BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of the Application of SFPP, L.P. (PLC-9) for Authority to Increase Rates for Transportation of Refined Petroleum Products.	Application No. A21-01-015

PREPARED REPLY TESTIMONY

OF

LEE O. UPTON, III

on behalf of

Tesoro Refining & Marketing Company LLC

October 29, 2021

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PREPARED REPLY TESTIMONY OF LEE O. UPTON, III

Q1. Please state your name, address, and position.

A1. My name is Lee O. Upton, III and I am the President of Premier Quantitative Consulting, Inc. ("PQC, Inc."), an economics and financial consulting firm located at 1080 Woodcock Road, Suite 285 in Orlando, Florida.

Q2. Would you please state on whose behalf you are filing this testimony?

A2. I am filing this testimony on behalf of Tesoro Refining & Marketing Company LLC ("Tesoro"). Tesoro is a refiner that produces refined petroleum products at its Wilmington refinery in Los Angeles and ships these refined petroleum products within the State of California on various pipelines that are owned by SFPP. It is my understanding that in January 2021, SFPP filed a rate application (A.21-01-015) to increase its intrastate rates by 25.527%. My colleague, Peter K. Ashton, performed a preliminary analysis of the cost of service that accompanied this rate increase and found, based on the limited data presented, that SFPP had understated its Test Period throughput volumes and overstated its costs. Tesoro is one of the largest shippers on SFPP's intrastate pipelines and is therefore directly affected by the level of these rates.

Q3. Could you describe your background?

A3. Prior to starting PQC, Inc. in 2014, I was a Principal with Innovation & Information

Consultants, Inc. ("IIC, Inc."), an economics and management consulting firm located in Concord, Massachusetts. I hold a B.S. degree in Physics from Wake Forest University, a M.S. degree in Physics from Emory University, and a M.B.A degree from the Crummer Graduate School of Business at Rollins College. Over my 25-year professional career, I have analyzed various facets of the petroleum industry including regulatory issues related to pipeline ratemaking and pipeline operations. I have been involved in a number of regulatory proceedings where I analyzed key ratemaking elements, including the appropriate rate of return to use in cost of service analyses.

Q4. Could you briefly describe some of the oil pipeline matters you have worked on?

A4. Most recently, I filed Prepared Direct Testimony and Prepared Answering Testimony, before the Federal Energy Regulatory Commission ("FERC") in *TransCanada Keystone Pipeline, LP,* Docket No. OR21-2-000 and consolidated dockets. I also have filed direct and supplemental testimony before the Regulatory Commission of Alaska ("RCA") in *Kenai Pipe Line Company*, TL33-306 and provided a Declaration regarding the return on equity for SFPP in Docket No. OR16-6 before the FERC.

In addition, I have been involved in a number of regulatory matters before the California Public Utilities Commission ("CPUC") and other regulatory bodies, where I have supported expert testimony involving cost of service analyses, including the appropriate determination of the rate of return. These proceedings include *Tesoro Alaska Pipeline Company*, Tariff Filing TL24-309 (RCA), *SFPP, L.P.,* Docket No. OR11-18 (FERC), *Application of SFPP, L.P.* in A.12-01-15 (CPUC), *SFPP, L.P.,* Docket No. IS11-444 (FERC), *Application of SFPP, L.P.* in A.09-05-014 (CPUC), *Application of San Pablo*

Bay Pipeline, LLC in A.08-09-024 (CPUC), *SFPP, L.P.*, Docket No. IS08-390 (FERC), *Enterprise TE Products Pipeline Company, LLC*, Docket No. IS12-203-000, *SFPP, L.P.*, Docket No. IS05-230 (FERC), *Big West Oil Co. and Chevron Products Co. v. Anschutz Ranch East Pipeline, Inc.*, Docket No. OR01-03-000 and OR01-05-000 (consolidated) (FERC), *Big West Oil Co. and Chevron Products Co. v. Frontier Pipeline Co.*, Docket No. OR01-02-000 and OR01-04-000 (consolidated) (FERC), *Big West Oil, LLC, Chevron Products Company, Sinclair Oil Corporation and Tesoro Refining and Marketing Company v. Express Pipeline LLC*, Docket No. OR02-8-000 (FERC), and *Big West Oil, LLC, Chevron Products Company, and Tesoro Refining and Marketing Company v. Platte Pipe Line Company*, Docket No. IS02-384-000 (FERC). In addition, I have also previously submitted comments to FERC on behalf of Tesoro Refining & Marketing Company LLC related to the Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity.

In addition to my regulatory work, I have studied various aspects of the petroleum industry, including authoring several research reports and presenting papers at industry conferences. Exhibit No. LOU-0002 is a copy of my curriculum vitae, which provides more information regarding my background.

Q5. What is the purpose of your testimony in this proceeding?

A5. On January 28, 2021, SFPP filed Advice Letter No. 44-O, notifying shippers and the Commission it intended to increase its system-wide intrastate rates by 10%. On the same day, SFPP filed a rate application seeking an overall 25.527% increase on its system-wide intrastate rates. Shippers subsequently protested SFPP's proposed rate increase. Prior to

a procedural schedule being set by the Commission, Tesoro sent discovery requests to SFPP designed to better understand the underlying assumptions and analyses supporting SFPP's proposed rate increase. Tesoro sent these requests in May 2021 and SFPP provided limited responses in June. SFPP filed Prepared Direct Testimony supporting its proposed rate increase on October 1, 2021. The Prepared Direct Testimony included SFPP's Test Year cost of service and achieved return analyses purporting to support the 25.527% rate increase. I have been asked by counsel for Tesoro to evaluate the cost of service and achieved return analyses presented by SFPP in support of the rate increase it requests in its tariff application. I respond specifically to the testimonies of Erik G. Wetmore (Exhibit No. EGW-0001), Michael J. Webb (Exhibit No. MJW-0001), and Michael A. Hanak (Exhibit No. MAH-0001), filed on October 1, 2021. I have, accordingly, evaluated whether the rates that Tesoro has been paying for the petroleum products it has been shipping on the intrastate portion of SFPP's pipelines have been just and reasonable. I note that the interval between SFPP filing its Direct Testimony and the due date for Shippers' Reply Testimony was only four weeks, due October 29, 2021. During this interval, SFPP has continued to provide rolling discovery responses. However, as of the date of drafting of this testimony, there are still discovery responses that have only recently been provided and other instances where SFPP is diligently working on a response but has yet to provide a response. As a result, my testimony provides the results of my analyses including my calculation of SFPP's cost of service based on the information that I have been provided and had the opportunity to review. I reserve the right to amend or update my opinions as SFPP continues to fulfill its discovery obligations and I have the requisite amount of time

to fully review and analyze the responses.

Q6. What conclusions did SFPP reach with respect to its proposed rate increase?

A6. SFPP witness Erik Wetmore calculated a Test Year cost of service of $122.1 million for SFPP's CPUC jurisdictional operations. He relied on inputs from SFPP witnesses Dr. Webb and Mr. Hanak with respect to his development of the cost of service. He also relied on Test Year throughput information provided by Mr. Sanborn. On the basis of Mr. Sanborn's Test Year throughput, Mr. Wetmore claimed that SFPP's revenues under existing rates would be $97.2 million. These results indicate an overall achieved return of 0.91% for SFPP, which serves as the basis for SFPP seeking a 25.527% rate increase. In fact, SFPP has already increased rates to the maximum 10% allowed and is seeking the additional rate increase in this proceeding.

Q7. Do you agree with Mr. Wetmore's cost of service, Test Year revenues and achieved return results?

A7. No. The testimony and exhibits filed by SFPP witnesses are replete with faulty and inaccurate assumptions that lead to a grossly overstated cost of service. This overstated cost of service, when coupled with SFPP's grossly understated Test Year revenues, create an incorrect image of a pipeline that is in dire need of a rate increase.[1] This is simply incorrect. For example, consider the Test Year revenues under existing rates. These are driven solely by Mr. Sanborn's erroneous Test Year throughput forecast. Mr. Ashton

[1] SFPP's own documents produced on October 25, 2021 indicate a company that is expected to **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** See SFP21 005824, included in Exhibit No. LOU-0064.

discusses the numerous errors and fallacies with Mr. Sanborn's analyses, which I will not repeat here. However, SFPP's own throughput and revenue forecast data that it uses in business decision-making contradict the revenue data and results reported by Mr. Wetmore. Recently SFPP produced forecast documents that indicate that throughput levels **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][2] [redacted] **[END HIGHLY CONFIDENTIAL]** $97 million that Mr. Wetmore projected using Mr. Sanborn's Test Year throughput assumptions and pre-existing rates.[3]

The cost of capital inputs provided by Dr. Webb are also an example of grossly exaggerated inputs that lead to an inflated cost of service. As I discuss in detail later in this testimony, Dr. Webb takes every opportunity to inflate the cost of capital by using an imputed capital structure that is heavily weighted towards equity, inflating the cost of debt by excluding lower cost debt instruments, and relying on flawed return on equity methodologies while also adding in an unwarranted and baseless risk premium to further inflate the return on equity, and thus, the overall cost of capital.

Q8. Could you please summarize the conclusions that you reached as a result of your analysis?

A8. Certainly. As discussed in detail in this testimony, I performed my own cost of service and

[2] SFP21 001271, SFP21 001273, included in Exhibit No. PKA-0005.
[3] Throughout this testimony, I define "pre-existing rates" as those rates in effect prior to SFPP's 10% increase.

Test Year revenue analysis. Based upon my review of the cost of service presented by SFPP's witnesses, and my own analysis, I have concluded the following:

- SFPP's request to increase its CPUC jurisdictional transportation rates by 25.527% is not justifiable and would not result in just and reasonable rates. In fact, my analysis indicates that SFPP is not entitled to any increase in its rates and instead, a rate reduction of approximately 1.97% should be implemented.
- Mr. Ashton's throughput analysis shows that SFPP has considerably understated Test Period throughput. As a result, SFPP has understated the expected Test Period revenue at pre-existing rates by approximately $11 million. Consequently, there is no basis for SFPP to request a rate increase of 25.527%. In addition, SFPP's cost of service, as determined by Mr. Wetmore, is also significantly overstated due to several erroneous assumptions and inputs.
- The first principal element that leads to an erroneous cost of service is SFPP witness Webb's cost of capital. I conclude that SFPP has overstated its cost of capital by using incorrect and flawed inputs for the capital structure, cost of debt, and return on equity. Using correct values leads to an overall cost of capital of 7.91% as compared to Dr. Webb's recommended cost of capital of 10.26%.[4]
- The second principal element that leads to an erroneous cost of service is the overstatement of operating expenses. The single largest items are Mr.

[4] Exhibit No. EGW-0003, Attachment B, page 1, line 2. Dr. Webb provided Mr. Wetmore with the cost of capital inputs, in lines 13 through 16 on this schedule, that are used to derive this weighted cost of capital.

Wetmore's treatment of General and Administrative ("G&A") expenses, particularly corporate overhead, as well as flawed assumptions regarding Test Period adjustments for environmental remediation expenses as well as the litigation expenses applicable to this proceeding.

- I also identified several other issues with SFPP's cost of service, including the erroneous determination of Test Year adjustments for other cost categories.
- Relying on Mr. Ashton's Test Period throughput analysis and my own analysis of other cost of service elements, I calculate an overall cost of service for SFPP of $106.3 million and an expected Test Year revenue at pre-existing rates of $108.4 million. According to my calculations, SFPP is earning an achieved return of 8.72% in its Test Period, even when using existing rates prior to any temporary or proposed increase. These results indicate SFPP is not entitled to any rate increase, and in fact, should implement a rate reduction. Exhibit No. LOU-0046 provides my cost of service results, including an analysis of the achieved return.

Q9. Thank you for that summary. Let's continue with your understanding of the SFPP California pipeline system.

A9. SFPP's intrastate operations include several different pipeline systems located throughout the State of California. These pipeline systems include the following:

- The North Line, which consists of approximately 860 miles of trunk pipeline in five segments that transports petroleum products from Richmond and Concord, California to Brisbane, Sacramento, Stockton, Rocklin, San Francisco and

Oakland Airports, Chico, Fresno, and San Jose, California.

- The West Line, which consists of approximately 700 miles of pipeline that transports refined petroleum products from various refineries and terminals in the Los Angeles area to Colton, Imperial, Ontario Airport, and to the Calnev Pipe Line.
- The San Diego Line, a 135-mile pipeline that serves Orange County and the San Diego area.
- The Bakersfield Line, which is a 100-mile line that runs north from Bakersfield to Fresno.

Q10. Do any of these pipeline systems include both CPUC and FERC oversight?

A10. Yes. The North Line has a terminus point in Reno, Nevada. Consequently, some of the volumes that originate in California are ultimately delivered in Nevada and those volumes and rates come under FERC jurisdiction. Similarly, the West Line has a terminus point in Phoenix, Arizona and likewise comes under FERC jurisdiction for those deliveries. Both of these systems have interstate and intrastate movements depending on the origin and ultimate destination of deliveries. In contrast, the San Diego Line and Bakersfield Line are exclusive to CPUC regulation.[5]

Q11. What are the principal topics that you discuss in your testimony?

A11. There are several sections to my testimony covering the following topics:

[5] Lastly, the SFPP system also includes assets that are not located in California. Among these are the East Line, which runs from Texas to Arizona, and the Oregon Line, which is contained within Oregon and runs from Portland to Eugene. Neither the East Line nor the Oregon Line are subject to CPUC oversight.

1. The definition of the Base Period and Test Period;
2. My determination of the appropriate rate of return that SFPP should be achieving and the appropriate rate base to which that return should be applied;
3. An assessment of SFPP's claimed operating expenses;
4. My conclusion regarding SFPP's cost of service, achieved return, and the level of reduction in rates required to achieve just and reasonable rates based on my cost of service analysis; and
5. An analysis of reparations owed to Tesoro for its overpayments.

BASE PERIOD AND TEST YEAR

Q12. What is a Base Period?

A12. In order to evaluate the costs associated with a regulated entity such as SFPP, we normally start with a Base Year that reflects a 12-month time period for which we have reliable cost data. At the same time, we need to make appropriate adjustments for any extraordinary or non-recurring items. In his cost of service analysis, Mr. Wetmore relied on a Base Period consisting of the 12 months ending November 30, 2020.

Q13. What is a Test Year?

A13. The Test Year is intended to reflect changes that have occurred or may be expected to occur over some reasonable and foreseeable time period. For example, FERC defines a Test Year as:

> A test period must consist of a base period adjusted for changes in revenues and costs which are known and measurable with reasonable accuracy at the time of

filing and which will become effective within nine months after the last month of available actual experience utilized in the filing.[6]

Mr. Wetmore uses calendar year 2021 as his Test Year, using the Base Period data as well as adjustments that he believes are known or knowable as of the end of the Base Period, which he incorporates into his Test Year.

Q14. Do you agree with Mr. Wetmore's assessment of the Base Period and Test Year?

A14. I generally agree with Mr. Wetmore's Base Period and Test Year definitions, even though I disagree with many of his Base Period assumptions and Test Year adjustments. I would note that in certain instances, the availability of full year calendar 2020 data may facilitate use of an additional month of data in evaluating certain Base Period assumptions, particularly with respect to operating expenses.

DETERMINATION OF AN APPROPRIATE RATE OF RETURN

Q15. What are the economic principles that underlie the determination of a fair and reasonable rate of return for a regulated pipeline such as SFPP?

A15. Regulated entities such as SFPP are entitled to rates that provide the regulated entity the opportunity to recover its costs, including capital costs through depreciation, and earn a reasonable rate of return on its capital. The rate of return is developed from the cost of capital, which is estimated by weighting the elements of how the company is financed (*i.e.*, debt and equity) by their percentages in the capital structure (*i.e.*, the percentages of debt and equity financing used by the company) and multiplying those percentages by their respective costs. These capital costs reflect investors' expectations based upon their

[6] 18 C.F.R. § 346.2(a)(ii), included as Exhibit No. LOU-0005.

perception of future risks. Economists view a fair or reasonable rate of return as one that will allow a pipeline to fulfill its obligation to provide service to its ratepayers and provide a level of earnings sufficient to maintain the integrity of invested capital and attract new capital at a reasonable cost in competition with other comparable investment opportunities. The economic principle of "opportunity cost" is the fundamental concept underlying the determination of a fair and reasonable rate of return on an investment, commensurate with returns an investor could expect to receive from other investments of similar risk.

Q16. Please explain how one evaluates risk.

A16. There are two elements of risk that investors consider in evaluating investment opportunities, business risk and financial risk. Business risk reflects the operating conditions and performance of a firm. Business risk can be both diversifiable and non-diversifiable. Noted experts Shannon Pratt and Roger Grabowski define diversifiable risk as "uncertainty of future returns due to the characteristics of the industry, the individual company, and the type of investment interest, and is unrelated to a variation of returns in the market as a whole."[7] All other risks facing the company are considered non-diversifiable. From an investor's standpoint, the non-diversifiable or systematic risk elements are most germane in evaluating the cost of capital. Business risk arises from the volatility of the firm's sales and earnings and relates to the operations of the firm. The second element of risk is financial risk, which measures the risk related to the amount of debt used to finance the operations of the firm. The two elements work together such that

[7] Pratt, Shannon P. and Roger J. Grabowski *Cost of Capital, Applications and Examples*, 5th Edition, Wiley, 2014 at pg. 191, included as Exhibit No. LOU-0006.

the market determines how much financial risk is acceptable to the firm given its level of both systematic and diversifiable business risk.

Q17. Please explain how this is relevant in determining SFPP's allowed rate of return.

A17. When investing in a particular company, investors require the opportunity to earn a return equivalent to the return they could expect to receive on an alternative investment of equivalent risk. This concept of the opportunity cost of capital is used to determine the just and reasonable rate of return that SFPP should be allowed to earn on its rate base. Estimating the cost of capital requires evaluation and consideration of companies that face similar risk profiles and engage in similar operations. In this way, one satisfies the economic principle of opportunity cost by relying on companies that have similar risk characteristics, and which therefore constitute risk-comparable alternatives to investing in the subject company.

Q18. Are there differences with respect to the returns an investor could achieve on debt instruments versus equity investments?

A18. Yes. Investors in debt and investors in equity have different required rates of return. Investors in debt instruments have a fixed claim on a firm's assets and any income must be paid to them before income flows to any equity investor. The return they receive takes the form of interest paid on the bonds or notes issued by the company, and they do not receive any share of the company's profits. Equity investments have the residual claim on the firm's assets and income, and therefore, equity investments are riskier than debt investments because debt obligations are required to be paid before equity returns flow to shareholders. Because of the lower risk associated with debt investments, debt holders

require a lower return than equity investors. Thus, the cost of equity and the cost of debt must be computed separately in order to determine the overall cost of capital for a company.

Q19. How is the overall cost of capital calculated?

A19. The overall cost of capital is the weighted average cost of debt and equity, where the weights for each component are the percentages of debt and equity in the company's capital structure. The formula used is:

$$Cost\ of\ Capital = (Cost\ of\ Debt \times Percent\ Debt) + (Cost\ of\ Equity \times Percent\ Equity)$$

CAPITAL STRUCTURE

Q20. What is the importance of capital structure in determining the cost of capital?

A20. Capital structure embodies the financial risk element of the rate of return by examining the financial leverage that a particular business uses to finance its operations. The financial leverage is determined by the amount of debt versus amount of equity used to finance the company. The capital structure should be representative of the financial leverage typically used in the industry.

Q21. What guidance does the CPUC offer with respect to calculating capital structure?

A21. In the Final Decision in the A.03-02-027 proceeding involving SFPP, the CPUC adopted a capital structure that reflected the "structure of the actual financing source," which was SFPP's corporate parent at the time, KMEP.[8]

[8] Decision 11-05-045, *Decision Resolving Case 97-04-025, Dismissing Application 00-03-044, and Resolving in Part Other Consolidated Proceedings* (May 26, 2011), included as Exhibit No. LOU-0018.

Q22. What guidance does the FERC offer with respect to calculating capital structure?

A22. Opinion 154-B[9] states that oil pipelines should utilize the actual capital structure of either the pipeline or its parent. Consistent with Opinion 154-B, the FERC has generally adopted the capital structure of the pipeline if it secures its own debt without the guarantee of its parent company. If the pipeline does not secure its own debt, the parent company's capital structure is utilized unless it is found to be anomalous.[10]

Q23. Please summarize the capital structure recommendation and methodology of SFPP witness Dr. Webb for the Test Period.

A23. Dr. Webb recommends a hypothetical capital structure of 60% equity and 40% debt for SFPP. His capital structure recommendation is not based on the capital structure of either SFPP or its corporate parent, Kinder Morgan, Inc. ("KMI"). Moreover, Dr. Webb is inconsistent in determining the cost of debt and the capital structure. For example, Dr. Webb purports to use KMI's actual cost of debt as the cost of debt for SFPP in determining SFPP's Test Year cost of capital. Yet he does not use KMI's actual capital structure as a proxy for SFPP, but rather a hypothetical capital structure. This inconsistency is not in accord with sound financial analysis. In other words, if Dr. Webb relies on KMI's actual cost of debt then a consistent approach would be to consider and use KMI's capital structure that supports the overall debt cost. Dr. Webb fails to do so in using a hypothetical capital structure.

Q24. Does Dr. Webb present any quantitative analyses or calculations to support his

[9] Opinion No. 154-B, 31 FERC ¶ 61,832 at 61,836, included as Exhibit No. LOU-0007.
[10] Anomalous refers to a capital structure outside the range previously accepted by the FERC. See Opinion 502, 123 FERC ¶ 61,287 at P176, included as Exhibit No. LOU-0008.

hypothetical capital structure of 60% equity and 40% debt?

A24. No, he does not. In response to discovery requests, Dr. Webb indicated that the entirety of his "analysis supporting his proposed capital structure" was contained in three pages of his Direct Testimony.[11] The referenced materials note that SFPP's debt is guaranteed by KMI and that KMI's capital structure is approximately 50% equity and 50% debt, followed by Dr. Webb's opinion that a 60% equity and 40% debt capital structure is appropriate for SFPP.[12] Dr. Webb's testimony is devoid of any quantitative analyses or calculations that support his recommended capital structure for SFPP and is based solely on his intuitive beliefs.

Q25. What rationale does Dr. Webb provide for using a hypothetical capital structure for SFPP rather than the accepted analysis of using the capital structure of KMI, SFPP's parent company?

A25. Dr. Webb argues that the capital structure of SFPP's corporate parent, KMI, is not applicable to SFPP from a risk perspective because SFPP is financially riskier than KMI. On this basis, Dr. Webb contends that SFPP can support less debt in its capital structure. However, I believe that Dr. Webb provides several misleading arguments to justify his support of hypothetical capital structure for SFPP.

Q26. Let's start with Dr. Webb's first argument about SFPP's financial risk vis-à-vis that of its corporate parent, KMI. Is his argument convincing?

