FILED
04-19-10
04:59 PM

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Application of SFPP, L.P. for authority, pursuant to Public Utilities Code Section 455.3, to increase its rates for pipeline transportation services within California.	)))))	Application No. 09-05-014 (Filed May 12, 2009)
And Related Matters.	)))	Application No. 08-06-008 Application No. 08-06-009 (Filed June 6, 2008)

CONCURRENT OPENING BRIEF
OF
SFPP, L.P. AND CALNEV PIPE LINE LLC

GOODIN, MACBRIDE, SQUERI,
DAY & LAMPREY, LLP
James D. Squeri
505 Sansome Street, Suite 900
San Francisco, CA 94111
Telephone: (415) 392-7900
Facsimile: (415) 398-4321
E-mail: jsqueri@goodinmacbride.com

Attorneys for SFPP, L.P. and Calnev Pipe Line LLC

Date: April 19, 2010

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

STATUTES

DECISIONS OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION

FEDERAL ENERGY REGULATORY COMMISSION ORDERS

OTHER AUTHORITIES

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Application of SFPP, L.P. for authority, pursuant to Public Utilities Code Section 455.3, to increase its rates for pipeline transportation services within California.	)))))	Application No. 09-05-014 (Filed May 12, 2009)
And Related Matters.	)))	Application No. 08-06-008 Application No. 08-06-009 (Filed June 6, 2008)

<u>CONCURRENT OPENING BRIEF OF SFPP, L.P. AND CALNEV PIPE LINE LLC</u>

In accordance with the adopted procedural schedule, SFPP, L.P. ("SFPP") and Calnev Pipe Line LLC ("Calnev") (together referenced as "Applicants") hereby respectfully submit their Concurrent Opening Brief in the above-referenced consolidated proceedings per the Assigned Commissioner's Scoping Memo and Ruling dated August 20, 2009.

The principal issue presented by the subject consolidated proceedings is whether SFPP's existing California intrastate pipeline rates, including the $5 million rate increase that is the subject of amended Application (A.) 08-06-008 and the $5 million rate increase that is the subject of A.09-05-014, are just and reasonable. As argued below and as fully supported by the record, it will be shown: (i) that SFPP is entitled to retain the $10 million in rate increases at issue; and (ii) that its overall, current system-wide intrastate rates, when evaluated by the Commission in consideration of various factors, including a forward-looking 2009 Test Year ("TY") cost of service ("COS") analysis, are just and reasonable.

I. INTRODUCTION

SFPP and Calnev filed parallel rate case applications in June, 2008 as required by Commission Decision No. 07-05-061, supporting the reasonableness of their respective, then-existing rates. Both applications further requested Commission endorsement and adoption of a form of "lighthanded" rate regulation of their intrastate pipeline operations that would rely upon an appropriate, reliable indexing mechanism as presumptively determinative of the reasonableness of future general rate increases requested by the two pipeline utilities.[1] ConocoPhillips Company, Chevron Products Company, Southwest Airlines Co., ExxonMobil Oil Corporation, Valero Marketing and Supply Company, Utramar, Inc., Tesoro Refining and Marketing Company and BP West Coast Products LLC (collectively "Shippers") protested the applications.

In September, 2008, pursuant to Section 455.3 of the Public Utilities Code (the special provision relating to rate increases by oil pipeline corporations), SFPP filed an amendment to its pending Application No. 08-06-008, requesting a rate increase of approximately $5.0 million applicable to rates to all California destinations to be effective as of November 1, 2008. In May 2009, SFPP filed A. 09-05-014, requesting Commission approval of a general rate increase of

[1] Applicants have abandoned their request for a form of "lighthanded" regulation predicated upon use of an index mechanism as the primary basis for Commission review and determination of the reasonableness of their respective rates. Nor do Applicants seek, or have they requested, Commission endorsement of so-called "market-based" rate authority for either SFPP or Calnev. As described more fully herein, Applicants, instead, seek no change in the Commission's existing policy and methodology for evaluating the reasonableness of their oil pipeline rates, which under the Commission's *Unocap* decisions, requires *(footnote continued)*

$5.0 million, once again under Pub. Util. Code § 455.3. Shippers filed timely protests to this application.

The issues presented by A. 08-06-008, as amended, and A. 09-05-014, as defined by the Assigned Commissioner's Scoping Memo and Ruling dated August 20, 2009 and still controverted by Shippers, are as follows:

- Are SFPP's existing rates, terms and conditions, including the $5 million rate increase that is the subject of amended Application (A.) 08-06-008 and the $5 million rate increase that is the subject of A.09-05-014 just and reasonable?

- Are SFPP's rates to be evaluated solely on the basis of a cost-of-service analysis or are SFPP's rates to be evaluated in the context of the *Unocap* factors or criteria, including (a) evaluation of competitive alternatives available to SFPP shippers, (b) examination of the extent, if any, that SFPP's intrastate rates are constrained by market forces, (c) comparison of SFPP's rates with other pipeline rates, and (d) analysis of SFPP's cost of service?

- What are reasonable forecasted, cost-of-service assumptions for SFPP for Test Year 2009 regarding: (i) throughput and associated revenues; (ii) operating expenses (including appropriate cost allocation between regulated interstate and intrastate systems as well as between CPUC-jurisdictional and non-jurisdictional entities); (iii) capital structure; (iv) cost of debt; (v) return on equity; and (vi) federal income tax allowances.[2]

II. SUMMARY OF SFPP'S POSITIONS AND RECOMMENDATIONS

The subject brief addresses two basic questions: (1) whether SFPP's rates should be reviewed solely on the basis of cost of service or should evaluation of rate reasonableness

---

consideration of various factors, including cost of service; pipeline rate comparisons, the availability of competitive alternatives; and the size and sophistication of the pipeline's shippers.

[2] With regard to treatment of federal income tax allowance ("ITA"), SFPP recognizes that the presiding ALJ has issue his ruling deferring consideration of the ITA in these proceedings and further indicating that resolution of the ITA issue in the consolidated proceedings before ALJ Long will be adopted as the law of the case in the subject proceedings. SFPP further recognizes that ALJ Long has issued a proposed decision that would deny an ITA for SFPP. For various reasons, SFPP believes that the proposed decision's treatment of ITA is unlawful and will file its comments on the proposed decision in that regard on May 3, 2010. In view of the foregoing, SFPP will not specifically address the ITA matter in the body of the subject brief. Instead, SFPP's argument in support of Commission recognition of a full income tax allowance as part of SFPP's cost of service is included as Attachment A hereto.

include other considerations in addition to cost of service; and (2) whether the Commission should find that SFPP's existing rates are just and reasonable. A summary of SFPP's positions and recommendations with respect to each of these questions is set forth as follows:

A. The Proper Standard For Evaluating SFPP's Rates Requires Commission Consideration Of The Totality Of Circumstances Surrounding SFPP's Services.

The Commission has expressly recognized that the factors it uses to determine the reasonableness of rates vary among the different industries it regulates:

> "Telephone utilities, water utilities, natural gas utilities and electric utilities are not the same and are regulated differently [than pipeline utilities]. We often recognize differences between utility customers; one of the most common distinctions we employ is the distinction between traditional "captive" ratepayers and large sophisticated customers. One of the more noticeable characteristics of this case is the nature of its central issue: a dispute between oil producers and oil pipeline companies over the allocation of transportation costs. Since our decision will not affect the price refineries pay for oil, ordinary Californians will see no change in the price of refined products…It is also true that no law or regulation prevents any competitor from attempting to serve Unocap's customers."[3]

The Commission referenced these distinctions between monopoly utilities and the regulated pipeline company as grounds for rejecting cost of service as the sole measure of the reasonableness of the pipeline's rates, choosing instead to exercise its discretion to consider other factors in evaluating the reasonableness of the pipeline's rates, including the availability of competitive alternatives, the comparability of the pipeline's rates, and the size and sophistication of the pipeline's customers. Essentially, the same circumstances that caused the Commission in the *Unocap* case to conclude that the Public Utilities Code does not set out any formulas to be used to determine reasonableness, much less dictate exclusive reliance on cost-of-service

[3] *City of Long Beach v. Unocal California Pipeline Company* ("*Unocap")* (1996); 66 CPUC 2d 28, at 33.

methodology, are present in the subject proceeding.[4]

Justification for using cost of service as the single yardstick for judging the reasonableness of SFPP's rates can only exist upon a showing that SFPP, just like traditional monopolies, possesses market power that, in the absence of rate regulation, would allow SFPP to set prices for captive customers as high as it wants. Shippers, however, have made no market power showing whatsoever, much less a showing that SFPP possesses market power. Consequently, no record exists upon which the Commission could make the finding of market power required to warrant strict reliance on cost of service as the measure of the reasonableness of SFPP's rates.

By contrast, SFPP has presented testimony demonstrating that it faces varying degrees of competition in the California markets which it serves, ranging from minimal competition in its Imperial market to substantial competition in the San Francisco and Los Angeles markets.[5] Dr. Webb has characterized the competition that SFPP faces as "moderate."[6] This acknowledged and undisputed fact that SFPP faces, at least, moderate competition for its pipeline services dictates Commission rejection of sole reliance on cost of service as the measure of the reasonableness of SFPP's rates.

Rather, just as in the *Unocap* case, the Commission should determine the reasonableness of SFPP's rates "based on the totality of the circumstances" surrounding the utility services provided by SFPP.[7] Such "totality of circumstances," once again as defined in *Unocap*, necessarily includes: (i) the size and sophistication of SFPP's customers; (ii) the availability of competitive alternatives to SFPP's services; (iii) the degree to which SFPP's rates compare

---

[4] *Id.*, at 31.
[5] Exhibit No. SFPP-2; "Report of EAI, Inc."
[6] Exhibit No. SFPP-1; "Prepared Rebuttal Testimony of Michael J. Webb;" at 3.

favorably to other pipeline rates; and (iv) the rate of return to be earned under a cost-of-service analysis of SFPP's existing rates. As summarized below, and argued in detail in Section IIIB, SFPP submits that the "totality of circumstances" relating to its utility pipeline services, including consideration of its anticipated rate of return under a cost-of-service analysis, supports a Commission determination that SFPP's existing rates are just and reasonable.

B. Based Upon the Totality of Circumstances, Including Consideration of Cost-of-Service, SFPP's Existing Rates Should Be Found to Be Reasonable.

While the Commission has stated that there is nothing in the Public Utilities Code that requires the exclusive use of cost-of-service ratemaking to ensure reasonableness, it has also indicated that "[c]ost-of-service ratemaking is an important - perhaps even the pre-eminent - ratemaking technique."[8] SFPP recognizes and accepts that cost of service is a significant evaluative mechanism or benchmark for use by the Commission in determining the reasonableness of SFPP's rates. In that regard, SFPP has presented its cost-of-service showing fully justifying just such a Commission finding.

Regarding SFPP's cost-of-service showing, the evidence of record demonstrates the following:

(1) Given declining throughput trends, continuing economic uncertainty, increased Corporate Average Fuel Economy (CAFÉ) standards and ethanol blending, Mr. Dito's 2009 Test Year ("TY") lower range estimates of total intrastate CPUC jurisdictional SFPP volumes of approximately 227 million barrels and associated revenues of approximately $112 million are

[7] *City of Long Beach v. Unocal California Pipeline Company* ("*Unocap")* (1996); 66 CPUC 2d 28, at 30.
[8] *Id.* at 31.

reasonable.[9]

(2) SFPP's 2009 TY cost of service is approximately $113.3 million,[10] based upon the following reasonable assumptions: (i) operating expenses (including depreciation) - $78,752,000; (ii) income tax allowance - $10,993,000; and (iii) return on rate base - $23,545,000, calculated on the basis of a debt-and-equity capital structure of 52.43%-47.57%; cost of debt at 6.56%, and a nominal return on equity of 15.01%.[11]

SFPP's showing, based upon reasonable forecasts and assumptions, demonstrates that its cost of service exceeds its revenue, with the result that SFPP will have the opportunity to earn a return that is within a range that should be found by the Commission to be acceptable. Shippers, however, have a diametrically opposed view of SFPP's cost of service, basing their entire challenge to the reasonableness of SFPP's rates on claims that SFPP is exceeding their forecasted $84.6 million to $89.9 million costs of service by anywhere from $37 million to $39 million.[12] Shippers, in reliance on traditional cost-of-service ratemaking, would have the Commission effectively dismantle SFPP, ordering in excess of $10 million in refunds and requiring SFPP to slash its forward-going rates by as much as 65%.[13] This extraordinarily wide disparity between SFPP's cost-of-service analysis and the Shippers' cost-of-service results emphasizes the inherent imperfection of reliance on cost of service, with its dependency on myriad forecasts, estimates and assumptions, as the sole standard for evaluating the reasonableness of SFPP's rates.

---

[9] Exhibit No. SFPP-9; "Prepared Direct Testimony of Peter Dito;" at 5, 17; also Exhibit No. CCS-2; "Testimony of Matthew O'Loughlin;" at 8.

[10] SFPP's TY 2009 cost of service of $113.3 million is based upon assumed throughput of 231 million barrels, which is the average throughput of the four different volume scenarios set forth in the Prepared Direct Testimony of Peter Dito. SFPP's TY 2009 cost of service, adjusted to reflect forecasted throughput of 227 million barrels, is $113 million. (Exhibit No. SFPP-14; Turner Direct; at 20).

[11] Exhibit No. SFPP-15; "Prepared Rebuttal Testimony of Thomas Turner;" Attachment A.

[12] Exhibit CCS-2; O'Loughlin, at 3; also Exhibit Tesoro-14; Ashton at 59.

[13] Exhibit Tesoro-14; Ashton at 6.

In the face of such extreme divergence between SFPP's and Shippers' respective views, it is all the more incumbent upon the Commission to afford cost of service its appropriate weight, while also considering other facts and circumstances that bear upon the reasonableness of SFPP's rates. While Shippers have elected to predicate their challenge to SFPP's rates on a questionable cost-of-service theory, SFPP, has presented independent and unrebutted testimony that, in conjunction with its cost-of-service showing, buttresses the conclusion that its existing rates are reasonable. Specifically, SFPP has presented: (i) a market power analysis indicating that it faces varying degrees of competition that constrain its ability to raise rates without losing significant volumes to trucking;[14] (ii) evidence that its pipeline rates, on a per barrel mile basis, compare favorably with other pipeline rates;[15] (iii) evidence that its shippers have, and do avail themselves of, competitive alternatives to use of SFPP's pipeline services, particularly with respect to short-haul movements of product to market; and (iv) favorable comparison of the average of all CPUC rates for years 1992 through 2009 with the average rate for all SFPP California movements that would have been justified if such rates had been subject to various indexes, including the Federal Energy Regulatory Commission ("FERC") index, the producer pipeline index for finished goods ("PPI-FG"), and the Consumer Price Index ("CPI").[16]

Shippers rest their case on cost of service and cost of service alone. SFPP rests its case on cost of service <u>and</u> unrebutted evidence addressing each of the non-cost-of-service factors identified by the Commission in the *Unocap* case as relevant to its evaluation of the reasonableness of a pipeline utility's rates. SFPP submits that there are two different ways in which the Commission should give consideration and weight to these factors other than cost of

---

[14] Exhibit No. SFPP-2 and Exhibit No. SFPP-3.
[15] *Id.*
[16] Exhibit No. SFPP-9.

service. First, evidence showing pipeline rate comparability, the existence of competitive alternatives, and rates that have increased less than various measures of inflation provides quantitative and qualitative information that SFPP's existing rates are not excessive. Secondly, in recognition that cost of service is itself an analytical tool that is dependent, to some degree, upon varied, untestable assumptions and informed speculation, non-cost-of-service considerations should be given more substantial weight in circumstances in which cost-of-service analysis would otherwise suggest that rates are either marginally or temporarily excessive.

As the Commission has appropriately recognized in the *Unocap* case, cost of service, albeit an important tool, is not by itself dispositive of the reasonableness of rates charged by pipeline utility that, like SFPP, serves sophisticated customers with competitive alternatives. In the absence of evidence that pipeline rates are persistently and significantly in excess of cost of service, the Commission can and should base its evaluation of the reasonableness of rates based upon consideration of all circumstances relating to the pipeline's utility services.

