BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Application of SFPP, L.P. (PLC9) for authority, pursuant to Public Utilities Code Section 455.3, to change its rates for pipeline transportation services within California.	Application 12-01-015 (Filed January 30, 2012)
And Related Matters	Case 12-03-005 Case 12-03-006 Case 12-03-007 Case 12-04-004 Case 12-04-006 Case 12-04-007

OPENING BRIEF OF TESORO REFINING AND MARKETING COMPANY

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TABLE OF CONTENTS

TABLE OF CONTENTS 2

TABLE OF AUTHORITIES 6

Introduction and Organization of Tesoro Opening Brief 7

PART I: TESORO'S RESPONSE TO THE ISSUES SPECIFIED IN THE SCOPING MEMO 9

PART II: SUMMARY OF TESORO'S POSITION WITH RESPECT TO SIGNIFICANT CONTESTED ISSUES 17

A. Overhead Expenses 17

B. Environmental Remediation Expenses 21

1. Mission Valley Site 22

a. The Source of the Leaks at Mission Valley 23

b. Prudence in Preventing Leaks and Spills from Occurring 29

c. Prudence in Cleaning Up Leaks and Spills After They Occurred 31

2. SFPP Remediation at Other Terminals 33

C. Legal Expenses 36

D. SFPP Right of Way Costs 39

E. Return on Equity, Cost of Debt and Capital Structure 39

PART III: LEGAL STANDARDS 42

A. Burden of Proof Requirement 42

B. Income Tax Allowance 44

PART IV: ANALYSIS OF THE COST FACTORS THAT COMPRISE SFPP'S COST OF SERVICE 44

I. DISCUSSION OF SFPP'S CLAIMED OVERHEADEXPENSES..... 44

A. SFPP's Claimed Overhead Expenses are Excessive and Should Be Rejected..... 45

1. SFPP's Overhead Allocation Methodology is Overly Complex, Highly Subjective, and Cannot Be Feasibly Audited..... 48

2. The SFPP Overhead Allocation Model Contains Errors in the Assignment of Costs to the SFPP Jurisdictional Pipeline..... 52

(a) Overstatement of Legal Costs..... 53

(b) Overstatement of the Environmental Remediation Costs and Labor Associated with Environmental Remediation Projects..... 56

(c) Direct Assignment Errors Highlighted in the Testimony of SFPP Witness Michael J. Webb..... 57

(d) Attachment AAA to the Rebuttal Testimony of Mr. Bradley Further Demonstrates Errors in Mr. Bradley's Direct Assignments..... 59

(e) Errors Leading to Cross-Subsidization..... 61

B. SFPP's Overhead Cost Allocation Methodology Improperly Excludes a Number of KMEP Entities that Benefit from KMEP Overhead Services...…..... 62

C. SFPP's Overhead Method Leads to Cross Subsidization..... 67

D. SFPP's Overhead Allocation Method is Defective Because It was Designed to Maximize Regulatory Benefits Rather Than as a Tool for Business Decision-Making..... 68

E. The Fact That SFPP's Allocation of Overhead is Much Higher than Other Pipelines Calls into Question the Validity of the Methodology…..... 71

F. The Overhead Allocation Methodology Recommended by Tesoro Witness Ashton Is an Objective and Reliable

Process for Determining SFPP's Overhead Costs..... 73

II. SFPP HAS FAILED TO PROVE WITH CLEAR AND CONVINCING EVIDENCE THAT IT IS ENTITLED TO CHARGE ITS SHIPPERS FOR THE COST OF REMEDIATING CONTAMINATION AT ITS TERMINALS..... 74

A. Introduction..... 74

B. SFPP's Mission Valley Site..... 80

1. The Cause of Leaks at the Mission Valley Site..... 80

2. Powerine Releases and SFPP's Revision to Its Allocation of Remediation Costs..... 87

3. Absence of Evidence of SFPP's Prudent Action and Operation of the Mission Valley Terminal..... 95

C. Other Mixed Asset Sites..... 99

Colton..... 102

Rocklin..... 107

Brisbane..... 108

Chico..... 110

D. 100% Carrier Sites..... 113

Concord..... 114

Stockton..... 115

Oakland Airport..... 116

Norwalk..... 118

E. Discovery Abuse..... 118

III. DISCUSSION OF OTHER OPERATING EXPENSES..... 124

A. UPRR Right of Way Rental Cost..... 125

B. Oil Losses and Shortages..... 128

C. Fuel and Power..... 129

D. Wage Increases..... 129

E. CPUC Litigation Expenses..... 130

IV. APPRORIATE RATE OF RETURN..... 131

A. Capital Structure Including the Treatment of Purchase Account Adjustments..... 131

B. Determination of Capital Structure..... 131

C. Inclusion of the Current Portion of Long Term Debt..... 136

Cost of Debt..... 138

Return on Equity..... 144

V. PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW..... 150

CONCLUSION..... 159

GLOSSARY OF TERMS AND ABBREVIATIONS..... 161

ATTACHMENTS

PUBLIC VERSION: CONFIDENTIAL MATERIAL REDACTED

TABLE OF AUTHORITIES

Cases

SFPP v. Public Utilities Commission, Case No. G046669 (CA Ct. of App., 4th Dist., June 13, 2013). [pages 16, 44, 130]

Southern California Edison Company v. FERC, Case No. 11-1471 (D.C. Cir. May 10, 2013). [page 150]

Commission Decisions

Proposed Decision Setting Rates and Ordering Refunds to Shippers on SFPP, L.P. Intrastate Refined Petroleum Products Pipeline, A.09-05-014 (June 22, 2011). [pages 21, 40]

Revised and Reissued Proposed Decision Determining Test Year 2009 Rate Base and Cost of Service for SFPP, L.P. and Calnev Pipe Line L.L.C. and Ordering Refunds, A.09-05-014 (April 6, 2012). [pages 41, 71, 132, 138, 147]

Re Pacific Bell, 27 CPUC 2d 1 (1987). [page 42]

Re Southern California Edison Company, 11 CPUC 2d 474 at 475 (1983). [pages 42, 43]

Re Southern California Edison Company, 53 CPUC 2d 452 (1994). [pages 43, 44]

Re San Diego Gas and Electric Company, 46 CPUC 2d 538 at 609 (1992). [page 43]

FERC Decisions

Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity, 123 FERC ¶ 61,048 (2008). [page 40]

El Paso Natural Gas Company, 86 FERC ¶ 61,033 (1999). [page 127]

Williams Pipeline Company, 31 FERC ¶ 61,377 (1985). [page 41]

Transcontinental Gas Pipeline Corporation (Transco), 84 FERC ¶ 61,084 (1998). [page 41]

Pursuant to Rule 13.11 of the California Public Utilities Commission's (CPUC) Rules of Practice and Procedure, Tesoro Refining and Marketing Company (Tesoro) is pleased to submit its Opening Brief in this proceeding.

INTRODUCTION AND ORGANIZATION OF TESORO OPENING BRIEF

The ultimate issue in this proceeding is the rate that is just and reasonable for SFPP, L.P. (SFPP) to charge shippers for the transportation of petroleum products on its California pipeline system.

In order to ascertain this rate, Presiding Administrative Law Judge Karl J. Bemesderfer conducted an evidentiary hearing from April 22, 2013 to May 6, 2013. During the course of that hearing, Judge Bemesderfer received into evidence extensive testimony and exhibits. In addition, Judge Bemesderfer enunciated the standards which SFPP must meet in order to justify the rate it is seeking to charge its shippers. According to Judge Bemesderfer, "The standard of proof that applies to these matters is clear and convincing."[1] In other words, the pipeline must justify each element of the rate it proposes to charge with "clear and convincing" evidence.

In this Opening Brief we will discuss in detail the legal standards and the burden of proof that SFPP must meet. We will also discuss each element of the rate that SFPP proposes to charge, the reasons why SFPP has failed to establish that rate as just and reasonable, and the manner in which Tesoro's cost of service expert Peter K. Ashton has formulated the alternative just and reasonable rate that SFPP should charge. We will, in addition, attach proposed findings of facts and conclusions of law that we recommend the

[1] Administrative Law Judge (ALJ) Bemesderfer, A.12-01-015 Transcript, Volume 1, page 10, lines 4-5.

Presiding Judge adopt. However, for the convenience of the ALJ, we will initially summarize the conclusions that we reach and will discuss in summary fashion the major contested issues in this proceeding.

Accordingly, Tesoro's Opening Brief is organized in the following manner:

Part I – Tesoro's Response to the Issues Specified in the Scoping Memo.

The Scoping Memorandum in this proceeding was issued on May 8, 2012 and specifies the issues that the Commission will decide in this case. In Part I of this Opening Brief, Tesoro summarizes its response to each of these issues.

Part II – Summary of Tesoro's Position with Respect to Significant Contested Issues.

In this portion of the Opening Brief, Tesoro will summarize its position with respect to the major elements of SFPP's cost of service that are in dispute. We will discuss the determination of SFPP's overhead expenses, environmental remediation expenses, legal expenses, right of way rental expenses and SFPP's return on equity, cost of debt, and capital structure.

Part III – Discussion of the Legal Standard to be Applied in this Proceeding.

In this portion of the Tesoro Opening Brief, we discuss the Commission decisions that require SFPP to prove through clear and convincing evidence that each element of its proposed cost of service is just and reasonable. We will also refer to a recent decision of the Court of Appeal sustaining the Commission's denial of an income tax allowance for SFPP.

Part IV – Full Discussion of Contested Issues

In this portion of the Opening Brief, Tesoro will fully demonstrate with citations to the Record that SFPP has failed to meet its burden of proof with respect to each of the

contested issues in this case. We also present a justification for adopting the cost of service proposed by Tesoro witness Peter K. Ashton.

Part V – Proposed Findings of Fact and Conclusions of Law

In Part V of this Opening Brief, Tesoro states the initial findings of fact and conclusions of law that it recommends that the Presiding Judge adopt.

PART I

TESORO'S RESPONSE TO THE ISSUES SPECIFIED IN THE SCOPING MEMO.

On May 8, 2012, the Assigned Commission issued a Scoping Memo defining the issues to be addressed in this proceeding. Tesoro responds to these issues as follows:

Issue Presented – Just and Reasonable Rates:

I. Are the rates, terms, and conditions in effect from March 1, 2012 that are the subject of A.12-01-015 and the consolidated complaints just and reasonable?

Tesoro Response:

No.

Tesoro witness Peter Ashton's cost of service analysis shows that even at SFPP's requested rate reduction of 6.76%, SFPP would over recover its cost of service by over 30%, and would earn an achieved return of over 18%. In addition, SFPP's achieved return on equity would, under its proposed cost of service, be 35%, far in excess of any reasonable rate of return. Mr. Ashton concludes that SFPP must reduce its rates by over 30%, not 6.76%.

Issue Presented – Throughput Capacity:

II. In the context of a cost of service analysis of SFPP's rates, what are reasonable amounts for:

(i) projected operating capacity, throughput and associated revenues on: (a) the total intrastate portions of SFPP's pipelines, (b) the individual pipelines; and (c) the segments to destinations;

Tesoro Response:

The parties have stipulated to an annual test period throughput volume of 232,570,000 barrels for the jurisdictional portion of the SFPP pipeline system.

Issue Presented – Capital Structure:

(ii) capital structure including the treatment of Purchase Accounting Adjustments and Goodwill

Tesoro Response:

The appropriate capital structure for SFPP is 57.74% debt and 42.26% equity. However, if "interest swaps" are included in calculating SFPP's long term debt, then SFPP's capital structure is 59.95% debt and 40.05% equity. These capital structure calculations are based on the capital structure of Kinder Morgan Energy Partners, LP (KMEP), SFPP's parent.

With respect to purchase accounting adjustments, the parties stipulated to eliminating consideration of PAAs in calculating SFPP's capital structure. Goodwill is not a factor in this case.

Issue Presented – Cost of Debt:

(iii) cost of debt;

Tesoro Response:

With KMEP's interest rate swaps included in SFPP's long term debt, the cost of debt of SFPP during the test period is 4.52%. If interest rate swaps are not included, SFPP's cost of debt is 6.01%.

Issue Presented – Return on Equity:

(iv) return on equity;

Tesoro Response:

Using the median of an appropriate proxy group and the discounted cash flow model, SFPP's return on equity in the test period is 11.50%. As a result, SFPP's weighted average cost of capital is 7.32%, if interest rate swaps are included in the cost of debt. If interest rate swaps are not included in the cost of debt, then SFPP's weighted average cost of capital is 8.33%.

Issue Presented – Intra/Interstate Allocation:

(v) Allocation of costs between interstate and intrastate systems and among separate intrastate systems;

Tesoro Response:

The allocation of costs between SFPP's interstate and intrastate system is not a contested issue in this case. Both shippers as well as SFPP rely on SFPP's "route directory" and stipulated volumes to determine the proportion of SFPP's total costs that should be allocated to the CPUC jurisdictional pipeline system.

Issue Presented – Overhead Costs:

(vi) allocation of overhead costs from the holding company structure (Kinder Morgan Energy Partners) and its own holding company structure (Kinder Morgan, Inc.) and related issues;

Tesoro Response:

The Massachusetts Method should be the sole method for allocating all corporate overhead expenses to SFPP. This formula is based on objective standards using the gross property, revenues and labor costs of each KMEP affiliate. In contrast, SFPP's direct assignment/MA hybrid approach is overly complex, contains numerous errors, omits

entities that should be included, cannot be verified, is highly subjective and is driven by regulatory incentives, not overall business decision-making. The appropriate amount of overhead expense that should be allocated to SFPP's jurisdictional service is $8.2 million.

Issue Presented – Operating Expenses:

(vii) the appropriate level of operating expenses, including but not limited to fuel and power costs, oil losses and shortages, litigation and environmental expenses, and any other operating or maintenance costs;

Tesoro Response:

Tesoro believes that the following operating expenses should be included in SFPP's cost of service:

(a) Fuel and Power Costs – $12.1 million. This figure represents SFPP's actual costs for 2012.

(b) Losses and Shortages – Negative $1.5 million. This figure is based on SFPP's actual operations during the first 10 months of 2012.

(c) CPUC Litigation Expenses – Direct charge of $1.9 million relating to CPUC litigation expenses. Tesoro believes that this expense should be included as a special surcharge and should not be embedded in the SFPP's cost of service.

(d) Other Legal Expenses – Tesoro believes that other legal expenses should be minimal. The largest other legal expense relates to the City of San Diego lawsuit over the Mission Valley environmental remediation which should either be disallowed entirely since SFPP has failed to establish that it is a jurisdictional expense, or at most should consist only of a response to an Appeal Brief to the Ninth Circuit in the City of San Diego lawsuit. In any

event, Tesoro believes that legal expenses, other than the direct charge for CPUC litigation, should be included in overhead and allocated through the MA Method.

(e) Environmental – Tesoro believes that only approximately $1.1 million in environmental remediation expenses should be charged to shippers for the reasons discussed in subsequent portions of this Opening Brief. In addition, Tesoro believes that SFPP's evidence and testimony regarding environmental issues has been tainted by discovery abuses, which the ALJ should recognize in determining whether SFPP has met its burden of proof.

A. Site Specific Comments

(i) **Mission Valley Site** – SFPP's own evidence indicates that SFPP and its experts cannot identify the precise location of the leaks that are responsible for remediation expenses at the Mission Valley site. Moreover, other evidence indicates that substantial non-carrier assets are present in the "manifold area" and that leaks did in fact emanate from non-carrier assets. Furthermore SFPP has not provided any testimony regarding the specific steps that it took in the late 1980's and early 1990's to prevent the occurrence of leaks at the Mission Valley terminal. SFPP has failed to establish that releases occurred on CPUC jurisdictional property and that it acted prudently in attempting to prevent leaks from occurring.

(ii) **Other Mixed Asset Sites** – In addition to providing no evidence of the specific efforts it made to avoid leaks and spills at other mixed asset sites, the Record also indicates the following regarding the cause of leaks and spills at these sites:

Colton – Several spills at this site could have occurred in non-carrier portions of the terminal. Those spills could have been the cause of the contamination that SFPP is remediating, not just a 1992 spill relied on by SFPP.

Rocklin – SFPP has failed to explain why a non-carrier tank at the terminal site was not a source of contamination.

Chico and Brisbane – The Record indicates that there have been a number of leaks at non-carrier locations within these terminals.

(iii) **100% Carrier Sites** – The Record indicates that various non-carrier assets at these sites could have been the source of the contamination SFPP is now remediating. In addition, SFPP failed to introduce any evidence regarding the efforts it undertook to prevent the occurrence of leaks and spills.

Concord – A U.S. Government facility is situated at the Concord terminal. SFPP has not explained why that facility is not responsible for the contamination at the terminal site. The site also contains nearby third party assets.

Stockton – The Record indicates that a portion of the contamination that SFPP is remediating was caused by a third party, Nustar Energy.

Oakland Airport – According to SFPP, both Chevron and Shell facilities at this site contributed to the contamination.

Norwalk – The U.S. Defense Department is presently engaged in clean-up activities at this site. SFPP has failed to differentiate between the contamination caused by the Defense Department and contamination attributable to the SFPP assets.

B. **Discovery Abuse**

Despite the fact that Tesoro requested critical documents in December 2012, SFPP did not provide many of those documents until April 2, 2013 when it submitted its Rebuttal Testimony. Other highly relevant documents were submitted even later in response to data requests associated with SFPP's Rebuttal Testimony. Moreover, these documents, which constituted the release history at these sites, were actually used by an SFPP witness in formulating his Direct Testimony in November 2012. SFPP engaged in other serious discovery abuses in connection with the presentation of its position that shippers should bear the cost of remediating its terminal sites.

Issue Presented:

(viii) such other and further cost of service components which may be in dispute?

Tesoro Response:

Tesoro believes that SFPP has incorrectly included approximately $8 million for right of way rental expenses in its cost of service. These expenses have merely been booked by SFPP and not actually paid. SFPP may never actually pay these expenses since the issue of SFPP's liability is in litigation and under review by the Court of Appeal.

Issue Presented:

III. In light of the Commission's rejection of an income tax allowance for SFPP, the extent, if any, to which SFPP must reflect prior ratemaking treatment of deferred income taxes in determining just and reasonable rates at issue in the subject proceedings or must otherwise refund to shippers such deferred income taxes.

Tesoro Response:

Tesoro believes that SFPP is required to reflect the Commission's prior exclusion of any income tax allowance in its cost of service. This position is supported by the decision the Court of Appeal issued on June 13, 2013 sustaining the Commission's rejection of an income tax allowance.[2] Tesoro further believes that all prior ADIT balances should be refunded to shippers.

Issue Presented:

IV. What is the appropriate rate base?

Tesoro Response:

So long as all ADIT balances are refunded to shippers, Tesoro agrees with SFPP that the rate base for the SFPP pipeline is $263.2 million.

[2] *SFPP v. Public Utilities Commission*, Case No. G046669 (CA Ct. of App., 4th Dist., June 13, 2013).

Issue Presented:

V. What, if any, refunds to shippers are appropriate?

Tesoro Response:

Tesoro witness Peter K. Ashton presents in Exhibits R-2 and R-3 to his Prepared Rebuttal Testimony the rates that are just and reasonable for the SFPP pipeline system based on a 2012 test year. A compliance filing by SFPP should establish the refunds that each shipper should receive. The refunds would be determined by multiplying the volume each particular shipper transported by the difference between the just and reasonable rate and the rate that SFPP actually charged.

PART II

SUMMARY OF TESORO'S POSITION WITH RESPECT TO SIGNIFICANT CONTESTED ISSUES

Although both SFPP and the shippers presented evidence with respect to each element of SFPP's proposed cost of service, Tesoro believes that the major contested issues in this proceeding are the determination of SFPP's: (i) overhead expenses; (ii) environmental remediation expenses; (iii) legal expenses; (iv) right of way rental expenses; and (v) SFPP's return on equity and debt.

A. Overhead Expenses

Overhead expenses are the single largest cost item in SFPP's cost of service. Kinder Morgan has organized its corporate structure so that neither SFPP nor its parent, KMEP, has any employees. Instead, the labor costs for operating and maintaining the SFPP pipeline system are provided by various employees of two other Kinder Morgan affiliates, Kinder Morgan, Inc. (KMI) and KMGP Services Company Inc. (GP Services). From a purely monetary perspective, the single most important question to be resolved in

this proceeding is how the services performed by these KMI and GP Services employees should be allocated to the SFPP cost of service.

The monetary importance of this issue is illustrated by the fact that there is an $11.7 million difference between SFPP's proposed overhead allocation and the allocation that Tesoro expert economist Peter K. Ashton believes is appropriate. In other words, out of the total SFPP operating expenses of $76.2 million, SFPP allocates $19.9 million to overhead. Mr. Ashton, on the other hand, allocates $8.2 million to overhead.

It is difficult to ascertain precisely how many KMI and GP Services employees devote time to SFPP. At one point in the 2009 ratemaking proceeding, A.09-05-014, Dale D. Bradley, Kinder Morgan, Inc.'s Account Director, appeared to state that "in excess of 7,000" employees were involved in providing services to SFPP.[3] During the current hearing, Mr. Bradley appeared to state that less than 9,000 employees were involved.[4] Mr. Bradley also stated that there were 9,000 GP Services employees on redirect.[5] In any event, it is clear that thousands of employees devote a portion of their workweek to SFPP. The issue is how to properly account for their time spent by the employees providing overhead services in the SFPP cost of service.

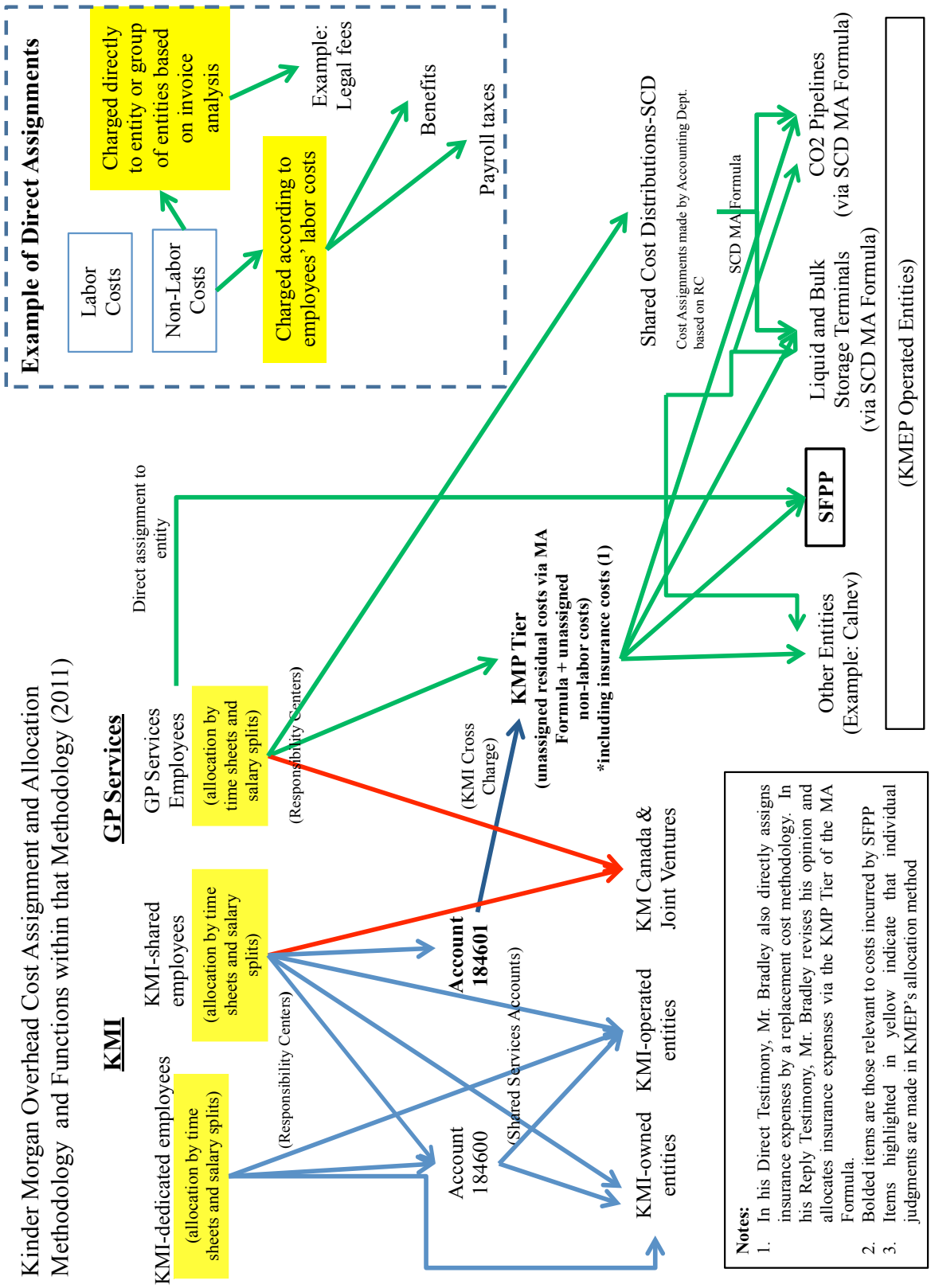
Shipper expert witnesses Peter K. Ashton and Dr. Daniel S. Arthur believe that certain legal costs associated with CPUC litigation should be directly assigned to SFPP, while all other labor-related overhead costs should be allocated using the Massachusetts Method (MA Method). Under the MA Method each KMI affiliate, including SFPP, is assigned a proportion of labor costs, associated benefits and other G&A costs such as

[3] Dale D. Bradley, A.09-05-014 Transcript, Volume 6, page 605, line 11.
[4] Dale D. Bradley, A.12-01-015 Transcript, Volume 2, page 176, lines 5-15.
[5] Dale D. Bradley, A.12-01-015 Transcript, Volume 2, pages 254, line 3-6.

insurance on the basis of several objective factors: i.e., gross revenues, total property plant and equipment and gross payroll.

On the other hand, SFPP has proposed an elaborate allocation arrangement in which each employee individually determines how much time he or she devotes to SFPP as well as other Kinder Morgan entities. Those time split arrangements are then reviewed by a supervisor and, according to Mr. Bradley, changed accordingly. The time splits are sometimes highly minute, with some employees claiming that they devote time to at least nine entities, including SFPP.[6] Some employees claim that they devote up to 100% to SFPP; others as little as 1%.[7] Splits are also broken out between carrier, non-carrier and military service. The chart below, which was Tesoro Hearing Exhibit 5A and is attached to this Opening Brief as Attachment No. 1, is a graphic depiction of the SFPP Overhead Allocation System. Both SFPP and Tesoro agreed that it accurately depicts the methodology that SFPP has been using.[8]

[6] *See* Attachment O to the Prepared Direct Testimony of Dale D. Bradley.
[7] Dale D. Bradley, A.12-01-015 Transcript, Volume 2, page 201, line 26 to page 203, line 2.
[8] See the exchange between Mr. Goldstein, ALJ Bemesderfer and Ms. Harper, A.12-01-015, Volume 5, pages 671-672.


Kinder Morgan Overhead Cost Assignment and Allocation Methodology and Functions within that Methodology (2011)
KMI
GP Services
KMI-dedicated employees
(allocation by time sheets and salary splits)
KMI-shared employees
(allocation by time sheets and salary splits)
GP Services Employees
(allocation by time sheets and salary splits)
Direct assignment to entity
(Responsibility Centers)
(Responsibility Centers)
(Shared Services Accounts)
Account 184600
Account 184601
(KMI Cross Charge)
KMI-owned entities
KMI-operated entities
KM Canada & Joint Ventures
KMP Tier
(unassigned residual costs via MA Formula + unassigned non-labor costs)
*including insurance costs (1)
Shared Cost Distributions-SCD
Cost Assignments made by Accounting Dept. based on RC
SCD MA Formula
SFPP
Liquid and Bulk Storage Terminals (via SCD MA Formula)
CO2 Pipelines (via SCD MA Formula)
Other Entities (Example: Calnev)
(KMEP Operated Entities)
Example of Direct Assignments
Labor Costs
Non-Labor Costs
Charged directly to entity or group of entities based on invoice analysis
Charged according to employees' labor costs
Example: Legal fees
Benefits
Payroll taxes
Notes:
1. In his Direct Testimony, Mr. Bradley also directly assigns insurance expenses by a replacement cost methodology. In his Reply Testimony, Mr. Bradley revises his opinion and allocates insurance expenses via the KMP Tier of the MA Formula.
2. Bolded items are those relevant to costs incurred by SFPP
3. Items highlighted in yellow indicate that individual judgments are made in KMEP's allocation method

Tesoro Exhibit 5A is a vivid graphic demonstration of why Mr. Ashton rejected the overhead allocation methodology that SFPP is proposing, and why ALJ Bemesderfer rejected the same SFPP methodology in the Proposed Decision which he issued on June 22, 2011 in proceeding A.09-05-014.[9] As Tesoro Exhibit 5A demonstrates, the SFPP methodology is unduly complex, and depends on thousands, if not tens of thousands of subjective judgments by Kinder Morgan employees and their supervisors. It is also virtually impossible to audit. As Judge Bemesderfer stated in his June 22, 2011 Proposed Decision:

> Even if we assume, for the sake of argument, that SFPP's direct assignment method of overhead allocation is more accurate than the MA method suggested by shipper witnesses (an assumption disputed by shipper witnesses), the difficulty of reviewing the daily time entries made by thousands of employees leaves us without a practical means of checking its accuracy. As SFPP's witness Bradley admitted on cross-examination, actually verifying the accuracy of those data entries would require "an army of people" following KMI or GP Services employees around and observing them. We also have to recognize, as pointed out by Ashton, that when an employee performs work for both regulated and unregulated entities, there is an incentive to assign as much time as possible to the regulated entity. We actively discourage this type of cross-subsidization and are reluctant to endorse a cost allocation methodology that appears to invite it. [10]

Those very same defects still characterize SFPP's overhead proposal.

B. Environmental Remediation Expenses

Since the early 1990's SFPP has been cleaning up substantial pollution at terminals on its California pipeline system. SFPP has also been passing the cost of its environmental cleanup efforts onto its shippers. Those costs have been very substantial.

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[9] Although ALJ Bemesderfer withdrew his June 22, 2011 Decision for further consideration, the decision nonetheless represents a cogent analysis of many of the cost of service factors that are relevant to the current proceeding.

[10] *See* Proposed Decision Setting Rates and Ordering Refunds to Shippers on SFPP, L.P. Intrastate Refined Petroleum Products Pipeline in proceeding A.09-05-014, dated June 22, 2011, pages 11-12.

For example, SFPP's total environmental cleanup costs for its 24 California terminals during the past five years alone have amounted to more than $58 million.[11] In the current test period alone, SFPP is asking its shippers to provide $7.4 million to support its environmental cleanup activities. [12]

As ALJ Bemesderfer pointed out at the outset of the evidentiary hearing:

> In order to recover its environmental cleanup costs, SFPP must prove both that the spills it has cleaned up came from its CPUC jurisdictional property and that it acted reasonably in attempting to prevent them in the first place and to clean them up after they occurred.
>
> The standard of proof that applies to these matters is clear and convincing. While standards of proof are by their nature subjective, I interpret the clear and convincing standard to mean that SFPP will have to prove more than the mere possibility that the spills could have come from CPUC jurisdictional property.
>
> As far as the reasonableness of its prevention and cleanup actions is concerned, SFPP will have to prove that it exerted substantially more than minimum efforts to prevent and remediate these incidents.[13]

SFPP has clearly failed to satisfy these requirements.