A26. No. Dr. Webb acknowledges that SFPP does not issue its own equity or debt.[13] He further

[11] Response to TES-SFPP-3.2, received on October 12, 2021, included as Exhibit No. LOU-0009.
[12] Exhibit No. MJW-0001 at 8:13-10:3.
[13] Exhibit No. MJW-0001 at 8:13-14.

acknowledges that SFPP's debt and financing is provided by KMI, its corporate parent. Despite this fact, his principal argument against using KMI's capital structure for SFPP for ratemaking purposes rests on his unsupported opinion that "KMI's actual capital structure reflects the risks associated with all of KMI's assets, and therefore does not capture the risk that SFPP faces with respect to its California operations."[14] Dr. Webb performs no analysis evaluating the risks faced by SFPP and its corporate parent and ignores the fact that KMI guarantees SFPP's financing. Despite his statement that KMI's capital structure is "insufficient for SFPP to attract investment,"[15] Dr. Webb does not present any data, studies, analyses, documents, or reports to support his proposition.

Q27. What factors do you think are important to consider when evaluating whether the debt ratio of a capital structure represents a greater level of risk?

A27. As a general proposition, when assessing whether or not a company faces a greater level of overall risk due to the level of its debt, it is important to consider the company's ability to repay that debt. If a company's operations are able to support its debt, having a higher debt to equity ratio does not pose a greater overall risk to investors. With respect to SFPP in particular, since KMI guarantees SFPP's debt, what is relevant is KMI's ability to service its debts. If KMI is able to do so, then there is no reason why its capital structure, including of course its level of debt, should not be used for regulatory purposes in establishing SFPP's capital structure. In fact, Dr. Webb attempts to use KMI's cost of debt in his rate of return calculations.[16] I discuss KMI's ability to service its debts and the risk

[14] Exhibit No. MJW-0001 at 9:4-5.
[15] Exhibit No. MJW-0001 at 9:8-9.
[16] Exhibit No. MJW-0001 at 10:7-9.

it faces below.

Q28. Dr. Webb points to the CPUC's approval of a 60% equity and 40% debt capital structure for Crimson California Pipeline L.P. as support for his recommendation of the same capital structure for SFPP in this proceeding. Does Dr. Webb provide any analysis to support his conclusion?

A28. No, he does not. Dr. Webb devotes a single Q&A to this point[17] and fails to provide any meaningful analysis evaluating the relative risks that SFPP and Crimson face. Dr. Webb's reference to the CPUC's capital structure decision in the Crimson case is without context and provides no helpful information in developing an appropriate and reasonable capital structure for SFPP in this proceeding. Dr. Webb's response to data request TES-SFPP-3.3 makes it clear that the entirety of his "analysis" comparing Crimson and SFPP is contained in the text of his testimony.[18] The eight lines[19] of his Direct Testimony which Dr. Webb cites as his "analysis" are the following:

> While SFPP and Crimson California operate in similar markets, it is noteworthy that market dynamics have changed since Crimson California submitted its application for authority to increase its rates in 2016. These market changes include the COVID-19 pandemic and the green energy initiatives that are discussed in further detail below. Thus, it is my opinion that setting SFPP's return at the median of these companies included in the proxy group would substantially understate the risk that SFPP faces, and thereby would fail to adhere to the core requirement of *Hope* and *Bluefield.*[20]

The referenced text provides no helpful information comparing Crimson and SFPP and instead provides irrelevant assertions about the COVID-19 pandemic and green energy

[17] Exhibit No. MJW-0001 at 9:19-10:3.
[18] Response to TES-SFPP-3.3, received on October 12, 2021, included as Exhibit No. LOU-0010.
[19] Exhibit No. MJW-0001 at 28:13-29:3.
[20] Exhibit No. MJW-0001 at 28:13-29:3.

initiatives.

Q29. Does your research indicate that Crimson and SFPP face comparable risk?

A29. No, quite the contrary. The Commission decision to which Dr. Webb refers explicitly states that neither Crimson California Pipeline Company, L.P. ("Crimson") nor its parent (Crimson Midstream) issue long-term debt.[21] This directly contrasts with SFPP's corporate parent, KMI. Unlike Crimson or its parent, KMI issues its own debt, which is rated as investment grade by Moody's and Standard & Poor's ("S&P"). Further, KMI and all of its subsidiaries, including SFPP, are party to a "cross guarantee agreement whereby each party to the agreement unconditionally guarantees, jointly and severally" the indebtedness of all other parties to the agreement.[22] Dr. Webb ignores the fact that Crimson's corporate parent, Crimson Midstream Operating, LLC ("Crimson Midstream") is not rated by Moody's or S&P because it issues no debt.[23] In fact, Dr. Webb's own testimony in the Crimson case indicates that the only debt to which Crimson has access "has restrictive covenants that are not found in the long-term debt that publicly traded oil pipelines normally issue."[24] This is certainly not the case with SFPP's parent, KMI, which had over $30 billion in long-term debt outstanding as of December 31, 2020.[25] Therefore, Crimson's access to debt financing differs materially from SFPP's access through its corporate parent, KMI. Crimson's and SFPP's debt financing situations are simply not comparable.

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[21] Decision 20-11-026, *In the Matter of the Application of Crimson California Pipeline L.P. for Authority to Increase Rates for Its Crude Oil Pipeline Services*, in A.16-03-009 and Related Matters, at pg. 36, included as Exhibit No. LOU-0011.
[22] KMI 2020 SEC Form 10-K, pg. 103, included in Exhibit No. LOU-0012.
[23] SFP21 001308, included in Exhibit No. LOU-0013.
[24] SFP21 001305, included in Exhibit No. LOU-0013.
[25] KMI 2020 SEC Form 10-K, pg. 78, included in Exhibit No. LOU-0012.

Q30. Is Dr. Webb's own characterization of Crimson's access to debt in the prior proceeding consistent with the testimony that he presents in this proceeding?

A30. No, it is not. In the prior proceeding, Dr. Webb testified that if Crimson were able to obtain debt financing, it would be rated no better than B level.[26] According to Moody's, B level debt is not investment grade, is considered speculative, and is subject to "very high credit risk."[27] In contrast, Moody's rates KMI's debt as Baa2, which is investment grade and subject to "moderate credit risk."[28] Dr. Webb's assertions that Crimson and SFPP face similar financial risk is contrary to the facts and appears to be simply an effort to increase the rate of return applicable to SFPP by inflating the equity portion of the capital structure.

Q31. What is Dr. Webb's next argument in support of a 60% equity and 40% debt capital structure?

A31. Dr. Webb argues that the capital structure adjustment he recommends for SFPP is necessary so that the firm is "able to attract capital and earn a reasonable return on its investment."[29]

Q32. Does Dr. Webb conduct any analyses or studies to support his argument?

A32. No. Dr. Webb's testimony is devoid of any analysis demonstrating that SFPP would be unable to attract capital or earn a reasonable return on its investment if the capital structure of its corporate parent were applied, as both CPUC and FERC precedent dictate.

Q33. Has Dr. Webb agreed that the appropriate capital structure for SFPP is that of its

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[26] SFP21 001308, provided in response to TES-SFPP-3.5, included as Exhibit No. LOU-0013.
[27] https://www.moodys.com/sites/products/productattachments/ap075378_1_1408_ki.pdf included as Exhibit No. LOU-0014.
[28] Ibid.
[29] Response to TES-SFPP-3.6, received on October 12, 2021, included as Exhibit No. LOU-0015.

corporate parent in prior proceedings?

A33. Yes. In a proceeding before the FERC,[30] Dr. Webb agreed with both shipper witnesses and FERC Staff that regulators should impute to SFPP the capital structure of its corporate parent, KMI. In this proceeding, Dr. Webb presents no rationale or data to support a departure from his prior opinion regarding SFPP's capital structure.

Q34. Is Dr. Webb's recommended capital structure for SFPP consistent with that reported in its compliance filings for the CPUC?

A34. No, it is not. For the years 2016 through 2018, SFPP's CPUC compliance filings present equity ratios between 49.55% and 51.29%.[31] This is clearly a deviation from the 60% equity capital structure recommended by Dr. Webb in this proceeding.

Q35. Given the numerous issues with Dr. Webb's capital structure presentation, let's turn to your recommendations. How have you determined the appropriate capital structure for SFPP?

A35. SFPP is not a publicly traded entity and does not issue its own debt. Therefore, I have determined that the appropriate capital structure for SFPP is based on the capital structure of its parent, KMI. KMI provided financing for SFPP's operations and guaranteed its debt. KMI's actual capital structure represents a mix of financial leverage (debt and equity) appropriate for operations under existing market conditions for a pipeline and therefore is representative of the risks faced by pipeline companies.

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[30] For example, see the Initial Decision in the OR16-6 Proceeding,160 FERC ¶ 63,006 at P 146 (July 21, 2017), included in Exhibit No. LOU-0016, noting that "all of the participants recommend using the capital structure of SFPP's corporate parent, KMI."

[31] SFPP Compliance Filings, California Public Utilities Commission, included as Exhibit No. LOU-0022.

Q36. Is your approach supported by prior CPUC decisions involving SFPP?

A36. Yes. In the A.09-05-014 proceeding, ALJ Bemesderfer concluded that "SFPP is deemed to have the same capital structure as its parent," which was Kinder Morgan Energy Partners ("KMEP") at the time.[32] Similarly, D.11-05-045 also imputed to SFPP the capital structure of its parent company.[33] That same approach should be used in this proceeding.

Q37. Is your approach supported by prior FERC decisions involving SFPP?

A37. Yes, it is. Since KMI acquired SFPP's prior owner, KMEP, the FERC has held that the capital structure of KMI should be used for SFPP for ratemaking purposes.[34]

Q38. What have you concluded to be the appropriate capital structure for SFPP for the Test Period?

A38. I have calculated the capital structure for SFPP for the Test Period to be approximately 47 percent equity and 53 percent debt.

Q39. How did you calculate the appropriate capital structure for SFPP?

A39. I used KMI's December 31, 2020 actual capital structure and adjusted that figure for purchase accounting adjustments ("PAAs") for the Test Period.

Q40. Can you provide a definition of PAAs?

A40. Certainly. PAAs are restatements of equity and asset balances in a company's financial

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[32] Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al*. at pg. 6 (April 6, 2012) included as Exhibit No. LOU-0017.

[33] Decision 11-05-045, *Decision Resolving Case 97-04-025, Dismissing Application 00-03-044, and Resolving in Part Other Consolidated Proceedings* (May 26, 2011) included as Exhibit No. LOU-0018.

[34] Initial Decision in the OR16-6 Proceeding, 160 FERC ¶ 63,006 (July 21, 2017) included as Exhibit No. LOU-0016; Opinion No. 522, 140 FERC ¶ 61,220 (September 20, 2012) included as Exhibit No. LOU-0019.

statements that are made when a company acquires assets.

Q41. What is your rationale for adjusting KMI's capital structure for PAAs?

A41. PAAs may result in a situation in which the account balances no longer reflect the actual original cost of regulated assets, which should not be permitted for ratemaking purposes.[35] The inclusion of a positive PAA leads to an inflated restatement of the investment base and the equity amount on the balance sheet, subsequently leading to an inflated allowed return on the equity portion of the rate base. For example, when KMEP acquired SFPP in 1998, SFPP wrote up the equity portion of the rate base to reflect the premium over the regulatory return that KMEP paid to acquire SFPP. The result was a write-up in both the carrier property and the equity components of SFPP's balance sheet. With respect to SFPP's capital structure, writing-up the equity component will lead to an inflated capital structure that is unduly weighted towards equity. It is therefore necessary to remove PAAs from SFPP's capital structure in order to ensure that the SFPP capital structure that is used in determining the regulatory return is consistent with the rate base used to determine SFPP's cost of service. In other words, adjusting SFPP's capital structure to remove PAAs ensures that the capital account is based on original cost.

Q42. Has the Commission rejected the inclusion of PAAs in prior proceedings?

A42. This Commission has uniformly ruled that ratemaking should be based on original cost, and the removal of PAAs is consistent with that principle. Additionally, in the A.09-05-

[35] *SFPP, L.P. Mobil Oil Corporation*, 86 FERC ¶ 61,022 at 61,097 (2000) included as Exhibit No. LOU-0020; *SFPP, L.P. et al.,* 111 FERC ¶ 61,334 at P 67 (2005), included as Exhibit No. LOU-0025 ("the purchase accounting adjustment, regardless of which entity's books it may be recorded on, cannot be reflected in rates absent a showing of specific benefit").

014 proceeding, ALJ Karl Bemesderfer upheld the position that PAAs must be removed from the equity portion of SFPP's parent company at the time, Kinder Morgan Energy Partners LP's capital structure.[36] The issue here is identical to that raised in the prior case.

Q43. Please describe how you adjust KMI's equity account in order to remove PAAs to correctly determine SFPP's Test Period capital structure.

A43. In discovery, SFPP indicated that KMI's total gross property balance of $53,654 million as of December 31, 2020 included $869 million of PAAs to the gross property attributable to regulated KMI subsidiaries.[37] I therefore removed $869 million from the equity balance stated in KMI's 2020 SEC Form 10-K.

Q44. Please explain how you determined the capital structure once you adjusted KMI's equity balance.

A44. Once I adjusted KMI's equity balance to remove the PAAs, I calculated KMI's percentage equity by dividing the adjusted equity balance by the sum of the adjusted equity balance plus the value of KMI's long term debt as of December 31, 2020. I calculated the percentage debt by dividing the value of KMI's debt as of December 31, 2020 by the sum of debt plus the adjusted equity balance. The formulas are:

$$Percentage\ Debt = \frac{Debt}{Debt + Equity}$$

$$Percentage\ Equity = \frac{Equity}{Debt + Equity}$$

This is shown in Exhibit No. LOU-0055, and results in a capital structure of 47.17% equity

[36] See Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al.* at pg. 6 (April 6, 2012) included as Exhibit No. LOU-0017.
[37] Response to TES-SFPP-2.3, included as Exhibit No. LOU-0021.

and 52.83% debt.

Q45. Have you compared this capital structure to that of other large pipeline companies similar to SFPP's parent, KMI?

A45. Yes, I have. I calculated the median capital structure for five large pipeline companies[38] that I include in my Test Period return on equity proxy group and found that the median capital structure for these companies was 46% equity and 54% debt. This approach establishes the reasonableness of using a 47.17% equity Test Period capital structure for SFPP.

RETURN ON EQUITY

Q46. How does Dr. Webb calculate his recommended Test Period return on equity for SFPP?

A46. Dr. Webb relies on the Discounted Cash Flow ("DCF") methodology as well as the Capital Asset Pricing Model ("CAPM"). For both methods, Dr. Webb implements his interpretation of FERC guidance with respect to the methodologies. At the outset, the CPUC is not obligated to adopt any FERC methodologies with respect to the return on equity. In my analysis of the return on equity, I address key methodological differences in more detail, including both a critique of Dr. Webb's reliance on FERC guidance and my own recommended computations. Returning to Dr Webb's methods, he uses a proxy group of companies that he claims are comparable to SFPP from an operational and risk perspective. To arrive at his ROE, Dr. Webb averages his DCF and CAPM results, and

[38] These include Enbridge Inc., Enterprise Products Partners LP, Magellan Midstream Partners LP, Plains All American Pipeline LP, and TC Energy Corp. I discuss the selection of proxy companies in great detail later in my testimony.

adds a 1.00% risk premium. After providing some background on the DCF and CAPM methodologies, I discuss the issues with Dr. Webb's DCF and CAPM analyses separately, and then explain why Dr. Webb's 100 basis point risk premium should be rejected.

Q47. Let's start with the DCF method. Can you briefly explain how the DCF methodology works?

A47. The DCF model is based on the theory that investors value an asset based on the expected future cash flows from owning that asset. For a stock, the value is based on the dividend payments expected to be received over the lifetime of holding the stock plus the value of the stock if it is sold. An important assumption of the DCF method is that a company's current stock prices embody the market's expectation of the rate of return that will be realized by investing in the company's stock. These cash flows may be dividends or the proceeds from selling the stock at some future date, and the discount rate is the cost of equity capital. This finance principle—that the price of stock in an efficient market will equal the discounted sum of expected future cash flows—can be expressed mathematically in the following equation:

$$P_0 = \frac{D_1}{1 + r_E} + \frac{D_2}{(1 + r_E)^2} + \frac{D_3}{(1 + r_E)^3} + \cdots + \frac{P_T + D_T}{(1 + r_E)^T}$$

Where P_0 is the current market price of the stock;

D_t is the dividend cash flow expected at the end of period t;

T is the last period in which a dividend cash flow is to be received;

P_T is the price of the "terminal value" of the stock (its price at the end of year *T*);

r_E is the cost of equity capital

Since the current market price (P_0) is known, all that is needed to infer the market cost of

equity (r_E), is a projection of expected future cash flows (*i.e.,* the future dividends D_t and, as applicable, a terminal price P_T).

Q48. What is a "single stage" DCF model?

A48. The simplest version of the DCF model assumes that dividends grow forever at a constant rate. Making this strong assumption permits an algebraic solution to the DCF equation, according to the following formula:

$$r_E = \frac{D_1}{P_0} + g = \frac{D_0}{P_0} \times (1 + g) + g$$

Where D_0 is the current dividend, which (the model assumes) investors expect to grow at rate g by the end of the next period,[39] and over all subsequent periods into perpetuity. Because a single growth rate is assumed to apply for all future periods, this version of the model is often called a "single stage" model.

Q49. Are there any issues with employing the constant growth version of the DCF?

A49. Yes. Assuming that a company's earnings will grow forever at a single rate is only realistic if the growth rate is sustainable in relation to the opportunities for growth in the industry or sector in which the company operates. Assumed rates of growth in particular sectors must in turn be sustainable in relation to reasonable projections of overall economic output, since "the economy" consists of the aggregate activity in all productive industries.

While a company may be able to grow more rapidly than the overall economy over

[39] Note that some implementations of the model attempt to account for variations in the timing of annual increases to quarterly dividends by assuming that the level of the next dividend D_1will reached by growing the most recent dividend at half of the annual growth rate. This version of the formula is $r_E = \frac{D_0}{P_0} \times (1 + 0.5 \times g) + g$.

a short or medium-term horizon, it cannot be expected to sustain such growth forever without effectively *becoming* most of the economy. For example, consider the fact that total GDP for the U.S. economy was approximately $21 trillion in 2020,[40] and Dr. Webb's analyses assume a GDP growth rate of 4.15%. Meanwhile, Apple Inc. had corporate profits of $57 billion in 2020 and Dr. Webb's workpapers indicate that the IBES growth rate for Apple was 12.6% as of the end of 2020. If Apple were to maintain a constant growth rate of 12.6% annual growth in its earnings while U.S. GDP grew at 4.15% annually, Apple's earnings would exceed total U.S. output by the end of the 21st century—an unrealistic (if not impossible) scenario. This is an extreme example, since Apple is among the largest and most profitable companies in the world. However, due to the mathematics of compounding, it is unrealistic to assume that any company can maintain constant perpetual growth at a rate exceeding that of the broader economy.

Similarly, while in the short or medium term, companies may be expected to grow slower than the broader economy, or even to shrink in absolute terms, it is unrealistic to assume that such growth can persist forever. A company growing at a perpetual constant rate much slower than the overall economy would eventually become economically irrelevant (or, in practical terms, go out of business).

Consequently, while the single stage DCF model is mathematically convenient, it can only be relied on to provide meaningful estimates of the cost of equity if the assumed growth rates are sustainable over very long time horizons.

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[40] OECD, https://data.oecd.org/gdp/gross-domestic-product-gdp.htm included as Exhibit No. LOU-0031.

Q50. What is a multi-stage DCF model?

A50. A multi-stage DCF ("MSDCF") model is one that assumes different rates of growth at different stages. A typical implementation of the multi-stage DCF begins with a "growth stage" during which the company's dividends or distributable cash flows grow at a company-specific forecasted rate of earnings growth. This is followed by a "transition stage" during which growth is intermediate between the company-specific growth and the overall rate of economic growth. Beginning after the transition stage, cash flows are assumed to grow perpetually at the forecasted rate of overall economic growth (*i.e.,* the long-term GDP growth rate). This final stage of perpetual constant growth is referred to as the "terminal stage."

Q51. How does a multi-stage DCF model address the issues with the constant growth DCF model?

A51. A multi-stage DCF explicitly constrains each company's growth rate to be equal to the economy-wide growth rate in the terminal stage. Therefore, once that stage is reached, the share of the larger economy growth represented any given proxy company's earnings will not be assumed to expand indefinitely or shrink toward zero. Rather, the company is assumed to maintain the same proportional size in relation to the broader economy. For this reason, the terminal stage of an MSDCF model is therefore sometimes called the "steady state" growth stage.

Q52. Do both the single stage and multi-stage DCF use a proxy group?

A52. Yes. Because SFPP is not publicly traded, we cannot directly measure its return on equity. Therefore, it is necessary to use a proxy group of comparable, publicly traded companies

to calculate the return on equity using the DCF model. After selecting a functionally comparable and risk appropriate proxy group, we can then apply the DCF formula discussed above to each proxy company to estimate the return on equity applicable to SFPP.

Q53. Can you provide a summary of the CAPM?

A53. The CAPM is an academically accepted, market-based method for calculating the return on equity. As noted in the May 20, 2021 FERC Policy Statement on return on equity:

> The CAPM is based on the theory that the market-required rate of return for a security is equal to the "risk-free rate" plus a risk premium associated with that security. The CAPM estimates cost of equity by adding the risk-free rate to the "market-risk premium" multiplied by "beta."[41]

The formula for the CAPM model is expressed as:

$$R_s = R_f + \beta(R_m - R_f)$$

Where R_s is the return on the security, R_f is the risk-free rate of return, R_m is the rate of return on the market as a whole, and β is beta or the volatility of the individual security relative to the market as a whole.

In addition, there are modified versions of the traditional CAPM that include adjustments (either up or down) for the relative size of the individual security versus the market. The subsequent formula is:

$$R_s = R_f + \beta\left(R_m - R_f\right) + R_{sp}$$

Where R_{sp} captures the size premium.

[41] Policy Statement on Determining Return on Equity for Natural Gas and Oil Pipelines, 171 FERC ¶ 61,155 at P 8 (May 21, 2020) ("2020 Policy Statement") included as Exhibit No. LOU-0023.

Q54. How is a proxy group used in the CAPM?

A54. As in the DCF method, because SFPP is not publicly traded, it is necessary to use a proxy group to calculate the return on equity using the CAPM. After selecting a functionally comparable and risk appropriate proxy group, we apply the CAPM formula discussed above to each proxy company to estimate the return on equity applicable to SFPP.

Q55. How is the remainder of this section of your testimony organized?

A55. First, I discuss multiple defects with Dr. Webb's proxy group and outline a proxy group that I consider to be more robust. I then discuss the proxy group selection process and my recommended ROE proxy group. Second, I discuss the application of the DCF method in this proceeding, including the defects that I identified with Dr. Webb's application of the methodology and my recommended calculations. Third, I discuss the Dr. Webb's flawed application of the CAPM and my recommended determination. I conclude by further pointing out the defects in Dr. Webb's ROE recommendation, and I present my recommendation for SFPP's Test Period return on equity using both the DCF and CAPM methods.

PROXY GROUP SELECTION

Q56. What is the purpose of creating a proxy group in order to determine the return on equity for a company that does not issue its own stock?

