BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

FILED
04-19-10
04:59 PM

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)

JOINT OPENING BRIEF
OF BP WEST COAST PRODUCTS LLC AND
EXXONMOBIL OIL CORPORATION

Todd L. Normane, Senior Attorney
BP Legal - Litigation
6 Centerpointe Drive; LPR 6-552
La Palma, CA 90623
714-228-6739
todd.normane@bp.com

Matthew C. Droz
Counsel - Refining & Supply
Exxon Mobil Corporation
3225 Gallows Road, Room 3D-2133
Fairfax, VA 22037
703-846-4188
matthew.c.droz@exxonmobil.com

Thomas J. Eastment
Gregory S. Wagner
Christina M. Vitale
Baker Botts L.L.P.
1299 Pennsylvania Ave., N.W.
Washington, DC 20004
202-639-7717
tom.eastment@bakerbotts.com
gregory.wagner@bakerbots.com
christina.vitale@bakerbotts.com

Counsel for BP West Coast Products LLC and
ExxonMobil Oil Corporation

Dated: April 19, 2010

DC01:548834.7

TABLE OF CONTENTS

TABLE OF AUTHORITIES

STATE CASES

STATE ADMINISTRATIVE CASES

STATUTES AND 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)

JOINT OPENING BRIEF OF BP WEST COAST PRODUCTS LLC AND EXXONMOBIL OIL CORPORATION

Pursuant to the "Scoping Memo and Ruling" issued by President Michael R. Peevey, the Assigned Commissioner, on August 20, 2009 ("Scoping Memo"), in the above-captioned proceedings pending before the Public Utilities Commission of the State of California ("Commission"), BP West Coast Products LLC ("BP West Coast") and ExxonMobil Oil Corporation ("ExxonMobil") respectfully submit this Joint Opening Brief.

I. BACKGROUND

This case was initiated by the filing of two general rate applications on June 6, 2008, one by SFPP, L.P. ("SFPP") in A.08-06-008, and the other by Calnev Pipeline LLC ("Calnev") in A.08-06-009.[1] On September 26, 2008, SFPP amended its application to increase its proposed rates by $5 million. On May 12, 2009, SFPP filed Application No. 09-05-014, which sought to increase SFPP's proposed rates by an additional $5 million ("2009 Application").

[1] All references to SFPP in this brief should be deemed to refer to Calnev as well, unless context dictates otherwise.

SFPP's Applications and its testimony propose cost-of-service rates, but SFPP also has proposed that the Commission limit its oversight of SFPP. SFPP claims that it faces competition on its intrastate pipeline system, and that it qualifies for a form of light-handed regulation.

Parts III.A to III.F of this Brief take issue with SFPP's proposed cost-of-service rates. SFPP has overreached in several instances, including an inflated rate of return on equity, an overstated cost of debt, and a capital structure weighted far too heavily toward the more expensive equity component. In addition, SFPP has included a claim for an income tax allowance even though, as a partnership, SFPP is not subject to income taxes. After correcting for these overstatements, SFPP's proposed rates should be decreased significantly. ExxonMobil and BP note that other shipper parties have addressed other cost items that SFPP has overstated. These other parties have also shown that SFPP has understated its design throughput. ExxonMobil and BP support the positions of these other shippers on the additional issues they address, but to avoid repetitions, ExxonMobil and BP will not separately address these issues herein.

Parts III.G and III.H of this Brief address SFPP's request for light-handed regulation. The Commission should reject SFPP's request because it is premature to consider extending light-handed regulation to SFPP. But even if the Commission were to find *Unocap* applicable, SFPP does not satisfy the criteria set forth in *Unocap*.[2] Among other tings, SFPP does not face sufficient competition to justify departing from strict cost-based regulation.

---

[2] *City of Long Beach v. Unocal Calif. Pipeline Co.*, 54 CPUC 2d 422, D.94-05-022 (May 4, 1994) ("*Unocap*"), *reh'g denied*, 66 CPUC 2d 28, D.96-04-061 (Apr. 10, 1996) ("*Unocap II*").

II. SUMMARY OF ARGUMENT

A. Cost of Service.

SFPP's proposed rates are not justified by its cost of service. SFPP proposes a cost of equity of 15.01% which is unjustifiably high and based on financial data from an aberrational and unrepresentative time in the economy. The data used by SFPP's witness, Dr. Vander Weide, are taken from the middle of the 2009 test period and are not representative of future conditions. ExxonMobil witness Dr. Horst proposed a cost of equity of 12.21%, which is based on more recent and representative data from November 2009. In his rebuttal testimony, Dr. Vander Weide neither updated his data nor responded to Dr. Horst's challenge to the June 2009 data. As a result, SFPP effectively has conceded this issue.

SFPP also should be required to calculate its cost of equity using the Two-Stage Discounted Cash Flow ("DCF") Method as opposed to the One-Stage DCF Method. Dr. Vander Weide incorrectly claimed his own statistical studies prove that the One-Stage DCF Method is superior to the Two-Stage DCF Method, yet he conceded at the hearing that his studies do not even address the Two-Stage DCF Method, let alone compare the two methods. Moreover, FERC's policy reasons for utilizing the Two-Stage DCF Method are persuasive here.

SFPP's cost of equity should be based on the median cost of equity of its proxy group. Dr. Vander Weide proposed to use a higher cost of equity drawn from the upper half of the proxy group range based on Mr. Dito's claim that SFPP bears a high degree of risk. However, Mr. Dito's testimony wholly failed to compare SFPP's risk to the risk of the other pipelines in the proxy group. Without such an analysis, Mr. Dito provided no basis for Dr. Vander Weide to conclude that SFPP's cost of equity should exceed the median. Dr. Horst, on the other hand, made several risk comparisons and concluded that SFPP does not bear a higher risk than the other pipelines in the proxy group. Dr. Vander Weide offered no rebuttal of Dr. Horst's conclusion and effectively conceded this issue as well.

As to debt, SFPP should be required to use Kinder Morgan Energy Partners' ("KMEP") cost of debt as reported to the SEC. Rather than use KMEP's actual reported cost of debt, SFPP put forth a hypothetical figure based on the cost of fixed-rate bonds that do not determine KMEP's actual cost of debt. This approach ignores the significant cost savings enjoyed by KMEP as a result of interest rate swap agreements. Commission precedent requires that such savings be passed through to a utility's customers. SFPP, therefore, should be required to use KMEP's actual reported cost of debt.

SFPP also should be required to include KMEP's short-term debt in its cost of debt. Although Commission precedent ordinarily excludes short-term debt from the cost of debt, KMEP treats its short-term debt as long-term. Under such circumstances, like FERC, the Commission should include in the cost of debt KMEP's short-term debt that it treats as long-term debt.

SFPP should use KMEP's actual capital structure as of September 30, 2009 (60.36% debt/39.69% equity) to determine its weighted average rate of return, rather than using a hypothetical capital structure (52.43% debt/47.57% equity) derived from a proxy group of pipelines. Dr. Vander Weide's attempt to justify his use of a proxy on the grounds that it is closer to KMEP's targeted capital structure of 50% debt/50% equity. KMEP's actual capital structure is not so divergent from the capital structures of the proxy group members as to be outside the zone of reasonableness.

SFPP is not entitled to include an income tax allowance in its cost of service for the simple reason that it does not incur income tax liability. California law does not permit utilities to charge customers for taxes that are not incurred by the utility. In addition, the record here provides substantial evidence that an income tax allowance is not warranted. While corporate pipelines require an income tax allowance to pay the tax liability of the pipeline and still achieve a return sufficient to attract investor capital, MLPs are different because they pay no income tax. Dr. Horst demonstrated that a return on equity derived from an MLP proxy group already ensures that the pipeline will recover a rate of return on equity sufficient to attract capital, even after accounting for the income tax liability of investors, because the pipeline does not pay out any of its revenue in taxes.

B. Light-Handed Regulation.

SFPP's proposal to be relieved of strict cost-of-service ratemaking should be rejected That proposal has changed over time, but every incarnation of it has been vague, overly complex, and practically impossible to administer. It is plain that SFPP's objective is to reduce regulatory scrutiny of its rates and operations and to charge rates in excess of its cost of service plus a reasonable rate of return. The Commission should reject SFPP's proposal and limit its rates to those it can justify on a cost-of-service basis.

In the initial application in A.08-06-008 ("Application"), SFPP asked the Commission to allow it to apply an indexing mechanism to its rates. In its application in A.09-05-014 ("2009 Application"), SFPP abandoned its proposal to index its rates automatically in favor of a mechanism whereby its rates would be evaluated according to a multitude of factors derived from the *Unocap* decision. But it did not abandon indexing entirely -- SFPP asked that it be used as an additional metric to judge the justness and reasonableness of SFPP's rates. *See* Exh. No. SFPP-10 at 19-24. As shown in SFPP's own testimony, and as discussed in detail below, indexed rates would far outpace rates justified by SFPP's cost of service. This divergence simply underscores that indexing is not a reasonable surrogate for cost-based rates.

SFPP's proposal to depart from cost-based rates under *Unocap* is at best premature. *Unocap* does not adopt a generally applicable light-handed regulatory approach for oil pipelines, but rather adopts a case-by-case approach. As former Commission President Fessler explained, it is at best premature to apply *Unocap* to SFPP in order to consider light-handed regulation. The Commission has had too little experience with the multi-tiered structure of SFPP and its parent entities, the absence of any employees in the regulated entity, and a self-proclaimed policy to maximize cash extraction from the regulated entity. Mr. Fessler also pointed out that reliance on trucking competition as a check on SFPP rates, in lieu of cost-based ratemaking, would not be in the public interest. Such an approach would allow SFPP to raise its rates up to the levels at which trucking would be competitive and thereby serve to increase the use of trucking, which is a considerably riskier mode of transportation according to the Fire Marshal. Finally, in the facts present in this case, even if the *Unocap* factors were applied here, SFPP failed to meet any of the criteria developed in that case. Accordingly, the Commission should continue to set SFPP's rates on a cost-of-service basis.

III. ARGUMENT

A. The Commission Should Reject SFPP's Proposed Cost of Equity And Adopt Dr. Horst's Proposal.

SFPP's witness Dr. Vander Weide proposed a cost of equity of 15.01%, Exh. No. SFPP-12 at 14:A39, that is unjustifiably high. Dr. Vander Weide's proposal is based on financial data as of June 30, 2009, an atypical time period that is unrepresentative of the U.S. economy going forward. Dr. Vander Weide used a "One-Stage" DCF method, which places an undue emphasis on near-term economic growth rates. Exh. No. SFPP-12 at 18 (Schedule 1). Moreover, Dr. Vander Weide selected a rate near the high end of the proxy group; given that

SFPP's risk is no greater than the average member of the proxy group, this upward adjustment above the median rte for the proxy group is not warranted.

The Commission should instead adopt Dr. Horst's recommendation of a 12.21% cost of equity, which is the median rate of return under the Two-Stage DCF Method for the six MLP oil pipelines in Dr. Vander Weide's proxy group based on data available as of November 30, 2009. Exh. No. ExxonMobil-1 at 4:10-14. This figure reflects (1) a more recent and representative date for valuing dividend yields, (2) a Two-Stage DCF method, which accounts for projections of long-term economic growth, and (3) a rate of return representing the median return derived from the proxy group.

1. The Commission Should Base The Cost Of Equity On The Most Representative Valuation Date For Calculating A Cost Of Equity.

SFPP proposes to calculate its rate of return using financial data from June 30, 2009. Those data are stale and reflect an aberrational economic period that is unrepresentative of likely future conditions. Accordingly, SFPP's proposal does not comply with Commission policy on test-year ratemaking.

In setting this case for hearing, the Commission set calendar year 2009 as the test year. Scoping Memo at 3, Issue VI. June 30, 2009 falls in the middle of the 2009 test year, and is a time when stock market prices were severely depressed. Exh. No. ExxonMobil-1 at 8:5-10. Abnormally low stock prices lead to high dividend yields (which are calculated as dividends divided by stock price), which in turn lead to an abnormally high return on equity. The Commission should not permit the use of aberrational data to predict future economic conditions, especially when the utility selects those data from the middle of the test year. As Dr. Horst explained: "To avoid the anomalous results of the last quarter of 2008 and the first half of 2009 and to be more consistent with the description of 2009 as the test year in this proceeding, I have updated Dr. Vander Weide's calculations to reflect data available as of November 30, 2009 . . . ." *Id.* at 8:11-14.

According to Commission policy, the objective of using a test year is to get as close as possible to the conditions that will apply in the future. *See Pacific Tel. & Telegraph Co. v. Pub. Util. Comm'n,* 401 P.2d 353 (Cal. 1965). The ratemaking process should use historical data "to present as nearly as possible the operating conditions of the utility which are known or expected to obtain during the future months or years for which the commission proposes to fix rates [i.e., the test year]." *Id.* at 644. The test-period results are then

> "adjusted" to allow for the effect of various known or reasonably anticipated changes in gross revenues, expenses or other conditions, which were not obtained throughout the test period but which are reasonably expected to prevail during the future period for which rates are to be fixed, so that the test-period results of operations as determined by the commission will be as nearly representative of future conditions as possible.

Id.

Issue VI of the Scoping Memo specified that "there shall be only one test year for all issues, including but not limited to cost of service and competition, and that test year will be 2009." Thus, SFPP's return on equity should be calculated using the 2009 data that best represent the rates of return that oil pipelines expect to earn in the future. Dr. Horst updated the return on equity calculation for data through November 30, 2009. Exh. No. ExxonMobil-1 at 8:11-18, Schedule 1. Dr. Horst's testimony was filed on December 22, 2009, making the November 30, 2009 data the most recent data then available. The updated data reflect economic circumstances close to the end of the test year, thereby providing a more representative reflection of future economic conditions than the earlier date used by Dr. Vander Weide. Indeed, as Dr. Horst explained, the five-month update is essential because June 30, 2009, the time at which Dr. Vander Weide computes his recommended return, was an aberrational period of depressed economic conditions and stock prices. Exh. No. ExxonMobil-1 at 8:5-15. Dr. Vander Weide's choice of an aberrational measurement date in the middle of the test year does not satisfy the policy of using data that best represent future conditions. In essence, SFPP is seizing on an abnormal time period six months from the end of the test period in order to maximize its cost of equity. The latest dividend yield information from the end of the test year is more representative of likely conditions after the test year than the mid-test year data. Accordingly, the Commission should adopt Dr. Horst's proposal to use data as of November 30, 2009, rather than Dr. Vander Weide's unrepresentative data.

In his rebuttal testimony, Dr. Vander Weide neither updated his data nor took issue with Dr. Horst's challenge to his use of June 2009 data. As a result, Dr. Vander Weide has effectively conceded this issue. SFPP's data is stale, aberrational, and obviously chosen to inflate SFPP's return on equity above the level appropriate to reflect future conditions. Accordingly, in light of Commission policy and in the absence of any justification or rebuttal by SFPP, SFPP should use a more representative date at or near the end of the test year to calculate its cost of equity.

2. The Commission Should Compute The Rate of Return On Equity On A Two-Stage DCF Method, Rather Than A One-Stage Method.

Dr. Vander Weide proposed to use a "One-Stage" DCF method, which limits the growth element of the DCF formula to the median IBES forecast of the growth rate of a given company's earnings per share ("EPS") over the next three to five years. Exh. No. ExxonMobil-1 at 9:5-11. Dr. Horst proposes, however, that SFPP should use a "Two-Stage" DCF method, which relies on a weighted average of that median IBES forecast (which is assigned a 2/3 weight) and an average of long-term forecasts of the growth rate in the U.S. gross domestic product ("GDP") (which is assigned a 1/3 weight). Exh. No. ExxonMobil-1 at 9:10 at 13-16.

