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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Application of San Pablo Bay Pipeline Company LLC for Approval of Tariffs for the San Joaquin Valley Crude Oil Pipeline.	Application 08-09-02 (Filed September 30, 2008)
And Related Matters	Case 08-03-021 Case 09-02-007 Case 09-03-027

CHEVRON PRODUCTS COMPANY'S REPLY BRIEF

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I. INTRODUCTION

Chevron's opening brief showed the Shell Pipeline has failed to meet its burden of proving its proposed rates and proposed terms and conditions of service are just and reasonable. As discussed in Chevron's brief, the evidence shows the following:

The Pipeline possesses – and has exercised – market power. The Pipeline's market power has manifested itself in the following ways:

- imposing a 74 percent rate increase between 2005 and 2006 with no meaningful loss of volume;
- forcing Chevron to sell its Coalinga crude to Shell at a discount;
- discriminating in favor of its affiliate, STUSCO, in (1) transportation rates; (2) pipeline loss allowance ("PLA"); and (3) "regrading" OCS to allow STUSCO to pass it off as more valuable SJV Heavy; and
- an HHI of 4,125, indicative of a highly concentrated San Joaquin Valley origin market from which shippers do not have economic alternatives sufficient to defeat an exercise of market power by the Pipeline.

As a result, the Pipeline's rates have been – and remain – unjust and unreasonable. Not only must the Pipeline's request for "market-based" rates be denied, Equilon and STUSCO should be ordered to refund to Chevron $51.4 million in unjust and unreasonable charges collected between April 1, 2005 and January 31, 2010. To ensure non-discriminatory service to all shippers going forward, the Commission should deny Equilon's attempt to escape its public utility obligations through a "back-door" transfer of the Pipeline to San Pablo Bay and withdrawal of assets from utility service, and adopt the Independent Shippers' proposed tariff.[1]

San Pablo Bay, however, says almost nothing about the evidence presented by Chevron and the other Independent Shippers. Reading San Pablo Bay's opening brief, one would barely know that Chevron had submitted prepared testimony or that there were evidentiary hearings.

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[1] The Independent Shippers are filing a joint reply brief addressing the tariff terms and conditions.

By and large, San Pablo Bay acts as if the only testimony in these proceedings came from its own witnesses, ignoring the evidence that is contrary to its vision of the world. Where it does acknowledge there is opposing testimony, it rarely goes further than to assert the opposing testimony is wrong, apparently intending to save any substantive comments for its reply brief, when Chevron will not have the opportunity to point out any misstatements. In fact, San Pablo Bay candidly acknowledges its intent to avoid any reply by the Independent Shippers, saying, "San Pablo Bay anticipates addressing all of the defects in Complainants' COS showing in full detail in its Reply Brief." (SP Op. Br. at 75 n. 175.)

The one exception to its ostrich-like stance comes in San Pablo Bay's approach to market-based rates. Implicitly recognizing that it has failed to prove the Shell Pipeline lacks market power, San Pablo Bay states – over and over again – that, even if it has market power, the Commission can keep its exercise of market power in check. (SP Op. Br. at 3, 4, 11, 33.) It is fundamental, however, that to be entitled to market-based rates in the first instance, the Shell Pipeline must <u>prove it lacks market power</u>. *City of Long Beach v. Unocal California Pipeline Co.*, D.94-05-022, 1994 Cal. PUC LEXIS 380 at **33-34 ("*Unocap I*"). The constant vigilance of the regulator is no substitute for a competitive market where market-based rates are concerned. San Pablo Bay's "fallback" reliance on regulation itself demonstrates the Shell Pipeline must be denied market-based rates.

STUSCO's brief is revealing in a different way. It makes clear STUSCO sees the Shell Pipeline's proposed tariff as a continuation of the way it ran the Pipeline before D.07-07-040:

- STUSCO admits the Shell Pipeline is currently being operated on a discriminatory basis in violation of its public utility obligations, saying, "Since the issuance of D.07-07-040 and D.07-12-021, the SJV Pipeline has <u>operated as a proprietary asset</u>." (STUSCO Op. Br. at 3 (emphasis added).) In other words, when the Commission did not grant STUSCO and Equilon's July 30, 2007 motion for a stay of D.07-07-040, they simply ignored the Commission and in essence granted themselves a stay.

- STUSCO eliminates any doubt the Shell Pipeline-proposed tariff is designed to maintain the advantages STUSCO has enjoyed with the Pipeline operating outside regulation: "San Pablo's proposed tariff conditions <u>continue the current protocol</u> for nomination and scheduling of shipper volumes." (*Id*. at 12 (emphasis added).)
- And, the exclusion of assets from the Pipeline is intended to allow STUSCO to continue to benefit from the "current proprietary asset structure" under which so-called "ancillary assets [tanks, truck racks, LACTs] have been used to facilitate Shell's overall efforts to <u>maximize its utilization of the pipeline assets</u>." (*Id*. at 15 (emphasis added).)

As discussed below, neither San Pablo Bay's brief or STUSCO's justifies granting the Shell Pipeline market-based rates. The $2.04 per barrel rate the Pipeline seeks is unjust and unreasonable, and the tariff terms and conditions it proposes unduly discriminate in favor of its affiliate, STUSCO. The Commission should adopt the $1.34 per barrel rate derived from Chevron's cost of service analysis, adopt the terms and conditions of service contained in the Independent Shippers' joint tariff, and order STUSCO and Equilon to pay Chevron refunds of at least $51.4 million for unjust and unreasonable charges from April 1, 2005 through January 31, 2010.

II. <u>SAN PABLO BAY FAILED TO PROVE THE SHELL PIPELINE LACKS MARKET POWER</u>.

Although Shell bears the burden, Chevron has proved the Pipeline possesses – and has exercised – market power. As a result, the Shell Pipeline is not entitled to market-based rates and owes Chevron and the other Independent Shippers tens of millions of dollars of refunds for charging unjust and unreasonable rates. Rather than taking issue with Chevron's proof, San Pablo Bay's brief ignores the evidence:

- The Shell Pipeline's ability to increase its rates by 74% over a one-year period in an environment of declining demand and without a significant loss in volume demonstrates the Pipeline's market power. (Chevron Op. Br. at 16-20.)
- At Coalinga, where the Shell Pipeline is the only pipeline connection, the fact that Chevron sells its crude to Shell at a discount shows the Pipeline's market power. (Chevron Op. Br. at 21.)

- The Shell Pipeline's ability to discriminate in favor of its affiliate, providing STUSCO lower rates, a lower PLA, and "regrading" OCS to pass it off as higher-value SJV Heavy – continuing for three years since the Commission declared the Pipeline a public utility – demonstrates the Pipeline's market power. (Chevron Op. Br. at 22-25.)

- Because light crude oil for blending is in short supply and refineries in the Bay Area would require a discount to take blended crude oil in lieu of the undiluted SJV Heavy they receive on the Shell Pipeline, the unheated pipelines to the Bay Area (KLM and CP) are not economic alternatives to the Shell Pipeline. (Chevron Op. Br. at 35-38.)

- Since Los Angeles refineries already purchase their desired crude slate and either cannot or will not take additional barrels of SJV Heavy without a discount, transportation to Los Angeles is not an economic alternative to the Shell Pipeline. (Chevron Op. Br. at 38-40.)

- Refineries in the San Joaquin Valley either cannot process SJV Heavy (Kern Oil), are not operating and have no intention of refining crude oil (Big West), or are already purchasing all the crude oil they can economically handle (San Joaquin Refinery) and therefore are not economic alternatives to the Shell Pipeline. (Chevron Op. Br. at 40-41.)

- The Shell Pipeline would profit from a rate increase of 15% over the competitive rate because Chevron and the other Independent Shippers do not have economic alternatives sufficient to enable them to divert the critical volume of undiluted SJV Heavy from the Shell Pipeline necessary to defeat a price increase. (Chevron Op. Br. at 41-45.)

- The HHI in the properly defined origin market is 4,125, well above the 2,500 threshold indicating a highly concentrated, non-competitive market. (Chevron Op. Br. at 46.)

Despite conceding that "whether the customers of San Pablo Bay have access to substitutes that restrain San Pablo Bay's ability to exercise market power" is "the fundamental question" (SP Op. Br. at 23), San Pablo Bay's opening brief does not address the evidence, including Dr. Cox's rigorous evaluation of the cost and feasibility of each potential alternative, presented by Chevron. As discussed below, San Pablo Bay has failed to prove the economic availability of a single alternate means of clearing the undiluted SJV Heavy the Independent Shippers currently ship on the Shell Pipeline. San Pablo Bay's opening brief fails to show the

Pipeline is entitled to market-based rates and has not exercised its market power to charge unjust and unreasonable rates.

A. San Pablo Bay Failed To Prove It Lacks Market Power In The San Joaquin Valley Origin Market.

San Pablo Bay acknowledges the question for the San Joaquin Valley origin market analysis is how producers "can economically clear their production." (SP Op. Br. at 17 (emphasis added).) Yet, San Pablo Bay does not demonstrate the practical, economic availability to clear the SJV Heavy production Chevron currently ships on the Shell Pipeline as a single one of the putative alternatives it includes in its origin market HHI. Although San Pablo Bay witness Dr. Webb claimed to have conducted a market analysis, his "analysis" did not follow the *Merger Guidelines* or any other generally-accepted methodology that could help the Commission determine whether Shell Pipeline shippers have sufficient alternatives to thwart a supracompetitive price increase. (Chevron Op. Br. at 26-27; *see* Webb, Ex. SP-2C at 25.) To the extent San Pablo Bay purports to provide a "market analysis," it relies on erroneous definitions of the relevant product and geographic markets and an incorrect understanding of "alternative." The result is an inaccurately low HHI that does not reflect the lack of viable competitors to the Shell Pipeline's transportation of undiluted SJV Heavy to the Bay Area refineries.

The appropriate product market is the service the Shell Pipeline provides to its non-affiliated customers: transportation of undiluted SJV Heavy crude. (Cox, Ex. Chevron-52C at 12-13.) San Pablo Bay disregards that the Pipeline's service is transportation, overlooks that heavy crude's viscosity limits its transportability, and improperly defines the product market as "all pipelinable crude oil." (SP Op. Br. at 15.) Defining the product market without reference to the actual service San Pablo Bay provides to its origin market customers enables San Pablo Bay to treat as alternatives entities such as Kern Oil that cannot refine heavy crude and could not assist in thwarting an exercise of market power by the Pipeline. (Cox, Ex. Chevron-52C at 28-29.)

Similarly, San Pablo Bay defines the geographic market as the San Joaquin Valley and District 3 (SP Op. Br. at 17), even though it is undisputed that District 3 is not in the San Joaquin Valley, not an economically accessible destination for San Joaquin Valley crude oil, and not the source of crude oil transported on the Shell Pipeline by any shipper other than the Pipeline's affiliate, STUSCO. (Cox, Ex. Chevron-52C at 28-30; Lee, Ex. Chevron-46 at 13-14; Lee, Ex. Chevron-47 at 26.) Including District 3 in its geographic market analysis enables San Pablo Bay to treat the Santa Maria refinery as an alternative, even though there is no way to economically transport crude from the San Joaquin Valley to the refinery and the refinery could not help San Joaquin Valley producers clear their heavy crude production or otherwise assist in thwarting a supracompetitive price increase by the Shell Pipeline. (Cox, Ex. Chevron-52C at 29-30.)

In addition to improperly defining the product and geographic markets, San Pablo Bay improperly defines "alternative," treating as an alternative <u>any</u> means <u>any</u> shipper on the Shell Pipeline uses to clear <u>any</u> crude oil. (SP Op. Br. at 36.) Whether a pipeline or refinery currently ships or processes some volume of SJV Heavy is not the question, however; the issue is whether the means can be used to <u>economically take additional SJV Heavy</u> that is <u>currently</u> shipped on the Shell Pipeline in order to defeat a price increase. (Chevron Op. Br. at 16 (citing *Unocap I*, 1994 Cal. PUC LEXIS 380 at **33-34.) If the alternative is not operating or has no capacity for SJV Heavy (for example, Big West and Kern Oil) or if it would cost more to use than the supracompetitive rate (for example, Line 2000 and KLM), the Shell Pipeline's customers would not shift to it in the event of a supracompetitive rate increase and it cannot assist in thwarting the Pipeline's market power. (Chevron Op. Br. at 28.)

San Pablo Bay concedes that determination of whether entities are "sufficiently close substitutes that they will compete is an empirical question" and "requires analysis of the economic factors." (SB Op. Br. at 21.) But, the only analysis of origin market economic factors in the record is the detailed evaluation Dr. Cox provided, calculating the cost of every potential alternative to the Shell Pipeline.[2] (Cox, Ex. Chevron-51 at Exhibit 5a-j.)

As discussed below, San Pablo Bay includes as "alternatives" pipelines and refineries Dr. Cox demonstrated would not be available to the Shell Pipeline's customers to transport the SJV Heavy they are currently shipping on the Pipeline.

1. The Big West, Santa Maria, and Kern Oil refineries are not alternatives for SJV Heavy.

Chevron proved the refineries in the San Joaquin Valley are not technical or economic alternatives to the Shell Pipeline. (Chevron Op. Br. at 40-41.) San Pablo Bay includes these refineries as alternatives, based not on analysis or refutation of Chevron's detailed factual showing, but on the high-level assumption, "If producers wish to avoid transportation costs, they are better off selling their oil to these refineries rather than shipping by pipeline to refining centers in San Francisco or Los Angeles, <u>assuming</u> they could sell the oil for a similar price." (SP Op. Br. at 35 (emphasis added).)