A56. The fundamental purpose of creating a proxy group is to identify publicly traded companies that are comparable and similar in risk compared to the risks faced by the subject pipeline. Both Dr. Webb and I perform a DCF and CAPM analysis on a list of publicly traded companies to develop a return on equity recommendation for the Test Period.

Q57. Do the FERC or CPUC offer any guidance with respect to selecting proxy group members?

A57. Yes. The FERC's long-standing policy has been that for a company to be included in a proxy group it must be publicly traded, recognized as an oil pipeline company, tracked by an investment service such as *Value Line*, and pipeline operations must be a large proportion of the company's business.[42] More recently, the FERC's 2020 Policy Statement[43] confirms these principles, while indicating a preference for a proxy group comprised of at least five companies. The FERC states that the reason for these selection criteria is that these companies are the ones most likely to have a risk profile comparable to the pipeline seeking to justify its rates.[44]

While the CPUC does not issue decisions regarding oil pipeline proxy groups as often as it does other utilities, in late 2020, the CPUC noted that it has historically employed three screens when selecting a proxy group: (1) exclusion of companies with non-investment grade credit ratings, (2) exclusion of companies with no dividend history, and (3) exclusion of companies undergoing restructuring or merger activity.[45] Additionally, the decision goes on to note that proxy companies "should be exposed to similar risks" as the subject entity.[46]

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[42] *Transcontinental Gas Pipe Line Corp.,* 90 FERC ¶ 61,279 at 61,933 (2000), included as Exhibit No. LOU-0024.
[43] 2020 Policy Statement, op. cit., P 64, included in Exhibit No. LOU-0023.
[44] 2020 Policy Statement, op. cit., P 4, included im Exhibit No. LOU-0023.
[45] Decision 19-12-056, *Decision on Test Year 2020 Cost of Capital for the Major Energy Utilities*, (December 19, 2019) https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M322/K633/322633896.PDF included as Exhibit No. LOU-0026.
[46] Ibid.

Q58. In view of the CPUC and FERC guidance discussed above, what criteria did you use in selecting potential proxy group companies from your initial list?

A58. I employed the following screening criteria to develop a risk-appropriate proxy group for SFPP:

- Screen 1 – publicly traded
- Screen 2 – company must be tracked by an investment service
- Screen 3 – investment grade credit rating
- Screen 4 – significant oil pipeline operations
- Screen 5 – operational independence
- Screen 6 – merger and acquisition (M&A) activity

Using these criteria, I selected companies that exhibit functional and operational similarity to SFPP such that they would be representative of the typical risk faced by a common carrier pipeline. To that end, the majority of the proxy company's activities should ideally be focused on liquid pipeline operations (per Screen 4), consistent with the FERC's criterion to focus on oil pipeline companies. Screen 5 extends the functional and operational analysis to examine the extent to which a company has operational independence. This factor includes assessing whether the company relies on a high proportion of revenues derived from contractual relationships with related parties. Companies that derive a considerable portion of their revenue and cash flows from business dealings with related parties, whether it is through guaranteed revenue or pricing arrangements with parents or affiliates, will ostensibly have a different business risk profile than industry participants operating regulated, common carrier oil pipelines such as SFPP.

Q59. What companies does Dr. Webb include in his return on equity proxy group?

A59. Dr. Webb indicates that he "analyzed various companies" and selected a proxy group

comprised of Magellan Midstream Partners LP, MPLX LP, Enterprise Products Partners LP, Shell Midstream, Phillips 66 Partners LP, Plains All American Pipeline LP, Enbridge Energy Partners LP,[47] and NuStar Energy LP.

Q60. Do you agree with the companies that Dr. Webb included in his Test Period proxy group?

A60. No, I believe that Dr. Webb has inappropriately included MPLX, Shell Midstream, Phillips 66 Partners, and NuStar.

Q61. Let's talk about MPLX first. Why should MPLX be excluded from the SFPP ROE proxy group?

A61. Marathon Petroleum Corporation ("Marathon" or "MPC") owns approximately 62% of the common units of MPLX and is the primary customer of MPLX.[48] MPLX functions as a subsidiary of Marathon, with the MPLX 2020 SEC Form 10-K indicating that Marathon "will continue to be an important source of our revenues and cash flows for the foreseeable future."[49] In 2020, Marathon was responsible for approximately 92% of MPLX's logistics and storage ("L&S") segment revenues, which includes liquids pipeline transportation. With respect to the L&S segment, MPLX notes that its assets are "strategically located within, and integral to" Marathon's operations.[50] In addition, the company's 10-K states that "we have entered into multiple transportation, terminal and storage services

[47] Dr. Webb appears to mistakenly refer to Enbridge, Inc. as Enbridge Energy Partners LP. Enbridge Energy Partners LP was acquired by Enbridge, Inc. in 2014 and is no longer publicly traded.
[48] MPLX 2020 SEC Form 10-K, pg. 3, included in Exhibit No. LOU-0027.
[49] MPLX 2020 SEC Form 10-K, pg. 3, included in Exhibit No. LOU-0027.
[50] MPLX 2020 SEC Form 10-K, pg. 11, included in Exhibit No. LOU-0027.

agreements with MPC. Under these long-term, fee-based agreements, we provide transportation, terminal and storage services to MPC and, other than under our marine transportation services agreement, most of these agreements include minimum committed volumes from MPC. MPC has also committed to pay a fixed fee for 100 percent of available capacity for boats, barges and third-party chartered equipment under the marine transportation services agreement."[51]

In 2020, MPLX earned approximately 79.9% of its revenues from related parties.[52] Therefore MPLX has a different and incompatible business risk profile compared to SFPP.

As a result, MPLX's risk profile and business relationships are not representative of typical common carrier oil pipelines.[53] MPLX should therefore be rejected for inclusion in the proxy group.

Q62. Why should Shell Midstream be rejected?

A62. Shell Pipeline Company LP ("SPLC") owns a 72% interest in Shell Midstream.[54] In 2020, the company's parent and affiliates accounted for approximately 75% of total revenues.[55] Shell Midstream functions as a subsidiary of Shell Oil since most of its assets were formerly owned by Shell Pipeline Company.[56]

From a financial risk perspective, Shell Midstream is highly levered. Its 2020 SEC Form 10-K indicates that the company is financed *entirely* with debt and reports negative

[51] MPLX 2020 SEC Form 10-K, pg. 11, included in Exhibit No. LOU-0027.
[52] MPLX 2020 SEC Form 10-K, pg. 101, included in Exhibit No. LOU-0027.
[53] As an example, Dr. Webb's August 31, 2021 DCF analysis includes a 35.40% IBES earnings growth rate for MPLX.
[54] SHLX 2020 SEC Form 10-K, pg. 6, included in Exhibit No. LOU-0028.
[55] SHLX 2020 SEC Form 10-K, pg. 120, included in Exhibit No. LOU-0028.
[56] SHLX 2018 SEC Form 10-K, pg. 7, included in Exhibit No. LOU-0029.

equity on its balance sheet. Shell Midstream owes nearly $2.7 billion to related parties and affiliates.[57] These facts call into question Shell Midstream's financial and operational independence from its parent company. Further, Shell Midstream's reliance on its affiliates for both revenue and financing suggests that Shell faces a different risk profile from other oil pipeline companies that deal primarily with third parties as their customers. Like MPLX, there is a financial incentive for Shell Midstream's parent companies to support its success. As a result of these assurances, Shell Midstream's financial and operational relationship with its affiliates may unduly influence the company's stock price or growth estimates. As a result, these indices may not be representative of the pipeline industry overall. For these reasons, Shell Midstream should not be included in the proxy group for SFPP.

Q63. Is Dr. Webb correct in including Phillips 66 Partners in the proxy group?

A63. No, he is not. Phillips 66 owns 74% of the common units of Phillips 66 Partners LP and therefore Phillips 66 Partners can be considered functionally a subsidiary of Phillips 66. Based on publicly available data, Phillips 66 Partners' assets are subject to contractual agreements and are largely directly connected to its parent company's owned or operated refineries.[58] The company's 10-K states that "many of our assets are physically connected to, and integral to the operations of, Phillips 66's wholly owned Alliance, Bayway, Billings, Ferndale, Lake Charles, Ponca City and Sweeny refineries and its jointly owned Borger and Wood River refineries. We have entered into long-term, fee-based commercial

[57] SHLX 2020 SEC Form 10-K, pg. 80, included in Exhibit No. LOU-0028.
[58] Phillips 66 Partners 2020 SEC Form 10-K, pg. 1, included in Exhibit No. LOU-0030.

agreements with Phillips 66… Under these agreements, Phillips 66 commits to provide us with minimum transportation, throughput or storage volumes, or minimum monthly service fees… and they are the source of a substantial portion of our revenue."[59]

These agreements and related party transactions influence the risk that Phillips 66 Partners faces. This is illustrated by the share of operating revenue derived from unrelated third parties that is publicly reported, which indicate that Phillips 66 Partners has a different and incompatible business risk profile compared to SFPP. In 2020, Phillips 66 Partners earned less than 1% of its revenue from unrelated parties, with over 99% coming from related parties.[60] Consequently, Phillips 66 Partners functions as an extension of its parent company instead of a distinct operating company, and as a result, faces different operating risks from other liquids pipeline companies such as SFPP. As with MPLX and Shell discussed above, the related party relationships that dominate Phillips 66 Partners' business operations may influence the company's stock price and growth estimates, rendering it inappropriate for inclusion in the proxy group.

Q64. Please discuss why NuStar Energy should be excluded from Dr. Webb's Test Period proxy group.

A64. NuStar Energy does not have an investment grade credit rating and therefore, consistent with both CPUC and FERC precedent, should be excluded from any proxy group used to determine SFPP's return on equity. Moody's Investment Service downgraded NuStar to

[59] Phillips 66 Partners 2020 SEC Form 10-K, pg. 1, included in Exhibit No. LOU-0030.
[60] Phillips 66 Partners 2020 SEC Form 10-K, pg. 35, included in Exhibit No. LOU-0030.

Ba3 in 2020,[61] indicating that the company's debts are subject to "substantial credit risk."[62] Similarly, S&P rates NuStar as BB-, defined as a business facing "major ongoing uncertainties or exposure to adverse business, financial, or economic conditions that could lead to the obligator's inadequate capacity to meet its financial commitments."[63] NuStar does not face comparable financial risks to SFPP, whose financing is guaranteed by its corporate parent, KMI, which does hold an investment grade credit rating.

Q65. Now, that we have discussed Dr. Webb's proxy group, how did you develop your proxy group for SFPP?

A65. I began by reviewing the Standard & Poor's *Issuer Ranking: North American Midstream Companies, Strongest to Weakest.*[64] The S&P *Issuer Ranking* is a list of 110 North American midstream companies.

Q66. Did any companies from your initial list fail your screening criteria?

A66. Yes. Exhibit No. LOU-0003 shows my rejection matrix. Because the DCF model used to calculate the ROE using a proxy group relies on stock price data as an input, it is necessary for companies included in the proxy group to be publicly traded. This screen is also applicable to the CAPM, where we require beta, a measure of the volatility of a stock versus the market, for each company. Of the 110 midstream companies in the S&P list, 39 are

[61] https://www.moodys.com/credit-ratings/NuStar-Energy-LP-credit-rating-600065527/ratings/view-by-class included as Exhibit No. LOU-0033.
[62] https://www.moodys.com/sites/products/productattachments/ap075378_1_1408_ki.pdf included as Exhibit No. LOU-0014.
[63] https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352 included as Exhibit No. LOU-0040.
[64] https://www.spglobal.com/ratings/en/research/articles/200211-issuer-ranking-north-american-midstream-companies-strongest-to-weakest-11340556 included as Exhibit No. LOU-0044.

publicly traded and pass Screen 1.

Q67. Did any companies fail your screen for being tracked by an investment service?

A67. No. Each of the candidate companies are tracked and rated by S&P, and therefore satisfy Screen 2.

Q68. Did you eliminate any companies because they did not have an investment grade bond rating?

A68. Yes. Exhibit No. LOU-0003 shows that of the 39 companies that passed Screens 1 and 2, 16 have investment grade credit ratings per S&P. These companies are:

- Enbridge Inc.
- TC Energy Corp.
- Enterprise Products Partners LP
- Magellan Midstream Partners LP
- Inter Pipeline Ltd.
- Kinder Morgan Inc.
- MPLX LP
- ONEOK Inc.
- Pembina Pipeline Corp.
- The Williams Cos. Inc.
- Keyera Corp.
- Phillips 66 Partners LP
- Energy Transfer LP
- Enable Midstream Partners LP
- Western Midstream Operating LP

For completeness, I also reviewed the Moody's and Fitch ratings for the 39 companies that passed Screens 1 and 2. Western Midstream Operating LP is rated as Ba2 by Moody's and BB by Fitch, both of which are not investment grade credit ratings. For this reason, Western Midstream Operating LP fails Screen 3.

Q69. Can you explain your fourth screen related to assessing the level of oil pipeline

operations?

A69. My fourth screen involved assessing the extent to which the remaining companies had significant oil pipeline operations. This entailed a comprehensive review of SEC financial documents, including the annual Form 10-K, as well as annual reports, to assess the business profile of each company. The 10-K and annual reports are reliable sources of publicly available information on a company's business and financial operations, including a description of the business and operating segments. A review of the 10-Ks and annual reports for the remaining companies resulted in the elimination of 8 companies, as shown in Exhibit No. LOU-0003. The companies I eliminated are:

- TC Energy Corp.
- Kinder Morgan Inc.
- ONEOK Inc.
- Pembina Pipeline Corp.
- The Williams Cos. Inc.
- Keyera Corp.
- Energy Transfer LP
- Enable Midstream Partners LP

Q70. Did you eliminate any companies using Screen 5, the evaluation of operational independence?

A70. Yes, I did. Screen 5 is an extension of my functional and operational review of potential proxy group members. I removed two additional companies based on my review of the SEC Form 10-K and annual reports, since these companies rely primarily on related party revenue or related party transactions as a major part of their business model. Companies that rely on related party transactions or affiliate relationships to generate a significant proportion of their revenue and or earnings will inherently have a different risk profile than

the typical common carrier oil pipeline, in view of the lack of operational independence and high degree of corporate control indicated by related party transactions. These factors can influence the inputs to the DCF and CAPM models such that the results would not be representative of the overall oil pipeline industry. As a result, I examined related party revenue as an important factor in determining whether a company was suitable for inclusion in the proxy group. Screen 5 removed Phillips 66 Partners LP and MPLX LP.

Q71. How does related party revenue factor into evaluating a potential proxy group company?

A71. The intent of the proxy group analysis is to identify companies that have similar risks and perform similar functions as those of the subject entity. In this case, while SFPP has a parent company, it does not derive a large share of its revenue through guaranteed business arrangements with affiliates. In fact, its largest customers are not affiliated with SFPP or its parent company, KMI. That is, affiliate transactions with owners of the pipeline do not account for a large share of SFPP's revenue. This directly contrasts with many publicly traded oil companies as well as certain MLPs, some of which engage in substantial and material related party transactions. As a result, there is a significant difference in terms of the business risk faced by these companies as compared to a pipeline company such as SFPP. Investors are very mindful of this distinction. As discussed above in my reply to Dr. Webb's proxy group composition, Phillips 66 Partners and MPLX are examples of this scenario.

Q72. Did you eliminate any companies because they recently experienced merger and

acquisition ("M&A") activity (Screen 6)?

A72. Yes, I did. I searched the remaining companies' websites for news releases related to M&A activity that could potentially influence the stock prices. After this review, I eliminated Inter Pipeline Ltd.

Q73. Why did Inter Pipeline Ltd. fail Screen 6?

A73. Throughout the first half of 2020, Inter Pipeline made public announcements related to a hostile takeover bid from Brookfield Infrastructure Partners LP. In addition, the company's board was considering a share exchange with Pembina during the first half of 2021. In February and June 2021 when the company issued news releases urging its shareholders to reject or take no action with respect to the unsolicited takeover bid, the stock price increased by approximately 29% and 8%, respectively. Because these activities appear to impact the stock price, Inter Pipeline fails Screen 6.

Q74. What companies passed all six screening criteria?

A74. Enbridge Inc., Enterprise Products Partners LP, Magellan Midstream Partners LP, and Plains All American Pipeline LP passed all six screening criteria.

Q75. After Screen 6, the proxy group contains only four members. What process did you undertake to expand the proxy group?

A75. The FERC 2020 ROE Policy Statement notes that the proliferation of diversified energy companies as well as acquisitions of pipeline companies by private equity firms have "further reduced the number of eligible natural gas and oil pipeline proxy group members."[65] In response, the FERC stated that it would "continue to relax the 50%

[65] 2020 Policy Statement, op. cit., P 60, included in Exhibit No. LOU-0023.

standard when necessary to obtain a proxy group of five members."[66] I therefore reconsidered the companies eliminated by Screen 4, the significant oil pipeline operations screen to assemble a proxy group of at least five members.

Q76. Which companies do you recommend including in the ROE proxy group to achieve five members?

A76. Based on my review of publicly available SEC Form 10-K and annual report information, I determined that Kinder Morgan Inc. and TC Energy Corp. should be added to the proxy group. This increases the number of companies in my proxy group to six.

Q77. Why is it appropriate to include Kinder Morgan in the ROE proxy group for SFPP?

A77. There are multiple reasons. First, Kinder Morgan describes itself as "one of the largest energy infrastructure companies in North America."[67] On November 26, 2014, the company acquired all of the assets of Kinder Morgan Energy Partners LP, a company previously included in FERC-approved oil pipeline ROE proxy groups.[68] Second, in 2020, the company's EBITDA split was approximately 63% natural gas pipelines, 14% products pipelines, 14% terminals, and 9% CO2. The company derives a significant portion of its revenues from pipeline transportation and is therefore primarily a pipeline company. Finally, Kinder Morgan is the owner of the subject company, SFPP, and is responsible for SFPP's financing.[69]

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[66] 2020 Policy Statement, op. cit., P 64, included in Exhibit No. LOU-0023.
[67] KMI 2020 SEC Form 10-K, pg. 4, included in Exhibit No. LOU-0012.
[68] https://ir.kindermorgan.com/news/news-details/2014/Kinder-Morgan-Announces-Closing-of-the-Merger-Transactions/default.aspx included as Exhibit No. LOU-0045.
[69] KMI 2020 SEC Form 10-K, pg. 62, included in Exhibit No. LOU-0012.

Q78. Why should TC Energy be included in the ROE proxy group for SFPP?

A78. Similar to Kinder Morgan, TC Energy is primarily a pipeline company.[70] Also similar to Kinder Morgan, liquids pipelines represent approximately 17% of TC Energy's total assets, compared to 71% for natural gas pipelines. Further, liquids pipelines represented approximately 18% of revenue. TC Energy also owns the Keystone Pipeline, which is the largest crude oil pipeline in North America.[71]

Q79. What companies comprise your final proxy group for the Test Period?

A79. My proxy group for the Test Period as of September 30, 2021 includes:

- Enbridge Inc.
- Enterprise Products Partners LP
- Magellan Midstream Partners LP
- Plains All American Pipeline LP
- Kinder Morgan Inc.
- TC Energy Corp.

APPLICATION OF THE DCF METHODOLOGY

Q80. Let's start with the DCF. Are there any aspects of Dr. Webb's DCF methodology for the Test Period with which you disagree?

A80. Yes. While Dr. Webb applies the FERC-approved two-stage discounted cash flow method, there are several issues with his approach. First, as discussed previously in this testimony, Dr. Webb's DCF analysis is based on a flawed proxy group that excludes appropriate companies and includes inappropriate companies. Second, Dr. Webb's analysis illogically assumes that the two-stage approach approved by FERC is the only appropriate method to

[70] TC Energy 2020 Annual Report, pg. 14, included in Exhibit No. LOU-0032.
[71] TC Energy 2020 Annual Report, pg. 5, included in Exhibit No. LOU-0032.

use before the CPUC. While I recognize that the FERC has endorsed the two-stage DCF method, my recommendation is that the CPUC recognize the inherent flaws in the FERC-endorsed approach to allow a more representative and accurate determination of the return on equity using the DCF approach.

Q81. How do you implement your multi-stage DCF model to estimate SFPP's cost of equity in this proceeding?

A81. My implementation of the MSDCF model assumes that each proxy company grows its dividend for five years at the IBES (consensus mean) EPS growth rate for that company ("initial stage"); that growth rate then transitions linearly over the *next* five years ("transition stage") toward the forecast future long-term GDP growth rate. This U.S. GDP growth rate, which I estimate by averaging long-range projections from the Social Security Administration, the Energy Information Agency ("EIA"), and BlueChip Economic Indicators,[72] is assumed to apply for all of the proxy companies in the terminal (steady state growth) stage of the model.

Q82. What stock price and dividend inputs do you use in your multi-stage DCF model?

A82. To smooth out any short-term stock price fluctuations, I take an average of the daily closing stock prices for each proxy group company over the six months period ending on my study date. I likewise use the most recent four quarterly dividends or distributions paid prior to my study date.

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[72] U.S. Social Security Administration, *The 2021 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds,* August 31, 2021. U.S. Energy Information Administration, *Annual Energy Outlook 2021,* February 2021. *Blue Chip Economic Indicators,* Haver Analytics, https://lrus.wolterskluwer.com/store/product/blue-chip-economic-indicators/.

Q83. What are the results of your multi-stage DCF analysis?

A83. I performed two sets of MSDCF cost of equity estimates for my six-member proxy group: one as of December 31, 2020, which is the date of the analysis Dr. Webb relies on for his ROE recommendation in this case, and one as of September 30, 2021, which is the most recent month-end for which I was able to obtain and analyze the necessary financial data. The inputs, growth assumptions and results for the December 31, 2020 analysis are presented in Table 1 below. The median cost of equity estimate for this proxy group is 10.14%, and the average is 10.02%.

TABLE 1
MULTI-STAGE DCF ESTIMATES AS OF DECEMBER 31, 2020

Company	Stock Price	Most Recent Dividend	IBES Growth Rate	Growth Rate: Year 6	Growth Rate: Year 7	Growth Rate: Year 8	Growth Rate: Year 9	Growth Rate: Year 10	GDP Long-Term Growth Rate	DCF Cost of Equity
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]
Enbridge Inc.	$40.42	$ 3.24	6.86%	6.43%	6.01%	5.58%	5.15%	4.73%	4.30%	13.91%
Magellan Midstream Partners	$39.16	$ 4.11	-0.40%	0.02%	0.45%	0.87%	1.30%	1.72%	2.15%	11.45%
Enterprise Products	$17.82	$ 1.78	-0.90%	-0.40%	0.11%	0.62%	1.13%	1.64%	2.15%	10.73%
Plains All America Pipeline	$ 7.35	$ 0.90	-18.10%	-14.73%	-11.35%	-7.98%	-4.60%	-1.23%	2.15%	5.25%
TC Energy	$57.71	$ 3.24	2.53%	2.82%	3.12%	3.41%	3.71%	4.00%	4.30%	9.55%
Kinder Morgan Inc.	$13.49	$ 1.04	-3.50%	-2.20%	-0.90%	0.40%	1.70%	3.00%	4.30%	9.23%
									Median	10.14%
									Average	10.02%

The inputs, growth assumptions and results for the September 30, 2021 analysis are presented in Table 2 below. The median cost of equity estimate for the proxy group is 12.78%, and the average is 11.32%.

