sup> San Pablo Bay Opening Brief, p. 11.

<sup>9</sup> San Pablo Bay Opening Brief, p. 12.

<sup>10</sup> *See, e.g., Opening Brief of Shell Trading (US) Company*, filed June 21, 2010 (“STUSCO Opening Brief”), pp. 9 – 10.

<sup>11</sup> San Pablo Bay Opening Brief, p. 51.

<sup>12</sup> Tesoro Opening Brief, p. 39.

<sup>13</sup> San Pablo Bay Opening Brief, pp. 20 – 33.

<sup>14</sup> Tesoro Opening Brief, pp. 20-27.

<sup>15</sup> San Pablo Bay Opening Brief, pp. 38 – 46.

<sup>16</sup> Tesoro Opening Brief pp. 29 – 30.

The list of all inaccuracies is alarmingly long, and demonstrates that Shell Pipeline has no intention whatsoever to allow regulation of its SJV Pipeline to get in the way of its discriminatory and predatory business practices.

**A. Shell Pipeline Has Utterly Failed To Meet Its Legal And Factual Burden Of Proof For Its Request For Market-Based Rates.**

**1. As A Matter Of Law, Shell Pipeline Bears The Burden Of Proof As A Utility Applicant.**

California statutory law requires that the applicant bears the burden of proof concerning its request for relief—in this matter, an extraordinary request for market-based rates in advance of ever having established a cost-of-service rate. Public Utilities Code Section 451 requires that all “charges demanded or received by any public utility” for a product, commodity or service rendered “shall be just and reasonable.” Section 451 further states that every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.

In addition, Commission precedent has long established that a utility applicant in a rate case has the burden of proof to show that its rates are just and reasonable.<sup>17</sup> In similar rate cases involving utilities in the electric industry, the Commission has emphasized that utilities bear the burden to justify their rate requests.<sup>18</sup>

The Commission has thus recognized the importance of placing the burden of proof on utilities in this regard. Indeed, the Commission has further stated:

There is a natural litigation advantage enjoyed by utilities, and the fact that we must rely in significant part on their experts, reinforces

---

<sup>17</sup> See, e.g., D.09-03-025, *Application of Southern California Edison Company (U338E) for Authority to, Among Other Things, Increase Its Authorized Revenues For Electric Service in 2009, and to Reflect That Increase in Rates and Related Matters*, 2009 Cal. PUC LEXIS 165, \*\*11-12 (recognizing that the burden of proof is “placed on the applicant in rate cases”); D.07-01-003, *Joint Application of Southern California Edison Company and San Diego Gas & Electric Company for the 2005 Nuclear Decommissioning Cost Triennial Proceeding to Set Contribution Levels for the Companies' Nuclear Decommissioning Trust Funds and Address Other Related Decommissioning Issues, Application of Pacific Gas and Electric Company in Its 2005 Nuclear Decommissioning Cost Triennial Proceeding*, 2007 Cal. PUC LEXIS 3, \*9 (“The applicants alone bear the burden of proof to show that the rates they request are just and reasonable and the related ratemaking mechanisms are fair.”).

<sup>18</sup> Emphasis added. D.05-08-039, *Application of Southern California Edison (U 338-E) for Authorization to Recover Costs Recorded in the Catastrophic Events Memorandum Account*, 2005 Cal. PUC LEXIS 561 (“D.05-08-039, 2005 Cal. PUC LEXIS 561”), \*7.

*the importance of placing the burden of proof in ratemaking applications on the applicant utilities.* [The utility] has the sole obligation to provide a convincing and sufficient showing to meet the burden of proof, and *any active participation of other parties can never change that obligation.*<sup>19</sup>

Thus, Commission policy recognizes that utilities, not other active parties, have access to information that would support their requests for rates and are thus required to bear the burden of proof.

Notably, the Commission has also recognized that the laws of evidence generally require that an applicant should bear the burden of proof as to its entire request for relief in a proceeding. The Commission has specifically stated:

Except as otherwise provided by law, *a party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he is asserting.* (Evid. Code, § 500.) To prevail, the party bearing the burden of proof on the issue must present evidence sufficient to establish in the mind of the trier of fact or the court a requisite degree of belief (commonly proof by a preponderance of the evidence). (Evid. Code §§ 115, 520.) The burden of proof does not shift during trial—it remains with the party who originally bears it.<sup>20</sup>

Undoubtedly, this statement confirms that it is the utility applicant that must prove that its rates are just and reasonable, which necessarily requires Shell Pipeline to show whether its customers, including Tesoro, have available supply alternatives to SJVH crude and transportation alternatives to the SJV Pipeline as part of Shell Pipeline's statutory and unshifting burden to justify Commission approval of market-based rates.

**2. Shell Pipeline Has Previously Conceded That It Bears The Burden Of Proof As To All Issues Related To Its Application.**

As Shell Pipeline has conceded in its Opening Brief and in previous statements to this Commission, Shell Pipeline has, at all times and for all issues, the burden of proof to support its unusual request for market-based rates.<sup>21</sup> However, Shell Pipeline attempts *for the first time* in

<sup>19</sup> Emphasis added. D.05-08-039, 2005 Cal. PUC LEXIS 561, at \*6.

<sup>20</sup> Emphasis added. D.07-01-027, *Bee Sweet Citrus, Inc., v. Southern California Edison Company (U 338-E)*, 2007 Cal. PUC LEXIS 73, \*\*13-14.

<sup>21</sup> San Pablo Bay Opening Brief, p. 5.

its Opening Brief to limit its burden by claiming that “the complainant shippers have failed to meet their burden of proving” that Shell Pipeline is a monopoly provider of utility services whose rates are unreasonable and should be based on a cost-of-service analysis.<sup>22</sup> Shell Pipeline further fails to argue or demonstrate that the burden of proof has shifted on any matter as a result of any legal theory or evidentiary showing. Not only is its unsupported conclusion wrong as a matter of law, but *Shell Pipeline previously conceded that it has the full burden of proof as to every issue* related to market-based rates in this case. Indeed, in its Response to Tesoro’s Motion For Reconsideration filed on March 10, 2010, Shell Pipeline has expressly stated:

San Pablo Bay does not dispute that it bears the burden of proving that its proposed rates are just and reasonable. San Pablo Bay further recognizes that it bears the burden of proving specific elements of its showing in support of the reasonableness of its rates, *including whether its customers, such as Tesoro, have economically reasonable alternatives to use of SJVH crude oil transported on the SJV Pipeline.*<sup>23</sup>

As Shell Pipeline has precisely stated, it bears the burden of proof as to *all* issues related to its application, including the issue of market power. Accordingly, Shell Pipeline cannot reverse its position for the first time at this late stage after hearings and discovery have been conducted. Conclusively, the record evidence in this matter shows that Shell and its affiliates have failed to meet this burden of proof.

### **3. Shell Pipeline Has Failed To Meet Its Burden Of Proof By Clear And Convincing Evidence.**

With regard to a utility applicant’s request for approval of rates, the Commission has expressly stated, “It is a fundamental principle of public utility regulation that the burden rests heavily upon a utility to prove it is entitled to rate relief and *not* upon the commission, its staff or any interested party . . . to prove the contrary.”<sup>24</sup> Thus, Shell Pipeline has the burden of proving

---

<sup>22</sup> San Pablo Bay Opening Brief, p. 5.

<sup>23</sup> Emphasis added. *Response of San Pablo Bay Pipeline Company LLC to Tesoro’s Motion for Reconsideration*, filed March 10, 2010, p. 2.

<sup>24</sup> Emphasis added. D.08-01-020, *In the Matter of the Application of Golden State Water Company (U133W) for an Order Authorizing it to Increase Rates for Water Service by \$ 14,926,200 or 15.77% in 2007; by \$ 4,476,000 or 4.31% in 2008; and by \$ 6,909,300 or 6.02% in 2009 in its Region II Service Area.*, 2008 Cal. PUC LEXIS 5 at \*2.

by “clear and convincing evidence” that its proposed rates are “just and reasonable.”<sup>25</sup> Shell Pipeline has utterly failed to meet that burden as discussed in the opening and reply briefs of *all* unaffiliated shippers on the pipeline system. Whether analyzed on a cost-of-service or “market” basis, Shell Pipeline’s proposed rates are patently unreasonable, providing an excessive return on investment, and rewarding Shell Pipeline for its years of evading and fighting against Commission regulation.

**B. This Matter Clearly Affects The Public Interest**

In its reckless disregard of the impact this matter would have upon the public interest, Shell Pipeline argues that this matter is just a question as to who will capture market revenues among all sectors: the pipeline, the refiners, or the producers.<sup>26</sup> This position clearly ignores the very purpose of public utility regulation—*i.e.*, to ensure that a monopolist does not exercise its market power and to assure that the public interest is served, as opposed to seeking merely to enhance regulated returns.<sup>27</sup> Indeed, it is well-recognized that the intent of regulation is to achieve the results of competition by means of reasonable prices and adequate service quality.<sup>28</sup>

**1. California Law And Commission Precedent Recognize That Regulation Of Oil Pipelines Serves The Public Interest.**

Contrary to Shell’s “pie-eating contest” scenario, California statutory law recognizes the importance of the oil industry to the public interest and economy. For instance, Public Resources Code section 25350(a) expressly states that the California Legislature has found that the “petroleum industry is an essential element of the California economy and is therefore of vital importance to the health and welfare of all Californians.” This essential industry includes the refineries of Tesoro and Valero, as well as the production facilities of Chevron and the SJV

---

<sup>25</sup> *Id.*; Pub. Util. Code § 451.

<sup>26</sup> RT 41 (Webb/San Pablo Bay).

<sup>27</sup> *See, e.g.*, American Bar Association Section Of Antitrust Law, Energy Antitrust Handbook (2009) p. 21, which states, “Price controls are necessary to ensure that the monopolist does not exercise its market power to disadvantage consumers, and supervision of investment and operating decisions is likewise necessary to assure that those decisions are consistent with the public interest, as opposed to seeking merely to enhance regulated returns.”

<sup>28</sup> *See, e.g.*, Garfield and Lovejoy, Public Utility Economics (1964) p. 1.

Pipeline or Shell Pipeline itself. As a matter of law, Shell Pipeline's application affects the public interest.

Moreover, this Commission considers and applies the public interest in discharging its statutory duties and responsibilities. Indeed, the Commission's mission statement succinctly articulates this fundamental consideration: "The California Public Utilities Commission serves the public interest by protecting consumers and ensuring the provision of safe, reliable utility service and infrastructure at reasonable rates, with a commitment to environmental enhancement and a healthy California economy."<sup>29</sup> In addition, California Public Utilities Code section 701 grants the Commission plenary power to do "all things" which are necessary and convenient to supervise and regulate every public utility in the State, including Shell Pipeline.

This Commission has recognized that refineries are essential facilities critical to the public interest.<sup>30</sup> In addition, the Commission has expressly considered the public interest in oil pipeline cases.<sup>31</sup> As part of its analysis to regulate oil pipelines, the Commission has to determine how the utility might best "serve[] the public interest by protecting consumers and ensuring the provision of safe, reliable utility service and infrastructure at reasonable rates, with a commitment to environmental enhancement and a healthy California economy."<sup>32</sup>

---

<sup>29</sup> See "California Public Utilities Commission: CPUC Mission," available at <http://www.cpuc.ca.gov/PUC/aboutus/pucmission.htm> (last visited June 21, 2010) (emphasis added).

<sup>30</sup> See, e.g., D.01-06-085, *Order Instituting Rulemaking into the Operation of Interruptible Load Programs Offered by Pacific Gas & Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company and the Effect of These Programs on Energy Prices, Other Demand Responsiveness Programs, and the Reliability of the Electric System*, 2001 Cal. PUC LEXIS 593, \*7 (stating that petroleum refineries should receive exemptions during the energy crisis for curtailments of electricity as "transportation fuels are critical to public health and safety . . ."); see also, D.01-07-035, *Order Instituting Rulemaking into the Operation of Interruptible Load Programs Offered by Pacific Gas & Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company and the Effect of These Programs on Energy Prices, Other Demand Responsiveness Programs, and the Reliability of the Electric System*, 2001 Cal. PUC LEXIS 538, \*4 (noting that the California Energy Commission recommended that the Commission exempt all fossil fuel infrastructure and ancillary services, including refineries, from electricity curtailment).

<sup>31</sup> In D.05-07-016, *Application of Pacific Gas and Electric Company to Establish Market Values for and Sell its Richmond-to-Pittsburg Fuel Oil Pipeline*, 2005 Cal. PUC LEXIS 292, \*\*26-28, the Commission evaluated a number of factors and ultimately "conclude[d] that approving these consolidated applications is in the public interest."

<sup>32</sup> Homepage of the California Public Utilities Commission ("CPUC"), available at <http://www.cpuc.ca.gov/puc/> (last visited on July 14, 2010.)