The Two-Stage method, which is the method currently used by FERC, yields a 12.21% median rate of return for the six MLP oil pipelines in Dr. Vander Weide's proxy group based on data available as of November 30, 2009.

SFPP should be required to compute its rate of return on equity under the FERC's Two-Stage DCF Method based on Dr. Vander Weide's proxy group using financial data as of November 30, 2009. Dr. Vander Weide's departure from the FERC Two-Stage DCF Method has no merit.

a. SFPP Uses Misleading And Irrelevant Statistics To Attempt To Justify Using A One-Stage DCF Method.

The only basis Dr. Vander Weide offers to support a One-Stage DCF Method is certain statistical studies that he and others have performed. See Exh. No. SFPP-12 at 12-13 (A33, A34 and A35). He erroneously claimed that his statistical studies demonstrate that a One-Stage DCF Method is superior to a Two-Stage Method. Exh. No. SFPP-13 at 10:1 to 12:3. In fact, as Dr. Vander Weide conceded during the hearing, the cited statistics do not compare the One-Stage DCF Method with a Two-Stage DCF Method, let alone demonstrate the superiority of the former. *See* Tr. 427:27 to 428:4 (Vander Weide); Exh. No. ExxonMobil-1 at 12-14. As Dr. Horst explained, the Two-Stage Method fills a gap in the One-Stage Method by accounting for long-term economic growth beyond the narrow time horizon of the IBES estimates. Exh. No. ExxonMobil-1 at 10:11 to 11:2. As a result, it provides a more complete and accurate tool to predict the growth of the investments in Dr. Vander Weide's proxy group. *Id.*; Exh. No. ExxonMobil-1 at 13:1 to 14:7.

Dr. Vander Weide's statistical studies address a completely different issue with no bearing on this case. Exh. No. ExxonMobil-1 at 12:12-21. Specifically, as Dr. Horst explained, the cited studies simply demonstrated that a company's P/E ratios are more highly correlated with stock market analysts' forecast of future growth of the company than with the company's actual historical growth. *Id.* The studies do not compare in any way the correlation of P/E ratios with a One-Stage (IBES-only) Method versus a Two-Stage Method that accounts for the long-term growth of the economy as a whole. *Id.* Thus, all that the studies tend to show, in terms of predicting future growth of a company's P/E ratio, is that IBES forecasts are superior to historical growth rates. *Id.* As a result, Dr. Vander Weide's studies provide no support for his proposed use of the One-Stage DCF method.

b. The Two-Stage DCF Method Should Be Utilized Here In Lieu Of The One-Stage Method.

The Two-Stage DCF Method, which is used by FERC, is superior to the One-Stage Method. Though the Commission certainly is not bound by FERC precedent, FERC's rationale for using a Two-Stage DCF Method is persuasive and should be used by the Commission in this case.

Under the DCF formula, return on equity equals current dividend yield (dividends divided by share price) plus the projected future growth rate of dividends.[3] The Two-Stage method used by FERC accounts for both short-term and long-term growth estimates in projecting the future growth of dividends. Both Dr. Vander Weide and Dr. Horst agree that the IBES estimates are valuable in projecting growth. The difference is that Dr. Vander Weide would stop with IBES, while Dr. Horst, in agreement with FERC, factors in a long-term growth estimate as well.

The short-term portion of the estimate is derived from security analysts' three to five-year forecasts for each company in the proxy group, as published by IBES. FERC, in using

[3] *Policy Statement on Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 at P 5 (2008) ("Policy Statement").

the Two-Stage DCF Method, seeks to base its growth projections on "the best evidence of the growth rates actually expected by the investment community."[4] FERC has held that the IBES five-year growth forecasts for each company in the proxy group are the best available evidence of the short-term growth rates expected by the investment community. FERC reasoned that (1) those forecasts are reliable because they are provided to IBES by professional security analysts, (2) IBES reports the forecast for each firm as a service to investors, and (3) the IBES reports are well known in the investment community and used by investors.[5]

However, FERC concluded that as a three to five-year projection, IBES data fails to reflect long-term growth expectations.[6] As Dr. Horst explained:

> The rationale for a Two-Stage DCF Method is that while the growth rate of a company's EPS may exceed the growth rate of U.S. GDP for the next 3-5 years, the long-term growth rate of any company's earnings per share will ultimately be limited to the long-term growth rate of the U.S. economy taken as a whole. Since a substantial portion of the current market value of a company's stock will not be reflected in its EPS within the next 3-5 years, the market value of a company's shares will reflect a composite of the 3-5 year IBES growth rate and the long-term GDP growth rate.

Exh. No. ExxonMobil-1 at 10:13 at 11:2 (citation omitted). Thus, FERC concluded that such long-term growth is best estimated on the basis of anticipated growth in the Nation as a whole in the long-term. For this estimate, FERC uses forecasts of long-term growth of the economy as a

---

[4] *Id.* at P 73.

[5] *Id.* at P 74. FERC held that IBES "remains the best and most reliable source of growth information." *Id.* at P 75.

[6] *See id.* at PP 96-97, 100.

whole, as reflected in the GDP. The GDP data is drawn from three different sources.[7] In determining the appropriate growth projections to use in its DCF analysis, FERC sought to approximate the growth projections investors would rely upon in making their investment decisions. This principle applies equally to the long-term growth projection, as it does to the short-term growth projection.[8]

In the Two-Stage DCF Model, the short-term forecast receives a two-thirds weighting and the long-term forecast receives a one-third weighting in calculating the growth rate.[9] FERC reasoned that "[w]hile determining the cost of equity nevertheless requires that a long-term evaluation be taken into account, long-term projections are inherently more difficult to make, and thus less reliable, than short-term projections."[10] Over a longer period, FERC stated that "there is a greater likelihood for unanticipated developments to occur affecting the projection."[11] Given the greater reliability of the short-term projection, FERC believed it was appropriate to give the short-term projection greater weight. However, continuing to give some effect to the long-term growth projection, FERC reasoned, would "aid in normalizing any distortions that might be reflected in short-term data limited to a narrow segment of the economy."[12] FERC strove to adhere to its policy of using a single long-term growth projection

---

[7] Policy Statement at P 6. The three sources used by the Commission are Global Insight: *Long-Term Macro Forecast – Baseline (U.S. Economy 30-Year Focus)*; Energy Information Agency*, Annual Energy Outlook*; and the Social Security Administration.

[8] *Id.* at P 88.

[9] *Id*. at P 6.

[10] *Id.*

[11] *Transcontinental Gas Pipe Line Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084 at 61,423-4 (1998).

[12] *Id.*

for all corporations, based on the fact that it is not possible to make reliable company-by-company long-term growth projections.[13]

Finally, FERC found that the differences between MLPs and corporations, and particularly the MLPs' lower growth prospects due to their distributions in excess of earnings, should be accounted for in the growth projection component of the DCF model.[14] As Dr. Horst explained:

> While corporate pipelines often retain a significant portion of their earnings to fund new investments, MLP pipelines generally distribute all available cash to their unitholders and fund new investments with newly issued debt and equity. Because of resulting differences in retained earnings and new shares issues, the long-term growth of a company's earnings per share is likely to be lower for an MLP than for a corporation, all other things being equal.

Exh. No. ExxonMobil-1 at 11:10-16. FERC also concluded that corporations (1) have greater opportunities for diversification because their investment opportunities are not limited to those that meet the tax qualifying standards for an MLP and (2) are able to assume greater risk at the margin because of less pressure to maintain a high payout ratio.[15] FERC concluded that the long term growth component for an MLPs equity cost of capital should be 50 percent of long term GDP, rather than the full long term GDP currently used for corporations.[16] At the time, that proposal resulted in a long-term growth projection of 2.22 percent, which was within the range

---

[13] Policy Statement at P 97 (citing *Northwest Pipeline Corp.*, Opinion No. 396-B, 79 FERC ¶ 61,309 at 62,382 (1997)).

[14] Policy Statement at P 66.

[15] *Id.* at P 93. FERC noted that it was a corporation's higher retention ratio that allowed this greater flexibility.

[16] *Id.* at P 106.

of long-term growth projections used by the investment houses for MLPs.[17] Further, FERC reasoned that using 50 percent of GDP appeared to result in a long-term growth projection that fell within any reasonable margin of error for such projections, while still giving recognition to the fact that investors expected MLPs' long-term growth to be less than that of GDP.[18] FERC thus determined that the collective long term growth rate for MLPs would be less than that of schedule C corporations.[19]

In sum, the Two-Stage Method accounts for both near-term growth (in the form of IBES estimates) and long-term growth (in the form of GDP projections). Although in the near term, the growth rate of a company's EPS may exceed the growth rate of U.S. GDP, the Two-Stage DCF Method reflects the fact that the long-term growth rate of any company's earnings per share ultimately will be limited to the long-term growth rate of the U.S. economy taken as a whole.[20] Because a substantial portion of the current market value of a company's stock will *not* be reflected in its EPS within the next 3-5 years, the market value of a company's shares will reflect a composite of the 3-5 year IBES growth rate and the long-term GDP growth rate. *See* Exh. No. ExxonMobil-1 at 11. Thus, the Two-Stage DCF Method provides a superior estimate of future growth and should be used in this case.

c. SFPP's Return On Equity Should Be Based On The Median Return On Equity Of Its Proxy Group.

Dr. Vander Weide proposes to use a cost of equity in the upper half of the proxy group range based on Mr. Dito's claim that SFPP bears a high degree of business risk. Exh. No.

---

[17] *Id.* at P 96.

[18] *Id.*

[19] *Id.* at P 94.

[20] *Id.* at P 94.

SFPP-12 at 15. Mr. Dito based this claim on the assertion that a high percentage of SFPP's and Calnev's pipelines under the Commission's jurisdiction are within High Consequence Areas as that term is defined by the U.S. Department of Transportation. *See* Exh. No. SFPP-10 at 25-26.

Risk is a relative concept, especially when determining a pipeline's return on equity from a range of comparable companies. But Mr. Dito's testimony fails to compare SFPP's risk to the risk of the other pipelines in the proxy group in terms of either the percentage of operations in High Consequence Areas or their other business risk. Exh. No. ExxonMobil-1 at 17. Without such a comparison, Mr. Dito provides no basis for Dr. Vander Weide to conclude that SFPP's cost of equity should be above the median for his six-MLP proxy group. *Id.* Simply put, SFPP cannot justify a rate of return above the median based on SFPP's relative level of risk without comparing SFPP's risk to the risk borne by the other pipelines in the proxy group.

Dr. Horst, on the other hand, did measure the risk of SFPP's parent, KMEP, against the risks of other companies. He summarized seven objective risk indices for each of the six MLP oil pipelines in Dr. Vander Weide's proxy group. Exh. No. ExxonMobil-1 at 17-20 and Schedule 2. Specifically, Dr. Horst looked at: (1) Value Line's Safety Ranking; (2) Value Line's assessment of a company's "financial strength;" (3) Value Line's assessment of the company's stock price stability; (4) Value Line's estimate of the company's "beta;" (5) S&P credit rating for a company's senior unsecured debt; (6) Thomson 5-Year EPS Stability Index for the company; and (7) the ratio of each company's cash flow before interest and income tax to its interest expense. *Id.*

For six of the seven indices, KMEP's risk is at or below the median for the proxy group, and for only one of the seven indices (EPS stability), KMEP was slightly above the median. *Id.* at 20:1-5. Even though KMEP had the highest debt ratio, its before-tax interest coverage ratio was below the median of the proxy group. Based on these comparisons of the values of risk indices for KMEP to the median results for the proxy group, KMEP's risk is no greater (and possibly lower) than the typical risk for the proxy group. Exh. No. ExxonMobil-1 at 17:20 to 18:2. Therefore, KMEP's risk does not justify placing SFPP's rate of return on equity above the median return on equity of the proxy group, as corrected by Dr. Horst (*i.e.,* 12.21% as of November 2009).

Again, Dr. Vander Weide did not offer any rebuttal of Dr. Horst's conclusion. Accordingly, SFPP should be required to adopt Dr. Horst's recommendation that the rate of return on equity be set at the median of the proxy group.

B. SFPP Should Be Required To Use KMEP's Cost of Debt As Reported To The SEC.

SFPP proposes to use the weighted average embedded cost of debt of its parent, KMEP, to determine SFPP's cost of debt to be applied in this proceeding. ExxonMobil and BP agree that SFPP should use KMEP's cost of debt, but disagree with the figure that SFPP has proposed. Rather than use KMEP's actual reported cost of debt, SFPP has put forth a hypothetical figure based on the cost of fixed-rate bonds that do not reflect KMEP's actual cost of debt. In so doing, SFPP incorrectly ignores the substantial cost savings it enjoys as a result of interest rate swap agreements, and improperly attempts to retain those savings for itself. The Commission repeatedly has held that such savings are to be passed through to a utility's customers. Accordingly, ExxonMobil and BP recommend that SFPP be required to use KMEP's actual cost of debt as reported to the SEC, which reflects the savings arising from interest rate swaps.[21]

[21] As discussed below, ExxonMobil and BP propose one minor adjustment to the reported cost of debt, which is in SFPP's favor, relating to KMEP's tax-exempt debt.

Dr. Horst testified that SFPP should be required to use KMEP's actual cost of debt, which accounts for the significant savings enjoyed by KMEP through its use of interest rate swap agreements. Exh. No. ExxonMobil-1 at 21. KMEP's reported cost of debt also includes certain short-term debt labeled as the "current portion of debt." Although this debt is due within one year, KMEP treats it as long-term debt by continuously refinancing it as it expires. Under those circumstances, there is no reason to exclude the cost of that debt for ratemaking purposes. After these two corrections are made, SFPP's cost of debt properly should be 4.37%,[22] rather than 6.56% as recommended by SFPP's witness Dr. Vander Weide. To reach the higher figure, Dr. Vander Weide ignored the actual cost that KMEP incurred during the test period and instead derived a figure from a simple weighted averaging of the embedded cost of KMEP's long-term fixed rate debt as of June 30, 2009. Exh. No. SFPP-12 at 15 & Schedule 2.

SFPP should be required to follow Commission precedent and use KMEP's actual cost of debt. Where KMEP was able to reduce its costs below the weighted average of its fixed-rate bonds, SFPP should be required to pass through those savings to its customers. SFPP also should be required to include KMEP's short-term debt in its cost of debt where KMEP treats that short-term debt as long-term.

---

[22] KMEP reported a cost of debt of 4.35% to the SEC for the third quarter of 2009. Exh. No. ExxonMobil-1 at 21:12 to 22:4, Att. C at C-5, Att. D at D-8. Dr. Horst testified that KMEP's reported cost of debt should be adjusted to account for the interest cost savings of KMEP's tax-exempt debt. He explained that this adjustment, which increases KMEP's cost of debt by two basis points, is necessary because KMEP's tax-exempt financing was unrelated to SFPP's operations. Exh. No. ExxonMobil-1 at 25:5 to 26:7.

1. KMEP's Cost Of Debt For Ratemaking Purposes Should Reflect The Effect Of Its Interest Rate Swap Agreements.

KMEP benefited greatly from its use of interest rate swap agreements during the test year, effectively reducing its cost of debt by approximately 200 basis points. Tr. 416:24 to 417:12 (Vander Weide). As Dr. Horst explained,

> under an interest rate swap agreement, one party (e.g., a financial institution with a high credit rating) agrees to pay another party (e.g., KMEP) the amount of interest on a stipulated amount (generally referred to as the "notional principal amount") of fixed interest rate debt in exchange for receiving the variable amount of interest on floating interest rate debt having the same principal amount.