III. <u>ARGUMENT IN SUPPORT OF THE REASONABLENESS OF SFPP'S EXISTING RATES</u>

The Commission has recognized that it is appropriate to consider the degree of competition an oil pipeline faces and adopt different regulatory structures and processes commensurate with the degree of competition an oil pipeline faces.[17] In *Unocap* and *Pacific*, the Commission assessed several factors in determining that Unocap and Pacific faced significant competition and that their rates were just and reasonable. First, the Commission examined the competitive dynamics of the market. Second, the Commission compared the pipelines' rates to the rates of other pipelines. Third, the Commission assessed the sophistication of the oil pipeline's customers. Fourth, the Commission assessed the possibility of new entrants entering the market. Finally, the Commission used a profitability test to assess whether the pipelines' rates were reasonable. SFPP believes that these various tests are appropriate as a measure of the reasonableness of its rate and asks the Commission to consider each of these, with appropriate weight accorded to the different factors.

Cost of service is an important, but not exclusive, measure of the reasonableness of SFPP's rates. If SFPP's rate-generated revenues do not exceed its cost of service, then its rates should presumptively be deemed reasonable. If its rate-generated revenues exceed cost of service, the Commission can either reject them as unreasonable or, in consideration of the other, so-called *Unocap* factors, conclude that the extent to which the pipeline's rate-generated revenues exceed cost of service does not render the rates unreasonable. As argued below record evidence of cost of service demonstrates that SFPP's existing rate-generated revenues do not exceed its cost of service. SFPP's rates are therefore presumptively reasonable. SFPP's showing with respect to the non-cost-of-service *Unocap* factors buttresses its cost-of-service evidence and, when taken together, SFPP's combined showing requires a Commission determination that SFPP's existing rates are reasonable.

A. SFPP's Existing Rates Are Reasonable Under a Cost-of-Service Analysis.

As set forth in detail below, SFPP's 2009 TY cost-of-service showing demonstrates that SFPP's test period cost of service, ranging from $113.0 to $113.7 million, exceeds its projected test period revenues of $111.9 million based upon projected throughput of 227 million barrels.[18]

---

[17] D. 96-04-061, *Unocap*, 66 CPUC 2d 28 (1996); D. 96-04-056, *Pacific Pipeline Systems, Inc.*, ("*Pacific")* 65 CPUC 2d 613 (1996).
[18] SFPP Exhibit No. 15; Turner; Attachment A; SFPP Exhibit No. SFPP-9; Dito, at 5.

Given that projected revenues at existing rates will be less than its reasonably assumed TY 2009 cost of service, SFPP's existing rates are presumptively reasonable.

In support of its 2009 TY cost-of-service showing, SFPP will demonstrate the following:

- SFPP has adopted an appropriate base period and test period in calculating its COS.
- SFPP's projection of TY throughput and related revenues is reasonable.
- It is reasonable for SFPP's TY COS to reflect a full income tax allowance.[19]
- SFPP's TY estimate of operating expenses is reasonable, particularly with respect to the following expenses: (i) allocated overhead; (ii) dismantlement, removal and restoration ("DR&R"); (iii) environmental remediation; (iv) oil gains/losses; and (v) fuel and power.
- SFPP's TY COS is based upon reasonable assumptions regarding cost of capital, including the following: (i) a debt-to-equity capital structure of 52.43%-47.57%; (ii) cost of debt at 6.56%; and a nominal return on equity of 15.01%.

In demonstrating the reasonableness of its 2009 TY COS showing, SFPP will necessarily contrast its COS of showing with that presented by shipper witnesses Ashton and O'Loughlin. The issues in dispute, relating to throughput/revenue forecasts as well as the constituent components of a reasonable COS, can be identified as follows:

With respect to throughput and related TY revenues, Tesoro witness Ashton recommends throughput ranging from approximately 239.4 million barrels to approximately 245 million barrels and TY revenue of $123.4 million based upon the average of his two volume scenarios.[20]

---

[19] As previously noted, in recognition that the income tax allowance issue is scheduled for resolution in pending proceedings before ALJ Long, the issue is addressed by reference to Attachment A hereto rather than in the body of the subject brief.

[20] Tesoro Exhibit No. 14; Ashton, at 22-23 and 59.

Witness O'Loughlin, on behalf of Chevron, Conoco Phillips, and Southwest Airlines, projects TY volumes of 245.6 million barrels and related revenues of $126.4 million.[21]

With regard to specific, disputed elements of the parties' cost-of-service calculations, the below-referenced depicts in tabular form the adjustments that witnesses Ashton and O'Loughlin would make to SFPP's COS of $113.3 million, producing their respective COS recommendations of $84.6 million and $89.9 million.[22]

	Tesoro	CCS
SFPP's Cost of Service	$113,291	$113,291
Operating Exp Adjustments:		
KMEP OH	($10,394)	($11,690)
DR&R	($2,027)	($1,420)
Environmental Exp	($1,942)	
Oil Gains / Losses	($504)	
Fuel & Power	$520	$823
Cost of Capital Adjustments:		
Income Tax Allowance	($10,017)	($11,102)
Equity ROR	($4,607)	
Capital Structure	($3,924)	
Cost of Debt	($37)	
Net Cost of Capital Adjustments	($14,366)	
Tesoro / CCS Cost of Service	$84,578	$89,902

SFPP contends that it will essentially "underearn" its 2009 TY COS by about $1 million, including an acceptable return. Shippers, on the other hand, would have the Commission believe that SFPP is "overearning" vis-à-vis its COS in amounts ranging from $36.5 million to $38.8 million. As argued more fully below, it will be shown that SFPP's cost-of-service analysis is reasonable while the Shipper' related showings are simply implausible.

[21] Exhibit No. CCS-2; O'Loughlin at 3-5.
[22] Tesoro Exhibit No. 14; Ashton; Exhibit 7; CCS-2; O'Loughlin; MPO-7. Note in the table above, cost of capital adjustments have a greater impact on COS when evaluated individually. Therefore, the sum of the individual cost of capital adjustments shown in the table is greater than the combined impact shown on the line "Net Cost of Capital Adjustments."

1. Base Year and Test Year Assumptions:

Tesoro witness Ashton criticizes SFPP's use of base period data which includes portions of 2008 and 2009 data as inconsistent with the instructions of the Scoping Memo. The Scoping Memo, however, does not state that the test period must reflect or even be based from calendar year 2009, as Mr. Ashton claims. Rather, the Scoping Memo states only that the "test year will be 2009."[23] Relying upon conventional test period principles, the base period reflects the most recently available 12 months of data, a principle which Mr. Ashton generally advocates.[24] The most recently available 12 months of data at the time of testimony preparation were July 2008 through June 2009 data. Appropriate test period adjustments were then made to reflect changes that have occurred or may be expected to occur in the reasonable and foreseeable future and that are reasonably estimable – a test period approach that is, once again, generally advocated by Mr. Ashton.[25] SFPP tends to agree with Mr. Ashton's stated understanding of base period and test period principles, and SFPP has properly followed these principles and applied them consistently with the intent of the Scoping Memo.

2. Throughput Projections and Related Revenues:

A principle justification for both of the consolidated rate increases at issue has been the precipitous decline in volumes transported on SFPP's intrastate pipeline in recent years, in conjunction with economic and environmental considerations that suggest a continuing, declining trend with respect to SFPP's throughput. For reasons set forth below, SFPP's projections of 2009 TY volumes of 227 million barrels and adjusted revenues of $111.9 million

[23] SFPP Exhibit No. 15; Turner
[24] Tesoro Exhibit No. 14; Ashton at 9.
[25] *Id.*

are more reasonable than shippers' TY projections of 245 million barrels of throughput and revenues of between $123 million and $126.5 million.

Because of the extreme uncertainty in the California petroleum outlook, SFPP presented a range of test year estimates of volumes/throughput for SFPP, based upon four different scenarios, ranging from 226. 8 million barrels to 238.9 million barrels, with 231 million barrels constituting the average of the four scenarios.[26] Actual SFPP intrastate jurisdictional volumes peaked in 2006 at 262.8 million barrels, dropping precipitously to 241.4 million in 2008, and further falling to 234.8 million in 2009. The table below depicts SFPP's actual volumes as well as SFPP's TY volume projections contrasted with volume projections sponsored by Tesoro and ConocoPhillips-Chevron-Southwest ("CCS"):

	Actual	SFPP	Tesoro	CCS
2003	254,633			
2004	257,021			
2005	260,614			
2006	262,770			
2007	262,522			
2008	241,430			
2009	234,832			
TY (Avg)		231,051	244,560	245,551
TY High		238,851	239,476	
TY Low		227,394	249,643	

Sources: 2003-2008 from CCS Ex. No. 2(MPO-6); 2009 from Tesoro Exhibit No. 11

The above-table shows graphically that shippers' TY 2009 projection of 245 million barrels unreasonably assumes a return to throughput levels last seen in 2007, prior to what has been described as the worst economic downturn since the Great Depression. By comparison, SFPP's most reasonable expected scenario of 227 million barrels comports with the declining trend in SFPP volumes. This is underscored by factors not even quantified in developing the test year volumes: continuing, unstable economic conditions, fundamental changes in consumer

[26] SFPP Exhibit No. 10; Dito at 5.

driving habits, and further environmental considerations, including stricter CAFÉ' standards and increased blending beyond 10% of ethanol, which will further depress gasoline consumption and related transportation pipeline transportation of gasoline. If the TY high of SFPP's four scenarios (238.9 million) is discarded as an outlier – given that it would require a major reversal of the declining trend shown above - the average of SFPP's TY projections drops to 228.7 million barrels.

SFPP submits that it is reasonable to anticipate a further decline of 3.3 % in TY throughput compared to prior year results. SFPP presented testimony supporting its forecast of further declining volume, associating the continuing drop in throughput with a variety of factors, including the following: (a) the effects of the price of gasoline on discretionary driving; (b) the high rate of unemployment and other economic factors; (c) the use of ethanol in gasoline; (d) alternate fuels (biodiesel); (e) Corporate Average Fuel Economy (CAFÉ) standards implementation; and (f) a probable paradigm shift: The American public is drifting away from the automobile.

The Energy Information Administration projects for the whole country a modest economic recovery in 2010 that is expected to increase gasoline consumption by 0.6%. However, in California, any such limited increase in gasoline volumes will be swamped by throughput volumes lost by SFPP due to increased requirements for ethanol blending. Even if the California economy follows the nation and experiences a modest recovery in 2010, and even if gasoline consumption increases 0.6 %, any such limited increase still will not come close to offsetting the 4.3% decrease in gasoline volumes anticipated because of mandated increases in ethanol blend requirements.[27]

---

[27] *Id.* at 7.

There is also significant evidence that there has been a fundamental shift in public attitudes towards driving that will inevitably contribute to a continuing decline in gasoline consumption. When the economy declines and unemployment increases, consumption of refined products will decline. This decline leads to decreased demand in a market and thus, less volumes on pipelines serving the depressed markets. A decline in income of 10 percent will lead to a decline in gasoline consumption of between 2.1 percent and 7.5 percent. Similarly, other research suggests that 30 percent of gasoline consumption is related to commuting; consequently, unemployed people will use less gasoline and will also cut back on discretionary travel.[28]

SFPP's expert witness directly addressed the question of whether he believes that demand in the markets served by the SFPP will ever return to its pre-recession levels?

> No, not with any level of certainty. It is possible that at some point demand in SFPP markets will return to its pre-recession levels. However, there are multiple reasons to believe that demand in these markets will never return to its pre-recession levels. For example, the Chief Executive Officers of BP and ExxonMobil recently stated that gasoline demand growth "has probably peaked" in the United States… Specifically, BP's CEO stated in June 2009 that BP "probably sold as much gasoline [in] the U.S. as we'll ever sell" in the first part of 2007… ExxonMobil's CEO offered a similar conclusion in May 2009. *Id.* In addition, the current administration has announced stringent mileage standards for the U.S. automotive fleet that are proposed to come into force in 2016, which means that vehicles will likely require less refined petroleum products. Finally, mandates requiring the use of more ethanol may cause the level of refined products transported on SFPP to decrease, because SFPP is not currently able to transport ethanol.[29]

Lower prices do not seem to help. Even as retail prices for gasoline plunged below $1.80 per gallon in December, 2008, consumption data showed that California drivers bought

---

[28] SFPP Exhibit No. 1; Webb at 44-45.
[29] *Id.* at 52-53.

significantly less gasoline in 2008 than they did in 2007, contradicting any expectation that lower gasoline prices would tend to cause consumption to rise. Because of concerns associated with continuing economic instability, people are simply driving less.[30] Shipper witness Ashton opines that the dramatic decrease in SFPP throughput, to the extent it is impacted by declining consumer consumption of gasoline, is merely a function of adverse consumer reaction to spikes in the price of gasoline and will rebound as gasoline prices moderate. There is no basis for any such conclusion. Gasoline prices did spike in California and nationwide in mid-2008. However, it is quite clear gasoline consumption in California peaked in 2005 well ahead of this price spike and ahead of the recent economic collapse in the US and California and that, since the 2008 spike, gasoline volumes have not returned to the 2005-06 levels.[31] People have fundamentally changed their driving habits.

Mandated use of ethanol is a further contributor to the trend of declining volumes on SFPP's intrastate pipeline system. For a variety of reasons, ethanol is not a product that can be moved in pipelines with a few exceptions.[32] For these reasons, ethanol is blended at terminals, not at the refinery. Given that California has now mandated an increase from 5.7% blend of ethanol/gasoline to a 10% blend of ethanol and gasoline, 10% of the volumes representing the ethanol blend must be trucked or railed to the terminal, with the other 90% remaining in the pipeline, resulting in a further 4.3%. reduction of SFPP throughput.[33]

Increased development and use of "biodiesel" will also contribute to anticipated declines in SFPP throughput. California policy makers have evidenced their intention to encourage

---

[30] *Id.* at 7-9.
[31] SFPP Exhibit No. 3; Leto at 9.
[32] *Id.* at 12-13.
[33] *Id.* at 13.

biodiesel as a renewable substitute for petroleum-based diesel fuel. Biodiesel, however, cannot be shipped in a multi-products pipeline. Biodiesel can only be shipped under very controlled circumstances much like ethanol. It can not be shipped in pipelines like SFPP's which carry jet fuel.[34]

The evolution toward stricter CAFÉ standards (mandated mileage efficiency), while not likely to have any impact upon SFPP TY 2009 projections, is nevertheless another indication of external forces beyond the control of SFPP that will serve to exert continuing downward pressure on SFPP throughput. It is just one more piece of evidence validating SFPP's expectation of a continuing decline in volumes as well as the reasonableness of relying upon SFPP's estimate of 227 million barrels of throughput and related revenues of $111.9 million in evaluating whether SFPP's expected achieved return at its existing rates is within a range considered acceptable by the Commission.

3. Operating Expenses:

SFPP's CPUC-jurisdictional operating expenses for TY 2009 are $66.5 million as part of SFPP's overall cost of service of $113.3 million. A principal component of SFPP's $66.5 million in TY 2009 operating expenses consists of $16.8 million in KMEP overhead either directly assigned or allocated to SFPP's intrastate pipeline operations. Of the $66.5 million in operating expenses recommended by SFPP, shipper witness Ashton would adjust (reduce) SFPP's proposed operating expenses as follows: (a) KMEP Overhead Attribution - $10.394 million; (b) DR&R - $2.027 million; (c) Environmental Expense - $1.942 million; and (d) Oil Gains/Losses - $.504 million. Shipper witness O'Loughlin would adjust (reduce) SFPP's proposed operating expenses as follows: (a) KMEP Overhead Attribution - $11.690 million; and

[34] *Id.* at 14.

(b) DR&R - $1.42 million.

