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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 08-09-024 (Filed September 30, 2008)
Chevron Products Company, Complainant, vs. Equilon Enterprises LLC, doing business as Shell Oil Products US; and Shell Trading (US) Company, Defendants.	Case 08-03-021 (Filed March 27, 2008)
Tesoro Refining and Marketing Company, Complainant, vs. Equilon Enterprises, L.L.C., doing business as Shell Oil Products (US); Shell Trading (US) Company; and San Pablo Bay Pipeline Company LLC, Defendants.	Case 09-02-007 (Filed February 13, 2009)
Valero Marketing and Supply Company, Complainant, vs. Equilon Enterprises, LLC, doing business as Shell Oil Products (US); Shell Trading (US) Company; and San Pablo Bay Pipeline Company LLC, Defendants.	Case 09-03-027 (Filed March 23, 2009)

VALERO MARKETING AND SUPPLY COMPANY'S OPENING COMMENTS ON PROPOSED DECISION OF ALJ BEMESDERFER

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VALERO MARKETING AND SUPPLY COMPANY'S OPENING COMMENTS ON PROPOSED DECISION OF ALJ BEMESDERFER

Pursuant to Rule 14.3 of the California Public Utilities Commission's ("CPUC" or "Commission") Rules of Practice and Procedure, Valero Marketing and Supply Company ("Valero") hereby respectfully submits these Opening Comments on ALJ Bemesderfer's March 9, 2011 Proposed Decision Setting Rates for Transportation of Crude Oil Between the San Joaquin Valley and the San Francisco Bay Area, Ordering Refunds and Adopting Tariffs for Heated Oil Service ("Proposed Decision").[1]

The Proposed Decision would (1) set a rate of $1.34 per barrel for the transportation of heavy crude oil ("SJVH") from Station 36 in the San Joaquin Valley to the San Francisco Bay Area refineries, including Valero's Benicia Refinery and Asphalt Plant, via the heated pipeline (the "Pipeline") operated by San Pablo Bay Pipeline Company LLC ("SPBPC"); (2) order the payment of refunds to Independent Shippers[2] for overcharges made by the Pipeline during the period from April 1, 2005 to the effective date of the decision; (3) approve the transfer of physical assets from the Pipeline's former owner to SPBPC; (4) deny the application to SPBPC to exclude certain tanks and truck racks from the assets transferred to it; and (5) adopt a tariff to govern the provision of heated oil transportation service by SPBPC. The Proposed Decision follows on Decision 10-11-010, in which the Commission denied SPBPC's application to charge market-based rates for transportation of SJVH on the Pipeline.

Valero fully supports the Proposed Decision and urges the Commission to adopt each of the Findings of Fact and Conclusions of Law.

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[1] By email of March 22, 2011, ALJ Bemesderfer extended the comment period from March 29 to April 8, 2011. In a separate ruling, the ALJ also increased the page limit for opening comments from 15 pages to 25 pages. *See* "Administrative Law Judge's Ruling Granting Motions to Increase the Comment Page Limit and for Final Oral Argument," March 21, 2011.

[2] "Independent Shippers" refers to Valero, Chevron Products Company ("Chevron"), and Tesoro Refining and Marketing Company ("Tesoro").

I. SUMMARY OF ARGUMENT.

The Commission's decision in D.10-11-010 expressly found that "[t]he Pipeline exercises significant market power over independent shippers of undiluted SJVH" and ultimately denied SPBPC's application for market-based rates.[3] The Proposed Decision now before the Commission is the logical extension of D.10-11-010 and, once adopted, will finally resolve the major issues in these lengthy proceedings.

As the Proposed Decision correctly concludes, the Pipeline has a monopoly on the transportation of heated SJVH crude oil from the San Joaquin Valley to the San Francisco Bay Area. This is not the first time the Commission has made such a determination. In 2007, the Commission recognized the "monopoly control" that the Shell Parties[4] hold over the Pipeline.[5] The Proposed Decision also correctly establishes just and reasonable rates for transportation of crude oil on the Pipeline for various periods dating back to April 1, 2005, concluding that the Independent Shippers are entitled to refunds of the difference between these just and reasonable rates and the actual rates paid. In the same vein, and recognizing the Pipeline's demonstrated market power, the Proposed Decision properly sets forth just and reasonable transportation rates on a going-forward basis. Finally, the Proposed Decision correctly adopts the tariff proposed by

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[3] D.10-11-010 at pg. 16 (Finding of Fact No. 22).