Thus, San Pablo Bay <u>assumes</u> the very thing it failed to prove. And, once having assumed it, San Pablo Bay uses the unproven assumption to include in its HHI entities that clearly are not economic, or even technical, alternatives for the SJV Heavy currently on the Shell Pipeline. Thus, San Pablo Bay pays no heed to the facts that Kern Oil only refines light crude, Santa Maria only refines OCS and local crudes, Big West Refinery is shut down,[3] and San Joaquin Refinery is already purchasing all the SJV Heavy it needs. (Chevron Op. Br. at 40-41.)

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[2] San Pablo Bay acts as if Dr. Cox's testimony does not exist, incorrectly claiming, "Witnesses for Independent Shippers have not performed any such critical analysis of the economics of use of substitutable crude oils or alternative pipeline transportation alternatives." (SP Op. Br. at 21.) Similarly, San Pablo Bay ignores the hundreds of pages of evidence Chevron presented establishing the costs of the potential alternatives to claim Chevron argues "without evidentiary support, that because these alternatives <u>may</u> be more expensive, they do not constitute viable competitors." (SP Op. Br. at 21 (emphasis in original).)

[3] As the ALJ saw during cross-examination, overwhelming evidence, including public announcements by Big West's new ownership, establishes that the shut-down Big West refinery will not process crude oil in the future. (Chevron Op. Br. at 29-30.) San Pablo Bay's opening brief persists in maintaining Big West is an alternative, ignoring the evidence and asserting, "During the pendency of these proceedings, there have been various changes in the status of the Big West Refinery. In December 2008, the refinery closed due to bankruptcy. In February, 2010, it was announced that the refinery would reopen. Given these facts and circumstances, it is appropriate to include the refinery as a competitor." (SP Op. Br. at 18.)

As Dr. Cox explained, none of these refineries is an economic alternative to the Shell Pipeline and none, except possibly San Joaquin Refinery, should be included in the origin market HHI.[4] (Chevron Op. Br. at 30 (citing Cox, Ex. Chevron-51 at Exhibit 5a-j).)

2. Chevron could not economically sell additional barrels of SJV Heavy to Los Angeles refiners.

Chevron provided analyses by Scott Sederberg and EAI establishing Los Angeles refineries would only be willing to purchase additional SJV Heavy at a substantial discount to the price Bay Area refiners are willing to pay. (Chevron Op. Br. at 38-40.) As Dr. Cox explained, the combined cost of this discount and transportation rates to Los Angeles is sufficiently high that Chevron would be economically better off paying supracompetitive rates on the Shell Pipeline than shifting the SJV Heavy it currently ships on the Shell Pipeline to Line 2000 to Los Angeles.[5] Even the Pipeline's own witness, Dr. Verleger agreed. (Chevron Op. Br. at 39; Verleger, Ex. SP-27 at 40.)

Although all the record evidence shows transportation of additional SJV Heavy to the Los Angeles market on Line 2000 is uneconomic in the face of a supracompetitive price increase by the Shell Pipeline (Chevron Op. Br. at 38-40),[6] San Pablo Bay persists in including Line 2000 in its HHI analysis. (SP Op. Br. at 37.) San Pablo Bay does so on the basis of an assertion, without citation and sandwiched between two sentences cited to the testimony of its witness Dr. Verleger: "[B]ecause buyers in the Bay Area and LA both compete to purchase SJV crude, the prices for producers selling to these two regions are <u>likely to be very similar</u>." (SP Op. Br. at 37

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[4] Even though San Joaquin Refinery is not an alternative for <u>additional</u> SJV Heavy, Dr. Cox included it in his HHI to ensure a conservative analysis.

[5] Dr. Cox included ExxonMobil's proprietary pipeline in his HHI to maintain a conservative analysis.

[6] San Pablo Bay suggests Chevron erred in considering the cost of Line 2000, criticizing Dr. Cox because he "argues that because Line 2000 is more expensive for Chevron than San Pablo Bay it is not an economic substitute," and "Dr. Cox simply assumes that because Line 2000 is <u>allegedly</u> more expensive than San Pablo Bay then the two lines must operate in different markets." (SP Op. Br. at 20, 22 (emphasis added).) As the record shows, Dr. Cox neither "assumed" nor "alleged." Rather, he followed the *Merger Guidelines* methodology to analyze the cumulative cost of each potential alternative, including Line 2000, to ascertain whether it would be a competitive alternative in the event of an exercise of market power by the Shell Pipeline. (Chevron Op. Br. at 30; Cox, Ex. Chevron-51, Exs. 5a-j.) In so doing, Dr. Cox determined the cost of using Line 2000 would exceed \$1.94 (Dr. Cox's conservative proxy for the competitive rate plus a 15% increase), and was therefore not a competitive alternative under the *Merger Guidelines*. (Cox, Ex. Chevron-51 at 47-49; Chevron Op. Br. at 38-39.)

(emphasis added).) In fact, Dr. Verleger's testimony is directly contrary. Dr. Verleger testified producers need to discount their crude to find a market in Los Angeles. Looking at the EAI study, Dr. Verleger said, "LA area refiners are unwilling to process additional SJVH at the prices being offered by Chevron. If Chevron were willing to make concessions on the price of SJVH, LA refiners would likely be interested in purchasing additional SJVH." (Verleger, Ex. SP-27 at 39-40 (emphasis added).) Dr. Verleger concluded L.A. refiners could have "profitably processed at least 40,000 bpd of SJVH during 2008, with an average reduction in margin to producers of \$1.65/bbl." (*Id*. at 40.) Of course, the refiners would have demanded at least an offsetting discount of \$1.65 per barrel on the crude price.

San Pablo Bay, however, contends because Chevron has historically used Line 2000 to ship some of its heavy crude (mostly to its own El Segundo refinery), Line 2000 must be available as an alternative for more of Chevron's SJV Heavy. (*See* SP Op. Br. at 22.) This assumption is inconsistent with basic economic principles: San Pablo Bay itself admits, "In economics, there is a concept known as revealed preference, which suggests that the best way to discern the most attractive choice among a series of options is to see how consumers behave. In this case, revealed preference provides insight into the most economic crude slate utilized by refiners." (SP Op. Br. at 26.) Because Los Angeles refiners are already refining the quantity of SJV Heavy that is most economically efficient, they will only accept additional barrels at a discount and this discount renders the total cost of shipping on Line 2000 and selling to Los Angeles refiners uneconomic for the barrels of SJV Heavy Chevron is currently shipping on the Shell Pipeline. (Chevron Op. Br. at 38-40.)

3. The excess capacity on the KLM and CP pipelines demonstrates the Shell Pipeline's market power.

San Pablo Bay makes much of the excess capacity on pipelines from the San Joaquin Valley, in particular the KLM and CP pipelines. (*See* SP Op. Br. at 18, 24, 35-36, 38.) While excess capacity may establish a potential alternative's "technical" availability, it does nothing to assist the Commission in understanding whether the pipeline is an economic alternative that could discipline the Shell Pipeline's market power.[7] As Chevron established, the shortage of light crude for blending and the lack of a market for blended crude in the Bay Area precludes shippers of undiluted SJV Heavy on the Shell Pipeline from economically using the excess capacity on the KLM and CP pipelines.[8] (Chevron Op. Br. at 35-38.) An alternative's excess capacity – or "technical" availability – is beside the point if the alternative cannot be economically utilized.[9] (Cox, Ex. Chevron-51 at 18 (alternative must be both physically usable and economically available).)

Rather than proving there are alternatives to the Shell Pipeline, the excess capacity on the KLM and CP pipelines underlines the Shell Pipeline's market power for two independent reasons. First, that shippers are continuing to pay Shell Pipeline's $1.90 rate when the KLM and CP pipeline rates are more than $0.60 per barrel lower indicates there are significant implicit costs to using these other pipelines that, as Dr. Cox demonstrated, render these alternatives uneconomic. (Chevron Op. Br. 37-38.) Secondly, excess capacity means the Shell Pipeline should be lowering – not raising – its rates. (Chevron Op. Br. at 31.) As Dr. Cox explained, "Even in more capital intensive industries, prices will tend to drop to the variable operating cost when capacity exceeds demand" and "the fact that Shell is imposing [rates based on replacement cost of its pipeline and related facilities] when it faces declining demand and has excess capacity can be seen as another indicator that the Shell Pipeline has market power." (Cox, Ex. Chevron-51 at 26-27.)

[7] That excess capacity exists on the pipelines from the San Joaquin Valley is not in dispute; however San Pablo Bay inflates the amount of capacity available. To state, "pipeline utilization is only about 58%," San Pablo Bay includes the capacity of Plains Line 63, a pipeline that has been out of service since 2009. (SP Op. Br. at 13.) To claim local refineries "process approximately 143.2 MBD of local SJV crude," San Pablo Bay includes both the Santa Maria refinery (which does not process any San Joaquin Valley crude) and the Big West Refinery (which is shut down). (SP Op. Br. at 35.) It also includes the Kern Oil refinery, which does not process any heavy crude.

[8] Although there is no excess capacity on Plains Line 2000, even if there were, the lack of a market for additional SJV Heavy in Los Angeles would still preclude use of this capacity.

[9] San Pablo Bay argues excess capacity on the Shell Pipeline is "one reason Chevron has not analyzed whether adding heaters to KLM is economical," suggesting this somehow indicates the Shell Pipeline lacks market power. (SP Op. Br. at 38.) This assertion ignores David Lee's rebuttal testimony that a detailed analysis was not necessary to know it would be uneconomic to replace the KLM line to provide heated service. (Lee, Ex. Chevron-47C at 23.)

B. <u>San Pablo Bay's Brief Attempts To Divert Attention From Its Failure To Prove The Shell Pipeline Lacks Market Power</u>.

San Pablo Bay's opening brief would have the Commission approve the Pipeline's request for market based rates without requiring that the Pipeline first demonstrate it lacks market power. San Pablo Bay disregards Commission precedent limiting market based rates to public utility pipelines that have shown they lack market power to argue the Commission should ignore the Pipeline's market power since its rates would be "*de minimus*" compared with current refiner and producer profits and because rate increases would eventually be subject to Commission approval. (SP Op. Br. at 41.)

The standard applicable to the Shell Pipeline's request for market-based rates is clear: The Commission may authorize a public utility pipeline to charge market based rates if, and only if, the pipeline first provides "a showing that there are practical alternatives to particular services offered by [the pipeline] such that its initial rates are subject to market discipline." *City of Long Beach v. Unocal California Pipeline Co.*, D.94-05-022, 1994 Cal. PUC LEXIS 380 at **33-34. "The standard approach to determine whether market based rates are appropriate for public utilities is to determine whether there is sufficient competition for the services that the utility is offering to warrant a relaxation of the rules establishing rates for those services based on the utility's historical costs." *In Re Pacific Pipeline Sys., Inc.*, D.96-04-056, 1996 Cal. PUC LEXIS 285 at *59.

The Pipeline's attempt to obtain market-based rates absent such a finding must be denied.

1. San Pablo Bay improperly attempts to use producer and refiner profits to justify its rates in disregard of the Commission's obligation to ensure utility rates are just and reasonable.

San Pablo Bay would have the Commission adopt a new standard to evaluate its entitlement to market based rates: whether the pipeline's market power would significantly impact producers' and refiners' margins and profits. (*See, e.g.*, SP Op. Br. at 34, 38, 40-42.) By attempting to minimize the impact of its transportation rates on "the price that producers like Chevron obtain for their San Joaquin Valley crude oil production" and "the margins of California refiners," San Pablo Bay underscores that it views this proceeding as a "pie-eating" contest to divvy profits between refiners, producers and the pipeline, rather than a ratesetting proceeding to ensure the public utility pipeline's rates are just and reasonable. (SP Op. Br. at 23-24, 34, 41.)

San Pablo Bay claims "the returns earned by the refineries and by Chevron far exceed the returns Mr. Van Hoecke calculates San Pablo Bay has earned." (SP Op. Br. at 42.) As Dr. Cox explained, this inappropriately conflates the value of transportation with the value of the commodity transported and has no bearing on the justness and reasonableness of the public utility's rate:

> [O]utside of differences in how products are transported, we would not expect the price of the transportation service to vary based on the demand of the end-product or the margin that either the distributor or the farmer make on the products. Suppose, for example, that the distributor makes a higher margin on avocados. Dr. Webb's approach would suggest that the 'competitive rate' for transporting avocados should be higher because the distributor is willing to pay more for avocados than for strawberries. This is clearly wrong and contrary to basic competition analysis.

(Cox, Ex. Chevron-52C at 8 (emphasis added).)

Refiner and producer profits are irrelevant to the cost of transportation. Not only are refiners and producers not public utilities subject to regulation, they have made, and continue every year to make, substantial ongoing investments in capital equipment and production infrastructure that far exceed the investment Shell has made in its pipeline over its lifetime. (Chevron Op. Br. 7-8.) The Pipeline does not "contribute capital to maintain production or to make up losses in bad years" and is not entitled to share in refiner and producer profits in good years. (Lee, Ex. Chevron-47 at 3.)

Although San Pablo Bay argues "the San Pablo Bay tariff has no measurable effect on refiner throughput, SJVH production, and prices at the pump – the rate only affects how the profits associated with producing, transporting, and processing SJV crude are split among the producer, pipeline, and refiner" (SP Op. Br. at 23-24), Dr. Cox explained the Shell Pipeline's excessive rates reduce producers' incentives to invest in San Joaquin Valley production. (Cox, Ex. Chevron-52C at 57.) Allowing the Pipeline to capture refiner and producer profits depresses investment and demonstrates the Pipeline has market power sufficient to charge rates in excess of the market value of transportation.

