SFPP, L.P.
Order on Petition for Declaratory Order
102 FERC ¶61,089 (2003)

SFPP, L.P. (SFPP) planned to increase the capacity on its East Line to Arizona at a cost of about $180 million, which was expected to increase its East Line rate base five-fold. SFPP filed for a declaratory order seeking assurances that it could thereafter charge cost-of-service rates on the East Line, and that the rates would only be subject to a minimum suspension period once filed.

The Commission addressed three issues. First, it determined that it was reasonable to determine, in advance, that the cost of the expansion should be rolled-in with the current rate base to produce one rolled-in rate for all East Line shippers, rather than segregate the cost of the expansion into an incremental rate for new shippers only, leaving existing shippers with their current indexed rate. The Commission found that unlike the users of gas pipelines, shippers of petroleum products have no right to contractual entitlements for the firm use of a given amount of capacity. The failure to expand the system will lead to curtailment of all shippers regardless of their relative seniority and length of time as East Line shippers. Requiring an incremental rate would be inconsistent with the anti-discrimination provisions of the Interstate Commerce Act. (at 61,244)

Second, the Commission concluded that, inasmuch as it was not making a determination that the rates to be proposed were just and reasonable, not addressing the methodology used to design the rates, did not reduce the burden on SFPP to file and justify its proposed rates according to established rules and precedent, and did not impair the rights of the shippers to protest any rates filed, it was appropriate to address the rolled-in versus incremental question at this stage. (at 61,244-45)

Finally, the Commission concluded that a one-day suspension of the rates to be proposed was appropriate under these circumstances. (at 61,245-46)

COMM-OPINION-ORDER, 102 FERC ¶61,089, SFPP, L.P., Docket No. OR02-13-000, (January 30, 2003)

SFPP, L.P., Docket No. OR02-13-000

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[¶61,089]

SFPP, L.P., Docket No. OR02-13-000

Order on Petition for Declaratory Order

(Issued January 30, 2003)

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, and Nora Mead Brownell.

1. On October 19, 2002, SFPP, L.P. (SFPP) filed a petition for a declaratory order concerning SFPP's proposal to increase the capacity of its East Line between El Paso, Texas, and Tucson and Phoenix, Arizona. The Commission will grant the petition in part. This action is in the public interest because it will reduce the regulatory burden associated with the construction of additional petroleum product pipeline service in a market where capacity is inadequate.

I. The Petition for Declaratory Order

2. In its petition SFPP asserts that it is currently the only petroleum products pipeline serving Phoenix and Tucson, Arizona, from the east, thus giving access to those markets from refineries located in New Mexico and Texas. SFPP's petition asserts that there is a significant need to expand the capacity of its East Line between El Paso, Texas, and points in Arizona as its Line has been operating at capacity since 1999. It states that refineries are being expanded in the El Paso area and that demand for service over its East Line is such that it can now carry only about 65 to 75 percent of nominated volumes. It asserts that this lack of capacity will increase when the Longhorn Pipeline begins operating from the Gulf coast to El Paso, Texas.[1] SFPP states that in light of this capacity shortage, it solicited non-binding expression of interests from shippers and received a strong response. Based on that response, it proposes to increase the capacity of its East Line by approximately 53,000 barrels per day on the El Paso to Tucson segment, and by approximately 44,000 barrels per day on the Tucson to Phoenix segment. SFPP estimates that approximately 75 percent of the increased capacity would be utilized in the first year of operation.

3. SFPP plans to install 10 miles of 16 inch pipeline while removing 160 miles of 8 inch pipeline between El Paso and Tucson, and to connect this new pipeline to an existing 12 inch pipeline. The remaining 12 inch pipeline would be connected to an existing 8 inch pipeline. This will result in two pipelines from El Paso to Tucson: one a combination of 16 and 12 inch pipelines, and a second one a combination of 12 inch and 8 inch pipelines. One continuous 12 inch pipeline would be installed between Tucson and Phoenix and the existing 8 inch pipeline would be removed from service. The estimated construction cost is $180 million. SFPP states that this would more than quintuple the East Line's current rate base. SFPP asserts that operating expenses, fuel and power, property taxes, and insurance, would also increase. Upon starting the service, SFPP intends to

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cancel its existing East Line tariffs and replace them with new increased tariffs reflecting the increased cost of service of the expansion.