The table referenced below summarizes the operating expenses recommended by each witness in this proceeding:[35]

Table 1 ($000's)

SFPP Operating Expense	SFPP	Tesoro	CCS
KMEP Overhead Expense	$16,801	$6,406	$5,111
DR&R Expense	$2,027	$0	$607
Environmental Remediation	$7,976	$6,034	$7,976
Oil Losses and Shortages	($1,313)	($1,817)	($1,313)
Operating Fuel and Power	$12,963	$13,472	$13,776
Remaining Operating Expense	$28,021	$28,021	$28,021
Total Operating Expense (Excl. Depr.)	$66,474	$52,117	$54,178

As can be seen above, the principal challenge to SFPP's forecasted operating expenses relates to the amount of overhead expenses incurred by KMEP on behalf of SFPP that is properly attributable to SFPP California jurisdictional operations. As argued more fully below, SFPP will demonstrate that its 2009 TY projection of overhead expenses, as is the case with respect to the other categories of cost comprising its overall operating expenses, is reasonable.

a. Overhead Costs:

To better understand the scope and extent of the overhead allocation issue, it is helpful to describe the relationship of KMEP to SFPP and the KMEP overhead that is attributable to SFPP. KMEP acquired SFPP in March 1998. Prior to being acquired, SFPP was essentially a stand-alone operating entity with its own employees and executive management team. SFPP no longer has its own employees and relies on KMEP for executive management oversight. Such management oversight costs include accounting, tax, pipeline logistics, engineering, environmental compliance, and insurance. Since acquiring SFPP in 1998, KMEP has evolved

[35] SFPP Exhibit No. 15; Turner at 5.

from a relatively simple organization of ten subsidiaries and just over $2 billion in assets, to a complex organization of over 90 subsidiaries and $18.5 billion in assets. The total KMEP overhead either allocated or directly assigned to SFPP (including its California-jurisdictional operations, its non-California jurisdictional operations, and its unregulated operations) amounted to $46.4 million during the base period.. On the other hand, the overhead SFPP incurred during the last year as a stand-alone entity, 1997, inflated to today's dollars would have been approximately $50 million, Thus, despite subsequent increases in costs of pipeline administration relating to more extensive accounting requirements (Sarbanes-Oxley) and more stringent environmental, and pipeline safety monitoring, SFPP's TY 2009 overhead allocation is smaller ($46.4 million) than the overhead expense attributable to SFPP in 1997 as a stand-alone entity ($50 million). Such evidence inherently demonstrates the reasonableness of the KMEP overhead attributable to SFPP in SFPP's 2009 TY showing.[36]

KMEP's "cost-causation" approach to attribute overhead expenses to all of its subsidiaries including SFPP and Calnev, as described more fully below, accurately matches overhead service costs on behalf of subsidiaries for which the overhead costs are incurred. In stark contrast, the "all-in" approach recommended by both shipper witnesses, Ashton and Arthur, completely disregard cost-matching principles and assume that simplicity is more important than accuracy. Shippers' interest in sacrificing accuracy for ease of administration explains the wide disparity between SFPP's showing in support of $16.8 million in KMEP overhead attributable to SFPP's CPUC-jurisdictional service of $16.8 million and the shippers' recommendations of $6.4 million and $5.1 million, respectively.

---

[36] SFPP Exhibit No. 14; Turner at 14.

SFPP's parent company, KMEP, employs a "cost-causation" approach that assigns or allocates its overhead costs to its subsidiary entities, including SFPP, based on the incurrence of the overhead costs. KMEP's approach matches overhead costs with the subsidiary or group of subsidiaries on behalf of which the overhead costs were incurred. In contrast to KMEP's approach, Mr. Ashton and Dr. Arthur employ an "all-in" allocation approach that sweeps all overhead costs into one bucket and allocates that one bucket of costs among all respective Kinder Morgan subsidiary entities with complete disregard for cost-causation principles.[37]

The first step under KMEP's "cost-causation" approach is the direct assignment of overhead costs to individual entities to the extent those overhead costs are directly attributable to those entities. This is accomplished by a simple allocation procedure on each employees time card and is updated as necessary. Second, KMEP assigns any indirect applicable overhead costs to groups of like entities (such as those in KMEP's products pipelines division, CO_2 division, or its bulk terminals division) to the extent overhead costs cannot be attributed to any single entity in step one, but can be attributed to a particular group of entities. Finally, KMEP allocates its overhead costs that are not directly assignable to individual entities or a group of entities utilizing a company-wide allocation methodology. KMEP utilizes the same allocation methodology at the group level to allocate overhead costs attributable to each particular group of entities among the entities in that group.[38]

KMEP identifies costs that are attributable to individual entities or groups of entities pursuant to uniform and defined accounting policies and procedures; SFPP's witness Bradley described the allocation methodologies used by KMEP as well as adjustments that are made

[37] Mr. Ashton allocates KMEP overhead among all KMEP subsidiaries, whereas Dr. Arthur allocates KMI and KMEP overhead among all KMI and KMEP subsidiaries.
[38] SFPP Exhibit No. 15; Turner at 6-7.

ensure an accurate attribution of KMEP overhead costs to SFPP and Calnev and provided Mr. Turner with the total KMEP overhead attributable to SFPP of $46.4 million.[39] Mr. Bradley's testimony directly addresses and rebuts Mr. Ashton's and Dr. Arthur's claims that KMEP is unable to accurately assign overhead costs.

Furthermore , with respect to treatment of labor expenses, a study performed by KMEP's consultant, KPMG, LLP ("KMPG"), reviewed and approved of KMEP's method of directly assigning costs to individual subsidiaries, directly assigning shared costs to groups of subsidiaries through the use of shared cost distributions, and allocating any residual costs through the Massachusetts formula. KPMG did determine that labor costs associated with certain employees which had previously been allocated could be more accurately assigned directly to the individual subsidiaries or groups of subsidiaries based upon time-based surveys. Secondly, KPMG identified several types of non-labor expenses that had previously been allocated using a shared cost distribution, i.e. the Massachusetts formula, that could be directly assigned to the subsidiaries on whose behalf those costs were incurred.[40] KMEP implemented KPMG's recommendations in 2009.

In contrast to KMEP's rigorous process for directly attributing costs to the entity that incurs them, Mr. Ashton's and Dr. Arthur recommend an "all-in" allocation approach that not only ignores cost-causation principles but violates them. Dr. Arthur devotes nearly his entire 57-page testimony to criticizing KMEP's overhead allocation approach, and attaches a plethora of exhibits in an attempt to support his criticisms. Mr. Ashton's criticisms of KMEP's overhead allocation, consuming 15 pages of his testimony, are virtually the same as Dr. Arthur's, albeit

[39] SFPP Exhibit No. 16; Bradley.
[40] *Id.* at 16.

less detailed. Mr. Ashton and Dr. Arthur espouse two fundamental themes in their far-ranging criticisms: (1) KMEP's books and records are not reliable, and (2) all KMEP entities should be allocated proportionately equal overhead regardless of the level of benefit actually received. Neither the alleged criticism or the recommended "solution" to the unreliability of KMEP's books is plausible.

First, Mr. Ashton and Dr. Arthur, without foundation and as roundly rebutted by Mr. Bradley, attempt to portray KMEP's books and records as so abysmally inaccurate that they are entirely unreliable and should be completely disregarded. In essence, their assertions are such that the result of any effort by KMEP to employ a reasonable cost-causation approach is simply not acceptable to shippers given their unfounded, and rather self-serving, assertions that the accounting records of KMEP are in some unstated way "cooked" and cannot be believed. Nor, apparently according to shippers, can the major accounting firm, KPMG, which conducted an intense review and audit of KMEP overhead procedures, be believed.

Secondly, KMEP owns, or partially owns, certain subsidiary entities that are operated by KMI or third parties, who provide the requisite overhead services. These entities are excluded from KMEP's overhead allocation because they do not cause the overhead costs to be incurred.[41] Nevertheless, Mr. Ashton and Dr. Arthur include these entities in their "all-in" allocation approach, on the basis that it is entirely irrelevant how little management oversight from KMEP is required. In other words, KMEP entities that require even one hour of management oversight must be allocated a portion of all KMEP overhead costs proportionately to entities that require full KMEP overhead services. Mr. Ashton and Dr. Arthur simply do not distinguish between minimal management oversight and full overhead service requirements. In an attempt to validate

[41] Mr. Bradley discusses the basis for excluding these entities in greater detail in SFPP Exhibit No. 16.

his inclusion of all KMEP subsidiaries in his "all-in" approach, Dr. Arthur claims the FERC ruled in a 1998 order, that a subsidiary must receive an allocation of the parent company's overhead costs if the subsidiary benefits from the incurrence of the corporate overhead in any way. Even a perfunctory review of that order he cites reveals that his interpretation is fundamentally flawed. Indeed, the order unequivocally supports the cost-causation approach used by KMEP. Moreover, Dr. Arthur fails to mention that the FERC has more recently ruled that including the entities KMEP excludes as Dr. Arthur advocates produces unreasonable results.[42]

The flaws in Mr. Ashton's and Dr. Arthur's "all-in" allocation approaches are readily demonstrable. A particularly glaring example of the unreasonableness of the "all-in" allocation approach is Mr. Ashton's claim that the $5.5 million in legal costs, which KMEP assigns directly to SFPP, are largely unrelated to transportation service provided to ratepayers. Mr. Ashton's claim has no basis and is simply wrong. The bulk of these costs were incurred solely for SFPP's ongoing legal matter regarding the value of its pipeline right-of-way. Yet under Mr. Ashton's recommendations, these SFPP-specific legal costs should be allocated among all KMEP subsidiaries. Dr. Arthur's proposal is even more egregious as he allocates those SFPP-specific costs to KMI's subsidiaries, as well as KMEP's.

In addition, Mr. Ashton and Dr. Arthur both suggest that a simple allocation model is preferred by regulators over accurate, albeit more complex approaches. There simply is no basis for this self-serving claim. Citing his cross-subsidization concerns of KMEP's "complex" approach nearly two dozen times throughout his testimony, it is instead Dr. Arthur's simple "all-in" approach that commits the ultimate cross-subsidy. Specifically, in his Table 1 on page 51 of

[42] 122 FERC ¶ 61, 133 (February 2008) at P 16.

his testimony, Dr. Arthur shows that KMEP's total overhead expense is $297.8 million, and that under his approach, SFPP would be allocated 5 percent of this amount, or $15.6 million. Inherent in Dr. Arthur's "all-in" allocation approach in his Table 1, is that he would allocate more than half of the $297.8 million to the KMEP entities that, as Mr. Bradley explains, receive little or no benefit from KMEP overhead services.[43] Thus, Dr. Arthur allocates more than 50 percent of the overhead costs that are specific to SFPP, to KMEP entities that have nothing to do with the incurrence of these costs, while at the same time, he allocates 5 percent of CO_2 and bulk terminal specific overhead costs to SFPP. Dr. Arthur's recommendation of his "all-in" approach belies any commitment to cost-causation principles and instead directly fosters the "cross-subsidization" that his approach is ostensibly designed to mitigate. In fact, Dr. Arthur would allocate over $150 million of KMEP's overhead to subsidiaries that receive virtually no benefit from these services.[44]

Even if there is merit to Mr. Ashton's and Dr. Arthur's criticisms regarding the accuracy of KMEP's direct assignment of applicable overhead costs – which as Mr. Bradley explains, there is not – the remedy would certainly not be the "all-in" allocation approaches employed by Mr. Ashton or Dr. Arthur. Under their "all-in" approaches, all vestiges of accuracy are eliminated and the cost-causation principle previously discussed is entirely ignored. Simply put, their allocation approaches explicitly ignore how and why KMEP's overhead costs are incurred and the amounts that are properly attributable to each entity.

Interestingly, Mr. Ashton and Dr. Arthur cite extensively to records in past FERC

---

[43] Dr. Arthur's "all-in" approach reflected in Table 2 on page 52 of his testimony is equally egregious by combining subsidiary entities and overhead incurred from two parent companies – KMI and KMEP.

[44] SFPP Ex. No. 15; Turner at 10; SFPP Ex. No. 16; Bradley at 26-39.

hearings as the basis for many of the criticisms they raise in their testimonies in this proceeding. However, throughout their extensive discussion of FERC records, both conveniently ignore that in separate initial decisions, two presiding judges at the FERC have recently rejected their "all-in" allocation approaches, stating that Dr. Arthur's claims of inaccuracy were unsupported or inconsequential. In the most recent initial decision, the presiding judge stated "[t]he all-in approaches …are flawed and would produce inaccurate and unreasonable results."[45]

Finally, short shrift should be given to the claims of Mr. Ashton or Dr. Arthur that purchase accounting adjustments ("PAAs") should be removed from the gross property plant and equipment factor of the Massachusetts allocation model for only FERC regulated subsidiaries of KMEP – rather than from both FERC-regulated and non-FERC regulated subsidiaries, as advocated by KMEP. PAAs arise in the accounting for acquisitions and generally reflect the difference between the value paid by KMEP for an acquisition versus the book value of the acquired entity's assets. Mr. Ashton's and Dr. Arthur's inclusion of PAAs associated with unregulated entities, and simultaneous exclusion of PAAs associated with regulated entities distorts the allocation and is designed simply to lower the overhead costs allocated to SFPP. As a basis for supporting his claim, Mr. Ashton states the FERC has long advocated the removal of PAAs from the gross plant factor for regulated entities. What he fails to acknowledge, however, is that the FERC and its presiding judges have rejected the inclusion of PAAs for unregulated entities, as advocated by Mr. Ashton and Dr. Arthur. Supporting SFPP's approach of excluding PAAs for both regulated and unregulated entities, the presiding judge in a recent proceeding stated the FERC requires balanced treatment of PAAs.[46]

[45] 129 FERC ¶ 63, 020 at P 767 (December 2009). Dr. Arthur was the witness for the ACV Shippers and Mr. Ashton was the witness for Tesoro.

[46] 114 FERC ¶ 61, 136 (February 2006) at P 17; 127 FERC ¶ 63, 024 (June 2009) at P 390; 129 FERC ¶ 63, 020

(footnote continued)

For all of these reasons, it is reasonable to include $16.8 million of overhead costs attributable to SFPP's California jurisdictional operations in evaluating SFPP's TY 2009 cost of service results and, ultimately, in considering whether the returns that SFPP will have an opportunity to earn under its existing rates are within an acceptable range.

b. DR&R:

SFPP's recommended cost of service includes a dismantlement, removal and restoration ("DR&R") provision and a related expense of $2.027 million. DR&R provides SFPP with the means to collect funds for transportation related costs that would not be incurred until after the ultimate termination of SFPP services – at which time, funds will no longer be collected from shippers. Absent a DR&R provision, SFPP will have no proper means to recover these costs.

DR&R is a legitimate cost recognized by the Commission for many utilities; and no one disputes that these costs will ultimately be incurred. In D. 07-03-044 issued on March 15, 2007, the Commission stated that: "[accrual accounting for removal costs is fair to ratepayers because it ensures that ratepayers pay for the removal costs of those assets that serve them."[47] The FERC has acknowledged the propriety of a DR&R provision, referencing its awareness "that a number of oil pipelines are currently collecting an allowance in jurisdictional rates to cover the future cost of retiring and removing facilities …"[48] Because there is a high probability that SFPP will incur costs associated with the retirement of facilities in the future, it is appropriate for each barrel moving through the pipeline, from now until termination date, to bear its fair share of these estimated future costs.[49]

Witness Ashton proposes to eliminate DR&R expense entirely from SFPP's operating

(December 2009) at P 781-785.

[47] SFPP Exhibit No. 15; Turner at 18.

[48] 101 FERC ¶ 61, 102 at P 65 (October 2002).

