anything other than the very small Naphtha volumes traded under the contracts. *Id.* Thus, it concludes, the Naphtha contracts should not be used to validate or invalidate any of the methodologies at issue in this proceeding. *Id.*

1952. Petro Star explains that contract proponents argue that the Naphtha contracts must be important because they represent so many transactions, so many barrels of Naphtha, and so many dollars. Petro Star Reply Brief at p. 10. It states that these arguments emphasize that, in absolute terms, the numbers associated with purchases and sales of Naphtha on the West Coast are large. *Id.* They do not, notes Petro Star, address the fact that most West Coast refiners acquire all or almost all of the Naphtha they use without purchasing it as a commodity, and, as a consequence, the number of actual deals struck is small. *Id.*

1953. According to Petro Star, the highest number of Naphtha contracts included in any witness's study was the 192 included in Tallett's, or only 24 contracts per year on the West Coast. *Id.* It states that these were contracts for all types of Naphtha for the eight-year, 1994-2001, period. *Id.* at pp. 10-11. Petro Star explains that more contracts are available from recent years than earlier, but even during the more recent 1999-2001 period, the contract analyses include fewer than three contracts per month. *Id.* at p. 11. In addition, continues Petro Star, these 94 contracts were spread among 12 different buyers, so that, on average, each of the refineries that did buy Naphtha during the period contracted to do so fewer than three times per year. *Id.*

1954. Petro Star points out that contract proponents attempt to bolster the significance of the contracts by emphasizing the sophistication of the transacting parties. *Id.* (citing Exxon Initial Brief at p. 242). But, according to Petro Star, Baumol, Toof, and Pulliam, cited as sources for that conclusion, did not claim any knowledge about the specific business underpinnings of the Naphtha contracts. *Id.* Further, asserts Petro Star, this depiction of an active, vibrant market for Naphtha is not borne out by the evidence. *Id.* at p. 12. Petro Star concedes that some individual contracts involve careful negotiation and it probably may be assumed that careful consideration went into the negotiation of the very large volume contracts, but the same assumptions should not be made of the small lots transported by truck. *Id.* If a transaction involves only a very small volume, Petro Star asserts that even a company like BP might not bring all of its sophistication to bear upon it. *Id.*

1955. Moreover, Petro Star takes the view that, in the absence of market transparency, it appears very unlikely that Naphtha purchasers who on average enter into fewer than three contracts per year are necessarily "particularly well informed buyers . . . who are regular participants in the Naphtha market," whether or not they represent very large firms. *Id.* (quoting Exxon Initial Brief at p. 246). Indeed, Petro Star points out that Exxon asserts that Toof's own analysis showed the average Naphtha price from 1992 through 2001 was the same whether one viewed Full Range or only Heavy Naphtha contracts, or volume weighted the contracts. *Id.* Petro Star argues that it seems unlikely that keen and sophisticated Naphtha buyers and sellers would value Full Range and Heavy Naphtha the same, or make transactions at prices irrespective of volume. *Id.*

1956. Petro Star explains that Toof conducted two sets of statistical analyses that attempted to prove the validity of the contract analysis: (1) he sought to predict Gulf Coast Naphtha prices using a regression formula derived from West Coast contract Naphtha prices and unleaded regular gasoline prices; and (2) he conducted "sensitivity" analyses to investigate the results of the contract analysis if different subgroups of the contracts were used or different assumptions were made in assigning prices to the different contracts. *Id.* at p. 13. In Petro Star's opinion, neither of these approaches did anything to prove that the Naphtha contracts prices are representative of Naphtha that is refined and used within refineries. *Id.*

1957. Exxon argues, Petro Star claims, that Exhibit Nos. EMT-360 and EMT-366, which compare actual Gulf Coast Naphtha prices with those predicted by a regression formula calculated using West Coast unleaded regular gasoline prices and Pulliam's and Tallett's contract databases, show there is a close relationship between gasoline prices and Naphtha prices on both the Gulf and the West Coasts. *Id.* In Petro Star's opinion, the exhibits, at most, show the relationship between gasoline prices and the Naphtha contract prices on the West Coast, but little or nothing about the relationship between gasoline prices and the West Coast Naphtha refined and utilized within refineries. *Id.* Petro Star asserts that the Naphtha contract prices reflect different economics than those that govern internally refined Naphtha. *Id.* at pp. 13-14.

1958. Toof's sensitivity analyses, according to Petro Star, similarly are irrelevant to the question of whether the contracts are representative of West Coast Naphtha, and Exxon's conclusion that the contracts show that Naphtha's value on the West Coast is significantly higher than its value on the Gulf Coast should similarly be limited to the value of the Naphtha contracts. *Id.* at p. 14.

E. IF CURRENT NAPHTHA VALUE IS NOT JUST AND REASONABLE, WHAT METHODOLOGY SHOULD BE USED?

1. Exxon

1959. Exxon states that the evidence is overwhelming that the current Quality Bank practice of using Platts Gulf Coast Naphtha price to value West Coast Naphtha does not produce a just and reasonable result and that, therefore, the Commission needs to determine what alternative methodology should be used instead to value West Coast Naphtha. Exxon Initial Brief at p. 251. It declares that Tallett's approach is the best methodology because it is based on West Coast market prices and a proven relationship between the value of Naphtha and the market prices of gasoline and jet fuel, the two products that are produced from Quality Bank Naphtha. *Id.* Also, Exxon asserts, the Tallett methodology produces a result that, it claims, is easy to administer and not subject to manipulation by any party. *Id.*

1960. Tallett, explains Exxon, derived a simple formula to value Naphtha on the West Coast based on the published West Coast prices of regular unleaded gasoline and jet fuel. *Id.* at p. 253. Exxon asserts that this methodology is analytically sound and produces a just and reasonable result for two reasons: first, Exxon notes, the primary use for Naphtha, on both the Gulf and West Coasts, is to make jet fuel and gasoline and published prices exist on both coasts for both products; second, Exxon points out, regression analysis performed by Tallett shows that the price of Naphtha on the Gulf Coast is almost entirely explained by the published prices of gasoline and jet fuel on the Gulf Coast. *Id.* at pp. 252-53.

1961. It is undisputed, according to Exxon that the primary use of Naphtha on both the Gulf Coast and the West Coast is to make gasoline, generally via catalytic reforming of Naphtha to raise its octane. Exxon Initial Brief at pp. 253-54. Further, Exxon claims, it is undisputed that the market value of Naphtha on both the West Coast and the Gulf Coast is determined primarily by its value in producing gasoline. *Id.* at p. 254. It also is undisputed, continues Exxon, that another use of Naphtha on both the West Coast and the Gulf Coast is to take the high end of the Quality Bank Naphtha cut and blend it into jet fuel.[655] *Id.* at p. 255. As a result, states Exxon, the value of Naphtha also is influenced by the price of jet fuel. *Id.*

1962. The evidence further shows, according to Exxon, that refiners have the ability to vary the output of their refineries depending upon market conditions by changing the cut point and thereby changing the proportion of Naphtha to be made into gasoline or jet fuel. *Id.* In addition, explains Exxon, depending upon the relative prices of gasoline and jet fuel, a refiner can vary the output of its hydrocracker to produce more or less jet fuel, with a corresponding reduction or increase in the amount of hydrocracker Naphtha produced. *Id.* at p. 256. Moreover, the evidence shows that there are times when jet fuel is actually more valuable to the refiner than gasoline, and that, in those situations, refiners increase the amount of the Naphtha cut that is processed into jet fuel. *Id.* Because of these close and undisputed relationships between Naphtha, gasoline, and jet fuel, Exxon states, Tallett employed a standard linear regression analysis to determine the relationship

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[655] Exxon points out that Ross, who initially contended that the use of Naphtha in jet fuel was wrong, withdrew that testimony, thereby conceding that some refiners do blend the 300°-350°F cut into jet fuel. Exxon Initial Brief at p. 255, n.99. Exxon also notes that Ross's estimate that less than 5% of Naphtha is blended into jet fuel was shown to be based on a miscalculation by Ross, and the correct percentage of Naphtha blended into jet fuel shown by Ross's own numbers was nearly 16%. *Id*

between the prices of Naphtha, regular unleaded gasoline, and jet fuel based on published prices for all three products which are available on the Gulf Coast.[656] *Id.* This regression analysis showed an almost perfect correlation between the price of Naphtha and the prices of both unleaded gasoline and jet fuel. *Id.* at pp. 256-57.

1963. Claiming to have established that the price of Gulf Coast Naphtha is almost totally explained by the price of Gulf Coast unleaded gasoline and jet fuel, Exxon argues, Tallett's analysis shows that the value of West Coast Naphtha for the period 1992 through 2001 was on average approximately $24.91/barrel, or about $2.44/barrel higher than the average Gulf Coast Naphtha during the same period. *Id.* at p. 257.

