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

ARCO Products Company, Mobil Oil Corporation, and Texaco Refining and Marketing, Inc.,)	
)	
	)	Case 97-04-025
Complainants,	)	(Filed April 7, 1997)
)	
)	
v.	)	Case 00-04-013
	)	Case 06-12-031
SFPP, L.P.,	)	Application 00-03-044
	)	Application 03-02-027
Defendant.	)	Application 04-11-017
	)	Application 06-01-015
And Related Matters.	)	Application 06-08-028
)	

OPENING COMMENTS OF TESORO REFINING AND MARKETING COMPANY TO PROPOSED DECISION OF ALJ DOUGLAS M. LONG

INTRODUCTION

Tesoro Refining and Marketing Company (Tesoro) is a substantial shipper of petroleum products on the pipeline system in this State that is owned and operated by SFPP, L.P. (SFPP). Tesoro is also a party in the consolidated rate proceeding that led to a Proposed Decision by ALJ Douglas M. Long on April 6, 2010 in Case (C.) 97-04-025 *et al.* Pursuant to the Procedural Schedule set forth in a Ruling by ALJ Long on April 14, 2010, Tesoro respectfully submits these Opening Comments on the Proposed Decision.

SUMMARY OF TESORO'S POSITION

At the outset of these Comments, Tesoro wishes to express its appreciation to ALJ Long for deciding issues that have been pending before the Commission for thirteen years. As we indicate below, Tesoro believes that the Proposed Decision correctly

resolves major rate issues. We also believe, however, that some corrections should be made to the Proposed Decision's determination of SFPP's capital structure and cost of debt. Additionally, Tesoro respectfully requests the Commission to issue an Interim Order that applies the rulings made in the Proposed Decision by ordering SFPP to reduce its rates immediately and refund certain improper charges to Shippers.

(i) Tax Allowance

First, Tesoro thoroughly endorses the ALJ's determination with respect to the income allowance issue. ALJ Long correctly found that SFPP and its affiliated companies have not been and still are not paying any federal or state taxes with respect to their California pipeline operations.¹ ALJ Long was therefore entirely correct in ruling that SFPP is not entitled to include an allowance for income taxes in its cost of service and thereby charge shippers for an expense that SFPP never incurred.²

The Proposed Decision further correctly declined to endorse the policy statement of the Federal Energy Regulatory Commission (FERC).³ This Commission operates under a different statutory regime from the FERC and is subject to a different set of binding judicial decisions. The California Supreme Court has clearly held that it is impermissible for ratepayers in this state to reimburse public utilities for "taxes the utility has not actually paid."⁴ Regardless of the discretionary policy concerns of the FERC, the California Supreme Court's doctrine properly governs the disposition of the tax allowance in this case.

¹ Decision Resolving Case 97-04-024, Dismissing Application 00-03-044, and Resolving in Part Other Consolidated Proceedings, FoF 4 at p. 38 (April 6, 2010) (hereafter "Proposed Decision of ALJ Long").

² *Id.* CoL 3 at p. 40.

³ *Id.* at pp. 23-25.

⁴ *Southern California Gas Company v. Public Utilities Commission*, 23 Cal. 3d 470, 477 (February 28, 1979) (hereafter "*SoCal* case").

(ii) Capital Structure and Return on Debt

Tesoro respectfully requests that a modification be made in the findings of the Proposed Decision with respect to the capital structure of SFPP and the appropriate cost of debt to be used in SFPP's cost of service.

The Proposed Decision correctly finds that the capital structure of SFPP's parent, Kinder Morgan Energy Partners (KMEP), should be used as the capital structure of SFPP for the purpose of CPUC rate proceedings.⁵ However, the Proposed Decision erred in selecting KMEP's capital structure. Instead of selecting KMEP's *actual* capital structure, the Proposed Decision selected a hypothetical capital structure that KMEP stated that it hoped to attain, but has never succeeded in achieving.⁶ Tesoro believes that the intent of the Proposed Decision was to use an actual capital structure, and therefore the Proposed Decision should be modified.

A similar modification should be made in order to use KMEP's actual cost of debt, including all elements that it treated as long-term debt.

(iii) Interim Relief

As we stated above, Tesoro is most appreciative that the Proposed Decision resolves certain important policy and legal issues in this case. However, those issues were first raised in proceedings that have been pending before the Commission for a considerable period of time. Equally important, the determinations made in the Proposed Decision mean that SFPP has been charging its shippers unjust, unreasonable and excessive rates for over thirteen years.

⁵ Proposed Decision of ALJ Long at p. 33.

⁶ *Id.*

Under the structure of the Proposed Decision, a further mediation will be held followed by further administrative litigation in the event that all outstanding issues are not resolved by the parties.⁷

We respectfully submit that it is inequitable for SFPP to continue to charge unjust and unreasonable rates while these additional proceedings take place. Tesoro further submits that it is unjustifiable for SFPP to retain revenues from shippers which the Proposed Decision recognizes it was never entitled to receive in the first place. Accordingly, in these Comments, we request the Commission to issue an Interim Order that requires SFPP to implement the rulings made in the Proposed Decision by reducing its rates immediately. We also request the Commission to order refunds by implementing the rulings in the Proposed Decision to the cases in the Consolidated Docket. In making this proposal, we are mindful of and take into account the decision of the Supreme Court of California regarding retroactive refunds.

ARGUMENT

A. The Proposed Decision Correctly Finds That SFPP Is Not Entitled to an Income Tax Allowance.

The income tax allowance issue presented in the SFPP cases is remarkably simple.

Under a cost of service rate methodology a public utility is entitled to pass expenses on to ratepayers only if the public utility actually incurs the expense.⁸ In this case there is no dispute as to whether SFPP actually incurs any income tax expense. It clearly does not. SFPP has admitted that neither it nor any of its affiliates pay any

⁷ *Id.* at pp. 37-38.

⁸ *Southern California Edison Company v. Public Utilities Commission*, 20 Cal.3d 813, 827 (May 25, 1978).

income tax to the Federal Government or to any State Government with respect to SFPP's pipeline operations.⁹

The Proposed Decision therefore is absolutely correct in determining that SFPP is not entitled to a tax allowance.

SFPP will undoubtedly claim that the Proposed Decision is inconsistent with the FERC's policy statement regarding the tax allowance that SFPP is permitted to take in its interstate operations. SFPP's contention is correct. The FERC permits SFPP to "presume" that its investors are subject to substantial taxes on SFPP's operations.