[49] SFPP Exhibit No. 15; Turner at 21.

expenses, while witness Arthur reduces SFPP's $2.0 million DR&R expense to only $0.6 million, by extending the period the DR&R funds are to be collected from approximately 24 years to 40 years. Mr. Ashton criticizes SFPP's DR&R expense on three points. First, he claims that because SFPP is not incurring any DR&R expense currently, that any collection of DR&R expense from shippers through tariff rates would essentially be regarded as a "reserve." He then claims SFPP's attempt to collect DR&R "reserves" from ratepayers is contradictory in principle to SFPP's remaining operating expenses that exclude any reserve accruals. Second, Mr. Ashton claims SFPP's DR&R estimate is speculative and overstated since it relies upon a calculation based on remaining useful life rather than when SFPP's operations will ultimately cease. He then surmises that SFPP's California intrastate service is likely to continue to function indefinitely. Third, Mr. Ashton claims any DR&R funds collected will be passed on to the owners of SFPP in the form of cash distributions. As a result, he claims there will be no funds available to pay the actual DR&R costs at the conclusion of SFPP's operations.[50]

Dr. Arthur seems to criticize SFPP's DR&R calculation on two grounds. First, similar to Mr. Ashton's claim, Dr. Arthur generically claims that it is inappropriate to collect from ratepayers estimated costs that are speculative in nature. Second, Dr. Arthur disagrees with using remaining useful life in calculating the DR&R provision. Although unlike Mr. Ashton, Dr. Arthur includes a DR&R component in his operating expenses for SFPP, albeit $1.4 million lower than SFPP's DR&R.[51]

Mr. Ashton's criticism that SFPP is not incurring any DR&R at the current time is rather eccentric given the very nature of DR&R renders it virtually impossible to be incurred while the

[50] *Id.* at 17.
[51] *Id.*

pipeline is in operations. A DR&R provision provides SFPP with the means to collect funds for dismantlement, removal and restoration of the pipeline systems upon the ultimate termination of SFPP's services. No one disputes that upon termination of service, SFPP's pipelines, at a minimum, must be purged of dangerous hydrocarbons and filled with nitrogen. This activity is a legitimately recoverable cost that the carrier must bear, but won't be incurred until after operations cease. The only means for a carrier to recover these costs, under traditional cost of service regulation, is through a provision in current tariff rates. By definition, SFPP's DR&R provision relates only to *future* costs because DR&R is not performed until after facilities are removed from service and SFPP terminates its operations.

Nor is there any merit to Mr. Ashton's second point that using remaining useful life is unreasonable since SFPP's California intrastate service is likely to continue to function indefinitely. It is Mr. Ashton who is unreasonable in his assumption that the pipeline will operate in perpetuity. While no one knows with certainty when SFPP will ultimately terminate services, it is quite reasonable to expect that service will terminate at some point in time, and that SFPP will be required to expend funds to perform DR&R. In a regulatory proceeding such as this, it is quite common to have to make reasonable judgments or forecasts based upon the information available. That a judgment is premised upon probabilities or approximations does not make it suspect or unreasonable. SFPP's DR&R calculation is based on the system-wide remaining life determined by depreciation rates approved by the FERC, which is the most reasonable proxy for the ultimate termination of SFPP services.[52] It is further worth noting that depreciation rates can be updated from time to time reflecting changes in the expected economic life.

---

[52] *Id.* at 19.

Mr. Ashton's last criticism, that any DR&R funds collected will be paid out as cash distributions to the owners of SFPP, so no funds will be available to pay the actual DR&R costs at the conclusion of SFPP's operations, is also without merit. Paying out any part or all of SFPP's cash flow as cash distributions to unit holders does not undermine SFPP's (or its owner KMEP's) ultimate responsibility for future liabilities such as its DR&R obligations. These costs will have to be paid, and SFPP will ultimately be responsible for them. Without a DR&R provision in SFPP's cost of service, SFPP's owners would not only be responsible for the funding, but would also bear the ultimate cost of DR&R, thus violating regulatory ratemaking principles.

Dr. Arthur, while agreeing that a DR&R allowance is appropriate, recommends that the remaining life assumption used to calculate SFPP's DR&R provision be extended from 24 to 40 years. This is completely arbitrary. A remaining life assumption based on approved depreciation rates is the most reasonable proxy for the ultimate termination of SFPP services. Both of the two examples provided by Dr. Arthur in an attempt to validate his belief that the remaining life used to calculate SFPP's DR&R provision should be extended to 40 years are flawed as explained in detail by SFPP witness Turner.[53]

DR&R is a cost of performing transportation service, and including a DR&R provision in SFPP's cost of service is the only means to recover this cost. The fact that DR&R costs will not be incurred until after the ultimate termination of SFPP services does not make them any less a cost of doing business nor does it mean that shippers should not bear them. There is also Commission precedent for including a DR&R provision in a company's cost of service. The "wait-and-see" recommendation of both Mr. Ashton and Dr. Arthur puts SFPP at risk of not

---

[53] *Id.* at 19-21.

adequately recovering its DR&R costs, if at all. That is, the longer a DR&R provision is withheld from cost of service, or is inadequate, due to some notion of speculation, the ultimate termination of services draws closer. As such, any annual DR&R provision in the cost of service would, by necessity, escalate assuming a fixed amount of DR&R funds would have to be accumulated over a shorter duration to a point where SFPP's rates could be prohibitive.
This also has the affect of inequitably benefiting current shipper barrels and burdening future shipper barrels. Further, SFPP's recommended DR&R expense of $2.027 million is reasonable in that it assumes SFPP can invest interim DR&R funds collected at an earnings rate equal to its cost of capital. If such interim funds were required to be set aside in a sinking fund, the annual amount to be included in SFPP's cost of service would have to be much greater (e.g.; assuming even a 5 percent earnings rate – which is much higher than current market conditions – would require an annual DR&R provision of $4.4 million.[54]

For all of these reasons, it is reasonable to include $2.027 million of DR&R expenses in evaluating SFPP's TY 2009 cost of service results and, ultimately, in considering whether the returns that SFPP will have an opportunity to earn under its existing rates are within an acceptable range.

c. Environmental Expense:

Witness Ashton proposes to arbitrarily reduce SFPP's environmental remediation expenses of $8 million by nearly $2 million. Mr. Ashton does not provide any meaningful basis for his adjustment other than his belief that SFPP picked the wrong 12 months of actual data as the basis for the 2009 test period. As previously discussed herein at Section 3(A)(1) above, SFPP has relied upon appropriate base period data, which is the same data that Mr. Ashton,

[54] Tr. Vol. at 591.

despite his criticism, has also used in his analysis. Mr. Ashton's criticism of SFPP's recommended environmental remediation expenses is based upon innuendo, not facts. Specifically, Mr. Ashton speculates that SFPP "seems" to be continually incurring higher environmental expense – yet he does not support this speculation with any facts whatsoever, nor does he say why environmental cost increases over time is wrong or even unusual.[55] Further, he provides no rationale why his "suspicions" justify a reduction of $2 million in SFPP expenses – rather than $1 million or $5 million or the entire $8 million.

Continuing with baseless insinuations, Mr. Ashton surmises that perhaps SFPP has no incentive to be a prudent operator since SFPP "is not responsible" for paying these environmental costs. Not only is this an empty insinuation, but it contradicts the fact that pipeline operators can face harsh consequences, including criminal charges, for operating a petroleum products pipeline in an unsafe manner. SFPP has operated its pipeline systems for over 50 years, and has done so under ever increasing environmental regulation and protocol. Product releases and spills are unfortunate, and yet unavoidable consequences of operating petroleum products pipelines. Mr. Ashton has provided no factual basis for attacking SFPP as an irresponsible pipeline operator.

Lastly, Mr. Ashton observes that 62 percent of SFPP's total $8 million environmental costs are on one project at SFPP's Mission Valley and that it is not clear how long cleanup of this site will last. Once again, he fails to describe why this fact is somehow inappropriate or even unusual, particularly given that Mr. Ashton makes no specific adjustment for the environmental costs at Mission Valley in his calculations.

---

[55] *Id.* at 23.

For all of these reasons, it is reasonable to include $7.976 million of environmental remediation expenses in evaluating SFPP's TY 2009 cost of service results and, ultimately, in considering whether the returns that SFPP will have an opportunity to earn under its existing rates are within an acceptable range.

d. Oil Losses/Shortages:

Mr. Ashton reduces SFPP's operating expense for oil losses and shortages by approximately $0.5 million. Mr. Ashton's adjustment is a concoction of the average losses and shortages recorded by SFPP in total during the years 2003 through 2007 multiplied by the 2007 ratio of CPUC-jurisdictional costs to total costs, then averaged again with the average of SFPP's CPUC-jurisdictional oil losses and shortages for 2007 and the 12-months ended June 30, 2009. Simply stated, Mr. Ashton's number is an average of two averages.

As justification for his proposed adjustment, Mr. Ashton claims the year 2008 for SFPP's oil losses and shortages was a "very unusual" and "anomalous" year and discounts the validity of 2008 gains/losses. Mr. Ashton, however, bases his conclusion that 2008 is anomalous solely on his observation of a historic trend in SFPP's total company oil losses and shortages. Looking at total company cost, as Mr. Ashton does, is misleading, since it fails to take into consideration how the cost on each pipeline system affects SFPP's CPUC-jurisdictional level cost. Moreover, despite Mr. Ashton's belief that it is not appropriate to include any portion of 2008 since it was such an anomalous year for SFPP's oil losses and shortages, he nonetheless includes the last half of 2008 in the average of his two averages. Therefore, Mr. Ashton is guilty of his own criticism.

SFPP presented testimony rebutting Mr. Ashton's assertion that 2008 oil losses/shortages costs were in any way anomalous. Such testimony showed SFPP's oil losses and shortages for the calendar years 2003 through 2007 by pipeline system. It also included SFPP's July 2008 through June 2009 base period costs. The proffered evidence demonstrates that for each pipeline system that is in CPUC-jurisdictional service, SFPP's base period oil losses and shortages cost, is well within the range experienced by SFPP in 2003 through 2007.[56] Therefore, even if 2008 were an anomalous year as Mr. Ashton claims – which by pipeline system it was not – SFPP's base period cost is not anomalous. Mr. Ashton's attempt to evaluate SFPP's oil losses and shortages at the total company level is irrelevant for CPUC-jurisdictional purposes and is misleading.

For all of these reasons, it is reasonable to reflect an adjustment of ($1.313 million) associated with oil losses and shortages in evaluating SFPP's TY 2009 cost of service and, ultimately, in considering whether the returns that SFPP will have an opportunity to earn under its existing rates are within an acceptable range.

e. Litigation Expenses:

Mr. Ashton recommends SFPP's litigation expense associated with this proceeding be amortized over a five year period and then be removed from the cost of service. Mr. Ashton believes this amortized amount should be recovered through a temporary surcharge rather than embedded in tariff rates in perpetuity, based on his belief that litigation expenses are not likely to be recurring in the future and will disappear once the subject litigation is resolved.

Mr. Ashton's recommendation violates his own general test period principles. Mr. Ashton does not specify when he believes this litigation will disappear; but, in all likelihood, it is well beyond what is reasonably known and estimable for test period purposes. Specifically, SFPP has been in litigation with the same group of shippers at the FERC for over 20 years, and over 10 years at the CPUC. Mr. Ashton has provided no basis for his assessment that these costs

[56] *Id.* at 27.

will disappear in the reasonably foreseeable future. Therefore, SFPP's litigation expense should be treated as any other operating expense in its test period cost of service.

4. Cost of Capital:

To arrive at reasonable assumptions regarding capital structure, cost of debt, and cost of equity to be used in calculating SFPP's TY 2009 cost of service and in evaluating whether the return that SFPP will have an opportunity to earn under its existing rates is within an acceptable range, SFPP relied upon the expertise of Professor James H. Vander Weide. Because SFPP does not have publicly traded stock, Professor Vander Weide estimated SFPP's cost of equity from stock market data for a group of comparable companies. The use of a group of comparable companies adds greater accuracy to cost of equity estimate because it reduces the inherent uncertainty associated with the cost of equity estimate for a single company.[57]

Based upon his analysis of the required return on common equity for a set of publicly traded oil pipeline proxy companies, Professor Vander Weide concludes that a reasonable determination of the cost of equity for SFPP is 15.01%. He further recommends a cost of debt equal to 6.56 percent and a capital structure containing 52.43 percent debt and 47.57 percent equity.[58]

As set forth below, SFPP submits that Professor Vander Weide's recommendations regarding cost of equity, cost of debt, and capital structure most reasonably reflect circumstances and conditions likely to obtain during the test period and beyond and should therefore be incorporated by the Commission in evaluating SFPP's TY 2009 cost of service.

---

[57] SFPP Exhibit No. 12; Vander Weide at 3.
[58] *Id.*

a. SFPP's assumed cost of equity is reasonable.

It is impossible to establish directly the cost of equity for SFPP because SFPP has no equity securities that are publicly traded. Consequently, Professor Vander Weide identified a group of six publicly traded companies with significant revenues from the transportation of crude oil or refined products, including Buckeye Partners, Enbridge Energy Partners, Kinder Morgan Energy Partners, Magellan Midstream Partners, NuStar Energy, and Plains All American Pipeline as appropriate proxies for SFPP. Given relative comparability between these six publicly traded companies and SFPP, Dr. Vander Weide concluded that his proxy group constitutes a reasonable sample upon which to base his assessment of the investment world's perceived risk of acquiring an equity interest in SFPP.[59]

Relying upon the Discounted Cash Flow ("DCF") method, he determined the cost of common equity for the proxy companies. The DCF model is based on the assumption that investors value an asset on the basis of the future cash flows they expect to receive from owning the asset. Thus, investors value an investment in a bond because they expect to receive a sequence of semi-annual coupon payments over the life of the bond and a terminal payment equal to the bond's face value at the time the bond matures. Likewise, investors value an investment in a firm's stock because they expect to receive a sequence of dividend payments and, perhaps, expect to sell the stock at a higher price sometime in the future.

A second fundamental principle of the DCF method is that investors value a dollar received in the future less than a dollar received today because they could invest a current dollar in an interest earning account and increase their wealth. Applying these two fundamental DCF principles to an investment in a bond leads to the conclusion that investors value their investment

[59] *Id.* at 8.

in the bond on the basis of the present value of the bond's future cash flows.

Dr. Vander Weide's application of the DCF model to his comparable companies produces a median result of 14.69 percent, and a range of results from 12.62 percent to 15.33 percent. Based upon this range of results, Dr. Vander Weide recommends that a cost of equity of 15.01 percent be used in evaluating whether SFPP's existing rates are likely to produce cost of service results that are within the Commission's acceptable range. The recommended 15.01 percent cost of equity is the midpoint of the median cost of equity for the comparable company group, 14.69 percent, and the high estimated cost of equity for the comparable company group, 15.33 percent. Dr. Vander Weide recommends a cost of equity in the upper half of the cost of equity results rather than recommending the median result because SFPP has greater business risk than the companies in the comparable company group.[60]

The shipper intervenors filed testimony directly challenging Dr. Vander Weide's cost of equity recommendation. The shippers, like Dr. Vander Weide, estimate SFPP's cost of equity by applying the DCF model to groups of proxy companies. Witness Ashton recommends a cost of equity of 12.43%;witness Horst recommends a cost of equity of 12.21%; witness Crowe recommends a return on equity of 10.25%.[61]

The shippers' various cost of equity recommendations reflect fundamental, analytical flaws that produce results that do not represent a reasonable basis for determining SFPP's cost of equity. The essential components of a proper DCF analysis require identification of an appropriate group of proxy companies, a valid estimate of the distribution yield component of the annual DCF model, and a valid estimate of the growth component of the DCF model.

---

[60] *Id.* at 14.
[61] Tesoro Exhibit No. 14; Ashton at 32; ExxonMobil – 1; Horst at 4; BP-1; Crowe at 17.

The respective shipper cost-of-equity analyses suffer from some or all of the following defects: (1) the dividend yield component of the DCF model is wrongly estimated; (2) the growth component is wrongly estimated; and (3) the selected proxy companies are not comparable to SFPP. As discussed below, the various DCF modeling results produced by the shippers are unreliable and should be rejected.