Exh. No. ExxonMobil-1 at 26:9-14. KMEP's SEC Form 10-Q for the third quarter of 2009 discussed KMEP's use of interest rate swaps:

> In order to maintain a cost effective capital structure, it is our policy to borrow funds using a mix of fixed rate debt and variable rate debt. We use interest swap agreements to manage the interest rate risk associated with the fair value of our fixed rate borrowings and to effectively convert a portion of the underlying cash flows related to our long-term fixed rate debt securities into variable rate cash flows to achieve our desired fixed and variable rate debt.
>
> ... as of September 30, 2009, we had a combined notional principal amount of $5.2 billion of fixed-to-variable interest rate swap agreements effectively converting the interest expense associated with certain series of our senior notes from fixed rates to variable rates based on an interest rate of LIBOR plus a spread.[23]

Exh. No. ExxonMobil-1 at 27:8-21, Att. D at D-14 and D-15; *see also* Tr. 415:24-28 (Dr. Vander Weide confirming that "KMEP has swapped fixed rate long-term debt for variable rate long-term debt"). Dr. Horst further explained that the notional principal amount of $5.2 billion that KMEP converted from fixed to floating interest rates represents about half of its approximately $10

---

[23] "LIBOR" refers to the London Interbank Offered Rate, a standard fluctuating rate used by banks in borrowing funds from one another. It is often used as a basis for variable rate debt instruments.

billion of total debt as of September 30, 2009. Exh. No. ExxonMobil-1 at 27:23-26.[24] Accordingly, KMEP has swapped approximately half of its fixed-rate debt for variable-rate debt, significantly lowering its cost of debt.

Dr. Vander Weide recommended that the Commission ignore these tremendous cost savings and permit SFPP to charge rates as if it had never entered into the interest rate swap agreements. He testified that SFPP should be permitted to use an "effective interest rate . . . equal to the geometric average of the floating interest rates the market expects the company to pay on the floating interest rate obligation over the life of the swap agreement." Exh. No. SFPP-13 at 18:9-12. According to Dr. Vander Weide, this effective interest rate will equal the interest rate on the fixed-rate debt. Exh. No. SFPP-13 at 18:22 to 19:4.

Dr. Vander Weide provided no empirical evidence to support his theories. At the hearing, he admitted that he has not studied the "ultimate accuracy of the market's predictions regarding the effective interest rate that is yielded over the life of the loan for the variable part of an interest-rate swap." Tr. 421:8-13. He further admitted that the variable interest cost that the borrower will actually incur is "highly uncertain." Tr. 424:21-26.

Most importantly, Dr. Vander Weide's approach is contrary to Commission precedent. Utilities that lower their debt costs through interest rate swap agreements must pass through the savings to ratepayers. In *Southwest Gas Corp.*, 44 CPUC 2d 199, D.92-05-016 (May 8, 1992), the Commission permitted Southwest Gas to enter into interest rate swap agreements, and held that "[i]t is proper for ratemaking purposes that any reduction in the effective cost of money resulting from Interest Rate Contracts including interest rate swaps, caps, floors and

[24] The reference in the testimony to September 20 was a typographical error, and should have been September 30.

collars be passed on to ratepayers in future cost of capital proceedings as a reduction in the cost of money for all Debt Securities." *Id.* at Finding of Fact #6.

Since *Southwest Gas*, the Commission consistently has focused on the effective interest rate resulting from the use of interest rate swaps, and has viewed the resulting savings as properly passed on to ratepayers. For example, in *Golden State Water Co.*, D.07-02-014, slip op. at 8 (Feb. 15, 2007), the Commission permitted a utility to enter into interest rate swaps and other interest rate management techniques, and held that such techniques "may be beneficial in minimizing the overall cost of debt while managing associated risks of interest rate movements. Ratepayers benefit as a result through the lowering of interest costs that may be passed through in a rate case proceeding." In *Pacific Gas & Elec. Co.*, D.04-10-037, slip op. at 39 (Finding of Fact #19) (Oct. 8, 2004) (emphasis added), the Commission authorized PG&E to enter into interest rate swaps and other arrangements because this would "enhance PG&E's ability to obtain capital at the lowest possible cost to PG&E *and its ratepayers*." In *Southwest Gas Corp.*, D.05-02-049, slip op. at 18 (Feb. 24, 2005), the Commission placed the utility on notice that it "may review the reasonableness of the effective interest rates for swaps, interest rate cap, floor, or collar agreements issued by Southwest in conjunction with Southwest's general rate case or other ratemaking proceedings." In *Southern Calif. Gas Co.*, D.03-07-008, slip op. at 10 (July 10, 2003), the Commission focused on the utility's savings arising from interest rate swaps: "During the time the swap was in effect, its floating rate approximated 1.93%, or 4.934% percentage points below the bond's fixed rate of interest, thus reducing the company's interest expense during that time by approximately $7 million before tax." While D.03-07-008 was a debt issuance authorization rather than a ratemaking case, the Commission "place[d] SoCalGas on notice that the reasonableness of any resulting interest rate and cost of money arising from debt capital are normally subject to review in cost of capital or general rate case proceedings." *Id.* at 13.

In each of these cases, the Commission made clear that the cost of debt for ratemaking purposes should reflect the lower debt cost attained by swapping fixed debt for variable debt. The utility's cost of debt is the effective interest expense during the relevant time period, and the effective interest expense during the test year is determined by the amount of interest actually paid, not by determining a theoretical cost of debt from the "geometric average of the floating interest rates the market expects the company to pay on the floating interest rate obligation over the life of the swap agreement" as proposed by Dr. Vander Weide. Exh. No. SFPP-13 at 18:19-12. Dr. Vander Weide's theories have no basis in Commission precedent and should be rejected. If there are savings as a result of interest rate swaps, they must be passed on to ratepayers, just like any other cost savings.

2. SFPP's Cost of Debt Should Include Debt Maturing Within One Year.

KMEP reported on its balance sheet $155.6 million as its "current portion of debt" and $10,247.4 million of long-term debt. Exh. No. ExxonMobil-1 at 23:1-5 and Att. D at D-4. The cost of the "current portion of debt" was included in KMEP's overall cost of debt reported to the SEC and should be included in SFPP's cost of debt for ratemaking purposes.

KMEP's $155.6 million of "current portion of debt" is divided into two categories: (1) $110 million of borrowing under its $1,850 million bank-credit facility, and (2) $45.6 million of debt that was long-term when issued but is now due within 12 months of its remaining maturity or payable on demand. Exh. No. ExxonMobil-1 at 23:8 to 24:2. KMEP stated that it plans to "negotiate a renewal of [its] credit facility before its maturity date." *Id.* at 23:12-14 and Att. D at D-8, D-9. Based on this, Dr. Horst testified that "it seems reasonable to assume that KMEP can and will rollover not only the $110 million that is has borrowed under its credit facility, but also the $45 million that was long-term debt at the time it was issued, but is now within 12 months of maturity." *Id.* at 24:6-12. Accordingly, the $155.6 million of "current portion of debt" should be treated as part of KMEP's total debt capital and the cost of that debt should not be removed from KMEP's overall cost of debt for ratemaking purposes. *Id.* at 24:14-16. Dr. Vander Weide offered no rebuttal to Dr. Horst's testimony on this issue and, therefore, the point should be deemed to be conceded.

ExxonMobil and BP recognize that the Commission generally does not include the cost of short-term debt in a utility's cost of debt,[25] but here KMEP treats its short-term debt as long-term. For the first category of short-term debt, KMEP has reported to the SEC that it intends to renegotiate its credit facility. For the second category, that debt was long-term when KMEP borrowed the funds; SFPP should not be able to exclude it simply because there are less than 12 months remaining in the term of the debt instruments.

FERC has a similar policy of excluding short-term debt from the cost of debt,[26] but under circumstances such as those presented here, FERC makes an exception to that general policy. The Commission should make the same exception here. In *SFPP, L.P.*, 113 FERC ¶ 61,277 at P 69 (2005), FERC found that when KMEP treated debt due in less than one year as long-term debt by routinely refinancing the debt when it expired and replacing the expired debt with new debt, it should be treated as long-term debt for purposes of calculating capital structure. Several Administrative Law Judges ("ALJs") at FERC have followed this precedent. In Docket No. IS08-390-002, the ALJ followed the FERC's ruling that "when KMEP treats short term debt as long term debt, although due in less than one year, this debt will be treated as long term debt."

[25] *See, e.g.*, *AT&T Commc'ns of Calif., Inc.*, D.06-06-070, slip op. at 22-23 (June 8, 2006).

[26] *See, e.g.*, *SFPP, L.P.*, 129 FERC ¶ 63,020 at P 645 (2009) (citing *Old Dominion Elec. Coop.*, 70 FERC ¶ 62,065, at 64,187 (1995)); *Pac. Gas Transmission Co.*, 43 FPC 837, 841 (1970).

SFPP, L.P., 129 FERC ¶ 63,020 at P 646 (2009). In Docket No. OR03-5-000, the ALJ held that while KMEP's commercial paper debt had a maturity date of less than one year, KMEP stated in its 2003 SEC Form 10-K that it had the ability and intended to refinance that debt on a long-term basis under its unsecured long-term credit facility. *Chevron Prods. Co. v. SFPP, L.P.*, 127 FERC ¶ 63,024 at P 123 (2009). Indeed, there SFPP itself had included such debt in its long-term debt for capital structure purposes. *Id.* at P 106. For these reasons, the ALJ concluded that commercial paper also should be included in the computation of the cost of long-term debt. *Id.* at P 123.

In Docket No. IS05-230, the ALJ also required SFPP to re-categorize commercial paper as long-term debt where SFPP "intended and had the ability to refinance all of [its] short-term debt on a long-term basis under [its] unsecured long-term credit facility." *See SFPP, L.P.,* 116 FERC ¶ 63,059 at P 87 (2006) (citation omitted). The ALJ stated that FERC precedent

> suggests the key inquiry in categorizing SFPP debt for ratemaking purposes is how debt is treated or used rather than when it matures. The record before me indicates KMEP treated and used the commercial paper at issue as long-term debt. I therefore find and conclude SFPP must re-categorize the commercial paper as long-term debt for debt cost purposes.

Id. Another ALJ made an identical ruling in Docket No. OR03-5-001. *See Chevron Prods. Co. v. SFPP, L.P.*, 125 FERC ¶ 63,018 at PP 556-57 (2008) (citing *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 69). Specifically, the ALJ ruled that

> [w]hile commercial paper debt is short-term in nature, Kinder Morgan treats some commercial paper as long-term debt . . . Despite SFPP's protestations, it is rather clear that Kinder Morgan considers these debts to be long-term in nature, else why would it report that to the Securities and Exchange Commission knowing that making false statements to a federal agency could result in criminal liability? Moreover, in 2005, the Commission held that SFPP's claim that debt was short-term, while treating it as long-term debt on its balance sheet, should be considered long-term debt.

Id. (citations omitted.)

For these reasons, the Commission should make a similar exception to its general rule and include KMEP's debt due in less than one year in the calculation of SFPP's cost of debt.

C. SFPP Should Use KMEP's Actual Capital Structure to Determine Its Weighted Average Rate of Return, Instead of Using the Average Capital Structure of a Proxy Group of Pipelines.

SFPP proposes to base its overall rate of return on a capital structure of 52.43% debt and 47.57% equity based on the simple average capital structure for six oil pipeline companies as of June 30, 2009. Exh. No. SFPP-12 at 15, Schedule 3. This proposed hypothetical capital structure should be rejected. SFPP should apply its parent KMEP's actual capital structure as of September 30, 2009 (of 60.36% debt and 39.64% equity) because (1) SFPP's last stand-alone capital structure was 59.9% debt; (2) FERC has consistently rejected using KMEP's alleged target and the 50-50 target ratio seems unrealistic; (3) KMEP's risk is at or below median risk of the proxy group; and (4) Dr. Vander Weide is inconsistent in his own methods, and is in some contexts willing to use KMEP's actual data as a proxy for SFPP (*i.e.,* when he uses KMEP's actual cost of debt).

Dr. Vander Weide recommends that KMEP's own capital structure not be applied to SFPP because its equity ratio is significantly below the long-run target capital structure, 50% debt and 50% equity, that KMEP states in its SEC Form 10-K. Exh. No. SFPP-12 at 15-16, footnote 3. As of September 30, 2009, KMEP's capital structure included 60.36% debt if the $156 million current portion of long-term debt was included and 60% debt and 40% equity if that debt is excluded. Exh. No. ExxonMobil-1 at 29:15-18.[27] Therefore, as Dr. Horst noted, the

[27] *Cf. Application of Chevron Pipe Line Company for Authorization to Increase Its Rates and Charges for Crude Oil Transportation Services I on Its California Pipelines,* CPUC Decision 08-12-046 (December 18, 2008) (imputing a hypothetical capital structure of 60-40 equity-debt where the parent's capital structure was 97-3). "Generally, imputed [capital] structures are

alleged 50-50 target seems unrealistic given KMEP's current 60-40 capital structure. Exh. No. ExxonMobil-1 at 29-30. Indeed, in 1999, the last year in which SFPP issued its own third-party debt without relying on credit support from KMEP, SFPP's stand-alone capital structure reflected 59.9% debt, which is nearly identical to KMEP's actual debt ratio as of September 30, 2009. Exh. No. ExxonMobil-1 at 29-30. Further, despite the fact that KMEP's debt percentage is the highest of any of the six oil pipelines in Dr. Vander Weide's six-MLP proxy group, 60% debt/40% equity is not so divergent from the figures in the proxy group as to be outside the zone of reasonableness, so there is no reason to impute a hypothetical capital structure derived from a proxy group.[28]

Further, as Dr. Horst notes, FERC consistently has rejected SFPP's claim that KMEP's alleged target capital structure should be used as a benchmark.[29] Instead, FERC has required SFPP to use KMEP's actual capital structure. Specifically, with respect to SFPP's earlier claim that KMEP had a corporate "goal" of 40 percent debt and 60 percent equity, FERC held that such a "subjective goal" was "irrelevant."[30] The fact that KMEP's professed goal has dropped from 60% to 50% equity in just a few years demonstrates that such goals are too subjective and unreliable to be used as a basis to depart from the actual capital structure.

There also is no basis from a relative risk perspective to depart from KMEP's capital structure for ratemaking purposes. Dr. Horst unequivocally demonstrated that the risk of

---

preferable when, as in this case, the actual capital structure differs markedly from the typical capital structures of regulated utilities in the same or closely related industries." *Id.* at n.1.

[28] The current portion of KMEP's long-term debt should be included for both cost of debt and capital structure purposes. This issue is discussed in detail in Section III.B.2.

[29] Exh. No. ExxonMobil-1 at 30 and n.14, citing *SFPP, L.P.,* 113 FERC ¶ 61,277 at PP 66-67 (2005); *SFPP, L.P.,* 116 FERC ¶ 63,059 at P 72 (2006).