1964. It is also apparent from the evidence, according to Exxon, that Tallett's approach is a conceptually sound way to value Naphtha on the West Coast, even though Williams disputes the transferability of the approach. *Id.*; Exxon Reply Brief at p. 273. The same processes, states Exxon, are used on both the Gulf Coast and the West Coast to process Naphtha into reformate to make gasoline and for blending the high end of the Naphtha cut into jet fuel. Exxon Initial Brief at p. 257. In addition, explains Exxon, the specifications for Naphtha on the two coasts are identical, as is the pricing point (waterborne) for all of the published prices. *Id.* It follows, according to Exxon, that the same relationship that exists on the Gulf Coast between the value of Naphtha and the prices of gasoline and jet fuel should also exist on the West Coast. *Id.* at pp. 257-58. Moreover, because Tallett's regression formula is derived from the relationship between Naphtha and the prices for both gasoline and jet fuel, rather than gasoline alone, Exxon asserts, it also has the advantage of tending to reduce the impact of price spikes that arise during periods of West Coast gasoline price volatility. *Id.* at p. 258.

1965. Exxon states that the validity of Tallett's approach is corroborated by Baumol's testimony that Tallett's Gulf Coast-derived regression formula is transferable to the West Coast because it produces results similar to O'Brien's independent analysis.[657] *Id.* at pp. 259-60. It also notes that Toof's pooled data test results lend further support to the transferability of Tallett's Gulf Coast-derived regression formula to the West Coast. *Id.* at p. 260. These pooled data tests, according to Exxon, showed that there is no statistically significant difference between the relationship of Naphtha, gasoline and jet

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[656] Exxon argues that regression analysis is a standard, straight-forward means of assessing the quantitative relationship among variables. Exxon Initial Brief at p. 256, n.100. Further, notes Exxon, no party contends that Tallett's methodology is inappropriate because it uses regression analysis to value West Coast Naphtha. *Id.* Finally, Exxon notes, the Circuit Court has made clear that methods based on regression analysis cannot be summarily rejected. *Id.* (citing *Tesoro*, 234 F.3d at p. 1291).

[657] *See* Exhibit No. PAI-147.

fuel between the two coasts and no structural difference between the two markets. *Id.* at pp. 260-61. Thus, states Exxon, the pooled data test results confirmed Tallett's hypothesis that the prices of Naphtha, regular unleaded gasoline, and jet fuel are related to each other on the West Coast in the same manner as they are related on the Gulf Coast. *Id.* at p. 261.

1966. Moreover, the reasonableness of Tallett's methodology is supported, in Exxon's view, by the rule of thumb used by Kutola, an experienced Naphtha trader. *Id.* at p. 267. Exxon explains that this rule of thumb calculates typical values for Naphtha on the West Coast as being from 61.97 to 68.97¢/gallon, or from $26.03 to $28.97/barrel, depending upon the quality of the Naphtha being valued. *Id.* at pp. 267-68. Because the Naphtha produced from ANS crude is good quality Naphtha due to its high N+A, this means, notes Exxon, that the formula identified by Kutola would value the West Coast Naphtha cut produced from ANS crude at a price significantly higher than the value produced by Tallett's methodology. *Id.* at p. 268.

1967. Exxon states that the reasonableness of Tallett's methodology is also confirmed by the results derived when Naphtha's value is calculated as a function of gasoline and crude oil prices. *Id.* at pp. 269-70. Thus, explains Exxon, if the price of Naphtha is determined as a percentage of the range between the price of gasoline and the price of crude oil using Gulf Coast prices, and this same percentage is then used to calculate a West Coast price of Naphtha using the price of gasoline and the price of ANS crude oil on the West Coast, the result is very close to Tallett's average West Coast Naphtha value for the same period. *Id.* at p. 270.

1968. Criticisms of Tallett's approach are, according to Exxon, wholly without merit. *Id.* at p. 270. Its position is that the evidence clearly demonstrates the validity of the Tallett approach and supports the transferability to the West Coast of the proven relationship between the prices of Naphtha, gasoline, and jet fuel that Tallett found to exist on the Gulf Coast. Exxon Reply Brief at p. 279. Exxon states there is no merit to the suggestion that Tallett's West Coast Naphtha valuation violates the Commission's order in *Trans Alaska Pipeline System*, 90 FERC ¶ 61,123 (2000). Exxon Initial Brief at p. 270. It explains that that order dealt with how a published price for West Coast Heavy Distillate should be adjusted to account for the fact that the West Coast Heavy Distillate proxy product has a lower sulfur content than the ANS Heavy Distillate cut. *Id.* Accordingly, continues Exxon, the issue in that situation was the magnitude of the sulfur processing cost adjustment that was needed to bring the ANS Heavy Distillate cut value into line with the published proxy price. *Id.* The situation at issue here is fundamentally different, notes Exxon, because there is no market-based published reference price for Naphtha on the West Coast. *Id.* In valuing West Coast Naphtha, Exxon asserts, the task is to establish a proxy price based on some other published market price or prices, with or without any further adjustments. *Id.* at pp. 270-71. Exxon states that, for that purpose, it is obviously both necessary and appropriate to use a market-based approach rather than a cost-based approach. *Id.* at p. 271. That is precisely what Tallett did, according to Exxon, and one of the benefits of Tallett's regression formula approach is that – unlike the Naphtha valuation methodologies proposed by Ross and O'Brien – no further cost-based adjustments are required. *Id.*

1969. Contrary to the claim of O'Brien, Exxon asserts, Tallett did not use Gulf Coast prices to value West Coast Naphtha. *Id.* Rather, Exxon points out, Tallett used his regression formula to value West Coast Naphtha on the basis of published West Coast prices of regular unleaded gasoline and jet fuel. *Id.* He used Gulf Coast prices, Exxon claims, only to find the relationship – defined in his regression formula – between the value of Naphtha as a feedstock and the prices of the end-products of that process. *Id.* Exxon argues that this is a reasonable approach, because Naphtha is used for the same purposes and processed in the same manner on both the Gulf Coast and the West Coast. *Id.* Nor does Tallett's regression formula rely on any fixed price differential, notes Exxon, but on variables whose values change as prices in the West Coast market change. *Id.*

1970. Exxon takes issue with the contention that it employed a regression-based approach to valuing West Coast Naphtha because it was in its economic interest to do so. *Id.* at pp. 271-72. It states that it used a regression-based approach because it is the simplest approach to apply, and because it produces results that are consistent with other reasonable West Coast Naphtha valuations. *Id.* at p. 272. Moreover, directly contrary to the claim that Exxon's goal was a formula that would produce the highest possible West Coast Naphtha values, Exxon points out, the evidence shows that by including jet fuel prices in the formula, Exxon actually reduced the West Coast Naphtha values produced by its formula. *Id.* Further, notes Exxon, the West Coast Naphtha values produced by the Exxon regression formula were also lower than the values reached by O'Brien on behalf of Phillips and Alaska. *Id.*

1971. Responding to Sanderson's claim that higher West Coast refining margins for gasoline and other finished petroleum products in comparison with crude oil costs skew the value of Naphtha when Tallett's approach is used, Exxon exclaims that there is no evidence supporting it. *Id.* at pp. 272-73. It adds that all of the witnesses agree that

> the price of Naphtha has closely tracked the price of gasoline on the Gulf Coast, a pattern that reflects the fact that, as Mr. Sanderson's own firm has stated "full range naphtha is most often priced at a discount to unleaded regular gasoline with the differential reflecting the costs of reformer processing."

Id. at p. 273 (citations omitted). Exxon declares that there is "every reason to expect that the price of Naphtha also tracks the price of gasoline on the West Coast." *Id.*

1972. Exxon also rejects Ross's assertion that the introduction of CARB gasoline has reduced the demand for Naphtha on the West Coast. *Id.* at pp. 273-74. It declares that, contrariwise, Naphtha is more attractive since the introduction of CARB gasoline because the aromatics in reformate made from Naphtha have a high octane, and because it has a low Reid Vapor Pressure, and no olefins or sulfur. *Id.* at p. 274. Exxon adds that, also contrary to Ross's testimony, Naphtha's value is enhanced by the rising demand for gasoline on the West Coast. *Id.* Nor, it claims, have refinery outages had any impact on West Coast demand for Naphtha. *Id.* Moreover, according to Exxon, the record supports a conclusion, converse to Ross's testimony, that the price of gasoline and jet fuel governs the value of Naphtha on the Gulf Coast despite the demands of the petrochemical industry. *Id.* at pp. 274-77.