The DCF model estimates the cost of equity by adding the investor's expected growth rate to the company's expected dividend yield. To estimate the expected dividend yield for the companies in their proxy group, Dr. Horst and Mr. Ashton estimate the current annual dividend by the average stock price over the last six months, multiplying the result by the first-year growth factor (1 + 0.5 g). In her DCF calculations, Ms. Crowe follows the same procedure as Dr. Horst and Mr. Ashton, but she argues that the Commission should accept a DCF result at the low end of her range of DCF results because, in her opinion, the DCF model overestimates the investors' required return when cash distributions are used to calculate the dividend yield component of the DCF model.[62] The shippers' witnesses multiply each company's current dividend yield by the factor (1 + 0.5 g) because the annual DCF model requires an estimate of the dividend yield at the end of the first year of the investment, rather than at the beginning of the first year of the investment. The shippers estimate the dividend yield at the end of the first year by multiplying the current or beginning of year dividend yield by the factor (1 + 0.5 g).

Dr. Vander Weide has explained the flaw in shippers' decisions to first assume that dividends are paid annually at the end of each year (as required under the annual DCF model) and then to estimate the expected end-of-year dividend yield by multiplying the company's current dividend yield by the factor (1 + 0.5 g) – thereby understating the cost of equity to the

[62] SFPP Exhibit No. 14; Vander Weide at 4.

proxy companies. As Dr. Vander Weide testified, the annual DCF model requires that the cost of equity be calculated by multiplying each company's current dividend yield by the factor (1 + g), not 50% of expected growth (1 + 0.5 g) as shippers have done.[63]

To justify their use of the factor (1 + 0.5 g), rather than the factor (1 + g), shipper witness must assume that: (1) the proxy companies will increase their dividends in different quarters of the next year; and (2) on average, the proxy companies will increase their dividends at the end of the second quarter, that is, half way through the year. However, the shippers' assumption that the proxy companies will increase their dividends, on average, at the end of the second quarter, is inconsistent with the fundamental assumption of their annual DCF model that dividends are only paid annually, at the end of the year. If a company pays dividends quarterly, as the shippers assume in their justification for using the factor (1 + 0.5 g), the quarterly DCF model should be used to estimate the cost of equity.[64]

In order to be conservative, Dr. Vander Weide used an annual DCF model, rather than a quarterly DCF model formula. Dr. Vander Weide further demonstrated the inaccuracy of Dr. Horst's claim that Dr. Vander Weide's use of the annual model produces a higher cost of equity result than the quarterly model. Contrary to Dr. Horst's assertion, a correctly applied quarterly DCF model typically produces a higher cost of equity result than the annual model used by Dr. Vander Weide to estimate SFPP's cost of equity.[65]

Dr. Vander Weide also demonstrated the error in witness Crowe's assertion that the DCF model <u>overstates</u> the investors' required rate of return on investment for Master Limited

[63] SFPP Exhibit No. 14; Vander Weide at 5.
[64] *Id.*

[65] *Id.* at 6.

Partnerships (“MLPs”) when cash distributions are used to calculate the dividend yield component of the DCF model. In particular, witness Crowe’s attempt to illustrate why using cash distributions to measure the yield component of the DCF model produces an incorrect estimate of the investors’ required rate of return on investment is itself shown to be in error. Ms. Crowe mistakenly assumes that the DCF model will produce a five percent rate of return on investment in her example if the dividend yield component is calculated using cash distributions. As previously noted, the investors’ first-year rate of return in the DCF model is equal to the dividend yield plus the percent change in the value of the account. Although Ms. Crowe is correct that, in her example, the first year dividend yield is five percent, she fails to recognize that the balance in the account has declined over the year by five percent (from $100 to $95). Since the five percent first year dividend yield in Ms. Crowe’s example is exactly offset by a five percent decline in the value of the account, the DCF rate of return on the account is zero. Thus, contrary to Ms. Crowe’s assertion, if cash distributions are used to calculate the dividend yield component of the DCF model, the DCF model will correctly estimate that the investors’ return in her example is zero.[66]

Dr. Vander Weide then presented evidence that the DCF model, when correctly run, provides accurate estimates of the investors’ required rate of return even when the cash distribution wholly represents a return of investment rather than a return on investment.[67]

The shipper witnesses and Dr. Vander Weide also differed in their estimation of the growth component of the DCF model. Dr. Vander Weide used the analysts’ estimates of future earnings per share (“EPS”) growth reported by I/B/E/S Thomson Reuters. The shipper witnesses

---

[66] *Id.* at 7-8.
[67] *Id.* at 8.

estimate the growth component of the DCF model in three steps. First, they obtain data on the analysts' median expected earnings per share ("EPS") growth rate published by I/B/E/S Thomson Reuters and the long-run GDP growth forecasts of EIA, Global Insight, and the Social Security Administration. Second, they adjust the average long-run GDP growth forecast from these three sources by dividing the average by two. Third, they calculate a weighted average of the analysts' median growth forecast and the adjusted long-term GDP forecast, giving the I/B/E/S growth rate a two-thirds weight and the adjusted average GDP growth rate a one-third weight.

Dr. Vander Weide testified that he uses the analysts estimate of future EPS growth because his studies indicated that the analysts forecasts are the best estimates of investors' expectations of future long-run growth.[68] Dr. Vander Weide recognizes, however, that it is difficult to test whether investors use analysts' growth forecasts or the FERC two-stage growth forecast because the FERC two-stage growth forecast is a linear function of the analysts' growth forecast. Given that his preferred growth rate measure is incorporated to a significant degree within the growth rate preferred by shippers, any statistical difference between the two with respect to their correlation to stock prices is masked. Nevertheless, Dr. Vander Weide believes his growth rate component, predicated on the analysis of market participants is superior to a growth component that weights analysts' expectations with various governmental projections of GDP.

While Dr. Horst and Mr. Ashton recommend essentially the same group of oil pipeline MLPs recommend by Dr. Vander Weide, Ms. Crowe recommends use of a proxy group consisting of ten oil and gas corporations that, according to Ms. Crowe, own at least one major

---

[68] *Id.* at 9.

interstate oil or gas pipeline. While SFPP is involved primarily in the oil pipeline business, none of Ms. Crowe's proxy companies involved primarily in the oil pipeline business. Most of Ms. Crowe's proxy companies is involved primarily in regulated and unregulated natural gas operations.[69]

In addition to using an inappropriate group of proxy companies, Ms. Crowe also includes highly unreliable results from two of her proxy companies in her analysis. Ms. Crowe's median DCF result for her proxy group of natural gas corporations includes a DCF result of 2.81 percent for Sunoco, Inc., and a DCF result of 8.99 percent for El Paso Corp. Both of these results are unreliable. The 2.81 percent DCF result for Sunoco, Inc., is unreliable because it is 343 basis points *less than* the 6.24 percent average yield on BBB-rated utility debt in December 2009, and financial experts agree that the cost of equity must be significantly greater than the cost of debt. The 8.99 percent result for El Paso Corporation is unreliable because El Paso's debt is rated below investment grade, and financial experts agree that it is difficult to estimate the cost of equity for financially-distressed companies such as El Paso.[70]

Ms. Crowe's DCF analysis produces a range from 2.81 percent to 14.26 percent for her proxy group. Ms. Crowe then places SFPP at a cost of equity, 10.25 percent, that is in the lower half of her DCF range. Ms. Crowe places SFPP in the lower half of her DCF range of results because she believes SFPP faces significantly less risk than her proxy companies. She provides no evidence to support her assessment of the relative risk faced by SFPP as opposed to natural gas companies. By contrast, SFPP has presented specific evidence showing the additional risks specific to its California intrastate pipeline operations that militate in favor of placing SFPP in

---

[69] *Id.* at 15.
[70] *Id.*

the higher half of the range produced by Dr. Vander Weide's DCF analysis, i.e. 15.01%.

b. SFPP's assumed cost of debt is reasonable.

Dr. Vander Weide recommends a cost of debt equal to 6.56 percent, by calculating the weighted average cost of the long-term debt shown on Kinder Morgan Energy Partners' ("KMEP") balance sheet. Mr. Ashton recommends a cost of debt equal to 6.53 percent; Ms. Crowe recommends a cost of debt equal to 4.66 percent; and Dr. Horst recommends a cost of debt equal to 4.35 percent.[71]

As did Dr. Vander Weide, Mr. Ashton arrived at his recommended cost of debt by calculating the weighted average cost of the long-term debt shown on KMEP's balance sheet. Ms. Crowe and Dr. Horst, however, contend that Dr. Vander Weide has overstated SFPP's cost of debt by more than 200 basis points, asserting that Dr. Vander Weide failed to take into account KMEP's interest rate swap agreements.

An interest rate swap agreement is an agreement between two parties in which one party agrees to pay a fixed interest rate on a notional principal to another party in exchange for receiving a variable interest rate on the same sum of money. Although the interest rate to be paid in each period on the floating rate obligation in an interest rate swap agreement is uncertain, interest rate swap agreements are generally priced so that the effective rate on the floating-rate obligation in the swap agreement is equal to the effective interest rate on an interest rate on the fixed-rate obligation in the swap agreement. If the effective interest rates on the floating rate and fixed rate obligations in the swap agreement were not equal, there would be no incentive for the parties to the swap agreement to make such an agreement. The main purpose of interest rate swap agreements is to hedge risk. Since interest rate swap agreements are generally priced so

[71] *Id.* at 17.

that the effective interest rate on the floating rate debt is equal to the effective interest rate on the fixed-rate debt obligation, interest rate swap agreements should have no effect on the company's effective interest rate over the term of the swap agreement.

Consequently, interest rate swap agreements should not be taken into account when calculating the cost of long-term debt because the effective interest rate on the floating rate obligation over the term of the agreement can only be estimated with great uncertainty, and, in any case, is likely to approximate the effective interest rate on the company's fixed-rate long-term debt.

c. SFPP's assumed capital structure is reasonable.

Dr. Vander Weide recommends a capital structure containing 52.43 percent debt and 47.57 percent equity. His recommended capital structure is the average capital structure for the comparable company group at June 30, 2009 that was used in connection with his DCF analysis.[72] Dr. Horst recommends a capital structure containing 60.36 percent debt and 39.64 percent equity; Mr. Ashton recommends a capital structure containing 61.7 percent debt and 38.3 percent equity; and Ms. Crowe recommends a capital structure containing 69.5 percent debt and 30.5 percent equity.[73]

Dr. Vander Weide recommends using the average capital structure for his comparable company group because KMEP's capital structure is significantly below its long-run target capital structure of 50 percent debt and 50 percent equity.[74] Although the average capital structure for his comparable group contains less than 50 percent equity, in his opinion, it is a

[72] *Id.* at 19.
[73] *Id.* at 20.
[74] *See* Kinder Morgan Energy Partners Form 10-K filed February 23, 2009, for the year ending December 31, 2008, at page 81: "We attempt to maintain a relatively conservative overall capital structure, financing our expansion capital expenditures and acquisitions with approximately 50% equity and 50%
(footnote continued)

reasonable approximation of KMEP's forward-looking capital structure. Dr. Vander Weide further notes that the average capital structure for Dr. Horst's DCF proxy group contains 53 percent debt and 47 percent equity.[75]

Mr. Ashton arrives at his recommended 61.7 percent debt/38.3 percent equity capital structure by beginning with KMEP's actual debt and equity balances at September 30, 2009, and then adjusting the equity balances in that capital structure for what he calls "purchase accounting adjustments" during the test period. Ms. Crowe, employing the same process including PAA adjustments, recommends a capital structure containing 69.5 percent debt and 30.5 percent debt.[76]

Mr. Ashton explains why he makes an adjustment to KMEP's equity balance to reflect purchase accounting adjustments as follows:

> PAAs are restatements of equity and asset balances, made when a company acquires assets. PAAs may result in a situation in which the account balances no longer reflect the actual original cost of regulated assets, which should not be permitted for ratemaking purposes. The inclusion of a positive PAA leads to an inflated restatement of the investment base and equity amount on the balance sheet, subsequently leading to an inflated allowed return on the equity portion of the rate base. [Ashton at 25. Footnote omitted.][77]

Dr. Vander Weide directly rebutted Mr. Ashton's assertion that purchase accounting adjustments produce an "inflated restatement" of the "equity amount on the balance sheet." He testified that the accounting entries made at the time of an acquisition reflect the fair value of the asset acquired and the actual financing, if any, used to acquire the asset. If the asset is acquired with cash, there will be no changes to the acquiring company's debt and equity balances at the

---

debt. In the short-term, we fund these expenditures from borrowings under our credit facility until the amount borrowed is of a sufficient size to cost effectively do either a debt or equity offering, or both."

[75] SFPP Exhibit No. 13; Vander Weide at 20.

[76] *Id.* at 20.

[77] *Id.* at 21.

time of the acquisition. If the asset is financed with a mix of debt and equity financing, the acquiring company's debt and equity balances will both increase to reflect the actual financing of the acquired asset. In no case will the debt and/or equity balances be "inflated" or "restated" to reflect anything other than the actual amounts of debt and equity that financed the acquisition.

Dr. Vander Weide also rebutted Mr. Ashton's assertion that removing purchase accounting adjustments from KMEP's equity balance is required to insure consistency between the accounting treatment of the regulated company's capital structure and the accounting treatment of its rate base. He testified that consistent regulatory accounting only requires that the company's total assets equal the sum of its total liabilities and its equity. It does not require that a downward adjustment to the regulatory rate base be accompanied by a downward adjustment to the equity percentage in the company's capital structure.

It is important to recognize the role a company's capital structure plays in the rate setting process. The company's capital structure reflects the percentages of debt and equity that finance the company's investment in rate base. In turn, the percentages of debt and equity on the company's balance sheet reflect the actual financing of a company's acquisitions. As discussed above, the accounting entries made at the time of an acquisition capture the actual debt and equity that have been used to finance the acquisition. As noted above, if the asset is acquired with cash, there will be no changes to the acquiring company's debt and equity balances at the time of the acquisition. If the asset is financed with a mix of debt and equity financing, the acquiring company's debt and equity balances will both increase to reflect the actual financing of the acquired asset. In no case will the debt and/or equity balances be "inflated" or "restated" to reflect anything other than the actual amounts of debt and equity that financed the acquisition.

If the Commission were to adjust a company's capital structure to reflect acquisition financing, the Commission would have to adjust both the debt and equity balances for the actual financing of the acquisition. Given KMEP's policy to finance its acquisitions with 50 percent debt and 50 percent equity, if the Commission were to adopt a recommendation such as Mr. Ashton's to remove purchase accounting adjustments, it should reduce both debt and equity in equal amounts.

B. Consideration of the Remaining *Unocap F*actors and Other Empirical Data Further Supports a Commission Finding that SFPP's Existing Rates Are Reasonable.

Various witnesses for SFPP's shippers have, at times, inaccurately characterize SFPP's request for a more "light-handed" form of regulation from the Commission as a request for freedom to charge whatever SFPP deems appropriate or believes the market can bear—in other words, the shippers assert that SFPP is essentially seeking deregulation.[78] Rather than seeking deregulation, SFPP is instead asking the Commission to evaluate the reasonableness of its rates in a context that recognizes the differences in status between a franchised, monopoly utility and a utility that faces competition. Specifically, SFPP asks the Commission to give substantial weight to the factors pertaining to the comparability of pipeline rates; the size and level of sophistication of SFPP's customers; the availability of competitive alternatives to SFPP's services; and the minimal impact of SFPP's rates on the ultimate consumer[79] along with its evaluation of SFPP's rates based upon cost of service.

---

[78] BCES-1; Fessler at 37.

[79] Specifically, using the most extreme positions of any party in this proceeding – O'Loughlin's revenue of $126.4 million and Ashton's COS of $84.6 million would imply SFPP excess revenue of $41.8 million. Dividing $41.8 million by the lowest recommended total intrastate volumes transported on SFPP's pipelines (Dito's 227.4 MMBBLS x 42 gallons per barrel) means that AT MOST $0.004 per gallon is at issue (see also Tr. at 89).