Contrary to Shell Pipeline's pattern of relying on unsupported conclusions, and then treating its own statements as fact, there is a significant public interest in this matter, as Shell Pipeline has the ability to exercise market power to the detriment of its ratepayers and the public. The importance of SJVH to the State of California and the refineries located in the San Francisco Bay Area remains undisputed. California crude oil production remains a vital component of the state's supply, accounting for 37% of total refinery receipts in 2005.<sup>33</sup>

Refineries in California have been constructed or modified to deal with the physical characteristics of crudes such as SJVH. In the case of existing and anticipated California production, that means heavy, sour crude (i.e., SJVH) which is concentrated in the San Joaquin Valley, Kern County.<sup>34</sup> Thus, the continued supply of SJVH remains vital to the survival of refineries in the Bay Area, as SJVH is a unique crude oil that has no reasonable substitutes.<sup>35</sup>

Indeed, the record evidence shows that the costs of foreign crude supply or transportation alternatives to the SJV Pipeline would be prohibitive, if even possible, and that increased use of trucking, marine shipments, and rail would significantly impact the environment.<sup>36</sup> Inevitably, a sudden interruption of SJVH supply would greatly increase costs to refineries, which would result in significant cost increases to refined products—a particularly intolerable result to the public in the current economic recession.

## **2. The California Economy Would Suffer Should Refineries Lose Access to SJVH.**

The health of California's economy is an additional public interest consideration that particularly resonates in these difficult times. With the state facing continuous budget shortfalls

---

<sup>33</sup> See Valero Exh. 8, Rebuttal Testimony of Daniel WM. Fessler for Valero Marketing and Supply Company, dated April 16, 2010 ("Fessler Rebuttal"), attached Exhibit B, Sheridan, California Crude Oil Production and Imports (April 2006).

<sup>34</sup> *Id.* at 5.

<sup>35</sup> See, e.g., Valero Exh. 5, Direct Testimony of Lauren K. Bird on Behalf of Valero Marketing and Supply Company, dated November 16, 2009 ("Bird Direct"), p. 15; Valero Exh. 6, Prepared Testimony of Kevin M. Lassahn for Valero Marketing and Supply Company, dated April 16, 2010 ("Lassahn Direct"), p. 5:18 – 6:10.

<sup>36</sup> See, e.g., Chambers Group, Inc., Finalizing Addendum to the Draft Environmental Impact Report for the Chevron Richmond Long Wharf Marine Terminal Lease Consideration (February 2007), Section 4.1, available at [http://www.slc.ca.gov/Division\\_Pages/DEPM/DEPM\\_Programs\\_and\\_Reports/Chevron%20Long%20Wharf/Chevron\\_Final.html](http://www.slc.ca.gov/Division_Pages/DEPM/DEPM_Programs_and_Reports/Chevron%20Long%20Wharf/Chevron_Final.html) (last visited on July 14, 2010) ("Chevron Draft EIR").

and an unemployment rate hovering around 12%, every effort should be made to preserve California jobs and tax revenue. Shell Pipeline plays a significant role in California's economy—not only is it the *only* pipeline able to transport a unique domestic crude oil to Bay Area refineries, but it also employs innumerable Californians directly and indirectly involved in the extracting, processing, refining, and marketing fields.<sup>37</sup>

Moreover, SJVH is a unique crude oil found only in California. The use of alternative crude oils found elsewhere in the world, in lieu of SJVH, would handicap refining operations. Moreover, it is in the public interest to reduce California's dependence on foreign "[c]rude oil imported from countries with volatile political and social structures [that] leaves California vulnerable to changing world events."<sup>38</sup>

In light of these considerations, it would hardly be wise for the Commission to approve an application that would severely impact Shell Pipeline's ratepayers, and thereby greatly increase the risk of further economic havoc to the public.

C. **Shell Pipeline Has Failed To Meet Its Burden By Relying On Critically Flawed Analysis And Unsupported Conclusions.**

As Shell Pipeline fully bears the burden of proof in this matter, and has no apparent regard for the public interest, this Commission must evaluate the instant application with close attention to the market power that Shell Pipeline and its affiliated entities possess. Their collective failure to show by clear and convincing evidence that the application for market-based rates is just and reasonable requires the rejection of the request for market-based rates and Shell Pipeline's proposed tariff (as detailed in Tesoro's Opening Brief).

---

<sup>37</sup> The California Energy Commission ("CEC") paper commences its discussion of California crude oil production by noting that: "The discovery of oil in Kern County in the late 19th century heralded a long history of oil production in California." Valero Exh. 8, Fessler Rebuttal, attached Exhibit B, p. 3. Moving forward to 2004, the CEC paper reports that 77% of California's onshore crude production originates in Kern County. In terms of the State's overall oil production, Kern County contributes 69%. The vital significance of the San Pablo Bay Pipeline is revealed by the fact that 58% of this production is SJVH. Id. at 5.

<sup>38</sup> Valero Exh. 8, Fessler Rebuttal, attached Exhibit B, p. 8.

**1. Shell Pipeline Relies Solely On Inapplicable Precedent To Support Its Application.**

In its Opening Brief, Shell Pipeline continues to singularly rely incorrectly on the *UNOCAP* and *Pacific Pipeline* decisions to support its request for market-based rates.<sup>39</sup> Indeed, the Shell Pipeline and STUSCO briefs are noteworthy in their failure to provide references to any legal or policy support for their positions. Further, the cited decisions do not support Shell Pipeline's request for market-based rates. In particular, the *UNOCAP* decisions do not apply where crude oil refineries are impacted. In D.96-04-061 (*UNOCAP III*), the Commission expressly limited its decision to oil producers and pipeline companies, unlike this case where refineries with no production or pipeline ownership are also involved. Shell Pipeline fails in its Opening Brief to address this important distinction.

In addition, neither the *Pacific Pipeline* nor the *UNOCAP* decisions involved a vertically-integrated pipeline system with the risk of affiliate preferences in the context of anticompetitive conduct. Moreover, these decisions concerned entirely different geographic markets and an outdated time period, which have no bearing on whether Shell Pipeline could exercise market power in *this* market at this time.<sup>40</sup> Thus, the Commission has no recourse than to use the DOJ Merger Guidelines and applicable HHI analysis provided by Chevron and Tesoro. This methodology has been used by this Commission previously and by the Federal Energy Regulatory Commission ("FERC"), but Shell Pipeline fails to provide a case that follows the DOJ Merger Guidelines, unlike the testimony and evidence presented by Tesoro and Chevron.

**2. Shell Pipeline's Critical Information Source Is Totally Unreliable.**

Not only is the limited precedent on which Shell Pipeline relies inapplicable in this case, but also the critical information source of its case is just not credible. The evidence and

---

<sup>39</sup> See San Pablo Bay Opening Brief, *passim*.

<sup>40</sup> D.96-04-056, *Application of Pacific Pipeline System, Inc., for Authorization to Issue 1,000 Shares of \$ 0.01 Par Value Capital Stock, To Incur Indebtedness and For Approval of Rates and Conditions of Service*, 1996 Cal. PUC Lexis 285 ("D.96-04-056, 1996 Cal. PUC Lexis 285"), \*\*81-84; D.94-05-022, *The City of Long Beach in its Proprietary Capacity and as Trustee for the State of California, Complainant, vs. Unocal California Pipeline Company, a Unocal Company, Defendant*, 1994 Cal. PUC Lexis 380 ("D.94-05-022, 1994 Cal. PUC Lexis 380"), \*\*42-46.

testimony in this proceeding conclusively shows that Shell Pipeline's entire case rests on inaccurate, speculative and misleading testimony.

As a prime example, Mr. LaBorne has testified as to nearly every issue in this case in some fashion, despite having no depth of knowledge or expertise on any of the subject matters on which he has opined. Mr. LaBorne addresses, and is the sole source, for eighteen (18) critical and different areas in Shell Pipeline's case on the crude oil market and price forecasts, throughput forecasts, market-based rates, buy/sell agreements, the competitive price threshold for market power analysis, the importance of transportation costs to crude oil producers, the cost of oil production in the San Joaquin Valley, rate comparisons to other pipelines, line fill, truck and rail alternatives for the Independent Shippers, pipeline alternatives for the Independent Shippers, Chevron oil production economics, differential charges for heavy crude oil, refund claims, tariff issues, the 2005 arbitration (in which he did not participate), Shell Pipeline's significant price increases for transportation of crude oil, and settlement negotiations that occurred in the course of this proceeding.<sup>41</sup>

Cross-examination of Mr. LaBorne at hearings indisputably revealed that he has no expertise or expert knowledge in any of the eighteen (18) subject matters upon which he has testified. He is not an attorney despite his repeated references to "the law", this Commission's orders, the 2005 arbitration, the refund claims at issue, or his creative legal interpretations of the buy/sell agreements at issue.<sup>42</sup> He is not an antitrust lawyer or market power analysis expert to opine on complex issues such as the competitive price threshold, market power analysis, or available alternatives for crude oil supply and transportation.

Mr. LaBorne is not a refinery engineer and has not been a crude oil trader for over a decade. Despite this, he attempts to opine on the crude oil market, crude oil prices,

---

<sup>41</sup> See generally, SP Exh. 21, Direct Testimony of Kevin E. LaBorne on Behalf of San Pablo Bay Pipeline Company LLC, dated September 30, 2008 ("LaBorne Direct"); SP Exh. 23, Rebuttal Testimony of Kevin E. LaBorne on Behalf of San Pablo Bay Pipeline Company LLC, Public Version, dated February 8, 2010 ("LaBorne Rebuttal"); RT 624-818, 862-903 (LaBorne/San Pablo Bay).

<sup>42</sup> See, e.g., Chevron Exh. 25, Kevin LaBorne CV. Indeed, perhaps if he were an attorney he would have found it imprudent to comment publicly—and inaccurately—at hearings on confidential settlement communications.

transportation charges, pipeline operations, tariff provisions, and the intricate negotiations of buy/sell agreements. Shell's statement in its Opening Brief that Mr. LaBorne "has years of experience in dealing with the California crude oil market"<sup>43</sup> is a stretch at best. Indeed, his most recent alleged experience as a crude trader is limited to two years in 1996-97, and is thus outdated under the most charitable interpretation.<sup>44</sup>

Mr. LaBorne is not an economist, which renders questionable his opinions on crude oil production economics, throughput forecasts, crude oil price forecasts, and the importance of transportation costs to crude oil producers. Indeed, his testimony as to the myriad of complex issues underscores his lack of credibility as a witness—and Shell Pipeline's failure to prove its case primarily hinges on his unreliable testimony.

In this regard, the evidence also shows that all of the witnesses critical to Shell Pipeline's case rely on Mr. LaBorne to reach their conclusions. Notably, Dr. Webb, Shell Pipeline's only witness on market power and market-based rates, relies on facts provided by other witnesses, particularly Mr. LaBorne, without any expert opinion or studies or analyses of his own.<sup>45</sup> Similarly, Mr. Hackett—Shell's critical witness on market alternatives for the Independent Shippers—testified on cross-examination that he relied on Mr. LaBorne for crude oil price information with respect to supply alternatives.<sup>46</sup>

Even Shell Pipeline's witnesses concerning rate design relied on Mr. LaBorne's speculative opinions to reach their conclusions. For instance, Mr. Rathermel relied on Mr. LaBorne's opinions on projected crude oil prices, Pipeline Loss Allowance ("PLA"), and

---

<sup>43</sup> San Pablo Bay Opening Brief, p. 61.

<sup>44</sup> RT 111 (Webb/San Pablo Bay); *see also*, Chevron Exh. 25, Kevin LaBorne CV, RT 625 (LaBorne/San Pablo Bay).

<sup>45</sup> *See, e.g.*, RT 230 – 236 (Webb/San Pablo Bay), where cross examination of Dr. Webb reveals that his testimony on market power takes a position that is contrary to accepted theories as confirmed in Tesoro Exh. 1, Market Power in California's Gasoline Market (which dispels the notion that imports of gasoline constitute marginal supply in California) and Tesoro Exh. 2, Correlation, Causality, and All that Jazz (which dispels Dr. Webb's notion that prices moving in lockstep mean that the products with those prices are in the same market). *See also*, RT 250-256 (Webb/San Pablo Bay) (reliance of Dr. Webb entirely on Mr. LaBorne, Mr. Dompke, and Mr. Hackett without any empirical analysis of his own).

<sup>46</sup> RT 368, 401 (Hackett/San Pablo Bay).

pipeline operations risks.<sup>47</sup> Dr. Verleger relied on Mr. LaBorne's conclusions as to pipeline alternatives for shippers, pipeline capacity, and throughput data to reach his conclusions.<sup>48</sup> Dr. Teece relied upon Mr. LaBorne's testimony on pipeline competitive and operational risks.<sup>49</sup> And, Mr. Van Hoecke relies entirely on Mr. LaBorne's opinions concerning pipeline volumes, PLA, crude prices, heavy oil cost differential, and refunds to calculate Shell Pipeline's cost-of-service rates.<sup>50</sup> Clearly, Shell's case as presented by these witnesses rests entirely on Mr. LaBorne's testimony.

As cross-examination revealed at hearings, Mr. LaBorne's testimony contains critical and consistent errors that fully impeach Shell Pipeline's case. The errors are numerous, but the following list highlights some of the most notable ones:

1. Mr. LaBorne first denied having ever engaged in discussions to sell Shell Pipeline, but then conceded in cross examination that Shell may have tried to sell the pipeline and was unsuccessful because the interest it received was too low.<sup>51</sup>
2. Mr. LaBorne stated in his prepared testimony that STUSCO is a shipper who may be owed refunds, but conceded in cross examination that STUSCO would need to pass through any refunds to the Independent Shippers given the current buy/sell arrangements.<sup>52</sup>
3. Mr. LaBorne testified as to alternative trains and trucking that could be used to transport crude, but it was revealed on cross examination that the pricing

---

<sup>47</sup> See SP Exh. 28, Direct Testimony of Harry Rathermel on Behalf of San Pablo Bay Pipeline Company LLC, dated April 1, 2009 ("Rathermel Direct"), p. 22; SP Exh. 29, Rebuttal Testimony of Harry Rathermel on Behalf of San Pablo Bay Pipeline Company LLC, dated February 8, 2010 ("Rathermel Rebuttal"), pp. 5-6.