1973. Williams's argument that Tallett's regression formula is not objective is clearly incorrect, according to Exxon. Exxon Reply Brief at p. 279. It explains that Tallett's regression formula determines the value of the West Coast Naphtha cut based entirely on objective West Coast prices for regular unleaded gasoline and jet fuel which are published by Platts. *Id.* at pp. 279-80. Further, Exxon maintains, the regression formula itself is also objective in that it is derived by a standard statistical formula that that can be run on any computer, with the result that no individual's judgment is required to calculate the formula, and anyone running the same analysis will get the same answer. *Id.* at p. 280. Finally, Exxon reiterates that the conclusion that Tallett's regression formula is a reasonable and appropriate method for valuing West Coast Naphtha was objectively validated at the hearings by a number of statistical tests as well as by other evidence in the record. *Id.* Accordingly, Exxon's position is that Tallett's approach is at least as objective a way to determine the value of West Coast Naphtha as any of the alternative methodologies. *Id.*

1974. It is not disputed, according to Exxon, that prices for both gasoline and jet fuel on the West Coast have been considerably higher than the prices for gasoline and jet fuel on the Gulf Coast throughout the period at issue in this proceeding.[658] *Id.* Assuming, as Williams does, that the prices of crude oil are similar on the two coasts, Exxon argues that the higher West Coast gasoline and jet fuel prices necessarily mean that the price differentials or refining margins between the prices of gasoline or jet fuel and the price of

[658] Exxon asserts that there is no evidence to support Unocal/OXY's contention that higher West Coast gasoline prices are a result of a non-competitive West Coast gasoline market. Exxon Reply Brief at p. 281, n.174. Rather, Exxon states, the higher gasoline prices are a result of the factors discussed in the Stillwater reports. *Id.* It also states that Unocal/OXY's argument about restraints on competition is particularly disingenuous in view of the evidence showing that a significant anticompetitive factor in the California market for CARB gasoline is Unocal's patents. *Id.*

crude oil are also higher on the West Coast than on the Gulf Coast.[659] *Id.* at pp. 281-82. However, Exxon maintains, this alone says nothing about the West Coast value of Naphtha, an intermediate product that is produced from crude oil and then used to produce finished products like gasoline and jet fuel. *Id.* at p. 282. Rather, Exxon states, the critical question is whether the value of West Coast Naphtha increases with increases in the prices of West Coast gasoline and jet fuel. *Id.* At the hearing, notes Exxon, Williams did not present any empirical evidence addressing this issue. *Id.* Instead, explains Exxon, all of the evidence pertaining to refining margins on which Williams relies, including both the Muse Stancil & Company data and Sanderson's analysis of "3-2-1 crack spreads," relates only to the differential between the price of finished products (such as gasoline or a mix of gasoline and low sulfur No. 2 fuel) and crude oil prices. *Id.* Those higher West Coast price differentials or refining margins relative to the price of crude oil provide no information about the price of Naphtha. *Id.*

1975. Moreover, Exxon asserts, directly contrary to Williams's unsubstantiated claims, there is substantial evidence showing that higher West Coast prices for gasoline and jet fuel, and the resulting higher West Coast refining margins, have resulted in correspondingly higher West Coast Naphtha values. *Id.* at p. 283. For example, Exxon states, Culberson testified that, regarding the high refining margins on the West Coast, he did not believe the refiners captured the entire margin, but that some could have been captured elsewhere. *Id.* Exxon believes that some of the margin is reflected in an increase in the value of gasoline feedstocks such as Naphtha. *Id.* Moreover, continues Exxon, in view of the undisputed evidence that the Gulf Coast price of Naphtha is determined virtually entirely by the prices of gasoline and jet fuel in the same market, the appropriate conclusion to be drawn from the fact that West Coast gasoline and jet fuel prices are substantially higher than Gulf Coast gasoline and jet fuel prices is that the value of Naphtha on the West Coast is also substantially higher than the price of Naphtha on the Gulf Coast. *Id.*

1976. Exxon further argues that the weakness of Williams's position is demonstrated by the charts that were submitted to show how Naphtha and VGO values compare to the values of gasoline and crude oil on the Gulf Coast and the West Coast. *Id.* at p. 284. Exxon believes it is clear from Exhibit No. EMT-476 that the value of Naphtha on the Gulf Coast more closely tracks the price of Gulf Coast gasoline rather than the price of crude oil. *Id.* That same pattern, notes Exxon, is also shown on the charts tracking the prices found in the West Coast Naphtha contracts and the West Coast Naphtha values calculated using Tallett's methodology against the prices of West Coast gasoline and

[659] Exxon maintains that this measurement of refining margin or differential between the West Coast price of gasoline and the price of crude oil is not a measure of profitability because such a claim disregards the undisputed fact that West Coast refinery costs are also significantly higher. Exxon Reply Brief at p. 282, n.175.

crude oil. *Id.* However, Exxon explains, the pattern is not found when the Gulf Coast Naphtha price is tracked against the prices of West Coast gasoline and crude oil. *Id.* In that scenario, Exxon states, the value of Naphtha does not track the value of the products into which it is made. *Id.*

1977. The result, Exxon declares, observed in comparing Gulf Coast Naphtha prices to the West Coast prices of gasoline and crude oil also is at odds with the results that one sees when a similar analysis is done comparing VGO prices with gasoline and crude oil prices. *Id.* at pp. 284-85. In that comparison, explains Exxon, the relationship between the price of the VGO feedstock and the price of gasoline on the two coasts is much more comparable. *Id.* at p. 285. Furthermore, Exxon notes, the charts show that, in the absence of special circumstances, such as a cat cracker outage, the value of an intermediate product is more closely tied to the value of the final product (gasoline) than to crude oil prices. *Id.* Exxon concludes that this evidence further serves to contradict Williams's theory that intermediate feedstocks do not share in the increased value of the final products. *Id.*

1978. Exxon also states that Petro Star errs in criticizing Tallett for basing his regression formula on ten years of pricing data covering the entire period from 1992 through 2001 rather than using only current pricing. Exxon Reply Brief at p. 287. In fact, Exxon maintains, Tallett's regression formula does calculate the West Coast value of Naphtha using current pricing because it computes the value of West Coast Naphtha using the current published prices for regular unleaded gasoline and jet fuel on the West Coast. *Id.* Moreover, Exxon points out, it was shown at the hearing that it made no significant difference whether Tallett's regression formula was derived from the full ten years of Gulf Coast pricing data that Tallett used, or from some smaller portion of that period. *Id.* It was also demonstrated, according to Exxon, that if there was reason to believe that the underlying relationship between the prices of Naphtha, gasoline, and jet fuel had changed, Tallett's regression formula could easily be rerun to test that belief and, where appropriate, the coefficients in his regression formula could be modified. *Id.* at pp. 287-88. Exxon argues, however, that no party has introduced any evidence to show that any modification of the formula would be appropriate at this time to reflect any change in market conditions. *Id.* at p. 288.

1979. Contrary to Ross's argument, Exxon argues, that Naphtha is used as a petrochemical feedstock on the Gulf Coast does not undermine Tallett's regression formula. Exxon Initial Brief at p. 274. Exxon also disagrees with Williams's argument that the Gulf Coast's importation of Naphtha to meet petrochemical feedstock demands results in a different supply/demand situation for Naphtha on the Gulf Coast which undercuts Tallett's use of a regression formula derived from Gulf Coast prices to value West Coast Naphtha. Exxon Reply Brief at p. 288. Exxon states that Williams's argument directly undercuts the claim of Williams and Unocal/OXY that the published Gulf Coast price should be used to value West Coast Naphtha, because the availability on the Gulf Coast of Naphtha for import from nearby Caribbean sources would tend to drive down the market value of Naphtha on the Gulf Coast. *Id.* at pp. 288-89.

1980. Further, while Exxon does not suggest that there is no significant petrochemical market for Naphtha on the West Coast, it asserts that there is no evidence that petrochemical demand on the Gulf Coast significantly influences the Gulf Coast Naphtha price, as Williams asserts. *Id.* at p. 289. According to Exxon, the evidence introduced by Culberson showing the views of Naphtha traders expressly indicates that Naphtha's value as a feedstock for the manufacture of gasoline and jet fuel is higher and this creates a cap on its value as a petrochemical feedstock. Exxon Initial Brief at pp. 274-75. As a result, states Exxon, the value of Naphtha on the Gulf Coast is determined by gasoline and jet fuel, not the petrochemical industry. *Id.* at p. 275.

1981. This conclusion is confirmed, in Exxon's view, by Tallett's regression analysis, which shows that over 98% of the variation in Gulf Coast Naphtha prices can be explained by changes in the gasoline and jet fuel prices. *Id.* According to Exxon, this means that, at a maximum, only about 3% of the variation in the Gulf Coast price of Naphtha might be caused by all other market factors, including the demand for Naphtha as a petrochemical feedstock. *Id.*; Exxon Reply Brief at p. 289. Exxon goes on to suggest that the fact that petrochemical usage does not significantly influence the demand for reformer-grade Naphtha on the Gulf Coast also is confirmed by the fact that the prices for Gulf Coast Naphtha follow very closely the movements in Gulf Coast gasoline prices, including both peaks and trough, and there is no "non-coincident spiking." Exxon Initial Brief at p. 275. Moreover, Exxon notes, the small variations between the Gulf Coast prices of Naphtha and gasoline are almost entirely explained by movements in the Gulf Coast price of jet fuel. *Id.* at pp. 275-76 (citing Exhibit No. EMT-384).[660] In Exxon's view this also refutes Williams's argument that petrochemical demand on the Gulf Coast undermines the application of Tallett's Gulf Coast regression formula to the West Coast. Exxon Reply Brief at p. 290.