SFPP understands that the size and sophistication of its customers and the degree to which it faces competition are not easily quantifiable metrics by which the Commission can evaluate whether a rate is too high or not; and SFPP has no ready formulation for how such qualitative factors should be incorporated in the Commission's evaluation of the reasonableness of its rates. Nevertheless, some weight should be afforded these real-world facts, if on no other basis than to support a finding, if appropriate, that SFPP rates are reasonable even if cost-of-service results might suggest otherwise. Further, in addition to its consideration of cost-of-service results, the Commission should give some weight to external sources of empirical data that validate the reasonableness of SFPP's existing rates **– in particular, SFPP asks the Commission to give substantial weight to evidence that since 1992 its rates have declined in real terms.**

As a utility moves along the continuum from a non-franchised monopoly to a situation where it faces moderate competition, the level of scrutiny that the regulator needs to apply decreases. To reiterate, this does not mean that the Commission can or should ignore SFPP and allow it to charge any rate it chooses. While the Commission does and must retain its authority to review and adopt or reject any rate proposal advanced by SFPP, and must also review and consider any shipper protest or complaint regarding the reasonableness of any such rate, the Commission is not under any mandate to use Cost of Service as the only metric for evaluating the reasonableness of rates. If the Commission were to see evidence that SFPP was, in certain circumstances, charging non-comparable pipeline rates to shippers who had no alternatives to use of the particular pipeline service and thereby insulated from any competitive consequences, it might in such a case be appropriate to apply a stricter standard of scrutiny to SFPP's costs. By the same token, it is not good policy for the Commission to discount evidence that a shipper has economic alternatives to a particular SFPP pipeline movement and declare the rate unreasonable based simply upon a strict cost-of-service analysis.

Given the Commission's statutory obligation to maintain continuing oversight with respect to the reasonableness of SFPP's utility charges as well as shippers' continuing access to the Commission for relief from any excessive or unreasonable charges, the risk of adopting a moderate level of scrutiny—while conserving Commission resources—is relatively low. Shippers maintain their recourse to the Commission with respect to any allegedly unreasonable rates or practices associated with SFPP utility services and SFPP reports its achieved regulatory return annually to the Commission in compliance with Decision 07-05-061. Perhaps more significantly, there is no consumer interest at stake, unlike the circumstances involving electric and natural gas utilities where consumer interests justify a stricter level of rate scrutiny.[80]

When, as is the case here, there is such an extreme divergence between SFPP and Shippers regarding calculation of SFPP's COS, it is incumbent upon the Commission to give full consideration to all factors that are relevant to its evaluation of the reasonableness of pipeline utility rates. The unrebutted evidence shows that: (i) SFPP's customers have competitive alternatives, both actual and potential, and the wherewithal to avail themselves of such alternatives; (ii) SFPP faces moderate competition, particularly from trucking (iii) SFPP's rates compare favorably with other pipeline rates; and (iv) over the past 18 years and as they stand at current levels, SFPP rates have increased less than the common measures of inflation.

In consideration of these factors, in conjunction with its evaluation of SFPP's cost of service, the Commission should determine that SFPP's existing rates are reasonable.

[80] Exhibit SFPP-1; Webb at 9.

1. The Size and Sophistication of SFPP's Customers Does Matter.

SFPP does not argue that that it should be immune from continuing regulatory oversight because its major customers have the size and sophistication to avail themselves of alternatives to SFPP's services. SFPP instead argues that the Commission, in acknowledgment that its strict regulatory oversight is unnecessary to protect captive customers subject to potential exploitation by SFPP, can be more flexible in giving weight to qualitative as well as quantitative information in determining the reasonableness of SFPP's rates.

Dr. Webb provided his explanation why it is appropriate for the Commission to evaluate the sophistication of SFPP's customers:

> [i] is again useful to draw a contrast between the economic circumstances of SFPP and the circumstances of a more traditional public utility. In this latter case, the utility is selling to a large number of individual customers. If this utility seeks to exercise market power over its customers these customers face little recourse either at the Commission or in the market place because they will have difficulty coordinating their actions. Basically they will face a "collective action problem" meaning that while the group of customers would like to take some action, perhaps bring a complaint at the Commission, this action has a cost. Each member of the group will hope that other members of the group will bear the cost and each individual may "free ride". As a result, no member of the group will take action and the utility will be able to exploit the customers. <u>Recognizing this possibility, the Commission stands in for the public.</u> (emphasis added.)

There is no such public interest in this case. Instead, as in *Unocap*, the customers of SFPP are large sophisticated corporations that are unlikely to face a collective action problem. Indeed, as shown in Table 1 below several of SFPP's shippers are owned by corporations whose market capitalization exceeds that of SFPP's parent, KMEP by a large factor. KMEP's market capitalization is $18.78 billion.[81]

---

[81] *Id.* at 12.

Table 1[82]

Company	Ticker Symbol	Market Capitalization ($ Bn)
BP plc	BP	190.91
Chevron Corporation	CVX	156.79
ConocoPhillips	COP	78.72
ExxonMobil Corporation	XOM	322.96
Royal Dutch Shell plc	RDS.A	188.43
Tesoro Corporation	TSO	1.94
Valero Energy CP	VLO	10.79

In the above table, Kinder Morgan would rank between five and six in market capitalization. In addition, several of these corporations have earned the largest profit of any corporation in history in the past few years and are themselves major pipeline owners and operators. Consequently, they clearly have the financial and technical wherewithal to ensure that their legitimate commercial concerns are addressed. However, if the Commission were to reverse its *Unocap* policy and ignore the sophistication of SFPP's customers, and apply the stricter ratemaking standards it applies to a utility serving a large number of small customers, the Commission may encourage "rent seeking."[83]

2. <u>SFPP Faces Moderate Competition; Its Shippers Have Competitive Alternatives.</u>

Only SFPP presented direct evidence addressing the market power issue; and only SFPP presented credible evidence demonstrating the existence of competitive alternatives to its

[82] Source: http://finance.google.com Accessed January 20, 2010.
[83] Exhibit SFPP-1; Webb at 12.

pipeline services.[84] Rather, shippers have relied almost exclusively on COS-related claims as their basis for asserting that SFPP's rates are excessive. Consequently, there is no evidence of record disputing SFPP's showing that it faces moderate competition and that its shippers have competitive alternatives.

The EAI report shows that the overall markets served by SFPP have a combined estimated HHI of 1465. SFPP delivered 580 thousand barrels per day (MBPD) of light product to these markets in 2008 and the non-SFPP distribution systems delivered 917 MBD. The greater Los Angeles and San Francisco Micro-Markets were determined to have HHI's of 1151 and 1905, respectively, below the thresholds at which the FTC or DOJ would consider a market highly concentrated and would therefore apply strict scrutiny before permitting a merger. SFPP's market shares in these areas were 2.3 and 36.6 percent respectively. [85] The shippers did not present a market power study of their own.

SFPP readily acknowledges that in certain of its markets, the HHI statistics prepared by EAI are above the thresholds at which the FTC or DOJ would consider a market to be highly concentrated. Similarly, in several markets the HHI statistics are above the thresholds at which the DOJ recommended deregulating interstate oil pipelines (i.e. 2,500). For this reason, Dr. Webb characterizes SFPP as only facing moderate competition and does not advocate deregulation of SFPP. In other words, the Commission should apply a higher degree of scrutiny to SFPP's rates than it would if SFPP faced a degree of competition similar to that at which the DOJ recommended deregulating interstate oil pipelines. In summary, just as any suggestion that

[84] Shippers' direct evidence regarding competitive alternatives to SFPP is limited to a revision of an inapplicable SFPP trucking study provided in a previous case, purporting to show that truck rates are so much higher than SFPP pipeline rates that trucking is not competitive.
[85] Exhibit SFPP No. 2; EAI at 2-3; Exhibit SFPP no. 1; Webb at 18.

SFPP should be totally deregulated is entirely inappropriate, any suggestion by shipper witnesses that the Commission should simply adopt wholesale its monopoly utility model of regulation is also entirely inappropriate given the level of competition faced by SFPP.

The unrebutted evidence shows that many of the markets downstream of the Los Angeles and San Francisco supply hubs are within economic trucking distance of local terminals and truck carriers including Stockton, Sacramento, Colton, San Diego and Fresno. EAI presented evidence of truck penetration of SFPP markets, based upon analysis of the equi-cost point between a barrel shipped on SFPP and a barrel shipped from a competing refinery terminal EAI defines the equi-cost point, i.e. the point of indifference, as the distance where the cost for trucking from a refinery terminal to the final destination equals cost for transporting by SFPP pipeline and subsequently trucking to the final destination. The study, which remains unrebutted, shows the following:

- For the Chico market, truck supply can be transported 57 miles towards Chico where it is equi-cost with SFPP supply moving via pipeline out of Concord to Chico, while Sacramento area supply can be transported 40 to 90 miles towards Chico which puts product into the core Chico market at 91 miles.[86]

- For the Sacramento market which is supplied via Chevron pipeline, SFPP pipeline and truck or supply product sourced at Benicia, truck supply can be transported by truck 42 miles towards Sacramento where they are equi-cost with SFPP out of Concord to Sacramento. Benicia area supply can be trucked 40 to 60 miles towards Sacramento which puts product into the core Sacramento market at 60 miles.[87]

- For the Stockton market which is supplied by SFPP and secondarily by truck supply originating in the SF Bay area, supply can be transported by truck 46 miles towards Stockton where they are equi-cost with SFPP supply moving via pipeline out of Concord. Benicia area supply can be trucked 40 to 80 miles towards Stockton which puts product into the core Stockton market at 58 miles.[88]

[86] Exhibit SFPP No. 2; EAI at 23.
[87] *Id.* at 24-25.
[88] *Id.* at 26.

- The San Francisco market is supplied via truck racks at five local refineries, local shipper owned and third party terminals and SFPP making it highly competitive.

- The San Jose market is supplied by a proprietary pipeline and trucking from the refineries. From Chevron Richmond refinery truck racks, truck supply can be transported by truck 45 miles towards San Jose where they are equi-cost with SFPP supply moving via pipeline out of Richmond to San Jose, while Richmond area supply can be transported 40 to 60 miles toward San Jose which puts product into the core San Jose market at 55 miles. Chevron also supplies San José with a proprietary pipeline.[89]

- The Fresno market is supplied via SFPP from two different refinery origins; and Bakersfield is the closest source of truck origin product for the Fresno market. Truck supply can be transported 67 miles towards Fresno where they are equi-cost with SFPP supply moving via pipeline out of Bakersfield to Fresno, while Bay Area supply can be transported about 66 miles toward Fresno which puts product about halfway towards the core Fresno market area at 102 miles.[90]

- The San Diego market is supplied via SFPP from LA are refineries and truck supply originating in the southern portions of the LA market area. From proprietary terminals in the southern LA area, truck supply can be transported 64 miles towards San Diego where they are equi-cost with SFPP supply moving via pipeline out of LA refineries to San Diego, while LA area supply can be trucked to the outskirts of San Diego at 80 miles versus fully into San Diego at 104.[91]

- For the Colton market, truck supply can be transported 37 miles towards Colton from LA refineries where they are equi-cost with SFPP supply moving via pipeline out of Watson to Colton. LA area supply can be transported 32 miles toward Colton; SFPP rates are very competitive relative to trucking and on average penetrate about half way to Colton.[92]

As referenced above, SFPP has presented its estimate of the location of equi-cost point for SFPP's various terminal and barrels trucked from competing facilities to satisfy consumption. As the evidence show, if SFPP raised its rates the equi-cost line would shrink back toward the source point. In other words, a shipper who was previously indifferent between either supplying its service stations with trucks transporting barrels out of an SFPP terminal or trucks transporting

[89] *Id.* at 28.
[90] *Id.* at 30.
[91] *Id.* at 34.
[92] *Id.* at 35.

barrels from one of the refiners or a terminal connected to a proprietary pipeline would no longer be indifferent. Instead, this shipper would reduce shipments on SFPP and would meet the demand of its service station customers using barrels sourced from the alternatives. The loss of these marginal customers serves as a significant restraint on SFPP's prices. As Mr. Dito testified, the loss of even a small amount of volumes can have a relatively large effect on net income. So, the possibility of losing these marginal customers and the difficulty of recapturing such lost customers explains why SFPP can not raise its prices to the levels that Messrs. Ashton and Crowley suggest they could. In other words, it is not necessary for SFPP to be the marginal supplier to the entire market. Instead, the loss of marginal customers is sufficient to discipline its prices.[93]

The evidence of record demonstrates that shippers, principally in the form of trucking, have economically viable, competitive alternatives to use of SFPP's pipeline transportation services. The evidence is equally compelling that the availability of such alternatives constrains the prices SFPP can charge for such shorter-haul movements without risking the loss of significant throughput.

3. <u>SFPP's Existing Rates Pass the Competitive Rate Test.</u>

The only evidence of record that compares SFPP's existing rates with the rates of other pipelines, or to the pipeline industry as a whole, shows that SFPP's rates are quite comparable to other pipelines with substantial intrastate components.[94] This evidence remains unrebutted.

One of the most widely used methods to compare pipeline rates expresses pipeline tariffs as cost to transport one barrel for one mile, i.e. cents per barrel mile (cpbm). When SFPP's rates

---

[93] SFPP Exhibit No. 1; Webb at 34-35.
[94] Exhibit SFPP No. 2; EAI at 42-49.

are compared versus the total population of intrastate rates reflected in EAI's pipeline rate comparison study, the plotted information shows at Table PRC-1 that SFPP tariffs are lower than the correlation with the total intrastate tariff population.

As another basis for comparison, the average of SFPP rates are compared with the total population of interstate and intrastate tariff rates. This was done for two movement lengths, 0 to 55 miles and over 55 miles. For the 0 to 55 mile range, the average of SFPP rates is 0.869 cpbm compared to the average rate of the total population of 1.21 cpbm, i.e. SFPP rates are 28 percent lower. In the over 55 mile range, the average of the SFPP rates is closer to the average of the rest of the population but still lower, 0.495 cpbm compared to 0.577 cpbm or 14 percent lower.[95]

A third way to examine the relationship of SFPP rates to the total other population rates is comparing the number of SFPP rates that fall above and below the median value of all the rates for the two movement length categories. For the less than 55 mile movement range, the median value is 0.921 cpbm and 75 percent fall below this median value. In the over 55 mile movement range, the median value of the entire range is 0.5345 cpbm and 50 percent of the SFPP rates fall below this value.[96]

Finally, SFPP rates are compared to rates for the other large West Coast product pipeline, Olympic pipeline. Similar to SFPP, Olympic is the major, multi-product pipeline serving the western Washington State market and the northern Oregon markets. This pipeline moves all of its product in the 55 mile plus range, and its average tariff is 0.438 cpbm compared to 0.495 cpbm for SFPP, very similar to but lower than SFPP rates.[97]

The conclusion of the EAI study is that SFPP intrastate rates are comparable or lower

---

[95] *Id.* at 46.
[96] *Id.*
[97] *Id.*

than intrastate rates charged across the total population of product pipeline companies in the United States, and there is no evidence of record to indicate otherwise.

4. SFPP's Rates Have Declined in Real Terms.

From 1992 to the present, the total increase in SFPP rates has been substantially lower than the various, standard measures of inflation. For example The FERC has adopted a tariff rate indexing approach as its primary approach to changing oil pipeline rates. The oil pipeline index was applied initially to determine a ceiling rate to apply from January 1, 1995 through June 30, 1995 by multiplying the value of each pipeline tariff rate as of December 31, 1994 by the initial oil pipeline index multiplier. The FERC bases its oil pipeline index on the producer price index for finished goods ("PPI-FG") in 1995. The percentage change in the oil pipeline index equals the percentage change in PPI-FG in the prior calendar year plus an adjustment to reflect the difference between the historical percentage charges in pipeline costs and in PPI-FG. This index has gone up and down in concert with economic conditions. The adjustment factor started of at minus one percent (PPI-FG -1.0%) and then increased to zero and is currently at plus 1.3 percent. It is adjusted every five years by FERC order after a hearing involving economic experts, pipeline Form 6 data, shipper comments and industry representatives.

In further support of the reasonableness of its existing intrastate rates, SFPP has compared the history of its California intrastate rate levels from 1992 through 2010 with rate levels during the same period that would have been justified under various indices, including the FERC pipeline index, the producer pipeline index for finished goods (PPI-FG), and the Consumer Price Index ("CPI").[98]

[98] SFPP Exhibit No. 10; Dito at 17-18.