San Pablo Bay's use of current refinery and producer profits to try to justify its rates for transportation is what magicians refer to as "misdirection": San Pablo Bay is attempting to divert attention from its obligation to prove the Pipeline lacks market power and instead to cause the Commission to focus on the current economics of the utility's customers. While it is understandable that San Pablo Bay would want to shift the Commission's attention, it cannot evade this Commission's obligation to ensure the Pipeline's rates are just and reasonable.

2. Contrary to San Pablo Bay's belief, the Commission's ongoing regulation is not a substitute for the Shell Pipeline proving it lacks market power.

While in one breath conceding the Pipeline could receive market rates only if it first establishes it lacks market power (*e.g.*, SP Op. Br. at 10, 22), San Pablo Bay argues in the next that the Commission should ignore the Pipeline's market power since any supracompetitive rate increases will, eventually, be subject to Commission approval and refunds: "Even assuming *arguendo* that San Pablo Bay possesses market power, the Commission's continuing regulatory oversight would preclude any attempt by San Pablo Bay to exercise such market power by charging supra-competitive rates." (SP Op. Br. at 33; *see also id.* at 3, 4, 11.)

The law is clear that the Commission must ensure that the pipeline lacks market power <u>before</u> authorizing market based rates. *City of Long Beach v. Unocal California Pipeline Co.*, D.94-05-022, 1994 Cal. PUC LEXIS 380 at **33-34; *In Re Pacific Pipeline Sys., Inc.*, D.96-04-056, 1996 Cal. PUC LEXIS 285 at *59. Following this, the Commission in both *Unocap I* and *Pacific Pipeline* – two cases on which San Pablo relies for other purposes – engaged in comprehensive analyses to ensure the pipeline lacked market power before authorizing market rates.

San Pablo Bay seeks to circumvent this standard, arguing, "Even if San Pablo Bay possesses market power . . . any attempt to extract excessive 'rents' from its shippers would be readily checked by the anticipated exercise of the Commission's regulatory oversight and shippers' access to Commission process." (SP Op. Br. at 3.) San Pablo Bay's position would render meaningless the Commission's decisions in the *Unocap I* and *Pacific Pipeline* cases as well as the substantial resources already devoted to evaluating the Pipeline's market power in this proceeding. In arguing that it "fully recognizes that it is the Commission's role – and not the market's – to 'discipline' rates charged for its public utility pipeline services" (SP Op. Br. at 11), San Pablo Bay ignores that it cannot receive market based rates unless it shows both the market <u>and</u> the Commission will discipline its rates.

San Pablo Bay's argument also ignores the implications of Public Utilities Code Section 455.3. The Legislature added this section to the Code after the Commission observed in *Unocap II*, "Any increase or decrease in those [authorized] rates will require further Commission review and approval." *City of Long Beach v. Unocal Cal. Pipeline Co.,* D.96-04-061, 1996 Cal. PUC LEXIS 280 at *6 ("*Unocap II*"). Today, Section 455.3 would allow the Pipeline to unilaterally increase its rates by 10% every 12 months without any Commission review or approval until after the fact – likely years after the fact. Pub. Util. Code § 455.3 (b)(5). To see the implications of San Pablo Bay's suggestion that ongoing regulation is an adequate "fail safe" in the face of the Pipeline's market power, consider this hypothetical. Assume San Pablo Bay's proposed $2.04 rate goes into effect on December 1, 2010. Under Section 455.3, the Shell Pipeline's future rate trajectory could look like this:

Date	Rate
December 1, 2010	$2.04
January 1, 2011[10]	$2.244
January 1, 2012	$2.468
January 1, 2013	$2.715

Thus, in little more than two years, the Pipeline could increase its rate to the $2.70 Dr. Webb claimed to be the "competitive rate." While shippers would be entitled to challenge the rates and could eventually receive refunds, such a challenge is a resource and time-intensive process, as the present proceedings and the SFPP litigation (C.97-04-025, et al.) have illustrated all too clearly. In the mean time, each of the Independent Shippers would bear the cost of a rate increase that is the product of the Shell Pipeline's market power.

C. The "Additional Empirical Evidence" San Pablo Bay Cites Does Not Demonstrate The Shell Pipeline Lacks Market Power Or Is Entitled To Market-Based Rates.

Under the heading "Additional Empirical Evidence," San Pablo Bay's opening brief argues the "market adjustment" in the Chevron/Tesoro crude sale contract; Chevron's posted prices at Coalinga; the 2005 decision of the Texas arbitrator; refinery and production field economics; and comparison with other Commission-approved market-based rates support its request for market-based rates. Putting aside that none of these issues go to the core question whether Chevron could economically divert its undiluted SJV Heavy from the Shell Pipeline in the face of a supracompetitive price increase, each ignores overwhelming contrary evidence. Refiner and producer economics were discussed above in Section II.B.1. San Pablo Bay's comparison with other pipeline's rates is addressed in Section IV.D.1 below. The remaining claims are discussed in the next three subsections.

[10] Section 455.3 only allows a rate increase every 12 months. Since the Shell Pipeline has not previously had a rate on file with the Commission, even though the $2.04 represents an increase over the rate it has been charging, the Pipeline could take the position the application of Section 455.3 is limited to tariffed rates.

1. San Pablo Bay continues to mischaracterize the contractual market adjustment.

The evidence shows the market adjustment is part of the price of the crude oil and not a transportation charge. (Chevron Op. Br. 31-32.) Ignoring this substantial body of evidence, San Pablo Bay continues to rearrange the order of the contract terms; continues to argue that the $0.80 market adjustment in the Chevron/Tesoro contract is part of the price of transportation; and continues to insist, "Chevron's $0.80 'Market Adjustment Fee' that it charges Tesoro is conclusive evidence that San Pablo Bay's proposed tariff is not above the competitive level."[11] (SP Op. Br. at 43-44.) San Pablo Bay's opening brief even claims the posted price is "the price for which Chevron and other producers are willing to sell the oil in the San Joaquin Valley" (SP Op. Br. at 44 (emphasis added).), although all the record evidence is that the posted price is the price at which the company is willing to buy – not sell –crude oil, a fact even Dr. Webb conceded. (Webb/SP, Tr. 108:17-20; *see also* Lee, Ex. Chevron-47 at 14.)

San Pablo Bay's argument regarding the market adjustment underscores yet again its view of this proceeding as a "big pie-eating contest," and the Pipeline's determination to get a bigger "slice of the pie." San Pablo Bay claims the market adjustment is a "pass-through charge from Chevron to Tesoro," and "Chevron could have paid STUSCO up to $2.70 and essentially been indifferent." (SP Op. Br. at 44 (emphasis added).) This assertion is false and supported by no evidence. In fact, Chevron would never be indifferent. The market adjustment in that crude sale contract is part of what Tesoro paid Chevron for the crude and is not a third-party charge Chevron simply "passed through" to Tesoro. Chevron would not be indifferent if Tesoro were required instead to pay that market adjustment to the Shell Pipeline.[12]

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[11] San Pablo Bay raises a new argument for the first time in its opening brief that "The fact that the $0.80 'market adjustment' remained static and in place for the duration of a 16-month contract contradicts the expected argument that the 'market adjustment' is intended to compensate Chevron for short-term variations in crude prices." (SP Op. Br. at 44 n. 100.) Since there is no evidence supporting this novel premise, it should be afforded no weight. As Dr. Cox explained, the market adjustment can be understood in part as a premium a refiner is willing to pay for a long-term contract to guarantee a steady supply. (Cox, Ex. Chevron-52C at 10.)

[12] Tesoro might be indifferent in this specific transaction if the transportation charge were $2.70 and the market adjustment were zero. Tesoro would not, however, be indifferent in a transaction where the agreed market adjustment was less than $0.80.

Beyond its fallacious "indifference" argument, San Pablo Bay ignores the substantial evidence proving in the real world the market adjustment is part of the price of crude. This evidence includes: data from Telerate showing that most crude sales occur at a P+ or P- to the posted price; the Chevron/STUSCO crude sale contract in which STUSCO agreed to an $0.80 market adjustment in a sale of crude at the lease with no transportation; the fact that Chevron pays lease royalties calculated on the posted price plus market adjustment; and Dr. Webb's concession that crude oil traders would be expected to try to sell crude for more than they would be willing to buy it (the posted price). (Chevron Op. Br. at 32-34.)

2. The discount at which Chevron sells crude to Shell at Coalinga establishes the Shell Pipeline possesses market power.

San Pablo Bay continues to argue Chevron's <u>posted prices</u> at Coalinga, where the Shell Pipeline is the only pipeline connection, show the Pipeline does not possess market power. (SP Op. Br. at 46.) In so arguing, San Pablo Bay's brief misrepresents San Pablo Bay's Exhibit SP-3 as showing what "Chevron actually collected" for crude sales at Coalinga. (*Id.*) Dr. Webb, the creator of the exhibit, admitted on cross-examination that the posted price data he used might not reflect any actual transactions. (Webb/SP, Tr. 318:16-18.)

In fact, the actual transaction data proves Chevron is discounting its crude sales to STUSCO at Coalinga. Dr. Cox testified Chevron took a discount of $0.15 per barrel on its sales of Coalinga crude to STUSCO, receiving only half the $0.30 premium Dr. Webb testified Coalinga crude should command. (Chevron Op. Br. at 21; Cox/Chevron, Tr. 1321:24-27; Cox, Ex. Chevron-51, Ex. 5e(1), p. 1 ("Private Contract. Includes discount for SJV Heavy from Coalinga."), Ex. 5f ("Discount for SJV Heavy Delivered at Coalinga"), Ex. 5j ("SJV Heavy from Coalinga is subject to a discount").) Contrary to San Pablo Bay's claim based on posted prices, the actual sales transactions at Coalinga prove the Shell Pipeline possesses – and has exercised – market power.

3. The Texas arbitrator's 2005 decision has no bearing on whether the Shell Pipeline's rate is just and reasonable.

San Pablo Bay proffers the rate set in the 2005 Texas arbitration as "support[ing] the validity of San Pablo Bay's proposed market-based rate of $2.04."[13] (SP Op. Br. at 39.) Implicit in this statement is the assumption the rate set in the Texas arbitration represents a reasonable "market" rate. Given the standard applied in that arbitration, it could only be evidence of a "market" rate if one further <u>assumes</u> (contrary to the evidence) the Shell Pipeline does not possess market power.

The contract governing the 2005 arbitration has two provisions relevant to San Pablo Bay's argument: (1) the governing law provision; and (2) the "commercial rates" provision. (Ex. Chevron-37.) The governing law provision provided as follows:

> 16. APPLICABLE LAW
>
> THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF TEXAS WITHOUT GIVING EFFECT TO ITS CONFLICT OF LAW RULES.

Under this provision, it did not matter that the Pipeline is located in California and provides solely intrastate service from producers in California to refineries in California. The terms of the contract were governed and interpreted according to Texas – not California – law.

The "commercial rates" provision, which contained the substantive guidance for the arbitration, provided as follows:

> 4. COMMERCIAL RATES
>
> Equilon will make transportation pursuant to the Agreement available to Texaco [Chevron's predecessor] at location differential rate terms and pipeline loss allowance terms <u>no less favorable than the commercial terms offered or agreed to by third parties for transportation</u> on those same proprietary pipelines for similar movements and similar volume commitments at that time. (Emphasis added.)

[13] San Pablo Bay continues to mischaracterize Chevron witness Lee's prepared testimony to claim Chevron considered the $1.69 rate "favorable" (SP Op. Br. at 40), even though Lee said no such thing (Lee, Ex. Chevron-47C at 11-12), as his oral testimony made abundantly clear. (Lee/Chevron, Tr. 1134:5-14; *see* Chevron Op. Br. at 19.)

Under this provision, the only inquiry for the arbitrator was the commercial terms "offered" by Shell or "agreed to" by a third party. It did not matter if the offer or the agreement were the product of an exercise of market power. It did not matter if the offer or the agreement were unjust and unreasonable under the standards applied by this Commission. The relevant inquiry was circumscribed in a way having more to do with the "pie-eating contest" San Pablo Bay is so fond of than the public utility ratesetting with which the Commission is concerned.

In light of this, the only relevance the 2005 Texas arbitration has to the present proceedings is the historical fact that it resulted in the $1.69 per barrel rate the Shell Pipeline charged from April 1, 2005 until it raised the rate to $1.90 effective January 1, 2006. The actual rates charged in 2005 and 2006 as a result tell an interesting story:[14]

Date	**Shipper**	**Delivery Point**	**Rate per barrel**
January 2005	STUSCO	Shell Martinez Refinery	$1.007
	Chevron	Tesoro Avon	$1.09
April 2005	STUSCO	Shell Martinez Refinery	$1.23
	Chevron	Tesoro Avon	$1.69
January 2006	STUSCO	Shell Martinez Refinery	$1.246
	Chevron	Tesoro Avon	$1.90

Thus, what the evidence shows is that the 2005 Texas arbitration marked the point at which the Shell Pipeline began to discriminate in favor of its affiliate to the detriment of the Independent Shippers. The rate differential between STUSCO's shipments to the affiliated Shell Martinez Refinery and Chevron's shipments to Tesoro went from less than eight cents in January 2005 – in line with LaBorne's estimate of the heated differential – to 46 cents in April 2005 and 65 cents in January 2006. The 2005 Texas arbitration does not provide any support for San

[14] SOURCE (for STUSCO rates): January & April 2005 (Ex. Chevron-12C); January 2006 (Ex. Chevron-13C).

Pablo Bay's claim that its current $1.90 rate is just and reasonable or that its proposed $2.04 rate is just and reasonable. (*See also* Section IV.C below.)