1982. Furthermore, Exxon claims, no evidence was introduced that would support the contention that the use of Naphtha as a petrochemical feedstock on the Gulf Coast has had any significant impact on the Gulf Coast price of Naphtha. Exxon Initial Brief at p. 276. In fact, Exxon states, the evidence shows a significant part of the Naphtha used as a petrochemical feedstock on the Gulf Coast is a different, lighter Naphtha than the heavier reformer-grade Naphtha and is used in steam crackers to produce ethylene. *Id.* Further,

[660] Exxon asserts that Exhibit No. EMT-384 squarely undercuts the claim that petrochemical demand props up the price of Naphtha during periods of low gasoline prices, for it demonstrates that it is jet fuel demand, not petrochemical demand, which props up the price of Naphtha during periods of low gasoline prices. Exxon Initial Brief at p. 276, n.101.

explains Exxon, no evidence was presented that the price of the ethylene that is produced from this lighter Naphtha has had any effect on Naphtha prices. *Id.* On the contrary, Exxon noted, Tallett demonstrated there was a very low correlation between the price of ethylene and the price of Naphtha on the Gulf Coast. *Id.* Further, the evidence showed that the ethylene steam cracking industry was a 'price taker' that would choose the least expensive of the many possible alternative feedstocks. *Id.* at pp. 276-77.

1983. There also was no showing, according to Exxon, that the price of benzene (produced from heavier Naphtha) had any impact on the price of Naphtha. *Id.* at p. 277. Only the aromatics in the reformer-grade Naphtha (benzene, toluene, xylene) are used in the manufacture of petrochemicals, explains Exxon, and this constitutes only 3 to 5% of the reformate. *Id.* This very limited use of reformer-grade Naphtha as a petrochemical feedstock on the Gulf Coast, continues Exxon, has no significant effect on the price of Gulf Coast Naphtha. *Id.* As Tallett demonstrated, notes Exxon, there also was a low correlation between the price of benzene and the price of Naphtha on the Gulf Coast. *Id.* The limited use of reformer-grade Naphtha as a petrochemical feedstock, does not, therefore, according to Exxon, distort the strong relationship between the prices of Naphtha, gasoline and jet fuel. *Id.*

1984. Also, Exxon argues, Williams's assertion that the Gulf Coast and West Coast markets for gasoline and jet fuel are different is wholly unsupported by any evidence at all. Exxon Reply Brief at pp. 290-91. The mere fact that gasoline and jet fuel are sometimes exported from the Gulf Coast to the West Coast only confirms, in Exxon's view, the undisputed fact that prices for gasoline and jet fuel are considerably higher on the West Coast than on the Gulf Coast; a fact that strongly suggests that the value of Naphtha is also considerably higher on the West Coast. *Id.* at p. 291. By contrast, notes Exxon, there is no evidence of any exports of Naphtha from the West Coast to the Gulf Coast that would support Williams's contention that Naphtha prices are higher on the Gulf Coast, and the mere lack of West Coast imports of Naphtha is the result of other market conditions and does not reveal anything about the relative price of West Coast Naphtha. *Id.*

1985. Williams's and Ross's contention that Tallett's regression formula approach did not provide a good predictor of West Coast VGO prices, according to Exxon, was not based on Tallett's regression formula for valuing West Coast Naphtha, but on an entirely different regression formula that Tallett used to compare the price of VGO against a standard crack spread formula of 2/3 the price of gasoline plus 1/3 the price of fuel oil. Exxon Initial Brief at pp. 277-78; Exxon Reply Brief at p. 291.

1986. Exxon also points out that Tallett never suggested that this Gulf Coast regression formula for VGO could appropriately be used to value VGO on the West Coast. Exxon Reply Brief at p. 292. According to Exxon, the evidence shows that the markets for VGO on the Gulf Coast and the West Coast are quite different due to the substantially larger demand for VGO on the Gulf Coast for the production of heating oil for markets in the Northeast and Midwest. *Id.* Moreover, notes Exxon, Ross conceded at the hearings that VGO is less valuable on the West Coast than it is on the Gulf Coast due to more stringent West Coast environmental requirements that make it more costly for refiners to process and use, and because, on the West Coast, there is no petrochemical demand for the olefins produced by VGO. Exxon Initial Brief at p. 278. Therefore, according to Exxon, the evidence showed that there were a number of factors – not applicable to Naphtha – that preclude use of the relationship between the prices of VGO, gasoline, and fuel oil on the Gulf Coast to value VGO on the West Coast based on the prices of West Coast gasoline and fuel oil. *Id.*

1987. Phillips and Alaska, Exxon notes, take the position that, in view of the significant differences between the markets for Naphtha on the West Coast and Gulf Coast, the West Coast Naphtha value must be based on West Coast market factors and prices rather than on Gulf Coast prices. *Id.* at p. 279. For this purpose, states Exxon, Phillips, via its witness O'Brien, supported by Alaska, propose to value the West Coast Naphtha cut on the basis of the price of regular unleaded gasoline in Seattle, less the cost of reforming and blending Naphtha into regular unleaded gasoline. *Id.* Exxon explains that O'Brien's methodology purports to take into account all of the refiner's costs, including marginal operating costs, fixed operating costs, and capital recovery costs. *Id.* As a result, notes Exxon, the value for West Coast Naphtha using O'Brien's method is somewhat higher than the value resulting from the Exxon proposal. *Id.*

1988. Exxon agrees with O'Brien's approach because it recognizes that the Gulf Coast and West Coast are different markets and that the value of Naphtha is directly linked to the value of gasoline on the West Coast, and because pricing data from West Coast Naphtha contracts supports his result. *Id.* at pp. 279-80. Notwithstanding this, Exxon points out, there are a number of problems with O'Brien's valuation methodology that make it less desirable than the Exxon proposal presented by Tallett. *Id.* at pp. 280-81. For example, notes Exxon, O'Brien's approach is highly complex, premised on a number of subjective judgments, and based on an outdated semi-regenerative reformer technology that is less efficient and produces lower yields than the continuous reformer technology that would be employed by a refiner today. *Id.* at p. 281. According to Exxon, O'Brien's reformer analysis also uses inconsistent pricing bases for valuing reformer yields. *Id.* Specifically, states Exxon, O'Brien uses a Seattle barge price for regular unleaded gasoline, while valuing the other reformer yields on the basis of the California-based prices that are used by the Quality Bank on the West Coast. *Id.* It explains that this results in a lower gasoline price and a lower value for Naphtha because the Seattle price for gasoline has been, on average, lower than the Platts Los Angeles price for gasoline. *Id.* Exxon notes also that O'Brien understates the costs of reforming Naphtha into gasoline on the West Coast by failing to use a West Coast location factor to adjust Gulf Coast costs upwards to West Coast levels. *Id.*

1989. Finally, Exxon believes that Phillips's contention that O'Brien's methodology should be preferred because it is the only proposal that is consistent with the methodology that the parties have agreed to use to value the Resid cut is also overstated. Exxon Reply Brief at p. 295. While consistency is important, Exxon asserts, it is much more important to select a methodology that generates the most reliable results than to select a methodology solely on grounds of consistency. *Id.* The goal of accurate relative values does not establish an overriding requirement of consistency or uniformity as Phillips contends; rather, according to Exxon, it only established a rule of "reasoned relative uniformity." *Id.* (quoting *Exxon*, 182 F.3d at p. 38).

1990. Exxon states that, like Exxon, Phillips and Alaska also have taken the position that the continued use of the Gulf Coast Naphtha price to value West Coast Naphtha is not just and reasonable. Exxon Initial Brief at p. 282. BP advocates, states Exxon, that the value of West Coast Naphtha be determined by the West Coast Naphtha valuation methodologies presented by either Tallett or O'Brien, but subject to the so-called "governor" proposed by Ross. Exxon Reply Brief at p. 296. The adoption of Ross's governor is opposed by Exxon, Phillips, and Alaska as being without justification and contrary to the evidence. *Id.* Exxon asserts that no party other than BP advocates its adoption. *Id.*

1991. While purporting to accept the principle that West Coast Naphtha should be based on the prices of West Coast petroleum products, Exxon maintains, Ross undercut that principle by proposing to superimpose on the resulting value of West Coast Naphtha a so-called "governor" or price ceiling. Exxon Initial Brief at p. 283. This ceiling, explains Exxon, would effectively cap the value of West Coast Naphtha to correct for alleged anomalies in the market for gasoline on the West Coast from 1999 through 2001.[661] *Id.* The size of the cap, explains Exxon, was to be based on an estimate of the additional costs that would be incurred to divert shipments of Naphtha from Venezuela to the West Coast that would otherwise go to the Gulf Coast. *Id.* Although there was no evidence that any shipments of Venezuelan Naphtha, in fact, had ever gone to the West Coast, Exxon states that the theory behind Ross's "governor" was that, if the price of Naphtha on the West Coast were to rise above the Gulf Coast price by more than \$1.85/barrel (the value of the cap proposed by Ross), such shipments would occur and effectively cap the West Coast Naphtha price at that level. *Id.* In later submissions, notes Exxon, Ross made a number of modifications to his proposed ceiling that served to reduce the size of the cap from \$1.85 to \$1.49. *Id.* at p. 284. Exxon states this change