However, this presumption is purely theoretical. No one has ever proven, in either a Federal or California state proceeding that anyone has ever actually paid income taxes, let alone whether or how much taxes have actually been paid. The CPUC is not bound by FERC's presumptions, particularly when they defy common sense as well as the decisions of the California Supreme Court. Indeed, the Supreme Court, in recalling *Pacific Telephone and Telegraph Company v. Public Utilities Commission*, found that

"By permitting Pacific to include in its costs a charge for federal taxes greatly in excess of its actual federal tax expense," we reasoned, the commission in effect forced the ratepayers to contribute capital to the telephone system a result wholly at odds with basic principles of ratemaking.¹⁰

Additionally, in the *SoCal* case, the California Supreme Court stated

It is thus elementary regulatory law that the 'return' – i.e. the profit – of the utility is calculated solely on the rate base – i.e., the capital contributed by its investors; the utility is not entitled to earn an additional profit on its expenses, but only to 'recover' them on a dollar-for-dollar basis as part of the rates.¹¹

⁹ Proposed Decision of ALJ Long at pp. 15-27.

¹⁰ 20 Cal.3d 813 at P 827.

¹¹ *SoCal* case at P 476.

We understand that SFPP has claimed both that it needs a tax allowance in order to enable it to attract capital in investment markets and that the revenues provided by the tax allowance are critical in permitting SFPP to expand and maintain the pipeline.

Those arguments are entirely without merit.

If SFPP believes that it cannot attract sufficient capital on the basis of its receipt of its actual capital and operating expenses plus a reasonable rate of return, it has a clear remedy. It can place those facts before the Commission in a rate application and seek a higher rate of return. Of course SFPP will have to justify the rate relief it seeks. Similarly if SFPP believes that it is not receiving sufficient funds to maintain or expand the pipeline through the recoupment of its actual capital and operating expenditures, including of course a reasonable rate of return, SFPP again has a clear and direct remedy. It can file an application with the Commission in which it lays out the facts and demonstrates that it needs a rate increase in order to support the maintenance or expansion of the pipeline. Each of those procedures is entirely proper. What is not proper however, is SFPP's position that it should receive a "cushion" of funds from its shippers to be used at SFPP's sole discretion for an expense that SFPP never incurs and over which the Commission has no supervisory oversight.

A fuller discussion of the income tax allowance and the underlying justification of the Proposed Decision's rejection of any such allowance for SFPP are presented in the brief of ExxonMobil Oil Corporation. Tesoro endorses that position.

We therefore urge the Commission to adopt ALJ Long's ruling with respect to tax allowance issues.

B. The Proposed Decision Correctly Stated the Principles for Determining SFPP's Capital Structure and Cost of Debt, But Inadvertently Misapplied Those Principles.

The Record in this Consolidated Proceeding demonstrates that SFPP does not have any employees and does not issue its own debt.¹² Rather, SFPP's operations are financed entirely by its parent, KMED.¹³ Since KMED is the financing source of SFPP's operations, the Proposed Decision correctly concludes that KMED's capital structure should be used in determining SFPP's permissible rate of return.¹⁴

However, we believe that the Proposed Decision inadvertently misapplied this ruling by selecting a hypothetical KMED capital structure, rather than KMED's actual capital structure.

The testimony in the Record indicates that the KMED capital structure that an SFPP rate of return witness advocated was 60% equity and 40% debt.¹⁵ That capital structure was, however, hypothetical. It was based entirely on KMED's statement that it had established a 60/40 equity to debt structure as the "target" that it wished to achieve.¹⁶ In fact, KMED has never achieved a 60/40 equity to debt ratio.¹⁷

In contrast, KMED's *actual* capital structure as of March 31, 2003 was 44.1% equity and 55.9% debt.¹⁸

Tesoro believes that it was the intention of the Proposed Decision to use KMED's actual capital structure. Tesoro further believes that in determining a rate of return for a

¹² Proposed Decision of ALJ Long at p. 10, Footnote 6 and p. 31.

¹³ *Id.* at pp. 32-33.

¹⁴ *Id.* at p. 33.

¹⁵ *Id.* at p. 30.

¹⁶ Prepared Direct Testimony of J. Peter Williamson on Behalf of SFPP, L.P., p. 2 (July 16, 2003).

¹⁷ Prepared Answering Testimony of Matthew P. O'Loughlin on Behalf of BP West Coast Products LLC *et al.*, p. 19 (August 15, 2003).

¹⁸ Prepared Rebuttal Testimony of J. Peter Williamson on Behalf of SFPP, L.P., pp. 3-4 (September 9, 2003).

regulated public utility, there is no basis for using a hypothetical capital structure that the company has never achieved. We therefore request that the Proposed Decision be changed so as to adopt a capital structure for SFPP for ratemaking purposes of 44% equity and 56% debt.

Tesoro believes that there is a similar error in the Proposed Decision's selection of SFPP's cost of debt. The Proposed Decision correctly states that in addition to using KMEP's *actual* capital structure to determine a rate of return, KMEP's actual cost of debt should also be used in SFPP's cost of service analysis.¹⁹ However, that ruling was not applied in the actual selection of a cost of debt. In Case No. A.03-02-027, SFPP witness J. Peter Williamson proposed a cost of debt of 7.08%, which was the estimate that the Proposed Decision adopted.²⁰ However, the Williamson SFPP estimate is based on 2002 data and is therefore outside the 2003 test period. More importantly, Dr. Williamson's cost of debt estimate excludes certain bonds and commercial paper which KMEP explicitly states is part of its long term capital structure.²¹ In its SEC filings, KMEP stated:²²

We intended and had the ability to refinance all of our short-term debt on a long-term basis under our unsecured long-term credit facility. Accordingly, such amounts have been classified as long-term debt in our accompanying consolidated balance sheet.

It is important to note that the debt that KMEP states in this SEC filing that it classified as long-term debt includes the commercial paper that Dr. Williamson classified as short-term debt. Furthermore, some of the debt that Dr. Williamson excluded related to

¹⁹ *Id.* at p. 33.

²⁰ *Id.*

²¹ Prepared Answering Testimony of Matthew P. O'Loughlin on Behalf of BP West Coast Products LLC *et al.*, p. 21 (August 15, 2003).

²² KMEP SEC Form 10-K, 2005, p. 138.

specific non-SFPP entities, even though the debt was issued by KMEP. A consistent approach to rate of return issues would require these debt instruments to be included as part of KMEP's overall debt because of KMEP's centralized cash management policy that permits the company to pool all cash between entities regardless of the source. In fact, SFPP Witness Thomas A. Turner explicitly included these debt elements in computing SFPP's cost of debt in SFPP's Application in A.03-02-027.²³

For these reasons, Tesoro does not believe that the cost of debt that the Proposed Decision selected reflects KMEP's actual long-term debt. We therefore urge the Commission to use instead KMEP's *actual* long-term cost of debt of 6.41% which shipper witness Matthew P. O'Loughlin correctly calculated for the 2003 test period on the basis of the principles that we have discussed above.

C. The Proposed Decision Should Be Expanded to Include Issues That Can Be Readily Resolved on the Basis of the Present Record.

In view of the extensive time period in which the cases in the Consolidated Docket have been pending before the Commission, Tesoro believes that any issue that can be readily decided on the basis of the current record should be resolved in the final decision that the Commission issues.