III. PROPER COST OF SERVICE ANALYSIS SHOWS THE SHELL PIPELINE'S PROPOSED RATES ARE NOT JUST OR REASONABLE.

Essentially reiterating its view of this proceeding as a "pie-eating contest," San Pablo Bay claims there is no "public policy" interest in regulating the Shell Pipeline and thus the Commission need not scrutinize the evidence with the same rigor as in other settings. (SP Op. Br. at 49-50; *see* Chevron Op. Br. at 13-15.) Instead, San Pablo Bay argues, the Commission should "consider that the Independent Shippers have various alternatives to the use of the [Shell] Pipeline along with the sophistication and resources required to act in and protect their own economic interests." (SP Op. Br. at 50.) As discussed in Section II.A above, the evidence establishes that the Independent Shippers do not have economic alternatives to clear the undiluted SJV Heavy they currently ship on the Shell Pipeline sufficient to defeat the Pipeline's exercise of market power. San Pablo Bay's suggestion that the Commission rely on the "sophistication and resources" of the Independent Shippers rather than Commission oversight to police the Pipeline's conduct signals a desire for a replay of the SFPP Pipeline litigation, some of which has been ongoing for more than 13 years. (*See* C.97-04-025.) Because the Shell Martinez Refinery is indifferent to the transportation rate (*See* Ex. Chevron-4, p. 37), unreasonably high rates allow the Pipeline's affiliate to profit at the expense of the Valero and Tesoro refineries and California consumers and businesses – profits it will never disgorge even if Commission proceedings eventually lead to a rate rollback. There is thus no public policy reason for granting the Shell Pipeline light-handed regulation and good policy reasons for requiring cost of service rate-regulation.

Following its effort persuade the Commission to look upon its proposed rates with indifference, San Pablo Bay makes a deliberate point of not addressing Chevron's testimony. Rather, San Pablo Bay's brief reads as though the only record evidence is its own. Relying on a cost of service showing Chevron and Tesoro already proved to be unreasonable, San Pablo Bay claims its "achieved return" if it gets the rates it wants would be just 9.55%, and thus within the range of reasonableness. (SP Op. Br. at 50.) San Pablo Bay's analysis is critically flawed: (1) it relies on a rate base inflated by over $100 million, (2) it depends on unreasonably and demonstrably low throughput assumptions that understate earnings, and (3) it assumes unreasonably high operating expenses. In fact, as demonstrated in Chevron's opening brief and again below, the achieved return on the Shell Pipeline's actual investment would be 35.1% – well beyond any return the Commission has authorized or considered reasonable. (Chevron Op. Br. at 67; O'Loughlin, Ex. Chevron-49 (MPO_60) at 76, Figure 13.)

A. The Shell Pipeline Inflated Its Rate Base By Over $100 Million.

Perhaps the most significant flaw in San Pablo Bay's analysis is valuing its rate base using the cost of reproduction new less depreciation ("CRNLD") methodology assuming the Pipeline was dedicated to public service for the first time in August 2007. San Pablo Bay's premise that Equilon dedicated the Shell Pipeline to public service on August 1, 2007 flies in the face of both logic and the evidentiary record. Dedication took place when the Shell Pipeline began providing third party service. The evidence showed, and the Commission found, this was no later than 1996. *Chevron Products Company vs. Equilon Enterprises*, LLC, D.07-12-021, 2007 Cal. PUC LEXIS 631 at *35. The record in that case contained no evidence concerning 2007. Equilon did not voluntarily approach the Commission on August 1, 2007 for approval to begin providing public utility service. Nor did Equilon, as ARCO and Unocap did, voluntarily settle a claim that its assets were dedicated, and thus voluntarily agree to dedicate the assets on a certain date. Rather, based on an evidentiary record the Commission found proved Equilon had been serving the public from 1996 through 2005 (the latest year for which record evidence existed), on July 26, 2007, the Commission held that Equilon, by its past actions, had dedicated the Shell Pipeline to public use.

Matthew O'Loughlin's testimony demonstrated the Shell Pipeline has been recovering its costs from its customers since at least 1996. (O'Loughlin, Ex. Chevron-48 (MPO_1) at 22-23.) Thus, while San Pablo Bay accuses Chevron of attempting "to transfer a portion of the utility investment value to current and former shippers" (SP Op. Br. at 57), the truth is that Chevron's approach allows the Shell Pipeline to continue to recover its investment, where San Pablo Bay's approach would allow the Pipeline to more than double recover its investment from shippers – shippers who have been paying for that investment since well before 1996. As discussed in Chevron's opening brief, the record evidence shows in 1996 an average of 60.6 percent and as high as 82.6 percent of the Shell Pipeline's capacity was devoted to third party service. (Chevron Op. Br. at 70; O'Loughlin, Ex. Chevron-48, MPO_14.) The only reasonable inference from these facts is that the Shell Pipeline began third party service long before 1996. Neither San Pablo Bay nor any other Shell entity has met its burden of proving otherwise.[15]

Moreover, as demonstrated in Chevron's opening brief, San Pablo Bay's recommended approach would unjustly reward Equilon for its years of evading public utility service and further reward Equilon for its years of fighting Commission regulation. Such an approach is not only unfair to shippers but would establish regulatory incentives for others to evade and fight against Commission jurisdiction, rather than to voluntarily submit to regulation. Equilon, unlike ARCO and Unocap, chose to fight against regulation and waited to file a rate case until after Chevron proved, and the Commission held, Equilon was providing public utility service since at least 1996. Equilon cannot now erase that record and base its rates on the false claim that it voluntarily dedicated its assets to the public in August of 2007.

The Commission has a "long-established practice that utility assets are to be valued at depreciated original cost at the time such assets are first dedicated to public service." *Application of Red and White Fleet, Inc.*, D.97-06-066, 1997 Cal. PUC LEXIS 229 at *47 (citing *Application of Southern Pacific Pipe Lines, Inc.*, D.88-11-059, 1988 Cal. PUC LEXIS 738 at *11 and *Application of California Water Service Co.*, D.94-02-05, 1994 Cal. PUC LEXIS

[15] In this ratemaking proceeding, the burden is on the utility to prove its rates are just and reasonable. *Application of Golden State Water Co.*, D.08-01-020, 2008 Cal. PUC LEXIS 5 at *2 ("It is a fundamental principle of public utility regulation that the burden rests heavily upon the utility to prove it is entitled to rate relief and not upon the commission, its staff or any interested party . . . to prove the contrary."). Thus, the burden is on the Shell Pipeline, not Chevron, to prove the just and reasonable rate base, and hence, if the Shell Pipeline wishes to use a method other than original cost ratemaking, to prove the dedication date.

78 at *12.) The Commission should not deviate from that practice absent a compelling justification by the utility. It should certainly not do so in a manner that rewards a utility's evasion of Commission regulation.[16]

B. The Shell Pipeline's Throughput Forecast Is Demonstrably Unreasonable.

One of the more egregious examples of San Pablo Bay's turning a blind eye toward the evidentiary record is its discussion of Kevin LaBorne's throughput forecast. (SP Op. Br. at 58-61.) As demonstrated in Chevron's opening brief, LaBorne forecast 2010 volumes to be 20,000 BPD lower than the average actual volumes for the first four months of 2010.[17] (Chevron Op. Br. at 61-66.) LaBorne did this by committing at least the following errors:

- LaBorne assumed a direct correlation between production decline and throughput decline on the Shell Pipeline. Historically there has been <u>no such correlation</u>.[18]

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[16] San Pablo Bay raises a number of arguments that are nothing more than attempts to relitigate issues already decided in D.07-07-040 and D.07-12-021. First, it argues Shell did not own the pipeline in 1996. (SP Op. Br. at 77.) This is irrelevant; Commission policy does not allow utilities to increase rates or rate base on a change in control.

Second, San Pablo Bay cites a 1994 Court of Appeal decision to claim the Pipeline was not a public utility in 1994. (SP Op. Br. at 77.) That decision addressed an evidentiary record that went no later than 1985. (*See* Stipulation Re: Issues of Fact, filed with the Court on March 22, 1993, at ¶¶ 1-2 (attached as Exhibit 4 to Chevron's Request for Official Notice, filed with the Commission on April 20, 2006 in C.05-12-004).) It thus has no bearing on whether the Pipeline was a public utility in 1996. Moreover, other than on review of a Commission decision, this Commission is not bound by a court order concerning a matter within the Commission's exclusive jurisdiction. *Miller v. Railroad Commission*, 9 Cal. 2d 190, 195 (1937).

Next, San Pablo Bay argues that reference in the *ARCO* and *Unocap I* decisions to the industry's use of "buy/sell" agreements means Shell's "buy/sell" agreements did not constitute public utility service. (SP Op. Br. at 77.) The Commission already held that they do.

Finally, San Pablo Bay argues, without legal citation, that Chevron should be estopped from asserting the Shell Pipeline was in common carrier service as early as 1996 because Chevron signed the "California Proprietary Pipeline Transportation Commitment Agreement," which referred to the line as proprietary. (SP Op. Br. at 77.) The Commission already held the Shell Pipeline is and has been providing public utility service, despite the name of the contract. Neither this Commission nor any court has ever held that the fact that a utility customer could only receive utility service by signing a contract estops the customer from later seeking redress from the Commission.

[17] When confronted with the actual 2010 throughput on cross-examination, LaBorne attempted to deny the facts by asserting the first four months of the year always experience disproportionately high throughput. (LaBorne/SP, Tr. 895:27-896:6.) As shown in Chevron' opening brief, the historical throughput data shows LaBorne was not being truthful. (Chevron Op. Br. at 65-66.)

[18] This fact makes irrelevant LaBorne's belated claim that Chevron's forecast of production decline "validated" his. (LaBorne/SP, Tr.682:11-683:22.)

(O'Loughlin, Ex. Chevron-48 (MPO_1) at 77; O'Loughlin, Ex. Chevron-49 (MPO_60) at 62, figure 9.) San Pablo Bay's brief ignores this fact.

- Even were production decline relevant, LaBorne's production decline forecast was patently unreasonable. Cross-examination revealed that, for each field, LaBorne picked the highest decline rate for the past 10 years and then forecast a decline at that rate for the following two years. (Ex. Chevron-29 (LaBorne's workpaper); LaBorne/SP, Tr. 677:18-682:19.) This allowed LaBorne to forecast an average decline of 9% for each of 2009 and 2010, even though the actual average decline for 2006-2008 never exceeded 4%. (Ex. Chevron-29.) San Pablo Bay's brief includes a table showing LaBorne's forecast (SP Op. Br. at 60), yet makes no mention of his workpaper or cross-examination.
- LaBorne reduced the throughput forecast by 5,000 BPD on the chance the Big West refinery might resume processing SJV Heavy, even though Alon, the purchaser of the refinery, specifically stated it will not do so. (LaBorne, Ex. SP-23 at 14; Exs. Chevron-9, Chevron-10 & Chevron-11; LaBorne/SP, Tr. 693:21-698:1.) San Pablo Bay's brief makes no mention of Alon's purchase of the refinery or its intention not to resume refining SJV Heavy, instead simply referring to an announcement in February that Big West will "reopen." (SP Op. Br. at 18.)
- LaBorne reduced his forecast by another 5,000 BPD on the chance the Commission would prohibit shipment of San Ardo and OCS crudes, even though no party has taken the position that either crude type should be excluded from the Pipeline. (LaBorne, Ex. SP-23 at 16; LaBorne/SP, Tr. 700:2-702:21; Ex. IS-1 at 8:8-9:4 and Att B at 5 (definition of SJVH).) San Pablo Bay's brief fails to acknowledge all parties support continued shipment of San Ardo and OCS crudes and there is thus no reason the Commission would *sua sponte* order the Shell Pipeline to discontinue shipping these crude oil types.

Perhaps recognizing the inescapable flaws in LaBorne's forecast, San Pablo Bay asserts that because O'Loughlin, rather than David Lee, testified about historical and forecast throughput on the Shell Pipeline, Lee somehow agrees with LaBorne's results-oriented analysis. (SP Op. Br. at 62.) If San Pablo Bay truly believed Lee would have supported LaBorne's throughput forecast, it would have asked Lee about it on cross-examination. Regardless, San Pablo Bay cannot ask the Commission to make a factual finding by speculating as to what a witness would have said if asked a question it chose not to ask.

LaBorne's unreasonably low throughput forecast alone understates the Pipeline's projected revenues by more than $15 million at year. (Chevron Op. Br. at 65.)

C. **The Shell Pipeline Includes Non-Recurring And Unreasonable Operating Expenses In its Test Year Forecast.**

San Pablo Bay's brief claims it used operating data limited to 2006, 2007 and 2008, and adjusted 2008 recorded operating expenses "to only reflect anticipated recurring costs, eliminating non-recurring costs associated, among other things, with infrequent events." (SP Op. Br. at 52.) This is not true. For example, the right-of-way expenses San Pablo Bay includes (SP Op. Br. at 63) are one-time expenses expected to be incurred only if the Commission allows Equilon to transfer the Pipeline to San Pablo Bay. These expenses were not incurred in 2006, 2007 or 2008, and, if incurred, will only be incurred once. The litigation expenses are also largely non-recurring expenses, such as the cost of fighting CPUC jurisdiction and the cost of litigating market-power issues; even cost of service litigation is infrequent in the case of pipelines. While San Pablo Bay claims it looked at 2006-2008, its witnesses included 2009 actual expenses, which were much higher, forecast equally high expenses for 2010, and then took the average of 2007 through 2010 legal expenses. (Rathermel, Ex. SP-29 at Ex. HJR-2, Schedule 14; *see* Chevron Op. Br. at 55-56.)