[4] The term "Shell Parties" generally refers to San Pablo Bay Pipeline Company LLC ("SPBPC") and Shell Trading (US) Company ("STUSCO"). Equilon Enterprises LLC ("Equilon") does business as Shell Oil Products US ("SOP US"). SOP US originated as a joint venture of affiliates of Shell Oil Company and Texaco Inc., and started operations in January 1998. Shell Oil Company became the sole owner of SOP US in February 2002. SOP US, by itself and through its affiliates and subsidiaries, is in the business of operating pipelines and product terminals in California, including the Pipeline. STUSCO is an affiliate of SOP US and serves as its supply and trading unit. STUSCO, by itself and through its affiliates and subsidiaries, operates a business in California that includes making and entering into arrangements on behalf of SOP US for the sale of transportation service on the Pipeline, and, as such, is a competitor of Valero. Equilon, SOP US, STUSCO, and SPBPC are referred to collectively herein as the Shell Parties and/or SPBPC.

[5] D.07-07-040, *Chevron Products Company v. Equilon Enterprises LLC, dba Shell Oil Products US, and Shell Trading (US) Company*, 2007 Cal. PUC LEXIS 331. The Commission noted that, "[t]hrough its monopoly control of the only heated pipeline between San Joaquin [Valley] and the Bay Area, Shell Oil is in a position to damage its competitors by denying them access to the pipeline or charging them an exorbitant price to use it." *Id.*

the Independent Shippers ("IS Tariff"). The IS Tariff, among other things, ensures that the Pipeline remains in heated service at reasonable rates and under fair terms and conditions of service. Only by adopting the Proposed Decision and the IS Tariff can the Commission preserve public utility service and guarantee that Valero and the other Independent Shippers will be able to continue to rely on the Pipeline for heated service, as they have done for decades.

The Commission acknowledged in D.10-11-010 that the evidentiary hearings in these proceedings were thorough. *See* D.10-11-010 at pg. 2 ("More than two dozen witnesses testified and more than 200 exhibits were admitted into evidence."). In addition, the eight days of hearings yielded more than 1,500 pages of transcript for oral testimony. There is no doubt that the parties' witnesses and experts had ample opportunity to testify and protect their arguments. The Administrative Law Judge ("ALJ") was an active participant in the hearings, asking witnesses to expand on their testimony, and permissively allowed evidence into the record. In sum, the ALJ presided over comprehensive evidentiary hearings and was able to determine which parties had the better arguments.

II. COMMENTS.

A. The Independent Shippers' Tariff Guarantees That All Shippers Are Treated Equally While Also Maintaining Heated Service.

This proceeding is about maintaining continued heated service at just and reasonable rates on the only heated pipeline that can transport heavy crude oil from the San Joaquin Valley to three San Francisco Bay Area refineries. To ensure the Pipeline remains in heated service at reasonable rates and under fair terms and conditions of service, this Commission must adopt the IS Tariff. The IS Tariff will ensure both that SPBPC can earn a reasonable return for operating and maintaining the Pipeline and that the needed cost of improvements to reduce the minimum volumes for the Pipeline can be included in the rate base. This is the only way to preserve public utility service and guarantee that Valero and the other Independent Shippers will be able to continue to rely on the Pipeline, as they have done for decades, even as San Joaquin Valley crude oil production declines.

The Proposed Decision correctly recognizes that "[a] pipeline dedicated to public use is a public utility subject to the jurisdiction of this Commission and, as such, required to provide service at just and reasonable rates to all shippers on equal terms." *See* Proposed Decision at pg. 13. The IS Tariff accomplishes this requirement by guaranteeing that all shippers on the Pipeline are treated equally, without jeopardizing heated service. Moreover, the IS Tariff must be adopted because the Commission has a duty to ensure that SPBPC will provide transportation service on terms that are fair to all shippers while also compensating SPBPC to allow it to make the investments necessary to preserve and maintain heated service in the future.

By contrast, in its own proposed tariff, SPBPC suggests terms and conditions of service for transporting SJVH that would grant STUSCO the ability to disrupt heated service and leave the non-affiliated shippers not knowing whether heated service would be offered on the Pipeline from one month to the next, or when the service would be discontinued or resumed. SPBPC's tariff also proposes that the SJVH shippers will pay all costs related to the shut down and resumption of heated service, notwithstanding that STUSCO has virtually a unilateral ability to dictate whether the heated service remains in effect. SP-72 at 10-12; *see also* RT Vol. 8 at 1433:27-1434:18.

As the Proposed Decision urges, the IS Tariff should be adopted in this proceeding. There are three basic principles in the IS Tariff:

(1) Heated transportation service on the San Pablo Bay Pipeline must continue;

(2) SPBPC should be encouraged to make the necessary rate-based investments to reduce the required throughput necessary to maintain heated transportation service on the Pipeline; and

(3) STUSCO should not be allowed to game or unduly benefit from the tariff.