<sup>48</sup> See SP Exh. 26, Direct Testimony of Philip K. Verleger on Behalf of San Pablo Bay Pipeline Company LLC, dated September 30, 2008 ("Verleger Direct"), pp. 17, 18, 19, 21, 24, 27.

<sup>49</sup> SP Exh. 33, Direct Testimony of Dr. David J. Teece on Behalf of San Pablo Bay Pipeline Company LLC, dated April 1, 2009 ("Teece Direct"), pp. 8-10.

<sup>50</sup> SP Exh. 37, Direct Testimony of Robert G. Van Hoecke on Behalf of San Pablo Bay Pipeline Company LLC, dated April 1, 2009 ("Van Hoecke Direct"), pp. 13-14, 22; SP Exh. 38, Rebuttal Testimony of Robert G. Van Hoecke on Behalf of San Pablo Bay Pipeline Company LLC, dated February 8, 2010 ("Van Hoecke Rebuttal"), pp. 34, 36, 38, 39.

<sup>51</sup> RT 637 – 638 (LaBorne/San Pablo Bay).

<sup>52</sup> RT 644 – 647 (LaBorne/San Pablo Bay).

information for these substitutes is outdated and the alternatives were far-fetched.<sup>53</sup> Mr. LaBorne and Dr. Webb made much of trucking and rail as potential alternatives, yet nowhere did they evaluate the cost of using trucks or rail to transport SJVH.<sup>54</sup>

4. Mr. LaBorne claimed that the KLM and ConocoPhillips pipelines were alternatives based on an inaccurate misreading of confidential Chevron sales data, which Dr. Webb then relied on for his testimony without evaluating the cost to ship SJVH volumes on this pipeline or the ConocoPhillips line.<sup>55</sup>

5. In his rebuttal testimony, Mr. LaBorne opined on the economic impacts in the event that Chevron shuts down its Richmond refinery, despite public statements by Chevron that there are no plans to do so.<sup>56</sup>

6. Mr. LaBorne provided throughput forecasts and revenue forecasts upon which Shell Pipeline's witnesses relied for their rate calculations, but cross-examination revealed that Mr. LaBorne had cherry-picked selections to overstate production decline numbers to favorably skew the rate data for Shell Pipeline's Test Year.<sup>57</sup>

7. Mr. LaBorne's testimony on throughput risk, which Dr. Teece and other witnesses relied upon for their rate analysis, was acknowledged in cross-examination to be an industry risk faced by all crude oil pipelines.<sup>58</sup>

8. Mr. LaBorne's calculation of Shell's proposed market-based rate was demonstrated to be pulled out of thin air, as he started with the rate that was charged to Valero for "spot" deals starting in 2007 (the highest current rate for any service),<sup>59</sup> when

---

<sup>53</sup> RT 660 – 663 (LaBorne/San Pablo Bay); RT 135:20-24 (Webb/San Pablo Bay) (“[A]nother way that you could get to the Bay is you could take – you could re-activate Line 63, also a Plains line, ship down to Los Angeles, go on a boat up to the Bay.”); RT 136:9-17 (Webb/San Pablo Bay) (Chevron could restart Estero Bay, even though Dr. Webb does not have “any idea how much it would cost” or “how long it would take to get the permits to re-activate that pipeline, [or reactivate] a terminal.”).

<sup>54</sup> SP Exh. 1, Direct Testimony of Michael J. Webb, dated September 30, 2008 (“Webb Direct”), p. 39.

<sup>55</sup> Chevron Exh. 52-C, Prepared Rebuttal Testimony of Alan J. Cox, Ph.D. regarding Shell Pipeline's Market Power on behalf of Chevron Products Company, dated April 16, 2010, Confidential Version (“Cox Confidential Rebuttal”), p. 37.

<sup>56</sup> RT 663 – 668 (LaBorne/San Pablo Bay).

<sup>57</sup> RT 672 – 700 (LaBorne/San Pablo Bay).

<sup>58</sup> RT 691:10-27, 733:25-27 (LaBorne/San Pablo Bay).

<sup>59</sup> SP Exh. 21, LaBorne Direct, p. 12.

this rate was used for less than one percent of the shipments on the SJV Pipeline in all of 2008, and no shipments were made at this rate for seven months of that year, including six of the eight months prior to Mr. LaBorne's filed testimony.<sup>60</sup>

9. Based on Mr. LaBorne's testimony, Dr. Webb insisted that the "market adjustment" referenced in the buy/sell agreements (which is the agreed addition to the price at which crude oil is posted to be purchased to the price at which it is actually sold) is just a transportation adder that should be included in the competitive rate for transportation.<sup>61</sup> When faced in cross-examination with evidence that the market adjustment was included in lease sale agreements as well as a variety of other forms of transactions where transportation was limited or not included at all,<sup>62</sup> Dr. Webb reluctantly conceded that Mr. LaBorne's interpretation of the market adjustment was *wrong*.<sup>63</sup>

10. While LaBorne claimed that "regrading" is simply a "more generic term" for "blending",<sup>64</sup> this claim is not credible, given that "regrading" means to "grade again or differently",<sup>65</sup> which is precisely what Shell Pipeline's invoices reflect is being done with the Outer Continental Shelf crude ("OCS") to the detriment of Tesoro's refinery.

11. In a final attempt to minimize the seriousness of the "regrading" of OCS to SJVH, Mr. LaBorne analogized it to adding "a little bit of orange water" to a bathtub full of blue water,<sup>66</sup> which, in fact, amounted to 7 million barrels "regraded" to SJVH from 2005 through the just first quarter of 2009, increasing the value of the OCS to STUSCO by about \$35 million.<sup>67</sup>

---

<sup>60</sup> Chevron Exh. 34, Demonstrative Exhibit.

<sup>61</sup> RT 109 – 111 (Webb/San Pablo Bay).

<sup>62</sup> RT 793 – 794 (LaBorne/San Pablo Bay).

<sup>63</sup> RT 114 (Webb/San Pablo Bay).

<sup>64</sup> RT 835:24-28, 836:13-26 (LaBorne/San Pablo Bay).

<sup>65</sup> Oxford Dictionaries, *available at* <http://www.askoxford.com> (last visited July 14, 2010).

<sup>66</sup> RT 837:9-18 (LaBorne/San Pablo Bay).

<sup>67</sup> RT 1416:14-16 (Grimmer/Tesoro).

Inevitably, the inaccuracies and misstatements in Mr. LaBorne's testimony have passed through to the conclusions of the many Shell Pipeline witnesses who relied on his testimony. As a result, Shell Pipeline's case is fatally flawed and rests on threadbare, unreliable assertions that wholly fail to meet the applicant's burden of proof in this matter.

Given the numerous errors in the presentation of Shell Pipeline's case, the Commission must rely on only the well-supported and sound analyses of the Independent Shippers to determine that Shell Pipeline has market power, that the rate to be charged must be the cost-of-service rate proposed by Tesoro, and that Tesoro is owed refunds for past unreasonable charges.

**3. As A Matter Of Law, Shell Pipeline Has Market Power And Is Thus Ineligible For Market-Based Rates.**

Contrary to its unsupported assertions in its Opening Brief, the "law of this case"<sup>68</sup> and the record evidence overwhelmingly indicate that Shell Pipeline is a monopoly, with the ability and potential to abuse its market power. Shell Pipeline and STUSCO still refuse to concede that they are bound by the prior Commission orders that were upheld on appeal to the courts and have been expressly acknowledged by the Presiding ALJ in this matter. The record, which includes voluminous economic analyses, market power analyses, and testimony of the Independent Shippers, shows that Shell Pipeline can and will exercise market power over its customers if the Commission grants its request for market-based rates.<sup>69</sup> The evidence presented by the Independent Shippers establishes that the product and geographic markets in this case are the transportation of SJVH crude oil from the San Joaquin Valley to the San Francisco Bay Area via the *only* available heated pipeline to meet the refineries' neat SJVH crude requirements—the SJV Pipeline.

---

<sup>68</sup> *Administrative Law Judge's Ruling Denying Defendants' Motion to Reject Response to Answers and Defendants' Motion to Dismiss Complaint*, filed May 27, 2009 in C.09-02-007, p. 3.

<sup>69</sup> See Chevron Exh. 51, Prepared Direct Testimony of Alan J. Cox, Ph.D. regarding Shell Pipeline's Market Power on behalf of Chevron Products Company, dated November 11, 2009, revised December 22, 2009 ("Cox Prepared"); Chevron Exh. 52, Prepared Rebuttal Testimony of Alan J. Cox, Ph.D. regarding Shell Pipeline's Market Power on behalf of Chevron Products Company, served April 16, 2001, Public Version ("Cox Rebuttal"); Tesoro Exh. 24, Prepared Testimony of Mark P. Berkman on Behalf of Tesoro Refining and Marketing Company, dated November 16, 2009 ("Berkman Prepared"); Tesoro Exh. 26, Prepared Testimony of Horace O. Hobbs, Jr. for Tesoro Refining and Marketing Company, dated November 16, 2009, with Errata, January 22, 2009 ("Hobbs Prepared").

**a. Shell Has Failed To Conduct A Proper HHI Analysis Of Its Market Power**

The market power analysis by Shell Pipeline is limited, inaccurate and varies significantly from accepted practice. In its Opening Brief, it asserts that Dr. Webb's market power analysis shows that the HHI in the origin market is 1,289.<sup>70</sup> However, as discussed in Tesoro's Opening Brief, this analysis contains critical flaws. Instead of analyzing realistically feasible alternatives as required to determine market power, Shell Pipeline's witnesses compare their proposed transportation rates to their view of refiner and producer profits, underscoring that Shell Pipeline's "market-based" rates are designed to capture a portion of the value of the investments made by their ratepayers.<sup>71</sup>

Shell Pipeline's case rests on the inaccurate testimony of Dr. Webb, who does not apply the traditional DOJ Merger guidelines to his market power analysis. As detailed in Tesoro's Opening Brief, Dr. Webb's application of the test contains unsupported, end-result driven assumptions, which are rife with inaccurate distortions of the geographic and product markets at issue in this matter.<sup>72</sup> Shell Pipeline continues to put forward a case that is, in sum, a "whole earth" crude oil case,<sup>73</sup> which assumes that oil from anywhere in the world is a suitable alternative to SJVH with respect to chemistry and price. No credible evidence or reliable analysis is presented to support this dubious assumption.

In contrast, Tesoro and Chevron witnesses such as Dr. Berkman, Horace Hobbs, and Dr. Cox conducted detailed analyses and studies of the crude oil market, crude oil transportation, and geographic market using the DOJ Merger Guidelines and Commission precedent.<sup>74</sup> For

---

<sup>70</sup> San Pablo Bay Opening Brief, pp. 19-20.

<sup>71</sup> As Lee explained, "Producers of crude oil take significant risks in drilling for oil. The returns earned not only cover the operating cost and capital required to drill but also provide cash flow to further invest into the area to help support the nation's crude oil production." (Chevron Exh. 47, Prepared Rebuttal Testimony of David R. Lee Regarding California Crude Oil Production and Transportation, Public Version, April 16, 2010 ("Lee Rebuttal"), p. 5.)

<sup>72</sup> Tesoro Opening Brief, pp. 17-20.

<sup>73</sup> See, e.g., SP Exh. 6-P, The Rebuttal Testimony of David J. Hackett, Public Version, dated February 8, 2010 ("Hackett Rebuttal"); San Pablo Bay Opening Brief at p. 23.

<sup>74</sup> See, e.g., Tesoro Exh. 24, Berkman Prepared, *passim*; Tesoro Exh. 26, Hobbs Prepared, pp. 18-27; Chevron Exh. 52, Cox Rebuttal, *passim*.

example, as a result of his more traditional and accepted analysis, Dr. Cox determined the HHI for the San Joaquin Valley origin market is over 4,000—well above the 2,500 threshold that indicates a highly concentrated market as a matter of law.

Similarly, Dr. Berkman concludes the HHI for the relevant market is well over the 2,500 threshold because there are no economic and available alternatives. Similar to Dr. Cox's analysis, Dr. Berkman's analysis recognizes that the measurement of capacity for calculating market share and market concentration must include both capacity in use and capacity that would be employed if prices were to rise. In either case, relevant capacity is included when it provides an economic substitute. Capacity that is unavailable or too expensive to serve as an economic substitute should not be included in the measurement of market concentration. This includes capacity that costs substantially more to use from the buyers perspective and capacity that that is too costly for the supplier to provide at a competitive price because of alternative uses.

**b. Shell Pipeline Has Failed To Prove That There Are Reasonably Available Supply Alternatives**

In its Opening Brief, Shell Pipeline wrongly asserts that the Independent Shippers claim that only “perfect” or “near-perfect” substitutes for the SJV Pipeline are alternatives.<sup>75</sup> The Independent Shippers have never made such an argument. However, it remains undisputed that as a matter of law, a competitive alternative must be available, economic and reasonable.<sup>76</sup> It must also be “less expensive to utilize than the cost imposed by the pipeline after the attempted exercise of market power.”<sup>77</sup> Shell Pipeline has failed to prove that there are any alternatives meeting these criteria—indeed, no such alternatives exist.