TABLE 2
MULTI-STAGE DCF ESTIMATES AS OF SEPTEMBER 30, 2021

Company	Stock Price	Most Recent Dividend	IBES Growth Rate	Growth Rate: Year 6	Growth Rate: Year 7	Growth Rate: Year 8	Growth Rate: Year 9	Growth Rate: Year 10	GDP Long-Term Growth Rate	DCF Cost of Equity
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]
Enbridge Inc.	$48.26	$ 3.32	9.51%	8.64%	7.76%	6.89%	6.02%	5.14%	4.27%	13.80%
Magellan Midstream Partners	$47.48	$ 4.11	9.08%	7.92%	6.76%	5.61%	4.45%	3.29%	2.13%	14.76%
Enterprise Products	$22.99	$ 1.80	10.20%	8.86%	7.51%	6.17%	4.82%	3.48%	2.13%	14.26%
Plains All America Pipeline	$ 9.92	$ 0.72	-20.31%	-16.57%	-12.83%	-9.09%	-5.35%	-1.61%	2.13%	3.50%
TC Energy	$60.80	$ 3.42	3.37%	3.52%	3.67%	3.82%	3.97%	4.12%	4.27%	9.82%
Kinder Morgan Inc.	$17.23	$ 1.07	6.92%	6.47%	6.03%	5.59%	5.15%	4.71%	4.27%	11.77%
									Median	12.78%
									Average	11.32%

Q84. Are you then recommending that the median figures be used in the DCF Analysis?

A84. Yes, I am.

Q85. Why do you believe the median ROE result from your DCF analysis is the most appropriate result?

A85. The CPUC has the discretion to select the return on equity from the proxy group within the range that it feels is most reasonable and consistent with the risks faced by SFPP. However, I also believe that FERC Opinion 502 should be seriously considered in this regard. In that opinion, FERC cites Opinion 414-A, stating, "the Commission considers all pipelines to be of average risk and generally sets ROEs that reflect the median DCF range, absent unusual circumstances and a showing of anomalously high or low risk."[73] In the present proceeding, I do not find any factors that warrant a departure from the median for SFPP, either through a selection of the 75th percentile (higher risk) or 25th percentile (lower risk), or the addition of a subjective risk premium. The calculation of the nominal equity rate of

[73] Opinion 502, 123 FERC ¶ 61,287 at P 195, included as Exhibit No. LOU-0008.

return using the DCF methodology for the proxy companies is shown in Exhibit No. LOU-0004.

Q86. Are you familiar with the so-called FERC "two-step" DCF model that Dr. Webb employed as part of his ROE analysis for this case?

A86. Yes. Consistent with the FERC's precedents and stated preference to set ROE for entities subject to its regulation based on a standard method, I have implemented that model when estimating the cost of equity in the context of FERC pipeline rate cases.

It is worth noting that while FERC's method is commonly referred to as a "two-step" DCF model, it is actually implemented using the single-stage DCF equation, albeit with a growth rate input that is a "weighted average" of each proxy company's IBES growth rate and the long-term GDP growth rate. Specifically, Dr. Webb's implementation of the two-step DCF model uses the following formula:

$$r_E = \frac{D}{P} \times (1 + 0.5 \times g_{IBES}) + g_{wtd\ avg}$$

$$\text{where } g_{wtd\ avg} = \frac{2}{3} g_{IBES} + \frac{1}{3} g_{GDP}$$

Applying one-third weight to the forecasted rate of future GDP growth serves to moderate somewhat the impact of any very high (or very low) company-specific IBES growth rate when deriving the "weighted average" growth rate that is assumed to apply in perpetuity.

Q87. Why do you rely on the multi-stage DCF model described above rather than the FERC two-step model for deriving your cost of equity estimates in this case?

A87. Compared to Dr. Webb's implementation of the FERC two-step DCF model, I believe my

implementation of the multi-stage DCF model provides a more reasonable projection of future dividends for the proxy group companies, thereby producing more reliable estimates of the cost of equity.

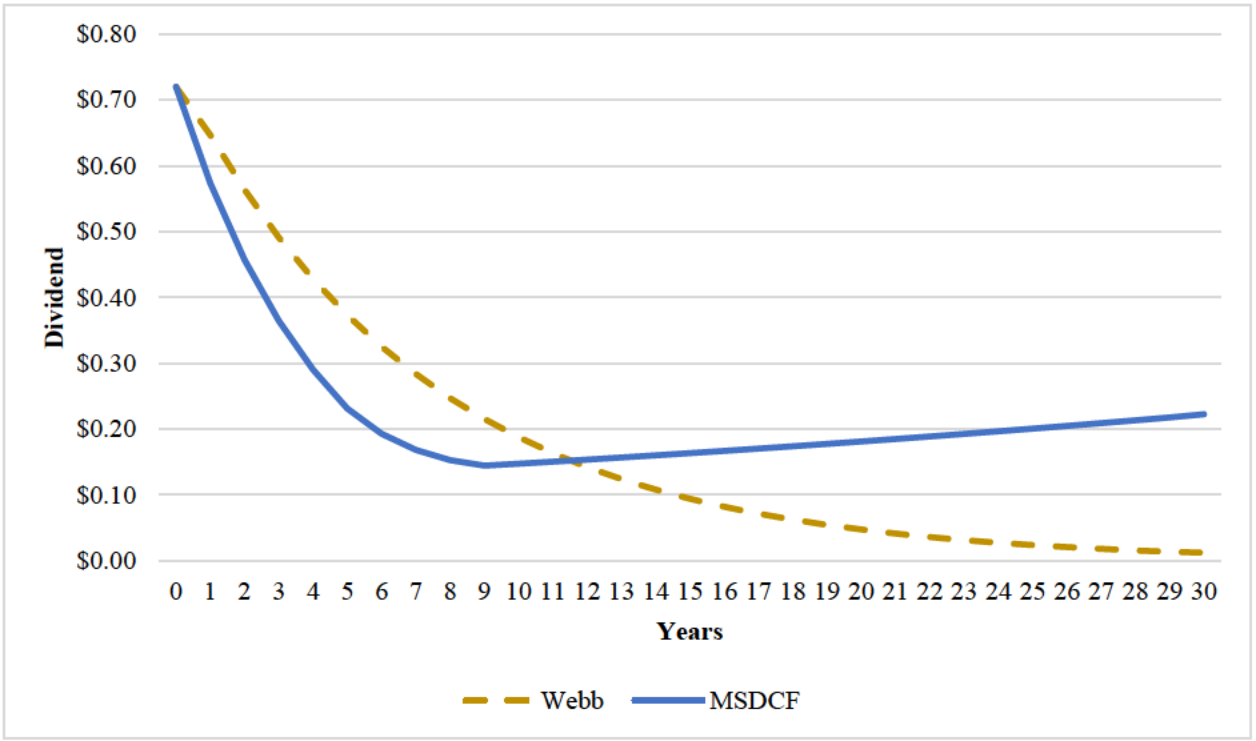
Consider, for example, Dr. Webb's two-step DCF estimation for Plains All American Pipeline, L.P. ("Plains" or "PAA") in his August 31, 2021 analysis. The IBES growth rate is -20.31%, and Dr. Webb uses a GDP growth rate of 2.07%.[74] The weighted average growth rate that Dr. Webb calculates for use in the two-step DCF model is therefore -12.85%.[75] Figure 1 shows the change in dividends by year for PAA using Dr. Webb's DCF method and the MSDCF method that I recommend. Because Dr. Webb's analysis uses the constant-growth (single stage) DCF equation, the FERC model inherently assumes this very negative growth rate will apply forever. This leads to the unrealistic dividend forecast represented by the dotted line in Figure 1 below, and also produces Dr. Webb's nonsensical -6.11% estimate for Plains' cost of equity. In contrast, my MSDC approach would produce a more realistic and useful projection of Plains' future dividends, depicted by the solid blue line in the figure, based on the same growth rate assumptions.[76]

[74] Exhibit No. MJW-0004.

[75] Ibid. $\left(\frac{2}{3} \times 20.31 + \frac{1}{3} \times 2.07 = 12.85\right)$

[76] Note that my DCF analysis as of September 30, 2021 produces an economically meaningful positive cost of equity estimate (3.6%) for Plains, using the same -20.31% IBES growth rate, and a higher GDP growth rate than Dr. Webb used.

Figure 1
Dividend Growth for PAA - Dr. Webb v. MSDCF

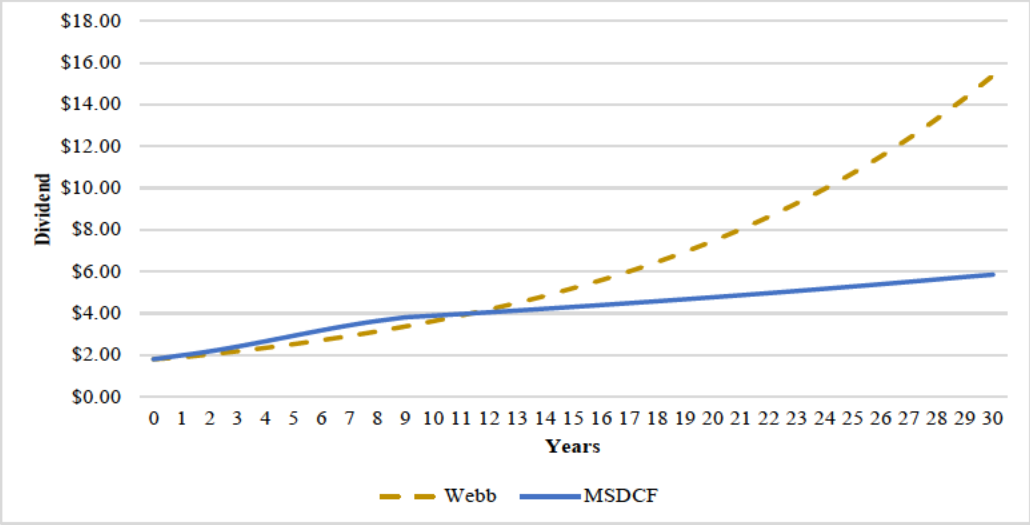


Q88. Does your MSDCF model only produce more realistic dividend growth projections for companies with negative growth rates?

A88. No. The same may be true for a company with a relatively high (though not necessarily extreme) positive growth rate. Consider the case of as Enterprise Products Partners ("Enterprise" or "EPD"), which has an IBES growth rate of 10.20% in Dr. Webb's August 31, 2021 analysis, corresponding to a 7.49% perpetual growth rate in the "two step" model after incorporating it in a weighted average with Dr. Webb's 2.07% GDP forecast. Though 7.49% may sound like a modest rate of growth, if applied in perpetuity it implies that Enterprise's earnings will double approximately each decade, with more than 8-fold growth over the next 30-years as depicted by the dotted line in the figure below. Figure 2 below plots the estimated dividends calculated by Dr. Webb's method and my method by

year. While my MSDC implementation (solid blue line in the figure below) would actually model slightly faster dividend growth for Enterprise over the next 10 years based on the same inputs, the trajectory of dividends is constrained to grow at a sustainable rate thereafter.

Figure 2
Dividend Growth for EPD - Dr. Webb v. MSDCF



APPLICATION OF THE CAPM METHODOLOGY

Q89. Does Dr. Webb use the CAPM to calculate a Test Period return on equity for SFPP?

A89. Yes, he does. However, there are a number of problems with his application of the methodology, including inclusion of inappropriate proxy group companies; use of *Value Line* betas; and use of an unreasonable forward-looking market-risk premium ("MRP"), including the use of a single-stage discounted cash flow to calculate the forward-looking MRP.

Q90. Let's start with Dr. Webb's inappropriate proxy group. Is this the same issue that you identified previously?

A90. Yes, Dr. Webb inappropriately includes MPLX, Shell Midstream, Phillips 66 Partners, and

NuStar in his proxy group. In addition, he incorrectly excludes Kinder Morgan and TC Energy from his proxy group. Because I have discussed the proxy group issue at length earlier in this testimony, I will not provide additional commentary, although the proxy group selection does influence the CAPM results as well.

Q91. Why do you disagree with Dr. Webb's use of *Value Line* betas in his CAPM approach?

A91. Dr. Webb uses *Value Line* as the source of beta in his CAPM calculation, claiming that *Value Line* is the only beta option approved by the FERC. However, in its ROE Policy Statement, the FERC merely stated that *Value Line* adjusted betas are a "reasonable" source to use in the CAPM.[77] The FERC went on to state that there may be certain cases where an alternative beta source would be more appropriate and that the Commission would address the selection of an appropriate data source for betas on a case-by-case basis.[78] In my opinion, it makes far more sense to use betas published by Bloomberg than betas published by *Value Line*.

Q92. Why does it make more sense to use Bloomberg betas in this proceeding?

A92. The purpose of using betas in the CAPM methodology is to account for the volatility of the individual proxy company relative to the market as a whole. Use of Bloomberg betas is far more consistent. For example, the *Value Line* adjusted betas that Dr. Webb uses are based on five-year weekly stock price history using the New York Stock Exchange ("NYSE") Composite Index as the benchmark for the market when determining the

[77] 2020 Policy Statement, op. cit., P 46, included as Exhibit No. LOU-0023.
[78] 2020 Policy Statement, op. cit., P 46, included as Exhibit No. LOU-0023.

volatility of a particular stock. The fact that *Value Line* betas are measured on returns for the larger NYSE Index is inconsistent with Dr. Webb's subsequent use of the S&P 500 index for calculating the market return portion of the MRP. It is well recognized that there should be consistency in the use of the market index for the market return and for the determination of estimates of beta.[79] The calculation of betas is sensitive to a number of factors including the particular market index that is used, and I therefore do not believe that betas that use the NYSE Composite Index are appropriate when Dr. Webb's MRP calculation uses the S&P 500 as the benchmark. For that reason, I recommend the use of betas calculated on a weekly, five-year basis from Bloomberg.

Q93. How does using Bloomberg betas address Dr. Webb's beta and market risk premium mismatch?

A93. Like *Value Line*, Bloomberg is a well-recognized source of financial data including data for betas.[80] Bloomberg betas can be obtained as of any time period required whereas *Value Line* betas are produced on a staggered quarterly basis which may not produce the most up to date information. Finally, and most importantly, Bloomberg computes its betas using the S&P 500 as the market index against which to measure a stock's volatility. This provides superior consistency in the CAPM since the S&P 500 would be used as the market index for both the betas and the market return portion of the MRP calculation.

[79] See for example, Eugene Brigham and Michael Ehrhardt, *Financial Management Theory and Practice,* 13th Ed., 2011, at pg. 262 and Roger A. Morin, "New Regulatory Finance," *Public Utilities Reports*, at pgs. 159-160 (2006).
[80] See Morin, op. cit., at pg. 154.

Q94. Do you agree with the MRP used in Dr. Webb's CAPM analysis?

A94. No. Dr. Webb calculates the MRP using a single-stage DCF model of all dividend paying members of the S&P 500 using short-term IBES earnings estimates. Dr. Webb screens out companies with negative earnings estimates or earnings estimates in excess of 20%. I do not believe that this is the only, or even the best, method to determine a forward-looking market risk premium. The single-stage DCF methodology used to calculate the MRP in Dr. Webb's CAPM illogically assumes that stocks will grow indefinitely at their 5-year growth rate without ever reverting to the long-term growth rate of the overall economy. The FERC previously identified this fallacy in stating that "an individual company cannot be expected to sustain high short-term growth rates in perpetuity."[81] In addition, a leading textbook by regulatory economist and financial expert Dr. Roger A. Morin points out the fallacy of utilizing a single-stage DCF methodology to calculate the MRP noting that,

> It is useful to remember that eventually all company growth rates, especially [but not only] utility services growth rates, converge to a level consistent with the growth rate of the aggregate economy.[82]

Implicit in the DCF approach used by Dr. Webb is the assumption that companies in the S&P 500, a proxy for the market, will grow (or decline) in perpetuity at their short-term (five-year) growth rates. By making this assumption, Dr. Webb produces an unrealistically high market-risk premium that is in excess of both historical returns and forward-looking MRPs calculated by other sources relied on by investors.[83] In addition, the FERC has

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[81] *Coakley v. Bangor Hydro-Electric Co.,* 150 FERC ¶ 61,615 at P 113 (2015) ("Opinion 531-B"), included as Exhibit No. LOU-0034.
[82] Roger A. Morin, *New Regulatory Finance,* Utilities Reports, Inc. 2005, pg. 308.
[83] For example, Bloomberg's forward-looking MRP was 7.13% as of September 30, 2021. For context, the long-term historical MRP was 7.25% as of September 30, 2021 according to Duff &

specifically recognized this fallacy of infinite growth, concluding in *Ozark Gas Transmission System* that "a projection limited to five years, with no evidence of what is anticipated beyond that point, is not consistent with the DCF model and cannot be relied on in a DCF analysis."[84]

Q95. What are the results of your CAPM analysis?

A95. As with the MSDCF model, I performed CAPM cost of equity estimates as of two dates: December 31, 2020 and September 30, 2021. In both cases, the inputs are derived as follows:

- The risk-free rate inputs are the average of the daily 30-year Treasury bond yields for the six-month period ending on the study date.
- The market risk premium ("MRP") is based on a six-month average of the forward-looking expected return on the S&P 500 stock index, as reported by Bloomberg based on its implementation of a market-level multi-stage DCF model. The MRP is calculated as the six-month average market return minus the six-month average 30-year Treasury yield.
- The betas are sourced from Bloomberg based on a five-year regression of weekly stock return data against the returns on the S&P 500.
- The results as of December 31, 2020 are reported in Table 3 below. The median for the proxy group is 9.12% and the average is 9.09%.

Phelps.

[84] *Ozark Gas Transmission System,* 68 FERC 61,032 at 61,105 (1994), included as Exhibit No. LOU-0035.

TABLE 3
CAPM ROE ESTIMATES AS OF DECEMBER 31, 2020

Company	Risk Free Rate	Market Risk Premium	Bloomberg (5-year) Beta	Unadjusted Cost of Equity	Size Premium	Adjusted Cost of Equity
	[1]	[2]	[3]	[4] = [1] + [2] * [3]	[5]	[6] = [4] + [5]
Enbridge Inc.	1.49%	7.13%	0.97	8.43%	-0.22%	8.21%
Magellan Midstream Partners	1.49%	7.13%	0.98	8.47%	0.71%	9.18%
Enterprise Products	1.49%	7.13%	1.19	9.94%	-0.22%	9.72%
Plains All America Pipeline	1.49%	7.13%	1.18	9.91%	0.75%	10.66%
TC Energy	1.49%	7.13%	1.09	9.29%	-0.22%	9.07%
Kinder Morgan Inc.	1.49%	7.13%	0.90	7.93%	-0.22%	7.71%
					Median	9.12%
					Average	9.09%

The results as of September 30, 2021 are reported in Table 4 below. The median for the proxy group is 9.88% and the average is 10.17%.

TABLE 4
CAPM ROE ESTIMATES AS OF SEPTEMBER 30, 2021

Company	Risk Free Rate	Market Risk Premium	Bloomberg (5-year) Beta	Unadjusted Cost of Equity	Size Premium	Adjusted Cost of Equity
	[1]	[2]	[3]	[4] = [1] + [2] * [3]	[5]	[6] = [4] + [5]
Enbridge Inc.	2.10%	8.10%	0.93	9.66%	-0.22%	9.44%
Magellan Midstream Partners	2.10%	8.10%	0.96	9.90%	0.71%	10.61%
Enterprise Products	2.10%	8.10%	0.90	9.36%	-0.22%	9.14%
Plains All America Pipeline	2.10%	8.10%	1.18	11.62%	0.71%	12.33%
TC Energy	2.10%	8.10%	0.90	9.41%	-0.22%	9.19%
Kinder Morgan Inc.	2.10%	8.10%	1.04	10.54%	-0.22%	10.32%
					Median	9.88%
					Average	10.17%

DISCUSSION OF DR. WEBB'S RISK PREMIUM

Q96. How does Dr. Webb use the results of his DCF and CAPM analyses to develop his

recommended Test Period ROE for SFPP?

A96. Dr. Webb equally weights the median result from his DCF and CAPM analyses to develop a composite ROE. He then makes a 100-basis point upward "risk adjustment" which he justifies by stating that "setting SFPP's return at the median of these companies included in the proxy group would substantially understate the risk that SFPP faces."[85]

Q97. Is Dr. Webb's 100-basis point risk adjustment justified?

A97. No. First, Dr. Webb does not present any meaningful reason to apply a risk premium in this proceeding. Second, Dr. Webb provides no meaningful analyses or calculations underlying his 100-basis point risk premium.

Q98. Let's start with Dr. Webb's arguments in support of a risk premium. What is Dr. Webb's first argument?

A98. Dr. Webb claims that the risk premium is appropriate because "SFPP needs to be able to recoup its cost through a shorter period/shorter economic life than what was anticipated when SFPP was first placed into service."[86] He then states that the risk premium boosts SFPP's revenues by approximately 1.34%, which he contends is necessary to compensate SFPP for the "reduction in throughput and the declining crude production and refined product demand forecasts."[87]

Q99. Is Dr. Webb's justification valid?

A99. No. In response to discovery requests, Dr. Webb indicated that a risk premium is appropriate when "a decline in throughput is compounded by other risks, like an uncertain

[85] Exhibit No. MJW-0001 at 28:17-29:1.
[86] Exhibit No. MJW-0001 at 30:12-14.
[87] Exhibit No. MJW-0001 at 30:14-17.

regulatory environment or a projected decline in demand for the firm's business."[88] He incorrectly asserts that both of these factors apply to SFPP.

First, Dr. Webb relies on red herrings to bolster his opinion that SFPP faces an uncertain regulatory environment, pointing to the cancellation of the Keystone XL project. Dr. Webb's mention of Keystone XL is spurious, having admitted in discovery that he did not perform any analyses or studies regarding increased risk facing SFPP as a result of the revocation of the Keystone XL presidential permit.[89] Second, as discussed by Tesoro witness Mr. Ashton in Exhibit No. PKA-0001,[90] Dr. Webb's assertions regarding the risk associated with SFPP's California operations and their impact on throughput is unfounded and contrary to throughput projections that SFPP itself has provided in this proceeding. Dr. Webb's claims regarding diminished future throughput on the SFPP pipeline system are also refuted by projections provided by shippers on the pipeline system.[91] Finally, Dr. Webb's argument that a reduction in throughput on SFPP is justification for a risk premium is circular. One of the key drivers of SFPP's requested rate increase is its projected throughput. Therefore, it is not appropriate for Dr. Webb to apply a risk premium to the return on equity because the impact of the change in throughput is captured in the calculation of what Mr. Wetmore believes are just and reasonable rates. Therefore Dr. Webb's position should be rejected outright.