San Pablo Bay also ignores O'Loughlin's testimony demonstrating recovery of the right-of-way conversion and litigation expenses is not just and reasonable, instead dismissing his adjustments as "made simply to reduce operating expenses." (SP Op. Br. at 63.) On the contrary, O'Loughlin's adjustments were based on sound regulatory principles. First, long-standing Commission precedent holds ratepayers must remain indifferent to any change in control, and costs associated with a change in control are thus not recoverable from ratepayers. *Application of Elia Najor*, D.08-09-008, 2008 Cal. PUC LEXIS 383 at *3 ("[T]he Commission requires that any sale of a public utility should not have any net consequences that cause the ratepayer to prefer the seller to the buyer. This requirement is referred to as the 'ratepayer indifference' test. For example, the ratepayer should not be subject to increased rates or reduced service as the result of a change of ownership."). (*See* Chevron Op. Br. at 57.) Second, there is no justification for requiring shippers to pay the Pipeline's costs of fighting Commission jurisdiction or trying to prove it lacks market power and should not be limited to cost of service rates. (Chevron Op. Br. at 56.) These costs provided no benefit to shippers and are properly borne by shareholders alone.

San Pablo Bay also ignores Chevron's evidence concerning the allocation of overhead expenses, apparently planning to address this issue only in its reply brief, when Chevron has no opportunity to respond. As Chevron demonstrated, however, San Pablo Bay's proposed allocation is not supported by competent, auditable evidence and must be rejected. (Chevron Op. Br. at 58-60.)

D. The Shell Pipeline's Cost Of Capital Analysis Is Fatally Flawed.

San Pablo Bay makes an argument in its brief not raised or supported by its cost of capital witness Dr. Teece: Because San Pablo Bay is not an independent company issuing stock and incurring debt in its own name, its ultimate parent company's cost of capital should be imputed. (SP Op. Br. at 64-65.) There are a number of problems with this reasoning. First, San Pablo Bay does not own the Shell Pipeline, Equilon does. Equilon is a company with assets worth billions and annual revenues in the tens of billions of dollars. (O'Loughlin, Ex. Chevron-48C, MPO_44.) There is no evidence that Equilon does not issue its own debt. Moreover, Dr. Vilbert and Mr. Ashton, the only witnesses to have addressed this issue, testified it is inappropriate to impute Royal Dutch Shell's cost of capital to the Shell Pipeline. Rather, the

Shell Pipeline's cost of capital should be estimated by looking at the cost of capital of companies owning and operating assets with similar risks. (Vilbert/Chevron, Tr. 507:12-26, 556:5-16 & 557:16-558:7; Ashton/Tesoro, Tr. 1075:11-18.)

San Pablo Bay continues to assert the Shell Pipeline's risk profile most closely resembles that of global integrated oil companies. The sole support for this position is the testimony of Dr. Teece, the flaws in which Dr. Vilbert exposed. Specifically, Dr. Vilbert demonstrated that:

- Dr. Teece omitted key risks faced by global integrated oil companies, such as the risk of doing business in unstable foreign countries;
- Dr. Teece conflated throughput risks with different risks global integrated oil companies face, such as the risks associated with crude oil exploration and production; and
- Dr. Teece improperly relied on diversifiable risks.

(*See* Chevron Op. Br. at 53-54; Vilbert, Ex. Chevron-23 (MJV_7) at 23-24.) San Pablo Bay's brief ignores Dr. Vilbert's testimony.

Instead, San Pablo Bay belittles Dr. Vilbert's use of master limited partnerships ("MLPs") as a proxy for the Shell Pipeline's cost of capital based on irrelevant distinctions that expose the flaws in San Pablo Bay's reliance on integrated oil companies as a proxy. San Pablo Bay claims the "Independent Shippers' selection of their particular proxy group is principally justified by the fact that the FERC has relied on similar proxy groups in its evaluation of rates for interstate crude oil pipelines." (SP Op. Br. at 65.) This statement is false. Dr. Vilbert used MLPs because they hold assets with similar risk profiles to the Shell Pipeline. (Vilbert/Chevron, Tr. 503:6-26.) Crude oil pipelines have used the same proxy group when filing rate cases with this Commission, and Shell Pipeline witness Van Hoecke himself relied on a comparable proxy group when testifying for Enbridge Energy before the FERC. (Chevron Op. Br. at 72; O'Loughlin, Ex. Chevron-48 (MPO_1) at 28-29; O'Loughlin, Ex. Chevron-49 (MPO_60) at 24.) Finally, this Commission recently accepted this proxy group as reasonable in a crude oil pipeline rate case. *Application of Chevron Pipe Line Co.*, D.08-06-042, 2008 Cal. PUC LEXIS 240 at *5.

San Pablo Bay identifies five attributes it claims differentiate MLPs from the Shell Pipeline. Even a superficial review of these attributes reveals: (1) some are not cost of capital risks; (2) any difference between the MLPs and the Shell Pipeline is dwarfed by differences between the integrated oil companies and the Shell Pipeline; and (3) some are, in fact, attributes the MLPs and the Shell Pipeline share.

The first attribute San Pablo Bay identifies is that the MLPs "are engaged in a variety of businesses in addition to the pipeline transportation of liquid hydrocarbons." (SP Op. Br. at 66.) The record contains no evidence of a difference in risk profile between pipeline transportation of natural gas and pipeline transportation of "liquid" hydrocarbons. San Pablo Bay also ignores the fact that the companies included in Dr. Vilbert's proxy group are all *pipeline* companies, all but one with extensive oil pipeline operations (the one without crude oil transportation business has extensive operations in petroleum products transportation). (O'Loughlin, Ex. Chevron-48 (MPO_1) at 42-44.) To the extent the companies' other businesses are relevant, this differentiates the integrated oil companies far more than the MLPs. The primary business of the integrated oil companies is the exploration and production of crude oil, followed by refining; pipeline transportation is a very small portion of their business. (Vilbert, Ex. Chevron-23 (MJV_7) at 9-10.)

The second attribute San Pablo Bay identifies is that not all of the companies in Dr. Vilbert's proxy group transport crude oil. (SP Op. Br. at 66.) Though it is true that <u>one</u> of the companies in Dr. Vilbert's group does not transport crude oil, that company is still a pipeline company with extensive operations in petroleum products transportation. (Vilbert, Ex. Chevron-23 (MJV_7) at 20-21.) The risk profile of a petroleum products pipeline is comparable to the risk profile of a crude oil pipeline. (*Id.*) It is certainly more comparable than the risk profile of a global crude oil exploration and production company.

The third attribute San Pablo identifies is that the MLPs "are geographically diversified with numerous receipt and delivery points and many shippers." (SP Op. Br. at 66.) As Dr. Vilbert explained, geographic diversification does not affect the cost of capital. (Vilbert, Ex.

Chevron-23 (MJV_7) at 15-17.) In fact, the MLPs are far less geographically diversified than the integrated oil companies. The MLPs operate within the United States and Canada. (*Id*. at 19.) The integrated oil companies operate on land and offshore throughout the world – in Africa, South America, Europe, Asia as well as North America. In any event, the physical location of the Shell Pipeline represents a diversifiable risk and is thus irrelevant to its cost of capital. (*Id*. at 15-17.)

Fourth, San Pablo Bay states MLP's "are relatively insensitive to fluctuations in the price of crude oil." (SP Op. Br. at 66.) This is no basis for distinction as the Shell Pipeline has shown no sensitivity to fluctuations in the price of crude oil. Its rates have gone in only one direction – up – and throughput has shown no spikes or dips based on the price of crude, remaining relatively constant with a rate of decline far less than the rate of decline of San Joaquin Valley crude oil production. (O'Loughlin, Ex. Chevron-49 (MPO_60) at 62, Figure 9.)

Finally, San Pablo Bay attempts to differentiate the MLPs on the ground that they "have annual revenues that are relatively stable and exceed those of San Pablo Bay by a multiple of several hundred." (SP Op. Br. at 66.) As just discussed, the evidence here shows the Shell Pipeline also has stable annual revenues. This is thus not a distinguishing factor, but a factor revealing comparability of the assets. San Pablo Bay itself has no revenue; apparently what San Pablo Bay meant to say was that the MLP revenues exceed those of the Shell Pipeline, which is owned by Equilon. Even if this were relevant (as Dr. Vilbert explained, it is not (Vilbert/Chevron, Tr. 560:2-562:11)), the revenues earned by the integrated oil companies vastly exceed those of the MLPs, and Equilon, which owns the Shell Pipeline, has revenues of tens of billions of dollars, comparable to those of the MLPs. (O'Loughlin, Ex. Chevron-48C, MPO_44.)

In sum, San Pablo Bay has failed to meet the burden of proving the integrated oil companies' cost of capital is a reasonable proxy for the Shell Pipeline's cost of capital, and thus has failed to prove its recommended capital structure and rate of return are just or reasonable.

San Pablo Bay attempts to moot its flawed reliance on the integrated oil companies as a proxy group by claiming, "Chevron's own expert has validated the reasonableness of Dr. Teece's recommendation that WACC of 10% to 11% is the best currently available guide for the Commission to evaluate the reasonableness of San Pablo Bay's achieved returns under its proposed market-based rates." (SP. Op. Br. at 67.) San Pablo Bay does not cite to Dr. Vilbert's testimony or cross-examination to support this proposition. This is because Dr. Vilbert did no such thing; on the contrary, Dr. Vilbert recommended a weighted after tax cost of capital ("WACC") of 9.48 percent, and an after-tax weighted-average cost of capital ("ATWACC") of 8.11 percent. (Vilbert, Ex. Chevron-23 (MJV_7) at 7.) San Pablo Bay distorts Dr. Vilbert's testimony by applying his recommended cost of equity to a different capital structure. (SP Op. Br. at 67.) As Dr. Vilbert testified in rebuttal (testimony San Pablo Bay again ignores), however, if the equity ratio increases, the cost of equity decreases. (Vilbert, Ex. Chevron-23 (MJV_7) at 27-28.) San Pablo Bay's brief improperly adjusts the capital structure without adjusting the cost of equity to claim Dr. Vilbert "validated" its result.

E. The Shell Pipeline's "Policy" Arguments Lack Merit.

San Pablo Bay ends its defense of its cost of service analysis with yet another policy argument, suggesting in essence, cost of service regulation is a waste of Commission resources. (SP Op. Br. at 68.) This policy argument, once again, assumes San Pablo Bay has met its burden of proving the Pipeline lacks market power and its rates are constrained by market forces. Given that the Shell Pipeline not only possesses market power, but has exercised it to the detriment of the Independent Shippers, discriminated and continues to discriminate against the Independent Shippers and repeatedly demonstrated nothing but contempt for Commission regulation, the Commission's resources are well spent ensuring the Pipeline charges only just and reasonable rates. (*See* Chevron Op. Br. at 16-25.)

IV. CHEVRON IS ENTITLED TO A REFUND OF AT LEAST $51.4 MILLION.[19]

San Pablo Bay and STUSCO both make frivolous legal arguments to the effect that, even if the rates the Shell Pipeline charged were not just and reasonable, Chevron is not entitled to

[19] Pub. Util. Code § 734 uses the term "reparations" rather than "refund." Chevron uses the terms interchangeably.

refunds. In addition, San Pablo Bay argues Chevron did not prove the rates the Shell Pipeline charged during the Refund Period were unjust and unreasonable. As with the rest of San Pablo Bay's brief, San Pablo Bay makes its arguments mostly without reference to Chevron's rebuttal testimony, instead acting as though it is not part of the record. On top of that, San Pablo Bay suggests there are flaws in Chevron's cost of service showing, but expressly defers explaining the alleged defects to its reply brief, when Chevron has no opportunity to respond.

Tesoro claims that it, not Chevron, is entitled to refunds for the unjust and unreasonable payments <u>Chevron</u> made to STUSCO.

Chevron responds to each of these arguments below.

A. <u>Ordering A Refund Is Not Illegal Retroactive Ratemaking</u>.

STUSCO argues ordering refunds constitutes illegal retroactive ratemaking. (STUSCO Op. Br. at 17-19.) STUSCO misreads the cases it cites and ignores Public Utilities Code Section 734. Section 734 provides the Commission may order refunds upon finding past rates were not just and reasonable. STUSCO relies upon *Pacific Tel. & Tel. Co. v. Public Utilities Commission*, 62 Cal. 2d 634 (1965). In that case, the Court addressed a situation in which the Commission had approved the utility's rates. Later, the Commission held a second ratemaking proceeding and found the rates it previously approved were not just and reasonable and ordered refunds. *Id.* at 641-642. In reversing the Commission's refund order, the Supreme Court limited its holding to cases in which the Commission had previously approved the utility's rates:

> [W]e have concluded that the legislature has not undertaken to bestow on the commission the power to roll back general rates <u>already approved by it under an order which has become final</u>, or to order refunds of amounts collected by a public utility <u>pursuant to such approved rates</u> and prior to the effective date of the commission decision ordering a general rate reduction.

Id. at *650 (emphasis added). In contrast, the Commission never approved the rates the Shell Pipeline charged from April 1, 2005 and continues to charge today. The holding in *Pacific Tel. & Tel. Co.* is thus inapplicable.

The rule against retroactive ratemaking applies only to rates already approved by the Commission in a final order. This is for good reason. Were the rule as STUSCO contends, it would incent companies such as STUSCO not to file their rates with the Commission because failure to do so would immunize the rates from challenge and allow STUSCO to evade its refund obligation.

Moreover, the Supreme Court's analysis and holding were limited to Public Utilities Code Section 728, which it found to be prospective only. *Id.* The Court did not address Section 734, which provides in relevant part:

> When complaint has been made to the commission concerning any rate for any product or commodity furnished or service performed by any public utility, and <u>the commission has found, after investigation, that the public utility has charged an unreasonable, excessive, or discriminatory amount</u> therefor in violation of any of the provisions of this part, <u>the commission may order that the public utility make due reparation</u> to the complainant therefor, with interest from the date of collection if no discrimination will result from such reparation. No order for the payment of reparation upon the ground of unreasonableness shall be made by the commission in any instance wherein the rate in question has, by formal finding, been declared by the commission to be reasonable. (Emphasis added.)