1. The Nomination Procedure Proposed By the Independent Shippers Guarantees That All Shippers Are Treated Similarly.

The nomination process proposed in the IS Tariff addresses ways to ensure heated service is maintained. First, it treats all shippers equally, so that one shipper cannot by itself deprive the others of heated service. Second, it establishes a process by which rate-based investments can be made to reduce the minimum volumes required to maintain heated service.

The Pipeline remains heated regardless of whether it is shipping only SJVH (which requires heated service), San Joaquin Valley Light ("SJVL") or a blend thereof ("SJVHB"). RT Vol. 3 at 415:18-20. SPBPC's tariff proposes 140,000 barrels per day ("BPD") as the minimum volume requirement for heated service.[6] If nominations are less than 140,000 BPD, SPBPC can, under its proposed tariff, elect to shut down heated service, purge the pipe, and charge shippers for the costs of the shutdown, purging, and restarting (when nominations are sufficient to again support heated service). SP-72 at 10-12; *see also* RT Vol. 8 at 1433:27-1434:18.

While this proposal may seem neutral, in reality it permits the single biggest shipper on the Pipeline, STUSCO, to determine whether this common carrier pipeline will offer heated service to Shell's refining competitors, Valero and Tesoro. Under SPBPC's tariff, if nominations were not sufficient to support heated service, Valero and Tesoro will be deprived of the SJVH they need, while STUSCO would continue to receive SJVHB. SPBPC's proposed tariff

[6] While the Independent Shippers require heated service for their shipments of neat, undiluted SJVH, SPBPC's affiliate, STUSCO, likely will be taking mostly SJVL and SJVHB which do not require heating to ship. The ALJ discussed SPBPC's proposal to offer interruptible heated service on the Pipeline and concluded that, "[s]ince an affiliate of San Pablo is a crude shipper, acting together they could effectively deny service to Independent Shippers by withdrawing enough proprietary oil from the pipeline to force a shut down." *See* July 15, 2009 Administrative Law Judge's Ruling Granting Motion to Extend Procedural Schedule at 2.

"contains nothing that would preclude Shell's affiliate shipper from 'gaming the system' by undernominating crude . . . knowing this would shut down heated service and SJVH supply to the competitors of Shell's refining affiliate." IS-1 at 13:24-14:1. This is because SPBPC's affiliate ships approximately 60% of the total volume on the Pipeline. RT Vol. 1 at 35:24-36:3. Therefore, under SPBPC's proposed nomination process, Shell's affiliate controls heated service to its competitors. The Independent Shippers' proposal properly focuses on meeting the minimum operating requirements.

In order to make sure that all customers are treated equally, the Independent Shippers have proposed a nomination procedure which guarantees that no single shipper will be able to determine whether heated service is provided. *See* IS-1, Att. B, Section 55. The Independent Shippers' nomination process stipulates that nominations will be for SJVH and SJVL in segregated batches, "with the intent of allowing SJVB blending and deliveries only after nominations have satisfied the Minimum Operating Requirements." IS-1 at 13:20-24. With this provision, all shippers have the same interest in seeing that the minimums are met.

2. The Independent Shippers' Tariff Promotes Investments to Reduce Minimum Throughput.

Under cost-of-service regulation, the owner of a common carrier pipeline has an incentive to make prudent investments for the future benefit of the pipeline and its customers. Under the IS Tariff, these investments would be placed into the rate base of the Pipeline and customers would support the investments through their rates. A pipeline company would thus have the proper incentive to invest in needed improvements. The needed improvements for the Pipeline are those that will reduce the required throughput as the production of SJVH declines. If SPBPC were acting like an owner of a regulated pipeline, it would have proposed a process by which such improvements could be approved by this Commission and placed into the rate base.

Since SPBPC has made no such proposal, the Commission should instead adopt the IS Tariff. *See* IS-1 at 14:26-15:18; *id.*, Att. B at 18-20 (Section 55.1).

Section 55.1 of the IS Tariff is intended to counter the fact that there is nothing in SPBPC's tariff that compels it to explore operating changes or make investments to reduce the minimum volumes necessary for heated service. Under the IS Tariff, the shippers and SPBPC work together to explore and implement cost-effective improvements to reduce the required minimum throughput. RT Vol. 8 at 1397:5-11. These improvements would be paid for by all shippers, regardless of whether they rely on heated service for their deliveries, since the improvement enables the Pipeline to continue operating for all customers and because SJVL and SJVHB pull heat off the pipeline system. RT Vol. 8 at 1445:5-8. The record in this case shows that relatively minor capital investments and changes to operating procedures can reduce those minimums. *See, e.g.*, RT Vol. 3 at 424:12-19, 425:6-426:2, 448:4-17. The IS Tariff guarantees that the shippers and the Pipeline will be properly incentivized to work together to reduce minimum throughput. For all of these reasons, the Commission should adopt the Proposed Decision and the IS Tariff.