4. SFPP asserts that the proposed expansion is supported by the California Energy Commission because the shipment of increased volumes of petroleum products from Texas to Arizona will help reduce the demand for product from California. This would reduce the need to import oil and petroleum products into California. SFPP also states that the proposed construction would also increase competition in the petroleum products wholesale and retail markets in Arizona and meet in rapidly increasing demand resulting from population growth in Arizona and New Mexico.

5. SFPP states that it will bear all the cost of the proposed East Line expansion. It asserts that it needs assurance that it can collect cost-of-service rates, as opposed to indexed rates, to justify this substantial investment. It asserts that the incremental volumes anticipated to be realized by the East Line expansion would result in returns that are too low to justify SFPP's investment in the expansion if SFPP were permitted to charge only the current East Line tariff rates, as indexed under the Commission's regulations. SFPP states that absent receipt from the Commission of the rulings requested in its petition, SFPP will not make the expansion despite SFPP's interest in doing so, shippers' interest in the project, and the demonstrable public benefits from enhanced service.

6. SFPP requests the Commission to make three rulings. First, it requests a determination that if the cost-of-service rates that would result from the additional investment would be 20 percent or more above the indexed rates now used on its East Line, this will constitute a substantial divergence between the resulting East Line costs and the East Line tariff rates that would result from the continued application of the Commission's index. Such a finding is required by Section 342.4(a) if a carrier seeks to change a rate to recover costs through newly filed rates rather than continuing to use the Commission's indexing methodology to recover its costs. Section 342.4(a) provides:

Cost-of-Service Rates. A carrier may change a rate pursuant to this section if it shows that there is a substantial divergence between the actual costs experienced by the carrier and the rate resulting from application of the index such that the rate at the ceiling level would preclude the carrier from being able to charge a just and reasonable rate within the meaning of the Interstate Commerce Act. A carrier must substantiate the costs included by filing the data required by Part 346 of this chapter. A carrier that makes such a showing may change the rate in question, based upon the cost of providing the service covered by the rate, without regard to the applicable ceiling level under §342.3.[2]

Second, SFPP's requests that the Commission find that a substantial divergence can be based on a capital investment such as SFPP's proposed investment in the East Line expansion. Finally, SFPP is requesting that any rates so filed be subject to a minimum suspension so that SFPP can recover the increased costs once the expanded system is placed in service.

7. SFPP concludes that without these assurances it would be imprudent to proceed with the investment because of risk and delay in recovering the additional costs of operating the East Line. SFPP cites *Express Pipeline Partnership*[3] and Phillips Petroleum Co. & Marathon Oil Co.[4] as holding that a declaratory order is appropriate under these circumstances.

II. Interventions, Protests, and Answers

8. Public notice of SFPP's petition was issued on September 26, 2002, with interventions and protests due on or before October 21, 2002. Timely interventions and protests were filed by Chevron Products Company (Chevron), Tosco Corporation (Tosco), Valero Marketing and Supply Company (Valero), and the Navajo Refining Company, L.P. (Navajo). These parties oppose granting the petition for declaratory order on the grounds that it is premature, or that any newly filed rates should be incremental rather than rolled in. The protesting parties are not unanimous in their arguments.

9. Timely interventions and comments were filed by BP West Coast Products LLC and ExxonMobil Corporation (collectively Indicated Shippers),[5] Quiktrip Corporation (Quiktrip), the State of Arizona ex rel. Janet Napolitano, Attorney General (State of Arizona), and Refining Holding Company (RFC). These parties support the petition for declaratory order on the grounds that it will encourage the construction of needed capacity and result in greater

petroleum supplies and competition in the Arizona market.

10. Longhorn Partners Pipeline L.P. filed a motion to intervene and requested leave to file an answer to the protests. SFPP also requested leave to file an answer. The motions to intervene are granted. Longhorn's and SFPP's requests to file answers are also granted in that they will provide additional information and clarification regarding the issues in this proceeding. In addition, Chevron filed a request to answer the answers. This latter request is outside the scope of Commission practice, adds little here, and is denied.