1. Mission Valley Site

By far, the largest remediation site on the SFPP pipeline system is the Mission Valley terminal in San Diego. Since at least 1992, SFPP has been remediating petroleum contamination at its Mission Valley site. In the current 2012 test year, SFPP is proposing to charge shippers $4.2 million for remediation activities.[14] SFPP claims that these

[11] *See* Attachment A to the Prepared Direct Testimony of Michael A. Hanak.
[12] SFPP had originally requested $9.6 million for remediation at all its sites, including over $6.4 million alone for remediating the Mission Valley site. However, when Tesoro questioned the proportion of the total environmental expenses that SFPP was charging to shippers, SFPP reduced the environmental remediation expenses in its cost of service by $2.2 million.
[13] ALJ Bemesderfer, A.12-01-015 Transcript, Volume 1, page 9, line 25 to page 10, line 16.
[14] As pointed out above in note 10, SFPP reduced the amount that it was asking shippers to provide, when Tesoro submitted testimony challenging the justification for shippers to subsidize SFPP's remediation efforts at Mission Valley.

remediation efforts will continue at that same $4.2 million level for the foreseeable future.[15]

a. The Source of the Leaks at Mission Valley

The Record in this case does not contain any substantial evidence that the leaks, which SFPP are now remediating, came from CPUC jurisdictional property at the Mission Valley site. The Record certainly does not contain "clear and convincing evidence."

First, none of SFPP's witnesses have been able to identify the precise source of the leak of petroleum that SFPP is presently remediating. Michael A. Hanak, Director of Environmental Health and Safety Department for KMI, testified that he has not been able to identify the specific asset that was the release source:

> Q. Am I correct in understanding your testimony as being - - as stating that you did not identify any particular facility in the manifold area as the source of the leak but believe that the manifold area contained only carrier property?
> A. That's correct.[16]

SFPP expert remediation witness, Dr. Robert E. Hinchee, has made similar statements. When asked in his Rebuttal Testimony if he could pinpoint the exact source of the contamination at Mission Valley, Dr. Hinchee stated:

> No, I cannot. Over the years there have been many releases at the MVT, some reported and undoubtedly some not reported, particularly in the early years of operations of the MVT. It is not possible to know the exact volume and sources of the releases driving the ongoing remediation efforts at the MVT.[17]

[15] SFPP witness Michael A. Hanak stated in his Direct Testimony, "SFPP will incur annual expenses at the above-noted level for at least the next ten years, and quite possibly well beyond ten years. *See* Prepared Direct Testimony of Michael A. Hanak, pages 11-12.
[16] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 569, line 24 to page 570, line 2.
[17] Prepared Rebuttal Testimony of Robert E. Hinchee, page 48, lines 4-9.

Dr. Hinchee reiterated that position in cross-examination, when he stated: "I can't tell you which line or which seal leaked or how many, no."[18]

Both Mr. Hanak and Dr. Hinchee claim that the leaks at Mission Valley emanated from "the manifold area."[19] Mr. Hanak further claims that since the manifold is a piece of equipment that is part of the CPUC jurisdictional pipeline, the leaks must have occurred from property within the regulatory jurisdiction of the CPUC.[20]

However, the clear evidence is to the contrary.

We are attaching to this Opening Brief Attachment No. 2, which is a blowup of the Mission Valley manifold. It was used during the cross-examination of Mr. Dito as Phillips 66 Exhibit 10. We have marked in green several of the delivery pipes that transport gasoline from the manifold to non-jurisdictional tanks on the Mission Valley site and to the non-jurisdictional SFPP harbor.

[18] Robert E. Hinchee, A.12-01-015 Transcript, Volume 3, page 439, lines 14-15.
[19] Mr. Hanak states that Mr. Dito told him that the "SFPP manifold is a carrier asset, and therefore I allocated 100% of the costs as carrier." *See* Prepared Direct Testimony of Michael A. Hanak, pages 19-20. Mr. Hinchee states that based on materials he studied, "the primary source of the current contamination at the MVT appears to be SFPP's manifold area." *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 48, lines 1-2.
[20] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 568, line 23 to page 569, line 11.

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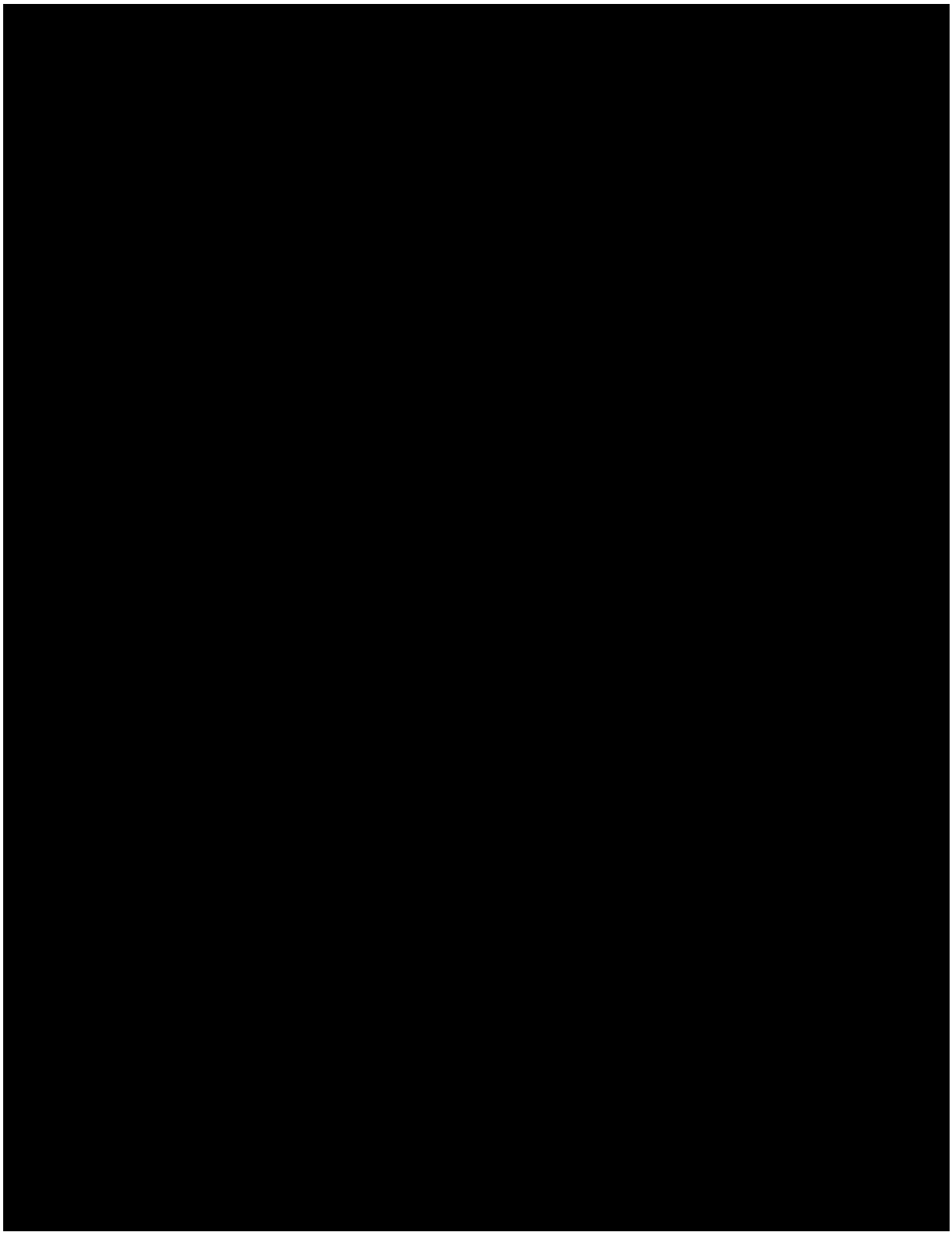

[CONFIDENTIAL INFORMATION REDACTED]

In his cross examination, Mr. Dito testified that the delivery lines which we have marked in green (among others) are not part of the jurisdictional pipeline, since the dividing line between carrier and non-carrier assets are the manifold valves.[21] Clearly the delivery lines to the harbor from the SFPP manifold, also marked in green, are outside CPUC jurisdiction. Based on that evidence, we respectfully suggest that SFPP cannot reasonably claim that simply because it is likely that the leaks at the Mission Valley site occurred "in the *manifold area*," it is equally likely that they occurred in the jurisdictional pipeline. As Attachment 2 indicates a majority of piping in the "manifold area" are delivery pipes that are not part of the CPUC jurisdictional pipeline.

A further issue that Dr. Hinchee addressed in his testimony [redacted][22] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted]

[21] Peter M. Dito, A.12-01-015 Transcript, Volume 5, page 714, 16-19. Mr. Dito labeled a copy of Phillips 66 Exhibit 10 (Confidential), and this later became Phillips 66 Exhibit 10-A (Confidential).
[22] Tesoro Exhibit 18 (Confidential).

[CONFIDENTIAL INFORMATION REDACTED]

[23] [CONFIDENTIAL INFORMATION REDACTED]

In responding to this material, Dr. Hinchee claims that Powerine's facilities cannot be regarded as the principal source of the contamination that SFPP is remediating because the remediation is focused on MTBE and Powerine did not receive gasoline with MTBE during the 1991 to 1992 period.[24] In taking this position, Dr. Hinchee cites exclusively to two pages of SFPP witness Peter M. Dito's Rebuttal Testimony, filed on April 2, 2013. Mr. Dito describes on these pages an inventory of the gasoline that SFPP delivered to Powerine during the 1990 to 1992 period, stating that these products do not contain MTBE.[25] Mr. Dito included these records as Exhibit BBB to his Rebuttal Testimony.[26]

However, that exhibit alone is certainly not definitive, because the evidence on this point is conflicting.

[27] [CONFIDENTIAL INFORMATION REDACTED]

[23] Tesoro Exhibit 18 (Confidential), , page 10. [CONFIDENTIAL INFORMATION REDACTED]
[24] Prepared Rebuttal Testimony of Robert E. Hinchee, page 50.
[25] Prepared Rebuttal Testimony of Peter M. Dito, page 8.
[26] *See* Attachment BBB to the Prepared Rebuttal Testimony of Peter M. Dito.
[27] Tesoro Exhibit 18 (Confidential), page 16; in Tesoro Exhibit 18 (Confidential),

[redacted][28] [redacted]. **[CONFIDENTIAL INFORMATION REDACTED]**

The evidence regarding MTBE releases from Powerine facilities during the period 1990 to 1992 is therefore contradictory. [redacted] **[CONFIDENTIAL INFORMATION REDACTED]**

Based on this evidence, Tesoro respectfully submits that with regard to the issue of MTBE in the Powerine gasoline supply in the early 1990's, the evidence is conflicting. No one side can demonstrate definitively that the Powerine gasoline supply did or did not contain MTBE in the 1990 to 1992 period. Consequently, the further conclusion must, we believe, be reached that SFPP has failed to meet its burden of demonstrating *by clear and*

[redacted], pages 9-10. **[CONFIDENTIAL INFORMATION REDACTED]**

[28] Tesoro Exhibit 18 (Confidential), page 17.

convincing evidence that the product that Powerine received in the 1990 to 1992 period did not contain MTBE.

Based on this conclusion, as well as the fact no SFPP witness can point to the source of the leaks at the Mission Valley site, the further conclusion must be reached that SFPP has failed to establish through clear and convincing evidence that the leaks that it is now remediating at the Mission Valley site occurred on CPUC jurisdictional property.

b. Prudence in Preventing Leaks and Spills from Occurring

SFPP has also failed to establish by clear and convincing evidence that "it acted reasonably in attempting to prevent [the spills that it is currently remediating] in the first place and to clean them up after they occurred."[29]

With respect to SFPP's prudence in preventing leaks in the first place, the record is again conflicting. Mr. Hanak testifies as to SFPP's general environmental protocol. But Mr. Hanak does not specifically state that he knows for a fact that SFPP applied that protocol at the Mission Valley site in the late 1980's and early 1990's.

Moreover, Dr. Hinchee's testimony creates considerable doubt that SFPP acted with prudence in that time period. Dr. Hinchee's testimony is replete with statements indicating that the petroleum pipeline industry, including of course SFPP, was oblivious to environmental concerns in the 1980's and early 1990's. The following is a sampling of Dr. Hinchee's testimony:

- "Multiple releases have occurred at the MVT. It is not clear when the first release occurred at the MVT. We know there was contamination present at the site as early as the late 1980's, but in all likelihood, some releases had occurred prior to that time."[30]

[29] ALJ Bemesderfer, A.12-01-015, Volume 1, page 10, lines 1-3.
[30] Prepared Rebuttal Testimony of Robert E. Hinchee, page 6, lines 6-8.

- "When MTBE was first encountered in groundwater, it was believed to be of little environmental concern by both regulators and the industry. It was not until the late 1990s that the significance of MTBE began to be understood and the use of MTBE began to be regulated."[31]

- "The primary reason for this systemic contamination is that many terminals, like the MVT, were constructed before the 1980s at a time when the environmental consequences of releases were not understood, and so releases would occur but no effective remediation actions would be taken. […] However, even after the environmental consequences of releases began to be recognized, releases decreased but continued in the normal course of business, further contributing to the existing contamination of those sites."[32]

- "[T]he release of MTBE and TBA at the MVT site occurred before there was a full industry, and regulatory, recognition of the environmental problems caused by MTBE and TBA. This contributed to the large groundwater plume developing at the site before effective remediation for MTBE and TBA was able to be put into place."[33]

In the face of that testimony, the only evidence in the Record that SFPP provided that it acted prudently in preventing leaks in the first place is Mr. Hanak's statement of the general protocol that SFPP observed. But, as we noted above, Mr. Hanak never testified as to whether SFPP actually implemented that protocol at Mission Valley and there is no testimony that Mr. Hanak had any personal knowledge of the particular steps that SFPP undertook at Mission Valley in the 1980's and early 1990's to prevent leaks and spills.

Under these circumstances, it is clear that SFPP has not met its burden of establishing by "clear and convincing evidence" that it took effective measures in the 1980's and 1990's to prevent the occurrence of the leaks and spills that it is now asking shippers to remediate. Dr. Hinchee's testimony that the entire industry, including SFPP, did not take effective measures to prevent leaks and spills because it lacked specific

[31] Prepared Rebuttal Testimony of Robert E. Hinchee, page 7, lines 15-17.
[32] Prepared Rebuttal Testimony of Robert E. Hinchee, page 9, lines 12-20.
[33] Prepared Rebuttal Testimony of Robert E. Hinchee, page 38, lines 9-12.

knowledge of the nature of the problem or its impact hardly supports the position that SFPP acted reasonably in attempting to prevent spills and leaks in the first place. It also provides no justification for shifting the burden of paying for remediation from the pipeline to its shippers.

c. Prudence in Cleaning Up Leaks and Spills After They Occurred

The Record is more complete with respect to SFPP's efforts to clean up the leaks and spills that occurred at the Mission Valley site after they occurred.

Dr. Hinchee does describe in some detail the efforts SFPP undertook to cleanup leaks and spills at the Mission Valley and Dr. Hinchee offers his expert opinion that SFPP acted reasonably. Clearly, Dr. Hinchee is well qualified in environmental remediation efforts and Tesoro concurs in SFPP's position that his opinion is entitled to some weight.

On the other side, however, are the following factors:

(1) A contemporaneous source observing SFPP's remediation efforts, [redacted][34] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted]

[redacted][35] **[CONFIDENTIAL INFORMATION REDACTED]**

(2) SFPP engaged in serious discovery abuse in connection with the documents on which Dr. Hinchee relied in his testimony. For example, Tesoro posed broad discovery requests to SFPP seeking the documents in its possession that relate to releases at the

[34] Tesoro Exhibit 18 (Confidential), page 7.
[35] Tesoro Exhibit 18 (Confidential), page 7.

Mission Valley site and the remediation actions that SFPP undertook.[36] Despite the fact that these data request were served on December 4, 2012 and December 17, 2012, SFPP did not produce at least 25 of the documentary exhibits to Dr. Hinchee's testimony until April 2, 2013, when Dr. Hinchee submitted Rebuttal Testimony. The evidentiary hearing was held less than three weeks later and Tesoro had no opportunity under the Procedural Schedule to respond.

There is, moreover, another aspect to the SFPP discovery abuse. Dr. Hinchee relies to a significant extent on documents that Mr. Hanak attaches to his Rebuttal Testimony. We believe that of the 60 Exhibits attached to Dr. Hinchee and Mr. Hanak's Rebuttal Testimony, 12 of the Attachments were entirely new to Tesoro, and Tesoro had no record of another 29 of the Attachments ever being previously provided in discovery.[37]

We expect that SFPP will claim, as it did at the hearing, that these discovery matters are complicated and that parties held numerous discussions to resolve differences and no one can really tell what should and should not have been produced, etc.[38] However the simple fact is that there was never any discussion or agreement that permitted SFPP to sandbag Tesoro with dozens of important new documents at the very last minute, effectively precluding Tesoro from evaluating that information or responding to the new

[36] Several Tesoro Requests will be discussed in detail in Part IV, but the data requests seeking all workpapers and records reviewed by SFPP witnesses included Request Nos. 46 and 47. Requests specifically seeking information about Mission Valley Corrective Action Plans, release histories and other related documents include Request Nos. 50, 53 and 54 served on December 4, 2012 as well as Request No. 86 served on December 17, 2012.
[37] *See* Attachment C and D of the Motion of Tesoro Refining and Marketing Company to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013.
[38] See the exchange between Mr. Goldstein and Ms. Boudreaux, A.12-01-015 Transcript, Volume 4, page 621, lines 10-27. See also Ms. Kohlhausen, A.12-01-015 Transcript, Volume 4, page 619, lines 11-13; Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 626, lines 10-14.

information.

On balance, we believe that it is a somewhat close question as to whether the Record demonstrates by clear and convincing evidence that SFPP has taken effective remediation efforts at the Mission Valley Site. Dr. Hinchee's endorsement of SFPP's actions as reasonable and appropriate is counter-balanced by highly critical comments regarding the effectiveness of SFPP's efforts by contemporaneous tribunals, [redacted]. **[CONFIDENTIAL INFORMATION REDACTED]** The fact also remains that SFPP has been conducting this remediation effort since at least 1992, over 20 years ago, at an enormous cost, and SFPP anticipates that these costs will continue into the indefinite future. On its face, this remediation effort hardly appears responsible and prudent. Furthermore, in determining whether SFPP has made a clear and convincing showing that its remediation efforts have been responsible and prudent, we would respectfully suggest that SFPP's discovery abuse should tip the balance in favor of a finding that SFPP has not met its burden of proof.

2. SFPP Remediation at Other Terminals

In addition to the Mission Valley site, SFPP is conducting environmental remediation at 23 other sites in California. It divides these sites into those with 100% carrier assets, those with 100% non-carrier assets, and those with mix of carrier and non-carrier assets, deemed Mixed Asset sites, depending on whether SFPP believes that other companies own tanks or other facilities at these terminals. The total amount that SFPP is asking shippers to pay for remediating these other sites is $3,167,986 a year. Tesoro will discuss the nature of the releases at these sites and the evidence in the Record as to whether they occurred on CPUC jurisdictional property in Part IV of this Opening Brief

rather than in this summary section. However, there are a number of general comments that can be made with respect to all of these sites.

First, SFPP has not provided any evidence regarding the particular efforts that it undertook to ensure that its equipment at these sites was secure and would not leak petroleum into the environment. The following testimony of Mr. Hanak is typical of the SFPP evidence. When asked why 96,000 gallons of unleaded gasoline leaked from SFPP storage tanks in 1992, Mr. Hanak responded, "I don't know the answer to that."[39] When asked what specific measures SFPP took in the 1990 to 1992 period to ensure the integrity of the leaking tank, Mr. Hanak responded, "I don't know the answer to that question because it was prior to my involvement."[40]

Secondly, unlike Dr. Hinchee's testimony with respect to Mission Valley, SFPP has not provided any testimony or expert opinion regarding the prudence of its remediation efforts at 23 of its other remediation sites in California. Mr. Hinchee does briefly reply to Tesoro witness Peter K. Ashton's claim that SFPP failed to conduct proper investigations after a 63,000-gallon spill at the Colton terminal. But Dr. Hinchee does so by providing his insight into industry practice in the 1970's, stating that: "In my opinion, SFPP's choice to delay investigation of the 1979 release until 1992 is in line with what industry practices were at the time and in no way implies that SFPP was acting unreasonably."[41] SFPP has simply not provided clear and convincing evidence that it prudently operated its facilities and took steps to avoid releases at its 23 other remediation sites.

Finally, SFPP's discovery abuse has been particularly egregious with respect to

[39] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 639, line 7.
[40] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 639, lines 19-21.
[41] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 55, lines 4-6.

these sites.

On December 4, 2013, Tesoro asked SFPP to produce the work papers and other documents that Mr. Hanak had reviewed or used in preparing his Prepared Direct Testimony regarding SFPP's environmental remediation sites.[42] For months SFPP claimed that it was "diligently working" on a response, and later provided some materials. But, it was not until March 29, 2013 that SFPP actually completed providing those workpapers, by producing the documented release history for several of the mixed asset sites. In fact, the group of documents that SFPP waited until March 29, 2013 to provide included the very same material that Mr. Hanak introduced into evidence two business days later as Attachments JJJ, KKK and LLL to his Prepared Rebuttal Testimony.[43] This information discusses specific releases that occurred at the mixed asset and 100% carrier sites.

Furthermore, even though SFPP did not produce this material until March and April of 2013, on cross-examination, Mr. Hanak testified that he actually reviewed all of this material *as early November of 2012* when he began to prepare his direct testimony:

> Q. Do I understand - - do I understand correctly that you had before you prior to November, when you did your direct testimony, Exhibits 26, 27 - - Exhibits 27, 28, and 29? You had that material before you.
> A. Yeah, I believe I did.[44]

Clearly, Tesoro has been placed at a serious disadvantage by SFPP's abuse of

[42] Tesoro served on December 4, 2012 Request No. 47, which stated: "For each SFPP witness that submitted testimony in the above captioned proceeding, please provide a copy of all records, workpapers, data and other materials relating to the subject matter of this proceeding that were reviewed and relied upon by each such witness and not otherwise produced."
[43] *See* Motion of Tesoro Refining and Marketing Company to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, April 15, 2013, page 17.
[44] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 626, lines 5-10.

discovery. We believe that this factor should weigh significantly into the determination of whether SFPP has met its burden of proof with respect to the remediation costs it seeks at the mixed asset and 100% owned asset sites.

C. Legal Expenses

There are two categories of legal expenses that SFPP has incurred.

SFPP has incurred direct litigation costs in connection with CPUC rate proceedings. SFPP and Tesoro disagree over both the amount and the proper treatment of these expenses from a ratemaking perspective. The difference between the parties in terms of the total expense is about $500,000 and Tesoro's witness Ashton actually advocates using the higher figure since it reflects test period costs.[45] Regardless, to the extent they have been prudently incurred and reasonable in amount SFPP's expenses in CPUC ratemaking proceedings should be allocated directly to SFPP as an operating cost item.

From a ratemaking perspective, however, these costs reflect a temporary expense item that should not continue indefinitely into the future. The Court of Appeal and the Commission have resolved many of the issues in dispute, e.g., income tax allowance, and in the not too distant future, the litigation between the parties should wind down. As a result, Tesoro recommends that CPUC litigation costs be recovered in the form of a temporary surcharge in rates as opposed as being embedded in the cost of service indefinitely in the future. Mr. Ashton estimates the surcharge at $0.0083 per barrel.[46]

The other legal costs are in a different category and should be included as part of SFPP's overhead calculation.

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[45] *See* Prepared Rebuttal Testimony of Peter K. Ashton, pages 65-66.
[46] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 66.

SFPP witness Erik G. Wetmore proposes to directly assign more than $8 million in legal expenses to SFPP. These expenses are specified on Schedule 12 to Attachment C to Mr. Wetmore's Rebuttal Testimony and consist of 26 separate items with various percentages allocated to the CPUC jurisdictional pipeline.[47] For example, one of the items, "Class Action (Concord/Stockton)," has an 87.39% assignment to SFPP; another item, "UPRR (AREMA 2)," has a 10.56% assignment to SFPP; still other items have a 100% allocation. The direct assignment of all these legal expenses is highly subjective. According to Mr. Wetmore's testimony, both the amount of legal fees that SFPP will be incurring as well as the proportionate amount of those legal expenses that are attributable to SFPP versus other Kinder Morgan affiliates are based on discussions that Mr. Wetmore conducted with individual Kinder Morgan attorneys and personnel.[48] Those discussions were undocumented and when he was asked on cross-examination to specify the individuals whom he consulted with respect to one of the significant cost items, Mr. Wetmore was unable to do so.[49] Mr. Wetmore was also unable to recall the date on which he had that discussion or what precisely was discussed.[50]

This type of allocation system suffers from the very same infirmity as SFPP's general overhead expense allocation methodology—it is subjective, unverifiable, subject to error and would naturally be biased towards an allocation to CPUC regulated entities, such as SFPP. SFPP's legal expenses, other than those for CPUC rate litigation, should

[47] *See* Attachment C to the Prepared Direct Testimony of Erik G. Wetmore, page 28.
[48] Erik G. Wetmore, A.12-01-015 Transcript, Volume 7, page 986, line 16-20. Also see Prepared Direct Testimony of Erik G. Wetmore, page 6.
[49] Erik G. Wetmore, A.12-01-015 Transcript, Volume 7, page 1021, lines 11-12, 14-16.
[50] Erik G. Wetmore, A.12-01-015 Transcript, Volume 7, page 1020, lines 23-25.

therefore be allocated through the same Massachusetts Method as SFPP's other overhead charges.

In addition, one of the legal expense items that Mr. Wetmore proposes to allocate to SFPP is a $3,898,397 annual proposed legal charge for defending an action brought by the City of San Diego.[51] In its lawsuit, the city claimed that SFPP has been negligent and imprudent at the Mission Valley site. This $3.9 million expense item is inappropriate for several reasons.

First, as we have pointed out previously, SFPP has failed to establish that any of the remediation expenses at the Mission Valley site should properly be charged to shippers. Therefore, the cost that SFPP incurs in defending a lawsuit claiming that it acted negligently and imprudently at the site should not be charged to shippers.

Additionally, the allocation of almost $3.9 million annually for legal costs involving the City of San Diego lawsuit is clearly excessive. The evidence introduced at the hearing demonstrates that summary judgment was entered for SFPP in that particular case on January 25, 2013 and that the City has filed a notice of appeal with the Ninth Circuit.[52] As a result, the only foreseeable task that SFPP's lawyers need to undertake in 2013 is filing a responsive appellate brief and participating in oral argument. That hardly requires a $3.9 million legal effort.

Furthermore, Mr. Wetmore, who takes responsibility for the legal costs in SFPP's cost of service, was unable to describe the nature of the effort needed in connection with the City of San Diego lawsuit in 2013 or why he believes that it necessitates spending $3.9

[51] Attachment C to the Prepared Direct Testimony of Erik G. Wetmore, page 28, line 9.
[52] *See* Phillips 66 Company Exhibit No. 16, pages 48-49.

million.[53] Clearly the $3.9 million cost item is unreasonable and should be eliminated or drastically reduced since SFPP has failed to produce evidence justifying the nature or amount of the legal effort.

D. SFPP Right of Way Costs

SFPP has included in its cost of service a charge of more than $7 million for right of way expenses that it is not in fact paying.[54] SFPP and the Union Pacific Railroad (UPRR) are engaged in a lawsuit to determine the right of way fees that SFPP must pay for the land area through which the SFPP pipeline passes in California. A lower court awarded judgment in favor of the UPRR and SFPP is appealing the court's decision.

Based on these facts, SFPP has accrued the cost of the additional right of way fees it will have to pay if it ultimately loses its lawsuit with the UPRR.

However, there is no sound basis for SFPP to presently charge its shippers for these additional right of way charges. Regardless of any accounting practice, the fact is that SFPP is not currently paying the additional right of way charge. It should not be permitted to recover from its shippers expenses that it has not yet paid.

E. Return on Equity, Cost of Debt and Capital Structure

This case presents a number of recurring issues with respect to SFPP's return on equity, cost of debt and capital structure.

The principal difference between SFPP and Tesoro with respect to SFPP's return on equity is the composition of a proxy group, the appropriate DCF methodology to employ, and the use of the median of that proxy group to determine a reasonable rate of

[53] Erik G. Wetmore, A.12-01-015 Transcript, Volume 6, page 944, lines 13-21; Erik G. Wetmore, A.12-01-015 Transcript, Volume 7, page 1016, line 25; Erik G. Wetmore, A.12-01-015 Transcript, Volume 7, pages 1023, line 25 to page 1024, line 27.
[54] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 65.

return. With regard to the proxy group, Tesoro has selected the companies for its proxy group on the basis of objective criteria. Each company that was included in Tesoro's proxy group was selected because it was heavily involved in the pipeline industry and faced similar risks and operating conditions to SFPP, as specified in the Federal Energy Regulatory Commission's *Policy Statement on the Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*.[55] SFPP on the other hand, while appearing to endorse these objective criteria, nonetheless excludes certain firms from its proxy group based on totally subjective factors.

With respect to the DCF methodology, Tesoro and the other Shippers employ a two-stage DCF model that is consistent with the methodology approved by the FERC and accepted by Judge Bemesderfer in the A.09-05-014 proceeding. This approach utilizes two different growth estimates whereas SFPP witness Vander Weide utilizes a DCF model with a single growth estimate that overstates the return on equity.

There is a further difference between Tesoro and SFPP with respect to the determination of SFPP's return on equity. Tesoro uses the median of the proxy group to select the SFPP return on equity that it considers reasonable. SFPP, on the other hand, uses the mean. The use of the median has been endorsed previously by the Commission and produces the fairest result since it automatically takes into account and eliminates the impact of outliers.[56]

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[55] *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 (2008).

[56] *See* Proposed Decision Setting Rates and Ordering Refunds to Shippers on SFPP, L.P. Intrastate Refined Petroleum Products Pipeline in Proceeding A.09-05-014, June 22, 2011, page 6.

The difference between Tesoro and SFPP's approach to determining a reasonable cost of debt focuses primarily on the use of interest rate swaps and the manner in which SFPP's cost of debt should be determined. ExxonMobil/BP witness Dr. Thomas Horst has developed the interest rate swap issue in detail. Stated most simply, if SFPP has been able to reduce its actual cost of debt through interest rate swaps, then those benefits should, under well-accepted cost of service ratemaking rules, be passed on to ratepayers. There is no reason why SFPP should claim a higher cost of debt than it is actually paying.

With respect to the determination of SFPP's cost of debt, SFPP uses a proxy group to compute the cost of debt. In contrast, both Dr. Horst and Mr. Ashton utilize SFPP's parent, KMEP's actual cost of debt. It is well-accepted regulatory practice that if a pipeline's parent issues debt on behalf of the pipeline, then the parent's cost of debt should be used in computing the cost of debt.[57]

The principal difference between SFPP and Tesoro with respect to capital structure is again SFPP's departure from basic cost of service ratemaking principles. Tesoro believes that it is well established that when a pipeline's own cost of service cannot appropriately be used to determine its capital structure, then the capital structure of its parent should be used in its place. SFPP's parent is, of course, KMEP. Tesoro therefore

[57] Mr. Ashton discussed CPUC and FERC precedent that supports the use of a parent's cost of debt. *See* Prepared Reply Testimony of Peter K. Ashton, pages 7-8, discussing FERC decisions: *Williams Pipeline Company*, 31 FERC ¶ 61,377 (1985); *Transcontinental Gas Pipeline Corporation (Transco)*, 84 FERC ¶ 61,084 (1998). Mr. Ashton also noted that ALJ Bemesderfer sustained the position that SFPP has the same capital structure as its parent, KMEP in proceeding A.09-05-014. *See* Revised and Reissued Proposed Decision Determining Test Year 2009 Rate Base and Cost of Service for SFPP, L.P. and Calnev Pipe Line L.L.C. and Ordering Refunds in Proceeding A.09-05-014.

uses KMEP's actual capital structure for ratemaking purposes. SFPP, on the other hand, reverts to an unnecessary proxy group.