[30] *SFPP, L.P.,* 113 FERC ¶ 61,277 at P 66 (2005).

investing in KMEP's MLP units appears to be no greater than the median risk of investing in the MLP units of Dr. Vander Weide's six-member proxy group. Exh. No. ExxonMobil-1 at 17-20, 31 and Schedule 2. This risk analysis also refutes Dr. Vander Weide's proposal to set SFPP's rate of return on equity above the proxy group median, explained above in Section III.A.2.c. It is telling that Dr. Vander Weide did not rebut any of Dr. Horst's risk analysis and related criticisms of Dr. Vander Weide's proposed hypothetical capital structure, but instead simply repeated his initial recommendations. *See* Exh. No. SFPP-13 at 19-21. Dr. Vander Weide's silence effectively concedes that there is no compelling reason to depart from the use of the parent company's actual capital structure for subsidiaries that do not have a stand-alone capital structure. Therefore, SFPP should apply KMEP's actual September 30, 2009 capital structure of 60.36% debt and 39.64% equity, instead of the June 30, 2009 average capital structure derived from the proxy group.

Finally, Dr. Vander Weide's proposal to depart from KMEP's actual capital structure lacks credibility because it reflects the inconsistency of his methods. He recommends that SFPP use KMEP's data in some contexts (such as using KMEP in his six-MLP proxy group as well as KMEP's actual cost of debt)[31], but in other contexts (like the capital structure calculation) he recommends that KMEP's data not be applied to SFPP. Exh. No. ExxonMobil-1 at 30-31. Dr. Vander Weide provides no rational basis for his selective reliance on KMEP's actual financing data.

[31] Of course, Dr. Vander Weide uses only the fixed rate portions of KMEP's debt and ignores interest rate swaps. *See* Section III.A.

D. SFPP Is Not Entitled To Include An Income Tax Allowance In Its Cost Of Service.

The Commission should reject SFPP's request to include an income tax allowance in its cost of service. As the Proposed Decision of ALJ Long in Case No. 97-04-025, *et al.* held, "[t]he Commission allows a regulated utility to recover in base rates a forecast of its operating costs to provide customers safe and reliable service. Because there is no corporate tax expense incurred by SFPP, there is no need for a tax allowance in rates." Proposed Decision, slip op. at 15. The Proposed Decision is in agreement with long-standing California law. But even without regard to the Commission's ultimate decision in C.97-04-025, the record here demonstrates that an income tax allowance is not justified.

1. Under Commission Precedent, Utilities Are Only Entitled To Pass Through The Costs of Taxes Actually Paid.

There is no dispute that SFPP, as a Master Limited Partnership ("MLP"), does not itself pay income taxes. The issue here is whether it nevertheless should be entitled to include in its cost of service an income tax allowance based on the tax liability of its investors.[32] As of the date of this brief, the Proposed Decision in Case No. 97-04-025, *et* al. is pending before the Commission, so the Commission itself has never directly addressed this specific issue.[33] Even before that Proposed Decision, however, there was case law strongly supporting the view that only actual taxes incurred by the utility should be recoverable in rates. In *S. Calif. Gas Co. v.*

---

[32] Calnev is a Limited Liability Company, but may elect to be taxed as if it were a partnership. As Dr. Horst noted in his testimony, "Page 114 of Calnev's FERC Form 6 for 2008 shows no current or deferred income tax expense (Accounts 670 and 671, respectively), [so] it can be assumed that Calnev has elected to be taxed as if it were a partnership." Exh. No. ExxonMobil-1 at 37, n.15. SFPP did not rebut this assumption and it should be deemed established.

[33] *See ARCO Prods. Co. v. SFPP, L.P.*, D.99-06-093, 1999 WL 699485 at *5 (June 24, 1999) ("[W]e have no established policy in this area, [and] we believe it is appropriate to consider alternatives . . . .").

Pub. Util. Comm'n, 591 P.3d 34, 37 (Cal. 1979), the Supreme Court of California stated that "[p]ermitting rates to be set on the basis of taxes the utility has not actually paid . . . in effect forces the ratepayers to contribute capital to be used for utility expansion." And in *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated*, D.04-02-063, slip op. at 114 (Feb. 26, 2004) ("*Pacific Bell*"), the Commission discussed at length its "established policy, affirmed by the California Supreme Court, that prohibited, to the extent allowed by law, the inclusion in rates of any taxes in excess of those actually paid by the utility." There, the Commission held that "[i]t is axiomatic that the only taxes a utility should be allowed to recover in rates are those that are incurred during the course of providing service to the public." *Id.*, slip op. at 117.

Not only is a utility ordinarily limited to charging its customers for actual taxes paid, but the pipeline also must pass through to ratepayers any cost savings it enjoys, including decreased or avoided taxes. *See San Gabriel Valley Water Co.*, D. 07-04-046, slip op. at 95-97 (Apr. 12, 2007) (holding that where a utility takes advantage of a "tax avoidance provision" of the Internal Revenue Code, it "cannot charge the ratepayers for phantom taxes"). From the principles of these cases, it follows that the benefits of SFPP's non-taxable status should flow through to ratepayers and that SFPP should not be permitted to charge its customers for the taxes of its investors. Moreover, as discussed in detail below, ExxonMobil's and BP's expert witnesses presented extensive testimony demonstrating that including an income tax allowance in SFPP's cost of service would overcompensate SFPP and its investors and would be inconsistent with cost-based ratemaking. As former Commission President Fessler stated, "if there was in fact no tax liability for the public utility, inclusion of an income tax allowance as an 'expense' for the public utility would substitute a test of 'skillfully avoided' for 'prudently incurred'. It would make a mockery of the ratemaking process." Exh. No. BCES-1 at 59:15-18.

2. The Record Demonstrates That SFPP Does Not Need An Income Tax Allowance To Fully Recover Its Costs.

a. MLPs Do Not Require An Income Tax Allowance Because MLPs Do Not Pay Income Taxes.

Dr. Horst's testimony explained that providing an income tax allowance to an MLP that does not pay income taxes "is inconsistent with fundamental principles of cost-based ratemaking." Exh. No. ExxonMobil-1 at 5:15-16. These fundamental principles were articulated by the United States Supreme Court in *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679 (1923) and *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and by the Supreme Court of California in *City and County of San Francisco v. PUC*, 490 P.2d 798 (Cal. 1971). In *Bluefield*, the Court held that utility investors are entitled to "a return . . . equal to that generally being made at the same time and in the same part of the country on investments in other business undertakings by corresponding risks and uncertainties . . . ." *Bluefield*, 262 U.S. at 603. The *Hope* Court similarly described the investors' entitlement as a "return . . . commensurate with returns on investments in other enterprises having corresponding risks." *Hope*, 320 U.S. at 603. And in *City and County of San Francisco*, the California Supreme Court held that "[t]he basic principle [of utility rate setting] is to establish a rate which will permit the utility to recover its cost and expenses plus a reasonable return on the value of property devoted to public use." 490 P.2d at 803. To put it in economic terms, "the purpose of cost-based regulation is to achieve in a regulated industry the same rates or prices that would have occurred in a price-competitive industry." Exh. No. ExxonMobil-1 at 33:4-6.

Because MLPs do not themselves pay income taxes, there is no need to include an income tax allowance in the pipeline's cost of service. Any tax allowance granted to the pipeline would translate to additional return for the MLP's investors. As discussed below, there is no basis to give an additional return to investors.

b. Corporate Pipelines Require An Income Tax Allowance To Attract Capital.

To understand why a non-taxed MLP does not require an income tax allowance, it is useful to examine the situation of a pipeline organized as a corporation. Corporate pipelines do incur income taxes and require an income tax allowance to pay those taxes. A pipeline that receives a return on equity calculated by the DCF method receives a return that is pre-tax to the investor, but post-tax to the pipeline. In other words, it receives the rate of return required to attract capital after paying the pipeline corporation's own taxes. If the corporate pipeline were to receive only a post-tax return without an income tax allowance, it would need to cut into its return to pay its taxes. That lower return likely would fail to attract sufficient capital to fund the pipeline's operations.

Regulatory commissions ordinarily base their rates for a corporate pipeline on a cost of service comprised of (1) operating expenses and overheads, (2) depreciation of investment in regulated property, (3) return on rate base, and (4) allowance for income taxes paid by the corporation. Exh. No. ExxonMobil-1 at 33:8-17. A utility's return on rate base is calculated by applying a weighted average of the utility's cost of debt and its cost of equity. Exh. No. ExxonMobil-1 at 34:1-5. The cost of equity, in turn, is the return referred to in *Bluefield* and *Hope*, *i.e.*, "the rate of return that the company's shareholder would reasonably expect to obtain on investment in other corporate equities of comparable risk." Exh. No. ExxonMobil-1 at 34:7-10. As Dr. Horst explained, that rate of return is a before-tax return from the shareholders' perspective. It is the return that investors expect prior to paying their own taxes. From the utility's perspective, the rate of return is an after-tax rate. That is, the return does not include a component to compensate the utility for its own tax liability on income derived from operation of the pipeline. Exh. No. ExxonMobil-1 at 34:10-19. Therefore, if the utility is a corporation that is subject to income taxation, it is necessary to add an income tax allowance to the allowed return on equity in order to fully compensate the corporation for its expenses incurred in providing service to the public, while still leaving a sufficient pre-investor-tax return to satisfy and attract investors.

The income tax allowance is calculated by "grossing up" the utility's cost of equity by the applicable income tax rate via the following formula: [Cost of Equity/(100% - tax rate)] x [tax rate]. Dr. Horst provided a simple numerical example on page 35 of his testimony. Exhibit No. ExxonMobil-1 at 35. There, he explained that where the investors demand a pre-tax return of 10%, and the corporate tax rate is 33.3%, the pipeline must collect an income tax allowance of 5% on the equity portion of its rate base. This will allow it to collect a total return on equity of 15%, which after deducting corporate income taxes of 33.3%, leaves a 10% return to satisfy the investors.

c. MLPs Do Not Require An Income Tax Allowance To Pay Its Investors' Income Tax Liability Because An MLP's Return On Equity Includes A Built-In Tax Allowance.

The rate of return for an MLP, like that for a corporation, is a post-pipeline tax, pre-investor tax rate of return. That is, it necessarily includes an amount necessary to pay the investors' taxes.

Dr. Horst referred to investors' receipt of a pre-tax rate of return derived from a proxy group made up of MLPs as a "built-in" tax allowance. As he testified, the "effective tax rates on income from different types of investments are reflected in the investments' before-tax rates of return." Exh. No. ExxonMobil-1 at 41:17-20. Dr. Horst demonstrated this built-in allowance in empirical terms by comparing the yields on taxable Baa-rate bonds to the yields on tax-exempt Baa-rated bonds. This comparison illustrates the effect of taxation on the rate of return required in the marketplace from an investment while holding all other factors constant. If investors do indeed receive a return sufficient to pay their taxes and provide an after-tax rate of return similar to other investments, then one would expect the taxable bonds to achieve a consistently higher return on a pre-tax basis. Dr. Horst's Chart 1 showed just such a result -- the yield on taxable bonds consistently outperformed the yield on tax-exempt bonds of the same credit rating by a steady margin. Exh. No. ExxonMobil-1 at 41:17 to 42:8 and Chart 1. Thus, if an investor expects to pay taxes on the income from an investment, the market will ensure that the return on that investment will compensate the investor for that tax liability.

SFPP does not pay income taxes as a result of the Omnibus Budget Reconciliation Act of 1987, which generally subjected MLPs to taxation as corporations, but exempted MLPs earning income from certain passive activities, including the transportation of oil by pipeline. Exh. No. ExxonMobil-1 at 39:5-14 (citing I.R.C. § 7704(d)(1)(E)). In light of SFPP's non-taxable status,

> the most straight forward way of meeting the cost-based ratemaking principles . . . articulated in *Bluefield* and *Hope* for MLP pipelines is to allow an MLP pipeline a return on equity derived from a proxy group of publicly traded MLPs (i.e., corporate pipelines should be excluded from the proxy group because their DCF rates of return will reflect the tax treatment of corporate shareholders, not MLP unitholders). If the rate of return on equity capital, capital structure, and cost of debt are all properly calculated, no income tax allowance would be necessary because the MLP pipeline's equity investors would derive the same rate of return as they could have obtained on other MLP investments of comparable risk.

Exh. No. ExxonMobil-1 at 8-18. Dr. Vander Weide's proxy group includes only MLPs so it would be a relatively simple matter to use the DCF rate of return derived from that proxy group (revised in accordance with Dr. Horst's recommendations), and exclude any income tax allowance. A rate of return derived from a group of MLP pipelines would allow SFPP to earn the return required to compensate its investors on a pre-tax basis at a level necessary to attract capital.

If SFPP is permitted to collect a rate of return on equity derived from an MLP proxy group *and* collect an income tax allowance, it will recover the tax liability of its investors twice over -- once through a rate of return that builds in an amount sufficient to compensate MLP investors for their tax liability, and once again through the allowance itself. SFPP's own witness from another proceeding, Dr. Schink, conceded that there was an overrecovery when he produced two charts illustrating the double collection of tax liability. *See* Exh. No. CCS-2 (MPO-1 at 26 (Fig. 7), 30 (Fig. 8)). The charts calculate the after-tax rates of return received by investors in MLP and corporate pipelines, and the market prices of the shares in each of those pipelines. In Figure 7, the MLP is given a tax allowance, and in Figure 8, the MLP is not given a tax allowance. Line 25 of each chart shows the "implied market price per share/unit" and Line 26 shows the "resulting after-tax equity return of the marginal investor." In both charts, the investors earn an identical after-tax rate of return (Line 26), regardless of the business form of the pipeline, and regardless of whether the MLP pipeline receives an income tax allowance. The difference is on Line 25[34]:

[34] Upon inspection of the formulas underlying the after-tax rate of return on Line 26, it becomes obvious why that amount remains consistent across each of the scenarios. Line 26 is equal to (Line 24/Line 25). Line 25 is equal to (Line 24/Line 1). Therefore, Line 26 is equal to [Line 24/(Line 24/Line 1)], which can be reduced and restated as Line 26 = Line 1. Because the assumed after-tax return on Line 1 was identical in each scenario, it must be the case that each amount on Line 26 would be identical. For this reason, Line 26 is essentially meaningless; it is Line 25 that illustrates the pipeline's extra return.

Facts	Share Value
MLP without tax allowance (Fig. 8, col. 4, Line 25)	$68.00
Corporation with tax allowance (Fig. 8, col. 5, Line 25)	$68.00
MLP with tax allowance (Fig. 7, col. 4, Line 25)	$100.00
Corporation with tax allowance (Fig. 7, col. 5, Line 25)	$68.00

The corporation's per share value is $68.00 when it collects a tax allowance, the same as the per-share value of an MLP without a tax allowance. But when the MLP is permitted to collect an income tax allowance, its per-share value jumps to $100.00. This extra share value is caused by investors paying a premium for an investment that provides a greater return than is necessary to pay the business's costs. Thus, SFPP's own documents demonstrate that if an MLP pipeline charges its customers an income tax allowance, that extra charge does not pay an expense incurred in providing utility service, but rather flows directly into the pockets of the investors. This also can be seen on Line 21 of Fig. 7. Even though Dr. Schink assumed that MLP and corporate investors would pay identical tax rates (Line 2 - 32%), the pre-tax income available to those investors is far greater for the MLP ($10,147,059) than for the corporation ($6,900,000). Under the rule of *Pacific Bell*, that "the only taxes a utility should be allowed to recover in rates are those that are incurred during the course of providing service to the public," this bonus tax allowance should be denied.