[88] Response to TES-SFPP-3.11, received on October 12, 2021, included as Exhibit No. LOU-0036.
[89] Response to TES-SFPP-3.12, received on October 12, 2021, included as Exhibit No. LOU-0037.
[90] Exhibit No. PKA-0001 at 37-39.
[91] Exhibit No. PKA-0001 at 37-39.

Q100. Does Dr. Webb offer any other arguments in support of his risk premium?

A100. Yes. Dr. Webb states that SFPP faces a higher level of commercial risk than the proxy group companies because "none of SFPP's California pipeline operations are supported by long-term contracts."[92] To support his point, Dr. Webb analyzes "large capital expenditures" for what he purports to be the 25 largest pipeline companies in the United States.[93] Based on his analysis contained in Exhibit No. MJW-0005, he concludes that 81% of new "large capital expenditures" were "supported by contracts," and because SFPP does not have long-term contracts, it faces "a higher level of commercial risk."[94]

Q101. How do you respond to Dr. Webb's analysis of capital expenditures by other pipelines?

A101. Dr. Webb's analysis is misplaced and irrelevant to evaluating the risks facing SFPP. First, as discussed by Mr. Ashton, SFPP's own throughput forecasts show no decline in the demand for SFPP's intrastate service. In fact, SFPP has been under **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][95] **[END HIGHLY CONFIDENTIAL]** Second, Dr. Webb's analysis is not applicable to SFPP. Dr. Webb's conclusion that SFPP faces increased risk because it does not have long-term contracts and is therefore at a disadvantage in engaging in capital investment projects is misleading. Dr. Webb's analysis in Exhibit No. MJW-0005 of selected capital expenditures for pipeline expansions,

[92] Exhibit No. MJW-0001 at 40:4-8.
[93] Exhibit No. MJW-0001 at 40:9-41:8.
[94] Exhibit No. MJW-0001 at 40:5-8.
[95] Exhibit No. PKA-0001 at 21-22.

conversions, and new construction is only meaningful if SFPP engaged in or planned to engage in activity similar to the large capital expenditure projects listed in the exhibit. However, SFPP indicated in discovery that it is "not currently undertaking and has no current plans to undertake construction, additions, or improvements to its California intrastate system in the next five years that would be equal to or exceed $100 million."[96] Furthermore, Dr. Webb presents no analysis of the terms of the contracts listed in Exhibit No. MJW-0005 or whether they are favorable to the pipelines or the future shippers. Consequently, Dr. Webb's analysis fails to add any meaningful information in assessing whether a risk premium is applicable to SFPP's return on equity.

Q102. Once Dr. Webb concluded that a risk premium was required for SFPP, how did he conclude a 100-basis point risk premium?

A102. In discovery SFPP was asked for the "analyses, calculations, and studies performed by Dr. Webb" that support his risk adder. Dr. Webb responded that pages 30 and 31 of his testimony contain the underlying analysis.[97] The referenced materials focus on Dr. Webb's argument that an ROE with a 100-basis point premium increases SFPP's revenues by 1.34% to compensate SFPP for reduced throughput and "declining crude production and refined product demand forecasts."[98] However, as discussed previously, this argument is without merit. The remainder of Dr. Webb's testimony on pages 30 and 31 is simply a meandering narrative discussing risk generally. None of the material to which Dr. Webb

[96] Response to TES-SFPP-3.14, received on October 12, 2021, included as Exhibit No. LOU-0038.
[97] Response to TES-SFPP-3.10, received on October 12, 2021. Response to TES-SFPP-3.8, received on October 12, 2021. Included as Exhibit No. LOU-0039.
[98] Exhibit No. MJW-0001 at 30:10-17.

pointed in his response to the discovery request includes any analyses or calculations that establish why 100-basis points is an appropriate risk premium for SFPP, as opposed to a negative risk premium or a risk premium of 500-basis points. As a result, neither the Commission nor the shippers are able to evaluate how Dr. Webb arrived at his 100-basis point risk premium. For this reason alone, it should be rejected.

Q103. Has Dr. Webb's risk adder for SFPP been rejected in the past?

A103. Yes. In the OR16-6 proceeding before the FERC, the ALJ rejected Dr. Webb's proposed 150-basis point adder to SFPP's ROE, finding that Dr. Webb failed to demonstrate that SFPP faced "highly unusual circumstances that indicate an anomalously high or low risk as compared to other pipelines."[99] The same is true here. Dr. Webb provides no justification as to why any departure from the median is appropriate. He also provides no quantitative basis for his selection of a 100-basis point premium as opposed to the 150-basis point premium that he advocated for SFPP elsewhere or some other arbitrary number.

Q104. Has Dr. Webb attempted to include a risk adder in his return on equity calculations in prior proceedings before the CPUC?

A104. Yes. In the Crimson proceeding, which Dr. Webb cites multiple times in his testimony, the CPUC rejected Dr. Webb's recommended 350-basis point risk adder. The CPUC found that Dr. Webb's risk adder was "subjective and unsupported by any calculation that analytically justifies the adder amount chosen."[100]

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[99] Initial Decision in Docket No. OR16-6, 160 FERC ¶ 63,006 at PP 384-386 (2017), included as Exhibit No. LOU-0016.

[100] D.20-11-026, *Decision Granting Crimson California Pipeline, LP Application for Rate Increase with Modifications,* Section 7.3, pg. 39, (November 19, 2020) included as Exhibit No. LOU-0011.

Q105. Should the Commission reject Dr. Webb's 100-basis point risk adder?

A105. Yes. Similar to the Commission's decision in the Crimson case, Dr. Webb's risk adder is completely without analytical support and appears to be chosen out of thin air. It should therefore be rejected outright.

Q106. What do you conclude is the appropriate Test Period return on equity for SFPP?

A106. I average the median results of my DCF and CAPM models as of September 30, 2021. This results in a nominal return on equity for SFPP of 11.33%.

COST OF DEBT

Q107. What role does the cost of debt play in calculating a just and reasonable rate of return for SFPP?

A107. The cost of debt represents the weighted average interest rate of a company's debts. The cost of debt is weighted by the debt percentage in a company's capital structure when determining the overall rate of return, or weighted average cost of capital ("WACC"). Consistent with using KMI's capital structure, KMI's cost of debt should be used for SFPP in the Test Period.

Q108. What cost of debt does SFPP witness Dr. Webb recommend?

A108. Dr. Webb recommends a cost of debt of 5.29% for the Test Period ending November 30, 2020. Dr. Webb claims that this cost of debt figure is the weighted average cost of debt of SFPP's corporate parent, KMI.[101] The calculations underlying Dr. Webb's 5.29% cost of debt are only available in his return on equity workpapers.

Q109. Do you agree conceptually that the appropriate cost of debt for SFPP is the weighted

[101] Exhibit No. MJW-0001 at 10:7-9.

average cost of debt of KMI?

A109. Yes, I do. In fact, this is consistent with my recommendation that KMI's capital structure be imputed to SFPP for ratemaking purposes. However, there are multiple issues with Dr. Webb's calculation of KMI's cost of debt, including:

- Dr. Webb's cost of debt is inconsistent with KMI's SEC Form 10-K;
- The debt balance on which Dr. Webb calculates KMI's cost of debt does not match the company's SEC Form 10-K; and
- Dr. Webb excludes the impact of interest rate and/or currency swap agreements on some of KMI's debt.

Q110. Let's start with the first issue. Can you explain how Dr. Webb's cost of debt does not match the debt reported in KMI's SEC Form 10-K?

A110. As Exhibit No. LOU-0012 demonstrates, KMI has reported to the SEC that its weighted average cost of debt as of December 31, 2020 is 4.86%.[102] This information is stated directly by KMI in its 10-K SEC filing. Yet, despite KMI's own statement to the SEC, Dr. Webb calculates KMI's cost of debt as 5.29%, a 43-basis point increase over the company's own public filings for the same time period. Moreover, Dr. Webb has not provided any meaningful explanation as to why his cost of debt calculation is more appropriate than the cost of debt figure that KMI itself states in its SEC filing.

Q111. Does the debt balance that Dr. Webb's uses to calculate his cost of debt match KMI's total debt?

A111. No, it does not. Beyond Dr. Webb's decision to ignore KMI's reported cost of debt, KMI's 2020 SEC Form 10-K indicates that as of December 31, 2020, KMI had total debt

[102] KMI SEC Form 10-K, pg. 105, included in Exhibit No. LOU-0012.

outstanding of $33.396 billion.[103] In contrast, Dr. Webb's cost of debt calculation is based on total debt of $30.502 billion. Dr. Webb is therefore excluding approximately $2.894 billion in debt from his calculations, including debt instruments with maturities in 2021 as well as debt instruments with variable interest rates.[104]

Q112. Can you describe which debt instruments Dr. Webb excluded and why?

A112. Yes. Dr. Webb inappropriately excludes debt that is due during the 2021 calendar year. There are four debt instruments listed in KMI's 10-K with a total of $2.400 billion outstanding. These debt instruments include a 5.00% corporate senior note, a 3.500% corporate senior note, a 5.80% corporate senior note, and a 5.00% corporate senior note. Dr. Webb states that he excluded these debt instruments because they are due within 2021 and therefore believes that they do not represent "long-term debt." Dr. Webb is not correct. In order to establish SFPP's cost of debt, it is necessary to determine KMI's actual cost of debt in the Test Period. For example, KMI routinely issues new debt to satisfy its current portion, thereby replacing the debt due within the course of the current year with new notes due further in the future. This process is demonstrated in Table 5 below which shows KMI's total debt balance and current portion reported for 2016 through 2020.

[103] KMI SEC Form 10-K, pg. 102, included in Exhibit No. LOU-0012.
[104] Response to JP-SFPP-2.4, received on October 8, 2021, included as Exhibit No. LOU-0041.

Table 5
KMI Debt, 2016-2020

Year	Total Debt	Current Debt
	Millions USD	
2016	$38,901	$2,696
2017	$36,916	$2,828
2018	$36,593	$3,388
2019	$33,360	$2,477
2020	$33,396	$2,558

Source: 2017-2020 KMI SEC Form 10-K

As Table 5 demonstrates, KMI's current debt has been relatively consistent during the past five years. In 2019 and 2020, the company retired its current portion of debt, but the balance of total debt outstanding actually increased in 2020 as a result of new issuances. This demonstrates that KMI's current portion of its long-term debt is essentially "rolled over" and replaced with new issuances and is therefore transitory in nature. In other words, KMI is not maturing the current portion of its long-term debt without replacement. Instead, the current portion of debt is the mechanism that KMI uses to finance its operations and therefore should be included in the cost of debt calculation for SFPP.

Q113. Does KMI include these four debt instruments that are due in 2021 in the weighted average cost of debt that it reports as of December 31, 2020?

A113. Yes, it does. KMI provided backup data with respect to its 4.86% weighted average cost that it reported to the SEC in its 10-K as of December 31, 2020.[105] The file provided, SFP21 000325,[106] provides detailed information as to how KMI determined its weighted average cost of debt as of December 31, 2020 and includes all four debt instruments that

[105] KMI 2020 SEC Form 10-K, pg. 105, included in Exhibit No. LOU-0012.
[106] SFP21 000325, included as Exhibit No. LOU-0042.

mature in 2021. Because we are estimating KMI's cost of debt and because these instruments are included in KMI's public filings, they should certainly be included in the Test Period cost of debt calculations in this proceeding.

Q114. Do any prior CPUC decisions involving SFPP offer clarity with respect to this issue?

A114. Yes. In the A.09-05-014 proceeding involving SFPP, ALJ Bemesderfer found that SFPP's cost of debt should include the current portion of long-term debt.[107]

Q115. What is the next issue with Dr. Webb's cost of debt calculations?

A115. Dr. Webb's cost of debt calculation excludes the impact of interest rate and currency rate swap agreements on some of KMI's debt. This inconsistent treatment leads Dr. Webb to increase the interest rate for two of KMI's notes and ignore other debt swaps to which KMI was a party, including those debt swaps that decreased the applicable interest rate.

Q116. Before you discuss Dr. Webb's inconsistent treatment with respect to adjusted interest rates, can you define an interest rate swap agreement?

A116. An interest rate swap is an agreement in which one party (*i.e.*, a financial institution) pays another party (*i.e.*, KMI) the interest rate on a certain amount of fixed rate debt in exchange for receiving the interest rate on the same amount of floating rate debt. The floating interest rate is often based on the LIBOR rate plus a fixed premium. The agreement is essentially a mechanism to convert fixed rate debt into floating rate debt or vice versa. KMI states in its 10-K that approximately $5.2 billion of its outstanding debt as of December 31, 2020 was subject to variable interest rates.[108]

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[107] *See* Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al.* at pg. 6 (April 6, 2012), included as Exhibit No. LOU-0017.
[108] KMI 2020 SEC Form 10-K, pg. 30, included in Exhibit No. LOU-0012.

Q117. Does the previously discussed 4.86% weighted average cost of debt that KMI reports in its 2020 10-K include the impact of interest rate swaps?

A117. Yes, it does.

Q118. You mentioned that Dr. Webb includes the impact of some interest rate swaps but not others in his calculations. Can you provide more detail?

A118. Dr. Webb adjusts the interest rates for two debt instruments listed in KMI's 2020 10-K. These debt instruments include the 1.50% and 2.25% corporate senior notes, with $917 million and $611 million outstanding, respectively. The 10-K states that KMI "entered into foreign currency contracts associated with these senior notes, effectively converting these Euro-denominated senior notes to U.S. dollars."[109] Instead of the values reported in U.S. dollars in the company's publicly available financial statements, Dr. Webb changes the 1.50% senior notes at $917 million outstanding to 3.79% senior notes with $814.5 million outstanding, and the 2.25% senior notes at $611 million outstanding to 4.668% senior notes with $543.0 million outstanding in his cost of debt calculations.

Q119. Does Dr. Webb make similar interest rate adjustments to account for the fact that KMI was party to other interest rate swap agreements as of December 31, 2020?

A119. No, he does not. Although Dr. Webb adjusts the interest rate for the Euro-denominated debts to reflect the "cross-currency swaps" in effect,[110] he ignores the impact on interest rates of the other interest rate swaps to which KMI was party as of December 31, 2020.

Q120. Do you agree with Dr. Webb that it is appropriate to adjust the interest rates on

[109] KMI 2020 SEC Form 10-K, pg. 102, included in Exhibit No. LOU-0012.
[110] KMI 2020 SEC Form 10-K, pg. 102, included in Exhibit No. LOU-0012.

certain debt instruments but not others when calculating a representative cost of debt for SFPP for the Test Period?

A120. No, I do not. It is important to remember that for the purposes of this proceeding, we are focused on estimating KMI's cost of debt at a specific point in time, and that the cost of debt that KMI reports in its 10-K includes the impact of interest rate swaps. It would, in my opinion, be fundamentally unfair for ratepayers to pay rates that are based on an interest cost that is not equal to KMI's actual cost, as Dr. Webb advocates.

Q121. Given the multiple issues with Dr. Webb's cost of debt recommendation, how did you determine the appropriate cost of debt for SFPP?

A121. For the Test Period, I relied on KMI's 2020 SEC Form 10-K, which contains KMI's total debt balance of $33.396 billion as of December 31, 2020.[111] The 10-K indicates that as of December 31, 2020, KMI's weighted average interest rate was 4.86%. Information from the 10-K is relied on by investors in KMI, and ultimately SFPP. It is therefore an excellent proxy for SFPP's cost of debt. Dr. Webb conceptually agrees that it is appropriate to impute KMI's cost of debt to SFPP and presented no evidence or analyses that indicate that we should depart in any way from KMI's stated cost of debt in determining SFPP's cost of debt. I therefore adopt KMI's stated cost of debt of 4.86% for the Test Period.

WEIGHTED AVERAGE COST OF CAPITAL

Q122. What do you conclude to be the appropriate Test Period weighted average cost of capital?

A122. I determined the weighted average cost of capital for SFPP by taking the appropriate cost

[111] KMI 2020 SEC Form 10-K, pg. 102, included in Exhibit No. LOU-0012.

of debt and return on equity and weighting them by their relative components in SFPP's capital structure for the Test Period. The weighted average cost of capital for SFPP is 7.91% as shown in Table 6.

TABLE 6
Test Period Weighted Average Cost of Capital ("WACC")

Cost of Capital Components	
Debt Capital Percentage	52.83%
Equity Capital Percentage	47.17%
Cost of Debt	4.86%
Equity Rate of Return (Nominal)	11.33%
Weighted Average Cost of Capital	7.91%

CALCULATION OF SFPP'S RATE BASE

Q123. Please define rate base from a ratemaking perspective.

A123. The rate base captures the underlying investment made in a pipeline's assets. With respect to the current proceeding, the rate base should encompass those assets that are specific to the carrier transportation of SFPP's intrastate movements in California. In CPUC cases, pipelines use a Depreciated Original Cost ("DOC") methodology to determine the pipeline's rate base.

Q124. What is Depreciated Original Cost?

A124. Depreciated original cost includes several elements, including carrier property in service, accrued depreciation, an allowance for funds used during construction ("AFUDC"), working capital, and accumulated deferred income taxes ("ADIT"). The combination of these elements provides the depreciated original cost for a pipeline as of a given point in time.

Q125. What is SFPP's carrier property in service?

A125. Carrier property in service is the cumulative amount invested in the pipeline's regulated assets, adjusted for retirements and transfers. For SFPP, the carrier's property in service would be limited to the jurisdictional assets used for intrastate transportation in California.

Q126. How did Mr. Wetmore identify the carrier property in service specific to SFPP's CPUC system?

A126. Mr. Wetmore describes the property records that SFPP maintains in which assets are associated with specific locations and facilities. As I discuss in more detail in the section on operating expenses, Mr. Wetmore attempts to group a number of different assets together based on these location codes and subsequently identify SFPP's system-wide carrier property by separate cost categories.[112] For example, Mr. Wetmore groups assets that are used entirely in providing California intrastate pipeline service under a "PUC" code which, he claims, is 100% applicable to SFPP's CPUC System.[113] At the other extreme, assets in the Cost Categories "OL" for Oregon Line and "EL" for East Line would not pertain to SFPP's CPUC system as they are located outside California. There are also several other property categories that include both FERC and CPUC jurisdictions, such as particular segments and facilities on the West Line and North Line. With respect to these mixed-use assets, Mr. Wetmore uses separation factors based on volume to determine the appropriate CPUC percentage.[114]

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[112] Exhibit No. EGW-0001 at 6:12-7:4.
[113] For example, see Mr. Wetmore's workpaper "EGW WP Prop (CPUC) HC PROT" and the associated queries in the Access database that pertain to the use of allocation codes.
[114] Exhibit No. EGW-0001 at 6:22-7:4.

Q127. How does Mr. Wetmore compute these separation factors?

A127. Mr. Wetmore relies on the Base Period volumes to compute the separation factors by line segment and cost category. Pursuant to Exhibit No. EGW-0004, Schedules 1 and 2, Mr. Wetmore computes the volume percentage pertaining to intrastate movements versus interstate movements for each line segment. He then applies these separation factors to the carrier property data to compute the carrier property specific to SFPP's CPUC system for the different segments. For example, Mr. Wetmore determined that the appropriate separation factor for asset used in movements on the West Line from Watson to Ontario was 43.98% intrastate and 56.02% interstate.[115] Mr. Wetmore subsequently applies this percentage to carrier property in service to isolate the CPUC carrier property in service for that segment.

Q128. Did you accept Mr. Wetmore's separation factors?

A128. Yes. If we wanted to update the separation factors based on new volume information it would be necessary to update not only our estimate for CPUC Test Year volumes, but also an estimate of future interstate volumes. Therefore, I agree with Mr. Wetmore's use of Base Period separation factors in determining the CPUC jurisdictional assets and expenses that pertain to mixed use operation.

Q129. What is SFPP's accrued depreciation?

A129. Accrued depreciation is the cumulative amount of annual depreciation, calculated by using the straight-line method of depreciation. While the accumulated depreciation is deducted

[115] Exhibit No. EGW-0004, Schedule 2, page 1, line labeled "CA2 – West Line – Watson to Ontario."

from the gross carrier property in service, pipelines are still able to recover annual depreciation expense in the cost of service, representing a return of capital. I also accepted SFPP's representation of its accrued depreciation for the Base Period ending November 30, 2020 and 2021 Test Year.

Q130. What is an Allowance for Funds Used During Construction ("AFUDC")?

A130. Capital costs incurred during construction may not be included in the rate base until assets are placed in service. Many capital projects are not only expensive, but they can take a considerable amount of time before the construction is finished and the asset or assets are placed in service. Regulators use AFUDC to compensate pipeline owners for these construction costs by allowing carriers to include the cost of financing the capital projects for assets that are under construction but not yet placed into service.

Q131. How does SFPP determine AFUDC balances?

A131. Mr. Wetmore indicated that he computed AFUDC based on SFPP's annual additions of CPUC intrastate carrier property in service, applying an annual rate of return. The rate of return multiplied by the additions equals the annual AFUDC. He subsequently amortized the AFUDC balance by applying SFPP's composite depreciation rate. Mr. Wetmore also accounted for interest during construction so as not to double count those items.[116]

Q132. Do you accept Mr. Wetmore's computations for AFUDC?

A132. While I accept the methodological approach implemented by Mr. Wetmore, I disagree with the rates of return used to compute the annual AFUDC. Specifically, for the years 2011

[116] Exhibit No. EGW-0001 at 13:2-18 and Exhibit No. EGW-0004, Schedule 5. For calendar year 2020, data are in SFP21 000029, included as Exhibit No. LOU-0043.

through 2020, Mr. Wetmore relied on Dr. Webb's Test Period cost of capital for all of those years, retroactively. I followed Mr. Wetmore's methodology and relied on my Test Year cost of capital, applied retroactively for 2011 through 2020. This is seen on Exhibit No. LOU-0055, Schedule 5.

Q133. What is SFPP's working capital?

A133. The rate base can also include working capital, including materials and supplies, prepayments, and oil inventory. I accepted SFPP's determination of its working capital.

Q134. Please define Accumulated Deferred Income Taxes ("ADIT") from a ratemaking perspective.

A134. ADIT arises in a regulatory setting because of the difference between regulatory and tax depreciation schedules. In a depreciated original cost methodology, assets are depreciated on a straight-line basis, so that the annual depreciation of an asset is uniform over time. However, for income tax reporting purposes, pipeline carriers can avail themselves of accelerated tax depreciation methods, such as the Modified Accelerated Cost Recovery System ("MACRS"), to calculate depreciation in determining their taxable income. While the total depreciation will be the same over the life of the asset, timing differences arise with respect to income taxes associated with the pipeline's operation.

Q135. Did SFPP at one point have an ADIT balance that was deducted from the rate base?

A135. Yes. According to SFPP's February 21, 2003 Compliance Filing in A.03-02-027, it reported a year-end ADIT balance of $34.3 million.[117] In a subsequent application in 2009

[117] SFPP's February 21, 2003 A.03-02-027 Application, Attachment C, page 5.

(A.09-05-014), SFPP reported an ADIT balance of approximately $43 million.[118]

Q136. Did Mr. Wetmore include any adjustment for ADIT in calculating his rate base?