We understand that the CCUV shipper group will point out in its Comments that the Commission can readily decide in the context of the Proposed Decision, issues involving the electricity surcharge that SFPP imposed in A.03-02-027 as well as refunds that the current Record indicates should be made with respect to SFPP's operations at Watson Station and the Sepulveda Line. We also understand that the CCUV shipper

²³ Prepared Direct Testimony of Thomas A. Turner on Behalf of SFPP, L.P, p. 17 (July 16, 2003).

group will address the proposed North Line attrition rate adjustment discussed in the Proposed Decision.

Tesoro endorses the comments of the CCUV shipper group.

D. The Commission Should Issue an Interim Order Requiring SFPP to Reduce its Current Rates Immediately and Make Refunds to Shippers for the Period October 24, 2002 to the Present Date.

Tesoro respectfully requests the Commission to implement immediately the determinations of the Proposed Decision as well as any modifications that it makes to the Proposed Decision.

We request that the Commission do so by issuing an Interim Order. As we discuss below, the Interim Order would:

(1) Direct SFPP to file a modification to the cost of service that SFPP submitted to the Commission on January 25, 2010 in Application No. 09-05-014. The modified cost of service would reflect the rulings made in the Proposed Decision as well as any changes made by the Commission to the Proposed Decision.

The Interim Order should require SFPP to reduce its current rates immediately so that the revenues it collects from shippers do not exceed a revenue requirement that is consistent with the Proposed Decision as ultimately approved.

The necessity, if not the urgency of issuing this type of order immediately is vividly demonstrated by the summary of its operations that SFPP filed with the Commission on April 30, 2010.²⁴ That summary indicates that, *according to its own data*, in 2009, SFPP was over recovering its cost of service by \$10 million. In other words, even accepting all of the costs that SFPP claims it has incurred – costs which the

²⁴ Compliance Filing of SFPP/Calnev Pursuant to Decision No. 07-05-061, April 30, 2010.

shippers in this proceeding believe are grossly inflated – SFPP is still receiving significantly more from the rates it charges its shippers than the Commission’s regulations permit.

The SFPP compliance filing indicates that SFPP’s actual jurisdictional revenues for 2009 were \$120.3 million and its cost of service was only \$110.7 million, producing an over recovery of almost 9 percent. However, that cost of service erroneously includes an income tax allowance of \$10.4 million which the Proposed Decision concludes is improper. If an income tax allowance were removed from SFPP’s 2009 cost of service, SFPP’s cost of service falls to \$100.3 million, resulting in an over recovery of \$20 million or 20%. Even without considering any of the other issues in this Docket, such as rate of return or operating expenses, the sheer level of SFPP’s over recovery underscores the importance of the Commission issuing an interim order directing SFPP to immediately reduce its rates.

(2) Direct SFPP to file modifications to the costs of service that it previously filed with the Commission on July 16, 2003 (A.03-02-027), November 9, 2004 (A.04-11-017), and August 25, 2006 (A.06-08-028) in order to reflect the rulings made in the Proposed Decision as well as any changes made by the Commission to the Proposed Decision. This aspect of the Interim Order would require SFPP to make refunds to shippers on the basis of the rulings made in the Proposed Decision as modified by the final decision the Commission issues. The refunds would be based on the actual volume of petroleum products that SFPP shipped. In general, refunds would be equal to the difference between the revenue requirement reflected in SFPP’s modified cost of service filings and the revenues it actually collected.

(3) Specify that if any shipper wishes to contest any portion of the modified costs of service that SFPP files pursuant to the Interim Order or SFPP's determination of the refunds that are due to shippers, the shipper can do so within the scope of the mediation and subsequent adjudication structure that the Proposed Decision establishes.

We discuss below each of the elements of the Interim Order that Tesoro requests the Commission issue and attach an Appendix that elaborates on the specific approach that we believe should be taken to provide refunds to shippers.

1. Immediate Reduction of SFPP's Rates.

We request that the Commission order SFPP to reduce its rates immediately to reflect the rulings made in the Proposed Decision as modified by the decision that the Commission ultimately issues. These reductions would be made by SFPP modifying the cost of service that it most recently filed on January 25, 2010 to reflect the rulings made by the Commission in this Docket. SFPP would then reduce its rates so that it would no longer be receiving current revenues that are in excess of the revenue requirement reflected in that modified cost of service.

The consolidated cases that are the subject of this proceeding have been pending before the Commission for a very long time. In fact, these cases go back to 1997, more than 13 years ago. The history of these proceedings, including the Record of the Consolidated Proceeding, demonstrates that shippers have been contesting the legitimacy of the tax allowance that SFPP has been taking from the very outset. In fact, the tax allowance issue was discussed by the Commission as early as August 6, 1998 as well as in decisions dated June 24, 1999 and September 2, 1999.²⁵

²⁵ *Arco Products Company v. SFPP, L.P.*, 81 CPUC 2d 573 (August 6, 1998) (hereafter "D.98-08-033"); D. 99-06-093; and D.99-09-038.

Similarly, the propriety of the environmental expenses that SFPP has taken and the proper allocation of expenses between interstate and intrastate service was first raised in 1997 and was also discussed in the Commission's 1998 and 1999 Decisions.²⁶ Capital structure issues, including the appropriate return that SFPP should receive, have been pending at least since 2003, when SFPP filed its rate application in A.03-02-027.

The Proposed Decision resolved each of these issues. We expect that the Commission will resolve further issues when it issues its final decision in this Docket. We respectfully suggest that there is no justifiable basis for permitting SFPP to continue to charge its shippers rates that are based on a cost of service that is contrary to the Commission's final order in this proceeding. We also believe that it is improper for SFPP to continue to charge shippers for electricity surcharges that are non-existent or to use a capital structure that differs from KMEP's actual capital structure.

We believe that these prospective rate reductions can easily be made on the basis of the recent comprehensive cost of service that SFPP filed on January 25, 2010.²⁷ A number of the elements of that cost of service include costs that are contrary to the principles stated in the Proposed Decision and the modifications that we request be made to the Proposed Decision. Tesoro therefore respectfully urges the Commission to issue an Interim Order at the same time that it issues a decision with respect to ALJ Long's Proposed Decision in this Docket. The Interim Order should direct SFPP to file a modification to the cost of service that it submitted on January 25, 2010 in order to give current effect to the rulings in the Commission's Final Order. The Interim Order should also state that if the revenue requirement stated in SFPP's modified cost of service is less

²⁶ D.98-08-033 at PP 11-12, 22; D. 99-06-093 at P 5; and D.99-09-038 at P 3.

²⁷ Prepared Rebuttal Testimony of Thomas A. Turner on Behalf of SFPP, L.P., Attachment A (January 25, 2010).

than the revenues that SFPP is currently collecting under its effective rates based on the January 25, 2010 cost of service, then SFPP should immediately reduce its rates consistent with the revised cost of service revenue requirement.