Thus, except where the Commission has previously found the rates to be reasonable, Section 734 authorizes the Commission to order refunds whenever the rates paid were not just and reasonable.

In any event, even if the Commission lacks authority to retroactively establish the just and reasonable rate for the Shell Pipeline, the Shell Pipeline's rate increases from 2005 through 2007 were imposed without Commission authorization and were thus illegal under Public Utilities Code Section 454 and applicable Commission precedent. (Chevron Op. Br. at 82-84.) Thus, the Shell Pipeline had no authority to charge more than $1.09 per barrel. As Chevron demonstrated in its opening brief, Chevron is entitled to a refund of $51,354,943 for shipments made through January 31, 2010, regardless of whether the Commission chooses to exercise its jurisdiction to determine the just and reasonable rate during the Refund Period.

B. <u>Chevron Is Entitled To Refunds Back To April 1, 2005</u>.

San Pablo Bay argues that, even if the Commission finds the rates the Shell Pipeline has been charging are unjust and unreasonable, Chevron is nonetheless "legally barred from seeking refunds prior to August 1, 2007 when the Commission first declared the SJV Pipeline to be a public utility." (SP Op. Br. at 80.) This argument rests principally on the fallacy that the Shell Pipeline was not a public utility until the Commission declared it to be. It is silly to suggest the only obligation a public utility evading regulation has is to comply with the Public Utilities Code <u>prospectively</u> after it is caught, and San Pablo Bay's position finds no support in fact or law. The definition a "public utility" is not dependent upon a Commission declaration; rather, an entity is or is not a public utility based on its actions:

> "Public utility" includes every . . . pipeline corporation . . .where the service is performed for, or the commodity is delivered to, the public or any portion thereof. . . .
>
> "Pipeline corporation" includes every corporation or person owning, controlling, operating, or managing any pipeline for compensation within this state.

Pub. Util. Code §§ 216(a) & 228.

The Shell Pipeline became a public utility when, by its actions, it dedicated its property to providing service to the public for compensation. The Commission's decision did not cause the Shell Pipeline to be a public utility. Indeed, the Commission has no authority to force a company to become a public utility. Rather, the Commission has jurisdiction, and exercised that jurisdiction in Decisions 07-07-040 and 07-12-021, to adjudicate facts and make a determination whether or not a company, by its own actions, dedicated its assets to public use and thus is a public utility. In this case, the Commission found the Shell Pipeline had been providing service to the public for compensation, and thus was a public utility, at least as early as 1996. *Chevron Products Company vs. Equilon Enterprises*, LLC, D.07-12-021, 2007 Cal. PUC LEXIS 631 at *35. The Shell Pipeline was a public utility, and subject to the requirements of Public Utilities Code Section 451, the moment it began providing public utility service.

San Pablo Bay's position amounts to a claim that the Shell Pipeline was free to charge unjust and unreasonable rates for the public utility service it was providing right up until the Commission issued D.07-07-040. (*See* SP Op. Br. at 80-81.) This is not only contrary to the plain language of the Public Utilities Code, and unsupported by case law, but contrary to public policy. Thus, there is no need, as San Pablo Bay claims (SP Op. Br. at 81), for modification of the effective date of D.07-07-040 to order the Shell Pipeline to pay refunds.

San Pablo Bay's statute of limitations argument is equally without merit. First, San Pablo Bay assumes, without analysis, the two-year statute of Public Utilities Code Section 735 applies. (SP Op. Br. at 81-82.) Since the Shell Pipeline had no rates on file with the Commission, by definition it charged rates in violation of Public Utilities Code Section 494. Under Public Utilities Code Section 736, the statute of limitations for a claim for refunds under Public Utilities Code Section 494 is three years. (Chevron Op. Br. at 81.)

Even if the two-year statute of Section 735 were applicable, Chevron's original complaint, C.05-12-004, tolled the running of that statute. (Chevron Op. Br. at 81-81.) San Pablo Bay argues, without legal authority, that C.05-12-004 cannot have tolled the statute of limitations because it was closed. (SP Op. Br. at 81.) San Pablo Bay misunderstands the nature of tolling. Tolling means the statute of limitations stopped running while C.05-12-004 was pending. That the clock started running again in August 2007 is irrelevant. Chevron filed C.05-12-004 in December 2005, seven months into the limitations period. The statute of limitations then stopped running until July 26, 2007, when D.07-07-040 issued. Chevron filed the current complaint, C.08-03-021, eight months later. The statute of limitations had thus been running for a total of 15 months – nine months less than the two-year limitations period provided by Public Utilities Code Section 735.

Equitable tolling "is a judge-made doctrine 'which operates independently of the literal wording of the Code of Civil Procedure' to suspend or extend a statute of limitations as necessary to ensure fundamental practicality and fairness." *Lantzy v. Centex Homes*, 31 Cal. 4th 363 (2003) (quoting *Addison v. State of California*, 21 Cal. 3d 313, 318-319 (1978)) (holding statute of limitations tolled where plaintiff first filed in federal court and, after federal case was dismissed and statute had run, filed state claim in state court); *see also Bollinger v. National Fire Ins. Co.*, 25 Cal. 2d 399, 405, 411 (1944) ("When claims are honestly made, care should be taken to prevent technical forfeitures . . ."). The doctrine works "to prevent the unjust technical forfeiture of causes of action, where the defendant would suffer no prejudice." *Lantzy*, 31 Cal. 4th at 370.

Courts evaluate three factors to determine whether tolling is equitable: "(1) timely notice to defendants in filing the first claim; (2) lack of prejudice to defendants in gathering evidence to defend against the second claim; and (3) good faith and reasonable conduct by plaintiffs in filing the second claim." *Downs v. Dep't of Water and Power of Los Angeles*, 58 Cal. App. 4th 1093, 1100 (1997) (holding the one year statute of limitations was equitably tolled where the second action "was based on the identical facts and charges" as those of the first action); *see also Collier v. City of Pasadena*, 142 Cal. App. 3d 971, 924 (1983); *Addison*, 21 Cal. 3d at 319. The first factor requires that the plaintiff filed the first claim within the statutory period and provided timely notice to the defendant of the second claim. *See Downs*, 58 Cal. App. 4th at 1100. The second factor requires that "'the facts of the two claims be identical or at least so similar that the defendant's investigation of the first claim will put him or her in a position to fairly defend the second.'" *Id.* (quoting *Collier*, 142 Cal. App. 3d at 925). The final factor requiring good faith and reasonable conduct by the plaintiff is "less clearly defined," but has been determined by courts based on the promptness of the plaintiff's second claim. *See id.*

Chevron satisfies all three factors. Chevron filed a timely complaint with the Commission in December 2005, providing timely notice to Equilon and STUSCO. The Commission bifurcated Chevron's original complaint into two parts, the first considering whether the Shell Pipeline is a public utility and the second, "an appropriate ratesetting proceeding." *Chevron Products Company vs. Equilon Enterprises, LLC*, D.07-07-040, 2007 Cal. PUC LEXIS 331 at *2. The Commission did not conduct the ratesetting in that case, effectively deferring it to the present proceedings. Since Chevron's current complaint for refunds is based on identical facts and charges as its first complaint, Equilon and STUSCO cannot claim to have been prejudiced in their ability to gather evidence to defend against the current complaint. Chevron acted in good faith and reasonably in filing its second action after awaiting the outcome of Equilon and STUSCO's petitions for review in the Court of Appeal and Supreme Court, and then filing its current claim for refunds.

Like the courts, the Commission has applied equitable considerations in deciding to toll the statute of limitations in cases where declining to do so would result in unfairness to the claimant. See *In Re MCI WORLDCOM, Inc. and Sprint Corp.*, D.02-07-030, 2002 Cal. PUC LEXIS 438 at *47. ("We feel justified in invoking the broad powers granted us in § 701, to do all things necessary and convenient in the exercise of our jurisdiction to supervise and regulate public utilities."). The CPUC has even declined to apply a statutory filing deadline where the complaining party in the case was "in the midst of replacing its in-house counsel." *Id.* at 43-44. The Commission has tolled the statute of limitations "[w]henever the commission institutes an investigation." *Investigation of All Counties Express, Inc., et al.,* D.86-11-061, 1990 Cal. PUC LEXIS 1016 at *1. ("[T]he institution of investigation by the commission shall toll the three-year period specified in this section until the commission has rendered its initial decision on the matter."); *see also Application of Pacific Gas and Electric Co.*, D.07-09-041, 2007 Cal. PUC LEXIS 448 at *38 (holding its decision declining to apply the statute of limitations where the Commission had conducted its own investigation was "the right outcome from a fairness standpoint because it provides a remedy to all customers who were adversely impacted by PG&E's backbilling and collection practices during the investigation period"); *Pac. Bell v. AT&T Commc'ns*, D.99-08-015, 1999 Cal. PUC LEXIS 517 (holding the statute of limitations was tolled "for any claim that Pacific may have for monies found by the arbitrator to be owed to Pacific and withheld by AT&T"); *In Re MCI WORLDCOM, Inc. and Sprint Corp.*, D.02-07-030, 2002 Cal. PUC LEXIS 438 at *3 (tolling the statute of limitations in other actions against the applicant pending the outcome of civil case involving three intervenors).

Equilon and STUSCO have not attempted to show any prejudice from the adjudication of Chevron's refund claim in this second complaint proceeding rather than the first. Since they have been on notice of Chevron's claim since December 2005, they could not make such a showing if they tried. As the refund issue is being addressed in this proceeding because of the Commission's decision to separate the issue of public utility status from rate issues, and Chevron has diligently pursued its refund claim in accordance with the Commission's directions, there are compelling reasons for the Commission to toll the two-year statute of Public Utilities Code Section 736 and hold Chevron entitled to refunds back to April 1, 2005.

C. <u>Contrary To San Pablo Bay, Ordering Refunds Would Not "Improperly . . . Abrogate The Terms Of Commercial Agreements."</u>

Though a heading in San Pablo Bay's brief states that an award of refunds would require the Commission to "improperly . . . abrogate the terms of commercial agreements," the substance of the section makes no such argument. Instead, it argues ordering refunds would require the Commission "to abrogate the arbitrator's decision establishing the rates charged for the SJV Pipeline transportation in 2005." (SP Op. Br. at 82 & 83.) This simply reiterates the argument the Commission already rejected in D.07-07-040, and is fatally flawed for at least two reasons. First, as discussed above in Section II.C.3, the arbitrator did not decide, and had no authority to decide, what the just and reasonable rate was. The arbitrator was limited to applying Texas law to interpret the contract between Chevron and Equilon, looking only to rates the Shell Pipeline may have offered to a third party or a third party may have accepted. (Chevron Op. Br. at 19.) Second, and more important, the Commission has exclusive jurisdiction to regulate the rates charged by public utilities; no arbitration can usurp that jurisdiction.

San Pablo Bay cites the Commission's discussion in D.07-07-040 of *Miller v. Railroad Commission*, 9 Cal. 2d 190 (1937), for the proposition that the Commission cannot set aside arbitration awards that predate the date the Commission officially assumes jurisdiction over a utility. (SP Op. Br. at 83.) The Commission's statement in its earlier decision, and *Miller's* holding, are just the opposite. The Commission summarized the holding of *Miller* as follows:

"[O]nce [the] Commission assumes jurisdiction over a public utility, [the] Commission may set aside any prior order or determination of courts in matters coming under the exclusive jurisdiction of the Commission." *Chevron Products Company vs. Equilon Enterprises, LLC*, D.07-07-040, 2007 Cal. PUC LEXIS 331 at *5 n. 1 (emphasis added). By definition a "prior" order is one issued before the Commission assumed jurisdiction. The Commission correctly read *Miller*, which states:

> after the commission has assumed jurisdiction over a public utility for the purpose of administering the law applicable to the activities of the utility, the commission has exclusive jurisdiction over the regulation and control of said utility and may take any action necessary to the proper and complete exercise of this jurisdiction. In the exercise of this jurisdiction the commission may set aside any prior order or determination of the courts in matters coming under the exclusive jurisdiction of the commission.

Miller, 9 Cal. 2d at 195 (emphasis added). The Commission assumed jurisdiction over the Shell Pipeline in D.07-07-040. It may now set aside any prior order. No prior determination, whether by court or arbitrator, precludes the Commission from exercising its exclusive jurisdiction to determine the Shell Pipeline's just and reasonable rates.

D. Chevron Proved The Rates The Shell Pipeline Has Charged Since April 1, 2005 Are Unjust And Unreasonable.

1. The rates charged are unjust and unreasonable compared to the rates charged by other pipelines.

San Pablo Bay's first argument is the Pipeline's rates are not unjust and unreasonable when compared to the rates charged by other pipelines. Though there are two other pipelines transporting crude oil from the San Joaquin Valley to the Bay Area – the KLM and the CP lines – San Pablo Bay does not compare the rate the Shell Pipeline has been charging to the rates those pipelines charged, for the obvious reason that their rates are substantially lower. Instead of comparing the rate to the KLM rate, San Pablo Bay dismisses the KLM line as unheated. (SP Op. Br. at 71.) Thus, when analyzing market power, San Pablo Bay claims KLM is in the same market, but when justifying its rates, San Pablo Bay claims it is not. San Pablo Bay further attempts to dismiss the KLM rate based on LaBorne's unsupported speculation that Chevron Pipe Line kept the rates artificially low. (*Id*. at 71-72.) The one fact San Pablo Bay cannot distort is that the Commission approved KLM's cost of service rates as just and reasonable. San Pablo Bay cannot credibly claim that its rate compares favorably to the rates charged by other pipelines without comparing its rate to the KLM rate.