Shell Pipeline attempts in its Opening Brief to rely on the testimony of Dr. Webb in this regard,<sup>78</sup> but Dr. Webb has relied entirely on Mr. Hackett to suggest that Tesoro, in particular, had alternatives to the use of SJVH and the SJV Pipeline for crude supplies to its Golden Eagle

---

<sup>75</sup> San Pablo Bay Opening Brief, p. 20.

<sup>76</sup> See, e.g., D.94-05-022, 1994 Cal. PUC LEXIS 380, \*46, Finding of Fact ¶25.

<sup>77</sup> Chevron Exh. 51, Cox Prepared, p. 12.

<sup>78</sup> San Pablo Bay Opening Brief, p. 20.

refinery. As Tesoro's Opening Brief has detailed, Mr. Hackett's testimony as to alternatives fails to hold water. He testified that his analysis did not include usage of a linear programming model, whether his own or obtained from a vendor.<sup>79</sup> Thus, Shell Pipeline's key witness on the "next best alternative" failed to use the very analytical tool used by refineries to determine available alternatives. In addition, Mr. Hackett has considered alternatives to include ones that are not currently available,<sup>80</sup> and alternatives for which significant changes to infrastructure would be necessary,<sup>81</sup> using criteria that he developed on his own.<sup>82</sup>

Shell Pipeline's Opening Brief also relies on Mr. Hackett's testimony to conclude that Brazilian Marlim is the best available supply alternative to SJVH which Tesoro currently uses,<sup>83</sup> despite the undisputed record evidence that Marlim crude has dissimilar assays as to quality compared to SJVH.<sup>84</sup> Refinery yields are scarcely mentioned in Mr. Hackett's testimony, and yet yields are crucial in judging the viability of alternative crudes. Further, he did not study and was unaware of any policy or procedures as to added tankers that may be needed to enter into the San Francisco Bay to unload at Avon, whether Coast Guard or other environmental permits were needed specifically or in general for his alternative.<sup>85</sup> He did not study any process constraints or compare the costs of the alternative supply,<sup>86</sup> and he did not know if added storage was needed at the refinery or how long any permits would take to put the added storage into operations.<sup>87</sup>

Shell Pipeline's Opening Brief attempts to suggest that Mr. Hackett "analyzed" the costs of SJVH and Marlim crudes, to conclude that the "cost and benefit" of Marlim is similar to SJVH.<sup>88</sup> On the contrary, Mr. Hackett has painted his own imaginary crude oil market with his

---

<sup>79</sup> RT 329 – 332 (Hackett/San Pablo Bay); *see also*, RT 934 (Van Zandt/Tesoro), as to Tesoro's use of linear programming models seven days a week to examine the market and determine which crudes have the most value for the refinery for a planning margin.

<sup>80</sup> RT 337 (Hackett/San Pablo Bay).

<sup>81</sup> RT 341 – 342 (Hackett/San Pablo Bay).

<sup>82</sup> RT 336 (Hackett/San Pablo Bay).

<sup>83</sup> San Pablo Bay Opening Brief, pp. 28-29.

<sup>84</sup> RT 365 (Hackett/San Pablo Bay).

<sup>85</sup> RT 348, 350 (Hackett/San Pablo Bay).

<sup>86</sup> RT 354 – 355 (Hackett/San Pablo Bay); *see* Tesoro Exh. 20, Response Nos. 262, 263, 264, and 265 of San Pablo Bay to Tesoro's Seventh Set of Data Requests, dated April 1, 2010.

<sup>87</sup> RT 356, 358 (Hackett/San Pablo Bay).

<sup>88</sup> San Pablo Bay Opening Brief, pp. 28-29.

own criteria rather than the reality of standard industry practice. Mr. Hackett's use of the "delivery cost" of crudes is the perceived market value of the API gravity difference between SJVH and SJVL. Only a linear program (LP) analysis would evaluate the product yield or refining value of Marlim versus SJVH, and Mr. Hackett admitted that he never conducted this essential analysis. Had he conducted such an analysis, he would have found that Tesoro could not entirely replace its SJVH crude supply with Marlim because of the differences in refining value. In addition, Mr. Hackett's use of the delivered cost of Marlim is flawed, as it does not include the lightering costs required and shipping constraints to deliver Marlim crude to the Bay Area at Tesoro's refinery.

Mr. Hackett was also unaware of the pricing differential between SJVH and Marlim,<sup>89</sup> and what price comparison he did make selectively considered elements (ignoring demurrage, and trans-shipment costs) while again relying on Mr. LaBorne for price information.

However, even with this selective price analysis, his next best alternative was still more expensive by at least \$2.45 a barrel.<sup>90</sup> As this would exceed the minimum 5-15% price threshold for market power established as a matter of law, Marlim is not an economic alternative. Thus as a matter of law, if the next "best" alternative is above the price threshold, which the evidence shows it is, then it is not an economic alternative consistent with the DOJ Merger Guidelines and the threshold price test for market power.

Unlike Shell's witnesses, Chevron's and Tesoro's expert witnesses have analyzed the characteristics of Brazilian crude and other alternative crude oils proposed by Shell. They have also compared the price and value of other crude oils with SJVH *in the Bay Area in the context of the extent to which the Tesoro and Valero refineries rely on SJVH crude.*<sup>91</sup>

In its Opening Brief, Shell inaccurately asserts that Tesoro's witnesses were required to provide, but did not provide any analysis of how its refinery economics would be impaired if the

---

<sup>89</sup> RT 366 (Hackett/San Pablo Bay).

<sup>90</sup> RT 369 (Hackett/San Pablo Bay).

<sup>91</sup> See, Tesoro Exh. 24, Berkman Prepared, *passim*; Tesoro Exh. 26, Hobbs Prepared, pp. 18-27; Chevron Exh. 52, Cox Rebuttal, *passim*.

refinery switched to an alternative crude oil supply.<sup>92</sup> Shell reverses the burden of proof it has as the applicant to support its request for market-based rates. Under Shell's logic, every applicant would be entitled to charge the maximum rates that its customers can absorb, and the customers would have to prove that they could not absorb the charges, presumably short of filing for bankruptcy law protections. This logic is clearly contrary to the concept of regulation and just another example of Shell Pipeline's stiff resistance to any regulation of its market power or business practices, and its reckless and inaccurate conclusions on law and record evidence.

Notwithstanding Shell Pipeline's burden of proof in this matter, Tesoro has provided far more information than Shell Pipeline's witnesses to aid the Commission in its determination of market power here. The testimony of Horace Hobbs for Tesoro provides a detailed analysis of Latin American and West African crude oils, including Brazil Marlim crude, to reach his conclusion that none of the foreign crude oils reasonably available to Tesoro have an API gravity level and sulfur content that is as low as SJVH.<sup>93</sup> In addition, Tesoro witnesses such as Mr. Miller and Mr. Van Zandt have pointed out that while in the long run Tesoro could receive crude oil from foreign sources, it cannot do so now on an economically sustainable basis, as Tesoro would have to invest in substantial additional capital in tankage and refinery upgrades to displace the ratable 40,000 to 50,000 barrels per day of SJVH that it now uses.<sup>94</sup> Dr. Berkman also compares the prices of foreign crude oil to SJVH in terms of API, sulfur content, and price, and even analyzes the reliability concerns that would arise with complete reliance on foreign crude oil, including supply interruption.<sup>95</sup> All of this evidence conclusively demonstrates that there is no "next best alternative" because any other supply of crude would rise above the price threshold established by law.

---

<sup>92</sup> San Pablo Bay Opening Brief, p. 21.

<sup>93</sup> Tesoro Exh. 26, Hobbs Prepared, pp. 11-17.

<sup>94</sup> See Tesoro Exh. 32, Prepared Testimony of Douglas E. Miller for Tesoro Refining and Marketing Company, dated November 16, 2009 ("Miller Prepared"), pp. 14-15; *see also*, RT 939-944 (Van Zandt/Tesoro).

<sup>95</sup> Tesoro Exh. 24, Berkman Prepared, pp. 15-22.

**c. There Are No Available Transportation Alternatives.**

Similarly, Shell Pipeline asserts that there is alternative pipeline transportation available to the Independent Shippers. However, the “alternatives” mentioned by Shell Pipeline are not physically and economically available to frustrate an exercise of market power. In that regard, Shell Pipeline has failed to present any evidence that there are current, available pipelines that could deliver all of Tesoro’s required neat SJVH from the San Joaquin Valley to the Golden Eagle Refinery. In its discovery, testimony, and in cross examination of Dr. Webb and Mr. LaBorne at hearings, no Shell Pipeline witness could point to a pipeline that is presently available for Tesoro to use as an alternative to transporting heated neat undiluted SJVH crude, other than the SJV Pipeline operated by Shell Pipeline.<sup>96</sup>

It remains undisputed that the SJV Pipeline is the *only* heated pipeline between the San Joaquin Valley oil fields and Martinez that can maintain adequate temperature for flow rate management and pumping operations to transport the neat SJVH crude necessary for Tesoro’s refinery.<sup>97</sup> As Tesoro witnesses have testified, neither the KLM pipeline owned by Chevron, nor the ConocoPhillips pipeline are viable options because neither pipeline has the heating capability necessary to transport neat SJVH crude, nor available capacity.<sup>98</sup> Thus, the SJV Pipeline remains the only source of pipeline transportation of neat SJVH crude, and can exercise market power in that regard.

Similar to its faulty analysis of pipeline transportation, Shell Pipeline can point to no studies to show that there are available economic alternatives using truck, rail and marine transport, but merely relies on anecdotal information and unrelated and inapplicable examples to conclude that adequate transport could be provided.<sup>99</sup> Shell Pipeline has not studied traffic

---

<sup>96</sup> See Tesoro Exh. 11, Response of San Pablo Bay to Tesoro’s Sixth Set of Data Requests, March 5, 2010; Tesoro Exh. 12, Response of San Pablo Bay to Chevron’s Fourth Set of Data Requests and Attachment C (“Schematic - Pre-2006 Configuration”) Thereto, dated May 22, 2009; Tesoro Exh. 13, Response of San Pablo Bay to Tesoro’s Seventh Set of Data Requests, dated April 1, 2010.

<sup>97</sup> Tesoro Exh. 25, Prepared Testimony of Ralph J. Grimmer for Tesoro Refining and Marketing Company, dated November 16, 2009, with Errata, dated January 22, 2010 (“Grimmer Prepared”), pp. 13-14.

<sup>98</sup> Tesoro Exh. 25, Grimmer Prepared, p. 14; Tesoro Exh. 26, Hobbs Prepared, pp. 8-9; Tesoro Exh. 32, Miller Prepared, pp. 12-14.

<sup>99</sup> Tesoro Exh. 4, Response of San Pablo Bay to Tesoro’s Seventh Set of Data Requests, April 1, 2010.

restrictions, air pollution restrictions, highway limitations, permitting for any transport source, existence of available infrastructure, or any other normal analysis to support its claims. On the other hand, Tesoro witnesses have addressed and analyzed these considerations to conclude that they are not viable alternatives for transportation.<sup>100</sup>

Mr. Grimmer and Mr. Hobbs have testified that the existing rail and truck loading and unloading facilities are grossly insufficient to handle the amount of SJVH that Tesoro processes. They stressed that the time required for major capital investments that would be needed to adapt these facilities would be substantial.<sup>101</sup> Mr. Grimmer also provides cost estimates of the significant investments that would be required to adapt the infrastructure to allow for more rail and truck transport,<sup>102</sup> whereas Shell provides no such analysis whatsoever. In addition, Dr. Berkman's testimony considers the substantial number of rail cars that Tesoro would have to secure to ship more than 40,000 barrels of crude oil per day, the estimated costs, rail traffic and congestion issues, the 100 daily truck trips that would be necessary to transport crude oil from the fields to a rail loading facility.<sup>103</sup>

As to trucking, Dr. Berkman notes the high current tanker truck rates, the construction of unloading facilities at the Golden Eagle refinery that would be necessary, and the enormous amount of trucks (more than 250 a day) that would be required to deliver the SJVH that the refinery requires for processing, as well as the congestion problems that would result from such an "alternative."<sup>104</sup> As Dr. Berkman's analysis demonstrates, other modes of transportation such as rail, truck and waterborne deliveries would represent costs that are at least 15% above pipeline shipping costs. For instance, rail shipments would be costly and require substantial capital investment. Truck shipments and ocean transport would also require significant expenses and would present logistical constraints for offloading and require investment in new crude oil

---

<sup>100</sup> See, e.g., Tesoro Exh. 24, Berkman Prepared, pp. 26-31; Tesoro Exh. 26, Hobbs Prepared, pp. 18-22.

<sup>101</sup> Tesoro Exh. 25, Grimmer Prepared, pp. 15-16; Tesoro Exh. 26, Hobbs Prepared, pp. 9-11.

<sup>102</sup> Tesoro Exh. 25, Grimmer Prepared, pp. 15-16; Tesoro Exh. 26, Hobbs Prepared, pp. 9-11.

<sup>103</sup> Tesoro Exh. 24, Berkman Prepared, pp. 10-11.

<sup>104</sup> Tesoro Exh. 24, Berkman Prepared, p. 11.

storage. In addition to cost, the alternative transportation modes result in greater environmental impacts and risks.