Dr. Vander Weide testified that "[i]f a tax allowance is not included in the Companies' revenue requirement, the after-tax return on investment for the Companies' partners would be less than the after-tax return on investment of corporate investors in the same utility assets." Exh. No. SFPP-12 at 16:A45. On rebuttal, he stated that if SFPP is denied an income tax allowance, the shippers will receive the benefits of SFPP's tax status twice. Exh. No. SFPP-

13 at 24:A73. According to Dr. Vander Weide, this will happen because "the cost of equity for the MLP proxy group is lower, as a result of their tax status, than it would be if the same companies were organized as corporations." Exh. No. SFPP-13 at 24:A72. Dr. Vander Weide's testimony is conclusory and unsupported. Moreover, it is contrary to the record as explained above, including the charts created by SFPP's own witness. Those charts demonstrate that if SFPP is denied an income tax allowance, its rate of return and its per-share value will be identical to its rate of return and share value if it were organized as a corporation. Dr. Vander Weide's testimony on this issue should be disregarded.

d. Congress Did Not Intend For MLP Pipelines To Charge Rates As If They Were Subject to Income Taxes.

SFPP has argued in FERC proceedings that Congress intended, as an investment incentive, for MLP pipelines to collect rates as if they were subject to two levels of taxation, and that therefore regulatory commissions should permit SFPP to collect an income tax allowance. SFPP's proposed double recovery is not justified by section 7704 of the Internal Revenue Code,[35] and no regulatory commission is authorized to approve rates for an MLP based on income tax costs that the MLP would incur if it were a corporation. Income taxes are costs like any other. *BP West Coast Prods., LLC v. FERC*, 374 F.3d 1263, 1291 (D.C. Cir. 2004) ("[I]ncome tax allowance is no different from the allowance of any other costs."); *City of Charlottesville v. FERC*, 774 F.2d 1205, 1207 (D.C. Cir. 1985). Such costs are recoverable in rates, but only if they are incurred or potentially incurred.

---

[35]Section 7704, added to the Internal Revenue Code by the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 330 (1987) treats certain publicly traded partnerships as corporations for income tax purposes, but exempts from taxation income from certain energy-related activities, including "income and gains derived from transportation (including pipelines transporting gas, oil, or products thereof) . . . of any mineral or natural resource . . . ." *See* Pub. L. No. 100-203, § 10211, 101 Stat. 1330 (1987). The D.C. Circuit interpreted that Act by citation but not by name in *BP West*, 374 F.3d at 1292-93.

California law dictates that only taxes actually incurred by a utility may be passed on to ratepayers. *S. Calif. Gas Co.*, 591 P.3d at 37 ("Permitting rates to be set on the basis of taxes the utility has not actually paid . . . in effect forces the ratepayers to contribute capital to be used for utility expansion."); *Pacific Bell*, D.04-02-063, slip op. at 114 (discussing the Commission's "established policy, affirmed by the California Supreme Court, that prohibited, to the extent allowed by law, the inclusion in rates of any taxes in excess of those actually paid by the utility."). SFPP's position, which it has argued explicitly at FERC and implicitly in this proceeding, is that SFPP and its investors should be permitted to keep the tax savings caused by the non-taxable status of MLP income. Even though FERC has permitted MLPs to retain these tax benefits, this Commission should apply California law and require SFPP to pass through tax benefits to ratepayers.

Section 7704 of the Internal Revenue Code, which allowed oil and gas pipeline MLPs to continue to avoid taxation at the pipeline level, and to pass through tax liability to the investor/partner level, does not authorize this Commission to allow MLP pipelines to recover in their rates a level of income tax expenses greater than the level of taxes to which they (and their investors) are subject. To be sure, the legislation adopting section 7704 preserved a tax advantage for oil and gas pipeline MLPs by allowing them to reduce the total tax burden on their income below the level to which they would be subjected as corporations. But such legislation did not empower or compel this Commission to ignore the just and reasonable standard applicable to rates set under the Public Utilities Code.

Indeed, SFPP already posed this very argument to the D.C. Circuit and the Court flatly rejected it. In *BP West,* SFPP argued that, in the legislation granting the tax advantage for MLPs, Congress intended to encourage investment by such pipelines. *BP West*, 374 F.3d at

1292. On this basis, SFPP argued that FERC was required to provide a tax allowance to cover "phantom" taxes that the pipeline would never incur, so as to provide an investment incentive purportedly intended by Congress. *Id.* The Court rejected SFPP's argument, noting that it "would equally apply to any decision by the Commission that caused the pipeline lower allowances rather than higher." *Id.* As the Court further explained, in enacting a statute directing that MLPs be given a tax advantage, Congress gave no authority to FERC to do anything, let alone abandon the just and reasonable standard by allowing pipelines to over-recover their costs. *Id.* As the Court stated:

> Such a mandate does not create for the agency 'a roving commission' to achieve those or 'any other laudable goal'. [citation omitted] The mandate of Congress in the tax amendment was exhausted when the pipeline limited partnership was exempted from corporate taxation. It did not empower FERC to do anything, let alone to create an allowance for fictitious taxes.

Id. at 1293.

It is true that subsequent to *BP West*, FERC adopted a new policy allowing MLP pipelines to recover an income tax allowance to cover income taxes actually or potentially incurred by the partners holding interests in the partnership.[36] The policy was upheld in *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007) ("*ExxonMobil*"). But nowhere in *ExxonMobil* did the Court recant its holding in *BP West* that the tax legislation giving MLPs a tax break over corporations did not empower FERC to permit an MLP pipeline to recover in rates "costs" for "phantom" taxes. To the contrary, the Court specifically noted that the FERC policy allowed recovery only for actual or potential tax liability of the partners. *Id.* at 955. Thus, nothing in *ExxonMobil* alters the Court's determination in *BP West* that section 7704 does not enable FERC, under the auspices of giving an investment incentive to MLP pipelines, to allow

[36] *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005).

an MLP pipeline to recover in rates amounts for income tax liability that neither the pipeline nor its partners can ever possibly incur. Accordingly, *BP West* directly refutes the notion that the tax legislation allows an MLP pipeline to recover twice for investor level taxes, and thereby retain (rather than pass through to ratepayers) the tax savings attributable to moving from a corporate structure to an MLP and avoid the double taxation imposed on corporations.

FERC itself has acknowledged that section 7704 does not authorize or support the inclusion in an MLP pipeline's cost of service of a level of income taxes that is the same as if the pipeline were a corporation. FERC concluded that the MLP must pass through to its ratepayers its tax savings, holding that the MLP's tax preference is "advantageous on its own merits without the addition of phantom taxes in a cost-of-service just as it is advantageous for companies without a cost of service that are covered by [Internal Revenue Code] section 7704's exception." *Lakehead Pipe Line Co.,* Opinion No. 397-A, 75 FERC ¶ 61,181, at 61,596 (1996). While FERC later discarded the income tax allowance methodology developed in *Lakehead*, it never disavowed its reading of section 7704 set forth there.

In fact, Congress has shown that when it intends for FERC or any other regulatory agency to allow a regulated enterprise to retain a legislatively created tax benefit, rather than pass it through to ratepayers, it has done so explicitly. For example, in the Revenue Act of 1964, Congress established an investment tax credit ("ITC") and expressly provided in the statute that federal regulatory agencies could not use the ITC to reduce the income taxes of a regulated entity for purposes of the entity's cost of service and rates. In other words, FERC was required to pretend as if regulated entities receiving the ITCs were still paying higher taxes and to base those entities' rates on the fictitious higher taxes. *See* Revenue Act of 1964, Pub. L. No. 88-272, § 203(e), 78 Stat. 35 (1964); *Kuparuk Transp. Co.,* 45 FERC ¶ 63,006, at 65,058 (1988) ("Pursuant to Section 203(c)(2) [sic] of the Revenue Act of 1964, the Commission may not use ITC's to reduce, directly or indirectly, KTC's Federal income tax expense and, therefore, rates. This restriction disallows the sharing of federal ITC benefits available to the company with the oil pipeline ratepayers."), *aff'd*, 55 FERC ¶ 61,122, at 61,383 (1991); *see also Williams Pipe Line Co.,* Opinion No. 154, 21 FERC ¶ 61,260, at 61,657-58 (1982) (interpreting section 203(e)(2) as prohibiting FERC from excluding ITCs from rate base).[37]

Unlike its treatment of ITCs under the Revenue Act of 1964, Congress did not include similar language in the legislation giving rise to the tax benefits for energy pipeline partnerships here at issue. In the absence of such statutory language, there is no basis to allow SFPP to retain the tax savings attributable to the legislation exempting energy pipelines from corporate taxation. These cost savings have no special legislative exemption and should be treated like any other tax reductions, such as a reduction in tax rates or an acceleration of depreciation (that the tax savings attributable to the acceleration of depreciation for tax purposes is reflected in reduced rates by means of the Accumulated Deferred Income Tax ("ADIT") computation). They must be passed through to ratepayers.

E. If SFPP Is Permitted An Income Tax Allowance, The Tax Rate Should Be Lowered To Reflect The Tax Rates Applicable To SFPP's Unitholders.

If SFPP were found to be entitled to an income tax allowance, SFPP's allowance nonetheless is excessive. SFPP has calculated what it terms a "full income tax allowance" using the maximum corporate tax rate of 35% and a state tax rate of 8.84%, which, after accounting for the deductibility of state income tax payments, yields a blended tax rate of 40.75%. Exh. No. SFPP-14 at 19:18-22. Mr. Turner was unable to justify using the maximum corporate rate to

[37] Opinion No. 154's holding on this issue was not disturbed on appeal. *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377, at 61,837, n.55 (1985).

calculate unitholders' federal tax liability; instead, he simply claimed that Dr. Vander Weide recommended that SFPP "reflect a full tax allowance" and that Mr. Turner interpreted that to mean that SFPP should use the 35% corporate tax rate. Tr. 463:10-25; *see also* Tr. 483:11-13 ("I was instructed to include a full tax allowance in the cost of service which my understanding is consistent with regulatory policy.").

There are two major faults with this approach: First, Dr. Vander Weide did not testify that SFPP's cost of service should reflect a "full tax allowance." He simply "recommend[ed] that an allowance for income taxes be included in the Companies' revenue requirement . . . ." Exh. No. SFPP-12 at 16 (A45).

Second, a large percentage of SFPP's unitholders are not corporations, and the 35% rate does not apply to them. Mr. Turner's recommendation fails to address the differing tax rates of SFPP's investors. *See* Tr. 540:18-20 (admitting that he did not "distinguish particular unitholders or investors in developing an income tax allowance for cost of service purposes."). Dr. Vander Weide was silent as to the proper tax rate but did state that he agreed with FERC's May 4, 2005 Policy Statement on Income Tax Allowances. Exh. No. SFPP-12 at 16:A46. The FERC method accounts for the varying tax rates applicable to different classes of unitholders - for example, individuals paying a lower effective tax rate than the maximum corporate rate. *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 at P 42 (2005); *see also SFPP, L.P.*, 113 FERC ¶ 61,277 at PP 29-32 (2005) (adopting presumptive income tax brackets for different classes of unitholders). Dr. Vander Weide presumably intended to adopt the FERC method, which necessarily does not grant a "full tax allowance" at the maximum corporate income tax rate as Mr. Turner recommended.

Even if SFPP is granted an income tax allowance in theory, it has failed to carry its burden to establish the amount of investor tax liability that ratepayers will be required to subsidize. There is no basis to compute the allowance on a 35% tax rate, and SFPP's allowance should be reduced accordingly. Exh. No. ExxonMobil-1 at 45:3-13.

F. SFPP Should Be Required To Reduce Its Cost Of Service To Return Its Excess ADIT Balance.

SFPP and Calnev have collected Accumulated Deferred Income Taxes ("ADIT") balances of approximately $43 million and $432,000, respectively, in order to fund deferred tax liabilities attributable to differences between book depreciation and accelerated tax depreciation. Those amounts have been collected from shippers to fund deferred tax liabilities. If the Commission denies SFPP an income tax allowance, "those balances should be amortized over the remaining lives of the depreciable property and returned to ratepayers through a reduction in the total cost of service." Exh. No. ExxonMobil-1 at 44:4-9. As Dr. Horst testified, "[i]n future years, the yet-to-be-amortized ADIT balance would continue to be offset against SFPP's rate base until the excess ADIT balance had been fully amortized." Exh. No. ExxonMobil-1 at 44:11-14.

G. SFPP Does Not Qualify For Non-Cost Based Rates Simply Because It Is Not A Franchised Utility.

As a threshold matter, SFPP claimed that it is inappropriate and unfair to regulate an oil pipeline on a cost-of-service basis as if it were a franchised utility. Its witness, Dr. Webb, testified that "in contrast to an electric utility or gas distribution company, SFPP does not serve the public directly. Instead, SFPP serves BP, ExxonMobil and other companies who constitute some of the largest corporations in the world." Exh. No. SFPP-1 at 20:9-12. Mr. Dito testified that "[t]reating SFPP like a monopoly by setting its rates based upon strict [cost of service], even though it clearly enjoys no such status - in fact, the testimony of other SFPP witnesses in this proceeding demonstrates that SFPP does not possess market power, much less monopoly power - accomplishes nothing more than requiring SFPP to charge noncompetitively low rates that benefit no one but the large oil company shippers." Exh. No. SFPP-1 at 18:7-12.

Dr. Webb and Mr. Dito's views run directly counter to established California law. SFPP is a common carrier within the definition of Section 211 of the California Public Utilities Code. *SFPP, L.P.*, D.07-05-061, slip op. at 4, 63, Finding of Fact No. 22 (May 24, 2007) ("Change of Control Order"). As such, it is a "public utility" as defined by Section 216(a) and a "pipeline corporation" as defined by Section 228. As a public utility, SFPP is subject to rate regulations like any other public utility. This status refutes any suggestion that SFPP should be subject only to light-handed regulation simply because it not a franchised monopoly with an exclusive service territory. Exh. No. BCES-1 at 15.

Historically, regulation in California began with the creation of the California Railroad Commission. Exh. No. BCES-1 at 15. The premise for establishing the Railroad Commission was that railroads represented a critical part of an emerging infrastructure offering advantages that individual citizens could not provide for themselves. The policy of the state was to favor the creation of rail infrastructure and to attract the capital to attain that objective. To that end the Commission extended to the railroads the power of eminent domain to take private land for a public purpose. Tr. 126:12-17 (Webb) ("Q: [W]hen a state grants an entity like SFPP or other oil pipeline the right of . . . eminent domain, that is for the public purpose of providing a service that is essential to public good, isn't it? A: I believe that is the theoretical basis and the legal basis."). Rates were established to ensure that investors were able to earn a predictable return on and of their capital.

But California was also concerned with the well being of its citizens: to that end from the outset no rate could be imposed unless and until it had been found to be "fair, just and reasonable." Exh. No. BCES-1 at 27:18-22 (Fessler). Further, there could be no rate discrimination and the railroads were expected to provide a level of service that met the needs of the public in a safe and sustainable manner.

Oil pipelines are directly analogous to railroads: they were never franchised monopolies, nor do they enjoy an exclusive service territory, but they do enjoy the right of eminent domain[38] and they provide a "transportation service" as a common carrier. Exh. No. BCES-1 at 17:11-15; 19: 10-11; 42: 17-18 (Fessler). An oil pipeline's obligation to provide an essential service to the public at just and reasonable rates is the *quid pro quo* of its right of eminent domain and the opportunity afforded a public utility to earn a fair return.

The central rationale for regulation is that certain businesses are "affected with the public interest." Exh. No. BCES-1 at 8:20-23 (Fessler). The hallmarks of these entities are that they provide services that are a necessity if an individual is to enjoy the opportunities of full participation in the economy and which, by their nature, are incapable of self-provision. Those authorized to offer such services or facilities – like SFPP – under the Commission standards are to do so on terms deemed equal, adequate (to both present and anticipated need), non-discriminatory and environmentally responsible, and at rates found by the Commission to be fair, just and reasonable.