B. The Proposed Decision Establishes Just and Reasonable Forward-Looking Rates.

The Proposed Decision correctly adopts the just and reasonable rate of $1.34 per barrel with a pipeline loss allowance ("PLA") of 0.10%. The alternative rate offered by SPBPC should be disregarded because, as the Proposed Decision notes, it was predicated on the argument that SPBPC lacks market power. The Commission put that issue to rest in D.10-11-010, finding that the Pipeline exercises <u>significant</u> market power over independent shippers of SJVH from the San Joaquin Valley to the Bay Area. *See* D.10-11-010 at pg. 16.

The ALJ heard all of the evidence necessary to conclude that a rate of $1.34 per barrel is just and reasonable. Indeed, the Proposed Decision separately considers the four elements of the proposed rate: rate base, capital structure, cost of capital, and operating expenses. Valero fully supports the testimony on this issue submitted by the other Independent Shippers.

C. SPBPC Owes Significant Refunds to Valero, and the Refund Period Extends Back to At Least April 1, 2005.

The Proposed Decision properly concludes that $1.23 per barrel is the just and reasonable rate for transportation of crude oil on the Pipeline between Station 36 and the Bay Area refineries from April 1, 2005 through December 31, 2005, and $1.246 per barrel from January 2006 forward. *See* Proposed Decision at pg. 30. Accordingly, the Proposed Decision orders the payment of refunds to Independent Shippers, including Valero, for overcharges made by the Pipeline during the period from April 1, 2005 to the effective date of this decision.

Valero concurs with the Proposed Decisions that the refund period should start from April 1, 2005. Chevron filed its complaint for refund overcharges (C.08-03-021) under California Public Utilities Code section 494 on March 27, 2008. The three year statute of limitation period found in section 736 of the Public Utilities Code applies to complaints filed under section 494. Importantly, Chevron's complaint was based on the Commission's decision in D.07-07-040 which, *inter alia*, found that Chevron had access to the Pipeline via buy-sell agreements for the five years prior to the decision, *i.e.*, from at least July 2002, and that during that period the Pipeline was in the business of transporting oil for a fee, using buy-sell agreements to set the fee. *See* D.07-07-040, Findings of Fact No. 8, Conclusion of Law No. 8. The Commission further concluded that the Pipeline owners had impliedly dedicated the Pipeline to public use, thereby making the Pipeline subject to the jurisdiction of this Commission. *Id.*, Conclusion of Law Nos. 1, 9. As a public utility, the Pipeline is required to provide nondiscriminatory service at just and reasonable rates, and any excessive charges imposed on Independent Shippers by the Pipeline in the three years preceding Chevron's complaint are subject to refund under Public Utilities Code section 494. While Valero filed its complaint case later than Chevron, when the ALJ consolidated the refund cases with SPBPC's rate case, all parties, including SPBPC, treated April 1, 2005 as the earliest date for which refunds could be sought.

Moreover, Public Utilities Code section 734 also would entitle Valero to refunds for the unreasonable rates it has paid since at least April 1, 2005. Section 734 states, 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 the commission has found, after investigation, that the public utility has charged an unreasonable, excessive, or discriminatory amount therefor in violation of any of the provisions of this part, the commission may order that the public utility make due reparation to the complainant therefor, with interest from the date of collection if no discrimination will result from such reparation.

Since at least April 1, 2005, Valero has paid SPBPC's affiliate, STUSCO, for transportation of SJVH pursuant to "buy/sell" agreements between them. Valero-7, Ex. 1 at 3. Therefore, Valero is entitled to a refund for the amount by which these payments exceeded payments at just and reasonable rates. *See* CAL. PUB. UTIL. CODE §§ 494, 734; *see, e.g.*, *Grayson-Owen Co. v. Southern Pac. Co.* (1913) 3 Cal. R.R.C. 336, 338 (if in any instance a rate higher than the one prescribed by a rule was collected, the rate collected would amount to an overcharge; the shipper paying the rate would become entitled to reparation to the amount of the difference between the rate collected and the rate prescribed).

The Commission has held that rate increases that have not been approved by the Commission are invalid and unreasonable, thus warranting an order of refunds. *See, e.g.,* D.98-10-023, *Ortega v. AT&T Commc'ns of California, Inc.*, 1998 Cal. PUC LEXIS 673 at **7-8.