As to Shell Pipeline's preferred alternative, marine shipping of Marlim crude from Brazil, it failed to study permitting, demurrage, availability of tankage, minimum cargo size required, availability of shipments in general, timing it would take to get an alternative supply assuming it was available, time and cost to retrofit the refinery to switch the baseload crude slates as suggested including adding tankage, as well as a whole host of other problems and questions that must be addressed before the alternative was determined to be suitable.<sup>105</sup>

In contrast, Mr. Miller has testified that there are logistic problems with unloading large amounts of crude oil from the Tesoro dock at Martinez, including storage tank facilities that are limited, and substantial costs that Tesoro would incur to have ships filled with crude oil wait in San Francisco Bay until they are unloaded.<sup>106</sup> In addition, Dr. Berkman has analyzed the logistical issues for waterborne delivery, demurrage charges (\$50,000 to \$100,000 *per day*), additional storage capacity needed for use of tankers, and the economic impact on the Golden Eagle refinery of using a substitute crude oil instead of SJVH.<sup>107</sup>

The evidence shows that Shell Pipeline has market power and would not hesitate to use it. Indeed, over the period of a year, immediately prior to actions by and before this Commission, Shell Pipeline nearly doubled its transportation rate from \$1.09 per barrel to \$1.90. Chevron and Tesoro were compelled to invest their time and money to seek protection from this Commission, and when they succeeded in 2007, Shell Pipeline filed an application to further increase its high rates. Thus, this is not a case where the Commission may rely on Shell Pipeline's good faith to refrain from exercising its market power. Shell Pipeline has failed to show by clear and convincing evidence that the Independent Shippers have alternatives to the SJV Pipeline, and thus, the Commission must deny the instant application for market-based rates.

---

<sup>105</sup> RT 350 – 353 (Hackett/San Pablo Bay).

<sup>106</sup> See Tesoro Exh. 32, Miller Prepared, pp. 15-16.

<sup>107</sup> Tesoro Exh. 24, Berkman Prepared, pp. 11-22.

**4. The Commission Should Adopt The Reasonable And Well-Supported Cost-Of-Service Rate Proposed By Tesoro.**

Given that Shell Pipeline has failed to prove its case for market-based rates, and in light of the extraordinary market power and affiliate concerns present in this case, it is imperative that the Commission adopt the cost-of-service rate proposed by Tesoro for Shell Pipeline. Over three years after the Commission ordered Shell Pipeline to file its tariff, Shell Pipeline provided a partial and unreliable cost-of-service analysis only in its prepared rebuttal testimony, as compared to the detailed analysis provided by Mr. Ashton and Mr. O'Loughlin throughout this proceeding. Contrary to its assertion that its cost-of-service showing "validates" its market-based rates,<sup>108</sup> Shell Pipeline's showing is rife with errors and self-serving manipulation of figures to arrive at grossly excessive rates and charges.

**a. The Commission Has Held That The Appropriate In-Service Date For Utility Service Is 1996.**

Like its market power analysis, Shell Pipeline's rate analysis distorts cost-of-service principles beyond reality. In its Opening Brief, Shell Pipeline takes issue with Tesoro's and Chevron's use of January 1996 as the starting point for when Shell Pipeline began providing public utility service, instead of the September 2007 date used by Shell Pipeline.<sup>109</sup>

The basis for the 1996 start date is clear and is based unequivocally on the Commission's prior rulings *in this case*. The Commission has already found that Shell Pipeline has been providing service to the public since at least 1996:

Corporate documents clearly state *Shell is in the business of transporting crude oil*. Shell has substantially more capacity on the SJV Pipeline than it needs and *has continually provided this capacity to third parties since 1996*.<sup>110</sup>

Based on this specific statement in D.07-12-021, and similar statements in D.07-07-040 as to the date that Shell Pipeline began its service as a utility,<sup>111</sup> Mr. Ashton placed the rate base

<sup>108</sup> San Pablo Bay Opening Brief at p. 49.

<sup>109</sup> San Pablo Bay Opening Brief, pp. 55-57.

<sup>110</sup> Emphasis added. D.07-12-021, *Chevron Products Company, Complainant, vs. Equilon Enterprises LLC, dba Shell Oil Products US, and Shell Trading (US) Company, Defendants*, 2007 Cal. PUC LEXIS 631, \*\*34-35.

<sup>111</sup> Tesoro Exh. 28-P, Prepared Testimony of Peter K. Ashton, Public Version, Public Version, dated December 8, 2009 ("Ashton Prepared"), p. 16.

into common carrier service beginning in 1996, rather than accepting Shell Pipeline's attempt to assume the plant was placed in common carrier service in 2007 for purposes of a cost-of-service rate calculation.

In another attempt to evade this Commission's factual determination that the SJV Pipeline was providing utility service since 1996, Shell Pipeline asserts that the language in D.07-12-021 is *dicta*. Shell Pipeline improperly relies on inapplicable precedent to suggest that the Commission must expressly state in its finding of facts that there is a dedication of property to public use to establish public utility status.<sup>112</sup> In fact, no Commission precedent or law supports Shell Pipeline's unique interpretations. As a matter of law, it is well-established that "dicta" consists of statements that appear to be "little more than a 'general observation[] unnecessary to the decision.'"<sup>113</sup> In Conclusion of Law No. 9 of D.07-07-040, the Commission specifically states, "Equilon and Shell Trading have manifested an unequivocal intention to dedicate the 20" Pipeline to public use by engaging in the business of transporting oil for a fee."<sup>114</sup> Undeniably, the Commission's factual determination that Shell Pipeline has provided pipeline capacity to third parties for a fee since 1996 is *directly relevant* and *necessary* to its material conclusion that Shell Pipeline operates as a utility subject to Commission jurisdiction. Thus, the Commission's express finding is *not dicta*, but a factual determination directly relevant to its ultimate finding of jurisdiction over Shell Pipeline.

Moreover, no precedent or law requires the Commission to present every single supportive factual determination relied upon for its conclusions in its formal findings of fact or conclusions of law. In effect, Shell Pipeline quibbles over the format of how the Commission drafted its decision. The impact of Shell Pipeline's position would render every Commission decision unwieldy as it would require the Commission's entire decision to be reduced to findings

---

<sup>112</sup> San Pablo Bay Opening Brief, pp. 76-82.

<sup>113</sup> *People v. Ranscht* (2009) 173 Cal.App.4th 1369, 1374, quoting *Fireman's Fund Ins. Co. v. Maryland Caulaty Co.* (1998) 65 Cal.App.4th 1279, 1301.

<sup>114</sup> D.07-07-040, *Chevron Products Company, Complainant, vs. Equilon Enterprises LLC, dba Shell Oil Products US, and Shell Trading (US) Company, Defendants*, 2007 Cal. PUC LEXIS 331 ("D.07-07-040, 2007 Cal. PUC LEXIS 331"), \*38.

of fact, or deem anything other than findings of fact as irrelevant to its decision. Clearly, the use of "1996" is based on the specific, directly relevant, and supportive language in a final Commission order, which decisions were appealed by Shell and which appeals were rejected by two courts. Thus, it is the law of the Commission and is the only justifiable date to use.

In addition to Commission precedent, the facts in this case support that 1996 is the appropriate in-service start date to calculate cost-of-service rates for Shell Pipeline. In 1996, 60.6 percent on average of pipeline capacity was devoted to third party service, and up to as much as 82.6 percent in one month.<sup>115</sup> In addition, in a predecessor proceeding (C.05-12-004), considerable evidence was presented that shows that over 50 percent of the capacity of the SJV Pipeline had been used by third parties since that time. Thus, it is clear that Shell Pipeline was providing public utility service long before 1996. Clearly, Shell Pipeline was profiting by providing common carrier service to third parties since at least 1996, and thus it must be appropriate to compute the fair market value of the rate base and begin depreciation of the rate base no later than this date.

**b. Shell Pipeline Fails To Support Its Proposed Rate of Return**

As to its rate of return calculation used in assessing the achieved return and computing the cost of capital (allowed rate of return) for determining cost-based rates, Shell Pipeline provides misleading and erroneous comparisons, continues to advocate use of a proxy group of companies that are not comparable, and relies on a distorted capital structure that unfairly skews other cost of service components, most notably the income tax allowance.

Contrary to its assertions, Shell Pipeline's rate of return analysis is incorrect and at odds with the results computed by both Tesoro's witness, Mr. Ashton, and Chevron's witness, Dr. Vilbert. Mr. Ashton's testimony reflects a cost of capital ranging from 8.61 percent to 9.83 percent between 2005 and 2009<sup>116</sup> and in each year, Mr. Ashton's analysis of rates of return is

---

<sup>115</sup> Chevron Exh. 48, Prepared Direct Testimony of Matthew P. O'Loughlin regarding Cost of Service on behalf of Chevron Products Company, December 8, 2009 ("O'Loughlin Prepared"), Attachment MPO\_14.

<sup>116</sup> Tesoro Exh. 28-P, Ashton Prepared, p. 38 and attached Exhibit 11.

below the value computed by Dr. Teece.<sup>117</sup> In fact, Mr. Ashton noted that under Shell Pipeline's proposed rates, the achieved return would be 23.75 percent, over *double* the amount computed by Dr. Teece—primarily because of Dr. Teece's unreliable selection of comparable companies used to determine the cost of equity and capital structure for Shell Pipeline.<sup>118</sup>

In his testimony, Dr. Teece recommends the use of a proxy group composed of large, multinational oil companies, which yield a capital structure of *over 90 percent equity*, a capital structure totally foreign to regulated utilities. The Independent Shipper witnesses have clearly shown that these large multinational companies are not comparable when assessing the risks faced by Shell Pipeline.<sup>119</sup> In addition, Chevron witnesses Mr. O'Loughlin and Dr. Vilbert extensively discuss in their testimony the impropriety of Dr. Teece's selection of a proxy group based on similar risks to Shell Pipeline.<sup>120</sup>

It remains undisputed that in a cost-of-service rate analysis for a new pipeline, the selection of an industry proxy group should yield a rate of return commensurate with market returns on investments that have corresponding risks—accordingly, the pipeline should yield a rate of return consistent with equivalent risks and uncertainties. While both Mr. Ashton and Dr. Vilbert select a sample of Master Limited Partnerships that are heavily engaged in the transportation of crude oil and refined products, similar to Shell Pipeline, Dr. Teece relies on a sample of major integrated oil companies. Unlike the proxy group used by Shell Pipeline, Mr. Ashton and Dr. Vilbert have selected companies that are primarily engaged in the pipeline transportation business and thus face operating and business risks that are much more similar to those faced by Shell Pipeline than the risks faced by the four integrated majors selected by Dr. Teece.

---

<sup>117</sup> SP Exh. 34, Rebuttal Testimony of Dr. David J. Teece on Behalf of San Pablo Bay Pipeline Company LLC, dated February 8, 2010 ("Teece Rebuttal"), attached Exhibit DJT-5, Schedule 3.

<sup>118</sup> Tesoro Exh. 28-P, Ashton Prepared, pp. 68-69, attached Exhibit 21.

<sup>119</sup> Tesoro Opening Brief, p. 41; Tesoro Exh. 28-P, Ashton Prepared, pp. 36-38.

<sup>120</sup> Chevron Products Company's Opening Brief, filed June 21, 2010 ("Chevron Opening Brief") at p. 52-55, Chevron Exh. 23, Rebuttal Testimony of Michael J. Vilbert regarding Cost of Service on Behalf of Chevron Products Company, dated April 16, 2010 ("Vilbert Rebuttal"), pp. 8-18, and Chevron Exh. 49, Prepared Rebuttal Testimony of Matthew P. O'Loughlin regarding Cost of Service on behalf of Chevron Products Company, dated April 16, 2010 ("O'Loughlin Rebuttal"), pp. 22-26.

Fundamentally, the risks faced by the integrated major oil companies selected by Shell Pipeline are completely inapplicable to the SJV Pipeline. For instance, multinational companies risk the appropriation of assets in foreign countries, such as the nationalization of natural gas reserves in Bolivia or a pipeline in Nigeria—clearly a risk that a San Joaquin Valley pipeline would not face. Multinational companies also face the enormous risks associated with the exploration and production of oil and gas reserves—also inapplicable here. As a result, Shell Pipeline’s reliance on a capital structure in excess of *90 percent equity* does *not* yield a return commensurate with the risks faced by Shell Pipeline. Thus, Shell Pipeline’s reliance on multinational companies for its proxy group is clearly self-serving and unreliable.

**c. Use of Shell Pipeline’s Proposed Capital Structures Results In Unjust And Unreasonable Returns**

Equally troubling is that Shell’s use of a capital structure in excess of 90 percent equity skews key cost-of-service components, which further increases the rates Shell Pipeline seeks to charge the Independent Shippers. For instance, the pipeline’s income tax allowance depends on an appropriate calculation of the return on rate base, which relies directly on Shell Pipeline’s faulty equity component of the capital structure. An overstated equity component will inflate the return on the rate base and as a result, inflate the income tax allowance component of the cost of service.<sup>121</sup>

Shell Pipeline’s overstated analysis is easily demonstrated by a comparison between Mr. Ashton’s realistic income tax allowance and Mr. Van Hoecke’s inflated income tax allowance. Mr. Ashton computed an income tax allowance of approximately \$7.6 million for his test year.<sup>122</sup> Comparably, Chevron witness Mr. O’Loughlin computed a test year income tax allowance of approximately \$6.7 million in his fair value rate base case.<sup>123</sup> In stark contrast, Mr. Van Hoecke computed a test year income tax allowance of approximately \$16.3 million.<sup>124</sup> If Mr. Ashton’s

---

<sup>121</sup> Chevron Exh. 23, Vilbert Rebuttal, p. 8, Table 1; Chevron Exh. 49, O’Loughlin Rebuttal, p. 27, Chevron Opening Brief, pp. 55, 60.