PART III

LEGAL STANDARDS

A. Burden of Proof Requirement

At the outset of the hearing, Administrative Law Judge Bemesderfer stated the burden of proof that SFPP must satisfy in this proceeding. According to Judge Bemesderfer, "The standard of proof that applies to these matters is clear and convincing."[58] In other words, the pipeline must justify each element of the rate it proposes to charge with "clear and convincing" evidence.

The standard that the ALJ stated is well supported by Commission precedent. For example, in *Re Pacific Bell* the Commission said that:

> The inescapable fact is that the ultimate burden of proof of reasonableness, whether it be in the context of test-year estimates, prudence reviews outside a particular test year, or the like, never shifts from the utility which is seeking to pass its costs of operations onto ratepayers on the basis of the reasonableness of those costs. Whenever the utility comes before this Commission seeking affirmative rate relief, it fully exposes its operations to our scrutiny and review.[59]

In *Re Southern California Edison Company* the Commission further stated, "the fundamental principle involving public utilities and their regulation by governmental authority is that the burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the Commission, its staff or any interested party…to prove the contrary."[60]

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[58] Administrative Law Judge (ALJ) Bemesderfer, A.12-01-015 Transcript, Volume 1, page 10, lines 4-5.
[59] *Re Pacific Bell*, 27 CPUC 2d 1 at 21 (1987) (Internal footnotes removed). Order modified 47 CPUC 2d 569 (1993).
[60] *Re Southern California Edison Company*, 11 CPUC 2d 474 at 475 (1983).

According to the Commission, unless the utility, "meets the burden of proving, *with clear and convincing evidence*, the reasonableness of all the expenses it seeks to have reflected in rate adjustments, those costs will be disallowed."[61]

The Commission has also discussed the burden of proof that a utility faces with specific reference to the recovery of environmental remediation costs. In *Re San Diego Gas and Electric Company,* the Commission stated as follows:

> We want to encourage the utility to remain fully responsive to clean-up needs. At the same time, the utility must establish the reasonableness of any clean-up expenses it wishes to pass through to its customers by showing not only that it incurred reasonable costs in its clean-up efforts, but that it was reasonable in its activities that led to the original contamination.[62]

Moreover, the Commission has disallowed rates increases that utilities have sought to recover costs related to accidents. For example, the Commission disallowed costs associated with an explosion that occurred at the Mohave Generating Plant (Mohave), which was owned and operated by Southern California Edison Company (SCE).[63] In that situation, a weld in a high-pressure steam pipe had ruptured on June 9, 1985 and killed six people. The Commission undertook a formal investigation into the causes of the accident and whether any of the costs of repairs could be recovered. The Commission stated that because SCE, "bears the burden of proving the reasonableness of the expenses it seeks to pass through in rates, SCE must prove that it operated and maintained the plant in a reasonable manner prior to the accident."[64] The Commission found SCE to have been less than diligent in its operating practices by continually operating the steam pipe at

[61] *Re Southern California Edison Company*, 11 CPUC 2d 474 at 475 (Emphasis added).
[62] *Re San Diego Gas and Electric Company*, 46 CPUC 2d 538 at 609 (1992), order modified on other grounds 48 CPUC 2d 447 (1993), order modified on other grounds 51 CPUC 2d 526 (1993).
[63] *Re Southern California Edison Company*, 53 CPUC 2d 452 (1994).
[64] *Re Southern California Edison Company*, 53 CPUC 2d 452 (1994) at 464.

temperatures well above the design level, lacking extensive records of the steam pipe's operation for significant periods of time, and failing to formulate a better safety program at the plant, especially after SCE became aware of a similar weld rupture at another utility generating plant.[65]

These cases underscore the obligation of SFPP to prove with "clear and convincing" evidence that each element of its rate is just and reasonable. For the reasons we discuss in detail in this Opening Brief, SFPP has failed to do so.

B. Income Tax Allowance

On June 13, 2013, the Court of Appeal issued a Decision in which it sustained the Commission's finding that SFPP is not entitled to an income tax allowance as part of its cost of service.[66] That ruling of course pertains to this case as well as the A. 11-05-045 proceeding.

PART IV

ANALYSIS OF THE COST FACTORS THAT COMPRISE SFPP'S COST OF SERVICE

In previous portions of this Opening Brief Tesoro summarized its responses to (i) the issues listed in the Scoping Memorandum; (ii) the principal contested issues in this proceeding; and (iii) the legal standards that SFPP must meet in order to satisfy its burden of proof with respect to each element of its cost of service. In this Part IV, Tesoro presents a detailed analysis of each of the cost of service elements of the SFPP pipeline, the reasons why many of SFPP's proposed costs are excessive, and Tesoro's

[65] *Re Southern California Edison Company*, 53 CPUC 2d 452 at 452 (1994).
[66] *SFPP v. Public Utilities Commission*, Case No. G046669, (CA Ct. of App., 4th Dist., June 13, 2013).

recommendation to the ALJ of an appropriate cost of service for CPUC jurisdictional service.

I. DISCUSSION OF SFPP'S CLAIMED OVERHEAD EXPENSES

A. SFPP's Claimed Overhead Expenses Are Excessive and Should Be Rejected.

Overhead expenses are one of the largest cost items in SFPP's cost of service. From a strictly monetary perspective, the single most important question to be resolved in this proceeding is how the overhead costs associated with the services performed by KMI and GP Services employees should be allocated to the SFPP pipeline. The monetary importance of this issue is illustrated by the fact that there is an $11.7 million difference between SFPP's proposed overhead allocation and the allocation that Tesoro expert economist Peter K. Ashton believes is appropriate. Tesoro witness Ashton testifies that the correct amount of overhead expenses to be allocated to SFPP's jurisdictional service is $8.2 million,[67] whereas Messrs. Bradley and Wetmore, SFPP witnesses, allocate $19.9 million in overhead expense to SFPP's jurisdictional service.[68] This represents 26% of SFPP's total claimed test period operating expenses.

Overhead expenses span a variety of different expenses ranging from corporate management, including the Office of the Chairman of Kinder Morgan, to more function-specific activities such as accounting, finance, insurance and legal. From a ratemaking perspective, SFPP incurs a portion of these costs as a beneficiary of the services provided by its parent KMEP. KMEP, through one of its operating limited partnerships (OLP-D), owns 99.5% of SFPP. According to SFPP Witness Dale D. Bradley, Accounting Director

[67] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 61 and Exhibit R-1.
[68] *See* Prepared Rebuttal Testimony of Erik G. Wetmore, Table 1, page 5.

at KMI, KMI is the ultimate parent of KMEP through KMI's sole ownership of KMEP's general partner KMGP.[69]

SFPP uses a complicated multi-step process in allocating corporate overhead expenses. First, SFPP attempts to directly assign GP Services corporate overhead costs to specific entities, based on a review of time splits and salary surveys. SFPP purports to make these direct allocations by tracking expenses in particular responsibility centers (RCs). Responsibility centers are departmental assignments, which SFPP has previously indicated are based primarily on functional duties.[70] Secondly, SFPP attempts to directly assign KMI corporate overhead costs to specific entities, based on a review of time splits and salary surveys. RCs are also used for recording KMI expenses. In the event a KMI shared-service employee is unable to ascertain for which KMEP-operated entity he or she is providing work, the time (and related costs) are billed to a shared services account. These shared services represent the "KMI Cross Charge." Finally, SFPP includes a pool of KMEP costs that are not attributable to any KMEP-specific entity. This pool includes certain non-assigned GP Services activity and KMI shared service expenses. SFPP allocates these costs using the Massachusetts Method ("MA Method").[71] The SFPP overhead cost allocation methodology involves tens of thousands of subjective judgments.

In contrast, Tesoro witness Peter Ashton employs an objective, straightforward, transparent method, the Massachusetts Method, to allocate all of KMEP's overhead costs. This method is identical to the overhead allocation methodology that Mr. Ashton employed in the A.09-05-014 et al., proceeding and was accepted by ALJ Bemesderfer.

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[69] *See* Prepared Direct Testimony of Dale D. Bradley, pages 5-6.
[70] *See* Prepared Direct Testimony of Dale D. Bradley, page 12.
[71] The KMI Cross Charge is also included in the costs allocated using the MA Method. *See* Prepared Direct Testimony of Dale D. Bradley, page 13.

The MA Method enables a regulated entity to allocate overhead costs to all subsidiaries that benefit from the provision of overhead services so that costs follow cost causation principles.[72] Under the MA formula, each KMEP affiliate, including SFPP, is allocated a proportion of labor costs, associated benefits and other overhead costs such as insurance on the basis of three objective cost factors: i.e., gross revenues, gross property plant and equipment and payroll. For each factor, ratios are computed among all of the subsidiaries and are then averaged. The resulting average ratio is then used to allocate overhead expenses to each subsidiary.

The record clearly shows that the method that SFPP has used to assign and allocate corporate overhead expenses to SFPP is overly complex, impossible to verify, and highly subjective. It also contains numerous errors, omits certain entities that benefit from KMEP services, and is driven by an effort to obtain regulatory advantages—not operational business considerations. Moreover, for financial reporting and business operations purposes, KMEP does not directly assign *any* overhead costs. KMEP's 2011 SEC Form 10-K explicitly states that its overhead expenses of $472 million are "[i]tems not directly attributable to any segment."[73] It is simply not credible that SFPP is somehow able to directly assign over $380 million of this $472 million, even though its statements to the SEC indicate that it is unable to attribute these costs to any entity or operating segment.[74]

As we discuss below, the MA Method is far preferable to the SFPP allocation process.

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[72] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 32.
[73] Prepared Reply Testimony of Peter K. Ashton, page 29.
[74] *See* Prepared Reply Testimony of Peter K. Ashton, page 29.

1. SFPP's Overhead Allocation Methodology is Overly Complex, Highly Subjective, and Cannot Be Feasibly Audited.

Under SFPP's direct assignment approach each employee by himself or herself determines how much time he or she devotes to SFPP as well as other Kinder Morgan entities. These time splits are then reviewed by a supervisor and, according to Mr. Bradley, changed accordingly.[75] The time splits are sometimes highly minute, with some employees claiming that they devote time to up to nine different entities, including SFPP.[76] Other employees claim that they devote up to 100% to SFPP; still others as little as 1%.[77] The time splits are further broken out between carrier, non-carrier and military service, again based on the subjective judgment of the employee and his or her supervisor.

A vivid indication of the extreme complexity and lack of transparency in the SFPP overhead allocation method is the fact that Mr. Bradley testified that as part of the SFPP overhead allocation process, the KMI IT department "recovered over 2.2 million emails and attachments" that could potentially have been relevant to verifying the salary splits and changes in those splits for 2011. He testified that ultimately 720,000 documents had to be reviewed and that "a review of this massive scale" may have left some relevant documents overlooked.[78] Mr. Bradley's description of the SFPP overhead allocation process demonstrates the overwhelming size, complexity, and opaqueness of the methodology and further shows the impossibility of either shippers or the Commission even attempting to verify its accuracy.

[75] Prepared Rebuttal Testimony of Dale D. Bradley, pages 11-12.
[76] *See* Attachment O to the Prepared Direct Testimony of Dale D. Bradley.
[77] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 2, page 201, line 26 to page 203, line 2.
[78] Prepared Rebuttal Testimony of Dale D. Bradley, page 13.

In a previous portion of this Opening Brief, we referred to Exhibit Tesoro 5A. This exhibit is a graphic depiction of the SFPP Overhead Allocation System. The Exhibit appears on page 20 of this Brief. Both SFPP and Tesoro agreed that it accurately depicts the methodology that SFPP is currently using.[79] It also is very similar to the method employed and rejected by Judge Bemesderfer in the A.09-05-014 proceeding. Exhibit 5A focuses on the two entities, GP Services and KMI, both of which provide corporate overhead services to SFPP. KMI includes both KMI-dedicated and KMI-shared employees. SFPP claims that KMI-dedicated employees do not allocate any corporate overhead to KMEP-operated entities because they do no work for them. In contrast KMI-shared employees allocate time to both KMI-operated and KMEP-operated entities.[80]

Exhibit 5A is a vivid graphic demonstration of why Mr. Ashton rejected the overhead allocation methodology that SFPP is proposing. As Exhibit 5A demonstrates, the methodology depends on thousands, if not tens of thousands of subjective judgments by Kinder Morgan employees and their supervisors. Those subjective judgments by individual employees are depicted by the yellow boxes in Exhibit 5A. According to Mr. Bradley, there are literally thousands of employees who make these decisions, and changes to these salary splits can and are made on a regular basis.[81] For example, in his Rebuttal Testimony, Mr. Bradley discusses the use of exception coding, in which certain employees override the normal salary splits on a regular basis.[82] The inherent nature of this indirect cost allocation methodology makes it virtually impossible to audit. In fact,

[79] Mr. Goldstein, A.12-01-015 Transcript, Volume 5, page 672.
[80] *See* Prepared Direct Testimony of Dale D. Bradley, pages 9-10.
[81] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 2, pages 172-173.
[82] *See* Prepared Rebuttal Testimony of Dale D. Bradley, page 9.

Mr. Bradley frankly confirmed this fact in the prior hearing when he said it would take "an army of people" to try to figure out what employees in his company actually do and "to see every function that was performed on behalf of SFPP."[83]

As we will discuss further, SFPP's system also has the potential of leading to cross-subsidization.

In an attempt to respond to Tesoro and Shippers' argument regarding the overly complex and highly subjective nature of SFPP's overhead allocation methodology, SFPP witness Bradley introduced a series of his own graphic depictions of the SFPP overhead allocation methodology.[84] The purpose of those charts was to show that Mr. Bradley's method was a more simplified approach than depicted in Tesoro Exhibit 5A. However, Mr. Bradley used three separate exhibits to illustrate the methodology. This, in and of itself, illustrates the complexity of the method. Furthermore, on cross-examination, it became clear that the charts presented by Mr. Bradley were an oversimplified depiction, and excluded important functions in his overhead cost allocation methodology. For example, SFPP Exhibit 26 used bolded lines in an attempt to indicate only those sources of costs affecting SFPP.[85] However on cross-examination, Mr. Bradley admitted that time splits affecting other entities not directly linked through bolded lines on the chart could also affect the costs allocated to SFPP.[86] Consequently, links depicted by the fainter and

[83] *See* Hearing Transcript of A.09-05-014 proceeding, Volume 6, pages 605-606.
[84] *See* SFPP Exhibits 26-28.
[85] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 5, page 673.
[86] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 5, pages 675-678.

dotted lines on Mr. Bradley's Exhibit 26 would also affect SFPP's assignment of costs.[87] Mr. Bradley also admitted that subjective judgment was involved in making these assignments.[88] Mr. Bradley further admitted that the three charts did not even include all of the different types of costs that are actually allocated in the overhead methodology.[89] For example, although Exhibit 26 states that it only depicts labor costs, other costs such as travel expenses, taxes, and cell phone costs are included in the methodology.[90] In addition, Mr. Bradley referred to still additional costs such as air permitting fees that were not captured in any of the three Exhibits he introduced.[91]

In comparing Tesoro Exhibit 5A to the SFPP Exhibits, it is also important to understand that Exhibit 5A shows functionally *how* the SFPP overhead methodology allocates costs through direct assignments, time sheets and salary splits, shared cost distributions and the MA method. This is obviously an important part of the SFPP overhead allocation methodology. In contrast, on cross-examination, Mr. Bradley testified that his exhibits did not include a description of how costs were assigned or allocated.[92] Thus the exhibits submitted by SFPP, while admittedly complex, do not come close to depicting the full complexity of SFPP's cost allocation methodology as Tesoro Exhibit 5A does.

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[87] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 5, pages 676-78.
[88] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 5, pages 677-78; 680-682.
[89] Dale D. Bradley, A.12-01-015 Transcript, Volume 5, page 686.
[90] Dale D. Bradley, A.12-01-015 Transcript, Volume 5, page 686.
[91] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 5, pages 686-687.
[92] See the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 5, page 687.

2. The SFPP Overhead Allocation Model Contains Errors in the Assignment of Costs to the SFPP Jurisdictional Pipeline.

Through a concerted effort, the shippers have been able to pierce at least a small portion of the complexity and opaqueness of the SFPP overhead cost allocation method to uncover errors in expenses attributable to SFPP's CPUC jurisdictional service. These errors include conceptual and theoretical errors that undermine the basic premise of KMEP's corporate overhead allocation methodology, as well as specific charges to SFPP which are clearly incorrect. Some of these incorrect assignments to the SFPP pipeline were identified by SFPP witnesses themselves.

Before discussing these particular charges, it would be useful to place in context the shippers' efforts to report errors in the allocation of specific costs to SFPP as opposed to other Kinder Morgan entities. Because of the sheer vastness of the data underlying the implementation of the SFPP allocation system, it is impossible for shippers to survey the entire system in order to verify the accuracy of assignments of costs to SFPP. That would require the "army" that Mr. Bradley testified was impossible to assemble. Therefore, all that the shippers can reasonably do in examining the overhead expenses allocated to the SFPP pipeline is to point out methodological flaws and identify the particular errors that they found in a small sampling of the entire system.

For that reason, Tesoro categorically rejects the approach that SFPP appears to suggest that the shippers must pursue. According to SFPP, in order to demonstrate that the SFPP indirect cost allocation methodology is flawed, it is the shippers that must identify widespread errors and costs that have been inappropriately allocated to SFPP. As we have pointed out above, that is an impossible task and is fundamentally flawed. Rather, as the ALJ clearly indicated, the burden of proof to establish the underlying

validity and accuracy of its indirect cost allocation system rests on SFPP. It is SFPP, not the shippers, that has the burden of proving the reasonableness and accuracy of its indirect cost allocation system by clear and convincing evidence.

It is in that context that we proceed to identify a number of specific errors in the assignment of overhead costs to SFPP.

(a) Overstatement of Legal Costs

The most significant error uncovered by the shippers is SFPP's overstatement of the legal costs that were directly assigned to SFPP. In its Direct Testimony, SFPP directly assigned, at least $2.2 million in legal costs to SFPP jurisdictional service, which it now admits was incorrect. SFPP concedes that these costs relate to non-jurisdictional service. SFPP removed that charge to the SFPP jurisdictional pipeline system in its Rebuttal Testimony. However, we believe that it would be instructive to examine the process, which led SFPP to remove the $2.2 million charge since it reveals systemic flaws that have undoubtedly left other inappropriate charges still allocated to SFPP.

SFPP had been assigning 100 percent of its legal expenses for certain environmental remediation litigation cases to SFPP carrier operations, including very substantial legal expenses arising from environmental remediation activity at the Mission Valley Terminal.[93] It was only after Mr. Ashton, challenged the propriety of allocating 100 percent of environmental and legal costs associated with the Mission Valley Terminal and City of San Diego litigation to SFPP that the pipeline changed its position. In its Rebuttal Testimony, SFPP conceded that 30 percent of the environmental remediation

[93] *See* Prepared Supplemental Reply Testimony of Peter K. Ashton, pages 68-71.

costs incurred at Mission Valley should be attributed to non-carrier carrier operations.[94] In actuality, all of the environmental remediation costs associated with Mission Valley should be allocated to non-jurisdictional service, as we discuss in a later section of this Opening Brief. Nevertheless, SFPP's admission that a substantial adjustment in its direct assignment costs was necessary reveals a significant error in Mr. Bradley's allocation model. It not only shows that $2.2 million was inappropriately charged to shippers on the SFPP pipeline system, but also highlights the conceptual problem of relying on subjective judgment to assign costs – even when the direct assignment of costs is purportedly supported by invoices.

In fact, the entire process through which the legal assignments are made are based entirely on inappropriately subjective judgments. Under the SFPP methodology it is Kinder Morgan staff attorneys who decide to which entities legal costs should be assigned and whether these costs should be classified as carrier, non-carrier or military.[95] Mr. Bradley indicates that the actual "coding" of the invoices to legal entities is handled by a KMI employee who is a Certified Public Accountant, with 10 years of audit experience and was hired specifically to account for legal costs.[96] Mr. Bradley implies that this individual works closely with the lawyers to ensure accurate coding and that her experience makes her highly competent and effective.[97] Nonetheless, this inferred

[94] *See* Prepared Rebuttal Testimony of Michael A. Hanak, at page 19, line 15 through page 20, line 3; Prepared Rebuttal Testimony of Erik G. Wetmore, at page 9, lines 13-18.
[95] SFPP Response to Tesoro Data Request No. 69, SFPP Response to Shippers 8-3. Also see the exchange between Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, pages 126-128.
[96] Prepared Reply Testimony of Dale D. Bradley, page 24, lines 18-24.
[97] Prepared Reply Testimony of Dale D. Bradley, page 25, lines 3-4.

standard of verification is irrelevant, since Mr. Bradley admitted on cross-examination that it is the lawyers that make the determination.[98]

Mr. Bradley also recognized that direct assignment of legal costs relies on highly subjective judgments. In response to a question posed by Judge Bemesderfer during the hearing, Mr. Bradley responded as follows:

> [Bemsderfer] Q: To the extent that [the lawyers are] allocating their time, would I be correct in inferring that they're doing it based on a subjective judgment about how they have spent their time since they are not keeping detailed time records?
>
> [Bradley] A: Yes.[99]

Moreover, there appears to be little internal check or readily available information as to how these Kinder Morgan lawyers assign legal costs. According to SFPP, it is Erik Wetmore who is in charge of putting together and sponsoring SFPP's cost of service.[100] However, when Mr. Wetmore was asked on cross-examination to describe the underlying work in a legal matter involving a $3.9 million charge to the SFPP pipeline, he was unable to do so.[101] The most information that Mr. Wetmore was able to provide is that he discussed the matter with Kinder Morgan attorneys several months ago.[102] But, Mr. Wetmore was unable to describe precisely what was discussed at that meeting or when the meeting was held or who attended the meeting.[103]

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[98] Dale D. Bradley, A.12-01-015 Transcript, Volume 1, page 128.
[99] See the exchange between ALJ Bemesderfer and Mr. Bradley, A.12-01-015 Transcript, Volume 5, pages 696-697.
[100] *See* Prepared Direct Testimony of Erik G. Wetmore, page 2. Also see the exchange between Mr. Goldstein and Mr. Wetmore, A.12-01-015 Transcript, Volume 7, pages 1008-1009.
[101] See the exchange between Mr. Goldstein and Erik Wetmore, Volume 7, pages 1010 to 1017.
[102] Erik G. Wetmore, A.12-01-015 Transcript, Volume 7, page 1020.
[103] See the exchange between Mr. Goldstein and Erik Wetmore, Volume 7, pages 1020-1021.

Apart from its inability to describe the work for which it is charging shippers legal fees, SFPP also appears to have failed to assess whether multiple entities have benefited from the legal costs associated with litigation. For example, on cross-examination Mr. Bradley acknowledged that if more than one Kinder Morgan entity was benefitting from litigation costs, then the costs involved should be split among multiple entities.[104] Nevertheless, on a number of occasions, SFPP was directly assigned all of the legal expenses arising from litigation that involved a number of different Kinder Morgan affiliates in addition to SFPP.[105]

(b) Overstatement of the Environmental Remediation Costs and Labor Associated with Environmental Remediation Projects.

Significant errors in directly allocating overhead costs to the SFPP pipeline also occurred in the context of environmental remediation expenses. As discussed above, after Mr. Ashton pointed out that environmental remediation costs were being inappropriately assigned to SFPP jurisdictional service, Kinder Morgan, Inc.'s Director of Environmental, Health and Safety Michael A. Hanak admitted that SFPP should have classified environmental remediation costs associated with the Mission Valley Terminal as 65 percent carrier and 30 percent non-carrier. SFPP had originally classified these expenses as 100 percent carrier.

Mr. Hanak's admission also carries over to the employee labor costs that have been allocated to the SFPP pipeline system. For example, Mr. Hanak is an RC Owner

[104] See the exchange between Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, pages 132-133.
[105] *See* SUV-3; also see the exchange between Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, pages 121-134.

(KMI RC 0248) and an RC Manager (GP Services RC 1011).[106] With respect to RC 1011, Mr. Hanak is responsible for verifying the accuracy of the salary splits for GP Services employees within RC 1011. Since Mr. Hanak erroneously believed that 100% of the costs of the 11 employees of RC1011 who were working on the Mission Valley site should be allocated to carrier activities,[107] the salary splits that he approved for RC1011 would have also been erroneous. Unfortunately, shippers have little ability to determine whether any of these salary splits were correctly coded, without joining Mr. Bradley's "army" to verify the basis upon which employees were coding their time and Mr. Hanak was verifying his own time.

(c) Direct Assignment Errors Highlighted in the Testimony of SFPP Witness Michael J. Webb.

In his Rebuttal Testimony, SFPP Witness Michael J. Webb states that he discovered several inconsistencies in the salary split reporting process. Dr. Webb indicates that he then directed that several corrections be made in order to adjust the amount of overhead directly assigned to SFPP. Ironically, Dr. Webb uses these errors to support his conclusion that the direct assignment methodology is accurate and reasonable. According to Dr. Webb the only errors that he discovered in a review of salary splits for G&A services to SFPP were *de minimus*. Therefore, those few errors according to Dr. Webb confirm the validity of the direct assignments as a whole.

A significantly more plausible conclusion would be that the direct assignment methodology itself is susceptible to error, as Dr. Webb found, and if Dr. Webb had looked

[106] *See* Bates labeled files SFPP12-005058 and SFPP12-005105.
[107] Since Mission Valley accounted at that time for about two-thirds of all environmental remediation activity on behalf of SFPP, it is highly likely that most of this RC's employees were involved in activities related to the Mission Valley terminal.

further would have revealed further errors. Moreover, Dr. Webb's analysis, which focused on comparing the salary splits contained in certain emails from the RC managers with the salary splits from the payroll group, hardly tests whether the salary splits for GP Services employees providing services to the product pipelines entities accurately reflect the functions they are performing. Rather, Dr. Webb's analysis simply tests whether the salary splits verified by RC owners and RC managers were correctly *input* into the Kinder Morgan accounting system.[108]

Moreover, in a significant number of instances, Dr. Webb was unable to find any information to corroborate whether the accounting records matched the salary splits recorded by the employees and RC managers or owners.[109] [redacted]. [110] **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]** It is hard to imagine that shipper representatives could also pick up the phone and speak directly with RC managers to obtain missing information about salary

[108] See the exchange between Mr. Adducci and Dr. Webb, A.12-01-015 Transcript, Volume 3, pages 341-344.
[109] See the exchange between Mr. Adducci and Dr. Webb, A.12-01-015 Transcript, Volume 3, pages 344-345, as indicated by the yellow shaded entries on Dr. Webb's Attachment FFF.
[110] Attachment FFF to Dr. Webb's Rebuttal Testimony (Highly Confidential), e.g., see page 32 of 77. In addition, Dr. Webb conceded that he performed no audit or verification process to determine whether his purported "accurate data set" was an accurate and reasonable reflection of the subject time splits and the entities the GP Services employees performed services for. See the exchange between Mr. Adducci and Dr. Webb, A.12-01-015 Transcript, Volume 3, page 344. More importantly, Dr. Webb also conceded that his purported analysis would classify as validated, and therefore accurate, any employee time split that was accepted by an RC manager even when such time splits were indisputably inaccurate. See the exchange between Mr. Adducci and Dr. Webb, A.12-01-015 Transcript, Volume 3, pages 344-47. In sum, Dr. Webb's purported "validation" analysis was demonstrated to be nothing more than a continuation of Mr. Bradley's claim that SFPP's direct assignments are accurate and reasonable without any means for the Commissions or shippers to verify the validity of such claims.

splits. Clearly, SFPP has formulated an overhead allocation methodology in which it is inherently impossible for shippers to verify either the accuracy of the initial salary splits, or, with respect to Dr. Webb's analysis, whether the accounting data is accurately capturing the salary split divisions that RC managers intend.

(d) Attachment AAA to the Rebuttal Testimony of Mr. Bradley Further Demonstrates Errors in Mr. Bradley's Direct Assignments.

Attachment AAA to Mr. Bradley's Rebuttal Testimony purports to track the way RC managers and owners verified direct assignments to individual entities. This is an effort by SFPP to validate its subjective decisions regarding direct allocations of overhead costs. However, the information contained in Attachment AAA shows quite the contrary. It shows that the salary splits as reported in the Attachment were not correct or accurate. As an example, Attachment AAA contains a number of e-mails that are sent to RC managers and owners as part of SFPP's "RC Manager Salary Split Validation Review." The e-mails originated from the employees in [redacted] **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]**who apparently direct the salary split validation process. These employees are [redacted]. **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]** According to the evidence in the Record, the salary splits for these employees indicate that [redacted][111] **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]** [redacted] **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]**

[111] *See* Attachment FFF to the Rebuttal Testimony of Michael J. Webb (Highly Confidential) and Attachment O to the Direct Testimony of Dale D. Bradley.

But the fact is that these employees are overseeing a validation process that affects, i.e., benefits, all of the entities to which Kinder Morgan employees assign time. As we pointed out previously, in some instances GP Services employees have split their salaries to 9 separate legal entities. We would therefore expect [redacted] **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]** would include assignment of time to a general corporate pool, or time to all of the Kinder Morgan entities that benefit from the RC validation process.

But in fact they do not. All of the time of these employees is primarily allocated [redacted]. **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]** This example is still one more illustration of how the SFPP methodology is unreliably subjective and can easily lead to cross-subsidization.

Another potential error identified in Attachment AAA to the Rebuttal Testimony of Mr. Bradley involves RC 1006 and GP Services employee Mark Jensen, whom Mr. Bradley in his Reply Testimony used as an example of the efficiency and accuracy of the direct assignment methodology.[112]

As evidence that the direct assignments of overhead expenses to SFPP are accurate and reliable, Mr. Bradley discusses the different changes Mr. Jensen implements in verifying his employees' salary splits.[113] Yet, even with the data provided by SFPP and Mr. Bradley, Shippers and the Commission do not have sufficient information to verify that Mr. Jensen's employees are in actuality matching the prescribed salary split dictated

[112] *See* Prepared Reply Testimony of Dale D. Bradley, page 23; Prepared Rebuttal Testimony of Dale D. Bradley, page 8. Also see the exchange between Mr. Goldstein and Mr. Bradley, A.12-01-015 Transcript, Volume 2, page 195.
[113] *See* Prepared Rebuttal Testimony of Peter K. Ashton, pages 36-37.

by Mr. Jensen (75 percent to SFPP carrier and 25 percent SFPP carrier).[114] As noted by Mr. Ashton, certain employees have changed their salary splits between SFPP and Calnev. But in order to be consistent with Mr. Jensen's 75/25 percent split between SFPP and Calnev the controllers' salary splits should theoretically continue to mirror the 75/25 percent SFPP/Calnev ratio.[115] But as Mr. Ashton points out there is divergence, at least for 2011 and 2012. Mr. Jensen's employees might have an aggregate split that deviates from his 75% SFPP/ 25% Calnev allocation.

Unfortunately, the evidence that SFPP has provided does not permit either the shippers or the Commission to investigate the potential for this error, a fact recognized by Dr. Webb. In his Rebuttal Testimony, Dr. Webb notes that even if we were to analyze the salary splits, the information produced could have little or no correlation to the actual costs allocated to entities through direct assignments, [116] because the direct assignment information does not include labor and non-labor G&A costs by employee, or the fact that some employees might be part-time.

(e) Errors Leading to Cross-Subsidization

Mr. Jensen's salary split also indicates the susceptibility of the SFPP indirect cost methodology to errors leading to cross-subsidization. In the A.09-05-014 proceeding, SFPP produced a copy of a KPMG report that included the results of salary split surveys for various SFPP employees. One employee was Mark Jensen. As indicated above, Mr. Jensen was Manager of the Orange Control Center. In KMPG's analysis, Mr. Jensen's salary split included time spent on non-carrier and military operations for both SFPP and

[114] *See* Prepared Rebuttal Testimony of Peter K. Ashton, pages 36-37.
[115] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 36.
[116] *See* Prepared Rebuttal Testimony of Michael J. Webb, pages 39-40.