H. *Unocap* Does Not Provide Support For SFPP's Rate Proposal.

Initially, SFPP sought authorization to increase its rates on a annual basis by an index factor. Application at 9-11. Under this method, SFPP would apply that index factor,

[38] Cal. Pub. Util. Code § 615 (2004).

intended to represent inflation, to the previous year's volume-weighted average rates in order to calculate an across-the-board rate increase, then distribute the increase among its various tariff rates as it saw fit. Application at 10. SFPP's indexing proposal would not have been constrained by costs in any way.[39] As a result, it would have replaced a determination of justness and reasonableness with perpetual automatic increases.

SFPP appears to have abandoned the indexing proposal from its Application. In its place, purportedly under the auspices of *Unocap,* SFPP has put forward an unwieldy array of subjective factors that ultimately would result in SFPP's charging rates in excess of its costs plus a reasonable return. To be sure, one of the factors is a cost-of-service analysis, but the results of that analysis are only to be evaluated as part of the larger totality of the circumstances. *See* Tr. 84:26 to 85:1 (Dr. Webb stating that "the more competition a pipeline faces, really the lower weight the Commission should give the cost of service.").

As the Applicant in this proceeding, SFPP "bears the burden of proof to show that the rates it requests are just and reasonable and the related ratemaking mechanisms are fair." *Pacific Gas & Elec. Co.*, D.07-03-013, slip op. at 4 (Mar. 1, 2007). SFPP has failed to demonstrate that its rates should be determined by any means other than strict cost-of-service regulation. It has put forward a vague and complex proposal that the Commission evaluate the justness and reasonableness of SFPP's rates by examining a variety of factors derived from the *Unocap* decision. *Unocap* provides no support for this proposal.

The Commission was careful to state in *Unocap* that it was not establishing a general formula for oil pipeline ratemaking. Each case must be evaluated on its own facts and

---

[39] In contrast, the FERC indexing method remains grounded in costs. A pipeline's shippers may file complaints against rates established through the indexing methodology "by showing there is a 'substantial divergence' between the [pipeline's] actual costs and its indexed rate." *Chevron Prods. Co. v. SFPP, L.P.*, 105 FERC ¶ 61,142 at P 3 (2003).

merits. SFPP in particular warrants close scrutiny, as the Commission found in the Change of Control Order. *See SFPP, L.P.*, D.07-05-061, slip op. at 27. There, the Commission was troubled by the lack of alternatives to obtaining service from SFPP, its structural complexity and lack of transparency, and the motivations of its owners to extract as much cash as possible from the pipeline's operations. Nothing has changed to alleviate the Commission's concerns. This is not the time to decrease the Commission's oversight of SFPP.

1. In *Unocap* The Commission Wisely Did Not Establish A General Formula For Granting Light-Handed Regulation, But Rather Adopted A Cautious Case-By-Case-Approach.

The Commission made it clear in *Unocap* that its decision was applicable only in the circumstances presented in that case and that it would separately examine every application on a case-by-case basis. Exh. No. BCES-1 at 22. As former Commissioner Fessler, who presided over the *Unocap* trilogy of decisions testified,

> [Unocap] does not stand for an established formula for determining whether product pipeline rates are just and reasonable. What it teaches is that there is no "formula" but rather an obligation to regard each rate setting proceeding as an occasion to thoroughly understand the circumstances and qualities of the particular applicant and only then to determine an appropriate set of evaluative criteria.

Exh. No. BCES-1 at 21:4-9.

In *Unocap*, the City of Long Beach requested the Commission reconsider its earlier determination to set Unocap's rates with reference to market indicators. In D.96-04-061, in which the Commission denied rehearing of *Unocap*, the Commission affirmed that "[t]he determination of reasonableness is a question of fact, which we evaluate using our independent judgment in light of the circumstances relevant to particular utilities. . . ." *Unocap II*, 1996 WL 228516 at *3. The Commission went on to affirm its finding that "Unocap's proposed rates are 'reasonable in view of the type of utility service at issue . . . and that there are sufficient practical alternatives to the pipeline service such that the initial rates are subject to market discipline.' . . ." *Id.*

Significantly, the Commission observed that its reliance upon these criteria did not constitute the formulation of any general set of rules applicable to a class of common carriers:

> As we have discussed above, the attempt to characterize the Decision as a deregulation of oil pipeline rates misunderstands the nature of our regulatory program. Here, we look to the nature of Unocap's business as part of a total mix of information we consider in evaluating whether Unocap's rates are reasonable under the Public Utilities Code. Since we have had so little involvement with oil pipeline utilities, we approach oil pipeline questions on a case-by-case basis. . . .

Unocap II, 1996 WL 228516 at *5.

Thus, in *Unocap,* the Commission wisely adopted a cautious case-by-case approach to proposals for light-handed regulation of oil pipelines. As described below the present case plainly is not one in which light-handed regulation is appropriate.

2. *Unocap* Is Not Applicable Here, Given The Commission's Concerns Over SFPP's Market Power, And Lack Of Transparency, And The Intentions Of Its Owners To Extract Cash From SFPP.

Unocap should not be applied in the circumstances presented by this case. Three years ago, in the Change of Control Order, the Commission expressed a number of concerns with the manner in which SFPP was structured and operated. SFPP has not shown any change in the facts that led to those concerns. This is not the time to decrease the Commission's oversight of SFPP under *Unocap* or any other precedent.

In the Change of Control Order, the Commission observed

> [t]hough Section 854 Applicants resist Shippers' characterization of SFPP and Calnev as natural monopolies and while no market power studies have been introduced in this record, neither can obscure the reality that SFPP and Calnev are the primary common

> carriers of refined petroleum products in this state. Indicated Shippers, referencing the pipelines' FERC Form 6 report for 2005, state that SFPP transported 263,729,529 barrels in California that year and Calnev, 6,478,705 barrels. A barrel is 42 gallons. The prepared testimony of their witness Ashton represents that the pipelines move "over one-third of the total volume of refined products consumed in California." (Ex. 102 at 3.) While it is always germane to inquire how a proposed change of control may affect a Commission-regulated public utility's rates, terms and conditions of service, the inquiry becomes increasingly more critical to the degree that utility customers have few effective alternatives. Even large, sophisticated entities like the oil companies who ship refined petroleum products over SFPP and Calnev are entitled to the assurance of fair and reasonable rates, terms and conditions of service.[16]
>
> ---
>
> [16] In contrast, the Commission's "light-handed" rate regulation of independent gas storage providers expressly relies upon a "let the market decide" policy based on the fact that those entities have no captive customers and must assume all market risks associated with any unused capacity. See for example, D.93-02-013, 1993 Cal. PUC LEXIS 66 at *87, Finding of Fact 37.

Change of Control Order, slip op. at 27.

When the Change of Control Order was issued the Commission was concerned not only with SFPP's market dominance but also with the lack of structural transparency and the motivation of Knight Holdco, the true party in interest, to extract all available cash in its quest of doubling the financial returns to the private individuals and financial investors who comprise Knight Holdco. *See* Change of Control Order, slip op. at 16, 28. In addition, at least one Commissioner was concerned by the fact that SFPP and Calnev did not have any employees. *Id.*, Commissioner Bohn's Concurrence at 5. As Commissioner Bohn summarized the issue,

> After today's decision, we have . . . two regulated utilities <u>with no employees</u>. For Calnev, one has to travel up <u>six layers</u> of corporate structure to find an entity with any employees. For SFPP, there are a mere five layers of corporate structure between the utility and a

> holding company with any employees. And there are two additional layers of corporate structure before one reaches the parent company, Knight Holdco, LLC. Knight Holdco, in turn, is subject to the control of five groups of investors, Carlyle, AIG, Goldman Sachs, Carlyle/Riverstone and KMI Rollover Investors, some of whom buy and sell utility stock in the ordinary course of business. At the end of the day, however, it is clear that the complex ownership structure fixes control and direction of these utilities in the ownership group, Knight Holdco.

Id. (emphasis in original).

These concerns remain. There is no proof in this record that the organizational structure of Kinder Morgan Inc. ("KMI") has changed appreciably since the issuance of the Change of Control Order. SFPP still has no employees. Tr. 135:18-23. Accordingly, the Commission's concerns remain unaddressed.

As Mr. Fessler observed, the conditions set forth in the Change of Control Order "center on maximizing the regulatory climate needed to assure the Commission's access to timely, accurate and complete information." Exh. No. BCES-1 at 6. Thus, the critical question for the Commission is whether it will elect to seek the information in circumstances in which it is in the self-interest of Knight Holdco to cooperate or resist. Mr. Fessler observed,

> To me it is precisely the concern noted by the Commission in 2007. In seeking information from an organizational pyramid with which it has no experience the Commission is clearly anxious as to its ability to obtain the level of cooperation it needs in order to meet its responsibilities.

Exh. No. BCES-1 at 28:16-23.

In his testimony Mr. Fessler drew a distinction between a rate case, in which the applicant has the burden of proof, and a complaint proceeding in which the consumer of utility services challenges rates or terms of service which the Commission had deemed presumptively just and reasonable. The former Commissioner's concern centered on the Commission's ability to gain access to the cooperation and data needed to discharge its regulatory responsibilities. In a complaint case, the Commission may demand the cooperation of out-of-state, foreign organizations, but it is only in a rate making proceeding that it is in the self-interest of segments in a holding structure and, ultimately, the parent entity to furnish the data. Exh. No. BCES-1 at 28:23 to 29:6.

As Mr. Fessler noted, the challenge for the Commission is to gather evidence of the level and kind of service which prevail at the time or are anticipated as future public need. The classical rate case is the best tool to achieve that result since it relies upon the self-interested participation from both the regulated entity as well as the users of the regulated services to gather that vital information. The traditional rate case is the means wherein the Commission engages the "public." Exh. BCES-1 at 6:18 to 7:5, 27:18 to 29:6.

In sum, SFPP's complicated organizational structure as well as its partnership agreements that provide for a distribution of "all available cash" remain in place. Exh. No. BCES-1 at 58:6-16. Thus, the Commission's concern as expressed in the Change of Control Order remains unchanged and therefore, without more experience with SFPP's organizational structure and motivations, this is not the time for the Commission to relax its regulation of SFPP's rates. As Mr. Fessler concluded, it would be "grossly premature" to remove from SFPP the full scrutiny of SFPP's costs in proceedings to review its proposed rate increases. Exh. No. BCES-1 at 11:8-15.

3. Even if Unocap Was Applicable, SFPP Does Not Satisfy The *Unocap* Criteria.

Even if the Commission were to evaluate SFPP's rates under the *Unocap* criteria, SFPP has failed to carry its burden under that case. In *Unocap*, the Commission denied a complaint by a party seeking to require an oil pipeline to charge cost-based rates. The factors considered were whether the proposed rates compare favorably with other pipeline rates; whether customers have reasonable alternatives to shipping on the pipeline; whether the pipeline faces potential competition from new pipelines; whether the pipeline's principal customers are sophisticated oil producers; and whether the pipeline's proposed rates provide for an acceptable rate of return. *Unocap II*, 1996 WL 228516 at *3.

SFPP has failed to demonstrate that it should be relieved from its burden to justify its rates under strict cost-of-service principles. SFPP has not satisfied any, let alone all, of the *Unocap* factors.

SFPP also failed to demonstrate the existence of sufficient actual or even potential competition. As to actual competition, the BCES Shippers' witness Mr. Crowley updated SFPP's own study showing that trucking does not provide realistic competition for movements on SFPP's pipelines, except for a few short haul services. Exh. No. BCES-2 at 6:20 to 7:7. Moreover, even if trucking were to provide some constraint on SFPP rate increases, relying on such competition would necessarily give rise to increased truck hauls. Mr. Fessler testified that any increase in the number and frequency of trucks transporting petroleum products in California would be contrary to the public interest. Exh. No. BCES-1 at 44:10 to 47:7. Based on this, the Commission should deny any proposal that would allow SFPP to increase its rates to a level that would approach the costs of trucking. As to potential competition, SFPP's own witness Dr. Webb conceded that the prospect of new pipeline construction to compete with SFPP is "unlikely." Tr. 165:6-8 (Webb).

Regarding the sophistication of SFPP's customers, while it is true that most of its customers are large corporations, the continued vitality of this *Unocap* factor is in serious doubt after the Commission's 2007 statement in the Change of Control Order that "[e]ven large, sophisticated entities like the oil companies who ship refined petroleum products over SFPP and

Calnev are entitled to the assurance of fair and reasonable rates, terms and conditions of service." Change of Control Order, slip op. at 27. Following that decision, there seems to be no basis to institute light-handed regulation just because a utility's customers are sophisticated.

Neither SFPP's historical nor its proposed rates of return support allowing SFPP to set rates without a strict cost-of-service justification. Under the Proposed Decision in *ARCO Prods. Co. v. SFPP, L.P.*, C.97-04-025 (Apr. 6, 2010), SFPP's historical rates of return were already too high. And as demonstrated by the shipper witnesses in this case, its proposed cost-based rate of return also is excessive. If SFPP's rates and return are already excessive, this is not the time to institute a lax approach.

Lastly, SFPP put forward an additional factor not included in Unocap for measuring justness and reasonableness of its proposed rates -- the rates that it would have charged over the past 18 years had it been permitted to increase those rates by an index factor approximating the rate of inflation. That proposal is problematic for two reasons. First, as discussed above, SFPP's historical rates have been shown to be excessive; showing that they could have been even higher under a different system does not justify light-handed regulation. Second, rate indexing produces inherently inflated rates because it adds an inflation factor to all aspects of a rate, even those aspects that do not increase with inflation. The fact that indexed rates diverge from SFPP's cost-based rates illustrates the unreasonableness of the indexing method rather than the inadequacy of SFPP's rates. Thus, it has no value as a barometer for justness and reasonableness.

If the Commission decides to apply the *Unocap* factors to SFPP, it should find that SFPP does not qualify for light-handed regulation.

a. SFPP Has Not Demonstrated That Its Rates Are Comparable To Rates On Pipelines That Are Influenced By Substantially Similar Factors.

SFPP attempted to show that its rates compare favorably with rates of other pipelines, but it made no attempt to show, as *Unocap* requires, that SFPP's rates and the rates of those other pipelines are derived from substantially similar factors. Thus, SFPP's rate comparability analysis has no value.

SFPP has presented the Report of EAI, Inc., authored by its witness Mr. Leto. *See* Exh. No. SFPP-2. Pages 42-49 of that report address the comparability of SFPP's rates to the rates of other pipelines. SFPP claimed that its rates are comparable to or lower than the rates of purportedly similar pipelines, and that as a result, SFPP satisfies this prong of the *Unocap* test.

As a threshold matter, in *Unocap* the Commission compared the rates of the pipeline at issue with the rates of competing pipelines. *Unocap*, 1994 WL 401065 at *4-*5. The EAI Report looks at pipelines outside of California that obviously are not SFPP's competitors.

Putting aside that flaw, the EAI Report also fails to satisfy the standard set forth in *Unocap*: "Rate comparisons are of little probative value unless there is a persuasive showing that factors influencing rates are substantially similar." *Unocap*, 1994 WL 401065 at *5. The Report skips past this concern and begins comparing SFPP's rates to the rates on other intrastate and interstate pipelines without regard to whether those rates are influenced by substantially similar factors. For instance, even though the pipelines used in the Report face varying levels of competition and are located in different regions of the country, the report makes no attempt to select only pipelines facing similar degrees of competition as SFPP or to analyze whether each pipeline used is "representative of a part of SFPP's system . . . ." Tr. 296:16 to 297:5, 297:25 to 298:3. Further, even though Mr. Leto admitted that the "cost per unit on a pipeline can be affected by the diameter" of the pipe, the study did not consider the diameter of the pipelines other than to discard certain long-haul, large-diameter pipelines. Tr. 298:4-9, 298:23-27. SFPP's analysis is far too rough and lacking in detail to provide a credible basis to conclude that the pipelines are truly comparable to SFPP. SFPP effectively asks the Commission to trust the pipeline's consultants. *See* Tr. 299:11-20 (Leto) ("[W]e didn't do a direct comparison. We just know that. That's expertise, I would suggest.").