[661] Exxon states that Ross failed to establish any meaningful definition of the term "pricing anomaly." Exxon Initial Brief at p. 286, n.102. It notes that, during the hearing, he stated his assessment of when a pricing "anomaly" existed amounted to little more than his subjective assessment of a particular context coupled with the fact that his governor came into play. *Id.*

reflects Ross's realization that he had made errors in his calculation of transportation costs.[662] *Id.*

1992. In his reply testimony, Exxon states, Ross added a price floor to his governor in recognition of the fact that Naphtha would not move to the West Coast unless the price were at least sufficient to cover the seller's cost of producing the Naphtha from crude. *Id.* Ross set the floor at the average of the high and low published Platts West Coast prices of ANS crude plus $4.00. *Id.* This $4.00 figure was "borrowed," explains Exxon, from a West Coast Naphtha contract which employed a price floor based on the price of ANS crude oil plus $4.00 to protect the cost base of the supplier. *Id.* Continues Exxon, Ross claims that he validated this figure on the basis of (1) the differential between the price of Gulf Coast Naphtha and the price of West Texas sour crude, based on Ross's assumption that West Texas sour crude was comparable to ANS crude, and (2) the differential between the prices of Naphtha and VGO on the Gulf Coast, based on Ross's assumption that the relationship between the prices of Naphtha and VGO on both the Gulf Coast and the West Coast would be the same.[663] *Id.* at pp. 284-85. According to Exxon, Ross's governor would substantially limit the West Coast Naphtha values produced by the Exxon, Phillips and Alaska valuation methodologies. *Id.* at p. 285. It argues that the proposed governor should be rejected as unjustified and contrary to the evidence. *Id.*

1993. As noted above, Exxon states, Ross bases the governor theory on his claim that "pricing anomalies" existed on the West Coast during the 1999-2001 period. *Id.* at p. 286. It contends that the pricing data for the products claimed as support by Ross do not sustain his pricing "anomalies" claim. *Id.* For example, Exxon states, the evidence shows the prices of Butane and LSR on the West Coast were not correlated with the price

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[662] Exxon notes that Ross acknowledged that he had miscalculated the transportation cost for diverting a Venezuelan shipment of Naphtha from the Gulf Coast to the West Coast – an error which reduced his proposed governor from $1.85 to $1.29. Exxon Initial Brief at p. 284. In addition, claims Exxon, Ross conceded that he had underestimated the transportation cost by failing to take into account the lack of backhaul opportunities for shipments to the West Coast, and to compensate for this omission, Ross further adjusted his transportation cost calculation by adding an additional 20¢ to his governor, thereby increasing the size of his proposed governor to $1.49. *Id.*

[663] Exxon notes that, shortly before the beginning of the Naphtha portion of the hearing, Ross withdrew his testimony valuing the West Coast Naphtha cut, thereby leaving only that portion of his testimony dealing with the governor. Exxon Initial Brief at p. 285. In this connection, explains Exxon, Ross stated that he would accept either the West Coast Naphtha valuation presented by Tallett on behalf of Exxon or the Naphtha valuation presented by O'Brien on behalf of Phillips and Alaska, provided that they were subject to the governor which he proposed. *Id.*

of West Coast gasoline at any time during the period 1994 to 2001. *Id.* Further, it states, unlike Naphtha, the use of Butane and LSR to produce gasoline is highly seasonal in that they cannot be blended into gasoline on the West Coast during the summer because of their high Reid Vapor Pressure. *Id.* at pp. 286-87. Exxon also notes that Ross admitted that the most pronounced spikes in the prices of Butane (in January 2001) and LSR (in 2000) were caused by spikes in natural gas prices that had nothing to do with gasoline prices. *Id.* at p. 287. Further, Exxon says, LSR is imported into the Gulf Coast mostly for use as a petrochemical feedstock, while LSR has no use as a petrochemical feedstock on the West Coast. *Id.*

1994. Exxon also takes exception to Ross's attempt to support his pricing "anomaly" theory on the basis of VGO prices. *Id.* at p. 287. It asserts that Ross's attempt to validate the import theory underlying his governor based on published data for VGO imports by West Coast refineries demonstrated just the opposite – that there is little, if any, correlation between spikes in the price of VGO on the West Coast and imports of VGO into the West Coast market. *Id.* at pp. 287-88. Exxon explains that Ross's own chart of the relationship between spikes in the West Coast price of VGO and the level of VGO imports into California shows no correlation at all on its face. *Id.* at p. 288 (citing Exhibit No. BPX-84). Moreover, notes Exxon, that chart shows that West Coast VGO prices were frequently well above Ross's cost of imports, and sometimes for periods of several consecutive months. *Id.*

1995. Exxon claims that, contrary to BP's argument, what the VGO price data shows is that VGO prices on the West Coast closely track West Coast gasoline prices, including price spikes.[664] *Id.*; Exxon Reply Brief at pp. 299-300. Further, Exxon claims, the evidence shows that the price of VGO on the West Coast is generally higher than the price of VGO on the Gulf Coast, and that this was particularly true in the 1999-2001

[664] Although the data showed a few instances in 1999 and 2000 where the price of gasoline went up and the price of VGO did not, or did not go up to the same extent, Exxon states, those instances were explained by outages of "cat crackers" or FCC units at West Coast refineries which both precluded the refinery from processing VGO into gasoline (thereby reducing the demand for VGO and making it less valuable) and reducing the refinery's output of gasoline (thereby reducing the supply of gasoline and making it more valuable). Exxon Initial Brief at p. 288, n.103 (citing Exhibit No. EMT-443); Exxon Reply Brief at p. 300. According to Exxon, these outages would not impact the value of West Coast Naphtha and, as Ross was forced to admit, might account for an increase in the value of West Coast Naphtha vis-à-vis West Coast gasoline during this period. Exxon Initial Brief at p. 288, n.103. Exxon states that the contention in Ross's pre-filed testimony that the cat cracker incidents would have lowered the demand for Naphtha, a contention which BP relies on in its brief, was thus shown at the hearing to be incorrect. Exxon Reply Brief at p. 301. Therefore, Exxon maintains, the West Coast VGO price data does not provide any support for Ross's proposed governor. *Id.*

period when West Coast gasoline prices spiked and West Coast VGO prices exceeded the Gulf Coast VGO prices by an amount greater than Ross's governor, thereby confirming that the prices of West Coast gasoline feedstocks follow the price of West Coast gasoline, including during periods of sharp increases in the price of gasoline. Exxon Initial Brief at pp. 288-89. The VGO price data, explains Exxon, thus directly refute Ross's claim that the West Coast prices of gasoline feedstocks do not respond to anomalous spikes in the price of gasoline because they are governed by the ability of West Coast refiners to import such feedstocks. *Id.* at p. 289.

1996. There also is no merit, according to Exxon, to BP's further argument that the need for Ross's governor is supported by a comparison of OPIS West Coast VGO prices with a 1993 settlement proposal that would have valued West Coast VGO on the basis of a 70/30 weighted average of the West Coast prices of regular unleaded gasoline and No. 2 fuel oil minus a deduction of 8¢/gallon. Exxon Reply Brief at p. 301. According to Exxon, the evidence shows that this 1993 settlement proposal, which Ross supported at that time, used the same 8¢/gallon deduction in valuing VGO on both the Gulf Coast and the West Coast notwithstanding the fact that West Coast refinery costs are higher than Gulf Coast costs. *Id.* at pp. 301-02. However, Exxon notes, Culberson testified in opposition to that proposal that VGO was typically priced on the Gulf Coast at "about 5 cents per gallon below the 70/30 price," while "West Coast [VGO] prices are usually 10 to 14 cents per gallon below the 70/30 price." *Id.* at p. 302 (quoting Exhibit No. EMT-493 at p. 6). Moreover, Exxon points out, the evidence shows that correcting the proposed 1993 settlement formula to use a more appropriate West Coast cost deduction of 12¢/gallon rather than 8¢/gallon largely eliminates the overvaluation that BP identifies and provides a result that is much closer to the OPIS West Coast VGO price than does the application of Ross's proposed governor. *Id.* Exxon asserts that the conclusion to be drawn from this evidence, therefore, is that the VGO formula in the 1993 settlement proposal used a cost deduction that was inadequate for the West Coast and not that any artificial price "governor" was needed to constrain the values produced by the proposed 1993 settlement gasoline-based VGO valuation formula. *Id.* at pp. 302-03.

1997. Exxon alleges that, even had anomalies in the pricing of intermediate feedstocks existed on the West Coast during the period 1999 to 2001, the governor proposed by Ross is not appropriately targeted to that alleged problem. Exxon Initial Brief at p. 289. It notes that Ross conceded the West Coast pricing anomalies addressed by his governor did not arise until 1999, and that there was no justification for applying his governor during non-anomalous periods like those that existed prior to 1999. *Id.* Nevertheless, continues Exxon, the evidence shows that his proposed governor would have been operative at least 80% of the time to determine the value of West Coast Naphtha prior to 1999. *Id.*; Exxon Reply Brief at p. 303. Further, explains Exxon, although the proposed governor would go into effect automatically in all future years, Ross conceded that, should future years look like the non-anomalous period that existed prior to 1999, there would be no need or justification for applying his governor. Exxon Initial Brief at p. 290.