2. Refunds Based on Rulings in the Proposed Decision

In addition to the prospective rate reductions discussed above, SFPP should also be required to refund to shippers the excess revenues it collected from October 24, 2002 to the present.²⁸ We respectfully suggest that these refunds be made in the following manner:

- (1) SFPP has already submitted its costs of service in the dockets that comprise these consolidated proceedings. SFPP should be ordered to submit revisions to those cost of service filings in order to reflect the rulings made by the Commission in response to the Proposed Decision.
- (2) SFPP's revised cost of service submissions would then be used to determine the interim refunds that it makes to shippers. In general, a comparison would be made of the revenue requirement stated in the revised cost of service and the actual revenues that SFPP received. SFPP would use the actual volume of petroleum products it shipped in determining its revenue requirement.
- (3) The refund amount would be the difference between the revenue requirement stated in the revised cost of service and the actual revenues SFPP received.

We discuss below the way these principles would be implemented in the dockets in this consolidated proceeding.

²⁸ As discussed in the Opening Comments of the CCUV shipper group, Tesoro recognizes that the rates for the Sepulveda Line and the Watson facilities will require a different treatment with respect to interim refunds. Tesoro defers to the CCUV shipper group on these issues.

a. SFPP Rate Filing A.03-02-027 (2003)

The first cost of service that Tesoro requests that SFPP modify in order to calculate refunds is the cost of service that SFPP filed with the Commission on July 16, 2003 in Docket No. A. 03-02-027.²⁹

As we pointed out above, there is an earlier docket in these consolidated proceedings. Certain shippers in this proceeding had filed a Complaint against SFPP on April 7, 1997 in Case No. 97-04-025. That Complaint challenged the justness and reasonableness of SFPP's then existing rates. The 1997 Complaint also raised the principal issues that were decided in the Proposed Decision – i.e., the permissibility of SFPP taking an income tax allowance, and the propriety of the environmental costs SFPP included in its cost of service.

Those issues were also specifically referred to in a decision that the Commission issued on June 24, 1999. In that Decision, the Commission held that tax and environmental expenses, as well as the jurisdictional status and rate reasonableness of the Sepulveda Line and the Watson facilities should be litigated and resolved in an evidentiary hearing.³⁰

The Proposed Decision that ALJ Long issued in this Docket, as finally determined by the Commission, will resolve each of the issues referred to in the Commission's 1999 Decision. It is clear that if the rulings made in the Proposed Decision were applied to SFPP's cost of service filing as of the date of the 1997 complaint, it would be evident that SFPP overcharged its shippers by a considerable amount, beginning at least as early as 1997, and is therefore obligated to refund those overcharges.

²⁹ See Exh. No. 104A, Attachment C, Schedule 1.

³⁰ D.99-06-093 at p. 7.

However, the Decision of the California Supreme Court in *Pacific Telephone and Telegraph Company v. Public Utilities Commission* appears to limit the refunds that can be collected in the 1997 Complaint Docket.

In the *Pacific Telephone* case, the Supreme Court held that

[T]he Legislature has not undertaken to bestow on the commission the power to roll back general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a commission decision ordering a general rate reduction.³¹

It would therefore appear that even though the Proposed Decision now finds that SFPP's 1997 cost of service was incorrect and as a result, SFPP charged unjust and unreasonable rates to its shippers, the Commission might be precluded from ordering full rate reductions and refunds because SFPP's rates in effect in 1997 were the same as the rates that the Commission had approved in 1992 as just and reasonable.³²

However, even if that were correct with regard to the rates that SFPP charged in 1997, the Commission is not precluded from ordering refunds of SFPP overcharges from October 24, 2002 to the present date. With respect to those rates, i.e., rates SFPP charged from October 24, 2002 to the present date, the Commission has full authority to order refunds.

There are several reasons why this position is correct.

First, on October 24, 2002, the Commission issued a Resolution that effectively terminated any prior finding that SFPP's rates were just and reasonable.³³

³¹ *Pacific Telephone and Telegraph Company v. Public Utilities Commission*, 62 Cal.2d 634, 650 (April 28, 1965) (hereafter "*Pacific case*").

³² *In Re SFPP, L.P.*, 44 CPUC 2d 200 (May 8, 1992).

³³ C.P.U.C. Resolution O-0043 (October 24, 2002).

In Resolution O-0043, the Commission stated that, “[W]e require that SFPP file a cost-of-service application to support its current rates and show its current return.”³⁴ Significantly, the Commission went on to rule that, “SFPP’s revenues are subject to refund, pending the outcome of the Commission’s decision in its cost-of-service proceeding.”³⁵ This ruling necessarily extinguished the Commission’s previous approval of the rates that SFPP had been charging since 1992. Clearly, the Commission was mindful of the *Pacific Telephone* case when it stated that SFPP’s rates as reflected in the cost of service that it required SFPP to file “will be subject to refund.”³⁶ Resolution O-0043 therefore necessarily removed any prior approval by the Commission of SFPP’s rates as of October 24, 2002 or any finding that they were just and reasonable. This position is supported by the fact that ALJ Long determined in the Proposed Decision that “A.03-02-027 . . . is a general rate case application by SFPP.”³⁷

Other portions of Resolution O-0043 also support this conclusion. For example, in the Resolution, the Commission stated that it required “a justification of SFPP’s current rates.”³⁸ The Commission further stated that:

SFPP should justify its current rates with a cost-of-service analysis that should show 1) development of separate cost based rates for the Watson enhancement facilities and for the 3.6 mile Sepulveda Line, 2) revenues, expense, and rate base for recorded year 2001 and estimated or recorded years 2002 and estimated year 2003 in the same accounts as shown in FERC Form 6, 3) the allocation of revenues, expenses, and rate base between California and other jurisdictions, and 4) a development of rate of return based on the return on equity, return on preferred stock, cost of debt, and a capital structure. The Commission can use the cost of service analysis submitted as a basis for deciding whether the current rates are fair and reasonable.

³⁴ *Id.* at p. 1.

³⁵ *Id.* at p. 11.

³⁶ *Id.* at p. 9.

³⁷ Proposed Decision of ALJ Long at p. 4.

³⁸ *Id.* at p. 7.

* * *

Revenue collected by SFPP from the date of this resolution to the date of the decision in the application will be subject to refund. Making SFPP's rates subject to refund is necessary because 1) we have not made a determination whether SFPP's total rates are reasonable at this time in the above complaints . . .³⁹

On July 16, 2003, SFPP filed a cost of service in A. 03-02-027, as ordered by the Commission in Resolution O-0043. The rulings made in the Proposed Decision that are at issue in this proceeding were specifically directed at this cost of service filing.