A136. No. Mr. Wetmore did not include any ADIT balance. Mr. Wetmore and SFPP rely on the Commission's Decisions in D.11-05-045 and D.12-036-026 that eliminated SFPP's income tax allowance. Mr. Wetmore indicated that once the Commission eliminated an income tax allowance for SFPP, then no ADIT balance would exist to either refund to ratepayers or deduct from the rate base.

Q137. Did Mr. Wetmore rely on any additional information in eliminating an ADIT balance from his cost of service analysis?

A137. Yes. Mr. Wetmore argues that a 2014 CPUC Settlement Agreement between SFPP and certain shippers prohibits shippers from raising ADIT issues in the current proceeding. According to SFPP, any outstanding ADIT issue was extinguished under the Settlement Agreement.

Q138. Do you agree with Mr. Wetmore's elimination of the ADIT balance?

A138. While I disagree that an ADIT balance would simply vanish due to the Commission's decision on income tax allowance, I recognize that the Settlement Agreement likely would have addressed or handled any ADIT claims at that time. Thus, in an effort to minimize areas of controversy, I am accepting Mr. Wetmore's elimination of any ADIT adjustment, as shown on Exhibit No. EGW-0003, Attachment B, page 3, line 9.

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[118] Prepared Direct Testimony of Thomas A. Turner, A.09-05-014, at Attachment B, Page 3, line 9, included as Exhibit No. LOU-0047.

Q139. Can you summarize your Test Year rate base?

A139. Yes. Exhibit No. LOU-0046, Attachment B, page 3 includes my results for SFPP's CPUC rate base. Specifically, I add SFPP's CPUC carrier property with its gross AFUDC additions before subtracting the accrued depreciation on carrier property and the accumulated amortization of AFUDC. This difference is the net book plant shown on Exhibit No. LOU-0046, line 7. Lastly, I add SFPP's CPUC working capital to determine the original cost rate base. I then calculate SFPP's Test Period rate base as $265.6 million.

OPERATING EXPENSES

Q140. Please explain your understanding of how Mr. Wetmore developed his Base Year operating expenses.

A140. Mr. Wetmore's Base Period operating expenses relies on KMI accounting data and Mr. Wetmore's creation of various groups into which he categorizes different types of operating expenses. The SFPP operating expense database, provided in discovery and as a workpaper to Mr. Wetmore's testimony,[119] includes specific accounting entries that specify the operating expenses for SFPP's system wide operation. These individual expense records have been coded to different locations and accounts. Using that information, Mr. Wetmore specifies the particular expense entries that pertain to SFPP's CPUC system. In compiling his Base Period operating expenses, Mr. Wetmore relies on the FERC Uniform System of Accounts ("USoA") for classifying operating expenses.[120]

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[119] SFP21 000006 and "EGW WP Exp Database HC PROT".

[120] Title 18, Chapter 1, Subchapter Q, Part 352 – *Uniform Systems of Accounts Prescribed for Oil Pipeline Companies Subject to the Provisions of the Interstate Commerce Act*, Electronic Code

The FERC USoA specifies a three-digit numerical account for each type of operating expense. Under the FERC USoA system, account numbers between 300 and 390 pertain to operating and maintenance ("O&M") expenses, while account numbers between 500 and 590 pertain to general and administrative expenses. For example, Account 500 includes amounts for employees "whose wages cannot be directly allocated to operations or maintenance." Similarly, Accounts 510 and 520 explicitly mention general and administrative services. Account 550 includes costs for "annuities, pensions, and benefits for active or retired employees, their beneficiaries or designees."

Q141. What is a location code?

A141. According to Mr. Wetmore, SFPP maintains its accounting records using "location codes," which are numeric identifiers associated with specific facilities, as well as general functions associated with more than one facility or geographic area.[121] An example of a location code specific to a facility would be a pump station or line segment, while an example of a broader geographic or functional area might be a location code associated with corporate operations based out of Houston.

Q142. How does Mr. Wetmore use the location codes to identify O&M operating expenses for SFPP's CPUC system?

A142. Yes. Mr. Wetmore assigns direct carrier operating expenses and allocates indirect operating expenses to SFPP's CPUC system based on location codes and cost categories.[122] For

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of Federal Regulations, https://www.ecfr.gov/cgibin/textidx?c=ecfr&SID=054f2bfd518f9926aac4b73489f11c67&rgn=div5&view=text&node=18:1.0.1.15.72&idno=18 included as Exhibit No. LOU-0048.

[121] Exhibit No. EGW-0001 at 5:3-6.

[122] Exhibit No. EGW-0001 at 5:12-20.

example, location code **[BEGIN HIGHLY CONFIDENTIAL/15(13)]** [redacted] **[END HIGHLY CONFIDENTIAL/15(13)]** Costs associated with this location code are entirely dedicated to CPUC operations, and therefore, Mr. Wetmore directly assigns these O&M operating expenses to SFPP's CPUC operations. Using the underlying SFPP expense database, the data indicate a total of **[BEGIN HIGHLY CONFIDENTIAL/15(13)]** [redacted] **[END HIGHLY CONFIDENTIAL/15(13)]** in O&M expenses for FERC Account 300 (salaries and wages) in Mr. Wetmore's Base Period. Mr. Wetmore subsequently assigns 100% of these expenses to FERC Account 300 in the "PUC" Allocation Code as stated in Exhibit No. EGW-0004, Schedule 9. Other location codes, such as **[BEGIN HIGHLY CONFIDENTIAL/15(13)]** [redacted] **[END HIGHLY CONFIDENTIAL/15(13)]** involved movements on SFPP's West Line, which includes both CPUC-regulated intrastate service and FERC-regulated interstate service. In these instances, Mr. Wetmore uses separation factors based on volume to allocate the directly assigned O&M operating expenses to SFPP's CPUC system. This method is the same Mr. Wetmore used in categorizing asset categories for determining SFPP's CPUC carrier property and associated depreciation, which I discussed previously in my testimony on the rate base. Mr. Wetmore's Base Period O&M expenses represent the sum of the operating expenses for SFPP's CPUC system in FERC Accounts 300 through 390 over the twelve-month period ending November 30, 2020, as shown on Exhibit No. EGW-0004, at Schedule 9.

Q143. Does Mr. Wetmore follow a similar process of using location codes when determining

SFPP's G&A operating expenses?

A143. Not entirely. Mr. Wetmore does rely on location codes when analyzing the SFPP G&A expenses. However, the G&A expenses include both "direct costs" as well as "indirect costs." As a result, while Mr. Wetmore directly assigns certain G&A expenses, there are other expenses that require an allocation from a larger set of G&A expenses. For example, location code **[BEGIN HIGHLY CONFIDENTIAL/15(13)]** [redacted] **[END HIGHLY CONFIDENTIAL/15(13)]** In developing his Base Period G&A operating expenses, Mr. Wetmore relies on assignment of direct costs and a combination of assignment and allocation of indirect costs.

Q144. How does Mr. Wetmore distinguish between "direct" and "indirect" costs?

A144. Mr. Wetmore defines direct costs as those costs that can be attributed to specific locations or subsidiaries, while indirect costs are those costs that cannot be directly attributed to specific locations or subsidiaries. Mr. Wetmore states that indirect costs must be distributed to multiple locations or subsidiaries using allocation factors.[123]

Q145. How does Mr. Wetmore determine his Test Year operating expenses for SFPP's CPUC system?

A145. After Mr. Wetmore developed his Base Period operating expenses for both O&M and G&A expenses, he made several Test Period adjustments. These adjustments included

[123] Exhibit No. EGW-0001 at 6:1-10.

ratemaking adjustments to the accounting treatment of certain items and also normalization or adjustment of operating expenses related to expected operating expenses that Mr. Wetmore believes are known or knowable as of the end of the Base Year.[124] Mr. Wetmore includes all of these Test Year adjustments in Exhibit No. EGW-0004, Schedule 9.

Q146. Do you agree with Mr. Wetmore's conclusions regarding the level of SFPP's Base Period and Test Year operating expenses?

A146. No. I disagree with Mr. Wetmore with respect to several issues related to his development of Base Period and Test Year operating expenses. I believe that Mr. Wetmore has incorrectly calculated the following cost categories:

- Development of SFPP's G&A costs, including legal fees and corporate overhead expenses;
- Treatment of CPUC rate case expenses;
- Adjustments for environmental remediation expenses; and
- Fuel and power adjustment based on erroneous Test Year volumes.

I discuss each of these operating expense issues in more detail in the remainder of this section of my testimony.

G&A COSTS

Q147. Please explain your understanding of how Mr. Wetmore determined SFPP's G&A operating expenses in his cost of service analysis.

A147. At the start, there is an initial pool of G&A costs for the entire KMI organization. Mr. Wetmore indicates that he can identify G&A costs within this cost pool by location code and cost categories, identical to the system described for operating and maintenance

[124] Exhibit No. EGW-0001 at 7:1-12.

expenses. However, most of the G&A costs that Mr. Wetmore summarizes in his operating expense exhibit fall into the "indirect costs" category. According to Mr. Wetmore, indirect costs "cannot be directly attributed to specific locations or subsidiaries."[125] These indirect costs include SFPP-specific legal fees (excluding rate case litigation costs), SFPP's ad valorem property taxes, direct and indirect corporate overhead, and regional office overhead.[126] In certain instances, Mr. Wetmore appears to be able to directly assign G&A expenses with specific locations and cost categories from SFPP's expense database.[127] These G&A expenses include certain employee benefits (FERC Account 550) and property taxes (FERC Account 580).[128] For these entries, Mr. Wetmore has tied the costs incurred to specific location codes and cost categories in a similar manner as his direct assignment of costs for operating and maintenance expenses. In addition to the employee benefits and property taxes, it also appears that Mr. Wetmore claims that he is also able to directly attribute other taxes, as well as permits, licenses, and fees directly to SFPP. Lastly, Mr. Wetmore includes additional line items drawn from the underlying expense database that pertain to his Test Year adjustments.

Table 7 below summarizes Mr. Wetmore's computations for overall G&A expenses. Column [2] summarizes the Base Period G&A costs drawn from the underlying SFPP expense database. Column [3] includes the ratemaking adjustments, including Test

[125] Exhibit No. EGW-0001 at 6:7-9.
[126] Exhibit No. EGW-0001 at 7:12-14.
[127] EGW WP Exp Database HC PROT, provided October 1, 2021.
[128] Exhibit No. EGW-0004, Schedule 9, lines 141-156 and lines 173-188. It is unclear whether Mr. Wetmore and SFPP have directly assigned the employee benefits, or if these represent "indirect costs" that are subsequently directly assigned. Regardless, these G&A expenses are coded to specific SFPP CPUC locations in the underlying data.

Year adjustments for G&A expense categories. Column [4] is the adjusted total, representing Column [1] plus Column [2]. Lastly, Column [5] represents the amount attributable to SFPP's CPUC System. The amounts shown in this column are the summation of the individual CPUC jurisdictional expenses after the application of separation and allocation factors. For example, the direct corporate overhead pertains to just the CPUC carrier portion of SFPP's direct overhead expenses. Other categories include the application of separation factors to determine the CPUC jurisdictional portion of directly assigned costs. As shown on Exhibit No. EGW-0004, Schedule 9, Mr. Wetmore determines the CPUC specific amounts based on the cost categorization and allocations of system-wide SFPP costs to the CPUC system. I discuss these allocations in more detail below.

Table 7
Mr. Wetmore's Summary of G&A Expenses

[1] "Indirect" G&A costs:	[2] Twelve Mos. Ending 11-30-20	[3] Ratemaking Adj.	[4] Adjusted Total	[5] 2021 CPUC Test Year Amount
Direct Corporate Overhead	$ 12,363,938	$ -	$ 12,363,938	$ 6,861,550
Indirect Corporate Overhead	$ 8,438,391	$ -	$ 8,438,391	$ 4,387,560
Legal Fees	$ 1,043,338	$ -	$ 1,043,338	$ 47,216
Ad Valorem Taxes	$ 9,683,122	$ -	$ 9,683,122	$ 4,312,337
Northern Region Overhead	$ 547,419	$ -	$ 547,419	$ 402,543
Southern Region Overhead	$ 177,920	$ -	$ 177,920	$ 70,958
"Direct" G&A costs:				
Employee Benefits (FERC 550)	$ 3,947,780	$ -	$ 3,947,780	$ 2,182,959
Property Tax (FERC 580)	$ 1,552,346	$ -	$ 1,552,346	$ 858,562
Other costs:				
CPUC Rate Case Expense	$ -	$ 700,000	$ 700,000	$ 700,000
PBOPs Cash Payments	$ -	$ 236,381	$ 236,381	$ 92,498
Other taxes	$ (15,924,147)	$ 16,899,513	$ 975,366	$ 407,912
Permits, Lic. & Fees	$ 1,202,814	$ -	$ 1,202,814	$ 696,309
All other	$ 105,279	$ -	$ 100,613	$ 125
Totals	$ 23,138,199	$ 17,835,894	$ 40,969,428	$ 21,020,529

Q148. Do you agree with Mr. Wetmore's analysis of G&A expenses for the Base Period and Test Year?

A148. No. I have several issues with Mr. Wetmore's analysis. My principal area of disagreement rests with his treatment and computations related to corporate overhead costs, and the employee benefits that are directly assigned to different cost categories in FERC Account 550. I also disagree with Mr. Wetmore's treatment of SFPP-specific legal fees, regional overhead, and the CPUC rate case expense.

Q149. Let's start with corporate overhead expenses. Please describe corporate overhead

expenses as they relate to SFPP.

A149. Corporate overhead expenses typically represent general and administrative ("G&A") expenses that are not specifically attributable to individual operating segments. For example, KMI's 2020 Form 10-K reported $653 million in "general and administrative and corporate charges" for 2020.[129] These G&A costs were reported separately from other segment results, which comports with Kinder Morgan stating that these G&A expenses are "generally not controllable by our business segment operating managers" and "include such items as unallocated employee benefits, insurance, rentals, unallocated litigation and environmental expenses, and shared corporate services including accounting, information technology, human resources and legal services."[130] SFPP has no employees, so it relies on KMI to provide G&A services.[131] From a cost of service ratemaking perspective, SFPP incurs a portion of these costs as a beneficiary of the services provided by KMI or its subsidiaries. Thus, only an allocation of G&A expenses associated with SFPP's CPUC-jurisdictional operations should be included in the operating expenses that are part of the CPUC-jurisdictional cost of service analysis.

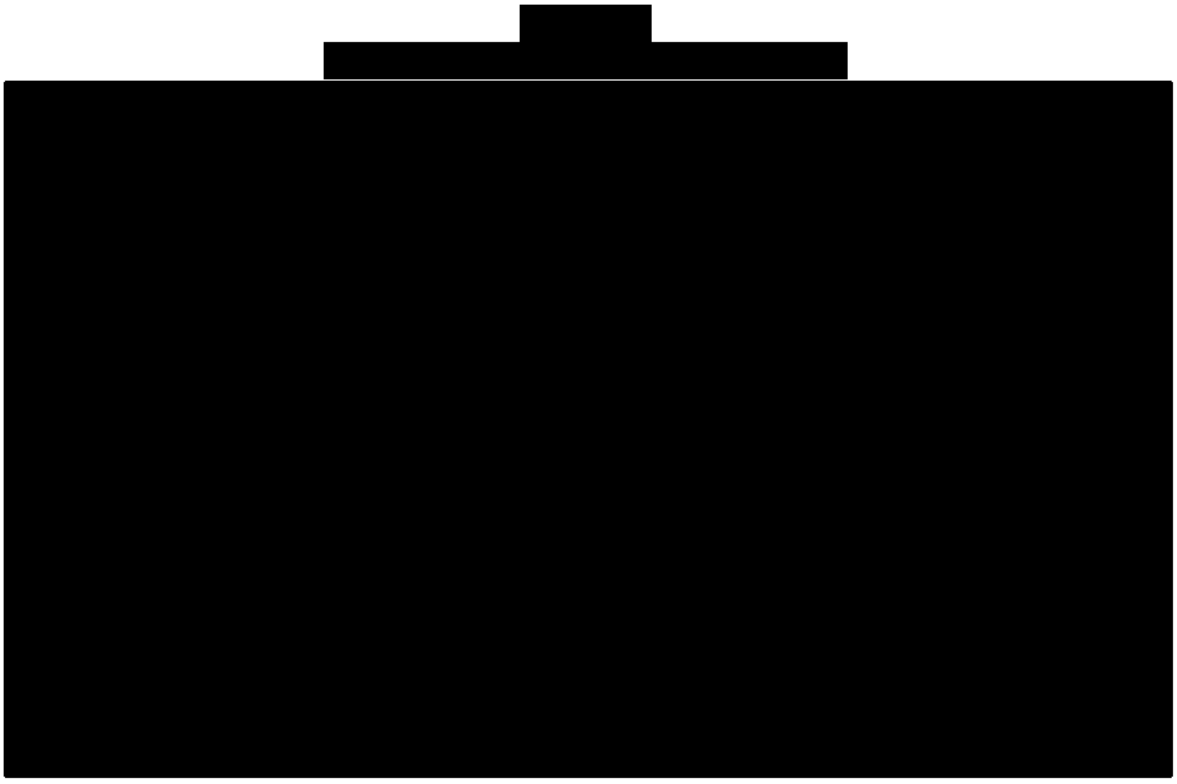
Q150. How does KMI determine the level of corporate general and administrative expenses

[129] KMI 2020 10-K at pg. 44, included in Exhibit No. LOU-0012.
[130] KMI 2020 10-K at pg. 42. Kinder Morgan goes on to note that "[o]ur general and administrative expenses and corporate charges include such items as unallocated employee benefits, insurance, rentals, unallocated litigation and environmental expenses, and shared corporate services including accounting, information technology, human resources and legal services." Included in Exhibit No. LOU-0012. Also, response to JP-SFPP-3.13(a), October 6, 2021, included as Exhibit No. LOU-0062.
[131] Response to Tesoro 1.25(b) and 1.25(c), September 16, 2021, included as Exhibit No. LOU-0049.

attributable to SFPP?

A150. KMI follows a complex, multi-step process to allocate corporate general and administrative expenses to SFPP. Figure 3 provides a schematic of the methodology KMI employs in determining what it believes are the appropriate G&A expenses to include in SFPP's CPUC-jurisdictional cost of service.

[BEGIN HIGHLY CONFIDENTIAL]



[END HIGHLY CONFIDENTIAL]

According to KMI, it directly assigns corporate overhead costs to specific entities that it believes incurs those G&A expenses. As Table 7 indicates, these direct assignments of corporate overhead specific to SFPP were approximately $12.4 million for the Base Period, with approximately $6.9 million attributable to SFPP's CPUC system. The next step in

allocating KMI's indirect costs involves assigning expenses to a specific group of subsidiaries. This occurs when G&A expenses cannot be identified at the entity level, but purportedly can be assigned to a group of entities that benefitted from these costs.[132] **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][133] **[END HIGHLY CONFIDENTIAL]** Mr. Wetmore delineates the different types of corporate overhead in his Prepared Direct Testimony, noting that SFPP incurs both direct corporate overhead and indirect corporate overhead.[134] As a result, SFPP not only has direct assignments of G&A expenses, but also receives an allocation of G&A expenses as part of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** The total indirect corporate overhead expenses allocated to SFPP as of the twelve months ending November 30, 2020 was approximately $8.4 million, of which

[132] Response to TES-SFPP-1.25(a), included as Exhibit No. LOU-0049.
[133] Response to TES-SFPP-1.25(a), included as Exhibit No. LOU-0049; SFP21 000084-85, included as Exhibit No. LOU-0053.
[134] Exhibit No. EGW-0001 at 8:10-13.

Mr. Wetmore states approximately $4.4 million should be allocated to SFPP's CPUC System in the Test Period.

Q151. Focusing on direct corporate overhead, how does KMI directly assign corporate overhead expenses to SFPP?

A151. Mr. Wetmore indicates that KMI's accounting records facilitate the direct assignment of corporate overhead costs to SFPP.[135] Although not discussed explicitly in Mr. Wetmore's Prepared Direct Testimony, SFPP explained in discovery that there are two categories of direct corporate overhead expenses, labor and non-labor.[136] For direct corporate overhead tied to labor, KMI indicates that direct assignments are made using percentage-based salary splits and hourly time sheets. Mr. Wetmore and KMI provided a hypothetical example involving an accounting department employee in the Houston office. That employee designates a 50/50 split between SFPP and Calnev, such that her labor costs, along with all related costs such as benefits and payroll taxes, would be split 50/50 between the two companies.[137] Non-labor costs such as benefits, payroll taxes, and legal fees are directly assigned to SFPP and other entities based on the type of expense, which according to KMI, may include following an employee's labor costs (*i.e.*, salary split) or invoice analysis. This process is shown in the Direct Assignments section of Figure 3.

Q152. How does KMI allocate indirect corporate overhead expenses to SFPP?

A152. KMI uses what is commonly referred to as the "Massachusetts Formula" ("MA Formula") for allocating indirect overhead expenses. The MA Formula relies on several cost drivers

[135] Exhibit No. EGW-0001 at 9:1-4.
[136] Response to TES-SFPP-1.26, September 16, 2021, included as Exhibit No. LOU-0051.
[137] Response to TES-SFPP-1.26, September 16, 2021, included as Exhibit No. LOU-0051.

to allocate costs that cannot be directly assigned to particular subsidiaries.[138] The MA Formula allocates corporate overhead expenses to a regulatory utility subsidiary by using the average of three specific ratios. In the traditional MA Formula, these ratios are (1) a subsidiary's gross revenue as compared to total gross revenues; (2) a subsidiary's gross property, plant and equipment as compared to total corporate gross property, plant and equipment; and (3) the subsidiary's gross payroll (or direct labor costs) as compared to total corporate gross payroll. After calculating all three ratios for each subsidiary, an average is computed of the three ratios. That average ratio is then applied to the overall corporate overhead expenses to determine the specific amount of corporate overhead expenses that should be allocated to each regulated utility subsidiary. This process is shown in the Indirect Cost allocation section of Figure 3.

Q153. Did KMI apply the MA Formula uniformly in each application of the methodology?

A153. No. For the allocation of indirect corporate overhead expenses among specific segment tiers (*e.g.*, Products, Terminals, CO_2), it appears KMI used the standard MA Formula cost drivers including gross revenue.[139] However, when allocating the Top Tier of residual KMI shared services expenses across all entities, KMI used a modified MA Formula which replaced gross revenue with net operating income.[140]

Q154. Once Mr. Wetmore quantified the total corporate overhead applicable to SFPP, how

[138] An overview is included in the FERC proceeding *Northwest Pipeline Corp.,* 71 FERC ¶ 61,253 at 61,984 (1995), included as Exhibit No. LOU-0052.
[139] Response to TES-SFPP-1.25(a), included as Exhibit No. LOU-0049 and SFP21 00091.
[140] Response to TES-SFPP-1.25(a), included as Exhibit No. LOU-0049 and SFP21 00179.

did he determine the CPUC-jurisdictional overhead costs?