Calnev.[117] Yet, in the current proceeding, Mr. Jensen allocates his time exclusively to carrier operations. [redacted][118] **[HIGHLY CONFIDENTIAL INFORMATION REDACTED]** What is less clear is what transpired between 2009 and 2011 that led SFPP to claim that Mr. Jensen and his controllers no longer have any oversight for non-carrier or military operations. On its face Mr. Jensen's 2011 salary split appears erroneous, with CPUC jurisdictional charges appearing to subsidize SFPP's non-carrier and military operations.

Of course, it would be impossible for the shippers to point out every example of cross-subsidization in the SFPP indirect cost allocation methodology. SFPP has admitted that neither the Commission nor shippers on the SFPP pipeline can comprehensively audit the salary splits and direct assignments for accuracy. However, since it is SFPP that has the burden of proof, we respectfully suggest that it is sufficient for shippers to point to the susceptibility of the SFPP indirect cost allocation system to error and the impossibility of auditing it to discover those errors.

B. SFPP's Overhead Cost Allocation Methodology Improperly Excludes a Number of KMEP Entities that Benefit from KMEP Overhead Services.

In his Direct Testimony, Mr. Bradley identifies three categories of KMEP subsidiaries and joint ventures that have been excluded from any overhead cost

[117] Exhibit DSA-20 to the Prepared Direct Testimony of Daniel S. Arthur.
[118] See Attachment AAA (Highly Confidential) to Prepared Rebuttal Testimony of Dale D. Bradley, pages 102-106.

allocation.[119] These entities include KMEP subsidiaries and joint ventures that receive the entirety of their G&A services and support from KMI; KM Canada; and joint ventures in which KMEP owns an equity interest of 50 percent or less and receive G&A services and support from a third party.

This system relies on two fundamental and erroneous assumptions. First, Mr. Bradley and SFPP assume that they can identify every instance in which a GP Services employee might have provided services, either directly or indirectly, that benefitted the excluded entities. The second assumption made is that the time allocation procedures and processes in place for KMI employees is transparent and reliable for assessing whether KMEP is appropriately computing the KMI cross charge. Neither of these assumptions is correct.

Although Mr. Bradley and SFPP have produced the salary splits for cross-charge employees, as well as the actual costs included in the cross-charge, as we noted previously and as confirmed by Mr. Bradley in cross-examination,[120] the actual costs charged to the general ledger may have no bearing on the salary splits implemented for KMI shared services employees.

Furthermore, despite Mr. Bradley's claim that GP services employees do not provide any services to excluded entities including joint ventures, shipper witnesses Dr. Arthur and Mr. Ashton have identified situations in which GP Services employees do

[119] *See* Prepared Direct Testimony of Dale D. Bradley, page 18.
[120] See the exchange between Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, pages 136-137.

perform overhead services for excluded entities.[121] In fact, Mr. Bradley continued to uncover additional instances in which GP Services employees oversee KMI employees.

In his Prepared Rebuttal Testimony, Mr. Bradley notes that he "discovered recently that an employee, Ms. Linda Meyer" was added to a KMI RC in 2011, yet was overseen by a GP Services employee.[122] Since Mr. Bradley is only recently discovering this additional employee, it highlights the inability of the shippers and the Commission to assess the accuracy of Mr. Bradley's assertion that there are no GP Services employees that provide services to the entities that Mr. Bradley has excluded from salary splits and direct assignments.

Mr. Bradley's recognition of Ms. Meyer as an employee that spends time on both KMI-Operated entities as well as products pipeline entities also directly contradicts statements he made under cross examination. Specifically, with respect to Ms. Meyer, Mr. Bradley states in his Prepared Rebuttal Testimony:

> I discovered recently that an employee, Ms. Linda Meyer, was added to KMI RC 0248 (Environmental Processes) for 2011, and similar to Mike Hanak's situation, reports to a GP Services employee (David Halphen in RC 1030). Ms. Meyer spends only 11% of her time supporting KMI-Operated Entities…[123]

Yet, when questioned at the evidentiary hearing as to whether he was aware of any employee that split time between KMEP product pipeline entities and KMI-Operated Entities, Mr. Bradley said, "None that I am aware of."[124]

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[121] *See* Prepared Direct Testimony of Daniel S. Arthur, pages 22-27; Prepared Reply Testimony of Peter K. Ashton, pages 35-36.
[122] *See* Prepared Rebuttal Testimony of Dale D. Bradley, page 27, note 11.
[123] Prepared Rebuttal Testimony of Dale D. Bradley, page 27, note 11. In addition, Attachment J to Mr. Bradley's Direct Testimony and SFPP12 004683 (Shippers 1-10) indicate that RC 0248 does not bill to the cross charge, which confirms that Ms. Meyer is billing to Account 184600 for time spent on KMI-Operated entities.
[124] Dale D. Bradley, A.12-01-015 Transcript, Volume 5, page 689.

In addition, although Mr. Bradley also attempts to minimize or dismiss the evidence that certain legal entities which he excludes from his analysis are undoubtedly receiving the benefit of overhead services from both KMI and GP Services, the fact is that he, himself, recognized that a number of operating limited partnerships within the KMEP organizational structure receive services from either RC 66 (the KMI RC for tax preparation) or RC 1007 (the GP Services RC for accounting).[125] In at least two instances, certain of the excluded entities record a positive value for gross property in 2011 separate and apart from any subsidiaries, and receive accounting services from RC 1007.[126] This data certainly appears to indicate that these entities should be assigned overhead costs that are now being borne by SFPP. This example is still another instance in which the SFPP overhead cost allocation methodology enables the pipeline to engage in improper cross-subsidization.

As discussed above, one of the excluded entities is KM Canada. Mr. Bradley's reason for excluding KM Canada from his corporate overhead expense methodology is his claim that KM Canada maintains a separate overhead cost allocation methodology for the National Energy Board (NEB), the regulatory body for KMEP's Canadian operations. However, even Mr. Bradley concedes that some GP Services and KMI personnel are providing oversight that benefits the KM Canada entities.[127] Faced with this inconsistency between his exclusion of KM Canada from the overhead allocation methodology and the clear evidence that KM Canada does receive overhead services from GP Services, Mr.

[125] See the exchange Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, pages 100-111.
[126] Exhibit DSA-33 to the Prepared Direct Testimony of Daniel S. Arthur, page 50.
[127] *See* Prepared Direct Testimony of Dale D. Bradley, page 9.

Bradley embarks on an effort to determine the amount of that benefit and remove it from his analysis.[128] According to SFPP, that benefit is $3.3 million.[129]

However, the effort by SFPP to quantify the dollar amount of services provided by GP Services and KMI personnel to Canadian operations is based on highly subjective and therefore suspect judgments that use surveys of RC managers whose employees provide services to KM Canada entities. A far more reasonable approach would be to simply eliminate the subjective nature of the effort to implement and interpret KM Canada surveys and instead include all the KM Canada entities into a single-tier MA Formula as recommended by Mr. Ashton. There is simply no sound basis for excluding entities that benefit from the provision of overhead services within the KMEP organizational structure.

In fact, when confronted with inherent errors because of the subjectivity of its allocation process, SFPP reverts to the MA Formula—which it should have used in the first place. The treatment of insurance expenses is an example of the failure of the SFPP methodology.

Mr. Bradley had originally proposed that insurance expenses be directly assigned to specific KMEP entities on the basis of a subjective determination of replacement cost values. In his Reply Testimony, Mr. Bradley changed his method for determining insurance expenses, opting to allocate insurance expenses using the three factors of the MA Formula for KMEP-owned entities included in his "KMP-tier."[130] While Mr. Bradley claims the reason was to limit contested issues, it is clear that Mr. Bradley realized the subjective nature of relying on direct assignments of insurance expenses. Specifically, the

[128] *See* Prepared Rebuttal Testimony of Dale. D. Bradley, pages 31-32.
[129] *See* Prepared Rebuttal Testimony of Dale D. Bradley, page 32.
[130] Prepared Reply Testimony of Dale D. Bradley, page 23, as discussed by Mr. Ashton in his Rebuttal Testimony pages 43-45.

direct assignment of insurance costs was based on arbitrary replacement cost values that lacked any objective basis.[131]

C. SFPP's Overhead Method Leads to Cross Subsidization.

We have previously alluded to the errors made by SFPP in assigning costs to SFPP that should have instead been assigned to non-carrier operations.[132] We will not repeat that discussion here.

We do wish to point out, however, that in his Prepared Rebuttal Testimony Mr. Ashton points out at length how the KMEP overhead cost allocation methodology invites cross-subsidization and incentivizes employees to load as much overhead cost as possible on regulated entities such as SFPP.[133] In addition to the points previously made in this Opening Brief, Mr. Ashton discusses the fact that, in contrast to SFPP and Calnev, KMEP

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[131] Furthermore, one of the issues presented in the SFPP overhead allocation methodology is whether REX, MEP and Plantation, which are all KMEP entities, should be included in the overhead cost allocation. In his cost of service model, Mr. Ashton does include these entities in his MA Formula. SFPP erroneously criticizes him for doing so because these are entities that do not consolidate into KMEP's 10-K. See the Prepared Reply Testimony of Michael J. Webb, pages 23-24. This criticism is misguided and in certain instances, simply wrong. As discussed in Mr. Ashton's Rebuttal Testimony, MEP and REX benefit from KMEP oversight and expense. See Prepared Rebuttal Testimony of Peter K. Ashton, pages 48-49. Although Plantation might not consolidate into the KMEP reporting segment data, it is clear that a portion of the G&A allocated to Plantation originally derives from the consolidated KMEP 10K G&A amount of $472.7 million. *See* Tesoro Exhibit No. 15; also see the exchange between Mr. Goldstein and Mr. Webb, A.12-01-015 Transcript, Volume 3, page 340.

[132] Examples of these errors are: (i) SFPP assigning 100% of certain legal costs to the jurisdictional pipeline; (ii) Mr. Jensen's failure to assign time to non-carrier and military operations in 2011 despite the fact that he did so in 2010 and despite the fact that SFPP continued to maintain non carrier and military operations in 2011; (iii) SFPP's failure to assign time to certain KMEP entities despite the fact that employees of GP Services provided overhead services to them; (iv) the failure to include KM Canada in the cost allocation pool; (v) Mr. Bradley's admission that several other KMEP entities were excluded from the overhead cost pool despite the fact that they received services from both KMI and GP Services RC's.

[133] Prepared Rebuttal Testimony of Peter K. Ashton, pages 40-41.

does not directly assign costs to the largely unregulated CO2 and Terminals entities. That omission reinforces the conclusion that the direct assignment methodology naturally leads regulated entities to cross-subsidizing other KMEP non-regulated companies. The fact that the SFPP indirect allocation system could lead to this cross-subsidization was, moreover, recognized by ALJ Bemesderfer in the A.09-05-014 proceeding. It remains a principal issue in the current proceeding

D. SFPP's Overhead Allocation Method Is Defective Because It Was Designed to Maximize Regulatory Benefits Rather Than as a Tool for Business Decision-Making.

There is no doubt that the overhead allocation methodology that SFPP is using in this proceeding was designed to maximize the regulatory benefits that SFPP can achieve in rate-making proceedings. It was not designed and is not being used for any real business purpose. That factor alone creates a substantial potential for cross subsidization.

In his Rebuttal Testimony, Tesoro witness Ashton describes the evolution of SFPP's overhead allocation methodology from the use of the objective straightforward Massachusetts Method to one that increasingly relies on direct assignments.[134] As the table on page 29 of Mr. Ashton's Rebuttal Testimony shows, it was only in 2007 that SFPP starting making direct assignments and only in 2008 and 2009 that direct assignments began to predominate the SFPP overhead methodology. The impetus for this move to widespread direct assignments was a study commissioned and paid for by SFPP,[135] which was performed by the consulting firm KPMG.[136] As Dr. Arthur discusses

[134] Prepared Rebuttal Testimony of Peter K. Ashton, pages 28-29.
[135] As Dr. Arthur points out, 100% of the costs of the KPMG study were allocated to SFPP which belies any claim that the purpose of the study was for anything other than ratemaking since SFPP was considered the only beneficiary of the study. *See* Prepared Direct Testimony of Daniel S. Arthur, page 20.

in his testimony, the KPMG study advocated the use of direct assignments for labor and non-labor costs including legal and insurance costs.[137] Dr. Arthur and Mr. Ashton point to evidence that the KPMG study was designed for ratemaking purposes only.[138] On cross examination, Mr. Bradley testified that the methodology recommended by KPMG is in fact the method that SFPP uses today.[139] Furthermore, he agreed that it was only after the KPMG study was completed that SFPP started making direct assignments of legal and insurance expenses and greatly expanded the direct assignments of labor costs.[140]

Mr. Bradley also agreed that the KPMG study was undertaken as an integral part of SFPP's cost of service study update and rate support.[141] The fact that the study was commissioned for ratemaking purposes inevitably introduces the potential for bias in its implementation. Kinder Morgan employees certainly recognized that the entire purpose of the study was to enable KMEP to assign more costs to SFPP than before. Therefore, GP Services and KMI employees had a substantial incentive to shift time recording and costs to SFPP when the system was implemented. Indeed Thomas A. Bannigan, President of Products Pipelines, told the RC Managers who were overseeing and verifying the recording and revision of salary splits, that rate-making was the driving force of the direct assignment methodology. Mr. Bannigan instructed these managers as follows: [redacted]

[136] *See* DSA-20.
[137] Prepared Direct Testimony of Daniel S. Arthur, page 19.
[138] Prepared Direct Testimony of Daniel S. Arthur, pages 17-19; Prepared Reply Testimony of Peter K. Ashton, pages 30-31.
[139] See the exchange between Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, page 62.
[140] See the exchange between Mr. Adducci and Mr. Bradley, A.12-01-015 Transcript, Volume 1, pages 65-66.
[141] Dale D. Bradley, A.12-01-015 Transcript, Volume 1, page 78.

[redacted][142]

[HIGHLY CONFIDENTIAL INFORMATION REDACTED]

A further indication that KMEP intends its indirect cost allocation methodology to increase the costs assigned to SFPP is the fact that KMEP's SEC Form 10-K does not make direct assignment of G&A costs and indeed explicitly states that its G&A costs reflect cost "items not attributable to any segment."[143] As Mr. Ashton points out in his Reply Testimony, even though KMEP explicitly states in its SEC Form 10-K that it cannot allocate or assign these costs to a particular segment or company, Mr. Bradley claims that he can accurately directly assign 80% of these costs to specific KMEP subsidiaries or subsets of entities within various operating segments.[144]

These contradictory positions confirm two important facts that Mr. Ashton discusses in his testimony.[145] First, if overhead expenses could be directly assigned, it would have a material impact on the earnings of various KMEP segments, and decision-makers in the company would naturally be expected to consider those impacts. Secondly, KMEP's failure to use such a direct assignment methodology confirms the fact that this method is used purely for ratemaking purposes, i.e., to augment the costs that are assigned to SFPP.[146]

Finally, additional evidence produced by SFPP in this proceeding further demonstrates that the financial reports reviewed and relied on by management in the normal course of business do not include any of the direct assignments found in SFPP's

[142] Exhibit AAA to Mr. Bradley's Rebuttal Testimony (Highly Confidential), page 2.
[143] Prepared Reply Testimony of Peter K. Ashton, page 29.
[144] Prepared Reply Testimony of Peter K. Ashton, page 29.
[145] Prepared Reply Testimony of Peter K. Ashton, page 30.
[146] Prepared Reply Testimony of Peter K. Ashton, page 30.

overhead methodology.[147] This is further evidence that SFPP's proposed methodology is motivated by enhancing the costs that can be assigned to SFPP and recovered from ratepayers and is therefore highly likely to be affected by the incentive of a parent entity to shift overhead costs to a regulated subsidiary. This is precisely one of the principal reasons that Judge Bemesderfer rejected this method in the A.09-05-14 proceeding.[148] The reasoning that led to the rejection of the SFPP overhead cost allocation methodology continues to apply today.

E. The Fact That SFPP's Allocation of Overhead is Much Higher than Other Pipelines Calls into Question the Validity of the Methodology.

Tesoro witness Peter K. Ashton convincingly demonstrated in his Rebuttal Testimony that the overhead costs that KMEP is allocating to SFPP through Mr. Bradley's overhead costs methodology is substantially higher than comparable pipeline companies.[149] In reaching this conclusion, Mr. Ashton compared the ratio of overhead expenses to the gross revenue for the proxy group of pipeline companies used in the equity rate of return computation. He found that SFPP's allocation of overhead costs was twice the amount of the highest of the proxy group. In fact, Mr. Ashton found that "when Mr. Bradley's overhead methodology is used, SFPP incurs overhead expenses that are over seven times greater than the median of the other pipeline companies."[150] This evidence

[147] Prepared Rebuttal Testimony of Daniel S. Arthur, pages 19-20 and Exhibits DSA-83 through DSA-87.
[148] See Revised and Reissued Proposed Decision Determining Test Year 2009 Rate Base and Cost of Service for SFPP, L.P. and Calnev Pipe Line L.L.C. and Ordering Refunds, A.09-05-014 at Section 3.3.2.1.
[149] *See* Prepared Rebuttal Testimony of Peter K. Ashton, pages 42-43.
[150] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 43.

vividly demonstrates that the amount being allocated to SFPP is excessive—undoubtedly because it is based on a fundamentally flawed methodology.[151]

In their Rebuttal Testimony, Mr. Bradley and Dr. Webb attempt to justify the high level of overhead being allocated to SFPP, stating that SFPP's operations are labor intensive and require more intensive management oversight.[152] Ironically, Dr. Webb points to litigation expenses as one element of these "higher" expenses. However, as we previously pointed out, SFPP has admitted that it has been incorrectly assigning legal expenses to the jurisdictional pipeline.

Mr. Bradley's contention that the SFPP operation is more labor intensive than other pipelines and therefore should be expected to incur a higher percentage of overhead costs is also somewhat ironic. Mr. Bradley is in fact pointing to one of the three factors used in the Massachusetts Method that is used to allocate overhead expenses—i.e., labor costs. If SFPP is a more labor intensive operation than other pipelines, then the MA method would take that factor into account in the allocation of overhead costs. In addition, many of the other factors to which Mr. Bradley points as support for SFPP's labor intensity, such as miles of pipeline and terminals will be reflected in the gross property element of the MA formula. Thus Dr. Webb and Mr. Bradley's arguments as to why SFPP may require a higher allocation of overhead expenses instead provides a strong argument for the use of the MA Method that Tesoro witness Ashton endorses.

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[151] Dr. Webb attempted to dismiss this evidence arguing that these other companies are engaged in activities other than pipeline operations (A.12-01-015 Transcript, p. 332-338); however the fact is that these companies are all engaged in significant pipeline transportation activities which is in fact why they comprise the pipeline proxy group that is used to compute the return on equity for oil pipeline companies.

[152] *See* Prepared Rebuttal Testimony of Michael J. Webb, page 22; Prepared Rebuttal Testimony of Dale D. Bradley, pages 6-7.

F. The Overhead Allocation Methodology Recommended by Tesoro Witness Ashton Is an Objective and Reliable Process for Determining SFPP's Overhead Costs.

Unlike SFPP, Tesoro Witness Ashton has provided a straightforward, transparent method for allocating corporate overhead costs to SFPP's CPUC-jurisdictional operations. Instead of relying on thousands of individual subjective judgments, Mr. Ashton relies on the objective MA Method, which uses gross revenue; gross property, plant and equipment; and direct payroll to allocate KMEP corporate overhead expenses to individual entities. The MA factors embody the principles of cost causation and in the current proceeding, represent the most accurate method for allocating corporate overhead expenses to SFPP.

Where appropriate, Mr. Ashton has made modifications and adjustments to ensure that the correct amount of overhead costs are captured in his analysis, including increasing the starting point of KMEP overhead expenses to account for the inclusion of certain non-consolidating entities. He also included entities that Mr. Bradley erroneously attempted to exclude. Mr. Ashton correctly rejected any purported "direct assignments" of corporate overhead costs. However, Mr. Ashton did directly assign to SFPP the cost of CPUC rate proceedings.

Specifically, Mr. Ashton began with the amount of G&A reported in KMEP's 2011 SEC 10-K filing, the $472.7 million amount that KMEP stated represents items that are not attributable to any segment of its operation. As discussed in his testimony, Mr. Ashton removed certain non-cash expenses and added additional G&A expenses for non-consolidating entities. The resulting amount was $407.7 million, which Mr. Ashton subsequently allocated to all KMEP-owned entities using the MA Formula. Mr. Ashton

thereby allocated $26.5 million in corporate overhead expenses to SFPP, of which $8.2 million is attributable to SFPP's CPUC jurisdictional operations.

In his Reply and Rebuttal testimony, Mr. Ashton also described an alternative calculation, which assumes that legal expenses can be assigned to specific entities in a reasonable, reliable, transparent and accurate manner. As discussed in his testimony, Mr. Ashton does not believe that it is possible to do so in the context of the present case. As the evidence has indicated, despite being based on "invoice analysis" the direct assignment of legal expenses still relies on the entirely subjective determination of certain individuals, and leads to significant errors. For example, SFPP erroneously assigned over $2 million in legal expenses to SFPP. Nevertheless, Mr. Ashton computed his alternative calculation, by removing legal expenses from his MA Method and directly assigning these costs to specific entities. The results of these calculations indicate a total of $9.9 million in corporate overhead expenses allocable to SFPP's CPUC jurisdictional operations for cost of service purposes.

II. SFPP HAS FAILED TO PROVE WITH CLEAR AND CONVINCING EVIDENCE THAT IT IS ENTITLED TO CHARGE ITS SHIPPERS FOR THE COST OF REMEDIATING CONTAMINATION AT ITS TERMINALS.

A. Introduction

SFPP is claiming that a significant portion of the expenses it has incurred to remediate pollution at 24 terminals and other locations should be recovered from the shippers on its California pipeline system. In its Direct Testimony in this proceeding, SFPP requested $9.6 million in environmental remediation expenses.[153] However, when Tesoro challenged the allocation of remediation costs between carrier and non-carrier

[153] *See* Attachment A to the Prepared Direct Testimony of Michael A. Hanak.

assets at the Mission Valley site, SFPP substantially revised its environmental remediation claim. In its Rebuttal Testimony, SFPP is now requesting that shippers provide $7.4 million to support its environmental cleanup activities on various portions of its CPUC jurisdictional pipeline.[154] That amount, as well, is wholly excessive.

There are 24 sites in California at which SFPP is currently incurring environmental remediation expenses: (1) Stockton Terminal; (2) Bradshaw Terminal; (3) Richmond; (4) Mission Valley; (5) Concord Terminal; (6) Norwalk; (7) Chico Terminal; (8) West Sacramento; (9) Imperial Terminal; (10) Brisbane; (11) La Habra; (12) San Jose Terminal; (13) Holt; (14) Balfour Road; (15) Horno Booster; (16) Rocklin Station; (17) Selby Pond; (18) Colton Terminal; (19) Elmira-Fox Road; (20) Elmira-A Street; (21) Oakland Airport; (22) Dublin - Iron Horse; (23) Brentwood Booster Station; and (24) American River. [155]

According to SFPP witness Michael A. Hanak, KMI's Environmental, Health, and Safety Director, he is the individual responsible for determining which of these sites involve remediation of contamination attributable to the CPUC jurisdictional system. Mr. Hanak is also the individual responsible for determining the allocation between carrier and non-carrier expenses at SFPP's 24 sites.[156] Based on Mr. Hanak's determinations, SFPP witness Erik G. Wetmore is then charged with allocating costs to intrastate service in the cost of service that SFPP is recommending that the Commission adopt.[157]

In his Direct Testimony, Mr. Hanak explained the process he undertook to make these determinations. Mr. Hanak stated that he asked SFPP witness Peter M. Dito to

[154] SFPP reduced the environmental remediation expenses in its cost of service by $2.26 million after it revised the percentages for the Mission Valley and Bradshaw sites. *See* Prepared Rebuttal Testimony of Erik G. Wetmore, page 11.
[155] *See* Prepared Direct Testimony of Michael A. Hanak, pages 9-10.
[156] *See* Prepared Direct Testimony of Michael A. Hanak, pages 18-20.
[157] *See* Prepared Direct Testimony of Michael A. Hanak, page 10-11.

identify the sites that consisted entirely of carrier assets,[158] as well as the sites that had a mix of carrier and non-carrier assets.[159] He labeled the latter sites the "Mixed Asset Sites."[160] According to Mr. Hanak, "At locations where carrier-only assets were present at the time of the relevant release(s), 100% of the remediation costs are charged to the carrier category."[161]

Unlike the carrier-only sites, the Mixed Asset Sites required a determination of the percentage of total remediation expenses that should be allocated to carrier and non-carrier. Mr. Hanak described that process for these sites as follows:

> For each Mixed Asset Site, I reviewed the documented release history, which typically identifies the site, the release date(s), the product released, the volume released, the volume recovered, and the indicated cause of the release. Release history information often provides sufficient information to identify the percentage of environmental remediation expenses that should be allocated to carrier as compared to non-carrier assets. In other cases, a mix of carrier and non-carrier releases warrants an allocation based on the number and/or size of the releases. However, in some cases, the release history is not sufficient to determine the appropriate allocation between carrier and non-carrier (*e.g.*, when the release history is incomplete to an extent that it is inconsistent with the level of contamination at the site). In those instances, I review other sources of data, such as site investigation reports, to see if they reference sources of contamination or if the geology/hydrogeology, analytical, or other data demonstrate a source area.[162]

SFPP's original carrier allocation expenses are stated in Schedule 10 of Attachment C of the Prepared Direct Testimony of Erik G. Wetmore. The environmental remediation expenses for each of the 24 sites from 2007 to 2011 were then listed in Attachment A of the Prepared Direct Testimony of Michael A. Hanak. Mr. Hanak stated that he understood from Mr. Wetmore that the carrier intrastate portion of the actual 2011

[158] Two sites have only non-carrier assets (Imperial and San Jose).
[159] *See* Prepared Direct Testimony of Michael A. Hanak, page 18.
[160] Prepared Direct Testimony of Michael A. Hanak, page 18.
[161] Prepared Direct Testimony of Michael A. Hanak, page 18.
[162] Prepared Direct Testimony of Michael A. Hanak, page 18-19.

environmental remediation expenses incurred by SFPP were included in the 2012 Test Year Cost of Service, except for the costs for the Richmond and Balfour Road sites.[163] SFPP had received No Further Action (NFA) letters from the state agencies overseeing the Richmond and Balfour Road sites, meaning that remediation activities could cease and no further expenses would be incurred.[164] According to Mr. Hanak, SFPP does not expect to receive NFA letters for the remaining California sites within the next three years.[165]

Following the submission of Mr. Hanak's Direct Testimony, SFPP revised the remediation expenses it attributed to CPUC jurisdictional assets by $2.26 million.[166] The most significant reduction occurred when Tesoro witness Peter K. Ashton pointed to evidence of a Powerine Oil Company (Powerine) leak at the Mission Valley site—a [redacted][167]

[CONFIDENTIAL INFORMATION REDACTED] On April 2, 2013, SFPP witness Dr. Robert E. Hinchee produced Rebuttal Testimony discussing the Powerine issue, and recommended that the carrier allocation for Mission Valley should be revised from 100% carrier to 65% carrier.

Contrary to SFPP's position, Tesoro believes that SFPP is entitled to only $1.1 million of the $7.4 million of the environmental remediation expenses it has attributed to the CPUC jurisdictional pipeline system. As the discussion in this section will

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[163] *See* Prepared Direct Testimony of Michael A. Hanak, page 11.
[164] *See* Prepared Direct Testimony of Michael A. Hanak, page 17.
[165] *See* Prepared Direct Testimony of Michael A. Hanak, page 17.
[166] *See* Prepared Rebuttal Testimony of Erik G. Wetmore, page 11.
[167] [redacted] **[CONFIDENTIAL INFORMATION REDACTED]** were included as Attachment A (Confidential) to the Supplemental Reply Testimony of Peter K. Ashton. It was also entered into evidence as Tesoro Exhibit No. 18 (Confidential).

demonstrate, SFPP has not come close to meeting the "clear and convincing" evidentiary standard that ALJ Bemesderfer established at the beginning of the evidentiary hearing with regard to environmental remediation expenses at the 24 sites in California. ALJ Bemesderfer stated as follows:

> […] In order to recover its environmental cleanup costs, SFPP must prove both that the spills it has cleaned up came from its CPUC jurisdictional property and that it acted reasonably in attempting to prevent them in the first place and to clean them up after they occurred.
>
> The standard of proof that applies to these matters is clear and convincing. While standards of proof are by their nature subjective, I interpret the clear and convincing standard to mean that SFPP will have to prove more than the mere possibility that the spills could have come from CPUC jurisdictional property.[168]

In this portion of its Opening Brief, Tesoro will initially comment on specific sites. The focus will largely be on Mission Valley, which constitutes over 50% of the total $7.4 million requested by SFPP. We will point out that while SFPP witnesses Michael A. Hanak and Dr. Robert E. Hinchee believe that the source of the leak is in the "manifold area," they have both testified that they are unable to identify the specific asset or assets in the manifold area that caused the contamination that SFPP has been remediating. In addition, the Mission Valley "manifold area" as described by SFPP witnesses includes a mixture of carrier and non-carrier assets, all of which are situated in close proximity to one another. It is therefore quite possible that non-carrier assets, including a number of gasoline delivery pipes in the "manifold area," could have been the source of the contamination now under remediation. That conclusion is certainly as plausible as the conclusion that it was carrier assets in the "manifold area" that caused the contamination. We will develop this point in the ensuing portions of this part of the Opening Brief.

[168] ALJ Bemesderfer, A.12-01-015 Transcript, Volume 1, page 9, line 25 to page 10, line 11.

We will also point out in the ensuing portions of this section of the Tesoro Opening Brief that the methodology Mr. Hanak used to allocate costs between carrier and non-carrier assets was flawed and incomplete, since he simply ignored evidence in an arbitration between SFPP and other parties that concluded that the primary cause of pollution at the Mission Valley site was non-CPUC jurisdictional assets. Although SFPP revised its allocation to reflect this incident after a Tesoro witness pointed it out, SFPP's current allocation to shippers on the jurisdictional pipeline of 65% of environmental expenses remains arbitrary. There is no "clear and convincing" evidence to support any allocation to shippers of any remediation costs at the Mission Valley site.

SFPP has similarly failed to provide any evidence, let alone "clear and convincing" evidence, with respect to the specific steps that it took at the Mission Valley site to mitigate the risk of releases in the late 1980's and early 1990's. While Tesoro is aware of some evidence submitted by SFPP regarding its overall policies concerning environmental matters, we are not aware of any evidence in the Record of this proceeding regarding SFPP's actual operation of the Mission Valley assets or of the specific procedures SFPP took to prevent releases from occurring at the Mission Valley site.

SFPP has also failed to meet its burden of demonstrating with clear and convincing evidence that leaks at other California remediation sites occurred on jurisdictional assets or that it acted with prudence in its operation of the terminals so as to prevent leaks. SFPP has not adequately explained why releases, which it identifies as having occurred at these sites and appear to be on non-jurisdictional property at the terminals, are not factored into the carrier allocations for the Mixed Asset Sites.

Tesoro will also address the abuses that took place during discovery, which prevented counsel from considering important documents that SFPP witnesses used in their analyses of environmental remediation expenses and operations. In fact, the documents that SFPP improperly withheld include the documented release history that Mr. Hanak relied upon in determining carrier allocations, as well as Corrective Action Reports and other documents that SFPP submitted to state agencies overseeing remediation progress. At the same time that SFPP was withholding these important documents, it was dumping tens of thousands of pages of material in the Data Room that it made available to the shippers. The effort was clearly designed to create an impossible burden for shippers, including of course Tesoro, in locating relevant documents with respect to SFPP's environmental remediation activities. The evidence of discovery abuse became even more apparent from statements made by SFPP witness Michael A. Hanak during the evidentiary hearing, and Tesoro respectfully submits that SFPP's abuse of the discovery process should be taken in account in determining whether SFPP has met its burden of proof with respect to causation and prudence issues.