Exxon contends that Ross's attempt at the hearing to avoid this problem by arguing that a pricing anomaly existed whenever his governor became operative to determine the West Coast Naphtha price was an obviously circular argument. *Id.*

1998. By using an extremely restrictive governor based on the Gulf Coast price of Naphtha plus $1.49/barrel, Exxon argues, Ross's proposed governor would also have the undesirable effect of imposing on the value of West Coast Naphtha any pricing anomalies that might arise on the Gulf Coast. *Id.* Were, for example, the price of Naphtha on the Gulf Coast to drop by reason of some event that did not affect the value of Naphtha on the West Coast, such as refinery outages, the proposed governor would inappropriately, Exxon claims, reduce the value of Naphtha on the West Coast for Quality Bank purposes. *Id.*

1999. Exxon states that, although BP is obviously aware of this fundamental flaw in Ross's proposed governor, it argues nevertheless that the governor would not do any harm and would serve as insurance during periods when there are no noticeable gasoline price spikes. Exxon Reply Brief at p. 304. It argues, however, that this would be true only if the governor did not actively intervene to determine the value of West Coast Naphtha during periods like 1994 to 1998 when there were no pricing anomalies, and thus no reason for the governor to be applied. *Id.* Exxon asserts that is most decidedly not the case with Ross's governor. *Id.* It concludes that, as the proposed governor would still apply 80% or more of the time even when there is no justification for its application, the governor is not an appropriate response to any anomalies in the pricing of intermediate feedstocks on the West Coast. *Id.*

2000. During the hearing, Exxon notes, Ross advanced, for the first time, an alternative justification for his governor based on the lack of a published price for Naphtha on the West Coast. Exxon Initial Brief at p. 291. Exxon explains that Ross argued that a lack of a published price inhibited supply and caused the price to be different, likely higher, than it would be if there were a transparent market. *Id.* Further, notes Exxon, Ross argued that his governor was an attempt to model a transparent market. *Id.* It claims that Ross offered no evidence that supported this alternative theory for his governor, and his economic analysis was directly contrary to the testimony of Baumol. *Id.* Exxon also maintains that, despite BP's attempts to justify the governor on the basis of the 'transparent market' theory, there is simply no credible evidence in the record to support the governor on that basis and overwhelming contrary evidence. Exxon Reply Brief at p. 305.

2001. Even were Ross's "transparent market" theory supportable as a matter of economic analysis, and Exxon asserts it is not, it maintains that the theory would not provide any lawful basis for valuing the Quality Bank West Coast Naphtha cut. *Id.* at p. 306. Exxon notes that the Circuit Court has ruled that all Quality Bank cuts must be assigned accurate relative values and this requires that all cuts must be valued, to the extent possible, on a reasonably consistent basis. *Id.* at pp. 306-07. It points out that every other Quality Bank cut is valued on the West Coast on the basis of its estimated actual market value to a refiner in the real world marketplace. *Id.* at p. 307. Further, according to Exxon, no cut is valued on the basis of what its value might be in an imaginary idealized market that does not reflect the market that actually exists in the real world. *Id.* Therefore, Exxon argues, BP's attempt to defend the governor on the basis of the manner in which market forces might operate in a hypothetical transparent market does not meet the *Exxon* court's valuation requirements. *Id.*

2002. Baumol's testimony, in Exxon's view, squarely refuted Ross's opinion that, as a result of the lack of a transparent market with published prices, the price of Naphtha on the West Coast is probably higher than it would be were there a published price. *Id.* Exxon states that prices are determined by relative strengths of buyers and sellers and only a seller with greater market power than a buyer can get an excessive price. *Id.* It explains that Ross presented no evidence, however, that sellers of Naphtha on the West Coast have greater market power than buyers, and claims that the evidence in the record squarely refutes that idea. *Id.* Exxon points out that purchasers of West Coast Naphtha are not primarily small firms that are easily out negotiated; rather, more than 90% of them are large firms that are unlikely to allow themselves to be subject to repeated overcharging. *Id.* at pp. 292-93. Therefore, concludes Exxon, there is no factual basis for Ross's opinion that the price of West Coast Naphtha is probably higher than it would be if there were a published market price. *Id.* at p. 293.

2003. Exxon points out that the pricing information available to both buyers and sellers of Naphtha on the West Coast is comparable to, or even better than, the information on which Platts or OPIS makes its price assessment, which is simply what an assessor can learn from phone calls and may be based on as few as one transaction in a month. Exxon Reply Brief at pp. 309-10 (citing Alaska Initial Brief at pp. 13-14). It also asserts that traders of oil products believe that their information is often better than that of the price publishing services. *Id.* at p. 310. Exxon notes that BP, itself, recognizes, in its brief, that price data published by Platts may be unsound and inappropriate to use. *Id.* In these circumstances, Exxon argues, there is absolutely no factual basis for Ross's contention that the incremental benefit of having one additional piece of price information – a published Platts or OPIS price assessment – would have the dramatic effects on the functioning of the market that are suggested by Ross. *Id.*

2004. Further, Exxon asserts, the theory supporting Ross's argument in support of the governor is directly refuted by substantial evidence in the record that, even in markets where there is a published West Coast price, the West Coast petroleum prices often exceed the corresponding Gulf Coast prices by substantially more than the amount of his governor. *Id.* at p. 313. For example, Exxon explains, the evidence shows that published prices exist on both the West Coast and the Gulf Coast for gasoline, jet fuel, VGO, propane, Isobutane, Light Distillate, and Heavy Distillate. *Id.* Nevertheless, according to

Exxon, the evidence demonstrates that West Coast/Gulf Coast price differentials substantially in excess of the $1.49/barrel transportation cost differential in Ross's governor have existed for all of these petroleum products, and those large price differentials have often persisted for long periods of time. *Id.* at pp. 313-14. Thus, Exxon concludes, Ross's claim that a published price would create a governor that would narrowly constrain West Coast/Gulf Coast price differentials is clearly not supportable. *Id.* at p. 314.

2005. Were the concept of Ross's governor valid, Exxon argues, one would expect to see actual movements of Naphtha to the West Coast at times of high West Coast prices. Exxon Initial Brief at p. 293. However, Exxon states, there is no evidence of any Naphtha cargoes actually moving into the West Coast at times of high West Coast prices. *Id.* It notes that Ross conceded that he had no evidence that any shipments of Naphtha or any other intermediate or finished petroleum product had been sent from Venezuela to the West Coast. *Id.* According to Exxon, Ross also conceded that there is very little trading in Naphtha on the West Coast, and Sanderson acknowledged that it is unlikely that Naphtha will be imported to the West Coast in the future.[665] *Id.*

2006. The substantial and persistent differentials between the West Coast and Gulf Coast prices for many petroleum products are also, in the opinion of Exxon, confirmed by the March 2002 Stillwater Report to the California Energy Commission, which stated that prolonged price differentials for petroleum products on the West Coast were a product of the insular nature of the California market, related to geography, product quality, commercial barriers and infrastructure limitations. *Id.* at pp. 294-95 (citing Exhibit No. EMT-489 at p. 101). As a result of these various physical and commercial constraints, Exxon notes, the report stated that California prices are substantially higher, sometimes for significant periods, than Gulf Coast petroleum prices plus the total cost to move goods between them, including transportation, duties, storage, time value of money, etc. *Id*. at p. 295. Therefore, according to Exxon, the Stillwater report squarely contradicts Ross's governor theory. *Id.*

2007. Further, Exxon claims, Ross's attempt to argue that the prices of jet fuel on the West Coast were capped by imports proved just the opposite. *Id.* It notes that Ross argued that East Coast, and not Gulf Coast, prices were the appropriate comparison for West Coast prices. *Id.* Even so, Exxon points out, the evidence showed that, contrary to

[665] Exxon also cites a study by Purvin & Gertz for Petróleos de Venezuela S.A., Exhibit No. PAI-185, which excluded the West Coast from its analysis of potential U.S. markets for Venezuelan crude oil on the ground that the West Coast was not a competitive market for Venezuelan crude oil and also excluded the West Coast from its analysis of potential U.S. markets for Venezuelan refined petroleum products. Exxon Initial Brief at p. 293, n.104.

the theory of Ross's governor, the West Coast price of jet fuel has exceeded the cost of imports from the East Coast by more than the value of his governor in 31 out of 72 months, or 43% of the time, between 1996 and 2001. *Id.* There also was no factual or logical basis whatsoever, according to Exxon, for Ross's attempt to dismiss all of the periods when West Coast jet fuel prices exceeded the Gulf Coast price by more than his estimated import cost as simply the result of overheated market conditions; for the very purpose of the West Coast Naphtha valuation for Quality Bank purposes is to reflect actual market conditions, not to suppress or disregard them. *Id.*

2008. Even were there some conceptual validity to Ross's idea of a governor on prices of Naphtha, the evidence clearly shows, according to Exxon, that Ross significantly understated the amount of the costs and other barriers that limit the import of Naphtha into the West Coast and the level of any such governor. *Id.* at pp. 296-97; Exxon Reply Brief at p. 314. As a result, there is no evidentiary support, argues Exxon, for the $1.49/barrel price cap imposed on West Coast Naphtha values by the governor proposed by Ross. Exxon Initial Brief at p. 297. Quite the contrary, Exxon asserts, all of the available pricing data indicates that the governor proposed by Ross is far too restrictive. *Id.*