Indeed, Public Utilities Code section 454 requires all public utilities to obtain Commission approval prior to increasing rates.[7] In *Ortega*, the Commission held that rate increases imposed without adhering to the Commission's established procedures were *per se* unreasonable and therefore subject to refund. *Ortega*, 1998 Cal. PUC LEXIS 673 at **7-8.

Here, STUSCO increased its transportation rates charged to Valero from $1.35-$1.40 per barrel effective March 1, 2003 to $1.90 per barrel on January 1, 2006. SPBPC increased its rates, again, to $1.98 on January 1, 2007. Each of these increases occurred without Commission approval, making them invalid from the outset. Moreover, the rates vary dramatically from the just and reasonable rates put forward in the Proposed Decision. Commission precedent firmly establishes that a public utility like SPBPC, that increases rates (charged through its affiliate STUSCO) without following established procedures, does not get a second bite at the apple to prove the rate increase were reasonable.

Public Utilities Code section 736 provides a three years statute of limitations for a refunds claim under section 494. Here, SPBPC violated section 494 by charging Valero rates pursuant to the buy/sell agreements that were not (and still are not) on file with the Commission.

Valero filed its complaint in this consolidated proceeding on March 23, 2009, but the Commission first ordered SPBPC to file tariffs for its third-party contracts on December 6, 2007. *See* D.07-12-021, *Chevron Products Company v. Equilon Enterprises LLC, dba Shell Oil Products US, and Shell Trading (US) Company* 2007 Cal. PUC LEXIS 631, at *19. SPBPC waited until September 30, 2008, to file its proposed tariffs. The statute of limitations under section 736 should extend to three years before the Commission's order; otherwise, SPBPC

[7] The only exception to this requirement is found in California Public Utilities Code section 455.3, which allows pipeline utilities, upon 30 days' written notice to the Commission, to increase rates up to ten percent annually without prior Commission approval. However, even those rate increases are subject to refund upon order of the Commission.

would benefit from its long delay in filing a tariff that precipitated Valero's complaint. This Commission should not reward SPBPC for its dilatory tariff filing and then claim that its filing had the effect of cutting off Valero's remedy. Thus, in any case for purposes of calculating the refund period, SPBPC should be equitably estopped from asserting the statute of limitations as a defense. The refund period properly extends back to at least April 1, 2005.

D. The Public Interest Is Served By Adopting the Independent Shippers' Tariff.

The Proposed Decision correctly concludes that the Pipeline has a monopoly on the transportation of heated SJVH from the San Joaquin Valley to the San Francisco Bay Area (Finding of Fact No. 1) and adopts the IS Tariff to govern the Pipeline's future operation (Finding of Fact No. 10). These findings are further supported in light of evidence establishing that the public interest is served by adopting the IS Tariff.

Valero witnesses testified that, in light of the unique history and issues surrounding the Pipeline and the critical importance of SJVH to Valero's operations, "[t]he public interest should be the defining factor in this proceeding." Valero-8 at 13:22. Indeed, consideration of the public interest is even more important given the uncontested fact that crude oil production in California (and in particular in the San Joaquin Valley) is in a state of steady decline. The public interest is advanced by adopting the IS Tariff.

1. Heated Transportation Service Must Be Allowed to Continue in Light of the Declining SJVH Production.

In 2006, the California Energy Commission's ("CEC") Fuels and Transportation Division traced the history of California from a state that was once a self-sufficient source of crude oil and an exporter to other states to its current posture of increasing reliance upon imports. *See* Valero-8 at 35:9-25; *id.*, Ex. B. The CEC paper offers a primer on crude oil characteristics which confirms the testimony of Valero witnesses Messrs. Bird and Lassahn on three critical qualities of SJVH: specific gravity or API, sulfur content and acid content. *Id.*, Ex. B at 2-3. The paper also confirms that refineries and asphalt plants in California have been constructed or modified to deal with the physical characteristics of crudes such as SJVH. In the case of existing and anticipated California production, that means heavy, sour crude (*i.e.*, SJVH) which is concentrated in the San Joaquin Valley. In sum, the statistics compiled by the CEC corroborate the testimony of Valero's witnesses that SJVH is a unique crude oil that has no reasonable substitutes. *See, e.g.,* Valero-5 at 15; Valero-6 at 5:18-6:10.