A154. Mr. Wetmore employed the "KN Method" to allocate SFPP's total corporate overhead to CPUC-jurisdictional costs. The KN method allocates costs between jurisdictional and non-jurisdictional service based on the ratios of direct carrier plant and labor.[141] These ratios are obtained by comparing the CPUC-jurisdictional amounts relative to the total amounts, which includes FERC interstate data, as well as non-carrier operations. Each overhead expense is classified as "labor," "plant," or "other." Labor expenses are allocated to CPUC-jurisdictional service based on the direct labor ratio, while plant expenses are allocated to CPUC-jurisdictional service based on the direct plant ratio. The "other" category is allocated between the labor- and plant-related categories in proportion to the ratio of those two categories, so that all expenses are ultimately classified as either labor- or plant-related.[142]

Q155. After the application of the KN Method, how much do KMI and Mr. Wetmore allocate in corporate overhead to the CPUC-jurisdictional operations of SFPP?

A155. As indicated in Schedules 13 and 14 of Mr. Wetmore's Exhibit No. EGW-0004, the amount of direct corporate overhead allocated to CPUC-jurisdictional operations was approximately $6.9 million and the total amount of indirect corporate overhead allocated to CPUC-jurisdictional operations was approximately $4.4 million. This results in a combined total of approximately $11.2 million in corporate overhead allocated to SFPP's

[141] See *KN Interstate Gas Transmission Co.,* 88 FERC ¶ 61,270 at 61,848 (1999) citing *Williams Natural Gas Co.,* 77 FERC ¶ 61,277 at 62,188 (1996).
[142] For example, if total plant expenses were $100 and total labor expenses were $150, then the other category would be considered 40% plant expenses and 60% labor expenses.

California intrastate service, as shown in Table 7. These amounts consist of the categories labeled "direct corporate overhead" and "indirect corporate overhead" in Mr. Wetmore's analysis and do not include the additional general and administrative costs that Mr. Wetmore includes on Exhibit No. EGW-0004, Schedule 9.

As discussed previously, Mr. Wetmore also listed an additional $2.6 million in directly assigned FERC Account 550 employee benefit costs to specific cost categories or as part of regional overhead.[143] Additionally, Mr. Wetmore included direct assignments for legal fees specific to SFPP's CPUC system, which accounts for another $47,000 in CPUC G&A expense.[144] Adding these elements together results in a total of $13.8 million in overhead or overhead-related costs that Mr. Wetmore attributes to SFPP's CPUC system through his method of cost assignment and allocation. Table 7 shows these figures. To place this figure in context, Mr. Wetmore's overall cost of service of SFPP California operations for his Test Period is $122.1 million.[145] Therefore, corporate general and administrative expenses alone are more than 10% of the total cost of service.

Q156. Do you agree with Mr. Wetmore's estimated corporate overhead expenses allocable to CPUC-jurisdictional service in his Test Year?

A156. No. KMI's methodology for assigning and allocating corporate overhead, as described and implemented by Mr. Wetmore, is overly complex, opaque, and nearly impossible to verify. Furthermore, the KMI method invites cross-subsidization, in view of the fact that there is

[143] Exhibit No. EGW-0004, Schedule 9, lines 141-160.
[144] These SFPP legal fees are only those allocated to the SFPP CPUC system and do not include the current rate case litigation expense for the current proceeding. Exhibit No. EGW-0004, Schedule 11.
[145] Exhibit No. EGW-0003, Attachment B.

an incentive for an employee to assign as much time to a regulated entity as opposed to an unregulated entity in order to maximize the amount of costs assigned or allocated to regulated entities.

Q157. How does the KMI method invite cross-subsidization?

A157. A regulated entity, such as SFPP, is able to recover operating expenses through rates determined by a cost of service analysis. Every dollar of operating expense increases the cost of service by a dollar, and the regulated entity typically seeks full recovery of all operating expenses. Therefore, if the regulated entity is a subsidiary of a larger company, which also has non-regulated subsidiaries, the parent company has a strong incentive to increase the amount of operating costs attributed to the regulated entity, understanding that those costs are fully captured in rates from a cost of service analysis. In contrast, there is no assurance that the non-regulated entity will recover one hundred percent of its operating expenses. As a result, when considering cost assignment and allocation between regulated and non-regulated subsidiaries, the parent company has an incentive to maximize the amount of costs allocated to the regulated entity. The CPUC has previously indicated it actively discourages this type of cross-subsidization and is reluctant to endorse a cost allocation methodology that appears to invite it.[146]

Q158. What are the flaws with KMI's direct assignments?

A158. At the outset, KMI's method of directly assigning G&A expenses, including corporate overhead, is inconsistent with how KMI presents data for financial reporting purposes. The

[146] Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al.*, at pg. 13 (April 6, 2012), included as Exhibit No. LOU-0017.

direct assignment methodology has its roots in the history of SFPP regulatory proceedings before the FERC and the CPUC. KMI continues to try and implement a direct assignment methodology for its regulatory proceedings involving SFPP, despite the fact that it is inconsistent with the presentation of financial data in its SEC Form 10-K. Specifically, in public documents filed with the Securities and Exchange Commission ("SEC"), KMI treats G&A expenses separately and does not report these expenses consistent with segment operations.[147] This departure from the methodology that KMI uses in its financial reporting to the SEC reinforces the notion that KMI's direct assignment methodology is contrived and self-serving for regulatory purposes. Second, the reliance on salary splits and surveys is virtually impossible to verify. In a previous proceeding involving SFPP before the CPUC, a KMI witness testified that it would take an "army" of people to verify the accuracy of the system that KMI had in place for direct assignment, a point the presiding ALJ noted in his Proposed Decision rejecting SFPP's direct assignment methodology.[148]

Q159. Is SFPP still using the direct assignments methodology that were highly criticized in the prior proceedings?

A159. Yes. KMI still implements salary splits and invoice reviews to support direct assignments. But it has become even more cumbersome to verify the accuracy of KMI's direct assignments. In discovery, Tesoro specifically requested underlying documents pertaining to time sheets, surveys, or studies that would support the direct assignment of corporate

[147] KMI 2020 10-K, pg. 44, included in Exhibit No. LOU-0012. See also response to JP-SFPP-3.13(a), included as Exhibit No. LOU-0062.
[148] Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al.* at pg. 13 (April 6, 2012), included as Exhibit No. LOU-0017.

overhead expenses to SFPP's CPUC-jurisdictional service between 2017 and the present.[149] KMI responded that the invoice support for all of KM's direct assignment is "extremely voluminous" but KMI's "detailed documentation" explaining the direct assignment process was provided in response to TES-SFPP-1.25. This "detailed documentation" amounted to a **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][150] [redacted][151] [redacted][152] **[END HIGHLY CONFIDENTIAL]**

Q160. Do these documents support the validity or transparency of KMI's direct assignment methodologies?

A160. No. Consider the PowerPoint presentation provided in SFP21 000079. **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

[149] TES-SFPP-1.26, received on May 17, 2021, included as Exhibit No. LOU-0051.
[150] SFP21 000079, included as Exhibit No. LOU-0057.
[151] SFP21 000080-83, included as Exhibit No. LOU-0058.
[152] SFP21 000092-163, included as Exhibit No. LOU-0059.

[redacted] **[END HIGHLY CONFIDENTIAL]** But SFPP did not provide any information or indication as to how these different components are evaluated when setting or determining salary splits for a particular employee. Moreover, the fact that the evaluation of factors determining direct assignments is made on a "department by department" basis, increases significantly the cumbersome task facing shippers and regulatory agencies in assessing the reasonableness and accuracy of these splits. As KMI adds layer upon layer of complexity, it decreases the transparency of the methodology, while also increasing the barriers for shippers and regulatory authorities to assess the accuracy and validity of the direct assignments it makes.

Q161. Did KMI provide any data on salary splits?

A161. The only information KMI has provided to date was a single document that included

quarterly salary split information by employee number, but specific only to SFPP.[153] As a result, the data only show the percent of each employee's time applicable to SFPP, without information as to what other entities, if any a particular employee might be assigning time. For example, I previously mentioned the hypothetical example that SFPP provided in discovery, where an employee splits her time equally between SFPP and Calnev.[154] That hypothetical contains more information than SFPP has provided in this proceeding, because the salary split data provided in discovery only show time devoted to SFPP. Having only one side of the data (*e.g.*, time to SFPP) means that shippers have no knowledge that this hypothetical employee was working on another regulated entity, Calnev, as opposed to terminals, CO_2, or other non-regulated entities. As of the drafting of this testimony, SFPP had provided limited information on the direct assignments of G&A costs.[155]

Q162. Why are the salary splits provided by KMI insufficient to support the direct assignment methodology?

A162. As one example, salary split entries are **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

[redacted]

[redacted]

[153] Response to TES-SFP-1.26, included as Exhibit No. LOU-0051. SFP21 000180-203, received on September 16, 2021, included as Exhibit No. LOU-0060.
[154] Response to TES-SFP-1.26, received on September 16, 2021, included as Exhibit No. LOU-0051.
[155] Tesoro had requested direct assignments by specific KMI entity in TES-SFP-3.19, included as Exhibit No. LOU-0061. SFPP initially objected to the request but agreed to provide year-end 2020 direct assignments by KMI entity. However, these direct assignments do not tie back to any salary splits, as the only salary split information provided pertained to SFPP.

[redacted][156][redacted] **[END HIGHLY CONFIDENTIAL]**

Q163. Please explain how the salary split information appears to contradict SFPP's direct assignment of overhead costs?

A163. I analyzed the SFPP expense database provided in Mr. Wetmore's workpapers. I examined the monthly amount of direct costs allocated to SFPP for general and administrative

[156] For example, see employee numbers **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

expenses with a description of "Labor." Conceptually, these direct costs should follow the direct assignments indicated by the salary splits. **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

Q164. Can shippers, or a regulatory agency, reasonably verify the derivation and application of these salary splits?

A164. No. Since KMI has indicated that **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** it would seem to be prohibitive for shippers or regulatory agencies to reasonably evaluate the direct assignment methodology. Indeed, it is difficult to also evaluate whether any cross-subsidization might be occurring, in view of the fact that KMI only provided the salary splits specific to SFPP. For example, **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][157] **[END HIGHLY CONFIDENTIAL]** We do not know if that

[157] SFPP21 000180-203, included as Exhibit No. LOU-0060.

person spent the time on a regulated entity, unregulated entity, or even an entity outside the Products segment (*e.g.*, Terminals). If that employee is splitting time between a regulated entity (*e.g.*, SFPP) and a non-regulated entity, then there is an incentive to shift as much time as possible to the regulated entity. In this case the percentage allocated to SFPP could be unreasonably high, in view of the incentive to load costs onto regulated entities. But without the underlying data, it is impossible to know if KMI has created a structure that produces this type of cross-subsidization.

Q165. You indicated that SFPP had only recently provided very limited data on direct assignments. What are these data?

A165. SFPP provided a summary of the amount of the 2020 KMI 10-K G&A that was directly assigned to subsidiaries among the different product groups.[158] These data indicate that KMI directly assigns **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** to KMI entities, with the balance allocated to either all KMI entities, or all entities in a particular product group. In addition, SFPP only recently provided information on direct assignments by specific KMI entity.[159] These data indicate that KMI directly assigned **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** in the calendar year 2020, with specific assignments to **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** entities. Interestingly, this data response indicates that SFPP had direct assignments of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

[158] SFP21 004363, provided October 19, 2021, included as Exhibit No. LOU-0063.
[159] SFP21 005821, provided in response to TES-SFP-3.19 on October 25, 2021, included as Exhibit No. LOU-0078.

[redacted] **[END HIGHLY CONFIDENTIAL]** that is directly assigned. This is striking, given that, as I discuss later, SFPP determines an allocation factor of only **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** when computing an allocation across all KMI entities. In addition, there is no apparent roadmap or underlying calculations to understand how the **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** relates to the amount of direct corporate overhead or G&A expenses that are incorporated in Mr. Wetmore's cost of service analysis. Lastly, there remains areas of confusion even within SFPP's own discovery responses. In the initial response to TES-SFP-3.17 on October 19, 2021,[160] SFPP indicated that **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Again, there is no roadmap or any calculations that reconcile how one goes from approximately **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** It is simply impossible for shippers or the Commission to understand or derive where these

[160] Response to TES-SFP-3.17, initial response provided on October 19, 2021, supplemental response on October 25, 2021, included as LOU-0077.

numbers come from, and they appear to show a far greater amount of direct assignments to a regulated entity such as SFPP as opposed to other KMI entities such as those that are not subject to regulation.

Q166. What do you conclude regarding KMI's direct assignment of corporate overhead expenses to SFPP?

A166. The methodology lacks transparency and does not provide shippers, or regulatory agencies, the ability to adequately assess or validate the reasonableness and accuracy of the direct assignments. This is critical in view of the incentive to load costs on the regulated entities, away from the unregulated entities.

Q167. Are KMI's indirect corporate overhead allocations also flawed?

A167. Yes. KMI's use of multiple "tiers" is not only confusing but is clearly at odds with KMI's financial filings. Specifically, KMI indicates that for this regulatory proceeding, it can identify groups of indirect corporate overhead costs that pertain to specific business segments, but not to specific entities within that product group. KMI's claim that it is able to identify specific G&A expenses for specific business segments (*e.g.*, Products Pipelines, Terminals, CO_2) is in stark contrast to the public financial representations of KMI. In its public financial reports, KMI states that G&A expenses are reported separately and not included in any segment specific financial information.[161] Furthermore, KMI has not provided sufficient data to evaluate the overall nature of its cost allocation methodology. It only provided detailed direct assignments for SFPP, with limited information on direct

[161] KMI 2020 10-K, pg. 42, included in Exhibit No. LOU-0012.

assignments to any other entity.[162] As a result, shippers are left to accept, without verification, the residual pool of indirect corporate overhead costs, under the assumption that direct assignments to all other KMI entities do not suffer the same flaws as those inherent in the direct assignments to SFPP. And again, shippers are left to accept, without verification, the identification of costs specific to the different product segments, most notably the products pipeline segment.

Q168. Does KMI or Mr. Wetmore provide the level of detail necessary to evaluate the amounts of indirect corporate overhead being allocated in each of these product groupings?

A168. No. The underlying data files provided by SFPP regarding corporate overhead do not provide sufficient information to evaluate whether these assignments and allocations are reasonable. SFPP's response simply reinforces the fact that SFPP is seeking to have shippers, and the Commission, accept without verification its *de facto* direct assignments and the multi-tier implementation of the various MA methods. For example, SFPP provided MA models pertaining specifically to the Products, Terminals and CO_2 tiers in response to discovery.[163] However, these models only illustrate the derivation of the MA factors applicable to the segment tiers, namely (1) gross revenue, (2) gross property, plant and equipment, and (3) payroll. Thus, while each file indicates the allocation factor for SFPP within the Products pool or tier, the files do not actually detail the specific indirect

[162] KMI had provided the total amount of direct G&A assignments by product group in response to JP-SFP-3.13(b) (included as Exhibit No. LOU-0062), SFP21 004363 (included as Exhibit No. LOU-0063), but without any detail on specific entities.
[163] Response to TES-SFP-1.25, included as Exhibit No. LOU-0049 and SFP21 0000166-179.

corporate overhead cost actually allocated to SFPP and included in Mr. Wetmore's analysis.[164] In particular, SFPP has not provided the total level of Product Pool G&A costs in the file. Likewise, SFPP provided a file that purports to contain the top tier MA formula, which identifies a MA factor of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**, but then does not include any data upon which to examine the total top tier indirect cost base to which this factor is applied. Ultimately, all that is recorded in KMI's SFPP database are single line entries with a description of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** by FERC Account and by month.[165] SFPP has yet to provide any reconciliation of how those monthly allocations tie back to KMI's residual pool (*e.g.*, after direct assignment) of indirect corporate overhead.

Q169. Are there additional issues with KMI's allocation of indirect corporate overhead expenses?

A169. Yes. KMI employs different inputs into the MA Formula for the segment tiers as compared to the top tier. With respect to the segment allocations, KMI relies on the traditional three factors of gross property, gross revenue, and payroll for each of the entities in the Products, Terminals, and CO_2 pools. But for the top tier allocation model, KMI replaces the gross revenue allocator with one tied to net operating income.[166] It might be possible to consider an allocation factor other than gross revenue when you have certain natural gas entities that

[164] *E.g.*, see SFP21 000091, included as Exhibit No. LOU-0065, which has the **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]**

[165] See Mr. Wetmore's workpapers and the file "EGW WP Exp Database HC PROT".

[166] See SFP21 000179, included as Exhibit No. LOU-0054.

have significant gas purchase costs. In a prior A.09-05-014 proceeding, the Administrative Law Judge's Proposed Decision accepted an MA Formula that accounted for the gas purchase costs of the KMI entity Tejas Gas LLC and its subsidiaries by using net revenue (*i.e.*, gross revenue less the costs of goods sold for gas purchases) as the appropriate allocation factor for that natural gas entity.[167] Subsequent to that decision, KMI has shifted to using a Modified Massachusetts Method, which relies on net operating income, when allocating shared service costs that support natural gas entities.[168] But, the use of net operating income can create some challenges, such as when the negative operating income for an entity is zero. In these cases, KMI has assigned a value of zero for that entity's net operating income, which alleviates the issue of theoretically assigning "negative" shared services costs to a particular entity. However, it may not be as robust as a revenue measure. Nevertheless, pending any additional information in discovery that might provide more insight into these cost allocation factors, I am willing to accept KMI's use of the Modified Massachusetts Method that relies on net operating income to allocated corporate overhead expenses.

Q170. What are your conclusions regarding KMI's allocation of corporate overhead expenses to SFPP?

A170. I conclude that the methodology employed by KMI is opaque, overly complex, and provides insurmountable challenges to anyone trying to validate the accuracy or reconcile

[167] Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al.*, at pg. 14 (April 6, 2012) accepting Witness Ashton's testimony and overhead methodology, which Mr. Ashton's Answering Testimony from December 22, 2009 describes at A89, Included as Exhibit No. LOU-0017.

[168] SFP21 000084-85, included as Exhibit No. LOU-0050.

the data. KMI obfuscates the issue by adding layers of complexity, under the false guise that these added layers of complexity somehow translate to an increase in robustness and accuracy of the method. Finally, the methodology advocated by KMI invites cross-subsidization between regulated and unregulated entities, in view of the multitude of opportunities to load costs onto a regulated entity through direct assignments.

Q171. How do you propose the Commission determine SFPP's corporate overhead costs in this proceeding?

A171. The allocation of corporate overhead expenses should be transparent, reliable, and replicable. The system set up and relied on by SFPP is neither transparent nor reliable. Instead, I advocate the use of a single-tier MA Formula applied to KMI's overall corporate G&A expenses. I rely on the traditional three factors of gross revenue, gross plant, property and equipment, and payroll.

Q172. What was the source of your starting pool of G&A costs to allocate as corporate overhead to SFPP?

A172. I begin with KMI's 2020 10-K amount of $653 million for general and administrative and corporate charges listed on page 44 of the annual filing.[169]

Q173. Were you concerned that by using the KMI 10-K amount you might be double counting any direct assignments of benefits, legal, or environmental expenses as well?

A173. Yes. KMI indicates in its annual filing that the expenses in its G&A 10-K amount include such items as unallocated employee benefits, insurance, rentals, unallocated litigation and environmental expenses, and shared corporate services including accounting, information

[169] Exhibit No. LOU-0012.

technology, human resources, and legal services. Mr. Wetmore includes a significant amount of directly assigned employee benefits costs in FERC Account 550, specific to a location, as opposed to direct corporate overhead.[170] These are expenses that are consistent with general and administrative expenses and have descriptions of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Based on my review of the data available to me as of the date of this testimony, those **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** costs are part of the overall KMI G&A pool of costs and therefore, I include them in my overall corporate overhead analysis and reject Mr. Wetmore's direct assignment of those G&A expenses.[171] In addition, I also reject Mr. Wetmore's direct assignment of legal fees to SFPP, since these fees are also captured in the overall KMI G&A amount from the 2020 10-K. Lastly, I also reject Mr. Wetmore's inclusion of regional overhead entries associated with the FERC accounts pertaining to G&A expenses.[172] It is my understanding that these costs are captured in the overall G&A amount reported in the 2020 10-K. Failing to reject these line items would result in double counting expenses and overstating the true general and administrative expenses associated with SFPP's CPUC-jurisdictional operations.

Q174. How did you determine the SFPP-specific portion of the overall corporate general

[170] Exhibit No. EGW-0004, Schedule 9, FERC Account 550, lines 141 through 158.
[171] Response to JP-SFP-4.2(b), October 25, 2021, included as Exhibit No. LOU-0066.
[172] In response to JP-SFP-3.14(c) and (d), SFPP indicated that certain amounts of Northern and Southern Regional Overhead were captured in the segment results in KMI's 10-K. As a result, I have not made any adjustment to the Northern and Southern Overhead captured in the O&M categories (FERC Accounts 300 through 390). Response included as Exhibit No. LOU-0067.

and administrative expenses?

A174. I used a single tier implementation of the MA Formula. For the purposes of this testimony, I accepted KMI's use of a Modified MA Formula approach to the "Top Tier," which represents cost allocation across all KMI entities. However, unlike Mr. Wetmore, I reject the direct assignment of corporate overhead expenses and also the allocation of corporate overhead costs to groupings of subsidiaries by product line. Instead, I use a single tier methodology because it provides clarity, transparency and the ability to easily reproduce the results. Furthermore, a single tier methodology is consistent with the approach endorsed by the presiding ALJ in the A.09-05-014 proceeding.[173] As a result, I accepted KMI's single tier allocation factor of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

[173] Proposed Decision of ALJ Karl J. Bemesderfer in Proceedings A.09-05-014 *et al.* at pg. 14 (April 6, 2012), included as Exhibit No. LOU-0017.

[redacted]

[END HIGHLY CONFIDENTIAL]

Q175. How did you subsequently determine the overall corporate overhead attributable to SFPP's jurisdictional CPUC operations?

A175. These calculations are shown in Table 8, Lines 4 and 5. I employed the results of Mr. Wetmore's KN analysis, as shown on Exhibit No. EGW-0004, Schedule 13. Specifically, the weighted average CPUC amount as a percentage of the total company was **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** from Mr. Wetmore's combined direct and indirect corporate overhead, and direct assignments of pension load and benefits load in FERC Account 550.[174]

[174] Exhibit No. EGW-0004, Schedules 13 and 14.

Q176. How did you include your computation of corporate overhead into your cost of service analysis?

A176. Exhibit No. LOU-0055, Schedule 9 demonstrates the incorporation of my corporate overhead expenses attributable to SFPP in the cost of service that I calculated for SFPP in this proceeding. First, I remove the entries for Mr. Wetmore's direct corporate overhead, indirect corporate overhead, and the direct assignments of employee benefits in FERC Account 550. I also remove SFPP's legal fees, as well as the regional overhead expenses in Mr. Wetmore's G&A expenses. I replace these amounts with my CPUC-jurisdictional corporate general and administrative expense amount of $9.5 million.

Q177. How does your determination of corporate overhead general and administrative expenses compare to the computations performed by Mr. Wetmore?

A177. My calculation leads to an overall reduction of approximately $4.4 million in corporate general and administrative expenses as compared to Mr. Wetmore's statement of the G&A costs that should be attributed to SFPP.