B. SFPP's Mission Valley Site

1. The Cause of Leaks at the Mission Valley Site

SFPP has not produced clear and convincing evidence that identifies the specific asset or assets that caused releases that produced the contamination it is currently remediating at the Mission Valley site.

In his Direct Testimony, Mr. Hanak described the process and evidence he used in determining at that time that 100% of SFPP's environmental remediation expenses at Mission Valley should be allocated to the CPUC jurisdictional pipeline. SFPP classifies

Mission Valley as a "Mixed Asset Site." When prompted for an example of how he conducted his carrier/ non-carrier allocation analyses for Mixed Asset Sites, Mr. Hanak described the process for Mission Valley:

> For example, at the Mission Valley Terminal, the spill history was incomplete as this history, contrary to known facts, contains no documented releases prior to 1993. In particular, we know from the environmental history that the State of California Regional Groundwater Control Board ("RWQCB"), San Diego Region, issued a Cleanup and Abatement Order (CAO 92-01) to SFPP and others on January 3, 1992 to begin investigating the source of environmental contamination in Mission Valley. In response to that order, a Site Characterization report was prepared by Simon Hydro-Search and submitted to the RWQCB on August 21, 1992 (attached as Attachment B). The investigations in the report conclude that substantial contamination at SFPP was 'emanating from the manifold area and extending south to San Diego Mission Road."[169]

Mr. Hanak noted that Figures 16 and 17 from this 1992 Site Characterization Report, "illustrate the areal distribution of contamination in groundwater as originating from the manifold area."[170] According to Mr. Hanak, "this information is highly relevant in identifying whether and to what extent the environmental remediation expenses at this site should be allocated to carrier versus non-carrier."[171]

In addition to the 1992 Site Characterization Report, Mr. Hanak also states that he reviewed a Site Investigation Report prepared by Aqui-Ver, Inc. and GeoSyntec Consultants, dated July 31, 2001.[172] This report states: "The results of the investigation indicate that a predominantly gasoline LNAPL plume containing MTBE is present as a single plume from the manifold area south into Qualcomm Stadium parking (Area 1, Figure 5-1)."[173] According to Mr. Hanak, Figure 5-1 from this report illustrates the plume

[169] *See* Prepared Direct Testimony of Michael A. Hanak, page 19.
[170] *See* Prepared Direct Testimony of Michael A. Hanak, page 19.
[171] *See* Prepared Direct Testimony of Michael A. Hanak, page 19.
[172] *See* Prepared Direct Testimony of Michael A. Hanak, pages 19-20.
[173] Attachment C to Prepared Direct Testimony of Michael A. Hanak, page 24.

originating from the manifold area.[174] Having identified the "manifold area" as the source of the release from these reports, Mr. Hanak stated that, "It is my understanding from Mr. Dito that the SFPP manifold is a carrier asset, and therefore I allocated 100% of the costs as carrier."[175]

But, as the evidentiary hearing made clear, the manifold area does not consist of a single discrete carrier asset, but rather is a collection of assets, some of which are carrier assets and many of which are non-carrier assets.[176] Moreover, Mr. Hanak as well as SFPP's Expert, Dr. Robert E. Hinchee admit that they cannot point to the specific carrier asset in the collection of carrier and non-carrier assets in the manifold area that caused the leaks that SFPP is remediation. In his written testimony, Dr. Hinchee stated that he could not identify the exact sources of the releases at Mission Valley:

> Q. Can you pinpoint with precision the exact source of the contamination within SFPP's manifold area?
>
> A. No, I cannot. Over the years there have been many releases at the MVT, some reported and undoubtedly some not reported, particularly in the early years of operations of the MVT. It is not possible to know the exact volume and sources of the releases driving the ongoing remediation efforts at the MVT.[177]

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[174] *See* Prepared Direct Testimony of Michael A. Hanak, page 20.
[175] *See* Prepared Direct Testimony of Michael A. Hanak, page 20.
[176] *See* Attachment No. 2 to the Opening Brief, which was also produced on page 25 of this Opening Brief. Mr. Dito testified that all but one of the lines between the diesel and and gasoline manifolds (going towards SFPP's tank farm) are non-carrier assets, in addition to three other lines that extend to the south of the gasoline manifold ("298 8-inch A, 297 8-inch A, and 296 8-inch A"). A. 12-01-015 Transcript, Volume 5, page 740, line 17, through page 742, line 14. On Attachment No. 2, we have indicated in green those lines we understand to be gasoline delivery lines.
[177] Prepared Rebuttal Testimony of Robert E. Hinchee, page 48, lines 4-9.

In his cross-examination, Dr. Hinchee testified: "I can't tell you which line or which seal leaked or how many, no."[178]

In his Rebuttal Testimony, Mr. Hanak acknowledged Dr. Hinchee's statement that it is impossible to identify with precision what percentage of the contamination is attributable to releases on SFPP's carrier assets.[179] During his cross-examination, Mr. Hanak also stated that no specific source was identified at Mission Valley as the source of the leak:

> Q. […] When you concluded that a hundred percent of all remediation costs to remove the contamination resulting at the Mission Valley site should be attributed to SFPP, which particular facilities in the manifold area did you regard as the source of the leak?
>
> A. No specific source was identified in my review of the release records for the Mission Valley Terminal.[180]

Moreover, the reports Mr. Hanak relied upon in his written testimony do not identify any of the specific assets in the "manifold area" as responsible for the releases that led to the Mission Valley contamination plume. In fact, Mr. Hanak was not even aware of all the specific assets in the manifold, including a number of delivery pipes which have since been identified as non-carrier: "I don't believe that I was aware of all the pipes at the time I made my original testimony."[181] Indeed, Mr. Hanak never even attempted to identify any specific asset as the source:

> Q. Am I correct in understanding your testimony as being - - as stating that you did not identify any particular facility in the manifold area as the source of the leak but believe that the manifold area contained only carrier property?

[178] Robert E. Hinchee, A.12-01-015 Transcript, Volume 3, page 439, lines 14-15.
[179] *See* Prepared Rebuttal Testimony of Michael A. Hanak, page 19.
[180] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 567.
[181] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 569, lines 9-11.

A. That's correct.[182]

Mr. Hanak's understanding is entirely incorrect. During the evidentiary hearing, SFPP witnesses Hanak, Hinchee, and Dito were first asked to identify the "manifold area." Dr. Hinchee was asked to label the manifold area, as he understood it, on Phillips 66 Exhibit 5.[183] That same Phillips 66 Exhibit 5 was later given to Mr. Hanak, who was also asked to identify the "manifold area."[184] That same Exhibit was then given to Mr. Dito, who was also asked to mark his understanding of the "manifold area." Mr. Dito marked his view of the manifold area in red.[185] The marked up Phillips 66 Exhibit 5, with all three SFPP witnesses' interpretations of the manifold area, was later submitted into the Record as Phillips 66 Exhibit 5-A.

The manifold area as drawn and identified by SFPP witnesses Hanak, Hinchee and Dito clearly contains a mixture of carrier and substantial non-carrier assets. These non-carrier assets consist of a maze of pipes that extend from the SFPP manifold valve to non-carrier proprietary pipes. As Mr. Dito noted in his Rebuttal Testimony:

> At each delivery point on SFPP's mainline system, there is a manifold valve that controls deliveries of product. […] For all of SFPP's facilities, the manifold valve serves as the dividing point between SFPP's carrier and non-carrier operations (and thus the dividing point between its assets). In other words, all assets upstream

[182] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, pages 569-570.
[183] Counsel for Phillips 66 asked Dr. Hinchee to draw the area Dr. Hinchee referred to when he said the primary release was in the manifold area. *See* the exchange between Ms. Luemers and Dr. Hinchee, A.12-01-015 Transcript, Volume 3, pages 431-432.
[184] See the exchange between Ms. Luemers and Mr. Hanak, A.12-01-015 Transcript, Volume 4, pages 651-652.
[185] Martha Luemers, A.12-01-015 Transcript, Volume 5, page 719, line 18 to page 720, line 8.

> of and including the manifold valve are considered to be carrier assets and all assets downstream of the manifold valve are considered to be non-carrier assets.[186]

During cross-examination Mr. Dito was asked to identify these manifold valves on Phillips 66 Exhibit 10. That exhibit is an enlarged version of a portion of Tesoro Exhibit 23 depicting the manifold assets. This enlarged version shows a maze of valves, delivery pipes, and other fixtures, and Mr. Dito was asked to mark the diesel and gasoline manifold valves that he had previously discussed as the dividing line between carrier and non-carrier assets.[187] Mr. Dito's markup of Phillips 66 Exhibit 10 was entered into the Record as Phillips 66 Exhibit 10-A.

On the basis of Mr. Dito's markup, Tesoro has created a version of Phillips 66 Exhibit 10, and has attached it to this Opening Brief as Attachment No. 2. It also appears on page 25 of this Opening Brief. Tesoro Attachment No. 2 shows the non-carrier portions of the gasoline delivery lines in the manifold area marked in green. As Attachment No. 2 indicates, a substantial number of non-carrier delivery lines extend from the manifold valves to the tank farm. There are also several outbound delivery pipes extending through the manifold area. Mr. Dito had identified these delivery pipes as well as non-carrier.[188] The "manifold area" is therefore not, as Mr. Hanak believed, a single carrier asset. Rather, it consists of a mixture of carrier and non-carrier assets. It is equally plausible, based on the Record established by SFPP witnesses Hank and Hinchee, that a

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[186] Prepared Rebuttal Testimony of Peter M. Dito, page 3. Mr. Dito also acknowledged that some sites consisted of carrier breakout tanks connected to the manifold by carrier piping, but this was not the case at the Mission Valley site. *See* Prepared Rebuttal Testimony of Peter M. Dito, page 4.
[187] Martha Luemers, A.12-01-015 Transcript, Volume 5, page 711, line 28 to page 712, line 4; Peter M. Dito, A.12-01-015 Transcript, Volume 5, page 714, 16-19.
[188] Peter M. Dito, A.12-01-015 Transcript, Volume 5, page 731, line 19.

non-carrier asset in the manifold area, rather than a carrier one, was the source of releases that led to the contamination plume being remediated at Mission Valley.

[redacted][189] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted][190] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted] **[CONFIDENTIAL INFORMATION REDACTED]** While Mr. Hanak denied that the reports he reviewed and attached to his testimony identified any contamination from leaking storage tanks,[191] [redacted][192] **[CONFIDENTIAL INFORMATION REDACTED]**

One other point should be discussed. Even though both Dr. Hinchee and Mr. Hanak state that they cannot identify the specific asset at Mission Valley that caused the contamination SFPP has been remediating, SFPP nonetheless assigned 65% of the

[189] Tesoro Exhibit 18 (Confidential), page 5.
[190] Tesoro Exhibit 18 (Confidential), [redacted], page 9. **[CONFIDENTIAL INFORMATION REDACTED]**
[191] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 569, lines 18-23.
[192] Tesoro Exhibit 18 (Confidential), [redacted], note 19. **[CONFIDENTIAL INFORMATION REDACTED]**

Mission Valley environmental remediation expenses to the carrier category. Mr. Hanak attempts to explain this allocation in his Rebuttal Testimony:

> […] based on his expert knowledge and unique and in-depth knowledge of the Mission Valley site, Dr. Hinchee testifies that it is reasonable to estimate that gasoline released from SFPP's assets in the Mission Valley Terminal manifold area contributed to at least 65 percent of the contamination that SFPP is currently working to remediate at this site. Therefore, I now believe that 65 percent of SFPP's environmental remediation expenses at the Mission Valley Terminal should be attributable to SFPP's manifold assets, which I understand from Mr. Dito are carrier assets.[193]

This allocation is as arbitrary as Mr. Hanak's previous 100% allocation. Although we will discuss the Powerine releases more extensively in the next section of this Brief, the fact of the matter is that neither Mr. Hanak nor Dr. Hinchee have any idea which specific asset at the Mission Valley site was responsible for releases.

The Record, therefore, strongly indicates that SFPP has not established with clear and convincing evidence that leaks at Mission Valley site occurred on CPUC jurisdictional assets. SFPP's witnesses frankly admit that they simply cannot identify the specific carrier or non-carrier assets involved and it is equally plausible on the basis of the evidence in the Record that all of the leaks occurred on non-CPUC jurisdictional property.

2. Powerine Releases and SFPP's Revision to Its Allocation of Remediation Costs

As discussed above, SFPP revised its carrier allocation for the Mission Valley site only after Tesoro submitted testimony that indicated that releases of contamination had occurred at assets owned by Powerine. Evidently, Mr. Hanak was unaware at the time of his Direct Testimony of the Powerine release, Judge Altman's decision or Dr. Jackson's

[193] *See* Prepared Rebuttal Testimony of Michael A. Hanak, pages 19-20.

opinion.[194] In his subsequent Rebuttal Testimony, Mr. Hanak deferred to Dr. Hinchee and revised the carrier allocation of Mission Valley remediation expenses to 65%. But, just as there was no basis for Mr. Hanak's 100% allocation, there is equally no basis for assigning 65% of remediation costs at Mission Valley to the shippers on the SFPP pipeline.

Dr. Hinchee's 65% allocation was based on his examination of documents involving Powerine. During the 1990's Powerine owned tanks on the Mission Valley site as well as delivery lines from the manifold valve to those tanks. Powerine also owned facilities for discharging gasoline from those tanks.[195] Dr. Hinchee stated that he was aware that testing for petroleum contamination had been conducted at the manifold area at the approximate time period in which the Regional Water Quality Control Board, San Diego issued its 1992 Cleanup and Abatement Order and that he was aware of the claim that two holes had been discovered in a Powerine pipe near the manifold area.[196] Based on the evidence involving discharges by Powerine, Dr. Hinchee was asked in his Rebuttal Testimony to state the percentage of the current contamination that he believed came from Powerine assets. In response, Dr. Hinchee stated that: "It would be reasonable to estimate that gasoline released from Powerine's pipeline contributed up to 30 percent of the contamination that SFPP is currently working to remediate at this site."[197]

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[194] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 604, lines 5-8.
[195] *See* Prepared Rebuttal Testimony of Peter M. Dito, page 7. [redacted] *See* Tesoro Exhibit 18 (Confidential), page 1; [redacted], note 24. **[CONFIDENTIAL INFORMATION REDACTED]**
[196] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 48.
[197] Prepared Rebuttal Testimony of Robert E. Hinchee, page 48.

When asked to assess the percentage of remediation costs that should be attributed in the current proceeding to SFPP as opposed to non-carrier assets, Dr. Hinchee then stated: "I think it would be reasonable to estimate that gasoline released from SFPP's assets in the MVT manifold area contributed to at least 65 percent of the contamination that SFPP is currently working to remediate at this site."[198] Dr. Hinchee explained the underlying basis of his estimate in the following manner:

> I began the calculation of my estimate by looking at the fact that SFPP accepted responsibility for at least 50 percent of the contamination in the 1993 Letter. As I mentioned earlier, SFPP proposed to accept this amount of responsibility with full knowledge of the two holes in the Powerine pipeline. This indicates to me that SFPP believed it was a significant contributor to the contamination at the site. I then factored in (1) the fact that Shell was found to not be liable for any of the contamination in the arbitration proceeding, and (2) the fact that I believe Powerine's responsibility should be lowered based on the fact it was not shipping MTBE in the years during which the holes on its pipeline were discovered. These additional factors led me to determine that it would be reasonable to assume that at least 65 percent of the responsibility for the current remediation at the MVT resides with SFPP.[199]

There is little to no basis in the Record for Dr. Hinchee's 65% allocation. At best, the Record in this proceeding contains conflicting evidence as to both the amount of contamination that Powerine released and whether that contamination contained MTBE. Whether the Powerine gasoline releases contained MTBE is an important factor, since Dr. Hinchee largely based his opinion that the Powerine release was not the principal source of the contamination at Mission Valley by citing evidence that the Powerine line did not ship MTBE in the period of time in which holes in the pipeline were discovered.[200] The only evidence on which Dr. Hinchee relied to reach this conclusion was gasoline volume

[198] Prepared Rebuttal Testimony of Robert E. Hinchee, page 51.
[199] Prepared Rebuttal Testimony of Robert E. Hinchee, page 51 (internal footnotes omitted).
[200] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, pages 50.

data that Mr. Dito had provided in his Rebuttal Testimony for the product that flowed through the Powerine pipeline from 1990 to 1992.[201] According to Mr. Dito, none of the products received by Powerine in this period contained MTBE.[202] Yet, Mr. Dito states no basis for his conclusion other than to refer to an attachment that does not address the MTBE issue.[203]

[redacted][204] **[CONFIDENTIAL INFORMATION REDACTED]**

[redacted]

[201] *See* Prepared Rebuttal Testimony of Peter M. Dito, page 8; Attachment BBB to the Prepared Rebuttal Testimony of Peter M. Dito.
[202] *See* Prepared Rebuttal Testimony of Peter M. Dito, page 8.
[203] *See* Prepared Rebuttal Testimony of Peter M. Dito, page 8; Attachment BBB to the Prepared Rebuttal Testimony of Peter M. Dito.
[204] *See* Tesoro Exhibit 18 (Confidential), page 16; [redacted] Tesoro Exhibit 18 (Confidential), [redacted], pages 9-10. **[CONFIDENTIAL INFORMATION REDACTED]**

[redacted][205] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted]

[redacted][206] **[CONFIDENTIAL INFORMATION REDACTED]**

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[redacted][208] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted]

[205] Tesoro Exhibit 18 (Confidential), [redacted], pages 9-10.
[206] Tesoro Exhibit 18 (Confidential), [redacted], page 10.
[207] Tesoro Exhibit 18 (Confidential), [redacted], page 10.
[208] Tesoro Exhibit 18 (Confidential), page 17.

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[redacted] **[CONFIDENTIAL INFORMATION REDACTED]**

Tesoro too made efforts to obtain these inventory records through discovery, by seeking the documents submitted by the parties in the 2003 arbitration proceeding. Tesoro Data Request No. 91 stated:

> Your attention is directed to page 2 of a letter dated May 23, 2008 from Michael J. Aguirre, City Attorney to the Mayor and City Council of San Diego. A copy of that letter is attached to these Data Requests as Attachment A. The letter states:
>
> > In 2000, Kinder Morgan filed a lawsuit against various parties including Equilon Enterprises LLC doing business as Shell Oil Products US [Shell], contesting responsibility for the discharge to the Site. Eventually, this dispute was arbitrated before retired Los Angeles Superior Court Judge Robert Altman. In 2003, Judge Altman issued his opinion concluding that Kinder Morgan was the sole cause of the "core" gasoline plume, which extends beneath Qualcomm Stadium in the direction of the San Diego River. The arbitration opinion was confirmed by the Superior Court and became final in late 2003.
>
> Please produce the following:
>
> a. A copy of Judge Altman's opinion;
> b. A copy of the decision issued by the Superior Court confirming Judge Altman's decision; and
> c. The documents filed by the parties before Judge Altman in the arbitration.[209]

SFPP at first refused to provide any information regarding the proceeding before Judge Altman, claiming that it would be unduly burdensome, would require the

[209] Tesoro Data Request 91, dated December 17, 2012 (Internal footnotes removed). This data request was quoted and discussed in detail in the Motion of Tesoro Refining and Marketing Company to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013.

production of a "vast amount of documents," and was already in the public record.[210] SFPP later agreed to provide only a copy of Judge Altman's decision, a copy of the proceeding before the Superior Court confirming Judge Altman's decision, and a docket sheet listing the documents that SFPP had submitted as exhibits during the proceeding. SFPP maintained that a Protective Order precluded SFPP from producing any third-party documents.[211]

However, that claim has a very hollow ring. [redacted], [212] [redacted] **[CONFIDENTIAL INFORMATION REDACTED]** SFPP could also have made reasonable efforts to obtain the consent of the other parties to produce all of the information Tesoro requested. [redacted]

[210] On January 15, 2013, SFPP responded: "SFPP objects to this request to the extent it seeks information that is publicly available or readily available to Tesoro from other sources other than SFPP with a reasonable expenditure of effort on the part of Tesoro given its position and resources. SFPP further objects to subpart (c) of this request as overly broad and unduly burdensome to the extent it seeks documents filed by parties other than SFPP or any other Kinder Morgan entity and to the extent it seeks all "documents" filed in the arbitration proceeding. If interpreted literally, this request could require the search and production of a vast amount of documents, a process which SFPP estimates, based on its preliminary analysis, could take a significant amount of time to complete, such that an extension of the remaining deadlines in the procedural schedule for this proceeding could be required; SFPP submits that a burden of this magnitude may not only be cost-prohibitive, but may also not be able to be achieved before reply or rebuttal testimony is due in this proceeding." *See* Motion of Tesoro Refining and Marketing Company to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013, footnote 34.

[211] *See* Motion of Tesoro Refining and Marketing Company to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013, page 20.

[212] Tesoro Exhibit 18 (Confidential), page 2.

[redacted]

[CONFIDENTIAL INFORMATION REDACTED] We respectfully suggest that SFPP's refusal to produce this information should be regarded as a factor leading to the conclusion that SFPP has failed to sustain its burden of proof with respect to the cause of the contamination that it is now remediating at the Mission Valley site.

In any event, the evidence in the Record regarding MTBE releases from Powerine facilities during the period 1990 to 1992 is contradictory and incomplete. Neither SFPP nor Tesoro can demonstrate definitively that the Powerine gasoline supply and pipeline did or did not contain MTBE in the 1990 to 1992 period. [redacted]

[redacted] **[CONFIDENTIAL INFORMATION REDACTED]** Since the burden of proof that SFPP must meet is very high, we respectfully suggest that the SFPP evidence does not establish in a "clear and convincing" manner that the Powerine releases accounted for only 30% of the total releases at the Mission Valley site. This conclusion by SFPP witnesses is both arbitrary and speculative. Equally arbitrary and speculative is Dr. Hinchee's decision not to attribute the remaining 5% of responsibility for environmental pollution to any party.[213] Simply plucking numbers from the air does not

[213] The cost sharing percentages that Mr. Hinchee relied upon in his Rebuttal Testimony had the percentages as follows: SFPP at 50%; Powerine at 40%; Shell at 5%; and Mobil at 5%. While Dr. Hinchee lowers the percentage of Powerine to 35% and raises SFPP's

constituted reasoned analysis. There is, in short, no reasoned basis for allocating either 65% or any other percentage to leaks from the SFPP jurisdictional assets.

The Powerine issue also raises serious questions about the legitimacy of Mr. Hanak's entire methodology and carrier versus non-carrier determinations. When he formulated his Direct Testimony, Mr. Hanak failed to consider a release at the Mission Valley site that was evidently well documented and that was also a major discussion point in the arbitration proceeding. The fact that SFPP revised its carrier allocation by 35% reveals just how significant a release SFPP considers it to be. If Mr. Hanak did not discover such a significant release through the documented release history and the other materials he reviewed—but Mr. Ashton could—then Mr. Hanak's underlying methodology would appear to be highly flawed. Tesoro believes that this episode points to the overarching issue of the absence in the Record of a clear portrayal of what occurred at the Mission Valley site, before, during and after the releases were detected. The necessity to establish exactly what happened at Mission Valley and how the contamination that is now being remediating occurred is of course an inherent part of SFPP's burden of proof.

3. Absence of Evidence of SFPP's Prudent Action and Operation of the Mission Valley Terminal

SFPP has also failed to provide a cogent explanation of the steps it took to mitigate and prevent releases from occurring at the Mission Valley site. Both Dr. Hinchee and Mr.

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responsibility to 65% because Shell was not found liable and SFPP was the largest operator at the Mission Valley site. *See* Prepared Rebuttal Testimony of Robert E. Hinchee, pages 49-51. During the evidentiary hearing, Dr. Hinchee stated he had no opinion regarding the remaining 5% and that he did not give any consideration when moving percentages around to moving them to Mobil. See the exchange between Ms. Luemers and Dr. Hinchee, A.12-01-015 Transcript, Volume 3, page 445.

Hanak provided evidence of the general processes taken in response to a release, and provided evidence of the evolving remediation system in place at the Mission Valley site. However, SFPP failed to introduce this same level of evidence with respect to the *specific* steps it took or the procedures it implemented to prevent releases from occurring in the first place at the Mission Valley site in the 1980's and 1990's. In fact, the only evidence in the Record appears to indicate that SFPP did not act with prudence in that period.

For example, Dr. Hinchee's Rebuttal Testimony creates considerable doubt that SFPP acted with prudence in the late 1980's and the early 1990's, when releases are believed to have occurred at the Mission Valley site. Dr. Hinchee testified that in order to properly assess the remediation actions of SFPP at the Mission Valley site, we need to understand the "standard industry remediation practices, including what those practices were prior to SFPP beginning remediation actions at the MVT site, what those practices were when SFPP began remediation action, and how those practices have evolved throughout SFPP's work at MVT…."[214]

Tesoro would agree. We would also agree with Dr. Hinchee's subsequent statements that strongly imply that SFPP did not take proactive steps to prevent leaks at the Mission Valley terminal. For instance, when Dr. Hinchee indicated that he could not pinpoint the exact source of the release, he noted that, "Over the years there have been many releases at the MVT, some reported and undoubtedly some not reported, particularly in the early years of operations of the MVT."[215] Dr. Hinchee went on to say that:

> Multiple releases have occurred at the MVT. It is not clear when the first release occurred at the MVT. We know there was contamination present at the site as early as the late 1980's, but in all likelihood, some releases had occurred prior to

[214] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 3.
[215] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 48.

> that time. As I explain in more detail below, we do not know the early history of the releases at the MVT because the terminal and pipeline industry itself, as well as the regulators of this industry, only because aware of the environmental issues associated with terminal land fuel transport and storage facilities in the mid-1980's. These releases at the MVT have resulted in one main source of the contamination at the site—a plume of gasoline that extended from SFPP's manifold area in a southwest direction across Friars Road, towards the City's Qualcomm Stadium.[216]

Dr. Hinchee continued by describing SFPP's indifference to the possibility of MTBE contamination during this period:

> […] When MTBE was first encountered in groundwater, it was believed to be of little environmental concern by both regulators and the industry. It was not until the late 1990s that the significance of MTBE began to be understood and the use of MTBE began to be regulated.[217]

Dr. Hinchee further stated that:

> […] The primary reasons for this systemic contamination is that many terminals, like the MVT, were constructed before the 1980s at a time when the environmental consequences of releases were not understood, and so releases would occur but no effective remediation actions would be taken. […] However, even after the environmental consequences of releases began to be recognized, releases decreased but continued in the normal course of business, further contributing to the existing contamination of those sites.[218]

Taken at face value, this testimony implies that SFPP did not take actual measures in the 1980's and 1990's to mitigate and prevent potential leaks and spills at the Mission Valley site because SFPP did not believe that those measures were necessary. Since the Record clearly establishes that the leaks which led to the current SFPP remediation activities occurred principally in the 1980's and 1990's, Dr. Hinchee's testimony, standing alone, would appear to indicate that SFPP did not act with prudence in attempting to mitigate and prevent leaks from occurring at the Mission Valley terminal.

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[216] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 6.
[217] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 7.
[218] *See* Prepared Rebuttal Testimony of Robert E. Hinchee, page 9.

SFPP will undoubtedly claim that we have distorted Dr. Hinchee's testimony since the thrust of Dr. Hinchee's comments were directed towards the entire pipeline industry's attitude towards environmental contamination. SFPP will doubtlessly further argue that prudence is a relative concept and must be determined with respect to industry standards. We disagree with that conclusion in the specific context of this case. The issue presented to the Commission in this case is whether SFPP or the shippers on its pipeline should bear the costs of remediating environmental pollution that occurred at the Mission Valley site. It might well be that neither SFPP nor the other members of the oil pipeline industry were aware of or took steps to mitigate and prevent leaks from terminal sites. However, their failure to do so should not shift the cost of remediation onto shippers. It is in this context that the issue of prudence should, we respectfully suggest, be decided.

[redacted][219] **[CONFIDENTIAL INFORMATION REDACTED]**

With respect to the separate issue of whether SFPP conducted remediation efforts prudently at the Mission Valley once it had discovered the release of petroleum contamination, the Record is contradictory. Dr. Hinchee testified at length regarding the steps that SFPP took to remediate the Mission Valley site and concluded that they were

[219] Tesoro Exhibit 18 (Confidential), page 6.

prudent and effective. Tesoro does not dispute Dr. Hinchee's considerable expertise and experience with respect to environmental remediation.

[redacted][220] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted][221] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted][222] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted] **[CONFIDENTIAL INFORMATION REDACTED]**

C. Other Mixed Asset Sites

SFPP has also failed to meet its burden of proof with respect to the other Mixed Asset Sites. As Mr. Hanak discusses in his Direct Testimony, he decided the amount of remediation expenses that he allocated to carrier and non-carrier accounts by reviewing the documented release history of each site.[223]

However, other than for brief references to Mission Valley and Colton, Mr. Hanak did not provide any evidence in his Direct Testimony regarding releases at the Mixed

[220] Tesoro Exhibit 18 (Confidential), page 7.
[221] Tesoro Exhibit 18 (Confidential), page 7.
[222] Tesoro Exhibit 18 (Confidential), page 7.
[223] *See* Prepared Direct Testimony of Michael A. Hanak, page 18.

Asset Sites. Mr. Hanak confirmed the accuracy of this observation at the evidentiary hearing.[224] Mr. Hanak also acknowledged in cross-examination that he did not identify in his Direct Testimony any of the specific assets that had caused the leaks at these Mixed Asset sites.

It was only during cross-examination at the evidentiary hearing that Mr. Hanak clarified the process through which he determined the allocation of remediation costs at the Mixed Asset sites between carrier and non-carrier. Mr. Hanak stated that he had reviewed the release history documents, including what is now Tesoro Exhibits Nos. 27, 28, and 29 in formulating his Direct Testimony.[225] In discussing how he used these documents, the discussion focused on the Chico site.

With respect to Chico, Tesoro Exhibit Nos. 27, 28, and 29 included 100 release incidents, 93 of which Mr. Hanak claimed were irrelevant in determining an allocation between the carrier and non-carrier accounts.[226] Of the seven events listed on Attachment JJJ of Mr. Hanak's Rebuttal Testimony, which he did regard as relevant, several of the release references were missing important information:

> Q. You have total volume released: Unknown; total volume recovered: Unknown. How do you know, if you don't know the volumes released or the volumes recovered, that that release related to the remediation effort?
>
> A. Well, I don't, and that's exactly why I included them.[227]

Mr. Hanak further testified that he included these releases as relevant in determining a carrier/non-carrier allocation at the Chico site because there was no way of determining

[224] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 585, line 18.
[225] Melvin Goldstein, A.12-01-015 Transcript, Volume 4, page 624, line 26 to page 625, line 2.
[226] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 625, line 12.
[227] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 627, line 22 to page 628, line 1.

from the information he examined whether these incidents did in fact contribute to remediation efforts: "I erred on the side of caution and I assumed that it did because there was no information about the release volume."[228]

This information substantially undercuts the validity of Mr. Hanak's underlying methodology in allocating remediation expenses at the Mixed Asset sites. Apparently Mr. Hanak regarded releases at these sites as relevant in determining an allocation, even though he lacked important information regarding the nature and volumes of those releases. That methodology is, we respectfully suggest, unreasonable and leads to the conclusion that SFPP has failed to meet its burden of proof in demonstrating that the releases at any of the Mixed Assets were attributed to carrier assets.