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III. Discussion

11. The purpose and standards for issuing a declaratory order were discussed in *Express, supra*. As stated there, Section 554(c) of the Administrative Procedure Act provides that an agency in its sound discretion may issue a declaratory order to terminate a controversy or remove uncertainty.[6] Rule 207 of the Commission's Rules of Practice and Procedure[7] provides that a person must file a petition when seeking a declaratory order. The rule does not include any requirement that a person have "standing" before filing a petition for a declaratory order. Thus, whether to consider providing declaratory relief under this provision is discretionary with the Commission.[8]

12. Under these standards the Commission may find, in the exercise of its discretion, that, as a general matter, in order to provide definitive guidance for all interested parties, it would be appropriate to address oil pipeline rate making issues, such as those raised by the petition of SFPP, in the context of a declaratory order proceeding. It is better to address such issues in advance of an actual tariff filing than to defer, as the protesters urge, until the rate filing is made, when the decision-making process would be constrained by the deadlines inherent in the statutory filing procedures. In many circumstances the public interest is better served by a review of the issues presented before a filing to put the rates into effect.[9]

13. Regarding the merits of this petition, the issues presented fall into three categories in the order raised by the parties. The first is whether it is appropriate to issue a declaratory order concluding that SFPP may file to recover increased costs utilizing cost-of-service rates. The second is whether it is premature to determine whether any rates filed to recover the expansion costs should be subject to a minimal suspension. As is discussed below, these aspects of SFPP's petition are well within existing Commission precedent. The third is whether any new rates should be priced incrementally rather than rolled-in to protect the existing shippers against the increased costs. This important underlying issue will be addressed first.

A. *Whether any Cost-of-service Rates Should Be Incremental or Rolled-In.*

14. Chevron and Navajo assert that SFPP's request for a declaratory order should not be granted because it assumes that any cost-of-service rate filing will result in SFPP rolling the cost of the enhancements into its existing rate base, *i.e.*, the resulting rates will be rolled-in rates. They assert that this will result in existing East Line shippers incurring a large rate increase for capacity that will benefit only the new shippers that will be the beneficiaries of the expanded capacity on SFPP's East Line. Navajo argues that the existing shippers will subsidize new shippers over the East Line unless incremental rates are used to recover the costs of the proposed expansion. Navajo asserts that the Commission's policies governing expansion costs under the Natural Gas Act are equally applicable to oil pipelines. It therefore concludes that the Commission should apply here the policy statement governing the determination of whether the expansion costs of natural gas pipeline should be rolled into existing rates or billed on an incremental basis.[10]

15. SFPP and Longhorn reply that Chevron and Navajo's protests reflect a course of conduct that is designed to protect their current markets against the impact of increased competition. That competition will occur because additional volumes of petroleum products would be able to reach the Arizona market from points in Texas and New Mexico. SFPP and Longhorn assert that the Commission has never required oil pipelines to price expansions on an incremental basis compared to a single cost-of-service rate that reflects the total capacity that

is being utilized. They assert that oil pipelines are common carriers that must be open to all product that is tendered to them, unlike gas pipelines that are contract carriers, and as such, oil pipeline shippers are not entitled to a amount of capacity defined by long term contractual arrangements.

16. They further argue that the common carrier obligation requires that, if there is insufficient capacity, the pipeline must pro-rate the capacity that is available on a non-discriminatory basis regardless of when the shipper first started using the facilities. SFPP further asserts that all shippers are entitled to the same maximum rate under the Interstate Commerce Act, and that using different rate methodologies for services between the same points would be unduly discriminatory. Finally, Longhorn asserts that the Commission has no authority to regulate oil pipeline entry. It argues that the adoption of incremental pricing would effectively regulate oil pipeline entry by requiring pricing that would make expansion projects infeasible.