2009. The fact that the ceiling in Ross's governor is much too low is also shown, in Exxon's view, by the undisputed fact that published West Coast prices for many petroleum products, including both intermediate and finished products, have routinely exceeded the Gulf Coast price by much more than the $1.49/barrel transportation cost differential estimated by Ross, and often for long periods of time. Exxon Reply Brief at p. 315. Exxon argues that these substantial and persistent West Coast/Gulf Coast price differentials for both finished and intermediate products well in excess of the price ceiling in the governor demonstrate beyond any serious question that the price ceiling of the governor, which is supposedly based on the cost of import, is unrealistically low. *Id.*

2010. Although Ross purported to base the size of his governor on certain shipping differentials, Exxon states, the evidence shows that he substantially underestimated the amount of those differentials and that he also failed to take into account a number of other costs that would tend to impede the flow of Naphtha to the West Coast during times of high Naphtha prices. Exxon Initial Brief at p. 298. Exxon notes that, despite the fact that Platts publishes tanker rates for shipments from both the Caribbean and Venezuela to the West Coast, Ross initially did not use those rates, but instead elected to use only the tanker rate for shipments from the Caribbean to the Gulf Coast, which he then adjusted.[666] *Id.* It states that he made no attempt to look for other published rates for

[666] Exxon explains that only on redirect examination at the hearing did Ross introduce an alternative governor based on a variable transportation differential for shipments from Venezuela to the West Coast. Exxon Initial Brief at p. 298, n.105.

shipments from Venezuela to the West Coast and Ross's adjustments were based on a series of assumptions and calculations that had no evidentiary support in the record. *Id.* at pp. 298-99.

2011. Ross's reliance solely on transportation differentials also led, in Exxon's view, to a substantial understatement of the proposed cap. *Id.* at p. 300. It asserts that the evidence makes clear that far more is involved in a decision to import Naphtha than the cost of transportation to the West Coast. *Id.* For example, Exxon explains, Ross failed to take into account that West Coast refiners typically produce all the Naphtha they need from existing crude slates. *Id.* Thus, continues Exxon, to take advantage of any available imported Naphtha, the refiner would need to switch to a different crude slate to process the imported Naphtha. *Id.* Because West Coast refineries typically purchase a significant quantity of crude under long-term purchase contracts and vessels are scheduled months in advance, Exxon states, such switching can involve a considerable amount of time and expense. *Id.* Therefore, Exxon concludes, a refiner would not purchase imported Naphtha unless the price was so much lower for an extended period of time as to compensate the refiner for all the costs and opportunity costs that would be incurred by importing Naphtha. *Id.* Exxon points out that Ross's governor made no allowance for the costs associated with changing the crude slate in order to accommodate imports of Naphtha. *Id.* at p. 301.

2012. Exxon states that BP also completely disregards these costs in its argument defending the value of the Ross governor. Exxon Reply Brief at pp. 318-19. Similarly, notes Exxon, BP's reliance on an exhibit listing 17 cargoes of Naphtha that were sent to the West Coast in its attempt to dismiss the voluminous evidence that West Coast imports are limited by barriers to entry is clearly misplaced in view of Ross's admission that every one of those 17 cargoes went to a single West Coast refiner. *Id.* at p. 319.

2013. In addition, because West Coast refineries have generally been able to meet their demand for Naphtha internally without any significant amount of imports, Exxon argues, West Coast refineries do not have the tank and terminal facilities needed to import substantial quantities of Naphtha. Exxon Initial Brief at p. 301. It claims that Ross made no allowance for the costs of additional storage or terminal facilities that would be required to handle Naphtha imports on the West Coast. *Id.* According to Exxon, the importance of this omission is confirmed by the fact that no Naphtha imports into the West Coast took place when the price of all products on the West Coast went up in 1999, 2000 and 2001. *Id.* Instead, notes Exxon, the market has responded to gasoline price spikes by the flow of gasoline into high-priced West Coast markets from adjacent markets, thereby directly moderating any gasoline price spikes. *Id.*

2014. The evidence also shows, in Exxon's opinion, that, in calculating the magnitude of his so-called governor, Ross substantially underestimated other costs that would be required to divert Naphtha to the West Coast. *Id.* at p. 302. For example, explains

Exxon, Ross initially failed to take into account the fact that, because there is no back-haul on shipments to the West Coast (unlike shipments to the Gulf Coast), chartering companies would charge substantially higher rates to divert shipments of Naphtha to the West Coast. *Id.* In addition, Exxon states, Ross failed to take into account that any shipment from the Gulf Coast to the West Coast would require very expensive Jones Act shipping using vessels built in the United States and crewed by United States citizens. *Id.* In short, concludes Exxon, Ross's transportation differential of $1.49/barrel was completely lacking in evidentiary support. *Id.*

2015. Exxon also asserts that Ross's governor failed to account for the fact that, in the real world, any discipline provided by imports would not occur instantaneously, but would occur only after weeks of validation and weeks of shipping. *Id.* In addition to the lag involved in validation of the price differential, Exxon points out that it could take an additional month to load, ship, and off-load a Naphtha cargo and still more time to reform and blend the Naphtha into gasoline. *Id.* at p. 303. Thus, explains Exxon, these real world time intervals render the shipping of Naphtha to the West Coast a slow and inefficient means of responding to temporary spikes in the price of West Coast gasoline. *Id.* Further, as a result of the considerable time required to decide on and implement a plan to import Naphtha in response to an increase in the price of West Coast Naphtha, Exxon states that the governor proposed by Ross would plainly not go into effect immediately, but only after a lag of at least a month or more. *Id.*

2016. Exxon also claims that Ross's governor did not take into account the added risks that a Venezuelan Naphtha shipper would incur if it diverted a shipment to the West Coast. *Id.* It points out that the evidence showed there is not a sufficiently robust West Coast market to ensure that a Naphtha shipper would obtain a compensatory price. *Id.* This risk is aggravated, explains Exxon, by the additional travel time needed to move product to the West Coast and the substantial delays that have frequently been experienced by shippers in transiting the Panama Canal. *Id.* Ross's transportation differential assumed that Naphtha shippers would be indifferent to all of these risk factors – an assumption Exxon argues is patently unreasonable. *Id.* at p. 304.

2017. Ross relies upon a single one of the nearly 300 West Coast Naphtha contracts – a long-term contract between companies 4 and 13 – to validate his "governor" price cap, reliance which Exxon claims is clearly misplaced. *Id.* at p. 305. It points out that the contract upon which Ross relied is the only one out of the hundreds of West Coast Naphtha contracts produced in this proceeding that has a price mechanism which is in any way comparable to his proposed governor. *Id.* at pp. 305-06. Moreover, explains Exxon, that contract did not involve the sale of Heavy Naphtha, but rather Full Range Naphtha, a product that is not equivalent to the Quality Bank Naphtha cut. *Id.* at p. 306. Further, continues Exxon, that contract contained a complex series of pricing terms, including reference to another contract, and there is no evidence as to the reasons why the contract was structured in that unusual way. *Id.* Exxon notes that Ross also admitted that he had no knowledge as to the reason for the price mechanism used in that contract. *Id.*

2018. In addition, notes Exxon, the contract upon which Ross relied provides no support at all for the magnitude of the price cap proposed by Ross. *Id.* at p. 307. In contrast to the $1.49/barrel price cap proposed by Ross, Exxon points out that the contract relied upon by Ross employed a far higher cap of 7.05¢/gallon, or $2.96/barrel – nearly twice the amount of the price cap proposed by Ross. *Id.* As a result, explains Exxon, the West Coast Naphtha prices established by that contract were either nearly the same as, or somewhat higher than, the value of West Coast Naphtha as valued by Tallett's regression analysis, depending on how the contract volumes are divided between Heavy Naphtha and LSR. *Id.* Therefore, Exxon concludes the contract on which Ross relied provides no support at all for the low West Coast Naphtha values that are produced by Ross's governor.[667] *Id.*

2019. Similarly, Exxon asserts that the evidence shows that another measure of the relative value of a gasoline feedstock on the Gulf Coast and West Coast is provided by MTBE, a clean product that is used on both coasts in the production of gasoline, is imported on the West Coast both from Venezuela and directly from the Gulf Coast, and has published prices on both coasts. *Id.* at p. 308. Exxon states that the differential between the price of MTBE on the Gulf Coast and the West Coast was in the 7.3¢/gallon ($3.07/barrel) range throughout the 1992 to 2001 period. *Id.* Insofar as this price differential reflects a more accurate measure of the true price differential between the Gulf Coast and the West Coast applicable to gasoline feedstocks, Exxon argues that the $3.07/barrel MTBE price differential further confirms that Ross's $1.49/barrel "governor" significantly understates the price differential that is needed to cause gasoline feedstocks to move into the West Coast. *Id.*