<sup>122</sup> Tesoro Exh. 28-P, Ashton Prepared, attached Exhibit 20, p. 1.

<sup>123</sup> Chevron Exh. 48, O’Loughlin Prepared, attached Exhibit MPO-5.

<sup>124</sup> SP Exh. 38, Van Hoecke Rebuttal, attached Exhibit RGV-6, Schedule 7.

recommended capital structure were applied to Mr. Van Hoecke's analysis, the income tax allowance would be reduced from \$16.3 million to approximately \$8.6 million—*almost a 50% reduction*.

**d. Shell Pipeline's Operating Expense Adjustments And Overhead Cost Allocations Are Totally Unsupported**

Shell Pipeline's Opening Brief devotes little more than two paragraphs to discuss operating expenses, and fails to address or respond to the adjustments performed by the Independent Shipper witnesses.<sup>125</sup> Instead, Shell Pipeline simply references the rebuttal testimonies of its witnesses Mr. Van Hoecke and Mr. Petersen concerning alleged "judgmental" decisions made by the Independent Shippers' witnesses.<sup>126</sup> As the record makes clear, Tesoro and Chevron repeatedly requested information in discovery to evaluate the assumptions underlying Mr. Rathermel's operating expense computations,<sup>127</sup> but Shell Pipeline refused to provide any such information. In effect, Shell Pipeline simply but unreasonably expects the Independent Shippers, or this Commission, to accept Shell Pipeline's representation of operating expenses without verification and without analysis.

Shell Pipeline also fails to meet its burden to support its allocation of overhead expenses to the pipeline's costs. These expenses represent almost \$10 million of the operating expenses incorporated in the cost of service rates computed by Mr. Ashton. Again, despite repeated requests by Chevron and Tesoro for underlying data supporting the proposed overhead expenses, Shell Pipeline failed to provide any responsive information, and continues to advocate a "black box" method of allocating overhead expenses.<sup>128</sup> At the very least, Shell Pipeline could have—but chose not to—present evidence of the components that comprise the basis for its overhead

---

<sup>125</sup> San Pablo Bay Opening Brief, p. 63.

<sup>126</sup> San Pablo Bay Opening Brief, p. 63, see fn 149 and 150.

<sup>127</sup> See Chevron Exh. 49, O'Loughlin Rebuttal, attached Exhibit MPO-67.

<sup>128</sup> See Chevron Exh. 49, O'Loughlin Rebuttal, p. 43; SP Exh. 36, Rebuttal Testimony of Matthew A. Petersen on Behalf of San Pablo Bay Pipeline Company LLC, dated February 8, 2010 ("Petersen Rebuttal"), p. 20.

expense allocation. In fact, Shell Pipeline refused to provide the most fundamental data, thereby leaving the Independent Shippers, and this Commission, with no recourse but to use regulatory precedent to apply appropriate cost allocation methodologies applied by Mr. Ashton in Tesoro's rate calculations.<sup>129</sup>

**e. Shell Pipeline Duplicates Its Charges For Pipeline Losses**

In addition to the above-referenced errors in its cost-of-service calculations, Shell Pipeline fails to address a critical issue associated with the PLA included in its proposed tariff. Specifically, Shell Pipeline double counts oil losses and shortages embedded in its proposed rates, as it computes both a PLA *and* oil losses and shortages expenses in its cost-based rate analysis.<sup>130</sup>

If Shell Pipeline had any intent to meet its burden of proof to support its proposed cost-based rates, it would have revised its rate analysis to either use an appropriate PLA *or* remove oil losses and shortages expenses from its the cost of service analysis.<sup>131</sup> Further, even if Shell Pipeline chose to use a PLA, its proposed rate of 0.15% is too high and inconsistent with reality, as pointed out by Chevron<sup>132</sup> and Tesoro.<sup>133</sup> Undeniably, Shell Pipeline's incredible proposal to charge PLA fees *twice* to its shippers is another reminder that Shell Pipeline will exercise its market power to charge the highest rate it can without any regard to the traditional and accepted methodologies of this Commission for calculating cost-of-service rates. As a result, the *only* cost-of-service rates that can be relied upon with any certainty are those computed by Messrs. Ashton and O'Loughlin.

---

<sup>129</sup> See Tesoro Exh. 29-P, Prepared Testimony of Peter K. Ashton, Public Version, Revised Version, dated January 22, 2010 ("Revised Ashton Prepared"), pp. 13-14; Chevron Opening Brief, pp. 58-60.

<sup>130</sup> Tesoro addresses this issue further in its Opening Brief. (Tesoro Opening Brief, pp. 43-44).

<sup>131</sup> See Tesoro Exh. 28-P, Ashton Prepared, pp. 53-55 and Tesoro Opening Brief, p. 44.

<sup>132</sup> Chevron Opening Brief, p. 69.

<sup>133</sup> See Tesoro Exh. 29-P, Revised Ashton Prepared.

**f. The Rates Calculated By Tesoro Are Just And Reasonable Unlike Shell Pipeline's Cost-Based Rate Proposal**

The only credible evidence of just and reasonable rates that are tailored to *this* pipeline are the cost-based rates proposed by Tesoro. These rates are both supported and verified by the work of Chevron's witnesses. At every turn, Shell Pipeline has sought to inflate its costs and to depress its throughput and resulting revenue, to falsely justify rates that are 49 to 60 percent higher than those proposed by Tesoro and Chevron. For instance, Tesoro computes a test period rate for the movement of SJVH from Station 36 to Avon of \$1.371 per barrel, which is closely comparable to the \$1.271 that Chevron calculated. In stark contrast, Shell Pipeline's alleged cost based rate of \$2.187 per barrel and Mr. LaBorne's "market-based" rate of \$2.043 per barrel are grossly inflated.<sup>134</sup>

As the record evidence reflects, the key dramatic differences in the cost-based rate analyses between Shell Pipeline and all other parties are as follows:

- Tesoro's test period total cost of service is \$67.9 million, versus \$97.9 million as computed by Shell Pipeline—a difference of about 45%.
- Shell Pipeline has overstated its rate base by almost \$100 million (\$239.3 million, versus Tesoro's \$142.9 million) due to its erroneous selection of an in service date of August 2007 contrary to the Commission's finding in D.07-07-040 that Shell Pipeline has provided common carrier service since 1996. This leads to an overstated rate of return, depreciation expense and income tax allowance.
- Shell Pipeline has used an unreasonable capital structure of over 90 percent equity versus Tesoro's recommended more traditional capital structure of 48 percent equity.
- Shell Pipeline's overstated rate base and capital structure result in an overstated income tax allowance by \$8.7 million (\$16.3 million versus Tesoro's \$7.6 million).
- Shell Pipeline has overstated its operating expenses (excluding depreciation) by \$9.4 million.
- Shell Pipeline has overstated its depreciation expenses by \$1.6 million or 28%.

---

<sup>134</sup> Tesoro Opening Brief, p. 36.

- Tesoro's analysis demonstrates that Shell Pipeline's proposed "market-based" rates would lead to an over-recovery of its cost of service by 48% and would allow Shell Pipeline to earn an achieved return of over 23%, far in excess of any reasonable rate of return for a pipeline company, even with the use of Shell Pipeline's flawed rate of return analysis.

As outlined in Tesoro's Opening Brief, Tesoro uses reasonable and realistic assumptions and data in developing its cost of service analysis for Shell Pipeline.<sup>135</sup> Tesoro's rate design properly produces total revenues that equate to a just and reasonable cost of service. Mr. Ashton in his Refund Reply testimony demonstrates that the criticism of his analysis and calculation of rates and refunds was totally unfounded, and that based on the changes to Shell Pipeline's own throughput analysis and minor changes to certain cost items, it is likely that his rates and refund estimates are too low and not too high.<sup>136</sup>

In a failed attempt to discredit Tesoro's refund analysis, Shell Pipeline improperly relies on rate comparisons used in the *UNOCAP* case to assert that Shell Pipeline's "properly adjusted" rate comparison demonstrates that the rates proposed by Shell Pipeline are reasonable.<sup>137</sup> However, Mr. Ashton specifically testified that he disagreed with several of the assumptions underlying the analysis that Shell Pipeline introduced at hearings.<sup>138</sup> For instance, the rate comparison used by Mr. Ashton in the *UNOCAP* proceeding reflected rates that were charged almost 20 years ago, and Shell Pipeline has failed to examine current rates.

Moreover, the exhibit presented by Shell Pipeline (Exhibit SP-45) at hearings, and upon which it now relies, included a number of "adjustments" for line fill, inflation, and heating. Mr. Ashton testified that he did not agree with these adjustments and indeed explicitly stated that he had a problem with the adjustments made by Shell Pipeline, as they were not accurate and did

---

<sup>135</sup> Tesoro Opening Brief, pp. 32-49.

<sup>136</sup> Tesoro Exh. 30, Prepared Refund Reply Testimony of Peter K. Ashton, dated April 16, 2010 ("Ashton Reply"), p. 2.

<sup>137</sup> San Pablo Bay Opening Brief, p. 70.

<sup>138</sup> SP Exh. 45, Unocal Rate Comparison (\$/Bbl) Chart.

not reflect a comparable set of circumstances.<sup>139</sup> Mr. Ashton also stated that a more appropriate comparison would compare Shell Pipeline's proposed rates to what the *UNOCAP* rate would be today.<sup>140</sup>

Not surprisingly, Shell Pipeline has failed to make this comparison in its Opening Brief. If it had done so, the reality it would face is that the "comparable" rate today is \$1.18 per barrel,<sup>141</sup> which is almost 35% lower than Shell Pipeline's proposed rate for the same movement, and about 3% lower than the rate for the same distance movement contained in Mr. Ashton's test year recommended rates.<sup>142</sup> Undeniably, Shell Pipeline's attempted adjustments to this existing rate is utterly specious and thus, Shell Pipeline's claim that its existing and proposed rates are justified by a rate comparison drawn from the *UNOCAP* proceeding is fatally flawed.

For these reasons, the evidence in the record demonstrates that Shell Pipeline has failed to meet its burden to prove that its proposed market-based rates or its alternative cost-of-service rates are just and reasonable. While Tesoro has presented objective estimates of Shell Pipeline's costs, Shell Pipeline has manipulated its costs and artificially depressed throughput estimates to reduce the revenue requirement and achieved return.

#### **g. Throughput And Crude Oil Production Decline**

In its Opening Brief, Shell Pipeline asserts that the skewed throughput and related revenue data sponsored by Mr. LaBorne is reasonable and reliable rather than the data presented by the Independent Shippers. Throughput and associated revenues are key elements in assessing

---

<sup>139</sup> RT 1045 – 1050 (Ashton/Tesoro); Mr. Ashton explicitly noted issues he had with the heating cost and inflation adjustments, and Tesoro's analysis of line fill costs supports the fact that this adjustment was also greatly overstated in SP Exh. 45, Unocal Rate Comparison (\$/Bbl) Chart.

<sup>140</sup> RT 1050 (Ashton/Tesoro).

<sup>141</sup> Available at [http://w3apps.conocophillips.com/PipelineTariffsPDF/CPPL\\_CALPUC\\_1.pdf](http://w3apps.conocophillips.com/PipelineTariffsPDF/CPPL_CALPUC_1.pdf) (last visited July 14, 2010). ConocoPhillips assumed ownership of the former UNOCAP pipeline system in California in 2005 and revised its tariffs again in 2008.

<sup>142</sup> Tesoro Exh. 29-P, Revised Ashton Prepared, attached Exhibit 21.

a pipeline's achieved return and in determining just and reasonable rates. Shell Pipeline falsely claims that Mr. LaBorne's forecast of test period volumes "reflects consensus" and reflects the fact that California production "is in a steady state of decline."<sup>143</sup> In addition, Shell Pipeline baldly asserts that the Independent Shippers' witnesses on throughput have no expertise related to crude oil production,<sup>144</sup> and that Mr. Ashton could not confirm whether OCS crude was included in his projections.

As with any statement made by Mr. LaBorne, Shell Pipeline's assertions as to throughput projections misrepresent reality. For instance, Mr. LaBorne projected a 14% decline in throughput between 2008 and his test period, even though the historical data he relies on suggests crude oil production has been declining by at most 3-4% per year. Furthermore, actual throughput on the SJV Pipeline declined by a negligible amount in recent years and actually increased in 2009 relative to 2008.

Notably, Mr. LaBorne selected the *largest decline rates* in any single year over a number of years in the selected fields he examined as the basis for his overall throughput decline. The single year decline by field varied dramatically and he only used the lowest single year in his analysis. This systematically inflated the rate of decline which was directly translated to a decline in throughput.<sup>145</sup> In addition, Mr. LaBorne's test period (2010) throughput projection is 20,000 barrels per day *lower* than the average actual throughput for the first four months of 2010.<sup>146</sup> Furthermore, Mr. LaBorne omitted various gathering volumes and revenues in his direct testimony which he added in his rebuttal testimony, and reduced the PLA percentage from 0.25% to 0.15%<sup>147</sup> despite that Shell Pipeline actually experienced a *gain* in 2009 from operating the SJV pipeline. If Shell Pipeline really believed its own throughput information, it would have

---

<sup>143</sup> STUSCO Opening Brief, p. 58.