17. The Commission first notes that Navajo and Chevron's arguments regarding rolled-in or incremental pricing would normally be premature given the procedural status of the petition. As has been discussed, the actual rate design for the proposed expansion is not part of this petition for declaratory order, and is therefore not raised on the face of the petition. However, SFPP has requested a ruling that it may file for cost-of-service rates under the conditions stated in its petition,

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and granting the petition would be a *de facto* recognition that "rolled-in" rates are appropriate. This is because granting the current petition makes sense only if SFPP can expect that the rates would be rolled-in because any shippers that have to pay incremental rates would probably not be competitive for the delivery of petroleum products to an expanding El Paso to Arizona market.

18. SFPP and Longhorn are correct that oil pipelines are common carriers. Unlike the users of gas pipelines, shippers of petroleum products have no right to contractual entitlements for the firm use of a given amount of capacity.[11] Thus, the failure to expand the system will lead to curtailment of all shippers regardless of their relative seniority and length of time as East Line shippers. SFPP and Longhorn are also correct that if an incremental rate is charged, this will be so favorable to the incumbent shippers that it will discourage the proposed expansion and defeat the opportunity for delivering more competitively priced petroleum products to the Arizona market. In fact, the State of Arizona, Quiktrip, and Indicated Shippers support the petition for declaratory order precisely because of the increased petroleum supply and competitive opportunities that will result. Thus, while the Commission cannot preclude Navajo and Chevron from raising the issue of incremental rates at the time SFPP files to recover the costs of its proposed expansion, the Commission concludes that requiring an incremental rate here would not conform to Commission policies governing oil pipeline rates and would be inconsistent with the anti-discrimination provisions of the Interstate Commerce Act.[12]

B. *Whether a Declaratory Order Is Appropriate*

19. Chevron argues that the cases cited by SFPP deal with proposed construction of a new pipeline, not an expansion, and are therefore not apposite. Chevron, Valero, and Tosco all argue that the request for declaratory order should not be granted in the absence of a full cost-of-service filing that justifies the proposed costs that would underlie the 20 percent increase that SFPP argues should be the threshold in this case, and which would permit it to file a cost-of-service case under Section 342.42(a) of the Commission's regulations. All three argue that previous declaratory orders by the Commission addressing oil pipeline construction have been premised on a full cost-of- service filing to assure that the Commission and the parties fully understand the implications of issuing the declaratory order.[13] They assert that any oil pipeline requesting a declaratory order on rate design or rate levels must provide that such a cost-of-service filing if the Commission is to rule on the petition in an informed manner.

20. Chevron also asserts that SFPP may inflate the costs contained in a cost-of-service filing in order to justify the threshold. Chevron further asserts that the Commission must determine whether the size of the expansion is appropriate and whether the proposed abandonment of some SFPP's East Line facilities is consistent with the public interest.

21. SFPP and Longhorn assert in reply that for the purposes of a declaratory order there is no difference between the major expansion proposed here and new construction involved in *Colonial* or *Express*. They argue that both involve the risk of large expenditures that would result in a large increase in the pipeline's rate base and

its cost-of- service. They also assert that SFPP is not asking the Commission to determine here that any proposed rates would be just and reasonable and that any filing would have to conform to the Commission's methodology for establishing cost-based rates for oil pipelines. They further argue that SFPP has not requested the Commission to approve a rate methodology or a projected rate level, the two types of issues that were addressed by the previously cited cases. SFPP also concedes that any cost-of-service filing would be subject to the prudence and used-and-useful standards that apply in oil rate making proceedings.[14] Finally, it rejects the notion that it has incentives to file a fraudulent cost-of-service filing or that it would do so.

22. The Commission concludes that a large scale line expansion such as SFPP is pursuing here is an appropriate subject for a declaratory order. As SFPP points out, there is no distinction between new construction and a large scale expansion in terms of the economic risk that may be involved. In the context of oil pipeline investments, where utilizing rates that will be charged to all shippers using the line reflects normal Commission policy, the carrier is seeking some certainty regarding its ability to recover a large increase in its costs by filing cost-of-service rates to recover the costs.

23. Moreover, if the petition for declaratory order is granted, the Commission will not be making any preliminary determination that the rates to be included in any filing are just and reasonable. The Commission is addressing a threshold issue that goes to determination of whether SFPP must continue to use its indexed rate levels, or instead may file a cost-of-service case to increase its rates above the indexed level in order to recover the costs associated with the proposed expansion.