A further issue with respect to the Mixed Asset sites in general is prudency. Tesoro is not aware of any information in the Record regarding the specific measures that SFPP took to ensure that its facilities at any of the Mixed Asset Sites, were conducted in a prudent and reasonable manner. During the evidentiary hearing, Mr. Hanak was asked whether there was any evidence submitted in his Direct Testimony regarding the measures SFPP took at the 24 sites in California to prevent leaks:

> Q. […] And my question is I understand that you have discussed this general methodology in your testimony. And what I'm asking you is apart from that general methodology, do you discuss the measures that SFPP took at each of the sites that are listed in your Attachment A to ensure that leaks did not occur from SFPP assets?
>
> A. I think specific to that question I didn't address that in this part of my testimony, no.[229]

[228] Michael A. Hanak, A.12-01-015 Transcript Volume 4, page 628, lines 5-7.
[229] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 590, lines 3-13.

In fact, in focusing in on the Colton site during a later discussion, Mr. Hanak could not even identify the specific steps taken to prevent leaks from the breakout tank involved in a 96,000 gallon spill that SFPP claims is the source of the contamination being remediated:

> Q. What specific measures did SFPP take, to your knowledge, in the 1990 to 1992 period to ensure the integrity of that tank?
>
> A. I don't know the answer to that question because it was prior to my involvement.[230]

Mr. Hanak reiterated this point later on:

> Q. And you don't know what standard of care was applied specifically to ensure that the tank would not leak?
>
> A. As I testified earlier, I don't know what was done in that early timeframe when I was not involved.[231]

On this basis alone, SFPP has failed to meet its burden of proof in this proceeding to establish that it acted prudently at any of the Mixed Asset Sites to prevent leaks from occurring in the first place.

We now proceed to discuss certain specific Mixed Asset Sites.

Colton

On the basis of the release history of Colton, which is included in Attachment JJJ of his Rebuttal Testimony, Mr. Hanak attributed 100% of remediation expenses to the carrier account. Mr. Hanak based that conclusion on just two incidents listed for Colton in Attachment JJJ.[232] [redacted]

[230] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 639.
[231] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 647.
[232] *See* Prepared Rebuttal Testimony of Michael A. Hanak, page 15-16.

[redacted]

[redacted][233] **[CONFIDENTIAL INFORMATION REDACTED]** [redacted]

[redacted]

[redacted][234] **[CONFIDENTIAL INFORMATION REDACTED]**

At the evidentiary hearing, Mr. Hanak noted, "there's one particular release that's driving the MTBE. It's a similar situation to Mission Valley where it's a large MTBE plume. So there's one particular release that's driving the remediation, this documented release on a carrier tank according to Mr. Dito."[235] Mr. Hanak later stated during the hearing that Mr. Dito specified which asset at Colton caused the leak:

> Based on me asking the question about what in the tank that was the largest release identified out there was the one that would be contributing to environmental remediation today, that Tank C 18 was the carrier that -- and then other discussions about, I think there was another leak in the manifold area, plus review of the distribution of the contamination at the site.[236]

[redacted]

[redacted]

[redacted]:

1) [redacted]

[redacted]

[redacted][237]

[CONFIDENTIAL INFORMATION REDACTED]

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[233] *See* Attachment JJJ (Confidential) Prepared Rebuttal Testimony of Michael A. Hanak, page 1.
[234] *See* Attachment JJJ (Confidential) of Prepared Rebuttal Testimony of Michael A. Hanak, page 1.
[235] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 576, lines 13-20.
[236] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 578, line 28 to page 579, line 9.
[237] Tesoro Exhibit 29 (Confidential), page 1.

2) [redacted][238]

[CONFIDENTIAL INFORMATION REDACTED]

3) [redacted][239]

[CONFIDENTIAL INFORMATION REDACTED]

4) [redacted][240]

[CONFIDENTIAL INFORMATION REDACTED] [redacted] **[CONFIDENTIAL INFORMATION REDACTED]**

5) [redacted][241]

[CONFIDENTIAL INFORMATION REDACTED] [redacted]

[238] Tesoro Exhibit 29 (Confidential), page 1.
[239] Tesoro Exhibit 29 (Confidential), page 1.
[240] Tesoro Exhibit 29 (Confidential), page 2.
[241] Tesoro Exhibit 29 (Confidential), page 2.

[redacted] **[CONFIDENTIAL INFORMATION REDACTED]**

6) [redacted][242] **[CONFIDENTIAL INFORMATION REDACTED]**

We expect that SFPP will state that there is insufficient information in the release history of these six incidents to determine whether they are relevant to the contamination that SFPP is now remediating or whether they occurred on carrier or non-carrier property. But, the information regarding one of the incidents that led Mr. Hanak to allocate 100% of environmental costs to the carrier account is of the very same quality.

The incomplete and conflicting Record regarding the releases at Colton that caused the leaks that SFPP is remediating, we believe, means that SFPP has failed to satisfy its burden of proving that leaks on CPUC jurisdictional property at the Colton site, resulted in the remediation costs that SFPP is asking shippers to pay.

SFPP's evidence regarding its prudency at the Colton Site similarly fails to satisfy its burden of proof.

We have already pointed out that SFPP has not submitted any evidence regarding the specific steps it took to prevent leaks from occurring at Colton in the first place. We also previously pointed out that during the evidentiary hearing, Mr. Hanak stated that he

[242] Tesoro Exhibit 29 (Confidential), page 3.

did not know the specific procedures implemented to ensure that the C-17 breakout tank did not leak.[243]

The other portion of a prudency analysis involves the effectiveness of SFPP's remediation efforts after a leak had occurred. In his Supplement Reply Testimony, Mr. Ashton pointed out that two significant releases had occurred at the Colton site. One of the releases, according to Cleanup and Abatement Order 88-114, occurred on December 10, 1987, when Unocal Corporation reported that because of operational errors, 22,000 gallons of unleaded gasoline overflowed from an aboveground storage tank.[244] The other release that Mr. Ashton discussed was a gasoline spill of 292 barrels on October 13, 1979 in the breakout tank area.[245] In conjunction with this spill, the Levine-Fricke report titled "Summary of Previous Investigations and Identification of Potential Petroleum Hydrocarbon Release Source Areas SFPP Colton Terminal Railto/Bloomington, California, stated that: "An investigation of the breakout tank area was not performed until after a 63,000-gallon spill occurred on December 22, 1992."[246] Mr. Ashton questioned why such an investigation of the 1979 leak never took place, and believed that it raised questions about the prudency and effectiveness of SFPP's remediation efforts at Colton.[247]

In response, Dr. Hinchee stated:

> […] In the 1970's, the industry was unaware of the environmental risks of fuel releases and regulators showed little interest. In fact, SFPP's recovery of 4,000 gallons shows a higher degree of reasonable management action than I have seen in response to most releases in that era. SFPP's decision not to address the release until the subsequent and much larger 1992 event was typical of industry practice at

[243] See the exchanges between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, pages 639, 647.
[244] Exhibit V to Prepared Supplemental Reply Testimony of Peter K. Ashton, page 3.
[245] Exhibit U to Prepared Supplemental Reply Testimony of Peter K. Ashton, page 19.
[246] Exhibit U to the Supplemental Reply Testimony of Peter K. Ashton, page 19.
[247] *See* Prepared Supplemental Reply Testimony of Peter K. Ashton, page 63.

> the time, as 1979 was in the early days of the industry's understanding of the behavior of released fuel. In my opinion, SFPP's choice to delay investigation of the 1979 release until 1992 is in line with what industry practices were at the time and in no way implies that SFPP was acting unreasonably.[248]

Dr. Hinchee's statements hardly demonstrate the prudency of SFPP's remediation efforts at Colton. To the contrary, they demonstrate that SFPP was aware of a significant spill, but decided to not investigate it. Equally telling, neither Dr. Hinchee's testimony nor any other evidence SFPP introduced in the Record indicates that SFPP made any changes to its monitoring of the breakout tank area for releases or potential releases prior to 1992, even though there had been leaks from that area in the past. SFPP has plainly failed to meet its burden of proof with regard the prudency of its measures to prevent and remediate spills at Colton.

Rocklin

Mr. Hanak identified eight releases in Attachment JJJ of his Rebuttal Testimony that he claimed were relevant to the remediation currently being undertaken at the Rocklin site. SFPP has allocated 100% of the cost of these remediation efforts to the carrier account.[249]

According to Mr. Hanak, Mr. Dito provided him with information that showed that seven of the eight releases occurred on carrier assets.[250] In order to make a determination regarding this last release, Mr. Hanak stated:

> […] I looked to other sources of information to determine what caused the release. I was able to conclude based on the most recent groundwater monitoring report for the Rocklin Station site that was filed with California Regional Water Quality Control Board on January 20, 2013 (Attachment QQQ), that no contamination was emanating from the only non-carrier asset at this site. I was able to conclude,

[248] Prepared Rebuttal Testimony of Robert E. Hinchee, page 54.
[249] Prepared Rebuttal Testimony of Michael A. Hanak, page 17.
[250] Prepared Rebuttal Testimony of Michael A. Hanak, page 17.

therefore, that the unidentified release could not have occurred on this non-carrier asset.[251]

However, the California Regional Board's report could not possibly have formed the basis of the determination regarding the Rocklin site in Mr. Hanak's Direct Testimony. That testimony was served on November 5, 2012. The California Report upon which Mr. Hanak claims to have relied upon was not filed until January 20, 2013. This time lapse illustrates further problems with Mr. Hanak's underlying methodology to determine the portion of SFPP's remediation costs that shippers should bear.

However, even if all of the releases at the Rocklin site did occur on carrier assets, SFPP has still failed to satisfy its burden of proof. There is no evidence in the Record of this proceeding regarding the specific steps that SFPP took at the Rocklin site to prevent leaks from occurring in the first place or the prudency and effectiveness of its remediation effort after leaks developed.

Brisbane

SFPP assigned 11.11% of remediation expenses at Brisbane to the carrier account.

According to Attachment JJJ, there are nine releases driving remediation at the Brisbane site. Eight of these incidents were eventually identified as non-carrier through release records or through a Remedial Action Plan submitted to the California Regional Water Quality Control Board on June 29, 2007. That information was included with Mr. Hanak's Rebuttal Testimony as Attachment KKK.[252] Mr. Hanak did identify another release at Brisbane as occurring at a manifold valve. Mr. Dito identified that property as a carrier asset. [redacted]

[251] Prepared Rebuttal Testimony of Michael A. Hanak, page 17.
[252] *See* Prepared Rebuttal Testimony of Michael A. Hanak, pages 12-13.

[CONFIDENTIAL INFORMATION REDACTED]

In deciding how to allocate expenses, Mr. Hanak stated:

> […] As was the case with the Bradshaw Terminal remediation site, I determined that no one specific release was driving the company's remediation efforts at this site more than the other releases. However, in comparison to the Bradshaw Terminal site, I could not base my allocation percentage for the Brisbane Terminal site on the amount of product that was released during the carrier release as compared to the non-carrier releases because the release records did not provide sufficient information to make that calculation. Therefore, I concluded it would be reasonable to allocate the environmental remediation expenses that the company incurred at this site between carrier and non-carrier assets based on the number of the releases that occurred at the site. This resulted in an allocation of 11.11 percent of the remediation expenses being allocated to carrier assets because only one of the nine releases that occurred at the site occurred on a carrier asset.[253]

However, even though Mr. Hanak only allocated 11.11% to the carrier account, that 11.11% allocation is defective. According to the 2007 Remedial Action Plan issued by LFR Inc. on behalf of KMEP on June 29, 2007, the July 2005 release appears to be somewhat insignificant. As the Remedial Action Plan stated:

> July 2005 Release: On July 22, 2005, a mixture of diesel and turbine NAPH was released from a valve within a trench during construction activities in the manifold area. Released fuel was primarily contained within the trench, and the majority of released fuel was recovered and placed into the trans-mix tank.[254]

Further describing the July 2005 release, the Remedial Action Plan also notes that: "Surface staining was excavated and disposed. Approximately 390 cubic yards of soil was subsequently excavated and disposed of as non-hazardous soil at the Forward Landfill."[255]

While SFPP may still be incurring remediation expenses at Brisbane, the Remedial Action Plan that Mr. Hanak had submitted into evidence strongly suggests that SFPP is no

[253] Prepared Rebuttal Testimony of Michael A. Hanak, page 13.
[254] *See* Attachment KKK of Prepared Rebuttal Testimony of Michael A. Hanak, page 9.
[255] *See* Attachment KKK of Prepared Rebuttal Testimony of Michael A. Hanak, page 21.

longer incurring costs for the particular release that led him to allocate 11.11% of remediation costs to the carrier account. The shippers should not be responsible for bearing any costs for remediation expenses at the Brisbane site.

Furthermore, the Remedial Action Plan does not discuss the reason why the valve release occurred and SFPP has not provided any evidence that it was operating this valve, or any other asset involved in any releases at the site, in a prudent and reasonable manner. In the absence of that evidence, SFPP has failed to meet its burden of proof for allocating any remediation expenses to its shippers at the Brisbane site.

Chico

SFPP has allocated 14.29% of remediation expenses at Chico to the carrier account.[256]

[redacted][257] **[CONFIDENTIAL INFORMATION REDACTED]**

Even though Mr. Hanak claims that he was very conservative in attributing releases to the carrier account when the release history indicates that important information is "unknown,"[258] there are at least two incidents listed in Tesoro Exhibit No.

[256] *See* Prepared Rebuttal Testimony of Michael A. Hanak, page 13-14.
[257] *See* Tesoro Exhibit No. 29 (Confidential). [redacted]
[CONFIDENTIAL INFORMATION REDACTED]
[258] See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 627, line 22 to page 628, line 1.

29 with product and release information given as unknown that were not taken into account by Mr. Hanak:

1) [redacted][259] **[CONFIDENTIAL INFORMATION REDACTED]**

2) [redacted][260] **[CONFIDENTIAL INFORMATION REDACTED]**

Mr. Hanak does not explain why he did not take these releases into account in his assignment of responsibility for remediation expenses.

As stated previously, Tesoro Exhibit No. 29 was produced by SFPP on April 15, 2013 and purports to be a document reviewed, relied upon or used by Mr. Hanak in putting together Attachment JJJ to his Rebuttal Testimony.[261] [redacted]

[259] Tesoro Exhibit No. 29 (Confidential), page 3.
[260] Tesoro Exhibit No. 29 (Confidential), page 7.
[261] SFPP produced in response to discovery the Bates labeled files SFPP 128055-SFPP12 128374; SFPP12 130920-SFPP12 130925; and SFPP12 130929. See the exchange between Mr. Goldstein and Mr. Hanak, A.12-01-015 Transcript, Volume 4, page 614.

[redacted][262] **[CONFIDENTIAL INFORMATION REDACTED]** It would seem that SFPP has never provided Tesoro with these additional release records, despite the fact that they were clearly requested in discovery.[263] Under these circumstances, Tesoro believes that SFPP's documented release history for Chico is patently defective and cannot be reasonably relied upon in determining an allocation of environmental remediation costs.

The records on which Mr. Hanak relied and the analysis he performed to establish a carrier/non-carrier allocation at Chico are defective for other reasons as well. Although Mr. Hanak testified that the release records he reviewed included an additional four sites,[264] only one of these releases allegedly occurred on carrier property. Mr. Hanak testified that he considered this release to be attributable to carrier property on the basis of the 2002 Revised Cleanup and Abatement Order, attached to his Rebuttal Testimony as Attachment LLL, and from discussions with Mr. Dito.[265] Attachment LLL, however, only states "The Discharger attributes releases to locations including, but not limited to, the manifold area and Tank #25 in the center of the tank farm."[266] No specific manifold asset

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[262] These incidents include the releases listed for Chico that occurred on September 24, 1987; 1990; December 1, 1998; and March 1, 2000.

[263] Tesoro issued data requests seeking all documents reviewed and relied upon by SFPP witnesses, including Mr. Hanak, in producing their direct testimony. Tesoro Data Request No. 47 stated:

> For each SFPP witness that submitted testimony in the above captioned proceeding, please provide a copy of all records, workpapers, data, and other materials relating to the subject matter of this proceeding that were reviewed and relied upon by each such witness and not otherwise produced.

See Tesoro's Motion to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013, pages 10, 17.

[264] Prepared Rebuttal Testimony of Michael A. Hanak, page 14.

[265] Prepared Rebuttal Testimony of Michael A. Hanak, page 14.

[266] *See* Attachment LLL of the Prepared Rebuttal Testimony of Michael A. Hanak, page 4.

is specified, and when asked if the Chico manifold includes delivery pipes, similar to the Mission Valley manifold, Mr. Hanak replied as follows during the hearing:

> I think it depends on the site. And for Chico, I don't know the answer to that. But I did confer with Mr. Dito and asked him if the manifold area there was carrier, and he said correct.[267]

When prompted, Mr. Hanak did acknowledge the fact that he did not know where the release had precisely occurred,[268] and went on to affirm that it was possible that the Chico release in the manifold area could have occurred on non-carrier pipes.[269]

In view of this Record, there is no basis for assigning any of the environmental remediation costs that SFPP has incurred at Chico to the shippers on its pipeline.

As with the other Mixed Asset Sites, SFPP also failed to provide any evidence that the assets involved in the releases at Chico were operated in a reasonable manner or that SFPP took any measures to mitigate the risk of releases at the site. In the absence of that evidence, SFPP has failed to meet its burden of proof in establishing that it was prudent at attempting to prevent leaks from occurring at the Chico terminal.

D. 100% Carrier Sites

As previously discussed in this Opening Brief, in his Direct Testimony, Mr. Hanak classified certain terminals as "100% carrier" and attributed all of SFPP's remediation expenses at these sites to the CPUC jurisdictional pipeline.[270] Mr. Hanak stated he did so because Mr. Dito had identified for him the sites that contained only carrier property. Mr. Hanak made no mention of any third party assets at these 100% carrier sites in his Direct Testimony.

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[267] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 631, lines 1-5.
[268] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 631, line 21.
[269] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 631, line 24.
[270] *See* Prepared Direct Testimony of Michael A. Hanak, page 18.

In response to Mr. Hanak's Direct Testimony, Tesoro witness Ashton pointed out in his Supplemental Reply Testimony that SFPP had failed to justify its position since it provided little to no evidence regarding these sites, with virtually no discussion of the third party assets that clearly did exist at those sites or the possibility that third party assets could have been involved in releases.[271] Mr. Ashton also pointed out that SFPP failed to provide any evidence that it acted prudently in operating these terminals or in subsequent remediation efforts.[272]

Thus, even though SFPP might well be incurring environmental remediation expenses at the Concord, Stockton, Oakland and Norwalk sites, which SFPP considers to be 100% carrier, SFPP is not entitled to recover those expenses since it has not shown with clear and convincing evidence that all of the leaks or spills at these sites came from CPUC jurisdictional assets or that it acted reasonably in operating its assets and took steps to prevent spills in the first place.

Concord

In his Supplemental Reply Testimony, Mr. Ashton noted that there appeared to be several third party facilities at the Concord site.[273] Mr. Ashton had discovered these facilities when reviewing a schematic of SFPP's pipeline operations at the site provided during discovery, and Mr. Ashton suggested that the existence of these facilities needed to be addressed by SFPP. If these third party facilities had been the source of releases on the Concord site, they might well have contributed to contamination plumes currently being remediated.

[271] *See* Prepared Supplemental Reply Testimony of Peter K. Ashton, pages 56-57, 65-68.
[272] *See* Prepared Supplemental Reply Testimony of Peter K. Ashton, page 67.
[273] *See* Prepared Supplemental Reply Testimony of Peter K. Ashton, page 65.

In response, Mr. Hanak contended in his Rebuttal Testimony that Mr. Ashton had not provided evidence that these locations had caused releases:

> […] First, Mr. Ashton has presented no evidence showing that third-party pipelines caused the contamination being remediated by SFPP at the Concord site; in fact, Mr. Ashton failed to even provide the names of the third-parties that he apparently believes could be responsible instead of SFPP. Second, California Regional Water Quality Board Cleanup and Abatement Order No. 92-082 requires SFPP, not these unnamed third party pipelines, to remediate impacts at Concord. SFPP has paid, and is continuing to pay, to remediate the Concord site. Therefore, SFPP should be entitled to recover its costs at this site.[274]

That testimony does not satisfy SFPP's burden of proof. If there are third party assets at the Concord terminal, as Mr. Hanak appears to concede in his Rebuttal Testimony, it is SFPP's responsibility to show where the leaks occurred in order to eliminate the possibility that they came from those third party assets. Mr. Hanak's Rebuttal Testimony does not do so and the burden of proof does not shift to Tesoro or Mr. Ashton. Moreover, SFPP has not provided any evidence of the specific procedures it undertook to prevent or mitigate the chance of releases occurring at Concord. In the absence of that evidence, SFPP has not met its burden of proof in this proceeding, and should not be able to recover the costs it claims for Concord.

Stockton

With respect to the Stockton Terminal, Mr. Ashton had also pointed to the fact that SFPP had not provided any evidence regarding environmental contamination at the site:

[274] Prepared Rebuttal Testimony of Michael A. Hanak, page 4.

[redacted][275]

[CONFIDENTIAL INFORMATION REDACTED]

In response, Mr. Hanak stated that, "[…] there was no need for the information Mr. Ashton alleges was not provided because SFPP only owns carrier assets at the Stockton site."[276] However, Mr. Hanak's position is entirely undercut by Attachment FFF to his Rebuttal Testimony. Mr. Hanak notes that this Attachment, "reflects the most recent groundwater monitoring report that has been submitted to the California Regional Water Quality Board concerning the Stockton remediation site."[277]

Attachment FFF to refers to at least one third party that has contributed to contamination at the Stockton site, NuStar Energy (NuStar). According to the Regional Board report, third-party releases may have occurred and may have been contributing to the contamination on site, in particular: "As acknowledged in the RWQCB letter dated June 20, 2011, petroleum concentrations in monitoring well SP/M-10 are likely attributable to off-site sources originating beneath the NuStar facility."[278] SFPP has not even addressed whether this NuStar contamination contributed to the contamination plume it is remediating.

Furthermore, as with other sites, SFPP has not provided any evidence that it operated the Stockton terminal facilities prudently so as to prevent leaks in the first place or has undertaken prudent and reasonable remediation efforts.

Oakland Airport

[275] Prepared Supplemental Reply Testimony of Peter K. Ashton, page 66.
[276] Prepared Rebuttal Testimony of Michael A. Hanak, page 6.
[277] Prepared Rebuttal Testimony of Michael A. Hanak, note 11.
[278] Attachment FFF to the Rebuttal Testimony of Michael A. Hanak, page 19 of 202.

Mr. Ashton also questioned SFPP's contention that all of the assets at the Oakland Airport Junction site belonged to the CPUC jurisdictional pipeline:

[redacted][279] **[CONFIDENTIAL INFORMATION REDACTED]**

As with the other carrier only sites, Mr. Hanak stated that there was no need for SFPP to provide any evidence of the source of contamination at the Oakland Airport since only SFPP owns assets at that site.[280] Mr. Hanak similarly criticized Mr. Ashton for not presenting any evidence of third party releases on site or of naming third party operations.[281]

However, the burden is on SFPP to clearly and convincingly show that all releases which have resulted in remediation activities came from assets on the CPUC jurisdictional pipeline, and that third party assets have not contributed to or have comingled with contamination SFPP is remediating. In this respect, SFPP fails to meet its burden of proof when it dismisses without any further discussion Mr. Ashton's testimony regarding non-SFPP connecting pipelines at the Oakland Airport. For example, Figure 11 of Attachment DDD to Mr. Hanak's Rebuttal Testimony, which is KMEP's Final Remedial Action Plan for the Oakland Airport Transfer Station, shows third party assets as potential sources of contamination.[282] Figure 11 depicts areas around an abandoned Chevron pipeline and an

[279] Prepared Supplemental Reply Testimony of Peter K. Ashton (Confidential), page 68.
[280] *See* Prepared Rebuttal Testimony of Michael A. Hanak, page 4.
[281] *See* Prepared Rebuttal Testimony of Michael A. Hanak, page 5.
[282] Attachment DDD of Prepared Rebuttal Testimony of Michael A. Hanak, page 55.

out of service 8" Shell pipeline as showing TPH soil concentrations.[283] It is SFPP, not Tesoro, that is responsible for showing where leaks occurred and establishing that they occurred on SFPP carrier assets. SFPP has failed to do so and has therefore failed to satisfy its burden of proof.

SFPP has also not shown what steps, if any, it took to prevent environmental contamination from occurring or that it acted reasonably and prudently in its remediation program.

For these reasons, SFPP should not be permitted to recover any costs resulting from remediation at the Oakland Airport site.

Norwalk

In his Supplemental Reply Testimony, Mr. Ashton discussed the reasons why SFPP has not proven that 100% of the assets, which could have led to leaks of petroleum at Norwalk, should be attributed to the jurisdictional pipeline, as SFPP claims. SFPP has still not shown with clear and convincing evidence that it operated its assets involved in the Norwalk site in a reasonable manner. It has also not established in the Record in this proceeding the steps it took to mitigate the possibility of releases at Norwalk. SFPP has therefore failed to meet its burden of proof with respect to environmental remediation expenses at the Norwalk site.

E. Discovery Abuse

SFPP's evidence regarding environmental remediation has been tainted by discovery abuse. In determining whether SFPP has met its burden of proof with respect to environmental remediation costs, we respectfully urge the ALJ to take into account

[283] Attachment DDD of Prepared Rebuttal Testimony of Michael A. Hanak, page 55.

SFPP's stonewalling of Tesoro's discovery requests and SFPP's production for the first time of important information months after Tesoro had requested it. In fact, much of that highly relevant information was produced for the very first time in SFPP's Rebuttal Testimony, only a few weeks before the evidentiary hearing and significantly after the Procedural Schedule permitted Tesoro to respond.

Early in the course of this proceeding, i.e., on December 4, 2012, Tesoro served a number of discovery requests on SFPP seeking workpapers and documents that SFPP witnesses had reviewed in the course of preparing the Direct Testimony that they had served on November 5, 2012. Tesoro Request No. 46 stated:

> For each SFPP witness that submitted testimony in the above captioned proceeding, please provide all records, workpapers, data, and analyses undertaken by each such witness in relation to this proceeding and his or her filed testimony in this proceeding that have not already been provided. Provide all data in the original electronic form, if available, with all links and formulae enabled.[284]

Similarly, Tesoro Request No. 47 stated:

> For each SFPP witness that submitted testimony in the above captioned proceeding, please provide a copy of all records, workpapers, data, and other materials relating to the subject matter of this proceeding that were reviewed and relied upon by each such witness and not otherwise produced.[285]

For months SFPP claimed that it was "diligently working" on a response, and later provided some materials. But, it was not until March 29, 2013 that SFPP actually completed providing those workpapers. On March 29, 2013, SFPP produced a supposed documented release history for several mixed asset sites, which included underlying data

[284] Tesoro Data Request No. 46, dated December 4, 2012. This data request was cited and discussed in Tesoro's Motion to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013.
[285] Tesoro Data Request No. 47, dated December 4, 2012. *See* Tesoro's Motion to Strike Portions of the Rebuttal Testimony of Peter M. Dito, Michael A. Hanak, and Robert E. Hinchee, dated April 15, 2013,

that Mr. Hanak used as Attachment JJJ of his Rebuttal Testimony. Mr. Hanak's Rebuttal Testimony with Attachment JJJ was then served on Tesoro on April 2, 2013, two business days after it had been produced in discovery.[286] The group of documents that SFPP waited until March 29, 2013 to provide to Tesoro also included the material that became Attachments KKK and LLL to Mr. Hanak's Rebuttal Testimony.

During the evidentiary hearing, further evidence of SFPP's withholding of documents reviewed by its witnesses in preparing their testimony became even more apparent.

As we indicated above, Attachment JJJ to Mr. Hanak's Rebuttal Testimony purported to show the relevant release history information for several of the California sites. After receiving Attachment JJJ on April 2, 2013, Tesoro served discovery related to Attachment JJJ's underlying workpapers on April 9, 2013. In response, SFPP served documents which bear Bates Nos. SFPP12 128055 – SFPP12 128374; SFPP12 130920 – SFPP12 130925; and SFPP12 130929. Tesoro later used these documents in its cross-examination of Mr. Hanak. These documents were admitted into evidence as Tesoro Exhibits 27 (Confidential), 28, and 29 (Confidential). They show hundreds of releases at the Mixed Asset Sites, providing details on volumes lost and recovered, locations of spills, assets involved, and immediate actions taken by SFPP personnel.

On cross-examination Mr. Hanak testified that he had actually reviewed these materials *as early as November of 2012*, while preparing his Direct Testimony:

> Q. Do I understand - - do I understand correctly that you had before you prior to November, when you did your direct testimony, Exhibits 26, 27 - - Exhibits 27, 28, and 29? You had that material before you.

[286] SFPP provided information regarding the release history for Brisbane, Colton and Chico in SFPP12 128523.

A. Yeah, I believe I did.[287]

These documents were clearly central to Mr. Hanak's analysis in November 2012 of the Mixed Asset Sites. By failing to provide them when Tesoro requested them in December of 2012, SFPP clearly obstructed Tesoro's ability to analyze and respond to the basis of SFPP's claim that shippers should be responsible for environmental remediation costs. In fact, by delaying production of these documents until April 15, 2013, following the submission of its Rebuttal Testimony, SFPP ensured that Tesoro would be severely disadvantaged in responding to SFPP.

Additionally, Tesoro had served other data requests in December 2012 seeking specific documents relating to environmental remediation sites. The documents Tesoro specifically requested were the Corrective Action Plans for the Mission Valley site. Tesoro Request No. 50, served December 4, 2012, stated: "Please provide a copy of the Corrective Action Plan for the following environmental projects: Mission Valley (81192), Colton Terminal (81423)."[288] In response, on January 18, 2013, SFPP provided documents which bear Bates Nos. SFPP12 005741-005863, SFPP12 005864-005977 and SFPP12 006057-006179. This material included the Site Conceptual Model and Off-Terminal Corrective Action Plan Mission Valley Terminal, dated September 8, 2005; the Site Conceptual Model and On-Terminal Corrective Action Plan Mission Valley Terminal, dated September 8, 2005; and the Mission Valley Terminal Corrective Action Plan, dated October 29, 1999.

[287] Michael A. Hanak, A.12-01-015 Transcript, Volume 4, page 626, lines 5-10.
[288] *See* Tesoro Data Request No. 50, dated December 4, 2012.

However, it became very clear to Tesoro several months later that SFPP had not produced all of the Corrective Action Plans issued for the Mission Valley site. In his Rebuttal Testimony, Dr. Hinchee relied upon an SFPP 1992 Corrective Action Plan for the Mission Valley site to show how SFPP responded to the issuance of the Regional Water Quality Control Board's 1992 Cleanup and Abatement Order (CAO).[289] This Corrective Action Plan was attached to Dr. Hinchee's Rebuttal Testimony as Exhibit NNN. That material had never been provided to Tesoro before it was filed as an exhibit to Dr. Hinchee's Rebuttal Testimony on April 2, 2013—months after Tesoro asked for it.

SFPP's failure to produce this 1992 Corrective Action Plan is particularly egregious. SFPP was surely well aware of the importance of Corrective Action Plans since they establish the approaches and remediation methods selected for each of SFPP's sites. As Mr. Hanak stated in his Direct Testimony:

> A Corrective Action Plan is an agency required document which typically provides a summary of the site conditions in what is commonly referred to as a conceptual site model. Another portion of the Corrective Action Plan provides a comprehensive feasibility analysis to present the possible remediation technologies which could work to address the contamination. After careful consideration, a preferred approach is recommended to the agency in the Corrective Action Plan.[290]

Moreover, the 1992 Corrective Action Plan for the Mission Valley site is particularly important, since it was issued shortly after the most significant leaks occurred at the Mission Valley site and could provide insight into where the releases occurred and what immediate measures SFPP took to inspect and maintain the leaks.

The 1992 Mission Valley Corrective Action Plan was not the only document provided for the first time through SFPP witnesses' Rebuttal Testimony on April 2, 2013.