SFPP presented a graphical comparison of the average of all CPUC rates for years 1992 through 2009 with the average rate for all SFPP's California movements that would have been justified if such rates had been subject to each of the three, referenced indices, FERC, PPI-G, and the CPI. SFPP provided a further comparison of the average CPUC rate for each of SFPP's intrastate movements for years 1992 through 2009 with the rate for each movement that would have been justified if such rates had been subject to the three different indexing mechanisms. The evidence presented demonstrates that SFPP's actual, average CPUC rates closely track what would have been justified if such rates had been subject to the FERC indexing mechanism, the PPI-FG, or the CPI. [99]

As further evidence of the reasonableness of its existing rates, SFPP compared its historical and projected California intrastate revenues from 1992 through 2010 with the level of annual intrastate revenues during the same period that would have been justified if SFPP's intrastate rates were set based upon the FERC index. Between 1992 and 2010, SFPP's actual revenues increased from $92,733,000 to projected revenues of $118,024,000, representing an increase of 27 %. Under the FERC index, SFPP's 1992 revenues of $92,733,000 would have been allowed to increase to $130,636,000 in 2010, an increase of 41%. Under the PPI-FG, 1992 revenues of $92,733,000 would have been allowed to increase to $131,977,000 in 2010, an increase of 42%. Under the CPI, 1992 revenues of $92,733,000 would have been allowed to increase to $143,509,000 in 2010, an increase of 54.7%.[100]

The fact that SFPP rates have, if anything, declined in real terms over time is further, empirical evidence of their reasonableness.

---

[99] *Id.* at 16-17.
[100] *Id.*

5. SFPP's California Operations Incur Additional Risk.

In addition to generalized risks of operating a product pipeline in CA, SFPP faces additional high risks associated with its California operations. Major portions of SFPP's intrastate pipeline system are either located within or near heavily urbanized areas and/or sensitive environmental habitat. 87.9% of SFPP pipelines under CPUC jurisdiction in California are in High Consequence Areas.[101] Major portions of SFPP's pipeline system are getting older and more difficult to maintain.

To further enhance safety and environmental protection in areas where a pipeline failure could have serious consequences for the public or the environment, federal authorities have designated as High Consequence Areas geographical locations and circumstances which require enhanced efforts and measures by pipeline operators to maintain pipeline integrity in such designated areas. As defined by the U.S. Department of Transportation, at 49 CFR 195.450, an HCA is:

> (i) a commercially navigable waterway - a waterway where a substantial likelihood of commercial navigation exists;
>
> (ii) a high population area - an urbanized area, as defined and delineated by the Census Bureau, that contains 50,000 or more people and has a population density of at least 1,000 people per square mile;
>
> (iii) other populated areas - a place, as defined and delineated by the Census Bureau, that contains a concentrated population, such as incorporated or unincorporated city, town, village, or other designated residential or commercial area; or
>
> (iv) an unusually sensitive area as defined in 49 CFR 195.6 - a drinking water or ecological resource area that is unusually sensitive to environmental damage from a hazardous liquid pipeline release.

---

[101] SFPP Exhibit No. 10; Dito at 20.

IV. CONCLUSION

Application of the *Unocap* principles is an appropriate and most administratively sensible process for evaluating the reasonableness of SFPP's rates. If, as here, SFPP presents to the Commission a full cost of service presentation and the requested rates produce revenues that provided a return acceptable to the Commission, it is a simple matter for the Commission to approve the rates. If the revenue were to exceed the cost of service, the Commission should properly look at the individual rates in light of the *Unocal* factors and determine if they are just and reasonable when considered in that further context. For instance, a rate to San Jose might be higher than reasonable under a strict cost of service analysis, but given the proximity to the refineries and the competing trucking and pipelines, the Commission could readily exercise its discretion and decide in its judgment that the rate is just and reasonable. The Commission might also consider evidence of the age of the investment and the small contribution to rate base in when performing this evaluation. While not an empirical algorithm, the Commission's judgment is certainly a valuable assessment of SFPP's rates and should not be simply limited to consideration of strict cost of service principles.

For all of the reasons set forth herein, and as fully supported by the record, SFPP respectfully requests that the Commission issue its order finding:

(i) that SFPP is entitled to retain the $10 million in rate increases at issue; and

(ii) that its overall, current system-wide intrastate rates, when evaluated by the Commission in consideration of various factors, including a forward-looking 2009 Test Year ("TY") cost of service ("COS") analysis, are just and reasonable.

Respectfully submitted this 19th day of April, 2010 at San Francisco, California.

GOODIN, MACBRIDE, SQUERI,
DAY & LAMPREY, LLP
James D. Squeri
505 Sansome Street, Suite 900
San Francisco, CA 94111
Telephone: (415) 392-7900
Facsimile: (415) 398-4321
E-ail:jsqueri@goodinmacbride.com

By *__/s/ James D. Squeri__________*
James D. Squeri

Attorneys for SFPP, L.P. and Calnev Pipe Line LLC

2539/001/X117944.v1

<u>ATTACHMENT A</u>

SFPP ARGUMENT IN SUPPORT OF FULL INCOME TAX ALLOWANCE

A. There Is No Legal, Factual, or Policy Basis to Deny SFPP a Full Income Tax Allowance.

SFPP's arguments regarding income tax treatment allowance primarily focus on reasons why the Commission should maintain a policy of affording SFPP a full income tax allowance in developing SFPP's TY 2009 cost of service.

Shippers recommend elimination of an income tax allowance for SFPP. The rationale supporting such radical and unprecedented ratemaking treatment is the simple fact that SFPP, which is organized as a partnership, does not itself pay taxes; rather, it is the individual partners who comprise the partnership that face actual or potential tax liability with respect to distributions received from the partnership. There is no evidence that any regulatory body, state or federal, that has adopted a tax allowance policy that is consistent with shippers' recommendation that no tax allowance be included in SFPP's TY cost of service.

The shippers' recommendation is in fact inconsistent with existing Commission policy. With regard to allowances for test-year income tax expense, existing Commission policy makes no distinction based upon the form of organization of the utility nor does it adjust the allowance to reflect income taxes actually paid by the utility:

> It is the practice of the Commission, in calculating the test-year income tax expense, to assume a separate return basis considering solely utility operations. By making this assumption the Commission presumes that the utility will pay the income taxes generated by the adopted rates. However, because of a utility's affiliated or nonutility operations, its actual income tax liability will be determined as one member of a consolidated tax return. <u>Thus, income taxes collected through authorized rates may not actually be paid, but may be used to offset tax losses of other non-utility and affiliated members of the consolidated return.</u>[1]

According to Commission policy, a regulated utility, like SFPP, is allowed an

[1] *Income Tax Expenses for Rulemaking Purposes* (1984) 15 CPUC 2d 42, at 49.

income tax allowance at the rates applicable to corporations, based on the authorized return on equity. In C. 97-04-025 also involving SFPP, the Commission did indicate an intention to review whether partnerships should be afforded different tax allowance treatment from that applied to corporations, specifically anticipating consideration of the so-called *Lakehead* approach endorsed by the FERC which, before its abrogation by a federal court of appeals, looked to the tax situations of the income attributable to the owners of a limited partnership rather than uniformly imputing a tax allowance at the corporate rate.[2]

Subsequent action by a federal court of appeals repudiated the Lakehead approach and caused FERC to abandon its *Lakehead* policy, suggesting, at a minimum, that this Commission need not give the *Lakehead* approach any more consideration. The Commission's stated intention to review the now-discredited *Lakehead* tax allowance policy indicated, at most, a willingness to consider an approach that could lead to a change in the calculation of the amount of tax allowances to which SFPP might be entitled as a limited partnership. It certainly did not evidence any intention to examine the question of whether SFPP should be denied any tax allowance at all, much less provide required notice of any such an intention. With the disappearance of *Lakehead* as the potential alternative for revising (not eliminating) tax allowance treatment for partnerships like SFPP, the Commission need not and should not give any consideration to the Indicated Shippers' proposal to create a new, unique policy that calls for complete elimination of any tax allowance treatment for public utilities organized as limited partnerships.

While the rehearing order in C. 97-04-025 states that the Commission has no established policy regarding the tax allowance for a utility that is organized as a limited

[2] CPUC Decision 99-06-093, 1999 Cal. PUC LEXIS 442, *4-5.

partnership,[3] it is further a matter of record that D. 92-12-085, issued in response to SFPP's 1991 application for a rate increase, reflects that SFPP was organized as a partnership at the time of the decision and that the rates approved by the Commission included a full allowance for federal income tax expenses, based on rates applicable to a corporation and the rate of return authorized for SFPP. Irrespective of the fact that the Commission has not enunciated a specific tax allowance policy for limited partnerships, any determination to provide SFPP with other than a full tax allowance would be a change in the existing tax treatment policy actually applied by the Commission to SFPP.

With respect to Commission consideration of a prospective policy change that would deny public utility partnerships any tax allowance for purposes of establishing rates on a forward-going basis, Shippers cannot point to any legal or regulatory precedent to support their view that SFPP should not be entitled to a federal income tax allowance. The FERC has recently addressed the issue of the appropriate tax allowance treatment for pipeline companies organized as limited partnerships and has concluded that such companies are entitled to a tax allowance on all partnership interests, or similar legal interests, if the owner of that interest has an actual or potential income tax liability on the public utility income earned through the interest.[4] While this Commission is certainly not bound by the determinations of the FERC, it is noteworthy that existing Commission tax allowance policy applied to SFPP is entirely consistent with the recent FERC order in acknowledging that it is the actual or potential tax impact upon the utility investor that is essentially determinative of utility entitlement to a tax allowance.

One need only look to the Commission's own analysis in the rehearing decision in

[3] D. 99-06-093, mimeo. at 9.
[4] "*Policy Statement on Income Tax Allowances*," May 4, 2005, 111 FERC P61, 139; 2005 FERC LEXIS 1129.

C. 97-04-025 to understand the fundamental consistency between the FERC's policy on income tax allowances and existing Commission policy regarding tax allowances. D. 99-06-093 succinctly describes the facts that are material to resolution of the tax allowance issue:

> SFPP itself does not in fact pay tax on the income it generates. This is because SFPP is organized as a limited partnership. [footnote omitted] However, this does not mean that income generated by SFPP is tax-free. The income SFPP generates is taxable in the hands of SFPP's owners, regardless of the amount of cash SFPP actually distributes to them. The amount of tax paid on income SFPP generates depends on the tax situation of each of its owners – including the possibility that the tax obligation may be passed on to a further, indirect, owner of SFPP or, ultimately, that the income might be non-taxable.[5]

Shippers have presented no policy argument for singling out SFPP, among all the public utilities regulated by the Commission, for punitive treatment. They make no effort to address the discriminatory nature of what is, in effect, a proposed "bill of attainder."[6] They make no claim in this proceeding that any particular rate charged by SFPP for pipeline transportation services is too high. Instead, Indicated Shippers simply rest upon the naive notion that if the partnership itself does not pay taxes then there is no reason why the utility partnership should recover any income tax expenses in its rates.

While Shippers betray their lack of understanding of the Internal Revenue Code by continuing to cling to the false notion that <u>none</u> of the income generated by SFPP and distributed to its owners is taxable, the Commission has already rejected the Shipper's fundamental premise that all of the income generated by SFPP escapes taxation. Although the

---

[5] D. 99-06-093, 1999 Cal PUC LEXIS 442, *5.

[6] Even if it is assumed that the Commission can lawfully differentiate the tax treatment applied to corporations and partnerships, Indicated Shippers made no effort to explain how the Commission can lawfully differentiate the tax treatment applied to two utilities, both of which are partnerships. In fact, the witness sponsoring Indicated Shippers' tax allowance proposal was unaware of the existence of Pacific Pipeline Systems, a Commission-regulated pipeline that, like SFPP, is formed as a master limited partnership but operates under a combination of cost-of-service and market-based rates. (<u>See</u> Tr. Vol. 4;

(footnote continued)

Commission acknowledges in D. 99-06-093 that it cannot determine how much tax is paid on income generated by SFPP, it just as readily recognizes that some of the income generated by SFPP is subject to ultimate taxation:

> Unfortunately, SFPP has a complex ownership structure, making it extremely difficult to determine how much tax is paid on the income it generates, and by whom. SFPP's ultimate owners are removed from the actual operating utility and ownership interests trade on the NYSE. If we assume that no tax will be paid on income generated by SFPP when we establish its rate of return, we will run the risk that for some owners, we will have effectively reduced their rate of return.[7]

The Shippers' tax allowance recommendation, premised on an assumption already rejected by D. 99-06-093, would result in a reduced rate of return for those owners who do have to pay taxes on income distributions from SFPP - the very risk identified by D. 99-06-093 as unacceptable.

In contrast to the lack of legal and policy support for the Shippers' position, the record reflects ample justification for Commission recognition of a full income tax allowance in determining SFPP's test-period cost of service. As a matter of fundamental fairness, SFPP should not be singled out among all of the state's regulated utilities and subjected to a unique ratemaking policy based simply on its form of organization. Applicability of a uniform tax allowance policy has the advantage of producing the same charges to customers regardless of the form of organization. There is no justification for ITA treatment that directly conflicts with applicable federal policy and would single out California MLP's for disparate and discriminatory treatment vis-à-vis every other MLP in the country; there is no justification for disincentivizing investment in a California MLP and discouraging investment in important

---

O'Loughlin at 462-463).

[7] *Id.*, at *5.

California infrastructure.

There is no reason for providing different tax treatment simply based upon the utility's form of organization, be it a corporation or an MLP. By not penalizing an entity for its selection of its preferred form of organization, choice of form is left entirely to the management of the utility the choice of form, without imposing direct consequences in the context of a rate decision, and thus allows management to take advantage of the choices offered by the Internal Revenue Code that are best suited to the utility.[8]

In considering whether a partnership should be treated differently from a corporation for tax allowance purposes, it is essential to understand why an income tax allowance is even recognized in a regulated utility's cost of service. When asked the purpose of an income tax allowance in determining a utility's cost of service, Professor Williamson responded as follows:

> The answer to the question has to start with why income tax is allowed in rate cases. And it begins with the introduction of very attractive depreciation rates enacted by Congress. The depreciation rates permit rather lower taxes – these ... accelerated depreciation ... rates, permit rather lower taxes than would be the result of using the sort of depreciation that is usually used for ratemaking purposes.
>
> When the privileged depreciation became available, the superior depreciation for tax purposes, the question was whether they will be used by the utilities themselves or whether they might be passed onto ratepayers. The Congressional intent clearly was to provide an incentive for companies to make investments, in which case the companies rather than the customers should benefit from the depreciation.
>
> When some regulatory Commissions began to use flow through, which diverted the benefits of the tax rules to the customers away from the company, Congress responded by saying if you are going to defeat our purpose of incenting investment, we will not permit these accelerated depreciation rates. The result was that the

[8] Ex. 102A; Williamson at 11.

> regulatory Commissions had to stop diverting the tax benefits that were gained by using flow through and had to restore them to the utilities.
>
> Now that is why the tax allowances are standard for incorporated utilities or utilities owned by corporations. Ultimately, the purpose is to support the Congressional purpose of providing an incentive for investment. And the California Commission has so far treated partnerships just the way it treats corporations with respect to income tax items.[9]

By allowing energy limited partnerships, like SFPP, to take advantage of the same attractive depreciation rates that are available to energy utility corporations, Congress has expressly indicated its intention that energy limited partnerships should enjoy incentives for reinvestment similar to those it has deemed appropriate for utility corporations.[10] It is, of course, just as important to the welfare of the state for SFPP to invest in its pipeline infrastructure as it is for PG&E, a utility corporation, to invest in its transmission and distribution infrastructure. Denial of a tax allowance to SFPP because it is a partnership, rather than a corporation, would deny SFPP funds for investment in direct contravention of congressional intent.