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Other than the incremental versus rolled-in rate issue implicit in the petition, and which was previously discussed, the ruling here does not address the methodology used to design the rates or rule on the prospective rate level that will result from the costs reflected in a particular methodology or filing. As SFPP and Longhorn argue, the rulings requested here are different from and narrower than the specific cost methodologies or prospective rate levels in the *Express*, *Colonial*, and *Plantation* cases.

24. Moreover, the ruling here is premised on the SFPP's making its eventual cost-of-service filing in a manner consistent with Commission regulations and oil pipeline costing methodology, supported by the appropriate documentation. This is the same documentation that would be required for all cost-of-service rate filings and does not decrease the burden on SFPP to make a filing that conforms to the Commission's regulations. If SFPP were to fail to do so, it would simply defeat the purpose it seeks here, which is to obtain assurance that the substantial increase in costs that SFPP anticipates will result from this expansion can be used to support and can be recovered through a cost-of-service filing.

25. The Commission therefore finds that the propriety of basing "substantiality" on the level of investment proposed, approximately $180 million, which most parties concede would at least quintuple the rate base of the East Line, presents an issue that is appropriately resolved through a declaratory order. Subject to the caveat that any filing by SFPP under Section 342.4(a) to change its rates must conform to the Commission's cost- of-service filing regulations, the Commission concludes that SFPP may file cost-of-service based rates to recover the projected capital cost of increasing the capacity of its East Line. In doing so, the Commission is not ruling that any such rates will be deemed just and reasonable, and nothing here deprives any shipper of an opportunity to file a protest challenging any such proposed rates. The Commission is also not making a determination that any particular level of prospective costs, or percentage divergence between the existing rates and those that would enable the carrier to recover such an increase, will be the standard for determining any substantial divergence in subsequent rate cases or requests for a declaratory order.

C. Whether a Minimal Suspension Is Appropriate.

26. Chevron and Valero assert that the request for a minimal suspension is also inappropriate. They assert that the Commission should not approve rate filings in advance, and that despite a general Commission policy in oil proceedings of short suspension, such suspension should not be automatic. They argue that this is because the cost of the construction is unknown and therefore its possible impact on shippers and the appropriateness of any filing cannot be judged at this time. They assert that any decision regarding suspension should not be made until all the facts and circumstances of the filing are before the Commission. Valero further argues that the Commission should not rule whether a short suspension is appropriate until the Commission determines whether the filing could have an anti-competitive impact on SFPP's shippers. Chevron also asserts that SFPP is

attempting to establish an arbitrary date upon which any increased rates will become effective.

27. SFPP and Longhorn reply that SFPP is not attempting to establish rate levels through its petition, that minimal suspension is consistent with the Commission's policy, and with the Commission's perception that consumers are less affected by oil pipeline rates than those of natural gas pipelines. SFPP replies that it is not attempting to establish a unilateral, arbitrary effective date for any proposed cost-of-service rates, stating that its petition specifically states that the effective date of the rates will be controlled by the in service date for the expanded facilities. RFC and Indicated Shippers support SFPP's request regarding any suspension with the reservation that any action here is not ruling on the prudence of the proposed investment or whether the resulting rates will be just and reasonable. They reserve all rights to review the proposed rates and to request the Commission to determine whether the proposed rates are just and reasonable.

28. The rationale for a short suspension was enunciated by the Commission in *Buckeye Pipe Line Company.*[15] In that case the Commission reversed a decision by its Oil Pipeline Board adopting a policy of seven month suspensions unless circumstances warranted a shorter period. The Commission ruled that unless the matter was referred to the Commission and the Commission determined otherwise, all oil pipeline suspensions were to be for one day. The Commission contrasted the situation of gas and utility consumers with that of oil pipeline shippers, stating that utility consumers were mobile and have more limited financial resources, and therefore had a greater need for protection than shippers involved in the litigation of oil pipeline rate proceedings. In contrast, oil pipeline shippers would almost always be identifiable for refund purposes because of their more consistent involvement with the pipeline. Since refunds were considered more likely to protect oil shippers than consumers, the Commission concluded that the consistent use of a shortened suspension period was appropriate for oil pipelines.