[289] Prepared Rebuttal Testimony of Robert E. Hinchee, page 20.
[290] Prepared Rebuttal Testimony of Michael A. Hanak, pages 4-5.

Tesoro identified a number of Exhibits to Mr. Hanak's and Dr. Hinchee's testimony that had never been provided to Tesoro. Attachments C and D of a Motion to Strike that Tesoro filed on April 15, 2013 list 60 Exhibits attached to Dr. Hinchee and Mr. Hanak's Rebuttal Testimony, 12 of the Attachments were entirely new to Tesoro, while Tesoro had no record of another 29 of the Attachments ever being previously provided in discovery.

SFPP will undoubtedly claim that it provided Tesoro with thousands of pages of documents in response to its discovery requests. But these documents were provided in a dump truck fashion, and as already noted above, did not even include all of the workpapers and documents used by SFPP witnesses in constructing their testimony. For example, on January 28, 2013, SFPP informed Tesoro that it had placed 41,345 pages of documents in its data room.[291] According to SFPP, these documents were responsive to Tesoro Request No. 87, which sought information about the causes of releases at the sites as discussed by Federal, state or judicial authorities.[292] Tesoro had no idea how this information was responsive to the Data Request. Two days later, on January 30, 2013,

[291] SFPP provided SFPP12 053546 – 094891 in response.
[292] Tesoro Data Request No. 87 states:

> Please provide the following information with respect to the Concord Terminal, Norwalk, Colton Terminal, Elmira-Fox Road and Mission Valley Remediation Sites:
>
> (a) any documents received by or transmitted to any Federal, state or local government office, officer or employee from 2007 to the present date that discuss the causes of releases at the Sites;
>
> (b) any other document received by or transmitted to any employee of SFPP or any of its affiliates from 2007 to the present date that discusses the cause of releases at the Sites;
>
> (c) any determination by any judicial or adjudicatory official from 2007 to the present relating to or discussing the causes of releases at the Sites or assessing any find, penalty or assessment on SFPP or any of its affiliates relating to releases at the Sites.

SFPP uploaded another 38,885 pages of documents in its data room, also allegedly responsive to Tesoro Data Request No. 87.[293]

Undoubtedly SFPP will further claim, as it did during the evidentiary hearing, that the discovery process was highly negotiated.[294] It is true that Tesoro discussed the document production issues with SFPP in an effort to reach a resolution. But, Tesoro was never aware during those discussions that SFPP was withholding documents that its witnesses actually used and had before them in November when they formulated Direct Testimony. Tesoro also never imagined that SFPP would withhold until its Rebuttal Testimony, important Corrective Action reports that Tesoro had requested almost five months earlier.

In determining whether SFPP has reached its burden of proof, Tesoro respectfully suggests that the discovery abuse described above should weigh into the balance of a finding that SFPP has not met that burden.

III. DISCUSSION OF OTHER OPERATING EXPENSES

In addition to overhead and environmental expenses, the parties dispute certain other operating expenses in the cost of service. These include the Union Pacific Rail Road (UPRR) right of way rental costs, fuel and power costs, oil losses and shortages, wage increases, and CPUC litigation costs.

Unlike SFPP witness Wetmore, Tesoro witness Ashton has taken a consistent approach to all of these operating expense categories in developing test period costs. Mr.

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[293] The material SFPP cited to in its response included SFPP12 017228 – SFPP12 025133, SFPP12 027500 – SFPP12 053360, SFPP12 094892 – SFPP12 098862, and SFPP12 12000 – SFPP12 126120.

[294] *See* Ms. Kohlhausen, A.12-01-015 Transcript, Volume 4, page 619, lines 11-13; Ms. Boudreaux, A.12-01-015 Transcript, Volume 4, page 621, lines 14-16.

Ashton's approach is to base adjusted 2011 expenses wherever possible on actual 2012 (test period) costs. In some cases, Mr. Ashton was provided with full year 2012 cost data and in other cases partial year data, which he has annualized. In every case, however, he has consistently used 2012 test year data to develop his operating cost estimates. Mr. Wetmore instead largely relies on 2011 data even though more recent 2012 data was available to him. The choice presented to the ALJ with respect to these costs is whether he wishes to use only 2011 costs even though a full record now exists as to the actual costs that SFPP has incurred in 2012.

The Table below shows Mr. Ashton's test year estimates for each of these expense categories and compares them with the SFPP's estimates. As the Table demonstrates, for certain expense categories, Mr. Ashton's test year cost estimates are higher than Mr. Wetmore and in other cases they are lower. The most dramatic difference relates to the UPRR right of way rental costs. The other differences essentially cancel each other out.

Summary of Differences in 2012 Test Year Selected Operating Expense Categories

Line No.	*Expense Category*	*Ashton*	*Wetmore*	*Difference*
1	Rental Expense	$ 5,999,188	$ 13,785,002	$ (7,785,814)
2	Oil Losses and Shortages	$ (1,537,270)	$ (1,106,971)	$ (430,299)
3	Fuel and Power	$ 12,139,738	$ 12,025,849	$ 113,889
4	CPUC Litigation Expenses	$ 1,939,373	$ 1,417,517	$ 521,856
5	Direct Wages	$ 9,819,426	$ 9,851,800	$ (32,374)
6	**Total**	**$ 28,360,455**	**$ 35,973,197**	**$ (7,612,742)**

A. UPRR Right of Way Rental Cost

In his written testimony, Mr. Wetmore added approximately $8 million in rental right of way expenses to the SFPP cost of service. The expenses, according to Mr. Wetmore, are attributable to a California Superior Court decision in a case between SFPP/KMEP and UPRR involving the appropriate value of certain right of ways over

which SFPP's pipelines traverse. In the present proceeding, there is no dispute between the parties with respect to two crucial facts involving the UPRR litigation. First, the Superior Court decision, which assessed additional rental expenses, is on appeal and SFPP has a possibility of reversing the decision and winning on appeal.[295] Secondly, both the Shippers and SFPP agree that SFPP has not yet made any cash payment for the additional amounts that might be owed pursuant to the Superior Court decision.[296]

Under these circumstances, it is inappropriate for SFPP to increase its cost of service by $8 million, and charge its shippers that amount, for expenses that SFPP has not yet paid and might never have to pay.

Under FERC rulemaking, the test period adjustments, such as the cost increase that SFPP proposes for UPRR rental amounts, are made only when the cost is "known and measurable." The determining factor in applying this standard is whether these higher costs have actually been paid. SFPP's costs have not. Mr. Wetmore claims that this cost is known and measurable because KMEP has recorded an accrual on its books, even though Mr. Wetmore himself agrees that neither KMEP nor SFPP has paid a penny of these higher costs to UPRR.[297] The accounting accrual that Mr. Wetmore references is

[295] See the exchange between Ms. Luemers and Mr. Wetmore, A.12-01-015 Transcript, Volume 6, page 923; see the exchange between Mr. Adducci and Mr. Wetmore, A.12-01-015 Transcript, Volume 7, page 959; Prepared Direct Testimony of Peter K. Ashton, page 43; Prepared Reply Testimony of Peter K. Ashton, page 60; Prepared Rebuttal Testimony of Peter K. Ashton, pages 63-64.
[296] See the exchange between Ms. Luemers and Mr. Wetmore, A.12-01-015 Transcript, Volume 6, page 924; see the exchange between Mr. Adducci and Mr. Wetmore, A.12-01-015 Transcript, Volume 7, page 958; Prepared Direct Testimony of Peter K. Ashton, page 43; Prepared Reply Testimony of Peter K. Ashton, page 59; Prepared Rebuttal Testimony of Peter K. Ashton, pages 63-64.
[297] *See* Prepared Reply Testimony of Erik G. Wetmore, p. 9; See the exchange between Ms. Luemers and Mr. Wetmore, A.12-01-015 Transcript, Volume 6, page 924; See the

similar to the accruals that SFPP and KMEP make for various environmental liabilities. Generally accepted ratemaking principles require that those accruals be eliminated in developing just and reasonable rates and only costs that are actually incurred and paid be included in the cost of service.[298] Indeed, this is exactly how Mr. Wetmore treats other accruals such as environmental liabilities, which he removes and substitutes actual cash costs in the SFPP cost of service.[299] The same logic should apply to UPRR rental expense. Therefore, no increase should be included in the cost of service other than for inflation in the test period of the actual rental amounts that SFPP has been paying.

As was pointed out on cross examination of Mr. Wetmore, had SFPP anticipated that it might be faced with higher costs as a result of its litigation with UPRR it could have requested the Commission to permit it to establish a "Memorandum Account." As Exhibit SUV-8 explains, a Memorandum Account permits a utility to keep track of costs arising from events that are not generally foreseen and therefore allows it to preserve the opportunity to seek recovery of those costs at a later date without seeking retroactive rate increases. The establishment of a Memorandum Account does not, of course, mean that the costs are recoverable, but merely provides a mechanism to track the costs, so if they become known and measurable, the pipeline can seek recovery at that time.[300] Although the opportunity was available to it, SFPP has not set up such an account and has not made any actual payment of these higher costs. It should not be allowed to include them in its cost of service.

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exchange between Mr. Adducci and Mr. Wetmore, A.12-01-015 Transcript, Volume 7, page 958.

[298] *El Paso Natural Gas*, 86 FERC ¶ 61,033 at p. 61,108-09 (1999).

[299] *See* Prepared Direct Testimony of Erik G. Wetmore, page. 14; Prepared Reply Testimony of Erik G. Wetmore, pages 12-13.

[300] Exhibit SUV-8

Finally, Mr. Wetmore recommends as an alternative approach that a per barrel surcharge be applied for these additional as yet unpaid costs.[301] For the same reasons that we previously discussed, a proposal to charge shippers for any costs that SFPP has not actually incurred is entirely inappropriate. Indeed, the whole purpose of the Memorandum Account is to provide a basis *in the future* for the pipeline to recover these costs. A surcharge that permits SFPP to collect expenses at the present time from its shippers when it has not yet incurred those costs is as objectionable as SFPP's attempt to recover all of those costs in the test period.

B. Oil Losses and Shortages

Oil losses and shortages are the expenses and revenues associated with the normal losses that occur as oil is transported in a pipeline as well as associated loss allowance revenue charged by the pipeline to account for those losses. Mr. Ashton proposes a negative expense of $1.5 million for this item, while Mr. Wetmore proposes a negative expense of $1.1 million. Mr. Wetmore bases his cost figure on an average of losses and shortages over the period 2007-2011 for one line, the West Line, and uses 2011 base period data for the other two jurisdictional lines (the South and North lines).[302] He uses a multi-year average for the West Line because he recognizes that 2011 was an anomalous period for the West Line since it recorded an actual expense (not a negative expense or revenue) of $5.2 million, when in fact the normal experience for the West Line was a shortages and loss expense figure of *negative* $0.8 million.[303] Nevertheless, Mr. Wetmore's analysis is incorrect because he still includes data for 2011 in his average. As

[301] *See* Prepared Reply Testimony of Erik G. Wetmore, page 10.
[302] *See* Prepared Direct Testimony of Erik G. Wetmore, page 18.
[303] *See* Prepared Reply Testimony of Peter K. Ashton, pp. 62-63.

Mr. Ashton points out 2011 was a completely anomalous year for losses and shortages on the West Line and thus should be excluded entirely from any average.[304] Another defect in Mr. Wetmore's analysis is his failure to use the 2012 that was available to him.[305]

In contrast, Mr. Ashton bases his test period estimate on actual data for the first ten months of 2012, which he then annualizes. Recognizing that oil losses and shortages can be volatile from year to year, Mr. Ashton then evaluated the reasonableness of his test period figure by comparing it to the average over the period 2007-2012, properly omitting from consideration the 2011 West Line experience. This resulted in a slightly higher negative expense of $1.65 million, but generally supports his recommended test period amount of negative $1.5 million. Therefore, Mr. Ashton's figure for losses and shortages is a more reasonable estimate.

C. Fuel and Power

With respect to SFPP's fuel and power expenses, Mr. Ashton uses actual fuel and power costs for 2012, following his consistent methodology of using actual 2012 costs wherever possible. In this case, Mr. Ashton arrives at a cost of fuel and power of $12.1 million that is slightly higher than SFPP witness Wetmore.[306] However, even though the $12.1 figure is higher than SFPP's cost factor, Tesoro recommends that it be used in the cost of service because it reflects a correct cost of service analysis.

D. Wage Increases

[304] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 67.
[305] Ironically Mr. Wetmore uses 2012 losses and shortages data in his rebuttal to Mr. Ashton, but fails to use it in his own calculations. *See* Prepared Rebuttal Testimony of Erik G. Wetmore, page 28.
[306] *See* Prepared Rebuttal Testimony of Peter K. Ashton, pages 67-68.

There is minor difference between Mr. Ashton and Mr. Wetmore regarding wage increases for the test period. Mr. Wetmore implements a wage increase of 3.1% effective January 1, 2012 when in fact the wage increase did not go into effect until February 10, 2012. Therefore, as Mr. Ashton points out in his testimony, the test period adjustment should reflect that fact that the wage increase was in effect for only 325 days of the year, not the full 365 as assumed by Mr. Wetmore.[307]

E. CPUC Litigation Expenses

Again consistent with his general approach with respect to operating expenses, Mr. Ashton used actual 2012 data wherever possible to determine CPUC litigation expenses. In determining the CPUC-related litigation expenses figure Mr. Ashton used the actual 2012 expenses of $1.9 million, which is higher than the base period figure used by Mr. Wetmore of $1.4 million.[308] However, regardless of which figure the Commission uses, SFPP's costs (legal and consultant fees) associated with the CPUC litigation should not be embedded in SFPP's cost of service and thus continue forever into the future, but should be implemented as a surcharge that would expire once the costs have been recovered and the litigation terminated. Although it is true that this litigation has continued for a number of years, it is likely that the Commission will finally resolve the principal legal issues in the near future. In fact, the disallowance of an expense for federal income taxes has already been decided by the Court of Appeals.[309] Therefore, we believe that a temporary surcharge is the only fair and reasonable way to handle these costs.[310]

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[307] *See* Prepared Reply Testimony of Peter K. Ashton, page 65.
[308] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 66.
[309] *SFPP v. Public Utilities Commission*, Case No. G046669 (CA Ct. of App., 4th Dist., June 13, 2013).
[310] *See* Prepared Rebuttal Testimony of Peter K. Ashton, page 66.

IV. APPROPRIATE RATE OF RETURN

A. Capital Structure Including the Treatment of Purchase Accounting Adjustments

A significant component in determining a pipeline's allowed rate of return is its capital structure. Capital structure refers to the pipeline's composition of debt and equity relative to total capital. In this case, the parties stipulated to eliminating consideration of Purchase Accounting Adjustments (PAAs) in calculating capital structure because of its minor impact.[311] However, PAAs are still relevant in calculating overhead costs.

While the parties have agreed not to include PAAs in the capital structure calculation, there are still several areas of disagreement between Tesoro and SFPP in calculating SFPP's returns:

- Tesoro recommends the use of a capital structure based on SFPP's parent company, Kinder Morgan Energy Partners (KMEP), rather than the use of a proxy group of pipeline companies;
- Tesoro recommends that SFPP's long term debt obligations arising from interest rate swap agreements be included in calculating its long term cost of debt; and
- Tesoro further recommends that SFPP's current portion of long term debt be reflected in its capital structure.

B. Determination of Capital Structure

SFPP's capital structure should be derived from KMEP's financial data. SFPP is not a publicly traded entity and does not issue its own debt. However, its parent, KMEP, is

[311] Motion of SFPP Requesting Adoption of Stipulation Regarding Purchase Accounting Adjustments, January 29, 2013.

traded on the New York Stock Exchange. Therefore, KMEP's capital structure is the most direct and reliable estimate of SFPP's capital structure.[312] As Mr. Ashton explains in his testimony, KMEP provides financing for SFPP's operations.[313] Additionally, KMEP's capital structure is representative of the risks faced by SFPP and the mix of financial leverage within KMEP is appropriate for operations under existing market conditions for a pipeline company.[314] The use of KMEP's capital structure is also consistent with ALJ Bemesderfer's prior decision.[315]

SFPP, through its witness, Dr. James H. Vander Weide, is incorrect in using a proxy group to determine SFPP's capital structure. Dr. Vander Weide uses a proxy group because he contends that KMEP's capital structure is atypical or anomalous.[316] Dr. Vander Weide's position is based on his contention that KMEP has a higher debt ratio than the average debt ratio of his group of comparable companies. According to Dr. Vander Weide, KMEP, therefore, faces a greater amount of financial risk.[317] Even though Dr. Vander Weide claims that the comparable companies have the same business risk as KMEP, Dr. Vander Weide implies that KMEP has greater overall financial risk than the other comparable companies.[318]

Dr. Vander Weide's risk analysis is seriously flawed. KMEP's capital structure does contain an unusual amount of debt for a pipeline company. However, KMEP still

[312] Prepared Reply Testimony of Peter K. Ashton, page 7.
[313] Prepared Direct Testimony of Peter K. Ashton, page 11.
[314] Prepared Direct Testimony of Peter K. Ashton, page 12.
[315] Prepared Reply Testimony of Peter K. Ashton, page 8; Revised and Reissued Proposed Decision Determining Test Year 2009 Rate Base and Cost of Service for SFPP, L.P. and Calnev Pipe Line L.L.C. and Ordering Refunds, A.09-05-014, footnote 5 (April 6, 2012).
[316] Prepared Reply Testimony of James H. Vander Weide, page 5.
[317] Prepared Reply Testimony of James H. Vander Weide, page 14.
[318] Prepared Reply Testimony of James H. Vander Weide, page 8.

has a lower debt ratio than Magellan Midstream Partners, L.P., a company that Dr. Vander Weide included in his initial proxy group of comparable companies.[319] Additionally, BP/ExxonMobil Witness Thomas Horst shows in his testimony that among the comparable companies in Dr. Vander Weide's proxy group, including KMEP, there is a more or less uniform upward progression of debt shares.[320] This means that there is no sharp break in the progression of the debt percentage and therefore no indication that any of the debt shares are anomalous. If the company with the highest debt ratio is considered anomalous and removed from the group, by the same logic the company with the next highest debt ratio would become anomalous and so on. Eventually all companies would be removed from the proxy group except the company with the lowest debt ratio.

In addition, contrary to sound financial practice, Dr. Vander Weide changes the composition of his proxy group with each version of his testimony. In his Direct Testimony, Dr. Vander Weide's proxy group excluded KMEP and Holly Energy Partners (Holly).[321] In his Reply Testimony, Dr. Vader Weide removed NuStar Energy LP (Nustar) and Magellan Midstream Partners LP (Magellan),[322] and in his Rebuttal he decided to add KMEP, but excluded Sunoco Logistics LP (Sunoco).[323] There is no principled reason for the changes that Dr. Vander Weide makes. In fact, the only purpose of the changes appears to be a sustained effort to exclude KMEP from his proxy group. This is an important point, because as the proxy group changes, so too the average and the range of capital structures of the proxy group. For example, if Dr. Vander Weide used the

[319] Direct Testimony of James H. Vander Weide, page 10.
[320] Prepared Reply Testimony of Thomas Horst, page 9.
[321] Prepared Direct Testimony of James H. Vander Weide, page 10.
[322] Prepared Reply Testimony of James H. Vander Weide, pages 33-34.
[323] Attachment AAA to Prepared Rebuttal Testimony of James H. Vander Weide.

same proxy group in his reply and rebuttal testimony that he used in his direct testimony, KMEP would fall inside of the range of capital structures of his proxy group.[324] In fact, under cross-examination Dr. Vander Weide admitted that when he removed companies from his proxy group it changed the average capital structure of the proxy group.[325]

Not only does Dr. Vander Weide change his proxy group multiple times, he also excludes some companies from the proxy group because he considers their capital structures to have too much or too little debt.[326] This is a highly subjective process and, in this case, seems designed only to lead to the preordained result that Dr. Vander Weide seeks to obtain. Moreover, Dr. Vander Weide's process is entirely circular. Dr. Vander Weide is using his own personal view of what is a "normal" capital structure in order to determine which companies he will include or exclude from his proxy group. Dr. Vander Weide then uses the results he obtains to determine what capital structure is normal. This circular logic allows Dr. Vander Weide to pre-determine the conclusion that KMEP's capital structure is "abnormal."

Another reason that Dr. Vander Weide excludes KMEP from his proxy group is because he claims that KMEP is a more risky investment compared to the other companies that he did include in the proxy group. Dr. Vander Weide reaches this conclusion on the basis of the amount of KMEP's debt. However, as Mr. Ashton points out in his testimony, financial experts generally consider not only the amount of debt, but the company's ability

[324] Prepared Reply Testimony of Peter K. Ashton, page 9; Attachment CCC of Prepared Rebuttal Testimony of James H. Vander Weide.
[325] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, page 862.
[326] Attachment AAA of Prepared Rebuttal Testimony of James H. Vander Weide.

to repay its debt in assessing its financial risk.[327] In this connection, Standard and Poor's specifically includes cash flow adequacy and liquidity in its measure of financial risk.[328] Cash flow adequacy bears on the interest coverage ratio, which Mr. Ashton discusses in his Reply Testimony.[329] Mr. Ashton shows that KMEP's ability to repay its debt as measured by the interest covered ratio is in line with, if not more favorable than the comparable companies, which indicates that its higher debt ratio does not pose a greater risk to investors.[330]

There is also evidence that KMEP is actually less risky than other comparable companies in Dr. Vander Weide's proxy group. As Dr. Horst discusses in his testimony, two of the factors that affect business risk are the size of the company and the diversity of its assets.[331] Dr. Vander Weide acknowledges that these factors affect business risk when he rejects Holly as a proxy company in part because of its small size,[332] and notes that the variability in the return on assets of KMEP overall is less than the variability in the return on assets of any one of KMEP's business segments.[333] Dr. Horst concedes that KMEP's large size and diverse businesses reduce its overall business risk compared with a typical proxy company.[334]

In view of the fact that KMEP does not have a greater financial risk and has less business risk than the other proxy companies, KMEP's capital structure should be used in

[327] Prepared Rebuttal Testimony of Peter K. Ashton, pages 7-8.
[328] Prepared Rebuttal Testimony of Peter K. Ashton, page 8.
[329] Prepared Rebuttal Testimony of Peter K. Ashton, page 8.
[330] Prepared Reply Testimony of Peter K. Ashton, pages 20-22; Prepared Rebuttal Testimony of Peter K. Ashton, pages 8-9.
[331] Prepared Rebuttal Testimony of Peter K. Ashton, page 11.
[332] SFPP Response to Tesoro Request No. 57, dated December 18, 2012.
[333] Prepared Reply Testimony of James H. Vander Weide, page 9.
[334] Prepared Rebuttal Testimony of Thomas Horst, page 12.

this proceeding. Doing so conforms to applicable precedent and would be just and reasonable.

C. Inclusion of the Current Portion of Long Term Debt

In his testimony, Mr. Ashton provided two separate measures of SFPP's capital structure depending on whether interest rate swaps are included in the cost of debt. Tesoro would recommend that the alternative involving the inclusion of interest rate swaps be adopted.

When KMEP terminates an interest rate swap agreement, it incurs a termination fee. Therefore, interest rate swaps can increase the amount of KMEP's long-term debt obligations. This increase is included in the total amount of long term debt in KMEP's 10-K.[335] If interest rate swaps are included in the cost of debt, Mr. Ashton recommends using a capital structure that includes these termination fees. Conversely, if interest rate swaps are not included in the cost of debt, no termination fee should be included in SFPP's cost of service.[336]

In addition, the current portion of KMEP's long term debt in SFPP's capital structure should also be included in SFPP's long term debt calculations. As Mr. Ashton discusses in his testimony, KMEP typically replaces its expiring long term debt with new long term debt.[337] As an example, Mr. Ashton pointed out that all KMEP long term debt maturing in 2012 was replaced with new long term debt during 2012.[338] Dr. Vander Weide argues that KMEP does not intend to refinance its long term debt because KMEP

[335] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.
[336] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.
[337] Prepared Rebuttal Testimony of Peter K. Ashton, page 10.
[338] Prepared Rebuttal Testimony of Peter K. Ashton, page 10.

does not "list" the current portion of its long term debt as long term debt.[339] It might well be, as Dr. Vander Weide points out, that the Financial Accounting Standards Board will only permit a company to list the current portion of its long term debt under long term debt if it has already taken action to refinance its debt.[340] But, even though KMEP's current portion of long term debt is listed as short term debt, nonetheless, KMEP intends to refinance this debt as long term debt. For these reasons, the determination of the Accounting Standards Board should not be translated into a ratemaking rule. KMEP invariably rolls over current long term debt, and it makes eminent good sense to include that current portion of KMEP's long term debt in determining the firm's capital structure.

There is, moreover, no basis to Dr. Vander Weide claim that the exclusion of the current portion of long term debt is supported by CPUC precedent.[341] In support of his position, Dr. Vander Weide cites a recent decision in which short term debt was excluded from the capital structure of California electric and gas utilities.[342] However, as Mr. Ashton explains in his testimony, the facts in the case presented by Dr. Vander Weide are significantly different from the facts in this case. The case cited by Dr. Vander Weide does not specifically focus on the current portion of long term debt and does not involve companies whose total long term debt has been consistently increasing over the past several years.[343] Additionally, the cost of debt calculation in the case cited by Dr. Vander Weide includes projected debt to be issued during the year,[344] which supports the proposition that projected additional long-term debt should be included. Finally, ALJ

[339] SFPP Response to Tesoro Data Request No. 128, March 8, 2013.
[340] Prepared Rebuttal Testimony of Peter K. Ashton, page 12.
[341] Prepared Reply Testimony of James H. Vander Weide, page 18, 23.
[342] Prepared Reply Testimony of James H. Vander Weide, page 18, 23.
[343] Prepared Rebuttal Testimony of Peter K. Ashton, page 14.
[344] Prepared Rebuttal Testimony of Peter K. Ashton, page 15.

Bemesderfer has ruled in the past that SFPP's cost of debt should include the current portion of long term debt.[345] Therefore, CPUC precedent clearly supports the position that the current portion of short term debt should be considered long term debt for purposes of computing capital structure.

For these reasons, Tesoro recommends that the Presiding Judge determine that SFPP's capital structure consists of 59.95 percent debt and 40.05 percent equity.[346] If the Presiding Judge rules that interest rate swaps should not be included in the cost of debt calculation, Tesoro recommends a capital structure of 57.74 percent debt and 42.46 percent equity.[347]

Cost of Debt

There are several areas of disagreement between shipper witnesses and SFPP witness Vander Weide with respect to the cost of debt calculation. Those issues, a number of which have been alluded to previously, are the following:

- Shipper witnesses recommend that SFPP's cost of debt be determined on the basis of KMEP's cost of debt. Dr. Vander Weide, on the other hand, wants to establish SFPP's cost of debt through a proxy group;
- Shipper witnesses urge that interest rate swaps be reflected in the SFPP cost of debt;
- Shipper witnesses recommend that the current portion of long term debt be included in determining SFPP's long term cost of debt; and

[345] Revised and Reissued Proposed Decision Determining Test Year 2009 Rate Base and Cost of Service for SFPP, L.P. and Calnev Pipe Line L.L.C. and Ordering Refunds, A.09-05-014 (April 6, 2012); Ashton Answering Testimony in Proceedings A.09-05-014 et al., at Exhibit 3 and 5.
[346] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.
[347] Prepared Rebuttal Testimony of Peter K. Ashton, page 27.

- Shipper witnesses recommend that tax exempt and special interest debt be included in determining SFPP's cost of long term debt.

With respect to the first issue, the same arguments that pertained to determining SFPP's capital structure apply here as well. There is no reason to use a proxy group when KMEP, SFPP's parent, provides a perfectly adequate long term debt figure. That is, moreover, the position taken by ALJ Bemesderfer in his proposed decision in the A. 09-05-014 et. al case.

In fact, in past cases, Dr. Vander Weide also calculated SFPP's cost of debt on the basis of KMEP's long term debt.[348] For example, SFPP's January 30, 2012 Application used a cost of debt based on KMEP's cost of debt and this calculation is attributed to Dr. Vander Weide.[349] The Declaration of Thomas Turner that was provided with the Application clearly states that Dr. Vander Weide provided him with the rate of return to be used in the cost of service calculation.[350] Therefore, the decision to use a cost of debt based on KMEP as opposed to a proxy group must have been made by Dr. Vander Weide. That position is supported by the discussion of risk factors, which appears in the previous portion of this Opening Brief.

SFPP's cost of debt should also include the effect of interest rate swap agreements. As we pointed out previously, interest rate swap agreements are essentially a mechanism to convert fixed rate debt to floating rate debt or vice versa. This fact is acknowledged in KMEP's 10-K, which states that some of its long term fixed rate debt is "effectively

[348] See for example Dr. Vander Weide's Rebuttal Testimony in proceeding A.09-05-014 at page 17; Attachment A to Declaration of Thomas A. Turner, page 1; Bates File SFPP12-000008.
[349] Prepared Rebuttal Testimony of Peter K. Ashton, page 20.
[350] Attachment A to Declaration of Thomas A. Turner, page 1.

converted to variable rates through the use of interest rate swaps."[351] In fact, KMEP targets a mix of 50 percent fixed rate debt and 50 percent floating rated debt, which it achieves through the use of interest rate swap agreements.[352]

As explained in Mr. Ashton's testimony, KMEP's cost of debt as reported in its SEC Form 10-K includes the effect of interest rate swaps.[353] Therefore, KMEP clearly considered interest rate swap agreements to be part of its actual cost of debt. Since floating interest rates tend to be lower than contemporaneous fixed interest rates, using a mix of fixed and floating interest rate debt has enabled KMEP to achieve substantial interest cost savings.[354] Dr. Horst shows that in nine out of the past 11 years KMEP has achieved significant cost savings through the use of interest rate swap agreements, while in the other two years the difference in KMEP's cost of debt was immaterial.[355] This fact was confirmed by SFPP witness Dr. Suresh M. Sundaresan. On cross-examination, Dr. Sundaresan testified that in nine out of 11 years, interest rate swaps have generated substantial interest cost savings to KMEP.[356]

In their written testimony, SFPP witnesses Vander Weide and Sundaresan claim that interest rate swaps do not influence KMEP's cost of debt. They further contend that interest rate swaps should not be included in SFPP's cost of debt because, at the initiation of the swap contract, the interest costs are expected to be the same over the life of the

[351] Kinder Morgan Energy Partners 2011 10-K, page 36; quoted in the Prepared Direct Testimony of Peter K. Ashton, page 20.
[352] Prepared Direct Testimony of Peter K. Ashton, page 19.
[353] Prepared Direct Testimony of Peter K. Ashton, page 19.
[354] Prepared Direct Testimony of Peter K. Ashton, page 20.
[355] Prepared Rebuttal Testimony of Thomas Horst, page 42; also see Schedule 8 and Chart 1 to the Prepared Rebuttal Testimony of Thomas Horst. .
[356] See the exchange between Mr. Wagner and Dr. Sundaresan, A.12-01-015 Transcript, Volume 6, page 800.

swap.[357] In other words, they claim that the floating leg of an interest rate swap agreement is lower than the fixed leg at the time an interest rate swap is initiated because the floating rate is expected to increase over time.[358] However, as Mr. Ashton explains in his testimony that is not how interest rates actually behave.[359] And, under cross-examination Dr. Sundaresan admits that sometimes interest rates go up and sometimes they go down.[360]

The arguments made by Dr. Sundaresan and Dr. Vander Weide are based on the "expectations hypothesis." An alternative explanation presented by Dr. Horst is the "liquidity preference hypothesis." Dr. Horst explains that under this theory investors prefer shorter term, more liquid investments, i.e., greater liquidity. Therefore, in order to induce investors to hold longer term fixed-rate debt, interest rates on longer term fixed rate debt must be higher than interest rates on shorter term or variable rate debt, all else being equal.[361] According to the liquidity preference hypothesis, the floating rate in an interest rate swap agreement is expected to be lower than the fixed rate.[362] This implies that KMEP is expected to achieve interest cost savings by using interest rate swap agreements.