Declining SJVH production may affect the Pipeline economics to the degree that, if the Proposed Decision and IS Tariff are not adopted, SPBPC might seek permission to discontinue heated service or abandon the Pipeline entirely. Moreover, if SPBPC were to throttle or discontinue heated service, this would have the effect of providing SPBPC's affiliates, including STUSCO and the Shell Martinez Refinery, with the ability to enhance their consumption of light and blended San Joaquin Valley crude – a declining natural resource – to the detriment of the Shell Parties' refinery competitors. The public interest would not be served by decreasing the availability of San Joaquin Valley crude to the Shell Parties' competitors in the refining market. The Commission already has taken the first step to preclude this occurrence in D.10-11-010 by rejecting SPBPC's request for market-based rates. Now, the Commission must adopt the IS Tariff that will ensure that SPBPC offers service at reasonable rates and under reasonable terms of service, without discrimination or preference, in a manner that preserves the ability of all shippers to have access to heated and blended service while also providing the proper incentives for improvements to be made to the Pipeline to enable it to continue to offer all current services to all shippers into the future.

2. Valero and the California Economy Would Suffer Should Valero Lose Access to SJVH.

The Proposed Decision is supported by the fact that the health of California's economy is an additional public interest consideration. The Pipeline plays a significant role in California's economy; not only is it the only pipeline able to transport a unique domestic crude oil to Bay Area refineries, but also it employs innumerable Californians directly and indirectly involved in the extracting, processing and marketing fields.

The Valero Benicia Refinery and Asphalt Plant together employ approximately 480 people (Valero-6 at 3:15-16) and both refining operations have been designed and optimized to process ratable shipments of approximately 20,000 BPD of SJVH. Should Valero lose access to this unique crude oil, its operations would certainly suffer, and its Asphalt Plant may even be forced to shut down. *Id.* at 13:4-7. Valero's witness Kevin Lassahn testified that the Valero Benicia Asphalt Plant pays state and local annual taxes in excess of $870,000 (*id.* at 20:10-12) and the retail consumption of the products that the Asphalt Plant produces ultimately generates approximately $21,000,000 in sales tax revenue for the state each year. *Id.* at 20:12-14.

Moreover, SJVH is a unique crude oil found only in California. Valero-5 at 5. SJVH is a critical feedstock for the Valero Benicia Refinery and particularly for the Valero Benicia Asphalt Plant. Without continued access to SJVH, operations at both facilities would suffer, thereby handicapping Valero's refining operations and potentially jeopardizing the continuity of its Asphalt Plant.

Valero urges the Commission to act consistent with the public interest and ensure that Valero and the other Independent Shippers have continued access to a unique and important state resource, SJVH, via the only means of transporting it to the Bay Area, the Pipeline. In addition, it is also in the public interest to reduce California's dependence on foreign "[c]rude oil imported from countries with volatile political and social structures [that] leaves California vulnerable to changing world events." Valero-8, Ex. B at 8. The Commission can positively address both of these public interest objectives by adopting the Proposed Decision and IS Tariff.

3. Shell's History of Affiliate Abuse Further Supports Both the Proposed Decision's Just and Reasonable Rates and the Independent Shippers' Tariff.

The Proposed Decision correctly notes that the IS Tariff aims to eliminate or reduce the opportunity for the Pipeline to be operated in ways that favor the Pipeline's affiliates or disadvantage the Independent Shippers. *See* Proposed Decision at pg. 26. In particular, the Proposed Decision remarks that "[t]he history of the Pipeline's operation lends credence to Independent Shippers' concerns regarding the possibility that the Pipeline's proposed tariff would permit such discriminatory operation." *Id.* at pgs. 26-27. The Shell Parties' history of affiliate abuse supports both the Proposed Decision's just and reasonable rates and the terms and conditions contained in the IS Tariff.

The Proposed Decision and IS Tariff must be adopted because the Commission has a duty to ensure that SPBPC will provide transportation service on terms that are fair to all shippers and that SPBPC makes the investments necessary to preserve and maintain heated service, particularly since SPBPC's affiliates neither require heated service nor have an interest in maintaining it.[8] In the decades of continued heated service, the only thing that has changed is the status of the Pipeline. It is inconceivable that when the Commission found that what SPBPC had been characterizing as a proprietary pipeline was actually a common carrier, that the Commission intended as a consequence that the service on which Valero has relied on for decades would have its quality jeopardized or that customers would now face unconstrained rates

[8] The issue is especially concerning given SPBPC's threat to terminate heated service shortly after filing its Application, a fact recognized in the Proposed Decision. *See* Proposed Decision at pg. 27, n.55.

and unfair terms and conditions. Yet, if the Commission does not adopt the Proposed Decision and IS Tariff, this counter-intuitive result could become a reality.