According to the Proposed Decision:

Subsequent to C.97-04-025, SFPP filed five separate applications for rate increases: A.00-03-44, filed March 16, 2000, A.03-02-027, filed February 21, 2003; A.04-11-017, filed November 16, 2004; A06-01-015, filed January 26, 2006; and A.06-08-028, filed August 25, 2006. These applications seek a separate and unique increase in retail rates *and were implemented subject to refund* . . .⁴⁰

Second, even if the Commission were to interpret Resolution O-0043 contrary to its express language, there would still be no legitimate basis for contending that the Commission had sanctioned any part of SFPP's rates under review in A.03-02-027 as just and reasonable.

In the C.97-04-025 proceeding, the Commission rejected the shippers' complaint on the basis of a finding that SFPP's revenues of \$77 million were less than the pipeline's 1996 cost of service of approximately \$77.4 million.⁴¹ However, SFPP's 1996 cost of service of \$77.4 million included an income tax allowance of approximately \$5.4 million,

³⁹ *Id.* As the Commission explained in D.98-08-033, the strength of any rate reasonableness determination significantly dwindles after multiple years without any further rate reviews. 81 CPUC 2d 573, 1998 WL 748593 at * 2-3. As reflected in the A.03-02-027 proceeding, this was the first time in over a decade where SFPP's rates were actually being subject to a general rate justification.

⁴⁰ Proposed Decision of ALJ Long at p. 4.

⁴¹ 81 CPUC 2d 573, 1998 WL 748593 at * 16.

which the Proposed Decision correctly finds to be inappropriate.^{42 43} With the income tax allowance removed, the evidence in C.97-04-025 demonstrates that SFPP was over recovering its cost of service or revenue requirement, including a reasonable return, by approximately \$5 million. The ruling made in the Proposed Decision therefore clearly establishes that, as of on April 7, 1997, when the Shippers' Complaint was filed, SFPP's rates could no longer be considered reasonable.

As we pointed out above, the California Supreme Court held in *Pacific Telephone* that the Commission is not at liberty to reduce rates retroactively upon a finding of unreasonableness when the rate under review was previously determined to be reasonable.⁴⁴ Rather, the Commission is required to adjust rates on a prospective basis.⁴⁵ In *Johnson et al. v Santa Clarita Water Company*, the Commission explained how the court's holding was to be applied. The Commission stated that while retroactive relief cannot be granted, the Commission can order that a general rate application be filed so that new rates can then be determined.⁴⁶

That is precisely what the Commission did when it issued Resolution O-0043 on October 24, 2002.

Consequently, the shippers' request for interim refunds does not run afoul of the prohibition against awarding retroactive refunds. Rather, as the record has demonstrated, because of the prohibition, SFPP will retain the windfall it received from charging unreasonable rates from 1997 through October 24, 2002, i.e. the date on which the Commission ordered SFPP to file a general rate application. In accordance with its

⁴² *Id.*

⁴³ Proposed Decision of ALJ Long at p. 27.

⁴⁴ *Pacific* case at P 11-12.

⁴⁵ *Id.*

⁴⁶ 64 CPUC 2d 520, 1996 WL 92875 at * 7.

determination in the *Santa Clarita* decision, the Commission placed all of SFPP's rates as subject to refund from October 24, 2002 to the present date.⁴⁷

In this manner, the Commission acted consistently with the rulings in *Pacific Telephone*. It established a proceeding to fix rates prospectively while protecting shippers and the consuming public from unreasonable rates by implementing a refund mechanism from that date forward. Indeed, any contrary interpretation would be entirely inconsistent with the express language of Resolution O-0043 and would lead to the illogical and unreasonable result of allowing SFPP to reap windfall over recoveries to the detriment of shippers and the consuming public for nearly a decade.

Moreover, the Commission's action in Resolution O-0043 follows established administrative practice in which an agency bases its decision on the policy in effect at the time a regulatory decision is made, and then applies that decision to the time frame in which a case has been pending.⁴⁸ Here, the Commission has correctly determined in the C.97-04-025 proceeding that public utilities, such as SFPP, which do not incur any income tax obligation should not be provided an income tax allowance for a non-existent expense. While the Commission is precluded by the *Pacific Telephone* decision from awarding refunds in the C.97-04-025 proceeding to shippers for the period 1997 through October 24, 2002 based on the unreasonableness of the rates SFPP charged at the time, no such limitation attaches once the next rate proceeding (i.e., A.03-02-027) begins and SFPP's overall rates are addressed.

⁴⁷ C.P.U.C. Resolution O-0043 at p. 12.

⁴⁸ *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947); *see also Molina v INS*, 982 F.2d 14, 22-23 (First Cir. 1992) ("Retroactive application of agency interpretations developed through adjudication is not automatically unlawful. To the contrary, retroactive application of new principles in adjudicatory proceedings is the rule, not the exception. And, agencies have broad legal power to choose between adjudication and rulemaking proceedings as vehicles for policymaking.") (citations omitted).

In other words, once a determination was made in the Proposed Decision and is made in the final decision that the Commission will issue that SFPP's rates in C.97-04-025 were unreasonable, SFPP's rates will lose any cloak of protection granted by the Commission's decision in 1992 approving those rates. This determination, consistent with *Pacific Telephone*, is then applied to the next full SFPP rate review. That full rate review, as we discussed above, was ordered on October 24, 2002 in Resolution O-0043. Therefore, beginning with the A.03-02-027 proceeding, full refunds, as well as interim refunds, are available to shippers since no SFPP rate or any part of an SFPP rate could any longer be considered reasonable under the *Pacific Telephone* doctrine.

Accordingly, based on both the express terms of Resolution O-0043 as well as the Commission's plain past precedent, SFPP should now be ordered to file a modification of its July 16, 2003 cost of service in A.03-02-027 in order to reflect the rulings made in the Proposed Decision as modified by the Commission's final decision. SFPP should then be ordered to make immediate refunds to its shippers on the basis of that modified cost of service filing.

b. Refunds in the Other Cases in this Docket

Over the course of the past decade, SFPP has filed at least seven separate applications for rate increases, most of which was accompanied by a cost of service computation. Some of these cost of service computations applied to all of SFPP's rates across the board; others applied only to specific projects or costs for which SFPP was proposing rate increases. Since the refund calculation needs to take into account each of the rate applications that SFPP made, a process consisting of several different calculations is

necessary. We are summarizing the refund calculation process that we recommend below and are including an Appendix that provides a further detailed explanation.

Beginning in May 2001, SFPP implemented a series of rate increases that were layered on top of each other. In 2003, SFPP started by providing a full cost of service analysis in response to Resolution O-0043. After 2003, each of the subsequent costs of service that SFPP filed was incremental. Therefore SFPP only provided incremental cost of service calculations for the costs or projects in these cost of service filings. On January 25, 2010, SFPP filed its only other comprehensive cost of service since July 16, 2003.