Though ostensibly addressing the CP rate, San Pablo Bay disregards the rate CP actually charged in 2007 (the year for which San Pablo Bay makes its comparison), and instead uses a distorted calculation to create a fictionalized "rate" – a rate CP has never charged. To do so, San Pablo Bay took CP's 1992 rate, added two cost elements (the cost of heating and the cost of line fill), and then inflated the rate using cost-based inflation metrics for the 15 years between 1992 and 2007. (SP. Op. Br. at 73-74.) As support for this "analysis," San Pablo Bay cites Exhibit SP-45. No witness sponsored Exhibit SP-45. The only witness who testified about it was Peter Ashton, who testified he did not agree with the inflation analysis or with several other assumptions. More importantly, Ashton testified the analysis itself was pointless because "it would also seem to me to more appropriately look at what the UNOCAP rate might be today and do that comparison." (Ashton/Tesoro, Tr. 1045:9-1050:18; *see also* Section IV.D.2(d) below re the appropriate cost of line fill). Contrary to what San Pablo Bay's brief would have the Commission believe, CP's actual rates – not the fantasy rate San Pablo Bay uses to try to justify its rate – have remained <u>unchanged since 1992</u>, as shown by the graphs in Dr. Webb's Appendix J. (Webb Ex. SP-1, App. J.)

After inappropriately dismissing the KLM rate and ignoring the CP rate in favor of a fictional rate based on a calculation supported by no witness, San Pablo Bay compares the Shell Pipeline rate only to the "per mile" rate charged by Plains Line 2000 – a pipeline constructed more than 40 years after the Shell Pipeline and serving a different market (Los Angeles). (SP Op. Br. at 70.) At the time of development, Pacific Pipeline System, Inc., the company that built Line 2000, was owned by Anschutz, Chevron, Texaco and Unocal. *In Re Pacific Pipeline Sys., Inc.*, D.96-04-056, 1996 Cal. PUC LEXIS 285 at *59. Thus, the major San Joaquin Valley crude oil producers were partners in the pipeline project. The parties all entered into financial arrangements to support construction and operation of the pipeline. *Id.* at 622 & 628. The rates were "integrally related" to the financing plan. *Id.* at 628. In other words, the rates were necessary to the viability of the line, which the parties also believed necessary. It is not reasonable to compare the rates on the Shell Pipeline, a much older line that has been recovering its costs for decades, to the rates a newer pipeline needed to finance its construction. As Chevron's David Lee explained:

> [Comparing the Line 2000 and Shell Pipeline rates on a "per mile" basis is] a completely misleading comparison. The Shell Pipeline is 50 years old and, except for any recent capital additions, its owners have recovered their investment and earned a return on it many times over. It travels through primarily flat terrain and rural areas for most of its length. The Line 2000 rate was originally set about 10 years ago with the agreement of the participating shippers for the express purpose of supporting the construction of a new pipeline. Line 2000 travels through rugged terrain (Tejon Pass) and a major urban area (Los Angeles). Suggesting the per mile rate on Line 2000 tells us anything about a reasonable rate on the Shell Pipeline makes as much sense as saying the per square foot price of a brand new high-rise condominium in downtown San Francisco indicates what the per square foot price of a house in Antioch should be.

(Lee, Ex. Chevron-46 at 83.)

When one compares the Shell Pipeline rate to the rates KLM and CP charged – a more reasonable comparison since those lines serve the same markets – the difference is stark. In 2007, the KLM rate from Rio Bravo to the Bay Area was $0.94 per barrel – less than half the Shell Pipeline's $1.90 rate. (Ex. Chevron-8.) Even when one adds LaBorne's twelve cent "market" differential for heated service and five cents for the Shell Pipeline's carrying cost for line fill (using O'Loughlin's line fill cost, which, as discussed below, is the reasonable cost) the difference is still 79 cents per barrel. The comparable rate on the CP line was $0.73 per barrel – also less than half the $1.90 Shell Pipeline rate. (Cox, Ex. Chevron-51, Ex. 5b(11).) Adding the cost of heat and line fill, the total cost on CP is $0.90 per barrel – $1.00 less than the Shell Pipeline rate. Thus, even if other pipelines' rates are relevant (given that there is no competitive market), the rates the Shell Pipeline charged during the Refund Period were not just and reasonable when compared to the rates charged by other pipelines.

2. The PLA charged is unjust and unreasonable.

San Pablo Bay's defense of the Pipeline's historical 0.25% PLA similarly obfuscates the relevant facts. San Pablo Bay concedes the PLA "is a mechanism to account for such losses" as occur "in transit through shrinkage, evaporation or in other ways." (SP Op. Br. at 7 n. 8; *see also* Lee, Ex. Chevron-46 at 24.) Rather than addressing the Pipeline's actual losses, San Pablo Bay points to three Commission-approved tariffs – Plains Line 63, Plains Line 2000 (Pacific Pipeline), and Crimson – it claims include a 0.25% PLA, and argues the 0.25% is "consistent with industry practice." (SP Op. Br. at 72.) San Pablo Bay also claims the Pipeline's reduction of its proposed going-forward PLA to 0.15% is a "gesture of good faith." (*Id.*)

None of the three tariffs supports San Pablo Bay's claim. When it was in operation, Plains Line 63 transported 27° gravity crude, much lighter than the 13° gravity undiluted SJV Heavy the Independent Shippers ship on the Shell Pipeline. (Lee, Ex. Chevron-47C at 19-20.) The losses expected with 27° gravity crude are substantially greater than the losses expected with 13° gravity crude, rendering the comparison meaningless. (*Id.* at 20.) Plains Line 2000, the pipeline with the only transportation rate San Pablo Bay claims justifies its proposed $2.04 per barrel rate, provides for a PLA based on <u>actual losses</u>, but no less than 0.10% and no higher than 0.25%. (Ex. SP-75, Rule 70.C.) In practice, Line 2000 has never charged more than 0.10%. (Lee, Ex. Chevron-46 at 25.) The Crimson tariff (Ex. SP-80) does not indicate what type of crude it transports; since San Pablo Bay did not support this exhibit with any testimony, it is impossible to say it has any relevance to the Shell Pipeline. On the other hand, the KLM pipeline, which serves the same markets as the Shell Pipeline, charges a 0.10% PLA. (Chevron Op. Br. at 49.) From at least 2005 through the present, the Shell Pipeline has charged its affiliated shipper, STUSCO, 0.15% PLA, all the time charging the Independent Shippers nearly twice as much at 0.25%. (Chevron Op. Br. at 23-24.)

Finally, unlike the pipelines whose tariffs San Pablo Bay cites and even KLM and Line 2000, there is record evidence as to the Shell Pipeline's actual losses. They averaged 0.092% from 2006 through 2008, and were even lower in 2009. (Chevron Op. Br. at 79.) From April 1, 2005 through January 31, 2010, the Shell Pipeline charged Chevron alone $7.4 million more in PLA than the Pipeline's actual losses, and Chevron is entitled to a refund of that amount plus interest. (Chevron Op. Br., App. D.)

3. The rates charged are unjust and unreasonable when measured on a cost-of-service basis.

San Pablo Bay claims the following errors in Chevron's cost of service showing for the refund period:

> (i) improper rate base valuation; (ii) overestimated depreciation expenses; (iii) failure to reflect Allowance for Funds used during construction ("AFUDC"); (iv) failure to reflect line fill cost responsibility; (v) improper treatment of Accumulated Deferred Income Taxes ("ADIT"); and (vi) a variety of unreasonable adjustments to San Pablo Bay's TY operating expenses.

(SP Op. Br. at 74-75.) Other than rate base and line fill, San Pablo Bay's brief says nothing more about these alleged errors. Instead, San Pablo Bay writes: "It is not necessary, however, to address all of the COS showing defects. . . . San Pablo Bay anticipates addressing the defects in Complainants' COS showing in full detail in its Reply Brief." (*Id.* at 75 & n. 175.) Despite San Pablo Bay's deliberate withholding of known arguments for its reply brief to prevent a response, Chevron will do its best to anticipate and address San Pablo Bay's arguments here.[20]

(a) Rate Base.

San Pablo's argument regarding "improper rate base" is the same one it makes in connection with the going forward rate, *i.e.*, it is improper to value the Pipeline on the basis that

[20] Even if the Commission were to agree with some of San Pablo Bay's criticisms, the appropriate response would not be to deny a refund, but to reduce the amount to reflect any error the Commission found. For example, if the Commission were to disagree with O'Loughlin's treatment of AFUDC (as discussed below, O'Loughlin treated AFUDC appropriately), the rates the Shell Pipeline charged were still unjust and unreasonable, but the appropriate refund might be $47 million, rather than $48 million.

it was providing public utility service since 1996 or earlier. Chevron has already addressed this argument in Section III.A above.

(b) Depreciation.

San Pablo Bay's contention that Chevron "overestimated" depreciation expense is puzzling since Chevron's calculated depreciation expense is lower, not higher, than San Pablo Bay's. We assume San Pablo Bay meant to claim Chevron understates, not overstates, the depreciation expense. There are two elements to this issue. The first is simply an extension of the rate base argument; at the lower rate base Chevron calculates, the depreciation expense is correspondingly lower. Second, San Pablo Bay may argue O'Loughlin used unreasonably low depreciation rates. Since O'Loughlin used depreciation rates from a depreciation study commissioned by the Shell Pipeline specifically for these assets, this argument has no merit. (O'Loughlin, Ex. Chevron-49 (MPO_60) at 30). O'Loughlin would have used the Shell Pipeline's actual depreciation rates, but the Pipeline refused to produce them in discovery. (*Id.* at 30-31.) As a check, O'Loughlin demonstrated the rates he used compare favorably to the contemporaneous depreciation rates used by other pipelines. (*Id.* at 31-33.) In the absence of information concerning the Shell Pipeline's actual depreciation rates, the ones O'Loughlin used are reasonable.

(c) AFUDC

San Pablo Bay's third contention, that O'Loughlin "fail[ed]" to reflect AFUDC, misstates the nature of the disagreement between the parties. O'Loughlin included AFUDC in his cost analysis. San Pablo Bay's witness Van Hoecke's criticism was that O'Loughlin began AFUDC in 2005. O'Loughlin's approach was appropriate because, regardless of the dedication date, if the Commission grants refunds back to April 1, 2005, 2005 will be the first year cost-based rates will apply to the Shell Pipeline. AFUDC is an adjustment to the rate base balance used to calculate cost-based rates for regulated utilities. (O'Loughlin, Ex. Chevron-40 (MPO_60) at 19-20.) AFUDC consists of capitalized debt and equity financing costs generated between the period in which an investment is made and when the investment is placed in service. (*Id.* at 20.) For unregulated entities, AFUDC is not a relevant balance that is created or analyzed when measuring profit or attempting to recover investment. (*Id.*) The evidence shows that, while charging rates outside of regulation, the Shell Pipeline was recovering its investment. (*Id.*) Such recovery presumably included financing costs. (*Id.*). Because it charged unregulated rates prior to 2005 that recovered part of its capital investment, there is no basis for the Shell Pipeline to recover its prior financing costs from current shippers. (*Id.*)

(d) Line Fill

San Pablo Bay argues line fill should be treated as a component of working capital. (SP Op. Br. at 78.) No witness so testified. To the contrary, San Pablo Bay witness Van Hoecke included working capital in his 2008 base case, but did not include any amount for line fill; the total working capital Van Hoecke included is $86,000. (Van Hoecke, Ex. SP-38 at Ex. RJV-6, Workpaper 1, line 8.)

San Pablo Bay further argues that this treatment is "consistent with the commonly used US GAAP accounting principle which values inventory at its current price." (*Id.* at 79.) Again, no witness so testified. In fact, this claim is not true. GAAP requires valuing inventory at the lower of cost or market. Accounting Research Bulletin No. 43, Chapter 4, Para. 48.

There is a good reason none of the expert witnesses took the position San Pablo Bay now advocates – it is wrong. Line fill is not comparable to inventory. The Shell Pipeline contributed line fill once, the first time it (or its predecessor) put crude oil into the pipeline. After that, shippers put crude oil into the line. Thus, while it is true the specific barrels the Pipeline contributed were pushed out by shipper-contributed barrels long ago, it is a fact that the Shell Pipeline made a single capital investment in line fill long ago; the Pipeline has not purchased crude oil annually to replace the line fill. Line fill is thus not at all like inventory, which is purchased by a company on an ongoing basis.

For this reason, O'Loughlin treated line fill like any other utility investment and valued it at the time the investment was made. To be conservative, O'Loughlin provided a line fill calculation assuming a 1996 dedication date – the latest point in time the Shell Pipeline, and associated line fill, were dedicated to public use based on the record before the Commission. (O'Loughlin/Chevron, Tr. 1199:6-1200:16.) Valuing the Shell Pipeline's contribution of line fill as of 1996 results in a per-barrel cost of $0.0459. (O'Loughlin, Ex. Chevron-50, MPO_93, p. 1.)

To support its contrary position, San Pablo Bay cites Exhibits SP-46, SP-52 and SP-53. (SP Op. Br. at 78.) No witness sponsored these exhibits. Rather, they were merely created and introduced by San Pablo Bay's counsel in cross-examination, though counsel did not actually cross-examine any witness on Exhibits SP-52 and SP-53. The only testimony regarding Exhibit SP-46 is Mr. Ashton's statement that he did not agree with the exhibit (even though San Pablo Bay labeled it as "Based on Mr. Ashton's Base Year Assumptions"). (Ashton/Tesoro, Tr. 1059:4-1063:1 ("I follow what you've done. I don't agree with it, but I follow what you've done.").)