More than anything else, this proceeding is about regulating a common carrier to ensure that heated service continues to deliver SJVH to the Pipeline's customers. SPBPC has operated the Pipeline to advantage its affiliated Shell Martinez Refinery. In short:

(1) The Independent Shippers have paid higher rates than STUSCO for the same transportation service. *See* Chevron-5C; *see also* RT Vol. 1 at 88:14-18, 89:3-27;

(2) The Independent Shippers have paid a higher pipeline loss allowance than STUSCO. *See* Chevron-46 at 23-24; Chevron-47C at 19; *see also* RT Vol. 1 at 52:15-21, 64:8-12;

(3) The Pipeline has blended inferior California Outer Continental Shelf crude ("OCS"), shipped by STUSCO, and charged the Independent Shippers as if the resulting blend was all SJVH. RT Vol. 1 at 67:1-23; *see also* Tesoro-31 at 12-13;

(4) Only the Independent Shippers have been required to ship minimum volumes. *See, e.g.*, Tesoro-27 at 12; *id.*, Atts. D, F; and

(5) SPBPC has threatened to discontinue heated pipeline service to the benefit of its affiliate and to the detriment of the Independent Shippers.

a. Shell Affiliates Own, Operate and Control Access to the Pipeline.

SPBPC, SOP US, STUSCO, and Shell Oil Company are affiliates and wholly owned by Shell.[9] Therefore, it makes no difference to Shell how much one of its subsidiaries pays SPBPC to transport crude oil on the Pipeline. Because the economic interests and incentives of Shell and the Independent Shippers are not aligned, SPBPC's proposed rate design for Pipeline shipments would allow it to charge discriminatory rates for services to competitors of its affiliated marketing and refinery entities.

[9] Although the Pipeline is owned by Shell Oil Company and operated by SOP US, access to it has been controlled by STUSCO. *See* Tesoro-25 at 8.

SPBPC's affiliates produce SJVH crude and transport it to the affiliated Shell Martinez Refinery in the Bay Area. The Independent Shippers are not similarly situated: the higher rates SPBPC proposes in this proceeding would negatively impact their bottom lines. Moreover, because both SPBPC and STUSCO profits eventually flow to their mutual corporate parent, SPBPC would not have the same concern about maintaining uninterrupted heated service to all shippers on the common carrier pipeline in the event that profits to its refinery (including profits that accrue from a superior competitive position vis-à-vis Tesoro and Valero) were greater than the profits from throughput on the Pipeline. *See, e.g.*, Tesoro-27 at 61. This is exactly the kind of ongoing affiliate abuse that Valero and the other Independent Shippers seek to prevent with the IS Tariff.

b. Shell Has Engaged in Ongoing Affiliate Abuse on the Pipeline.

STUSCO has manipulated (and currently still can manipulate) the nomination process by under-nominating the amount of volumes it intends to ship on the Pipeline. This unique position allowed SPBPC to threaten the Independent Shippers in October 2008 with terminating heated service, a threat its proposed tariff would perpetuate.[10] While the threat from SPBPC disappeared after the Independent Shippers sought relief from the Commission, the event shows how vulnerable the Independent Shippers are to what Shell itself does on the Pipeline and why the IS Tariff should be adopted by the Commission.

Moreover, diminished or discontinued heated service on the Pipeline would advantage the Shell Parties at the expense of their competition. If the Commission were to adopt the SPBPC tariff, one of the likely results would be that the Independent Shippers would lose access

[10] Due to the minimum volume requirements for heated service on the Pipeline, under-nominations by a substantial shipper could result in total nominations that would fall below the minimums for a given pipeline segment.

to SJVH, a declining resource, and SPBPC's affiliates would be able to monopolize both the consumption and use of that resource to the detriment of their competitors.

c. SPBPC Operates the Pipeline to Advantage Shell Affiliates.

SPBPC has a history of operating the Pipeline system in a manner that economically advantages its affiliated Shell Martinez Refinery at the expense of unaffiliated Independent Shippers.

First, SPBPC has used private oil storage tanks to divert higher quality Kern River SJVH crude that Chevron ships on behalf of Tesoro and Valero into a private tank reserved for segregated shipment to the Shell Martinez Refinery. *See* Tesoro-31 at 10. Second, SPBPC has used a separate storage tank at Coalinga to receive higher sulfur "west side" SJVH that was being delivered by Shell Oil to STUSCO in the oilfield. Third, SPBPC blends higher sulfur – and, therefore, lower quality – OCS crude with SJVH at Olig for shipment on the Pipeline. RT Vol. 1 at 67:1-23. The OCS blending is solely for the benefit of the Shell affiliate, STUSCO, the only shipper of OCS. *See* Tesoro-31 at 12. Thus, SPBPC's blending of OCS into SJVH is a naked example of Shell seeking to benefit its affiliate, STUSCO (the only shipper of OCS), at the direct and substantial cost to the Independent Shippers.

d. Shell Affiliates Pay Substantially Lower Pipeline Transportation Rates Than Independent Shippers.