The study also did not account for the use of incentive rates by some pipelines. Instead, Mr. Leto ignored the lower rates charged by some pipelines to higher-volume shippers, and simply compared base rates charged by those pipelines to SFPP's rates. Tr. 294:2 to 295:12, 276:27 to 277:10. By using the higher tariffs for some pipeline, the results are skewed to appear that SFPP's rates are lower than the median of the purportedly comparable pipelines' rates than they actually may be.

Because the EAI Report did not select pipelines whose rates are influenced by substantially similar factors as the rates on SFPP's intrastate system and because it artificially inflated the effective rates of some of the pipelines it did use, the Report fails the standard established in *Unocap* and its findings should not be used to set or justify SFPP's rates.

b. SFPP Has Not Demonstrated That Its Customers Have Competitive Alternatives To Shipping On SFPP's Pipelines.

i. SFPP Has Not Demonstrated That Trucking Provides Competition to SFPP's Pipeline Movements.

In July 2007 the Commission evaluated the competitive circumstances facing the two California utilities and found, as a matter of fact, that:

> SFPP and Calnev are the primary common carriers of refined petroleum products in California. Several private pipelines also exist, and transportation by ship/barge along the coast and by truck elsewhere provides some limited competition for SFPP and Calnev.

D. 07-05-061, Finding of Fact 22, at p. 63. SFPP did not challenge the finding which defeats qualification for the *Unocap* criteria.

In these proceedings, SFPP failed to demonstrate that trucking of refined petroleum products throughout California serves as a competitive restraint on SFPP's ability to raise prices. The BCES Shippers' witness Mr. Crowley demonstrated that SFPP does not face any meaningful competition from trucks even if one adopted SFPP's own model for evaluating competition between truck costs and its pipeline rates. Exh. No. BCES-2 at 6:20-11:4. SFPP's witness Mr. Dito conceded that the creator of the SFPP methodology, Mr. Kehlet, another KMEP official, agreed that the methodology "is correct as a methodology for comparing the costs of trucking with the costs of pipelining and then subsequent trucking on the SFPP system in California." Tr. 363:19-23 (discussing Exh. No. ExxonMobil-BP-2 at 11:4-23[40]). Mr. Crowley accepted SFPP's model used in an earlier proceeding, updated it with current figures, and concluded that SFPP's current use of pipelines plus short-haul trucking does not face competition from a "trucking only" mode of transport except for a few short-haul routes. Exh. No. BCES-2 at 3:15 to 7:7. Thus competition - even "moderate competition" as alleged by SFPP - is in fact nearly non-existent.

SFPP concedes that the competition from trucking is only meaningful for short hauls. SFPP admitted in its Application that "market forces act as a check on the rates that SFPP can charge with respect to many of its pipeline movements . . . [a]t least with respect to its shorter-haul pipeline movements . . . ." Application at 5. But if competition truly provided a meaningful constraint on SFPP's rates, it is unlikely that SFPP would be able to file for

[40] The page numbers refer to the internal numbering of the deposition transcript at Exh. No. ExxonMobil-BP-2.

successive $5 million rate increases as it has done in this proceeding. *See* Exh. No. BCES-1 at 13:9-16; 2009 Application at 1, n.1.

Indeed, as shown by the Applicants' 2006 presentation before another public body, the market mechanism which Applicants assert is an adequate substitute for a Commission determination of reasonableness would permit SFPP to raise rates by more than 400% before truck haulage would become an economical alternative. *See* Exh. BCES-1 at 43-44 and Exhibit 1 entitled "Calnev Projects Update" attached thereto. As a rate control mechanism, an alternative that becomes competitive only which pipeline rates are raised by several hundred per cent is not "meaningful." Thus, SFPP's assertion that it confronts "substantial competition" from trucks is not credible. *See* Application at 9.

SFPP's witness Mr. Dito claimed, on one hand, to know that if rates on "certain of SFPP's pipeline movements . . . were to be further increased <u>significant throughput would likely be diverted to trucks.</u>" Exh. No. SFPP-11 at 5:16-21. (emphasis added). But on the other hand, he suggested that a shipper's election to divert to trucks volumes which had been shipped by pipeline is "considerably more complicated than simply comparing available truck rates with pipeline tariff rates as Mr. Crowley has done." Exh. No. SFPP-11 at 6:6-7. Mr. Dito launched into an analysis of the factors that a supplier will consider in determining whether to ship by truck or pipeline and concluded that:

> [t]o a significant degree, the amount of product or throughput which SFPP could lose as a result of an increase in its pipeline rates is dependent on many proprietary and subjective factors unique to each potential shipper on SFPP's system. From my experience, there are probably as many ways for a company to review proprietary trucking costs as there are companies.

Exh. No. SFPP-11 at 7:7-11. Mr. Dito contradicted his own conclusion - that the decision making process is uncertain and utterly unpredictable - by predicting that if rates in areas where trucking posed a competitive presence increased, significant throughput would be diverted to trucks. Exh. No. SFPP-11 at 5.

In 2007, the Commission found that the incentive of the owners of SFPP is to increase from "one to two billion dollars per year the financial returns to the private individuals and financial investors who sit atop this [the Kinder Morgan] pyramid." Change of Control Order at 61, Finding of Fact No. 11. When SFPP's own witness cannot tell a consistent story regarding the extent to which trucking is competitive with pipeline service, the Commission cannot rely on trucking competition as a replacement for cost-of-service ratemaking to restrain SFPP's financial incentives.

Indeed, Mr. Dito went further, undermining SFPP's argument that trucking presents "significant" or even "moderate" competition by warning that there may not be an adequate supply of trucks available to the aggrieved shipper and that, even if the trucks are physically available, there are potential traffic problems and complications in securing trucks from third parties. Exh. No. SFPP-11 at 8:3-22. He acknowledged that securing truck service may require long-term contracting. Exh. No. SFPP-11 at 8:16-22.

Finally, Mr. Dito advanced another proposition that casts doubt on the wisdom of the Commission's acceptance of trucking competition as a substitute for a cost-based determination of just and reasonable rates: the time lag factor. Exh. No. SFPP-4 at 12. In *Pacific Pipeline System, Inc.*, 65 CPUC 2d 613, D.96-04-056, 1996 WL 230224 at *22 (1996), the Commission defined market power as "the power to profitably raise price above the competitive level for a non-transitory period of time and not lose so many sales in the process that the price increase must be rescinded." Mr. Dito conceded that the diversion to trucking, in response to a pipeline rate hike, will not happen quickly but will take the form of "a gradual erosion that may take place depending on many factors enumerated previously." Exh. No. SFPP-11 at 12:13-15 (emphasis added). If there even is such an erosion in SFPP's volumes following a rate hike, Mr. Dito effectively conceded that it would be gradual over an extended period of time. In the meantime, SFPP would continue to collect rates in excess of its cost-of-service – advancing KMI's goals via an unjust and unreasonable extraction of cash from the California economy.

For these reasons, SFPP has failed to demonstrate that there is sufficient competition under *Unocap*.

ii. SFPP's Proposal Would Justify Market-Based Pricing On Pipeline Segments That Do Not Face Competition.

SFPP is attempting to obtain light-handed regulation across its entire intrastate system, but did not demonstrate that each of its segments faces competition. In effect, SFPP seeks to justify light-handed regulation on routes that even SFPP concedes to be non-competitive based on a putative showing of competition on other routes. Dr. Webb admitted at the hearing that SFPP "would be in a position to raise rates in those markets to a greater extent where they have more market power than in those areas where they have less market power." Tr. 100:8 to 102:23. Mr. Leto admitted that the degree of competition that trucking presents differs from market to market. Tr. 312:22-25 (Leto). That being the case, SFPP's one-size-fits-all approach should not be countenanced. Even in SFPP's Application, it could not bring itself to claim that it faced competition on all pipeline segments, and instead stated merely that "[a]t least with respect to its shorter-haul pipeline movements, market forces act as a check on the rates that SFPP can charge with respect to many of its pipeline movements." Application at 5. Given SFPP's agreement that it faces less competition on some pipeline segments than others, its proposal to implement light-handed regulation on its entire system cannot be approved under *Unocap*.

iii. To The Extent SFPP's Proposal Would Increase The Use Of Trucking, It Presents An Unacceptable Safety Risk To The People Of California.

SFPP's proposal relies on competition purportedly presented by the transportation of refined petroleum products by trucks. If the proposal were approved, SFPP would test the boundaries of whatever price constraints trucking may offer as opposed to the current method of long-range shipments by pipeline and shorter deliveries made by truck. This necessarily would lead to more trucking of refined petroleum products. Dr. Webb agreed that, unconstrained by regulatory limitations, a company will raise its price to the level of the next-highest alternative. Tr. at 106:3-8 (Webb). Dr. Webb further conceded that SFPP would even give up some volumes to competitors if it meant earning a greater amount of total revenue. Tr. 212:9-18 (Webb).

Given that SFPP is seeking to let the market decide the limits of its rates, and given that SFPP admittedly would seek to increase those rates to a level that incentivizes more trucking, SFPP's proposal necessarily would increase the risk to public safety.

Mr. Fessler testified that the Commission should be alarmed by SFPP's implicit encouragement of the use of more trucks. At a minimum, before the Commission could abandon cost-of-service ratemaking in favor of Applicants' proposal, it would have to examine thoroughly the impact on the public interest of essentially automating pipeline rate increases to the point at which current pipeline customers were forced to divert substantial quantities of petroleum products to truck deliveries. Most alarmingly, SFPP's alternative ratemaking mechanism dependent on trucking competition would increase substantially the risk of human fatalities in California. A 1993 report of the California Fire Marshal found that the transportation of petroleum products and crude oil by pipeline was 300 times more likely than transportation by pipeline to result in loss of human life. Exh. No. BCES-1 at 44-46. Indeed, the Fire Marshal warned that:

> A general understanding of these relative risks is essential for those considering regulatory changes which could increase the cost of hazardous liquid pipeline construction, operation, and/or maintenance. Any increase in the shipping costs associated with such changes would likely result in a portion of the throughput being diverted from pipelines to other transportation modes. Since these other modes generally expose the public to a higher risk than pipelines, any such diversion may actually decrease overall transportation safety . . . .
>
> There are already signs of this occurring, especially in Southern California. The crude from many of the older production fields which was historically transported by pipeline, has been diverted to truck transportation which has the worst safety record.

Exh. No. BCES-1 at 46:18 to 49:6 (citing California State Fire Marshal, *Hazardous Liquid Pipeline Risk Assessment* at 16 (1993) (emphasis added)). Similarly, in *Wickland Pipelines LLC*, D.02-11-023, 2002 WL 31557643, at *3, *6 (Nov. 7, 2002), the Commission found that a proposed jet fuel pipeline would "eliminate a potential health and safety hazard to public safety" by moving shipments of jet fuel from tanker trucks to the pipeline. Even Dr. Webb admitted that trucks are less safe than shipping by pipeline. Tr. 131:19-26 (Webb).

In a different context, KMEP, SFPP's parent, in support of its proposal to construct a pipeline from Concord to Sacramento in 2003, promoted the benefits to public health, safety, productivity and the environment of shifting the transport of refinery products away from surface transportation in favor of its own pipeline infrastructure. Exh. No. BCES-1 at 47:18 to 49:12 and Exhibit B thereto. Indeed, KMEP even cited the concerns and finding of the California State Fire Marshal, as discussed above. Exh. No. BCES-1 at 49:1-7. Now that its interests have changed, SFPP's current arguments to the contrary are self-serving and disingenuous.

c. SFPP Has Not Demonstrated That There Is A Realistic Possibility That New Market Entrants Would Compete With SFPP If SFPP Raises Its Rates.

SFPP bears the burden to demonstrate that "there are sufficient practical alternatives" to its service that its proposed rates are "subject to market discipline."[41] *Unocap*, 1994 WL 401065, at *12. SFPP offered nothing but conjecture and failed to carry its burden. Dr. Webb testified in a conclusory fashion that Big West might reopen its Bakersfield refinery if SFPP exercised market power in the right geographic areas. Exh. No. SFPP-1 at 15:16-19. He also testified that "[g]iven the right economic conditions," Plains might reverse a currently idled pipeline and convert it to refined product service. Exh. No. SFPP-1 at 15:19 to 16:2. There are merely unsupported speculations that do not satisfy SFPP's burden under *Unocap*.

When questioned about the possibility of a greenfield pipeline being constructed in California that could compete with SFPP, Dr. Webb agreed that was "unlikely." Tr. 165:6-8. This is in accord with KMEP's Form 10-K filed with the SEC for 2009, which stated the following with regard to competition from other pipelines: "We believe that high capital costs, tariff regulation, and environmental and right-of-way permitting considerations make it unlikely that a competing pipeline system comparable in size and scope to our West Coast Products Pipelines operations will be built in the foreseeable future." Exh. No. ExxonMobil/BP-1 at 4; Tr. 164:13-21. SFPP's witness Mr. Leto stated, with respect to construction of a greenfield pipeline, that "[i]t would take multiple years" and that he had not assessed the viability of such a project. Tr. 338:10-15, 339:1-7; *see also* Tr. 311:11-17 (Mr. Leto admitting that environmental scrutiny would add to the regulatory barriers to constructing a new pipeline). As discussed above, the hallmark of market power is the "the power to profitably raise price above the competitive level

---

41 BP and ExxonMobil defer to other shippers regarding market concentration issues, including Herfindahl-Hirschman Index calculations.

for a non-transitory period of time and not lose so many sales in the process that the price increase must be rescinded." *Pacific Pipeline System, Inc.*, 65 CPUC 2d 613, 1996 WL 230224 at *22 (1996). Obviously, if a project has questionable viability, and even if built, would take "multiple years" and face significant regulatory scrutiny, that project will not constrain an existing pipeline like SFPP from raising prices for a significant period of time. SFPP has not shown that it would face competition from new market entrants if it raised its rates.

d. The Size And Sophistication Of SFPP's Customers Is No Reason To Apply Less Scrutiny To SFPP's Rates.

One of the *Unocap* factors is whether the pipeline's "principal customers are sophisticated oil producers . . . ." *Unocap II*, 1996 WL 228516 at *3. Because of the sophistication of such customers, the Commission held that the "regulatory oversight needed . . . is different than that which we seek to provide for customers of monopoly water companies or electric utilities." *Unocap*, 1994 WL 401065 at *12.

This approach has questionable application to this case. In the Change of Control Order, the Commission held that even sophisticated entities like SFPP's customers, which have "few effective alternatives," are entitled to just and reasonable rates:

> While it is always germane to inquire how a proposed change of control may affect a Commission-regulated public utility's rates, terms and conditions of service, the inquiry becomes increasingly more critical to the degree that utility customers have few effective alternatives. Even large, sophisticated entities like the oil companies who ship refined petroleum products over SFPP and Calnev are entitled to the assurance of fair and reasonable rates, terms and conditions of service.

Change of Control Order, slip op. at 27. This more recent order, applying directly to SFPP, appears diminish this *Unocap* factor in the context of this case.