In calculating refunds, we start with the SFPP July 16, 2003 cost of service and request the Commission to order SFPP to file a modified version of that cost of service that reflects the Commission's rulings on the Proposed Decision as modified by the final decision. The next step involves subtracting the revenue requirement stated in the modified SFPP cost of service from the actual revenues SFPP collected. This difference would then be computed in percentage terms as compared to SFPP's actual revenues. The percentage amount would then be applied to the rates that SFPP charged shippers in each origin/destination pair. The difference between the collected rate and the new revised rate would then be multiplied by the actual volumes shipped to determine each shipper's specific refund amount.

This process would be repeated with regard to each subsequent cost of service filing that SFPP submitted. That process involves the subsequent adjusted incremental costs of service to the adjusted full cost of service that SFPP presented in 2003. A full explanation of this refund process is provided in the Appendix.

3. Any Dispute Regarding the Modified Cost of Service That SFPP Files Pursuant to the Interim Order Should Be Subject to the Mediation and Adjudication Processes Described in the Proposed Decision.

Tesoro's objective in requesting the Commission to issue an Interim Order directing SFPP to reduce its current rates and provide immediate refunds is to avoid another protracted period of time in which SFPP continues to charge shippers unlawful rates and retains the proceeds of the unlawful rates it has charged in the past.

Tesoro is therefore willing to accept for the time being the revised cost of service filings that SFPP will submit as well as SFPP's determination of the interim refunds to which shippers are entitled on the basis of those revised cost of service filings. We assume that SFPP will act in good faith.

In fairness, however, shippers should be permitted an opportunity to challenge SFPP's filings and refund determinations if they disagree with them. The Proposed Decision establishes a structure that provides an expeditious vehicle for doing so.

The Proposed Decision directs the parties to engage in mediation with respect to any issue that has not been resolved. In the event mediation is unsuccessful, the Proposed Decision states that the Commission will proceed to adjudicate the matter.⁴⁹ Tesoro requests that the Interim Order provide that any dispute regarding the revised cost of service that SFPP files or the refunds that SFPP determines is appropriate be handled within the context of that mediation/adjudication process.

CONCLUSION

Tesoro wishes to express its appreciation to ALJ Long for resolving important issues that have been pending in the SFPP rate cases for a considerable period of time.

⁴⁹ Proposed Decision of ALJ Long at pp. 37-38.

Perhaps the most important of these issues is the tax allowance that SFPP has been taking, despite the fact that it has not paid any income taxes on its operations and does not at the present pay any such taxes. Tesoro believes that the Proposed Decision correctly finds that SFPP is not entitled to take any such allowance for non-existent costs.

Tesoro also believes that ALJ Long has correctly decided the environmental expenses that SFPP may properly take and the principles on which SFPP's cost of capital should be determined. We believe however that an error was made in applying those principles to the capital structure of KMEP, SFPP's parent, and to SFPP's cost of debt.

Finally, Tesoro strongly believes that SFPP should no longer be permitted to charge shippers rates that the Proposed Decision has effectively determined are unjust and unreasonable. Tesoro therefore respectfully requests the Commission to issue an Interim Order requiring SFPP to reduce its current rates immediately and refund certain excessive revenues, with interest, that it has obtained from its shippers.

Respectfully submitted,

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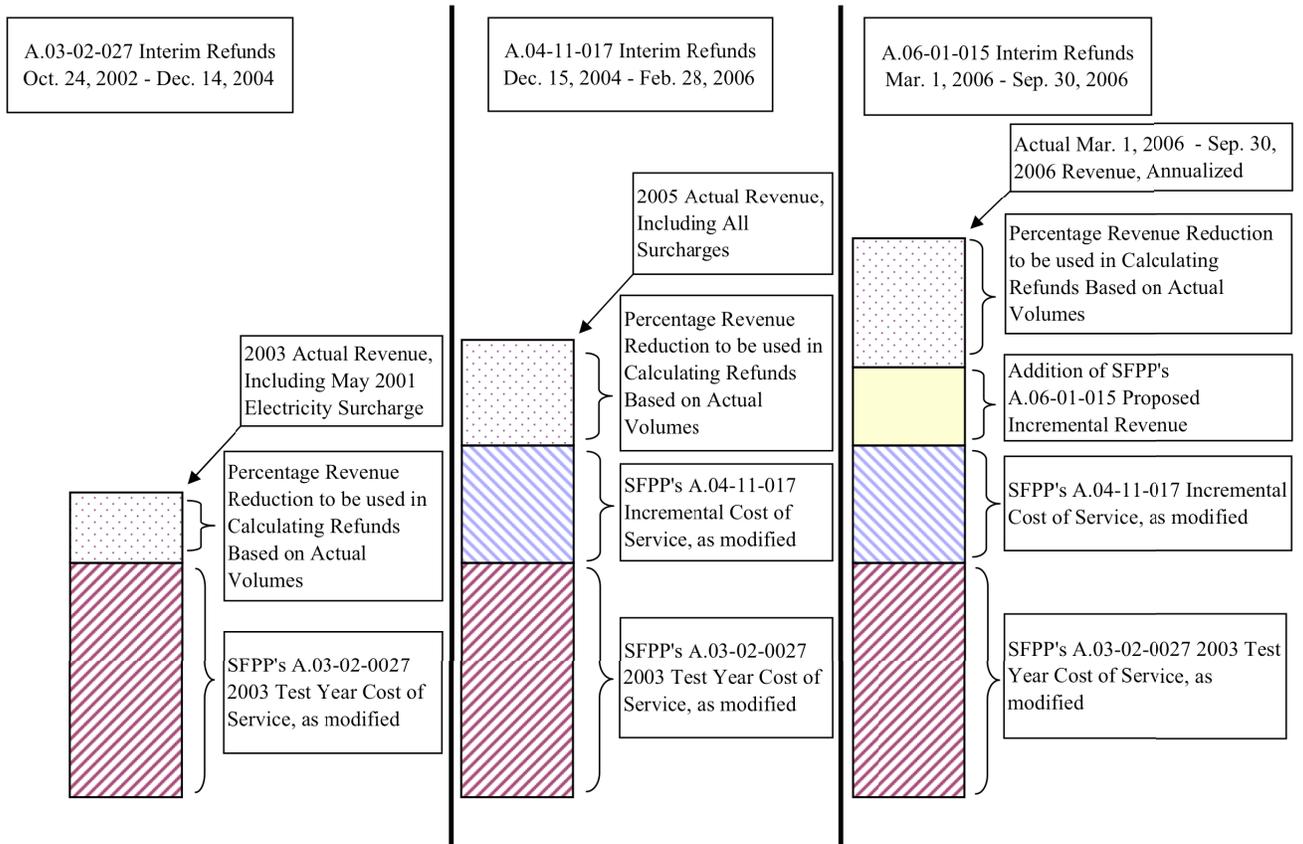
*Counsel for Tesoro Refining and
Marketing Company*