SPBPC charges the Independent Shippers more for transportation than it charged its own affiliate, even taking into account SPBPC's estimate of the cost-based differential for heated service compared to unheated service.

A Shell Pipeline Invoice (Chevron-5C) shows that SPBPC charged its affiliate Shell Martinez Refinery \$1.526 for shipping SJVHB and charged Valero \$2.03 for <u>shipping the same</u>

crude oil. *See* Chevron-5C; *see also* RT Vol. 1 at 88:14-18. When asked why Valero paid more to ship the same oil on the Pipeline, SPBPC witness Dr. Webb could not give a clear answer:

> Q: [W]hy . . . will [Valero] pay more to ship the same blend of oil in this pipeline[?]
>
> A: [. . .] I think it is difficult to disentangle in this buy/sell the transportation from the other elements. And we are currently in this sort of odd limbo where we are a public utility but we don't have tariffs on file, and so we are having to conduct our business through these buy/sells.

RT Vol. 1 at 89:3-27. In fact, Dr. Webb later denied that the rate differentials showed any affiliate preference and testified:

> Q. […] Mr. LaBorne's testimony asserts there is a cost difference; that's what you said makes this blend and the heavy different products, the different cost to move them. And Mr. LaBorne has testified that is in the range of $0.12 to $0.13. So my next question is given that STUSCO was charged only a $1.246 for movement to the Shell Martinez refinery, that based on what Tesoro was paying, should have been charged $1.69 or a $1.70. Does that indicate to you favoritism towards the affiliate?
>
> A. No.
>
> Q. Just legitimate way of doing business?
>
> A. Again, no clue. We don't know – we aren't seeing all of the parts of the transaction.

RT Vol. 2 at 218:25-219:12.

SPBPC's witness Kevin LaBorne provided no more clarity when describing the rates the Shell Martinez Refinery pays for crude oil transported on the Pipeline:

> Q. So the refinery, owned by Equilon, negotiated with its affiliate, Shell Trading, for the amount that STUSCO would pay to Equilon on behalf of the pipeline for transporting crude oil to the refinery; is that right?
>
> A. It is to the extent that – I mean what we're talking about here are affiliate transactions and transfer values. So I look at – I look at those transactions as more of an allocation between business units.

RT Vol. 4 at 650:22-651:3.

According to SPBPC's own witness, the aptly described "affiliate transactions" and "allocation[s] between business units" determine the rates which Shell affiliates pay to move crude on the Pipeline. This is precisely the type of behavior the Commission must assure is not permitted to continue.

e. SPBPC Charges the Independent Shippers a Higher Pipeline Loss Allowance Than It Charges STUSCO.

Another instance of Shell's affiliate abuse is found in the disparate PLA rates charged by SPBPC. Because some crude oil is lost in pipeline transit through shrinkage or evaporation, a PLA accounts for such losses, either by measuring the actual losses or by using an imputed amount. *See* Chevron-46 at 24. However, it is not supposed to be a profit center. RT Vol. 5 at 842:9-11.

SPBPC currently charges Valero and the other two Independent Shippers a 0.25% PLA for each shipped barrel of SJVH. *Id*. at 23-24. By contrast, SPBPC charges STUSCO a lower PLA of 0.15%. *See* RT Vol. 1 at 52:15-21, 64:8-12; *see also* Chevron-47C at 19. SPBPC's witness could not offer a coherent justification for the difference. RT Vol. 2 at 220:7-10.

By contrast, Chevron provided ample evidence, heard and considered by the ALJ, that a PLA of 0.10% is just and reasonable. The ALJ accordingly adopted the 0.10% PLA in the Proposed Decision, which now should be adopted by the Commission.

III. CONCLUSION.

For all of the foregoing reasons, the Commission should adopt the Proposed Decision's Findings of Fact and Conclusions of Law.

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CERTIFICATE OF SERVICE

I, Thomas E. Morgan, hereby certify that I have this day served a copy of the document titled **VALERO MARKETING AND SUPPLY COMPANY'S OPENING COMMENTS ON PROPOSED DECISION OF ALJ BEMESDERFER** on all parties on the most recent official service lists in proceeding C09-03-027 and in consolidated proceedings A.08-09-024, C08-03-021 and C09-02-007 via electronic mail and U.S. Mail.

Executed this 8th day of April, 2011 at San Francisco, CA

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