San Pablo Bay's counsel marked Exhibit SP-52, which is labeled "Based on Mr. O'Loughlin's Assumptions," and Exhibit SP-53, which is labeled "Based on Mr. Van Hoecke's Assumptions," but did not ask O'Loughlin (or any other witness) a single question about them. (Tr. 1201:14-1202:7.) On redirect examination, O'Loughlin testified that he "reject[s] the characterization [of Exhibit SP-52] that it reflects my assumptions with regard to the appropriate treatment of the line fill carrying cost calculation. So I think the entire exhibit in and of itself is inappropriate and does not accurately reflect my opinions or assumptions about how that should be done." (O'Loughlin/Chevron, Tr. 1202:14-1203:1.) O'Loughlin explained the basis for his opinion as follows:

> As I described earlier, line fill is contributed to the pipe – if the line fill is going to be contributed by the pipeline, it's essentially the same as the pipeline contributing other assets. And we've – as my testimony reflects, we've valued those assets either at original cost or I've also looked at fair value in terms of 1996, but one does not continually revalue the assets that are in use by the regulated

> utility to reflect changes in those valuations over time, and this applies to line fill as well. This table would appear to attempt to do that, which I believe is inappropriate.

(O'Loughlin/Chevron, Tr. 1203:13-27.) It is a basic principle of regulation that a public utility may not increase its rates (and need not decrease them) as the market value for its assets used in service to the public increases (or decreases). There is no principled reason to treat line fill any differently.

(e) ADIT

As with AFUDC, San Pablo Bay does not explain the nature of the claimed error in O'Loughlin's analysis with regard to ADIT. (SP Op. Br. at 74-75.) Chevron assumes it is the same criticism Van Hoecke made in his rebuttal testimony. Though Van Hoecke claimed O'Loughlin used different depreciation rates for ADIT than for rate base (Van Hoecke, Ex. SP-38 at 27), Van Hoecke did not state whether this alleged error had the effect of understating or overstating cost of service, and did not quantify the alleged error. Van Hoecke thus provides no basis to reject or modify O'Loughlin's refund recommendation.

E. <u>Chevron, Not Tesoro, Is Entitled To Refunds For Unjust And Unreasonable Rates Chevron Paid To STUSCO</u>.

Tesoro takes a novel and unsupported position on refunds: Even though Chevron – not Tesoro – paid STUSCO to transport crude oil, Tesoro claims that Tesoro – not Chevron – is entitled to refunds for the unjust and unreasonable rates Chevron paid. Tesoro gets to this position by claiming it is a third-party beneficiary of the "buy/sell" agreements between Chevron and STUSCO. Tesoro, however, presented no evidence that either Chevron or STUSCO <u>intended</u> Tesoro to be a third-party beneficiary of their "buy/sell" agreements. Rather, Tesoro merely states Chevron has no refinery connected to the Shell Pipeline. (Tesoro Op. Br. at 53.) But Chevron does have production fields connected to the Pipeline. Chevron entered into the "buy/sell" agreements with STUSCO to clear its crude oil production. The one "buy/sell" agreement in evidence requires STUSCO to deliver the crude "into Chevron's connecting pipeline facilities for Chevron's account." (Van Zandt, Ex. Tesoro-27, App. C, p. 1.) That some of that crude may have then been delivered to Tesoro does not make Tesoro an "express" beneficiary, as Tesoro claims. Tesoro cites no case holding a relationship similar to the one here renders a third party an "express" beneficiary.[21]

Tesoro next cites Public Utilities Code Section 453.5. Section 453.5 provides:

> Whenever the commission orders rate refunds to be distributed, the commission shall require public utilities to pay refunds to all current utility customers, and, when practicable, to prior customers, on an equitable pro rata basis without regard as to whether or not the customer is classifiable as a residential or commercial tenant, landlord, homeowner, business, industrial, educational, governmental, nonprofit, agricultural, or any other type of entity. (Emphasis added.)

Tesoro suggests this statute requires the Commission to direct Equilon and STUSCO to pay Chevron's refunds to Tesoro. Tesoro, however, was not the customer, Chevron was. That some of the crude oil Chevron paid to have transported was ultimately delivered to Tesoro does not make Tesoro the Shell Pipeline's customer. Tesoro's interpretation of the Code would lead to absurd results: any time a business customer sought refunds, the Commission would have to look behind the business to determine whether it passed through costs to its customers (and perhaps to whether those customers passed the costs through to their customers). Thus, under Tesoro's interpretation, the Commission would order an electric utility that served a grocery store to pay refunds to the grocery store's customers, rather than the grocery store itself. This is an unsupported (and impractical) interpretation of the statute.

Finally, Tesoro relies on inapposite Commission precedent. Tesoro cites D.94-03-040, in which the Commission ordered PG&E, a public utility, to pass on to its retail customers refunds

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[21] The three cases Tesoro cites (Tesoro Op. Br. at 52 n. 218) are inapposite. *Kaiser Engineers, Inc. v. Grinnell Fire Protection Systems Co.*, 173 Cal. App. 3d 1050 (1985), reversed the trial court's sustaining of a demurrer without leave to amend on the basis of Lab. Code § 3864 (insulating an employer from indemnity claims unless based on an express written contract). The Court of Appeal held plaintiff agent did not need to be identified by name to come within the terms of the employer's express agreement to indemnify "the Government and its agents." In *Cartwright v. Viking Industries, Inc.*, 249 F.R.D. 351, 356 (E.D. Cal. 2008), the District Court denied a motion to dismiss a class action against a window manufacturer, holding, "Assuming plaintiffs' allegations [that the agreements between the window manufacturer and the window distributors were intended to benefit plaintiffs] are true, plaintiffs have sufficiently alleged facts demonstrating that privity exists between Viking and plaintiffs." *Bleecher v. Conte*, 29 Cal. 3d 345 (1981), is a specific performance case having to do with the covenant of good faith and fair dealing and mutuality of obligation. The phrase "third party beneficiary" does not appear anywhere in the decision.

the FERC ordered interstate pipelines to pay to PG&E. In that case, the Commission exercised its jurisdiction over PG&E, the party receiving the refunds, to require PG&E to pass refunds it received to its ratepayers. Unlike PG&E, Chevron is not a public utility subject to the Commission's jurisdiction. To the extent Tesoro believes it is entitled to some portion of Chevron's refunds, that claim must be based on some contract between Chevron and Tesoro. The Commission has long held it has no jurisdiction to adjudicate contract disputes between private parties, and thus no basis to order either the Pipeline or Chevron to give Chevron's refunds to Tesoro.[22] *E.g.*, *Windmill v. Alco Transportation Co.*, D.86-05-044, 1986 Cal. PUC LEXIS 321 at *9 ("The Commission has no jurisdiction to hear and determine contract disputes.").

V. EQUILON HAS MADE NO ATTEMPT TO JUSTIFY THE TRANSFER OF UTILITY ASSETS TO SAN PABLO OR THE REMOVAL OF ASSETS FROM UTILITY SERVICE.

A. The Commission Should Deny The Request To Transfer Equilon's Public Utility Assets To San Pablo Bay.

San Pablo Bay's opening brief does not address Public Utilities Code Section 851 or the request to transfer Equilon's public utility assets and obligations to San Pablo Bay. Equilon produced no evidence and has not proved the proposed transfer is not adverse to the public interest. Equilon's failure to even address the Section 851 issue underscores the Shell entities' disregard for Commission regulation, in this case, the Commission's Rules of Practice and Procedure and the Commission's statutory duty under Section 851. As Chevron demonstrated in its opening brief, Equilon failed to comply with Rule 3.6 of the Rules of Practice and Procedure, and the proposed transfer is adverse to the public interest because it places the public utility assets in a shell company with a potentially higher risk profile. (Chevron Op. Br. at 102-04.)

[22] In fact, if Chevron had purported to assign its refund claim to Tesoro, the Commission would be precluded from recognizing the claim. *See* Pub. Util. Code § 734 ("no assignment of a reparation claim shall be recognized by the commission except assignments by operation of law as in cases of death, insanity, bankruptcy, receivership, or order of court").

San Pablo Bay will no doubt attempt to respond to Chevron's arguments in its reply brief. This is an area in which Equilon bears the burden of proof, however. Equilon should have presented evidence on the issue and, as Equilon's proxy, San Pablo Bay should have addressed the issue in its opening brief.

B. The Commission Should Not Allow Equilon To Withdraw Any Pipeline Assets From Public Utility Service.

Ironically, after spending two and a half years vehemently denying it had dedicated any assets to public utility service, the Shell Pipeline now asks the Commission to "trust it," claiming it "has identified in detail the assets that comprise the SJV Pipeline facilities that have been dedicated to public utility service . . . [and] various proprietary or idle tanks and truck rack facilities that will be . . . maintained as non common carrier property, i.e., not in public utility service." (SP Op. Br. at 84-85.) San Pablo Bay argues Chevron failed to prove the various tanks and other assets the Pipeline wishes to withdraw from public utility service and retain as "private" are used and useful. (SP Op. Br. at 84-87.) San Pablo Bay confuses the burden of proof. If Equilon wishes to withdraw assets from service, Equilon must prove that they are not used and useful; Chevron has no burden of proof in this regard. Pub. Util. Code § 851; *Application of Pacific Gas and Electric Co*., D.04-03-036, 2004 Cal. PUC LEXIS 89 at *40 ("In a § 851 proceeding, the public utility bears the overall burden of proof that the proposed transaction is in the public interest and will not interfere with the right of the public to adequate service at reasonable rates.").

San Pablo Bay attempts to skirt the burden of proof by claiming these assets were never dedicated to public use in the first place. (SP Op. Br. at 85.) When the Commission granted Chevron's motion for summary judgment in D.07-07-040, it found the Pipeline – the entire Pipeline – to be a public utility. There is no requirement that Chevron separately prove each part of the Pipeline was dedicated. Nevertheless, Mark Georgen, a former Shell employee, testified contrary to the Pipeline's current claim. He said during his tenure with Shell prior to joining Tesoro in 2005, the Pipeline used the same assets for STUSCO's proprietary trading activities and service to third parties. (Georgen, Ex. Tesoro-3 at 5-6.) Even STUSCO concedes the storage tanks and truck racks "have been used to facilitate Shell's overall efforts to <u>maximize its utilization of the pipeline assets</u>." (STUSCO Op. Br. at 15 (emphasis added).) Georgen's testimony, as well as David Lee's, shows how the tanks the Pipeline proposes to keep for its affiliate's private use are used and useful in utility service. (Georgen, Ex. Tesoro-3 at 13-14; Lee, Ex. Chevron-47C at 7-10; *see also* Chevron Op. Br. at 105-06.)

With regard to the truck racks, San Pablo Bay asserts Chevron's position here is inconsistent with that previously taken by its affiliate, Chevron Pipe Line ("CPL"). (SP Op. Br. at 87.) Even were this relevant, it is not true. As the CPL advice letter San Pablo Bay introduced makes clear, before asking for permission to withdraw the truck racks from public utility service, CPL contacted all shippers to determine whether any were interested in using them. No one other than Chevron USA, Inc. ("CUSA") was. (Ex. SP-79 at 3 ("CPL's attempt to find interests of other entities in increased truck capability brought no indication of interest of any entity other than CUSA. . . . CPL states that it disclosed to shippers . . . of its intent to request approval of transfer of the ownership of the New Kettleman Truck Unloading Facility to CUSA. No shipper expressed any opposition to the proposed transfer.") Here, in contrast, Chevron, Tesoro, and Valero all want access to use the Shell Pipeline truck racks, and oppose the Pipeline's effort to keep them for its affiliate's sole use.

VI. <u>CONCLUSION</u>

As demonstrated in Chevron's opening brief and this reply, the Shell Pipeline failed to meet its burden of proving its proposed rates and proposed terms and conditions of service are just and reasonable. Instead, Chevron's evidence showed the Pipeline possesses – and has exercised – market power. As a result, the Pipeline's rates have been – and remain – unjust and unreasonable and its request for "market-based" rates must be denied. As the evidence proved, even after the Commission declared the Pipeline to be a public utility in July 2007, Shell continued to discriminate in favor of its trading and refining affiliates and threatened to shut down the heated service on which Chevron and the other Independent Shippers rely to ship undiluted SJV Heavy.

On these facts, the Commission should deny the Pipeline's requests and rule in Chevron's favor on its complaint as follows:

- The Commission should adopt the transportation rate of $1.34 per barrel for test year 2010 established by Chevron's cost of service showing.
- The Commission should adopt the Independent Shippers' proposed tariff terms and conditions; they are the only terms and conditions that eliminate affiliate preference and put all shippers on an equal footing.
- The Commission should order Equilon and STUSCO to refund to Chevron $51.4 million in overcharges on Chevron's shipments to its Bay Area refinery customers from April 1, 2005 through January 2010.
- Finally, the Commission should deny Equilon's "back door" attempt to withdraw some assets from utility service and to transfer the remainder to its affiliate, San Pablo Bay.

Dated: July 19, 2010

Respectfully submitted,

By: __/s/ Joseph M. Malkin_____________
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PROOF OF SERVICE BY E-MAIL

I am more than eighteen years old and not a party to this action. My business address is Orrick, Herrington & Sutcliffe LLP, The Orrick Building, 405 Howard Street, San Francisco, California 94105-2669. On July 19, 2010, I served the following document:

- **CHEVRON PRODUCTS COMPANY'S REPLY BRIEF**

on the interested parties in consolidated Dockets A.08-09-024, C.08-03-021, C.09-02-007 and C.09-03-027 in this action by electronic mail to the following:

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I declare under penalty of perjury that the foregoing is true and correct.

Executed on July 19, 2010, at San Francisco, California.

/s/ Nancy Lee-Ramos
Nancy Lee-Ramos