Dr. Sundaresan claims that it is inconsistent with fundamental economic principles to argue that KMEP could profit from interest rate swap agreements because it does not cost anything to enter into these agreements.[363] However, this argument is directly contradicted by the liquidity preference hypothesis. According to the liquidity preference

[357] Prepared Reply Testimony of Suresh M. Sundaresan, page 12; Prepared Reply Testimony of James H. Vander Weide, pages 25-26.
[358] Prepared Reply Testimony of Suresh M. Sundaresan, pages 8-9.
[359] Prepared Rebuttal Testimony of Peter K. Ashton, pages 16-17.
[360] See the exchange between Mr. Wagner and Dr. Sundaresan, A.12-01-015 Transcript, Volume 6, page 781.
[361] Prepared Rebuttal Testimony of Thomas Horst, page 33.
[362] Prepared Rebuttal Testimony of Thomas Horst, page 35.
[363] See the exchange between Mr. Wagner and Dr. Sundaresan, A.12-01-015 Transcript, Volume 6, page 791.

hypothesis, investors view the fixed interest rate cash flows as less desirable than the floating interest rate cash flows. If investors view one set of cash flows as riskier or less desirable than the other, the two sets of cash flows cannot be priced equally. In other words, investors must expect to profit from accepting riskier or less desirable investments. The fact that investors demand a higher return for taking on more risk is certainly a general principle of economics, which is acknowledged by Dr. Vander Weide.[364] Therefore, the fact that it costs nothing to switch from a fixed interest rate to a floating interest rate is not an indication that KMEP cannot profit from switching from a fixed interest rate to a floating interest rate. KMEP can and has profited significantly from interest rate swap agreements by lowering its debt costs. Furthermore, Dr. Vander Weide admits that KMEP may even lock in the interest cost savings by terminating the interest rate swap agreement early.[365]

Dr. Sundaresan also claims that when there is a gain or loss from an interest rate swap that appears on a company's income statement, there should be a corresponding gain or loss associated with the underlying debt liability that is being hedged.[366] According to Dr. Sundaresan, these two gains or losses roughly cancel each other out. Dr. Sundaresan is referring to the fact that the market value of fixed rate debt will change if interest rates go up or down. This is true for all fixed rate debt, not only fixed rate debt that has a corresponding interest rate swap agreement. However, unlike the gain or loss associated with an interest rate swap agreement, the change in the market value of fixed rate debt

[364] Prepared Direct Testimony of James H. Vander Weide, page 7.
[365] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, page 896.
[366] See the exchange between Mr. Wagner and Dr. Sundaresan, A.12-01-015 Transcript, Volume 6, pages 786-787.

does not reflect any anticipated changes in interest costs or principal amount of debt outstanding. Instead, the change in market value of fixed rate debt reflects changes in investors' willingness to hold the fixed rate debt given alternative investments available, such as new fixed rate debt being issued at the current market rate. Therefore, changes in the market value of KMEP's debt do not factor into costs included in KMEP's income statement. Additionally, gains or losses in the market value of fixed rate debt do not factor into the rate of return calculation for rate setting purposes.[367] This means that a loss in the market value of KMEP's debt does not offset the interest cost savings generated by an interest rate swap agreement from a rate setting standpoint.

Consistent with the capital structure calculation, SFPP's cost of debt should include the current portion of long term debt. Additionally, the cost of debt should include tax exempt and special purpose debt. While Dr. Vander Weide claims that tax exempt and special purpose debt is only available for specific projects, KMEP's 10-K explains that the company has a centralized cash management system which concentrates the cash assets of its operating partners and subsidiaries in order to lower its cost of debt.[368] Therefore, Mr. Ashton includes tax exempt and special purpose debt in his cost of debt and capital structure calculations. However, since KMEP's tax exempt and special purpose debt represents less than one percent of KMEP's total debt outstanding, the impact of including these two types of debt is *de minimus*.[369]

[367] Prepared Direct Testimony of James H. Vander Weide, page 7, lines 7-12.
[368] Prepared Rebuttal Testimony of Peter K. Ashton, page 15.
[369] Prepared Rebuttal Testimony of Peter K. Ashton, page 15.

Based on these considerations, Tesoro recommends a cost of debt of 4.52 percent, which includes the impact of interest rate swaps.[370] Alternatively, should the Presiding Judge rule that interest rate swaps should not be included in the cost of debt calculation, Tesoro believes that the appropriate cost of debt for SFPP, based on KMEP's embedded cost of debt, is 6.01 percent.[371]

Return on Equity

The parties agree that SFPP's return on equity should be calculated by using a discounted cash flow (DCF) methodology based on a proxy group of comparable companies. However, there are several areas of disagreement between shipper witness Ashton and SFPP's witness Vander Weide regarding the determination of the SFPP return on equity. Those disagreements involve:

- The composition of the proxy group;
- The use of a two stage DCF growth model as opposed to a one stage growth model;
- The use of the midpoint convention in computing the dividend yield; and
- The use of the median as opposed to the mean to determine the return on equity from the proxy group.

In his Direct Testimony, Mr. Ashton recommends that the proxy group consist of Buckeye Partners LP, Enbridge Energy Partners, Enterprise Products Partners, KMEP, Magellan Midstream Partners LP, NuStar Energy LP, Holly Energy Partners LP, Plains All American Pipeline LP and Sunoco Logistics LP.[372] This is the same proxy group used

[370] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.
[371] Prepared Rebuttal Testimony of Peter K. Ashton, page 27.
[372] Prepared Direct Testimony of Peter K. Ashton, page 18.

by shipper witness Horst.[373] All of these companies are heavily involved in the pipeline industry and face similar risks and operating conditions to SFPP.[374]

In his return on equity analysis, SFPP witness Vander Weide used a subset of the proxy group used by Ashton and Horst. The reason that Dr. Vander Weide has a smaller group is because Dr. Vander Weide again kept making up different subjective standards, which he then used to eliminate various members of the group. In fact, Dr. Vander Weide changed his proxy group with each version of his testimony. As we pointed out previously, Dr. Vander Weide's initial proxy group excluded KMEP and Holly.[375] In his Reply testimony, he removed NuStar and Magellan.[376] Finally, in his Rebuttal testimony, Dr. Vander Weide removed Sunoco, but added KMEP.[377]

Dr. Vander Weide's proxy group changed with each version of his testimony because he changed and inconsistently applied his selection criteria. His stated selection criteria for his proxy group in his Direct Testimony were that the company under consideration: (i) was publicly traded; (ii) had significant pipeline operations; (iii) had been in operation for at least 5 years; (iv) was followed by Value Line; (v) had I/B/E/S growth estimates; and (v) was not the subject of a merger that has not yet been completed.[378] These selection criteria are similar to the criteria used by Dr. Horst and Mr. Ashton. The only reason that Dr. Vander Weide's proxy group differs from the shippers' group is Dr. Vander Weide's arbitrary rejection of certain companies whose returns he

[373] Prepared Rebuttal Testimony of Thomas Horst, Schedule 9.
[374] Prepared Direct Testimony of Peter K. Ashton, page 18.
[375] Prepared Direct Testimony of James H. Vander Weide, page 10.
[376] Prepared Reply Testimony of James H. Vander Weide, pages 33-34.
[377] Attachment AAA to Prepared Rebuttal Testimony of James H. Vander Weide.
[378] Prepared Direct Testimony of James H. Vander Weide, page 9.

does not like, *even though* the companies he rejects meet all of the selection criteria that all parties endorse.[379]

Under cross-examination Dr. Vander Weide admitted that he applied additional selection criteria that are not outlined in his testimony in formulating various different versions of his proxy group.[380] According to Dr. Vander Weide he rejected companies that clearly met his stated selection criteria because of his own subjective judgment in assessing risk. We would suggest that Dr. Vander Weide's use of subjective criteria undercuts the entire methodology, which he says he endorses. The purpose of the five objective criteria listed above is in part to assess risk. Standard and Poor's risk assessment shows that the proxy companies all possess the same general level of business and financial risk.[381] Standard and Poor's considers all of the proxy companies to be of medium to low qualitative risk and average to low volatility risk.[382] The point is inescapable that Dr. Vander Weide is simply rejecting companies in order achieve his own pre-ordained result.

Furthermore, Dr. Vander Weide's reasons for rejecting companies that meet his initial selection criteria also appear to change or be applied inconsistently. For example, in his Rebuttal testimony he rejects Magellan because its debt ratio is too high.[383] This reason was different from the reason cited in his reply testimony, i.e., that Magellan's

[379] Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, page 836, line 10; See also SFPP Response to Tesoro Request No. 56, dated December 18, 2012.
[380] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, page 836.
[381] Prepared Rebuttal Testimony of Peter K. Ashton, page 9.
[382] Prepared Rebuttal Testimony of Peter K. Ashton, page 9.
[383] Attachment AAA to Prepared Rebuttal Testimony of James H. Vander Weide.

I/B/E/S growth estimate of negative three percent was too low.[384] However, Magellan's debt ratio has been roughly the same with each round of Dr. Vander Weide's testimony.

The second area of disagreement between the shipper witnesses and SFPP witness Vander Weide is the use of a two stage DCF model as opposed to a one stage DCF model. While the one stage DCF model relies on a single growth rate, the two stage DCF model uses a composite growth rate that is based on both I/B/E/S growth estimates and a long term growth rate. As Mr. Ashton explains in his testimony, the DCF model assumes a growth rate in perpetuity, but the I/B/E/S estimate only applies to the next three to five years.[385] Therefore, the two stage model uses a composite growth rate in order to reflect differences in investor expectations over different time periods.

In this case, the long term growth rate used in the composite growth rate must reflect the fact that the proxy group companies are Master Limited Partnerships (MLPs). In the long term, corporations are expected to grow at the same rate as the Gross Domestic Product (GDP), but MLPs are expected to grow at a lower rate.[386] Mr. Ashton uses a long term growth rate of 50 percent of GDP in order to account for the higher distribution payouts and lower long term growth prospects of MLPs.[387] This is the same method used by FERC and is consistent with ALJ Bemesderfer's prior proposed decision.[388]

Dr. Vander Weide, on the other hand, contends that I/B/E/S growth estimates only forecast growth for the next three to five years because the long run is uncertain. He

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[384] Prepared Reply Testimony of James H. Vander Weide, page 34.
[385] Prepared Reply Testimony of Peter K. Ashton, page 16.
[386] Prepared Reply Testimony of Peter K. Ashton, page 17.
[387] Prepared Reply Testimony of Peter K. Ashton, page 17; Prepared Rebuttal Testimony of Peter K. Ashton, page 21.
[388] Prepared Direct Testimony of Peter K. Ashton, pages 17-18. *See* Revised and Reissued Proposed Decision Determining Test Year 2009 Rate Base and Cost of Service for SFPP, L.P. and Calnev Pipe Line L.L.C. and Ordering Refunds, A.09-05-014 (April 6, 2012).

argues that Mr. Ashton does not present any evidence that I/B/E/S growth estimates are a reliable estimate of the perpetual growth rate of MLPs.[389] That criticism is certainly not valid, and Mr. Ashton explains in his testimony that MLPs have a lower long term growth rate because of their higher distributions and lower risk.[390] Mr. Ashton also presents considerable evidence that investor expectations of growth rates for MLPs such as the proxy group companies tend to be below GDP growth. For example, Mr. Ashton shows that Citicorp and Wachovia forecasted long term growth rates for MLPs that were considerably lower than the projected GDP growth rate at the time of the forecast.[391] In fact, Mr. Ashton shows that a perpetual growth rate of 50 percent of forecasted GDP growth may be overly generous. Due to the fact that MLPs have primarily grown through acquisitions, which is not a growth strategy they will be able to pursue in the long term without eventually consuming the entire market, some analysts question MLP's ability to grow at all in the long term.[392] Therefore, the two stage DCF model using a long term growth rate of 50 percent of forecasted GDP growth provides a more accurate estimate of the cost of equity for each proxy company.

Dr. Vander Weide also commits an error in the growth rate that he uses for his one stage DCF model. He uses I/B/E/S data that he claims only changes once per month on the Thursday before the third Friday of the month.[393] Therefore, he claims that data that

[389] Prepared Rebuttal Testimony of James H. Vander Weide, page 16.
[390] Prepared Direct Testimony of Peter K. Ashton, page 17.
[391] Prepared Rebuttal Testimony of Peter K. Ashton, page 21.
[392] Prepared Rebuttal Testimony of Peter K. Ashton, page 21.
[393] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, pages 828-829.

he collects during the first two weeks of March should reflect data as of February 28th.[394] However, the data that he actually collected in March reflects data from March, not February. Under cross- examination Dr. Vander Weide admitted that the growth rate that he uses for Magellan reflects the I/B/E/S estimate that first appeared on March 11th.[395] Once again Dr. Vander Weide appears to have manipulated the data in order to achieve a pre-ordained result that he has in mind. We would respectfully suggest that Dr. Vander Weide has little, if any credibility and his entire return on equity analysis should be rejected.

There is one last return on equity issue that needs to be addressed. Analysts who use the DCF model also use the midpoint convention. The midpoint convention assumes that dividends are paid in the middle of the year. As Mr. Ashton explains in his testimony, the proxy group companies pay dividends every quarter and can increase their dividends at that time. This means that dividends are paid on average in the middle of the year.[396] Dr. Vander Weide claims that it is a fundamental assumption of an annual DCF model that dividends are paid at the beginning of the year. That position is not correct and as Mr. Ashton points out, the DCF model can be adjusted to assume that dividends are paid at the beginning, middle or end of the year.[397] Therefore, it is important to use the variation of the DCF model that best reflects the situation that is being modeled. In this situation, that variation is the midpoint convention.

[394] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, page 833.
[395] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, page 830.
[396] Prepared Rebuttal Testimony of Peter K. Ashton, page 19.
[397] Prepared Rebuttal Testimony of Peter K. Ashton, page 19.

Furthermore, the appropriate measure to calculate the overall return on equity from the proxy group returns is the median. As Mr. Ashton explains in his testimony, the median is a more appropriate measure than the mean because it is not as affected by extreme values.[398] This is the same logic that led the Court of Appeals for the DC Circuit earlier this year to sustain the use of the median in calculating the return on equity.[399]

In response to Dr. Vander Weide's contention that the mean is preferable to the median,[400] Mr. Ashton points out that both the mean and the median are accepted statistical measures of central tendency.[401] In fact, Dr. Vander Weide admitted under cross-examination that the median reflects all data points because they are used to identify the middle value.[402]

For these reasons, Tesoro respectfully requests that the Presiding Judge accept the 11.5 percent return on equity recommended by Mr. Ashton for the SFPP pipeline,[403] and the use of Tesoro's recommended capital structure, cost of debt, and return on equity to produce an overall weighted average cost of capital for the test period of 7.29 percent.[404] Alternatively, if the Presiding Judge rules that interest rate swaps should not be included in the overall cost of debt, then SFPP's overall cost of capital would be 8.33 percent.[405]

V. PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

[398] Prepared Reply Testimony of Peter K. Ashton, page 18.
[399] *Southern California Edison Company v. FERC*, Case No. 11-1471, page 17 (D.C. Cir. May 10, 2013).
[400] SFPP Response to Tesoro Request No. 62, dated December 18, 2012.
[401] Prepared Reply Testimony of Peter K. Ashton, page 18.
[402] See the exchange between Mr. Wagner and Dr. Vander Weide, A.12-01-015 Transcript, Volume 6, pages 843-844.
[403] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.
[404] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.
[405] Prepared Rebuttal Testimony of Peter K. Ashton, page 26.

For the convenience of ALJ Bemesderfer, Tesoro has prepared the following Proposed Findings of Fact and Conclusions of Law based on the information presented in this Opening Brief.

FINDINGS OF FACT

Overhead

1. SFPP allocates $19.9 million to overhead.
2. Tesoro witness Peter K. Ashton allocates $8.2 million to overhead.
3. Tesoro witness Peter K. Ashton utilizes the Massachusetts Method in allocating overhead costs, the same Method employed and accepted in the A.09-05-014 et al., proceeding.
4. SFPP utilizes a multi-step allocation arrangement in which individual employees make determinations about how much time is devoted to specific Kinder Morgan entities, and then a supervisor reviews those employees' determinations.
5. ALJ Bemesderfer in his Proposed Decision dated June 22, 2011 in the A.09-05-014 proceeding had previously rejected this type of allocation arrangement.
6. SFPP witness Dale D. Bradley testified that 720,000 documents had to be reviewed to verify the salary splits and changes to those splits for 2011.
7. SFPP and Tesoro agreed that Tesoro Exhibit 5A accurately depicts the methodology that SFPP is currently using.
8. SFPP submitted SFPP Exhibits 26, 27, and 28 to depict its overhead allocation methodology.
9. SFPP Exhibits 26, 27, and 28 do not include all of the different types of costs actually allotted in the overhead methodology.

10. SFPP assigned at least 2.2 million in legal costs to SFPP jurisdictional service, which it now admits was incorrect.

Environmental

1. SFPP is incurring costs related to environmental remediation activities at 24 sites within California.
2. SFPP is requesting from shippers a total of $7.4 million to support its environmental cleanup activities at various terminals of its jurisdictional pipeline system.
3. Of the 24 sites in California that SFPP owns, 16 of the sites contain carrier property only. 2 sites contain non-carrier property only.
4. SFPP allocates all costs from its 16 carrier only sites to carrier property.
5. The six remaining SFPP sites in California, labeled the Mixed Asset Sites, contain both carrier and non-carrier assets.
6. The Mixed Asset Sites include: Mission Valley, Bradshaw, Brisbane, Chico, Colton, and Rocklin.
7. SFPP made a determination for each Mixed Asset Site regarding the allocation of expenses to carrier and non-carrier property.
8. SFPP witness Michael A. Hanak stated that releases with important information missing or unknown were considered as relevant in allocation determinations.
9. SFPP at one time attributed 100% of the remediation costs at Mission Valley to carrier property.
10. SFPP witnesses identified the “manifold area” as the source of releases at Mission Valley.

11. The Mission Valley "manifold area" as defined by SFPP witnesses contains both carrier and non-carrier assets.
12. No specific assets in the "manifold area" have been identified by SFPP as the source of contamination currently under remediation at Mission Valley.
13. A release from a Powerine pipeline in 1992 was recently identified as a principal contributor to the Mission Valley contamination under remediation.
14. SFPP revised its carrier allocation at Mission Valley from 100% to 65% to account for the newly identified 1992 Powerine release.
15. SFPP is currently seeking $4,198,582 in remediation costs for the Mission Valley site.
16. There have been at least 100 releases recorded at the Chico site between 1970 and 2007.
17. A single release from the Chico "manifold area" occurring on an unspecified date in 1990 was allocated to carrier property.
18. The "manifold area" at the Chico site includes both carrier and non-carrier assets.
19. The specific asset in the "manifold area" involved in the 1990 release at the Chico site has not been identified.
20. SFPP allocates 14.29% of remediation expenses at Chico to carrier property.
21. SFPP is requesting $11,602 from ratepayers for this single carrier release at the Chico site.
22. SFPP identified two releases that have contributed to the contamination currently under remediation at Colton.

23. A release of 2,283 bbls of unleaded regular from a breakout tank occurred at Colton on December 22, 1992.
24. A release of an unknown amount of unleaded regular occurred at Colton on August 5, 1993.
25. SFPP allocated 100% of the environmental remediation expenses at Colton to carrier property.
26. SFPP is requesting $748,124 from ratepayers for the environmental remediation activities at the Colton site.
27. SFPP identified eight releases that were relevant to the remediation at the Rocklin site.
28. SFPP allocates 100% of the environmental remediation costs at Rocklin to carrier property.
29. SFPP is requesting $160,245 from ratepayers for the environmental remediation activities at the Rocklin site.
30. There are nine recorded releases at the Brisbane site that SFPP has identified as driving remediation activities.
31. SFPP witnesses only identified one of the nine releases at Brisbane to carrier property by relying on a 2007 Remedial Action Plan issued on June 29, 2007.
32. The carrier release identified by SFPP occurred on July 22, 2005 and released an unknown quantity of a mixture of diesel and turbine NAPH.
33. SFPP is requesting $13,270 from ratepayers for the environmental remediation activities at the Brisbane site.

34. SFPP is requesting $1,268,367 in relation to the Concord, Stockton, Oakland Airport, and Norwalk sites.
35. The Concord, Stockton, Oakland Airport and Norwalk sites are classified as containing only carrier property.
36. Third party assets are located at the Concord, Stockton, Oakland Airport and Norwalk sites.

Other Expenses

1. SFPP included $8 million in rental right of way expenses related to a California Superior Court decision in a case between SFPP/KMEP and Union Pacific Rail Road its proposed cost of service.
2. The California Superior Court decision is on appeal.
3. SFPP has not yet made any cash payment of the additional amounts that may be owed pursuant to the Superior Court decision.
4. SFPP witness Wetmore proposed a negative oil losses and shortages expense of $1.1 million.
5. SFPP witness Wetmore based his oil losses and shortages expense on an average of losses and shortages over the period 2007-2011 for the West Line, while using 2011 base period data for South Line and North Line.
6. 2011 was an anomalous period for the West Line.
7. Tesoro witness Peter K. Ashton bases his oil losses and shortages estimate of negative $1.5 million on actual data for the first ten months of 2012, which was then annualized.

8. Tesoro witness Ashton uses actual fuel and power costs in his cost of service analysis.
9. Tesoro witness Ashton calculates a $12.1 million fuel and power figure, a higher figure than Mr. Wetmore's calculation.
10. SFPP witness Wetmore implements a wage increase of 3.1% effective January 1, 2012.
11. The wage increase did not go into effect until February 10, 2012.
12. Tesoro witness Ashton uses the actual 2012 CPUC litigation expenses of $1.9 million.
13. SFPP witness Wetmore uses a base period figure for CPUC litigation expenses of $1.4 million.

Rate of Return

1. The parties agree that SFPP's return on equity should be calculated by using a Discounted Cash Flow (DCF) methodology based on a proxy group of comparable companies.
2. Shipper witnesses Ashton and Horst used a proxy group consisting of Buckeye Partners LP, Enbridge Energy Partners, Enterprise Products Partners, KMEP, Magellan Midstream Partners LP, NuStar Energy LP, Holly Energy Partners LP, Plains All American Pipeline LP and Sunoco Logistics LP.
3. SFPP witness Vander Weide used a subset of the proxy group used by shipper witnesses by applying additional subjective selection criteria.
4. Mr. Ashton uses a long term growth rate of 50 percent of the forecasted increase in Gross Domestic Product the same method used by the FERC.

5. Using Mr. Ashton's analysis the Test Year 2012 Capital Structure of SFPP is 59.95% Debt and 40.05% Equity
6. Using Mr. Ashton's analysis the Test Year 2012 Cost of Debt of SFPP is 4.52%
7. Using Mr. Ashton's analysis the Test Year 2012 Cost of Equity of SFPP is 11.50%
8. Using Mr. Ashton's analysis the Test Year 2012 Weighted Average Cost of Capital of SFPP is 7.32%.

CONCLUSIONS OF LAW

1. SFPP has failed to prove by clear and convincing evidence that its corporate overhead cost allocation methodology involving direct assignments based on salary splits and subjective timekeeping records is accurate, reliable, transparent or reasonable.
2. SFPP has failed to prove that the direct assignment of legal costs is accurate, reliable, transparent or reasonable.
3. The Commission has discretion to rely on the transparent and objective Massachusetts Method to allocate corporate overhead expenses to SFPP and to the CPUC-jurisdictional operations of SFPP.
4. Consolidated Test Year 2012 KMEP Overhead Expenses properly allocable to SFPP are $26,500,751 and Consolidated Test Year 2012 KMEP Overhead Expenses properly allocable to the CPUC-jurisdictional operations of SFPP are $8,177,651.
5. SFPP has not met its burden of establishing with clear and convincing evidence that the spills at the Mission Valley site emanated from CPUC jurisdictional property.

6. SFPP has not met its burden of establishing by clear and convincing evidence that it acted reasonably in attempting to prevent spills at the Mission Valley site in the first place.
7. SFPP is not entitled to recover any of the costs it requested in its application for environmental remediation at the Mission Valley site.
8. SFPP has not met its burden of establishing by clear and convincing evidence that the spills at Colton, Chico, Rocklin and Brisbane emanated from CPUC jurisdictional property.
9. SFPP has not met its burden of establishing by clear and convincing evidence that it acted reasonably in attempting to prevent spills at the Colton, Chico, Rocklin, and Brisbane sites in the first place.
10. SFPP is not entitled to recover any of the costs it requested in its application for environmental remediation at the Colton, Chico, Rocklin, and Brisbane sites.
11. SFPP has not met its burden of establishing by clear and convincing evidence that the spills at the Concord, Stockton, Oakland Airport and Norwalk sites emanated from its CPUC jurisdictional property.
12. SFPP has not its burden of establishing by clear and convincing evidence that it acted reasonably in attempting to prevent spills at the Concord, Stockton, Oakland Airport and Norwalk sites in the first place.
13. SFPP is not entitled to recover any of the costs it requested in its application for environmental remediation at the Concord, Stockton, Oakland Airport and Norwalk sites.

14. SFPP's request for $7.4 million in environmental remediation expenses should be denied.
15. Only those costs that have been incurred and paid should be included in the SFPP cost of service.
16. SFPP has not paid increased rental amounts to the Union Pacific Rail Road as a result of a lawsuit between SFPP and Union Pacific Rail Road. Consequently, those increased rental expenses should not be included in the SFPP cost of service.
17. Tesoro witness Ashton's figure for oil losses and shortages of negative $1.5 million is a more reasonable estimate than SFPP witness Wetmore's figure of negative $1.1 million.
18. Tesoro witness Ashton's figure of $12.1 million for fuel and power costs is a more reasonable estimate than SFPP witness Wetmore's cost analysis because it uses actual 2012 costs.
19. SFPP wage increases of 3.1% should reflect the fact that it was in effect for 325 days of the year.
20. CPUC litigation expenses should not be embedded in the cost of service, and should instead be recovered as a temporary surcharge that would expire once the costs have been recovered and litigation terminated.

CONCLUSION

For the reasons set forth above, Tesoro Refining and Marketing Company respectfully requests that the Presiding Judge adopt the cost of service set forth by Tesoro witness Peter K. Ashton in exhibits R-2 and R-3 to his Prepared Rebuttal Testimony.

Tesoro further respectfully requests that the Presiding Judge adopt the proposed findings of fact and conclusions of law enumerated above.

GLOSSARY OF TERMS AND ABBREVIATIONS

ADIT: Accumulated Deferred Income Tax; ADIT arises when a regulated pipeline accumulates deferred income taxes because of differences between the timing of depreciation expenses for ratemaking as opposed to income tax reporting purposes. Tax law often permits depreciation to be accelerated for computing income taxes, while for ratemaking purposes depreciation is usually computed on a straight-line basis. As a result, the pipeline will owe less in taxes in its early years of operation and more in taxes in later years relative to the amount of taxes collected for ratemaking purposes.[406]

Cross-subsidization: An economic phenomenon that occurs when one entity pays for more costs that it incurs relative to another entity that pays less than it incurs; the former entity is said to be cross subsidizing the latter. This typically occurs between a regulated and an unregulated entity within the same consolidated company such as with KMEP. Under such situations, there is an incentive to assign as much time as possible to the regulated entity because both entities benefit from the provision of the corporate overhead services but the regulated entity is more easily able to pass on costs to ratepayers. [407]

DCF: Discounted Cash Flow model; this model is a generally accepted method used to calculate a company's return on equity. [408]

Exception Coding: The process by which certain Kinder Morgan employees override the normal salary splits on a regular basis.[409]

Interest Rate Swaps: Interest Rate Swaps refers to an agreement in which one party (i.e. a financial institution) pays another party (i.e., KMEP) the interest rate on a certain

[406] Prepared Revised Direct Testimony of Peter K. Ashton, page 25.
[407] Prepared Revised Direct Testimony of Peter K. Ashton, page 37.
[408] Prepared Revised Direct Testimony of Peter K. Ashton, page 14.
[409] Prepared Rebuttal Testimony of Dale D. Bradley, page 9.

amount of fixed rate debt in exchange for receiving the interest rate on the same amount of floating rate debt.[410]

G&A Costs: General and Administrative Costs; corporate overhead expenses that are not specifically attributable to individual operating segments.[411]

GP Services: KMGP Services Company, Inc.

KMI: Kinder Morgan, Inc., the ultimate parent of KMEP.

KMI Cross-charge: The costs attributable to KMI shared-service employees who provide services to both KMEP-owned and operated entities, as well as KMI-owned and operated entities. The cross charge arises when these KMI shared-service employees do not directly assign their time to specific KMEP-operated entities and instead are billed to a shared services account which is then in turn billed to SFPP and other KMEP entities via the Massachusetts method.

MA Formula: Massachusetts Formula; a generally accepted cost allocation methodology that relies on three cost drivers including (1) gross revenue, (2) gross property, plant, and equipment and (3) gross payroll (or direct labor costs) to allocate corporate overhead costs that cannot be directly charged to particular subsidiaries.[412]

Manifold Area: The area that contains the piece of equipment (the manifold), which is part of the CPUC jurisdictional pipeline and connects to various delivery pipelines within a terminal or other facility.

[410] Prepared Revised Direct Testimony of Peter K. Ashton, page 20.
[411] Prepared Revised Direct Testimony of Peter K. Ashton, page 27.
[412] Prepared Revised Direct Testimony of Peter K. Ashton, pages 29-30.

Mixed Asset Sites: Environmental remediation sites that contain a mix of carrier and non-carrier assets, depending on whether companies other than SFPP own tanks or other facilities at these terminals.

MTBE: Methyl Tertiary Butyl Ether; a volatile, flammable, and colorless liquid that is an alleged source of the Mission Valley plume.

MVT: Mission Valley Terminal, located just north of San Diego.

OLP-D: Kinder Morgan Operating L.P. "D", one of five operating limited partnerships through which KMEP holds its ownership interests. OLP-D owns 99.5 percent of SFPP, which owns and operates all of the lines at issue in this proceeding. The other 0.5 percent of SFPP is owned by Santa Fe Pacific Pipeline, Inc. ("Santa Fe"), an unaffiliated company.[413]

PAA's: Purchase Accounting Adjustments; restatements of equity and asset balances made when a company acquires assets. 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.[414]

RCs: Responsibility Centers; RCs are departmental assignments based primarily on functional duties. An RC typically is comprised of a group of people reporting to a common individual and performing a similar function.[415]

TBA: Tertiary Butyl Alcohol, the resulting biodegradation product of MTBE.

[413] Prepared Direct Testimony of Dale D. Bradley, page 5.
[414] Prepared Revised Direct Testimony of Peter K. Ashton, page 12.
[415] Prepared Direct Testimony of Dale D. Bradley, page 12.

CERTIFICATE OF SERVICE

I, Aaron Wesley Korenewsky, certify that I have on this 1st day of July 2013, served a copy of the foregoing:

OPENING BRIEF OF TESORO REFINING AND MARKETING COMPANY

by transmitting an e-mail message with the documents attached to each of the persons listed on the official service list available on the California Public Utilities Commission website.

In addition, I have caused a copy of the foregoing document to be served by FedEx overnight delivery to the following addressee:

ALJ Karl J. Bemesderfer
California Public Utilities Commission
505 Van Ness Avenue, Room 5008
San Francisco, CA 94102-3214

I declare under penalty of perjury that the foregoing is true and correct. Executed this the 1st day of July 2013 at Washington, D.C.

/s/ Aaron Wesley Korenewsky

Aaron Wesley Korenewsky

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Back to Service Lists Index

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TOP OF PAGE
BACK TO INDEX OF SERVICE LISTS