May 3, 2010

APPENDIX

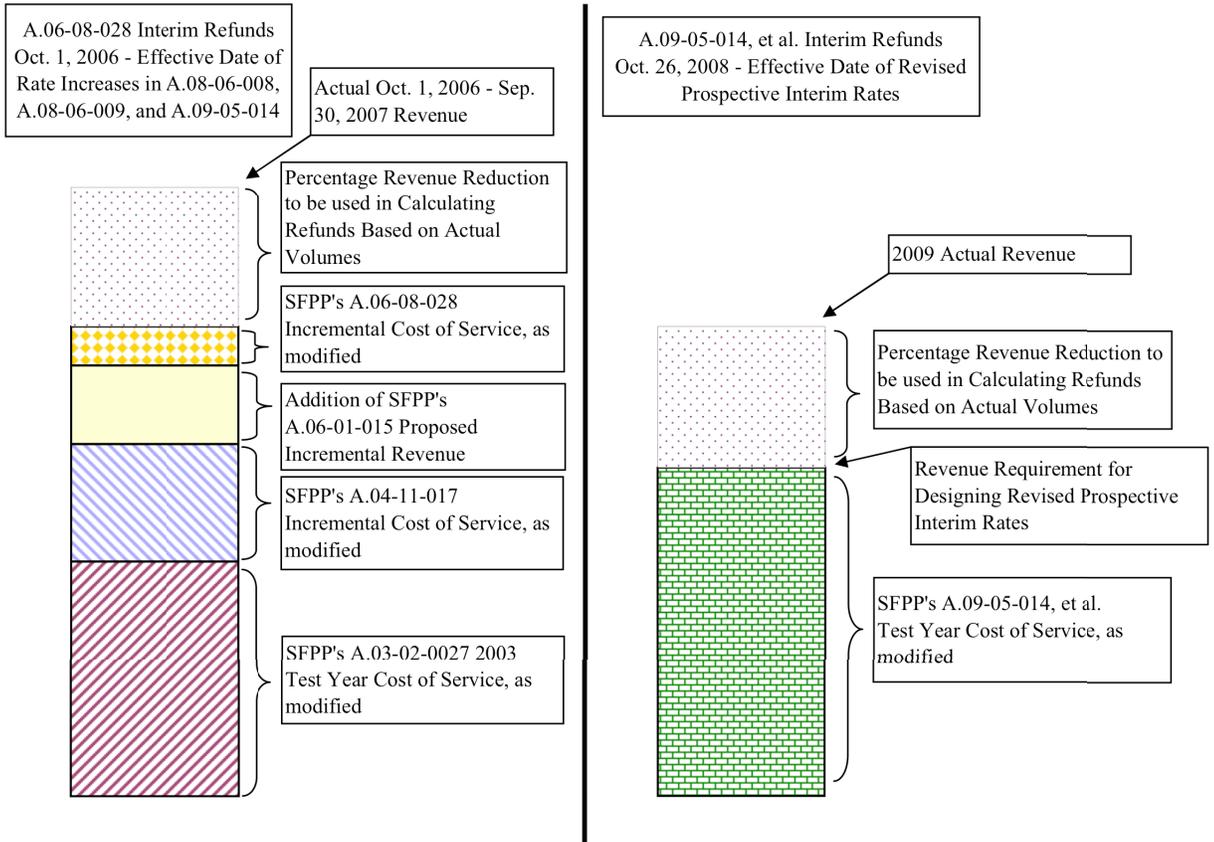
The schematic diagram below depicts the manner in which interim refunds should be calculated.

OVERVIEW OF INTERIM REFUND CALCULATION All Cost of Service Data Modified to Reflect Proposed Decision as Ultimately Approved



OVERVIEW OF INTERIM REFUND CALCULATION

All Cost of Service Data Modified to Reflect Proposed Decision as Ultimately Approved



A. Refund Calculations for the Period October 24, 2002 to December 14, 2004.

The first section of the diagram depicts the way refunds would be calculated for the period October 24, 2002 to December 14, 2004. The rates SFPP collected in 2003 at the time of its July 16, 2003 application in A.03-02-027 included base rates as well as an electricity surcharge it began collecting in May 2001. SFPP's May 2001 electricity surcharge increased rates between different origin-destinations by different percentages. As a result, SFPP's rate increases were not applied uniformly across destinations, nor were the surcharges based on a fully allocated rate design.⁵⁰ Calculating interim refunds despite SFPP's lack of any coherent rate design can nevertheless be accomplished by applying a uniform percent reduction to SFPP's collected rates for each origin-destination combination, and then refunding the difference between the collected rate and the reduced rate. Actual shipper volumes would be used for this purpose. The refund amount would be the difference between the rate SFPP collected from the shipper and the modified rate multiplied by the quantity of petroleum products transported.

In order to calculate a percent reduction in the collected rate for interim refunds, the Commission should direct SFPP to recalculate its 2003 test period cost-of-service as presented in its July 16, 2003 Application, Attachment B, to reflect the Commission's decision in this proceeding. The recalculated 2003 test period cost-of-service should then be compared to the revenue actually collected under SFPP's rates as of the end of 2003. Those revenues would include the May 2001 electricity surcharge and would be based on actual intrastate volumes transported by SFPP (thereby removing any possibility of a dispute regarding the appropriate volumes to use in calculating the interim refunds).

To the extent the collected revenues exceed the revised cost-of-service by the electricity surcharge revenue (*i.e.*, approximately \$6 million a year) the Commission should direct SFPP to refund, with interest, all electricity surcharge revenues collected from October 24, 2002 through the present period.

⁵⁰ A fully allocated cost rate design separates the total cost of service into distance and non-distance related costs, with non-distance related costs consisting of certain types of General and Administrative expenses and all other costs being distance related costs. Then the distance-related costs are allocated to origin-destination combinations based on barrel-miles (with differences in rates driven by the mileage between origin-destination combinations) and the non-distance related costs are allocated on a per barrel basis equally to each origin-destination combination. Therefore, the rates are designed to recover the cost of service given the volumes for each origin-destination combination used to derive the rates.

To the extent, after refunding the electricity surcharge revenue, the collected revenue still exceeds the revised cost-of-service, SFPP should be directed to refund, with interest, the revenues in excess of the cost-of-service collected from October 24, 2002 through the effective date the rates at issue in A.04-11-017 were put into effect, using the same percentage reduction method discussed above.

B. Refund Calculations for the Period December 15, 2004 to February 28, 2006.

On November 9, 2004, SFPP filed an incremental cost of service in A.04-11-07 to implement surcharges to its existing rates to recover costs involved with its North Line expansion project. Here, again, SFPP's proposed rate increases were not uniformly applied to origin-destination combinations. Nevertheless, interim refunds for the A.04-11-017 increased rates can be calculated, based on the combination of the revised 2003 test year cost-of-service in A.03-02-027 as supplemented by a revised incremental A.04-11-017 cost-of-service, by applying a uniform percent reduction to SFPP's collected rates excluding the A.03-02-027 electricity surcharge. The refund would thus be the difference between the collected revenues at the collected rates (minus the A.03-02-017 electricity surcharge) and the revised cost-of-service.