<sup>144</sup> STUSCO Opening Brief, p. 61.

<sup>145</sup> RT 677 – 678; 681 – 684 (LaBorne/San Pablo Bay).

<sup>146</sup> Compare SP Exh. 23, LaBorne Rebuttal, Attachment A to Chevron Exh. 32, Shell Monthly Shipper Data, dated April 2010, p. 5.

<sup>147</sup> See SP Exh. 23, LaBorne Rebuttal.

initiated design studies to address minimum throughput issues. Ironically, Shell Pipeline's witnesses indicated that the design studies were not yet necessary.<sup>148</sup>

When cross-examined concerning his questionable projections, Mr. LaBorne claimed that there was a 50 percent probability that the Big West refinery would come back on line and divert up to 10,000 b/d away from Shell Pipeline, despite being presented with clear evidence that the purchaser of the Big West refinery, Alon, has indicated that it has no plans to run crude oil in the refinery.<sup>149</sup> As noted above, the list of errors in Mr. LaBorne's throughput forecast renders invalid Shell Pipeline's entire rate analysis.

Contrary to Shell Pipeline's unsupported claims, there is absolutely no "consensus" among the parties regarding future throughput on the SJV Pipeline. Further, the record evidence unequivocally demonstrates that Mr. LaBorne's analysis of throughput is biased to produce a result that is beneficial only to Shell entities. In contrast, Mr. Ashton's independent analysis proposes reasonable and reliable throughput estimates. He has extensive experience with issues related to California crude oil production and transportation since the early 1980s, and furthermore, he has developed crude oil supply models and production forecasts for the federal government.<sup>150</sup> Shell Pipeline also conveniently fails to disclose that it did not provide any data that separately categorized OCS for throughput projections, and Mr. LaBorne significantly lowers OCS throughput in future years due to customer objections to "regrading."<sup>151</sup>

Unlike Mr. LaBorne's creative throughput projections, Mr. Ashton's projections rely on actual 2009 throughput data for Shell Pipeline, CEC projections, and recent events that clearly

---

<sup>148</sup> RT 475-476 (Dompke/San Pablo Bay); *see also*, Ex. Tesoro 7, Response of San Pablo Bay to Tesoro's Seventh Set of Data Requests, April 1, 2010.

<sup>149</sup> RT 693 – 698 (LaBorne/San Pablo Bay); Chevron Exh. 9, Alon Big West Refinery Article entitled Alon Plans to Downsize Big West Refinery, Process No More Crude Oil, dated March 25, 2010; Chevron Exh. 10, Alon Bakersfield Refinery Article, entitled United States: Alon to Open Bakersfield Refinery, Process Gasoil., dated March 26, 2010; and Chevron Exh. 11, Alon Bakersfield Refinery Article entitled Alon to Open Bakersfield Refinery, Process Gasoil (Update 1), dated April 27, 2010.

<sup>150</sup> As Tesoro Exh. 29-P, Revised Ashton Prepared, attached Exhibit 1 indicates, Mr. Ashton has also been involved in numerous pipeline rate cases in which development of test period throughput estimates is a key dimension of such analysis.

<sup>151</sup> RT 1053 (Ashton/Tesoro).

would have an impact on throughput.<sup>152</sup> Mr. Ashton also noted in his testimony that recent new discoveries in the San Joaquin Valley were likely to somewhat mitigate any decline in production in other fields, a key fact ignored by Mr. LaBorne.<sup>153</sup> Nevertheless, Mr. Ashton's test period throughput estimate reflects an almost 3% decline in total throughput relative to 2007. Chevron's independent forecast also supports and validates Mr. Ashton's conclusions.

Given the wide disparity between Tesoro's and Shell Pipeline's throughput forecasts, and the numerous flaws in Shell Pipeline's forecast, the Commission has no recourse but to adopt the reasonable and sound cost-of-service analysis of Tesoro.

**5. The Commission Should Order Refunds To Tesoro For Shell Pipeline's Unreasonable Charges.**

**a. Tesoro's Analysis of Refunds Owed Should Be Adopted.**

As stated in the Scoping Memo issued in this matter, this rate case is consolidated with a series of complaints by Chevron, Tesoro and Valero for refunds for overcharges for transportation.<sup>154</sup> The issues with regard to refunds are few, but meaningful:(1) from what date should Shell Pipeline pay refunds; (2) what is the amount of refunds that should be paid—that is, the rate that should be applied for the period against which the actual rate charged should be subtracted; and, (3) to whom the refunds should be paid.

The record evidence shows that Shell Pipeline increased its rate from \$1.09 per barrel in January 2005 to \$1.686 per barrel on April 1, 2005, and to \$1.90 per barrel on January 1, 2006, without Commission approval, and the rates vary dramatically from any appropriate cost-of-service rate.<sup>155</sup> Accordingly, that such rates charged were unjust and unreasonable, and thus Shell Pipeline owes refunds from at least April 1, 2005 until the present. Specifically, the amount of refunds calculated by Mr. Ashton amounts to at least \$40.1 million through September

---

<sup>152</sup> Tesoro Exh. 30, Ashton Reply, p. 24.

<sup>153</sup> Tesoro Exh. 29-P, Revised Ashton Prepared, p. 13.

<sup>154</sup> See *Complaint of Tesoro Refining and Marketing Company*, filed in C.09-02-007 on February 13, 2009; *Amended Complaint of Tesoro Refining and Marketing Company*, filed in C.09-02-007 on March 5, 2009; *Scoping Memo and Ruling of Assigned Commissioner*, filed April 27, 2009 (consolidating all complaint actions).

<sup>155</sup> Chevron Exh. 46, Direct Testimony of David R. Lee Regarding California Crude Oil Production and Transportation on behalf of Chevron Products Company, dated November 16, 2009 ("Lee Prepared"), p. 27.

2009 with additions for refunds and interest after September 2009 to the date the Commission establishes stated rates and a tariff, and that the refunds must be paid to Tesoro for crude oil delivered to it under buy/sell arrangements.

Shell Pipeline completely misinterprets the law in asserting that Public Utilities Code section 735 bars the claims for refunds in this matter. Section 735 specifically provides, "If the public utility does not comply with the order for the payment of reparation within the time specified in the order, suit may be instituted in any court" to recover payment of the refund within a year from the order of refunds. Thus, Section 735 allows a complainant to file suit in court to recover refunds *after* the Commission has ordered the public utility to pay refunds and the utility has failed to comply with that order. There has been no such order here, and the claims for refunds are not barred as Shell Pipeline misrepresents.

Similarly, Shell Pipeline's assertion that it is entitled to an offset in its rates for line fill provided under its buy/sell agreements to date has no merit. Shell Pipeline assumes, without any supporting facts, that the rate charged under the buy/sell agreements did not include an implicit charge for line fill. No evidence has ever demonstrated that the buy/sell rate did not incorporate an implicit charge for line fill.

Moreover, line fill is not part of the cost-of-service rate that Tesoro computed, nor is it typically treated as part of a pipeline company's cost of service. Shell Pipeline has failed to offer any evidence of its actual costs of line fill, and it has the burden to do so. It provided no direct or rebuttal testimony on this issue. During the cross examination of shipper witnesses it did present two exhibits, SP-46 and SP-52, which purport to compute the cost of line fill. However, these exhibits were not sponsored by any Shell Pipeline witness and were criticized by both Mr. Ashton and Mr. O'Loughlin as being unreasonably high.<sup>156</sup> Mr. LaBorne offered an "estimate" of \$0.20 for line fill, but there was no basis, explanation or support for this number. In contrast, Mr. O'Loughlin provided a sound estimate of \$0.0459 per barrel as the cost of line fill, properly

---

<sup>156</sup> RT 1059 – 1063 (Ashton/Tesoro); RT 1202-1203 (O'Loughlin/Chevron).

treating it as a capital cost borne by the utility at the time it was placed into public service (1996).

Undeniably, Tesoro's calculation of refunds is the most reliable and consensus position in this proceeding. First, Mr. Ashton used the same basic approach to determining the appropriate cost-of-service rate for refunds as did Shell Pipeline.<sup>157</sup> Second, when all criticisms of Mr. Ashton's analysis were taken into consideration, with the exception of the in-service date provided by Commission order and the appropriate rate of return and capital structure, the impact of the suggested adjustments do not vary the result in any significant way.<sup>158</sup> Mr. Ashton actually cautions that his refund calculations may be too low.<sup>159</sup> Mr. Ashton further used a year-by-year calculation to track any changes in the cost-based rates to determine the appropriate level of refunds for that year.<sup>160</sup>

In yet another attempt to elude this Commission's jurisdiction, Shell Pipeline asserts that Tesoro and Chevron have improperly based their refund calculations on a date of April 1, 2005 instead of August 1, 2007.<sup>161</sup> Shell Pipeline relies on inapplicable precedent approving a settlement allowing the utility to base rates on the "fair value" of property voluntarily dedicated to public service. However, as noted in the opening briefs of Tesoro and Chevron, Shell Pipeline's claims are unsupported by fact or law.<sup>162</sup>

Thus, contrary to Shell Pipeline's assertions,<sup>163</sup> it is uncontroverted that April 1, 2005 is the date to be used as the base to calculate refunds. Beginning in 2008, the volumes were no longer fully covered by a buy/sell between STUSCO and Chevron and also include the buy/sell entered into between STUSCO and Tesoro. Clearly, the potential refund continues to grow as the volumes are flowing to Tesoro at the transportation rate of \$1.90 per barrel. Thus, the total

---

<sup>157</sup> Tesoro Exh. 29-P, Revised Ashton Prepared, pp. 17-18.

<sup>158</sup> Tesoro Exh. 30, Ashton Reply, pp. 7-8.

<sup>159</sup> Tesoro Exh. 30, Ashton Reply, pp. 7-8.

<sup>160</sup> Tesoro Exh. 30, Ashton Reply, p. 3.

<sup>161</sup> San Pablo Bay Opening Brief, pp. 80-81.

<sup>162</sup> Tesoro Opening Brief, pp. 49-51; Chevron Opening Brief, pp. 80-82.

<sup>163</sup> San Pablo Bay Opening Brief, p. 80.

refund will only be capable of calculation when the final rates and tariff are put in place on the system and rates for the reparations period are computed.

When comparing the Tesoro proposed cost-based rate with Shell Pipeline-dictated \$1.90 per barrel under the buy/sell agreements, the refund to Tesoro would be \$40.1 million as of late 2009.<sup>164</sup> This number is not affected by the changes and criticisms leveled against Mr. Ashton's analysis, as they are *de minimis* in the total calculation, but the \$40.1 million calculated by Mr. Ashton does not include additional refunds and interest after September 2009.<sup>165</sup>

Regardless of the final calculation, it is essential that the Commission order refunds from April 1, 2005, which are supported by the evidence and as a matter of law.

**b. Tesoro Should Be Paid Refunds As A Matter Of Law And Equity.**

The law and evidence conclusively mandate that Tesoro is the party entitled to recover refunds for all volumes delivered to it under a buy/sell agreement. In an apparent attempt to limit the amount of refunds owed, Shell Pipeline has asserted that the refunds claimed by Chevron and Tesoro are duplicative, that the burden to prove unreasonable charges has not been met, and that refunds are only owed from August 1, 2007 instead of April 1, 2005.<sup>166</sup> Shell Pipeline's assertions are directly contrary to the record evidence and this Commission's previous orders in D.07-07-040.

Pursuant to California Civil Code Section 1559, an agreement, made expressly for the benefit of a third party, may be enforced by that party at any time before the parties thereto rescind it. The buy/sell agreements continue to be the only means by which Tesoro receives its crude oil supply to date through Shell Pipeline's utility system. In addition, it is clear that the buy/sell agreements were made "expressly" for the benefit of Tesoro, were "shams" to avoid Commission jurisdiction and were used in lieu of a tariff for ratepayers. Tesoro need not be

---

<sup>164</sup> Tesoro Exh. 29-P, Revised Ashton Prepared, p. 5.

<sup>165</sup> Tesoro Exh. 30, Ashton Reply, pp. 26-27. Notably, Mr. Ashton's discussion of refunds does not include the "regrading" of OCS to SJVH, as it is not the subject of any of the consolidated complaints in this matter.

<sup>166</sup> San Pablo Bay Opening Brief, pp. 69-83.

named in the buy/sell agreement or otherwise identified to be an express beneficiary to collect refunds.<sup>167</sup>

Moreover, the sole purpose for Chevron to enter into a buy/sell agreement with STUSCO for shipment of SJVH crude on the SJV Pipeline has been to sell crude oil to Tesoro. As part of that sale, Chevron passed through the crude oil transportation charges to Tesoro. Indeed, Chevron does not even have a refinery in the San Francisco Bay Area where the SJV Pipeline ends—only Shell, Tesoro and Valero do. Thus, the buy/sell agreements between STUSCO and Chevron were made expressly for the benefit of Tesoro, and Tesoro can directly collect refunds from Shell.

The California Public Utilities Code and Commission precedent further support Tesoro's claim that it should directly receive refunds from Shell. California Public Utilities Code section 453.5 requires public utilities to pay Commission-ordered refunds to its current and, when practicable, prior customers.<sup>168</sup> Commission precedent has recognized that the purpose of Section 453.5 is to ensure that customers who suffer the improper rates are the recipients of the appropriate refund. The Commission has stated, "In Public Utilities Code § 453.5 the Legislature prescribed a procedure for distributing refunds that attempted to *match refund payment with the customers whose rates reflected the excessive costs that were the subject of the refund.*"<sup>169</sup> Clearly, the law contemplates that the ratepayer who actually paid the excessive charges should receive the refund for the charges.