Elimination of a tax allowance would have a devastating impact not only upon SFPP's ability to invest in infrastructure but also upon its ability to maintain existing operations. If SFPP were required to reduce its revenue requirement by 14% (and its rates by 7%) just to reflect elimination of a tax allowance, a strict cost-of-service approach could easily result in rates for certain segments that would be too low to justify continued operation.

B. Fairness as Well as Other Policy and Legal Considerations Require Continued Inclusion of a Full Tax Allowance in SFPP's Cost of Service.

D. 99-06-093 (the "Rehearing Decision) issued in C. 97-04-025 succinctly frames the tax issues requiring further consideration: (i) whether the Commission should adopt the

[9] Tr. Vol. 2; Williamson at 209-210.
[10] Tr. Vol. 3; Williamson at 295, lines 10-17.

approach endorsed by FERC in *Lakehead Pipeline Co.* (1996) 75 FERC ¶ 61, 181 of looking to the tax situations of the owners of a limited partnership rather than imputing a tax allowance at the corporate rate; and (ii) whether alternative approaches to tax allowances for limited partnerships, including the FERC approach, are consistent with the *Southern Cal. Gas* line of cases.[11]

Given that the *Lakehead* approach has been found to be legally deficient and is no longer endorsed by the FERC, the one alternative to a full tax allowance identified in the Rehearing Decision, i.e. *Lakehead* treatment, has been effectively eliminated from Commission consideration. The Rehearing Decision further demonstrates that complete elimination of the tax allowance for SFPP, as proposed by CCUV is not one of the alternative approaches worthy of Commission consideration.

In D. 99-06-093, the Commission expressly dismissed the same, simplistic argument repeatedly advanced by CCUV asserting that SFPP is not entitled to a tax allowance because it does not itself pay income taxes. First, the Commission acknowledged that tax allowances for utility partnerships are permissible under the *Southern Cal. Gas* line of cases, recognizing that the key factor is whether utility distributions to their investors are ultimately subject to taxation and not whether or what amount of taxes are paid by the utility itself:

> Contrary to the [complainants'] claims, we do not believe the relevant cases prevent this result. In Income Tax Expenses for Ratemaking Purposes (1984) 15 Cal. PUC 2d 42, we adopted a similar approach for utilities filing consolidated returns with non-utilities. In such cases, the utility's actual tax was affected by the performance of affiliate entities. We determined the correct approach was to assume that the utility would pay tax on a stand-alone basis and use that amount of tax to set rates. We rejected the contention that the allowance for income tax be determined using the best estimate of tax actually paid. (15 Cal. PUC 2d 49.) The

[11] CPUC Decision 99-06-093, 1999 Cal. PUC LEXIS 442.

> key factor in the court cases appears to be the effect of tax consequences on the rate of return. Where tax consequences have the effect of reducing the rate of return, it may well be permissible to raise that return.[12]

Secondly, the Commission specifically rejected the sole premise of CCUV's tax disallowance argument, i.e. that SFPP is not entitled to a tax allowance simply because it does not itself pay income taxes. The Commission has made it quite clear that the fact that SFPP itself does not pay income taxes is not even necessarily relevant to the determination of the level of tax allowance to which SFPP is entitled, much less determinative of SFPP's right to any such tax allowance:

> SFPP itself does not in fact pay tax on the income it generates. This is because SFPP is organized as a limited partnership. [footnote omitted] However, this does not mean that income generated by SFPP is tax-free. The income SFPP generates is taxable in the hands of SFPP's owners, regardless of the amount of cash SFPP actually distributes to them. The amount of tax paid on income SFPP generates depends on the tax situation of each of its owners – including the possibility that the tax obligation may be passed on to a further, indirect owner of SFPP or, ultimately, that the income might be non-taxable.
>
> Unfortunately, SFPP has a complex ownership structure, making it extremely difficult to determine how much tax is paid on the income it generates, and by whom. SFPP's ultimate owners are removed from the actual operating utility and ownership interests trade on the NYSE. If we assume that no tax will be paid on income generated by SFPP when we establish its rate of return, we will run the risk that for some owners, we will have effectively reduced their rate of return.[13]

That leaves CCUV's recommendation to exclude any tax allowance from SFPP's cost of service resting upon the factually and legally incorrect assertion that income earned by

[12] CPUC Decision 99-06-093, 1999 Cal. PUC LEXIS 442, *4-5.
[13] *Id.*, *5.

SFPP is not subject to taxation at any of SFPP's ownership levels.[14] The Rehearing Decision itself, while recognizing the difficulty in determining how much tax is paid on income generated by SFPP given that tax liability is dependent on each individual investor's tax status, implicitly acknowledges that some indeterminate number of SFPP's owners are subject to actual or potential income tax liability. Furthermore, SFPP presented evidence demonstrating that its income is quite obviously subject to taxation.[15] It is therefore nonsense for CCUV to argue that SFPP is not entitled to any tax allowance because it has not met its burden of proving how much tax is paid on the income it generates and by whom.[16] SFPP was not required to present evidence to support a *Lakehead* approach to tax allowances. Instead, SFPP favors continuation of Commission policy providing for a full income tax allowance and has more than met its burden of demonstrating the legal and policy considerations which favor just such an approach, including the fact that SFPP's owners are subject to actual or potential tax liability with respect to income and distributions attributable to SFPP's public utility operations.

The Commission's position is quite clear that neither the amount of taxes actually paid by a utility nor the amount estimated to be actually paid by the utility is the determinant of the utility's tax expense allowance. Essentially, the amount of taxes actually paid by SFPP itself is irrelevant to the Commission's determination of a proper income tax expense allowance for SFPP. It is obvious that a utility that pays no taxes and that earns income that is not subject to taxation is not entitled to any tax allowance. That, of course, is not the subject situation given evidence that SFPP's income is quite clearly subject to taxation.[17]

---

[14] CCUV Initial Brief at 27.
[15] SFPP Ex. 206(R) at 2-4.
[16] CCUV Initial Brief at 27.
[17] The Rehearing Decision references the difficulty of quantifying the amount of tax paid on income generated by SFPP because, among other things, there is the possibility that as income is passed on to indirect owners of SFPP it might ultimately be non-taxable. (D. 96-06-093, mimeo. at 6, fn. 4). SFPP is
(footnote continued)

C. The FERC *Policy Statement on Income Tax Allowance* Further Validates Existing Commission Policy Favoring a Full Income Tax Allowance for SFPP.

In response to *BP West Coast,* the FERC issued its *Policy Statement on Income Tax Allowance (*"*Policy Statement*") expressly reversing the income tax allowance holdings of its earlier *Lakehead* orders and concluding:

> . . . that it should return to its pre-*Lakehead* policy and permit an income tax allowance for all entities or individuals owning public utility assets, provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets.[18]

While the Commission is no more bound by the FERC's policy statement than it is bound by *BP West Coast*, it is noteworthy that the policy considerations which prompted the FERC to favor tax allowance treatment for partnerships are entirely consistent and consonant with existing Commission policy regarding treatment of utility income tax allowances. As a reason for returning to its pre-*Lakehead* policy, the FERC rejected the relevance of the fact that the utility partnership/pass-through entity pays no cash taxes itself and instead focused on the fact that the owners of a pass-through entity pay income taxes on the utility income generated by the assets they own via the device of the pass-through entity. In FERC's view, the taxes paid by the owners of the pass-through entity are just as much a cost of acquiring and operating the assets of the entity as if the utility assets were owned by a corporation. FERC further noted that the return to the owners of pass-through entities will be reduced below that of a corporation investing in the same asset if such entities are not afforded an income tax allowance on their

---

unaware of the circumstances in which this eventuality might occur. As SFPP's witness noted: "Under the unrelated business taxable income rules of the Code, even tax exempt entities are subject to taxation on income from a publicly traded partnership." (SFPP Ex. 206(R) at 2).

[18] 111 FERC ¶ 61, 139 (2005) at P. 33.

public utility income.[19]

The FERC's rationale for a tax allowance for partnerships as set forth in the *Policy Statement* is identical, if not strikingly similar, to the rationale for providing a tax allowance to a pass-through entity that itself does not pay taxes that was expressed by the Commission in its Rehearing Decision:

> SFPP itself does not in fact pay tax on the income it generates… this does not mean that income generated by SFPP is tax-free. The income SFPP generates is taxable in the hands of SFPP's owners... If we assume that no tax will be paid on income generated by SFPP when we establish its rate of return, we will run the risk that for some owners, **we will have effectively reduced their rate of return.**[20] (emphasis added.)

In further support of tax allowance treatment for pass-through entities, the FERC notes that there is no rational reason to limit the income tax allowance to public utility income earned by a corporation. Public utility income controlled directly by an individual may also be taxed. The partnership entity is simply an intermediate ownership device that leads to the same tax result.[21] Finally, the FERC concluded that the provision of an income tax allowance to partnerships in proportion to the interests owned by entities or individuals with an actual or potential income tax liability does not create a phantom tax liability. An income tax allowance for pass-through entities properly simply recognizes in rates the actual or potential income tax liability ultimately attributable to regulated utility income.

The Opinion issued on May 29, 2007 by the United States Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") in *ExxonMobil Oil Corporation, et al., v. FERC,* Docket No. 04-1102, et al. finds that the FERC's Income Tax Allowance Policy, which

[19] SFPP Concurrent Opening Brief, Attachment A at 2.
[20] CPUC Decision 99-06-093, 1999 Cal. PUC LEXIS 442, *5.
[21] SFPP Concurrent Opening Brief, Attachment A at 16.

affords limited partnerships an income tax allowance on all partnership interests to the extent that the owners of those interests had an actual or potential income tax liability conforms with applicable federal law.

The Commission is free, of course, to establish its own policy regarding tax allowance treatment for partnerships like SFPP. The fact that the FERC after substantial and comprehensive analysis of the issue has essentially adopted a tax allowance policy that mirrors the Commission's previously established policy strongly suggests that there is no reason for the Commission to change.

While there is ample justification for the existing Commission policy of allowing a full tax allowance for SFPP, including the policy reasons most recently articulated by FERC, denial of an income tax allowance to SFPP, and SFPP alone, as recommended by CCUV would be patently unfair and unreasonable. No regulatory body, state or federal, has adopted the radical policy position advocated by CCUV. The proposal of CCUV to eliminate a tax allowance for SFPP should be rejected out of hand.

D. Any Change in the Commission's Policy Regarding Tax Allowances for Utility Ratemaking Purposes Could Only be Applied Prospectively to SFPP.

It is important for the Commission to recognize the procedural context in which the tax allowance is now presented for Commission consideration because the procedural posture of the matter dictates that any change, albeit unwarranted, in tax allowance policy for SFPP could only be given effect prospectively. No portion of the electricity surcharges collected since October 24, 2002 that are at issue in A. 03-02-027 are subject to refund based upon a change in tax allowance policy.

The issue of the amount of federal income tax allowance properly includable in SFPP's rates was reserved for consideration by D. 99-06-093 (the "Rehearing Decision") issued in C. 97-04-027. C. 97-04-025, in turn, involves a challenge to the reasonableness of existing SFPP rates that had previously been found reasonable by the Commission. The Commission has described the legal limits on its authority to act in response to a complaint challenging the reasonableness of rates:

> The complainants ask that rates be adjusted and a refund plus interest be paid pack to 1983. Rates are set prospectively, not retroactively…The rates charged today were found reasonable in prior rate proceedings, and even if, as alleged, these rates are today excessive, the Commission cannot grant any retroactive relief in the proceeding (PU Code §734). However, the Commission can and will order the Company to file a general rate application to justify the continuation of the rates and charges presently in effect.[22]

While C. 97-04-027 has been consolidated with A. 03-02-027, Resolution O-0043 which gave rise to A. 03-02-027 expressly limits the issue to be addressed to SFPP's request in Advice Letter 14 to collect $5.77 million in annual electricity surcharges.[23] Resolution O-0043 only references the income tax allowance issue in describing matters pending in C. 97-04-027 and specifically notes that the issues in pending in C. 97-04-027 and other matters involving SFPP are not germane to the Commission's resolution of the validity of SFPP's electricity surcharge increase.[24] Neither Resolution O-0043 nor the ALJ Scoping Memo establishes that the electricity surcharge revenues at issue in A. 03-02-027 are being collected subject to refund based upon potential Commission change in tax allowance policy for SFPP ordered in C. 97-04-027. Therefore, there can be no refund of electricity surcharge revenues in A. 03-02-027 based upon any change in tax allowance policy that might follow from a decision issued in C. 97-04-027.

---

[22] *Johnson v. Santa Clarita Water Company*, Decision 96-01-026, 1996 Cal. PUC LEXIS 43, *21.
[23] Resolution O-0043 at 7.
[24] *Id.*

CERTIFICATE OF SERVICE

I, Lisa Vieland, certify that I have on this 19th day of April 2010 caused a copy of the foregoing

CONCURRENT OPENING BRIEF OF SFPP, L.P. AND CALNEV PIPE LINE LLC

to be served on all known parties to A.09-05-014, A.08-06-008, A.08-06-009 listed on the most recently updated service list available on the California Public Utilities Commission website, via email to those listed with email and via U.S. mail to those without email service. I also caused courtesy copies to be hand-delivered as follows:

Commissioner President Michael R. Peevey
California Public Utilities Commission
Executive Division
505 Van Ness Avenue Room 5218
San Francisco, CA 94102

ALJ Karl Bemesderfer
California Public Utilities Commission
505 Van Ness Avenue, Room 5006
San Francisco, CA 94102

I declare under penalty of perjury that the foregoing is true and correct. Executed this 19th day of April 2010 at San Francisco, California.

/s/ Lisa Vieland
Lisa Vieland

2539/001/X118402.v2
04/19/10

Service List
Updated 3/17/10
A.09-05-04; A.08-06-008; A.08-06-009

RICHARD E. POWERS, JR.
repowers@venable.com

STEVEN A ADDUCCI
saadducci@venable.com

THOMAS J. EASTMENT
tom.eastment@bakerbotts.com

GEORGE L. WEBER
glweber44@aol.com

MARCUS W. SISK, JR
sisk.marcus@dorsey.com

MARCUS W. SISK, JR.
sisk.marcus@dorsey.com

MELVIN GOLDSTEIN
mgoldstein@goldstein-law.com

GEORGE L. WEBER
glweber44@aol.com

R GORDON GOOCH
gordon_gooch@earthlink.net

ANDREW J. DALTON
VALERO ENERGY COMPANY
Valero Marketing and Supply Company
ONE VALERO PLACE, ROOM 264
SAN ANTONIO, TX 78212-3186

TODD NORMANE
todd.normane@bp.com

Robert C. Cagen
rcc@cpuc.ca.gov

JAMES D. SQUERI
jsqueri@gmssr.com

MARTHA C. LUEMERS
luemers.martha@dorsey.com

DAVID A. BERG
dberg@airlines.org

CHRISTINA M. VITALE
christina.vitale@bakerbotts.com

GREGORY S. WAGNER
gregory.wagner@bakerbotts.com

JOSHUA B. FRANK
joshua.frank@bakerbotts.com

FREDERICK G. JAUSS IV
jauss.fred@dorsey.com

NANCILEE HOLLAND
Nancilee.Holland@huschblackwell.com

PAMELA SILBERSTEIN
pamela.silberstein@huschblackwell.com

DIANE B. CVITKO
cvitko.diane@dorsey.com

MATTHEW A. CORCORAN
mcorcoran@goldstein-law.com

EUNICE B. SUTTER
eunice.b.sutter@exxonmobil.com

BARRON DOWLING
bdowling@tsocorp.com

DIANE I. FELLMAN
Diane.Fellman@nrgenergy.com

HILARY CORRIGAN
cem@newsdata.com

MARGARET J. STORK
stork.margaret@dorsey.com

DORSEY & WHITNEY LLP
eFilingPA@dorsey.com

PAUL M. PREMO
paulpremo@msn.com

Belinda Gatti
beg@cpuc.ca.gov

Eugene Cadenasso
cpe@cpuc.ca.gov

Karl Bemesderfer
kjb@cpuc.ca.gov

PUC/X118419.v1
04/19/10