29. The Commission finds that SFPP has appropriately requested a declaratory order regarding the possible suspension period for the cost-of- service rates it may file to recover the costs of expanding its East Line. As Longhorn, SFPP, and

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the supporting shippers state, it is Commission policy to use minimal suspensions in oil pipeline cases because the interests of consumers are less likely to be affected. The Commission's methodology for establishing cost based rates for oil pipelines has been defined in detail in Opinion Nos. 435, 435-A and 435-B,[16] and any cost-of-service filing must follow that methodology and be based on verifiable costs. Thus, contrary to the arguments of the protesting shippers, by accepting a short suspension the Commission would not be automatically ruling that the rates SFPP may file would be just and reasonable, nor giving SFPP a blank check to submit any level of costs without regard to regulatory requirements.

30. The assurance requested here is that SFPP not be forced to accept large losses pending the effective date of rates once it is prepared to place a costly expansion in service to meet shipper needs simply because a protest is filed.[17] The refund requirement protects shippers against any accounting errors or disputes about the appropriateness of particular elements of the filing. Subject to the caveat that SFPP must make a complete filing as required by the Commission's regulations, the Commission will grant SFPP's request that a cost-of-service filing to recover the investment in the East Line proposed here be effective the date requested by SFPP,[18] so long as a shortened suspension would be consistent with the Commission's policy as stated in Buckeye.

***The Commission orders*:**

The petition for declaratory order is granted to the extent described in the body of this order.

[1] SFPP stated in its petition that Longhorn was expected to begin operations in late 2002. The earliest date is now expected to be May 2003.

[2] 18 C.F.R. §342.4 (2002).

[3] 75 FERC ¶61,303, at p. 61,967 (1996).

[4] 58 FERC ¶61,290, at p. 61,932 (1992).

[5] Indicated Shippers support granting the petition, and then present an extensive argument why SFPP's position on this issue of "substantial divergence" is inconsistent with SFPP's position on the issue of "substantially changed circumstances" in another proceeding. This is not germane to this order and will not be addressed here.

[6] 5 U.S.C. §554(c)(1988).

[7] 18 C.F.R. §385.207 (1995).

[8] *See, for example, Phillips Petroleum Company and Marathon Oil Company*, 58 FERC ¶61,290 (1992); and *Longhorn Partners Pipeline*, 73 FERC ¶61,355 (1995).

[9] *Express*, 75 FERC at p. 61,967.

[10] *Citing Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶61,227 (1999).

[11] Part 284 of the Commission's regulations makes clear that gas pipelines must make capacity available on a firm basis at the maximum rate if the capacity is available. All gas pipeline tariffs provide some type of tie breaker in the event that capacity is inadequate to meet the demands of all the potential shippers. 18 C.F.R. Part 284.

[12] 49 App. U.S.C. §§2 and 3 (1988).

[13] *Citing Express Pipeline Partnership*, 75 FERC ¶61,303 (1996) (*Express*); *Colonial Pipeline Co.*, 89 FERC ¶61,095 (1999) (*Colonial*); and *Plantation Pipe Line Co.*, 98 FERC ¶61,129 (2002) (*Plantation*).

[14] *See* SFPP's Motion for Leave to Answer and Answer of SFPP, filed November 2, 2002, at 14, *citing Kuparuk Transportation Company*, 55 FERC ¶61,122 (1991).

[15] 13 FERC ¶61,267 (1980) (*Buckeye*).

[16] *SFPP, L.P.*, 86 FERC ¶61,022 (1999) (Opinion No. 435); *SFPP, L.P.*, 91 FERC ¶61,145 (2000) (Opinion No. 435-A); *SFPP, L.P.*, 96 FERC ¶61,281 (2001) (Opinion No. 435-B).

[17] Given the history of the parties, protests would appear to be a virtual certainty even if every aspect of SFPP's filing achieved regulatory perfection. This is not the standard by which a request for short suspension would be judged.

[18] As noted, SFPP states this will reflect the in-service date of the facilities, and in any event can be no earlier than the date that the proposed rates are actually filed.

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