In that regard, when an intermediary is involved in the pass-through of rates to the ratepayer, the Commission requires a public utility to ensure that supplier refunds reach the ratepayers who previously paid the imprudent costs in their rates.<sup>170</sup> Commission precedent

---

<sup>167</sup> See *Kaiser Engineers, Inc. v. Grinnell Fire Protection Systems Co.*, (1985) 173 Cal.App.3d 1050; *Cartwright v. Viking Industries, Inc.*, 249 F.R.D. (2008) 351, 356; *Bleecher v. Conte*, (1981) 29 Cal. 3d 345.

<sup>168</sup> Cal. Pub. Util. Code § 453.5.

<sup>169</sup> Emphasis added. D.02-02-051, *Application of Southern California Edison Company (E 3338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs. Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E) Petition of The Utility Reform Network for Modification of Resolution E-3527*, 2002 Cal. PUC LEXIS 170, \*89.

<sup>170</sup> D.94-03-040, *Application of Pacific Gas And Electric Company for authority to Adjust its Electric Rates Effective November 1, 1991; and to Adjust its Gas Rates Effective January 1, 1992; and for Commission Order*

reflects that the Commission has approved refunds to be directly paid to ratepayers rather than intermediary service providers.<sup>171</sup>

Chevron's witness David Lee has stated twice that the "location differential" referenced in the buy/sell agreements, which this Commission found is a transportation charge, is merely passed through to the refinery customers.<sup>172</sup> The "market adjustment", unlike the location differential, is actually a part of the commodity cost, for which the producer may pay royalties and receive its compensation for sale of the commodity. Therefore, the location differential charge and PLA are the charges that are subject to refunds.

A refund to Tesoro is owed from three buy/sell transactions at issue here: (1) those volumes delivered to Tesoro under a direct buy/sell with STUSCO in place since 2008, (2) the earlier Chevron buy/sell agreement with STUSCO clearly executed on Tesoro's behalf, and (3) the 2008 replacement buy/sell agreement of Chevron and STUSCO for crude oil purchased by Tesoro. Chevron, however, may be entitled to separate refunds for transactions which do not involve its buy/sell agreements with Tesoro.

**c. The Rule Against Retroactive Application Of Rates Is Inapplicable With Respect To Refunds.**

In yet another attempt to circumvent this Commission's regulation of Shell Pipeline, STUSCO asserts that the Independent Shippers claims for refunds of past unreasonable charges should be rejected as the Commission does not have the authority to apply rates retroactively.<sup>173</sup> This assertion is wrong as a matter of law.

---

*Finding that PG&E's Gas and Electric Operations During the Reasonableness Review Period from January 1, 1990 to December 31, 1990 were Prudent*, 1994 Cal. PUC LEXIS 159, \*\*73-74.

<sup>171</sup> See, e.g., D.94-04-088, *Order Instituting Rulemaking into Natural Gas Procurement and System Reliability Issues; And Related Matters*, 1994 Cal. PUC LEXIS 347, \*44 ("Section 453.5 requires us to direct utilities to distribute refunds, 'when practicable,' to the same customers who paid for the utility service which is the subject of the refund... We cannot approve that portion of the settlement which would deny core aggregation customers a pro rata share of the \$65 million because to do so would violate Section 453.5"); D.10-01-024, *Order Instituting Rulemaking Adopting Rules to Account for the Consideration Allocated to California Core Natural Gas Ratepayers Under Settlements of Natural Gas Antitrust Cases I-IV*, 2010 Cal. PUC LEXIS 9, \*\*15-16 ("Attachment A to this decision...is adopted to establish refund methodology procedures including any payments to core-elect, core-subscription, core-aggregation and wholesale transportation customers").

<sup>172</sup> RT 1158, 1179 – 1180 (Lee/Chevron).

<sup>173</sup> STUSCO Opening Brief, pp. 17-19.

STUSCO cites Public Utilities Code section 728 in support of its assertion,<sup>174</sup> which authorizes the Commission to fix by order the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be observed or enforced when the Commission finds after a hearing that the rates or classifications of a utility are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential. This section authorizes the Commission to fix reasonable rates after a finding that the established general rates of a utility are unreasonable or discriminatory. *Nothing* in this section prohibits the Commission from ordering refunds for rates that have not been approved by the Commission previously, which constitute *reparations* to a complainant for previously unapproved unjust and unreasonable charges.<sup>175</sup>

It is well-established that Commission precedent has limited the rule against retroactive ratemaking to prevent retroactive changes to previously established rates for utilities. In *Southern California Edison Co. v. Public Utilities Commission*, (1978) 20 Cal.3d 813, upon which STUSCO relies in its Opening Brief, the California Supreme Court *approved* a Decision by the Commission requiring Southern California Edison (“SCE”) to refund to its customers, through an amortized billing credit, the amounts overcollected by operation of SCE’s fuel adjustment clause. SCE argued that the Decision constituted retroactive ratemaking because the funds were collected pursuant to a rate structure found by the Commission to be just and reasonable.<sup>176</sup>

The Court rejected this argument, and found that that the Order did not constitute retroactive ratemaking.<sup>177</sup> The Court first acknowledged its decision in *Pacific Telephone and Telegraph Company v. Public Utilities Commission*, (1965) 62 Cal.2d 634, 676, on which STUSCO also relies in its Opening Brief, where the Court acknowledged and clarified that the

---

<sup>174</sup> STUSCO Opening Brief, p. 18.

<sup>175</sup> See Public Utilities Code section 734, which provides that when a complaint has been filed with the Commission for unjust and unreasonable rates, and the Commission has found in favor of the complainant, the Commission is authorized to “order that the public utility make due reparation to the complainant therefor, with interest from the date of collection if no discrimination will result from such reparation.”

<sup>176</sup> *Southern California Edison Co.*, 20 Cal.3d at 815.

<sup>177</sup> *Southern California Edison Co.*, 20 Cal.3d at 829.

rule against retroactive ratemaking applies only when the establishment of a utility's general rate *previously established* by the Commission is at issue:

The above cases establish that *once a lawfully adopted rate is fixed a subsequent finding that it is either unreasonably high or low* does not justify either refunding excess revenues collected pursuant to the rate or retaining revenues collected pursuant to an invalid rate increase. To either refund or retain on the basis of what would have been a reasonable rate constitutes retroactive ratemaking.<sup>178</sup>

Notably, however, the Commission has also found that rate increases that have not been specifically approved by the Commission, such as in this matter, are invalid and unreasonable, thus warranting an order of refunds.<sup>179</sup>

In that regard, the Commission specifically created an exception to the rule against retroactive ratemaking where refunds are ordered to remedy a violation of law. For instance, in *Independent Energy Producers Association, California Manufacturers Association, Toward Utility Rate Normalization, Complainants, vs. Pacific Gas and Electric Company, Defendant*, Decision No. 99-12-022, PG&E requested rehearing of a Commission decision ordering refunds to the complainants for PG&E's unlawful circulation of newsletters that sought to defeat certain changes in legislation.<sup>180</sup> PG&E argued that the ordered refunds constituted retroactive ratemaking, as the Commission had previously established that its rates were reasonable in PG&E's previous general rate case.<sup>181</sup> The Commission expressly stated:

Moreover, the refund ordered does not change a rate; rather, *the refund was ordered to remedy PG&E's violation of the law*, namely the spending of monies collected from ratepayers on an improper purpose. We would not have approved of a rate that would permit PG&E to violate Public Utilities Code Section 453(d). Consequently, our act of ordering a refund did not involve ratemaking, and thus, the prohibition against retroactive ratemaking does not apply.<sup>182</sup>

---

<sup>178</sup> *Southern California Edison Co.*, 20 Cal.3d at 836 (emphasis added).

<sup>179</sup> See, e.g., D.98-10-023, *Ortega v. AT&T Communications of California, Inc.*, 1998 Cal. PUC LEXIS 673 ("D.98-10-023, 1998 Cal. PUC LEXIS 673") at \*\*7-8.

<sup>180</sup> *Id.* at \*\*1-3.

<sup>181</sup> D.98-10-023, 1998 Cal. PUC LEXIS 673, \*\*6-7.

<sup>182</sup> Emphasis added. *Id.* at \*\*7-8.

Undoubtedly, given that the utility at issue in this matter is a pipeline with *no previously determined rates established by this Commission*, the record evidence in this case supports an order of refunds, which would not constitute retroactive ratemaking. Since at least April, 2005, the SJV Pipeline has been operated as a common carrier without a valid tariff on file, in violation of California law.<sup>183</sup> As the undisputed evidence shows, the application at issue here is to establish rates for the first time for Shell Pipeline for service on the SJV Pipeline. To date, the Commission has promulgated no general rates for the pipeline or its operator, and thus has the full authority to issue refunds for unreasonable charges from 2005 to the present.

The rule against retroactive ratemaking is inapplicable in this regard, as the Commission would not make any adjustment to an established basic rate charged to Shell Pipeline's customers if refunds were ordered. Further, even if rates were somehow previously established, this Commission is authorized to issue refunds to remedy a violation of law, similar to the unauthorized and unlawful rate increases that Shell Pipeline has imposed on its shippers in this case. To accept STUSCO's logic, every order of refunds for unlawful charges by any utility would be illegal retroactive ratemaking, which would be contrary to Public Utilities Code section 734.

#### **V. CONCLUSION AND REQUEST FOR RELIEF**

For the foregoing reasons, Tesoro respectfully requests that the Commission (1) deny Shell Pipeline's application for market-based rates, (2) adopt the cost-based rates proposed by Tesoro, and (3) order Shell Pipeline to pay refunds to Tesoro for excessive charges made from April 2005 to the present.

---

<sup>183</sup> See, e.g., Public Utilities Code § 451.

Dated: July 19, 2010

By:   
David L. Guard  
Tara S. Kaushik

MANATT, PHELPS & PHILLIPS, LLP  
One Embarcadero Center, 30th Floor  
San Francisco, CA 94111  
Telephone: (415) 291-7400

*Attorneys for Tesoro Refining and Marketing  
Company*

300122121.3

**PROOF OF SERVICE**

I, Kim O.T. Trinh, declare as follows:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to this action. My business address is MANATT, PHELPS & PHILLIPS, LLP, One Embarcadero Center, 30th Floor, San Francisco, California 94111-3719. On July 19, 2010, I served the within:

**REPLY BRIEF OF TESORO REFINING AND MARKETING COMPANY**

on the interested parties in this action addressed as follows:

*See attached service list.*

- (BY PUC E-MAIL SERVICE)** By transmitting such document electronically from Manatt, Phelps & Phillips, LLP, San Francisco, California, to the electronic mail addresses listed above. I am readily familiar with the practice of Manatt, Phelps & Phillips, LLP for transmitting documents by electronic mail, said practice being that in the ordinary course of business, such electronic mail is transmitted immediately after such document has been tendered for filing. Said practice also complies with Rule 1.10(b) of the Public Utilities Commission of the State of California and all protocols described therein.
  
- (BY U.S. MAIL)** By placing such document(s) in a sealed envelope, with postage thereon fully prepaid for first class mail, for collection and mailing at Manatt, Phelps & Phillips, LLP, San Francisco, California following ordinary business practice. I am readily familiar with the practice at Manatt, Phelps & Phillips, LLP for collection and processing of correspondence for mailing with the United States Postal Service, said practice being that in the ordinary course of business, correspondence is deposited in the United States Postal Service the same day as it is placed for collection.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on July 19, 2010, at San Francisco, California.

  
\_\_\_\_\_  
Kim O.T. Trinh

**PUC E-Mail Service List**  
**A.08-09-024; C.08-03-021; C.09-02-007;**  
**C.09-03-027**  
**[Updated July 16, 2010]**

Barbara.hickl@shell.com  
jleslie@luce.com  
elichtblau@orrick.com  
michael.hindus@pillsburylaw.com  
JMalkin@Orrick.com  
epoole@adplaw.com  
jsqueri@goodinmacbride.com  
mgo@goodinmacbride.com  
dhuard@manatt.com  
mcorcoran@goldstein-law.com  
mgoldstein@goldstein-law.com  
Kris.mira@shell.com  
Robbie.ralph@shell.com  
Tim.Gehl@shell.com  
bdowling@tsocorp.com  
andrew.dalton@valero.com  
Darren.Stroud@valero.com  
jpmosher@aeraenergy.com  
wesley.spowhn@pillsburylaw.com  
bcragg@goodinmacbride.com  
cassandra.sweet@dowjones.com  
tkaushik@manatt.com  
mday@goodinmacbride.com  
judypau@dwt.com  
vidhyaprabhakaran@dwt.com  
cem@newsdata.com  
dcoh@chevron.com  
rock@cipa.org  
alf@cpuc.ca.gov  
kjb@cpuc.ca.gov

**U.S. Mail Service List**  
**A.08-09-024; C.08-03-021; C.09-02-007;**  
**C.09-03-027**  
**[Updated July 16, 2010]**

Administrative Law Judge  
Karl Bemederfer  
California Public Utilities Commission  
ALJ - Division  
505 Van Ness Avenue, Room 5006  
San Francisco, CA 94102-3214

300126172.1