In order to calculate a percent reduction in the collected rate for interim refunds, the Commission should direct SFPP to recalculate its incremental cost-of-service presented in its November 9, 2004 application, to reflect the Decision the Commission issues in this Docket. The recalculated incremental North Line expansion cost of service should then be combined with the revised 2003 test year cost of service and then compared to the revenue collected under SFPP's increased A.04-11-017 rates using the actual 2005 volumes transported on SFPP's intrastate system. To the extent the collected revenue, minus the A.03-02-027 electricity surcharge revenue, is in excess of the combined 2003 test year cost of service plus the revised A.04-11-017 incremental cost of service, the excess revenue, plus interest, should be refunded on the basis of the percentage amount that the collected revenue exceeds the combined costs of service through the effective date of the SFPP rate increase in A.06-01-015.

C. Refund Calculations for the Period March 1, 2006 to September 30, 2006.

On January 26, 2006, SFPP filed an Application in A.06-01-015 seeking an incremental surcharge to reflect alleged anticipated "extraordinary" costs in its annual operating expenses for 2006 to 2008. Once

again, SFPP's proposed rate increases were not uniformly applied to origin-destination combinations. However, interim refunds for the A.06-01-015 increased rates can be determined based on combining the A.03-02-027 and A.04-11-017 costs-of-service and adding the A.06-01-015 increased cost level and by applying a uniform percent reduction to SFPP's collected rates, excluding the A.03-02-027 electricity surcharge in the rates, for each origin-destination combination, and then refunding the difference, plus interest, between the collected rates and the revised and reduced rates.

In order to calculate a percent reduction in the collected rate for interim refunds, SFPP should be directed to compare the combined A.03-02-027 and A.04-11-017 cost of service, plus the proposed A.06-01-015 increased cost level to the revenue actual collected under SFPP's increased A.06-01-015 rates, minus the A.03-02-027 electricity surcharge revenue, using the actual volumes transported on SFPP's jurisdictional system. To the extent the collected revenue, minus the A.03-02-027 electricity surcharge revenue, is in excess of the combined A.03-02-027 and A.04-11-017 cost of service plus the proposed increased A.06-01-015 cost level, the excess revenue should be refunded. The calculation of the refund should be based on the percentage amount that the collected revenue exceeds the combined cost of service through the effective date of the SFPP rate increase in A.06-08-028.

D. Refund Calculations for the Period October 1, 2006 to September 30, 2007.

On August 25, 2006, SFPP filed an incremental cost of service in A.06-08-028 to implement surcharges on its then existing rates based on claimed incremental costs associated with, among other things, transporting ultra low sulfur diesel on its system. Again, SFPP's proposed rate increases were not uniformly applied to origin-destination combinations. And, again, calculating interim refunds on SFPP's A.06-08-028 surcharges can be determined based on the combination of the revised 2003 test year cost of service in A.03-02-027, the revised incremental A.04-11-017 cost of service, plus the proposed A.06-01-015 cost increase and the revised A.06-08-028 cost of service. The calculation involves applying a uniform percent reduction to SFPP's collected rates, excluding the A.03-02-027 electricity surcharge as discussed above, for each origin-destination combination, and then refunding the difference, plus interest, between the collected rates and the revised and reduced rates.

In order to calculate a percent reduction in the collected rate for interim refunds, SFPP should be directed to recalculate its incremental cost of service presented in its August 25, 2006 Application, Exhibit B, to incorporate the Commission's determinations. The recalculated incremental A.06-08-028 cost of service should then be combined with the revised 2003 test year A.03-02-027 cost of service, A.04-11-017 incremental cost of service, and the A.06-01-015 proposed cost increase, and then compared to the revenue collected under SFPP's increased A.06-08-028 rates using the actual volumes transported on SFPP's jurisdictional system. To the extent the collected revenue under the A.06-01-015 proposed cost increase, minus the A.03-02-027 electricity surcharge revenue, is in excess of the combined A.03-02-027, A.04-11-017, and A.06-08-028 incremental costs of service, this excess revenue, plus interest, should be refunded calculated on the percentage amount that the collected revenue exceeds the combined costs of service through the effective date of SFPP's rate increase in A.08-06-008 and A.08-06-009 and A.09-05-014.

E. Refund Calculations for the Period October 26, 2008 to the Date on Which New Interim Prospective Rate Reductions Are Implemented

SFPP's A.09-05-014, et al. proceedings involve two separate cost increases filed on September 26, 2008 and May 12, 2009. SFPP's cost increases were made effective October 26, 2008 and June 12, 2009, respectively. On January 25, 2010, SFPP submitted a comprehensive cost of service to justify both of its proposed cost increases. As a result of SFPP's comprehensive cost-of-service filing, there is no need to any longer combine prior costs of service. Rather, to calculate interim refunds, SFPP should be directed to file a revised January 25, 2010 cost of service that implements the Commission's determinations in this Docket. Then, SFPP should be directed to compare its actual 2009 revenues with the revised January 25, 2010 cost of service. To the extent the actual 2009 revenues exceed the modified January 25, 2010 cost of service, SFPP should be directed to provide interim refunds, plus interest, based on the actual volumes transported, from October 26, 2008 up to the date the new reduced rates are placed into effect. These refunds would be calculated on the same percentage reduction and origin-destination pair basis discussed above with respect to A.03-02-027.

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

ARCO Products Company, Mobil Oil Corporation, and Texaco Refining and Marketing, Inc.,)	
)	
	)	Case 97-04-025
	)	(Filed April 7, 1997)
Complainants,)	
)	
	)	Case 00-04-013
v.	)	Case 06-12-031
	)	Application 00-03-044
SFPP, L.P.,	)	Application 03-02-027
	)	Application 04-11-017
Defendant.	)	Application 06-01-015
	)	Application 06-08-028
And Related Matters.	,	

CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of:

**OPENING COMMENTS OF TESORO REFINING AND MARKETING
COMPANY TO PROPOSED DECISION**

by transmitting an e-mail message with the document attached to each and every party and interested person named in the official service lists in the above-captioned proceedings last updated on April 22, 2010, and as set forth on the attached Service List and in a sealed **FEDERAL EXPRESS** envelope affixing a pre-paid air bill addressed to James D. Squeri and on ALJ Douglas M. Long as set forth on the attached Service List, and causing the envelope to be delivered to a **FEDERAL EXPRESS** agent for delivery.

Executed on May 10, 2010, at Washington, D.C.

Timothy L. Wilson, Jr.
TIMOTHY L. WILSON, JR.

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(Last updated April 22, 2010)

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