SFPP's witness Dr. Webb testified that SFPP's customers deserve less protection because of the collective action problems that afflict individual customers but do not restrain large oil companies like SFPP's shippers. According to Dr. Webb, without governmental intervention, a utility is able to exploit individual customers because they are unable to coordinate their actions to oppose the pipeline, but the pipeline is unlikely to be able to exploit "large sophisticated corporations" in a similar fashion. Exh. No. SFPP-1 at 11:1 to 12:11. "If SFPP takes advantage of them, they have numerous means to respond, including bringing alleged bad acts to the attention of this Commission." Exh. No. SFPP-1 at 20:13-15.

Dr. Webb concludes from this theoretical exercise that it is safe to set SFPP's rates using the looser standards advocated by SFPP. According to Dr. Webb, if the rates are too high, the shippers can always file a complaint. In a nutshell, SFPP is arguing that because its shippers have greater resources than individual utility customers and can ably present their grievances to the Commission if the rates become too high, the Commission should not apply a strict cost-of-service ratemaking regime to SFPP, and instead "let it slide" if SFPP's rates are not completely cost-justified.

SFPP's reasoning is hopelessly circular - SFPP would have the Commission slacken the standards applied to its rates because shippers can afford lawyers and can file complaints. But those lower standards would apply to the very complaint process that supposedly would protect shippers. If SFPP has its way, at no point would the shippers be assured of just and reasonable rates that do not exceed SFPP's costs plus a reasonable rate of return.

Large sophisticated customers, according to Dr. Webb, are able to engage in rent-seeking, which he defined as "a term of art used by economists to denote the use of the legislative or regulatory process to appropriate value from some other party." Exh. No. SFPP-1 at 12:14-15. In Dr. Webb's view, when SFPP's shippers oppose SFPP's rate increases, they are trying to extract undeserved value from the pipeline by "us[ing] the procedures and policies of this agency . . . ." Exh. No. SFPP-1 at 13:9-12. This is an "entirely wasteful" exercise, according to Dr. Webb. Exh. No. SFPP-1 at 13-:3-5. Therein lies the crux of Dr. Webb's position -- the Commission should prevent, or at least impede, the attempts of SFPP's customers to oppose rate increases.

Dr. Webb conceded at the hearing that his rent-seeking argument cuts both ways. He explained his initial view that the difference between the cost of service figure proffered by SFPP of $110 to $115 million, and the figure put forward by the shippers of $80 to $85 million "potentially would represent value that the shippers are seeking to appropriate." Tr. 142:20-26. This difference arises from disagreements over cost allocations, rates of return on debt and equity, capital structure, the recoverability of an income tax allowance, throughput levels and several other areas. Dr. Webb's belief that the differing positions of the parties are caused by the shippers' attempt to appropriate value from the pipeline reflects a biased assumption that the pipeline is infallible. Obviously, that is not the case, as even Dr. Webb later admitted. When asked whether it would be equally true that "[t]o the extent that SFPP is seeking to overstate their costs or understate their throughput, . . . SFPP is seeking rents from the value of refinery commodity products," Dr. Webb agreed. Tr. 143:13-18. Ultimately, as Dr. Webb concurred, whichever party loses a given ratemaking issue is the "rent-seeker" in that the losing party was attempting to appropriate value that did not belong to it. Tr. 144:10 to 145:4. That being the case, the rent-seeker cannot be identified until the case concludes and the issues are decided. Tr. 145:5-10. Obviously, if the Commission cannot identify "wasteful" rent-seeking prior to the completion of a rate case, it cannot establish an *ex ante* policy designed to avoid such waste.

Once Dr. Webb's theories are properly understood, it is clear that SFPP is simply attempting to foreclose opposition to its rate increases by portraying such opposition as wasteful and inefficient. Just because SFPP's customers are large sophisticated corporations does not justify allowing the pipeline to charge higher rates. As the Commission has recognized, "[e]ven large, sophisticated entities like the oil companies who ship refined petroleum products over SFPP and Calnev are entitled to the assurance of fair and reasonable rates, terms and conditions of service." Change of Control Order, slip op. at 27.

e. SFPP's Achieved And Proposed Rates Of Return Indicate That SFPP Should Remain Subject To Strict Cost-Of-Service Regulation.

BP and ExxonMobil defer to other shippers as to SFPP's achieved rate of return except to note that the Proposed Decision in *ARCO Prods. Co. v. SFPP, L.P.*, C.97-04-025 (Apr. 6, 2010) found that SFPP's historical rates were excessive because it had overstated its weighted cost of capital by nearly 200 basis points. Proposed Decision, slip op. at 32, 34. If this proposed decision is adopted by the Commission, many of SFPP's historical rates will be found to have been unjust and unreasonable, and SFPP will pay substantial refunds. Therefore, there is no basis to use SFPP's historical rates of return as a benchmark for justness and reasonableness for future rates.

BP and ExxonMobil also note that there are substantial differences in the recommended cost-of-service rates put forward by SFPP and the various shippers. Where SFPP recommended a return on equity of 15.01%, a cost of debt of 6.56%, a capital structure of 52.43% debt/47.57% equity, and an income tax allowance based on the maximum corporate tax rate of 35%,[42] Dr. Horst recommended a return on equity of 12.21%, a cost of debt of 4.37%, a

42 Exh. Nos. SFPP-12 at 14-16, SFPP-14 at 19:18-20.

capital structure of 60.36% debt/39.64% equity, and no income tax allowance.[43] SFPP's proposed rate of return is significantly out of line with a just and reasonable rate. Its attempt to evade a rigorous analysis of its claimed cost of service should be denied.

4. SFPP Has Not Demonstrated That Inflation Indexing Should Be Used To Gauge The Justness And Reasonableness Of SFPP's Rates.

SFPP also proposed that the Commission should evaluate the justness and reasonableness of its rates by comparing the existing rates to those that would have obtained had SFPP used a variety of indexing mechanisms similar to the method used by FERC. *See* Exh. No. SFPP-10 at 21:14 to 24:17. To accomplish this, Mr. Dito compared SFPP's revenues over 1992 to 2010 to the revenues it would have received if it had applied to its 1992 rates (1) the FERC index, which is based on the producer price index for finished goods ("PPI-FG") plus an adjustment, (2) the unadjusted PPI-FG, and (3) the Consumer Price Index ("CPI"). Exh. No. SFPP-10 at 22:19 to 24:17 and Exhibits A-C thereto. He found that SFPP's actual rates over that period would have been the same or greater if the various index increases had been applied. From this, Mr. Dito concluded that the existing rates should be deemed just and reasonable. Mr. Dito's demonstration proves only the folly of indexing: over time, a rate increased by an inflation factor will significantly outpace a rate justified by the pipeline's cost of service.

There are several problems with Mr. Dito's approach. First, Mr. Dito admitted that indexed rates would substantially overrecover SFPP's costs. Tr. 366:4-11. As such, there is no conceivable reason to rely upon indexing as a valid point of comparison. It is simply meaningless for SFPP to claim that its rates are just and reasonable because they are the same or less than rates that substantially overrecover SFPP's costs. For this reason alone, SFPP's proposal to evaluate its rates against indexed rates should be disregarded.

---

[43] Exh. No. ExxonMobil-1 at 4:10 to 5:16.

Second, rate indexing inherently leads to an overrecovery of costs. Under an indexing regime, every element of SFPP's rates is increased by an inflation factor. Generally speaking, a pipeline's overhead and operating costs may be sensitive to inflation, but not all of its costs have any relation to inflation. For instance, depreciation, rate of return, right-of-way expenses and property taxes fluctuate independently of inflation. Yet an indexing regime increases the rate to account for hypothetical increases in those costs. By increasing SFPP's rates across the board, over time the indexed rates naturally will outpace SFPP's actual cost of service. For that reason, it is not a useful tool to judge the justness and reasonableness of SFPP's rates.

Third, the indexed rates are a useless metric because many of SFPP's historical rates were already so high as to be unjust and unreasonable. As discussed above, Judge Long's Proposed Decision found that SFPP's rates from April 1997 through December 2006 included improper costs and that the rates from 2003 forward were calculated using an inflated rate of return. Although that decision is not final, it strongly indicates that SFPP's historical rates, even un-indexed, were too high. Accordingly, it is meaningless to compare those rates against an even higher hypothetically indexed rate.

IV. CONCLUSION

The Commission should reject SFPP's proposal for light-handed regulation and require SFPP to refile its rates in accordance with the recommendations herein, and to pay refunds to shippers to the extent it has collected rates in excess of the refiled rates.

Respectfully submitted,

/s/ Thomas J. Eastment

Thomas J. Eastment
Gregory S. Wagner
Christina M. Vitale
Baker Botts L.L.P.
1299 Pennsylvania Ave., N.W.
Washington, DC 20004

Counsel for BP West Coast Products LLC and
ExxonMobil Oil Corporation

Dated: April 19, 2010

CORRECTED CERTIFICATE OF SERVICE

I hereby certify that I have this day served by electronic mail the foregoing Joint Opening Brief of BP West Coast Products LLC and ExxonMobil Oil Corporation upon the persons listed below:

PARTIES

RICHARD E. POWERS, JR.
VENABLE, LLP
575 7TH STREET N.W.
WASHINGTON, DC 20004
For: Southwest Airlines Company / Air Transport Assoc of America, Inc.
repowers@venable.com

GEORGE L. WEBER
WEBER & ASSOCIATES
1629 K STREET, N.W., SUITE 300
1800 PILLORY DRIVE
VIENNA, VA 22182
WASHINGTON, DC 20006
For: Chevron Products Company
glweber44@aol.com

R GORDON GOOCH
ATTORNEY AT LAW
TRAVIS & GOOCH
851N NORTH GLEBE ROAD, SUITE 1911
ARLINGTON, VA 22203
For: ExxonMobil Oil Corp.
gordon_gooch@earthlink.net

ROBERT C. CAGEN
CALIFORNIA PUBLIC UTILITIES COMMISSION
LEGAL DIVISION, ROOM 5026
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3214
For: DRA
rcc@cpuc.ca.gov

STEVEN A. ADDUCCI
VENABLE, LLP
575 7TH STREET, N.W.
WASHINGTON, DC 20004-1601
For: Valero Marketing & Supply Company & Ultramar, Inc.
saadducci@venable.com

MARCUS W. SISK, JR
DORSEY & WHITNEY LLP
1801 K STREET, N.W., SUITE 750
WASHINGTON, DC 20006
For: ConocoPhillips
sisk.marcus@dorsey.com

MELVIN GOLDSTEIN
GOLDSTEIN & ASSOCIATES, P.C.
1757 P STREET, N.W.
WASHINGTON, DC 20036
For: Tesoro Refining and Marketing Company
mgoldstein@goldstein-law.com

ANDREW J. DALTON
VALERO ENERGY COMPANY
ONE VALERO PLACE, ROOM 264
SAN ANTONIO, TX 78212-3186
For: Valero Marketing and Supply Company
Andrew.dalton@valero.com

TODD NORMANE
BP AMERICA, INC.
BP West Coast Products, LLC
6 CENTERPOINTE DRIVE; LPR 6-552
LA PALMA, CA 90623
For: BP West Coast Products L.L.C.
todd.normane@bp.com

JAMES D. SQUERI
ATTORNEY AT LAW
GOODIN, MACBRIDE, SQUERI, DAY & LAMPREY
505 SANSOME STREET, SUITE 900
SAN FRANCISCO, CA 94111
For: SFPP, L.P./Calnev Pipe Line L.L.C.
jsqueri@gmssr.com

MARTHA C. LUEMERS
DORSEY & WHITNEY, LLP
1717 EMBARCADERO ROAD
PALO ALTO, CA 94303
For: ConocoPhillips Company
luemers.martha@dorsey.com

INFORMATION

DAVID A. BERG
AIR TRANSPORT ASSOCIATION OF AMERICA, INC
1301 PENNSYLVANIA AVENUE, N.W., STE 1100
WASHINGTON, DC 20004
For: Air Transport Association of America, Inc.
dberg@airlines.org

NANCILEE HOLLAND
HUSCH BLACKWELL SANDERS LLP
750 17TH STREET, NW, STE. 1000
WASHINGTON, DC 20006
Nancilee.Holland@huschblackwell.com

PAMELA SILBERSTEIN
HUSCH BLACKWELL SANDERS LLP
750 17TH STREET, NW, SUITE 1000
WASHINGTON, DC 20006
pamela.silberstein@huschblackwell.com

DIANE B. CVITKO
DORSEY & WHITNEY LLP
1801 K Street, N.W., STE. 750
WASHINGTON, DC 20036
cvitko.diane@dorsey.com

BARRON DOWLING
ASSOCIATE GENERAL COUNSEL
TESORO REFINING AND MARKETING COMPANY
300 CONCORD PLAZA DRIVE
SAN ANTONIO, TX 78216
bdowling@tsocorp.com

CHRISTINA M. VITALE
BAKER BOTTS L.L.P.
1299 PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20004-2400
christina.vitale@bakerbotts.com

GREGORY S. WAGNER
BAKER BOTTS L.L.P.
1299 PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20004-2400
gregory.wagner@bakerbotts.com

JOSHUA B. FRANK
BAKER BOTTS L.L.P.
1299 PENNSYLVANIA AVENUE, NW
WASHINGTON, DC 20004-2400
joshua.frank@bakerbotts.com

FREDERICK G. JAUSS IV
DORSEY & WHITNEY LLP
1801 K STREET, N.W., SUITE 750
WASHINGTON, DC 20006
jauss.fred@dorsey.com

MATTHEW A. CORCORAN
GOLDSTEIN & ASSOCIATES, P. C.
1757 P STREET, N.W.
WASHINGTON, DC 20036
mcorcoran@goldstein-law.com

EUNICE B. SUTTER
EXXON MOBIL CORPORATION
3225 GALLOWS ROAD-3D-2133
FAIRFAX, VA 22037
eunice.b.sutter@exxonmobil.com

HILARY CORRIGAN
CALIFORNIA ENERGY MARKETS
425 DIVISADERO ST. SUITE 303
SAN FRANCISCO, CA 94117-2242
cem@newsdata.com

DORSEY & WHITNEY LLP
1717 EMBARCADERO ROAD
PALO ALTO, CA 94303
eFilingPA@dorsey.com

PAUL M. PREMO
ENERGY ECONOMICS CONSULTING
310 HAZEL AVENUE
MILL VALLEY, CA 94941-5054
paulpremo@msn.com

DIANE I. FELLMAN
NRG WEST
73 DOWNEY STREET
SAN FRANCISCO, CA 94117
Diane.Fellman@nrgenergy.com

MARGARET J. STORK
DORSEY & WHITNEY, LLP
1717 EMBARCADERO ROAD
PALO ALTO, CA 94303
stork.margaret@dorsey.com

STATE SERVICE

BELINDA GATTI
CALIFORNIA PUBLIC UTILITIES
COMMISSION - ENERGY DIVISION
AREA 4-A
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3214
beg@cpuc.ca.gov

EUGENE CADENASSO
CALIFORNIA PUBLIC UTILITIES
COMMISSION - ENERGY DIVISION
AREA 4-A
505 VAN NESS AVENUE
SAN FRANCISCO, CA, 94102-3214
cpe@cpuc.ca.gov

KARL BEMESDERFER
CALIFORNIA PUBLIC UTILITIES
COMMISSION - DIVISION OF
ADMINISTRATIVE LAW JUDGES
ROOM 5006
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3214
kjb@cpuc.ca.gov

Dated at Washington, D.C. this 19th day of April, 2010.

/s/ Thomas J. Eastment
Thomas J. Eastment