RATE CASE LITIGATION EXPENSES

Q178. How does SFPP witness Mr. Wetmore recommend handling litigation expenses associated with this proceeding?

A178. Mr. Wetmore includes $3,500,000 per year in CPUC rate case litigation expenses, amortized over five years ($700,000 per year).[175]

Q179. What support does Mr. Wetmore provide for his forecasted rate case litigation

[175] Exhibit No. EGW-0001 at 19:15-19.

expenses?

A179. Mr. Wetmore states that his forecasted rate case litigation expenses are reasonable in light of past expenses incurred in CPUC and FERC proceedings involving SFPP. In discovery, SFPP provided an Excel spreadsheet[176] containing the forecasted expenses for its law firms and outside experts. The forecasted numbers contain no underlying calculations, backup, or other analyses indicating how the level of rate case litigation expense was developed.

Q180. Do you agree with Mr. Wetmore's recommendation?

A180. No. While I believe that SFPP is entitled to recoup its reasonable rate case litigation expenses from shippers, I disagree with including an estimate in SFPP's Test Period rates. First, while SFPP has provided an estimate of its expenses, the actual cost that SFPP will incur associated with this proceeding will not be known or knowable until the proceeding concludes. In the event that SFPP's costs are lower than its estimate, this would result in shippers paying rates based on costs not actually incurred by SFPP. Second, in the event that SFPP's rates remain in effect for longer than five years, shippers would continue to pay $700,000 per year as part of SFPP's cost-based rates that SFPP is no longer incurring.

Q181. How do you recommend handling SFPP's rate case litigation expenses in this proceeding?

A181. I recommend that a litigation surcharge be used to recover reasonable costs associated with this proceeding over a five-year period. This ensures that SFPP is made whole for the actual expenses it incurs as part of this proceeding, while simultaneously guaranteeing that

[176] SFP21 004362 (included as Exhibit No. LOU-0068), provided in response to TES-SFPP-3.24 (included as Exhibit No. LOU-0069).

shippers do not pay rates that include costs SFPP did not incur.

FUEL & POWER

Q182. What adjustment does Mr. Wetmore make for SFPP's fuel and power expense?

A182. Mr. Wetmore states that "the amount of fuel and power a pipeline incurs over a period is directly related to the throughput of the pipeline during that period."[177] He then adjusts SFPP's Base Period fuel and power expenses upward by $1.3 million to account for the increase in volumes projected by SFPP witness Mr. Sanborn.

Q183. How did Mr. Wetmore calculate his Test Year adjustment?

A183. Mr. Wetmore relied on Mr. Sanborn's Test Period volume adjustment, which replaced April to June 2020 volumes with September to November 2020 volumes. Mr. Wetmore subsequently replaced April to June 2020 fuel and power expenses with September to November 2020 fuel and power expenses.

Q184. Do you agree with Dr. Wetmore's recommendation?

A184. No. I am relying on the Test Year throughput recommendation from Mr. Ashton, as opposed to Mr. Sanborn's erroneous Test Year throughput estimate. As a result, I determined my own Test Year fuel and power expense estimate to match Mr. Ashton's Test Year throughput recommendation. Table 9 presents the summary of my Test Period fuel and power estimate.

[177] Exhibit No. EGW-0001 at 22:3-6.

[BEGIN HIGHLY CONFIDENTIAL]

[END HIGHLY CONFIDENTIAL]

Q185. How did you determine your Test Year fuel and power throughput estimate?

A185. First, I examined the historical data of fuel and power expenses for SFPP's CPUC intrastate system. I analyzed data for 2018 through 2020, as shown in rows [a] and [b] of Table 9. I subsequently computed the fuel and power per barrel in row [c]. In row [d], I computed a weighted average over these three years. Although 2020 appears to be slightly anomalous, I believe that my calculations are conservative since I include 2020 in my average results. Next, I relied on Mr. Ashton's Test Year throughput estimate and applied the weighted average fuel and power per barrel to this Test Year throughput to determine the Test Year fuel and power expenses. I subsequently include these fuel and power expenses in FERC Account 330 in Exhibit No. LOU-0055, Schedule 9.

Q186. How does your Test Year fuel and power estimate compare to the historical data?

A186. My Test Year fuel and power estimate is similar to the amount SFPP incurred in 2019 for intrastate service. This makes sense, in view of the fact that Mr. Ashton's Test Year throughput estimate is also very close to 2019 actual volumes.

ENVIRONMENTAL REMEDIATION EXPENSES

Q187. What is the amount of CPUC jurisdictional environmental remediation expense that Mr. Wetmore includes in his cost of service?

A187. Mr. Wetmore's workpapers indicate that SFPP's Test Period environmental remediation expenses for both CPUC and FERC jurisdictional operations are approximately $9.6 million. Of that $9.6 million, Mr. Wetmore claims that $7.0 million is attributable to CPUC jurisdictional service, representing approximately 8.5% of Mr. Wetmore's total operating expenses and nearly 6% of Mr. Wetmore's total cost of service.[178]

Q188. Did you make any adjustment to SFPP's environmental remediation expenses?

A188. Yes. Mr. Wetmore included a Test Year adjustment of $4 million for environmental remediation expenses associated with the Walnut Creek/Iron Horse Terminal ("IHT") incident. I recommend excluding the entirety of SFPP's CPUC jurisdictional expense associated with the Walnut Creek incident for the Test Year.

Q189. Before you explain why you excluded these expenses from SFPP's Test Year cost of service, can you provide a summary of the Walnut Creek incident?

A189. On November 20, 2020, **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

[178] Mr. Wetmore's total operating expenses are $81.717 million. Mr. Wetmore's total cost of service is $122.067 million.

[redacted][179] [redacted] [END HIGHLY CONFIDENTIAL]

Q190. Please explain why you excluded SFPP's Test Year expense estimate for Walnut Creek environmental remediation.

A190. The Walnut Creek release was an extraordinary event that resulted in the release of 1,000 barrels of petroleum products into a California waterway. **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Further, the Walnut Creek event is of a scope and order of magnitude far greater than typical environmental incidents on SFPP and would certainly be considered

[179] SFP21 001446, included as Exhibit No. LOU-0070.
[180] SFP21 001449, included as Exhibit No. LOU-0070.

a one-time, non-recurring event. It should therefore be eliminated from the Test Period costs.

Q191. What percentage of Test Period environmental remediation expenses does Walnut Creek comprise?

A191. The Walnut Creek incident alone accounts for over 57% of SFPP's forecasted CPUC jurisdictional environmental remediation expenses in the Test Year analysis performed by Mr. Wetmore.[181]

Q192. How does SFPP witness Mr. Hanak characterize SFPP's environmental remediation costs associated with the Walnut Creek incident?

A192. Despite accounting for the majority of SFPP's forecasted CPUC jurisdictional environmental remediation expenses for the Test Period, Mr. Hanak dedicates a single Q&A to the costs associated with Walnut Creek in his Direct Testimony.[182] Mr. Hanak concludes that "given the nature of the Walnut Creek incident and the anticipated remediation activities, I expect SFPP to incur, at a minimum, $20 million in environmental remediation costs for this site over the next five years."[183]

Q193. How does SFPP witness Mr. Wetmore treat SFPP's environmental remediation costs associated with the Walnut Creek incident?

A193. Mr. Wetmore relies on SFPP witness Mr. Hanak to obtain the $4 million in forecasted environmental remediation expenses for Walnut Creek that he includes in his Test Period cost of service. Mr. Wetmore notes that this level of costs is representative of what SFPP

[181] Exhibit No. EGW-0004, Schedule 10.
[182] Exhibit No. MAH-0001 at 22:1-9.
[183] Exhibit No. MAH-0001 at 22:1-9.

"expects to incur for the foreseeable future."[184]

Q194. Did Mr. Hanak's direct testimony include any calculations or documents supporting the $20 million cost estimate?

A194. No. However, in response to a discovery request,[185] SFPP provided a worksheet detailing the environmental remediation efforts at the Walnut Creek site. **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][186] **[END HIGHLY CONFIDENTIAL]**

Q195. Did Mr. Hanak indicate how long he anticipated SFPP conducting environmental remediation efforts at the Walnut Creek site?

A195. No, however Mr. Hanak stated that "it is typical to spend five to ten years on the investigation and site characterization process alone,"[187] and that "remediation efforts may take longer than 10 years or even decades to complete."[188]

Q196. Do you agree that SFPP is entitled to recover a normalized amount of environmental remediation costs in its cost of service?

A196. Yes, which is why I am not recommending any adjustment to the costs associated with sites other than Walnut Creek. Below I explain my rationale for classifying the costs associated with the Walnut Creek release as extraordinary and non-recurring, and further

[184] Exhibit No. EGW-0001 at 18:6-20.
[185] TES-SFPP-3.39, received on October 12, 2021, included as Exhibit No. LOU-0071.
[186] SFP21 003024, included as Exhibit No. LOU-0072.
[187] Exhibit No. MAH-0001 at 13:11-12.
[188] Exhibit No. MAH-0001 at 9:1-5.

demonstrate that to the extent SFPP should be able to recover costs associated with the Walnut Creek incident, those costs should be significantly lower on an annual basis than the amount Mr. Wetmore includes in the Test Period.

Q197. Let's start with your characterization of the Walnut Creek incident as extraordinary. Have you prepared any analyses to demonstrate that the costs associated with the Walnut Creek release are anomalous and non-recurring and therefore inappropriate for inclusion in SFPP's cost of service?

A197. Yes. Exhibit No. LOU-0055 shows my analysis of SFPP's cash expenditures multiplied by their carrier percentage for environmental remediation sites, excluding Walnut Creek, from 2016 to 2020. In that exhibit, I calculate the total number of sites that SFPP was remediating each year, the total carrier cash expenditures per site, and the average and median environmental remediation cost per site excluding the Walnut Creek incident.

Q198. What are the results of your analysis?

A198. As Exhibit No. LOU-0079 and Table 10 below show, **[BEGIN HIGHLY CONFIDENTIAL]** [redacted]

[redacted] **[END HIGHLY CONFIDENTIAL]** SFPP's own data demonstrates the highly abnormal and non-recurring nature of the Walnut Creek incident.

Q199. Are there any other factors that contributed to your decision to exclude expenses associated with the Walnut Creek incident from the Test Year cost of service?

A199. Yes. **[BEGIN HIGHLY CONFIDENTIAL]** [redacted][189] [redacted]

[189] SFP21 001446, included as Exhibit No. LOU-0070.

[redacted][190] [redacted] **[END HIGHLY CONFIDENTIAL]** This calls into question the prudence of SFPP's remediation efforts since discovering the initial release.

Q200. Does SFPP carry insurance through which it might be able to recover environmental remediation expenses associated with the Walnut Creek site?

A200. Yes, it does. SFPP indicated in a discovery response that it carries insurance for environmental remediation activities. SFPP stated that it has not made any insurance claims from 2017 through the present because the costs have "not exceeded SFPP's self-insured retention amount of $20 million."[191] SFPP noted that it had filed a "notice of potential insurance claim" for the Walnut Creek site but had not yet submitted an actual claim.[192]

Q201. On the basis of that discovery response, is it your understanding that SFPP can seek reimbursement from its insurance carriers for costs related to a single remediation site in excess of $20 million?

A201. Yes, that is my understanding. Combined with Mr. Hanak's testimony that remediation

[190] SFP21 001448., included as Exhibit No. LOU-0070.
[191] TES-SFPP-2.15, received on October 1, 2021, included as Exhibit No. LOU-0073.
[192] TES-SFPP-2.15, received on October 1, 2021, included as Exhibit No. LOU-0073.

efforts can take ten years or even decades to complete, it is unclear why SFPP is asking shippers to reimburse it for the $20 million self-insurance amount in just five years when SFPP believes that it could potentially incur costs for the Walnut Creek incident over decades.

Q202. In the event that SFPP is permitted to recover costs associated with the Walnut Creek incident from shippers in its cost of service, do you agree that the $4 million annual amount recommended by Mr. Hanak and included by Mr. Wetmore in his Test Year cost of service is appropriate?

A202. No, I do not. As discussed above, SFPP's self-insured retention is $20 million per environmental remediation site. In the event the costs associated with the Walnut Creek incident exceed $20 million, ostensibly SFPP would file a claim seeking reimbursement from its insurance carriers. Thus, the hypothetical maximum that SFPP would need to recover from ratepayers is $20 million because that is the maximum it will need to pay after receiving insurance proceeds. Mr. Hanak's testimony makes it clear that remediation at the Walnut Creek site will likely continue for more than five years and that it could continue for decades.[193] Therefore, SFPP's recommended five-year normalization period[194] is unreasonable and places an undue burden on shippers. By including $4 million in Walnut Creek expenses in the Test Period, SFPP would be made whole in five years when its own witnesses have testified that the cleanup will last considerably longer than five years.

[193] Exhibit No. MAH-0001 at 9:4-5.
[194] Exhibit No. MAH-0001 at 22:4-9.

Therefore, in the event that SFPP is permitted to recover any costs associated with the Walnut Creek incident in its rates, I recommend a normalization period of 20 years for the $20 million cost, consistent with SFPP's insurance policies and Mr. Hanak's testimony that environmental remediation activities can occur over decades. This would result in a Test Period cost of $1 million associated with the Walnut Creek incident.

Q203. What do you conclude is the appropriate amount of CPUC jurisdictional environmental remediation expenses to include in SFPP's Test Period cost of service?

A203. As shown in Schedule 10 of Exhibit No. LOU-0055, I recommend that SFPP's Test Year cost of service include a total of $3.0 million in environmental remediation expenses. This is the total CPUC amount for all sites except Walnut Creek.

COST OF SERVICE RESULTS

Q204. How did you compute your Test Year cost of service?

A204. Exhibit No. LOU-0046 contains my cost of service computations for the Test Period. Specifically, I include a return on the rate base plus operating expenses, depreciation, and amortization of AFUDC. Attachment B, page 1 of Exhibit No. LOU-0046 shows my Test Period cost of service is approximately $106.3 million. This Test Period cost of service includes the overall return on rate base using the appropriate cost of capital. In addition, the cost of service includes my Test Period adjustments to SFPP's operating expenses. As noted on Line 4 of Attachment B, page 1 of Exhibit No. LOU-0046, I do not include an income tax allowance. The Commission's Decision D.11-05-045 disallowed an income tax allowance for SFPP. As I discussed previously in my rate base section on ADIT, this results in a zero for the income tax allowance. I summarize my cost of service results in

Table 11.

Table 11
Cost of Service Results

Line		($000s)	
1	Total Return on Rate Base	$ 20,957	[a]
2	Total Operating Expenses, Incl. Deprec. and Amort.	$ 85,305	[b]
3	Total Cost of Service	$ 106,262	[c] = [a]+[b]
4	Test Year Revenue at Pre-Existing Rates	$ 108,393	[d]
5	Excess / (Deficient) Revenue	$ 2,130	[e]=[d]-[c]
6	Percent Reduction in Revenue to Equal Cost of Service	-1.97%	[f] = -[e]/[d]

Q205. How does your Test Period cost of service compare to SFPP's revenues calculated using Mr. Ashton's throughput recommendation?

A205. Table 11, Line 4 shows Test Year revenue of approximately $108.4 million when using Mr. Ashton's Test Year throughput and SFPP's pre-existing rates prior to the date it filed its rate application and increased its rates by 10%. As the Table shows, the Test Year revenue is higher than the cost of service by approximately $2.1 million.

Q206. What have you concluded with respect to SFPP's CPUC jurisdictional rates and its request for a 25.527% rate increase?

A206. Table 12 provides a comparison of SFPP's Test Year revenue at both the 10% increase SFPP instituted as of March 1, 2021 and at the 25.527% rate increase it seeks in its rate application. In both cases, the resulting Test Year revenues are significantly in excess of SFPP's Test Year cost of service. My analysis clearly shows that the rate increase that SFPP is proposing is without merit and is unjustified.

Table 12
Comparison of Cost of Service with Test Year Revenue Given SFPP Rate Increases

Line		($000s)	
1	Total Cost of Service	$ 106,262	[a]
2	Test Year Revenue at 10% Increase	$ 119,235	[b]
3	Excess / (Deficient) Revenue	$ 12,973	[c] = [b]-[a]
4	Test Year Revenue at 25.527% Increase	$ 136,064	[d]
5	Excess / (Deficient) Revenue	$ 29,802	[e] = [d]-[c]

Q207. Please explain why you believe that SFPP's CPUC-jurisdictional proposed rate increase is not justified.

A207. My cost of service analysis shows that the total Test Period cost of service for SFPP's CPUC jurisdictional operations is $106.3 million. Applying SFPP's rates at the requested rate increase to reasonable and defensible Test Period volumes results in total revenues of approximately $136.1 million. Using this revenue estimate, SFPP's overall achieved rate of return is 19.16%, which significantly exceeds any just and reasonable return. In contrast the just and reasonable overall rate of return that I calculate for SFPP is 7.91%. Indeed, if SFPP were permitted to increase its rates by 25.527%, its achieved return on equity would be 35.40%, compared to my recommended return on equity of 11.33%. Clearly, these results show that SFPP's proposed rate increase is not justified.

Q208. Should SFPP be entitled to any increase to its CPUC jurisdictional rates?

A208. No. In fact, the results of my analysis show that not only should the Commission reject SFPP's request for a rate increase, but instead, the Commission should instruct SFPP to implement a 1.97% rate reduction. This conclusion is justified because SFPP's Test Year

revenue at existing rates exceeds the cost of service that I calculated for SFPP.

Q209. Have you computed just and reasonable rates that reflect your proposed reduction?

A209. Yes, these are shown in Table 13. I recommend a reduction of 1.97% for all of SFPP's CPUC intrastate rates. I have summarized those rates for the delivery locations where Tesoro has had shipments over the past several months.

Table 13
Recommended Rates for Tesoro Delivery Points

Delivery Location	Pre-Existing Rate	Recommended Rate
Bradshaw	$ 0.3212	$ 0.3149
Chico	$ 0.5696	$ 0.5584
Fresno N	$ 0.9820	$ 0.9627
Sacramento	$ 0.3212	$ 0.3149
San Jose	$ 0.2321	$ 0.2275
Stockton	$ 0.2929	$ 0.2871
Mission Valley	$ 0.6341	$ 0.6216
Orange	$ 0.1985	$ 0.1946
San Diego	$ 0.6621	$ 0.6491
Colton	$ 0.2717	$ 0.2664
Arco Hynes	$ 0.0860	$ 0.0843
Imperial	$ 0.6597	$ 0.6467

Recommended rate is represents a 1.97% reduction in pre-existing rates, prior to 10% increase March 1, 2021

REFUNDS AND REPARATIONS

Q210. Is Tesoro entitled to a refund for overpayments since March 1, 2021?

A210. Yes. SFPP instituted a temporary 10% rate increase on all intrastate movements as of March 1, 2021. My analyses show that the increase is not warranted, and Tesoro should not have had to pay the additional 10% over pre-existing rates since March 1, 2021.

Q211. How did you calculate the damages owed to Tesoro?

A211. SFPP provided monthly information on Tesoro's CPUC shipments by delivery location between March 2021 and August 2021.[195] As of the date of this testimony, these were the data available to me. As a result, I have only calculated refunds through August 2021, but would expect the Commission to require SFPP to pay refunds, including interest, from March 1, 2021 through the Commission Decision. Tesoro is entitled to a refund equal to the 10% increase over pre-existing rates. This difference is Tesoro's overpayment to SFPP since March 1, 2021. I subsequently multiplied the monthly volume delivered to each location by the overpayment amount. These analyses are contained in Exhibit No. LOU-0056.

Q212. Did you also calculate interest on the overpayments and refunds due Tesoro?

A212. Yes. In calculating the interest to which Tesoro is entitled, I used the monthly average rate determined from the three-month commercial paper rate reported by financial institutions, in accordance with prior Commission rulings.[196] The average three-month commercial paper rate is obtained directly from the Federal Reserve Board's "Selected Interest Rates" (Statistical Release H.15). Therefore, the monthly interest rate to be applied to the refunds due to Tesoro represents the annual three-month commercial paper rate, expressed as monthly value, as of the end of each shipment month.[197] I calculated the monthly interest

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[195] SFP21 000035, SFP21 000327, included as Exhibit No. LOU-0074.
[196] D.02-04-059, issued April 22, 2002 at pg. 25, included as Exhibit No. LOU-0075. Also, see CPUC Decision 05-09-007, which states that "use of the three month commercial paper interest rate to calculate interest on refunds to ratepayers is consistent with established Commission precedent." (2005 Cal. PUC LEXIS 340, at 45), included as Exhibit No. LOU-0076.
[197] The monthly rate is simply the annual rate divided by 12.

based on the assumption that payments made for the prior month's shipments occur midmonth in the following month. For example, the transportation charges associated with shipments in June would be paid on the 15th of July. Consequently, the interest does not begin accruing until the transportation charges are assumed to have been paid and are delayed by half a month from the end of month reparations amount. I included the compounded interest in the end of month.

Q213. What was the total amount of refunds, plus interest, due Tesoro through August 2021?

A213. Tesoro is entitled to refunds of **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** These results are presented in Exhibit No. LOU-0056.

Q214. Did you also calculate reparations for Tesoro?

A214. Yes.

Q215. Please explain how reparations are different from refunds.

A215. My analysis indicates that SFPP is over-recovering its cost of service for the Test Year. This means that not only should SFPP be denied a rate increase, but the Commission should require SFPP to reduce its pre-existing rates. Specifically, I determined that a 1.97% reduction in SFPP's pre-existing rates is required. Consequently, even apart from the 10% increase, Tesoro has been paying rates that are in excess of just and reasonable rates. I have calculated reparations on these amounts since March 1, 2021, which is consistent with the date on which Tesoro protested the SFPP rate application. Exhibit No. LOU-0056

includes my computation of damages on the amounts that Tesoro has paid above and beyond the just and reasonable rate.

Q216. What was the total amount of reparations, including interest, due Tesoro through August 2021?

A216. If the Commission directs SFPP to reduce its rates in accordance with my analysis, the total amount of reparations, including interest, due Tesoro through August 2021 is **[BEGIN HIGHLY CONFIDENTIAL]** [redacted] **[END HIGHLY CONFIDENTIAL]** Because I only have data through August 2021, I believe that the Commission should order reparations on all volumes shipped by Tesoro from March 1, 2021 until issuance of a Commission decision in this proceeding. Furthermore, I recommend that the Commission grant the permanent reduction in rates demonstrated by my analysis.

Q217. Does this conclude your testimony?

A217. Yes.

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of the Application of SFPP, L.P. (PLC-9) for Authority to Increase Rates for Transportation of Refined Petroleum Products.	Application No. A21-01-015

CERTIFICATION OF LEE O. UPTON, III

I, Lee O. Upton, III, hereby certify that I am submitting the foregoing Prepared Reply Testimony of Lee O. Upton, III on behalf of Tesoro Refining & Marketing Company LLC, which was prepared by me or under my direction, and that the contents thereof are true and correct to the best of my knowledge, information and belief.

/s/ Lee O. Upton, III

Lee O. Upton, III

Dated: October 29, 2021