2020. During the hearings, notes Exxon, Ross suggested an alternative formula for his

[667] Exxon further explains that applying the Ross governor with the higher $2.96/barrel price cap found in that contract rather than the $1.49/barrel cap proposed by Ross to the West Coast Naphtha values determined by Tallett's regression formula would result in a reduction of the average West Coast Naphtha value for the 1994 through 2001 period from $25.48/barrel to $24.71/barrel – a reduction of 77¢/barrel. Exxon Initial Brief at p. 307, n.108. (In its brief, Exxon states that the reduction is 77¢/gallon. However, Exhibit No. EMT-440 at p. 1 shows that the comparisons are on a per barrel basis.) Exxon also states that application of the Ross governor with the $2.96/barrel cap would reduce the Tallett West Coast Naphtha value for the period 1994 through 1998 by only 8¢/barrel, while it would reduce the Tallett West Coast Naphtha value for the period 1999 through 2001 – the period of alleged anomalies – by $1.95/barrel. *Id.* By contrast, notes Exxon, application of the Ross governor with the $1.49/barrel cap reduces the average price by an average of about $3.35/barrel over the 1999-2001 period. *Id.*

proposed governor. *Id.* Under the alternative proposal, explains Exxon, instead of a fixed price cap of $1.49, Ross suggested that a variable transportation differential could be used.[668] *Id.* Although Ross continued to assert that his proposed price cap of $1.49 should be used, Exxon points out that he offered this alternative in case the Commission should prefer a monthly movable ceiling. *Id.* at p. 309. Exxon notes that Ross's price floor remained unchanged. *Id.*

2021. Ross's alternative formula for his proposed governor addresses only two of the many deficiencies in his proposal, according to Exxon. *Id.* It points out that, while he replaced his initially proposed fixed price cap of $1.49 with a variable transportation differential based on published freight rates for shipments from Venezuela to both the Gulf Coast and the West Coast, the alternative formula still does not address the most fundamental deficiencies of his governor. *Id.* First, Exxon states, he did not provide any justification for imposing a governor at all, because he provides no evidence that a governor is needed to correct for any so-called anomalies in the pricing of intermediate feedstocks, or that any price governor actually operates in the marketplace for such feedstocks on the West Coast. *Id.* at pp. 309-10. Also, although Ross's alternative formula introduces current freight rates, Exxon points out, it does nothing to take into account the many other costs that were erroneously omitted from his governor, including the need for additional storage facilities on the West Coast, or the additional risk posed by the substantial time lag involved in shipments to the West Coast. *Id.* at p. 310. Moreover, states Exxon, given that the alternative formula is essentially the same as the formula used to calculate his original $1.488 price ceiling, the obvious inadequacy of the magnitude of Ross's original price ceiling when viewed against both the West Coast Naphtha contracts and other evidence of actual Gulf Coast/West Coast price differentials is equally apparent in this alternative. *Id.*

2022. While Exxon maintains that there is no valid theoretical or evidentiary basis for the governor, in the event that the Commission was to attempt to impose some sort of price limits on the West Coast Naphtha values analogous to the proposed governor, it is also clear from the evidence that the governor would have to be fundamentally changed in certain respects. Exxon Reply Brief at p. 320. Exxon asserts that the ceiling would

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[668] Exxon states that this variable transportation differential would be computed by the Quality Bank Administrator on the basis of the Worldscale annual rate for shipments from Venezuela to Los Angeles multiplied by the Platts freight rate for shipments from the Caribbean to the West Coast, plus the Worldscale Panama Canal charge adjusted to metric tons, reduced by the Worldscale annual rate for shipments from the Venezuela to Houston multiplied by the Platts freight rate for shipments from the Caribbean to the Gulf Coast. Exxon Initial Brief at pp. 308-09. Later in the hearings, notes Exxon, Ross made additional changes to his proposed formula for the governor, including the addition of a new working capital charge. Exxon Initial Brief at p. 309, n.109.

need to be higher and there would have to be a time lag inserted. *Id.* at pp. 320-21.

2023. Similarly, Exxon asserts that the evidence shows that the differential between the Gulf Coast price of MTBE and the West Coast price of MTBE has consistently been in the range of 7.3¢/gallon or $3.07/barrel throughout the 1992 to 2001 period.[669] *Id.* at pp. 321-22. Exxon notes that this MTBE price differential is over twice the size of the $1.49/barrel price ceiling suggested by Ross. *Id.* at p. 322. It suggests that this MTBE price differential is particularly significant because, like the transparent market that Ross purports to be simulating by his governor, MTBE is a clean petroleum product with published prices on both coasts that is actually imported on the West Coast from Venezuela. *Id.* The $3.07/barrel MTBE West Coast/Gulf Coast price differential provides strong additional evidence, in Exxon's view, that the $1.49/barrel price ceiling proposed by Ross's governor is far too small, and that any price ceiling would have to be at least twice the amount suggested by Ross. *Id.*

2024. In addition, because the evidence clearly establishes that it would take a month or more for potential shippers of Naphtha to validate and respond to any spike in the price of Naphtha on the West Coast, Exxon argues that it is undisputed that no price cap created by the potential for Naphtha imports on the West Coast could possibly operate within the first month of any increase in the West Coast price of Naphtha. *Id.* It follows, according to Exxon, that any price ceiling based on potential Naphtha imports should not go into effect until after period of a least a month has passed, and then it would apply only if the West Coast/Gulf Coast price differential exceeded the amount of the price ceiling during the second month as well as the first month. *Id.* at pp. 322-23.

2025. While these changes to the governor proposed by Ross would not cure the lack of theoretical and evidentiary justification for the governor, Exxon argues, the need for these fundamental changes starkly demonstrates the complete reformulation of the governor that would be required to bring it into compliance with the evidence. *Id.* at p. 323.

2026. Turning to the Petro Star alternative proposal for valuing West Coast Naphtha presented through the testimony of Dudley, Exxon described it as being based on the relationship between Gulf Coast Naphtha prices and a weighted incremental differential between Gulf Coast and West Coast VGO prices and Gulf Coast and West Coast LSR prices.[670] Exxon Initial Brief at p. 311. The sole objective of Petro Star's proposal,

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[669] Exxon states that there was no merit to either Ross's or BP's attempt to classify MTBE as a finished product in view of the undisputed fact that MTBE is a blendstock that is an important ingredient in the production of gasoline. Exxon Reply Brief at p. 322, n.207.

[670] Exxon explains that Dudley calculated a price differential between Gulf Coast and West Coast Naphtha based on the average price differential between Gulf Coast and

claims Exxon, was to attempt to devise some method of valuing West Coast Naphtha that does not rely on finished gasoline prices. *Id.*

2027. Exxon asserts that there is no logical or evidentiary basis for Dudley's proposal. *Id.* By arbitrarily avoiding any connection between the value of Naphtha and gasoline, the principal product that is produced from Naphtha, Exxon states, Dudley simply turned his back on the product from which 90% or more of West Coast Naphtha derives its value. *Id.* at pp. 311-12. Additionally, Exxon criticizes Dudley's methodology as being plucked from thin air, because Dudley did nothing to validate it. *Id.* at p. 312. It notes that Dudley did not compare his valuation results with the West Coast Naphtha contracts or consult any petroleum product traders to validate his results. *Id.* Nor, according to Exxon, did he compare his results with the values that would have been produced by the linear programming or price differential methodologies that he himself ordinarily used to value petroleum products in the real business world. *Id.*

2028. Petro Star, according to Exxon, advances as the two strengths of the Dudley methodology that "(1) it uses current Gulf Coast Naphtha prices as a starting point, and (2) it avoids reliance on the West Coast finished gasoline market." Exxon Reply Brief at pp. 325-26 (quoting Petro Star Initial Brief at pp. 9-10). Exxon suggests that neither of these so-called strengths provides any justification for Dudley's approach. *Id.* at p. 326.

2029. In view of Petro Star's position that Gulf Coast prices should continue to be used to value West Coast Naphtha, Exxon states, it is not surprising that Petro Star regards Dudley's reliance on current Gulf Coast Naphtha prices as the starting point for valuing West Coast Naphtha as a strength. *Id.* However, Exxon asserts, Petro Star offers no evidence at all as to why using current Gulf Coast prices to value West Coast Naphtha is reasonable or appropriate, and there is overwhelming evidence that the Gulf Coast Naphtha price is not a reasonable basis for valuing West Coast Naphtha. *Id.*

2030. Exxon also notes that Petro Star offers no justification whatever for Dudley's avoidance of any reliance on West Coast gasoline prices, as it agrees that virtually all Naphtha on the West Coast is used to manufacture either gasoline or jet fuel. *Id.* Moreover, notes Exxon, Dudley testified that, when he valued West Coast Naphtha for other clients, he always used the West Coast price of gasoline as his starting point. *Id.* Indeed, Exxon states, the only reason that Dudley could offer for his avoidance of the use of West Coast gasoline prices was that he was told to do so by Petro Star. *Id.* at pp. 326-27. What the evidence shows, in Exxon's view, is that this "strength" (not using

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West Coast VGO and the average price differential between Gulf Coast and West Coast LSR. Exxon Initial Brief at p. 311. It further explains that the average VGO and LSR price differentials were then weighted on the basis of their relative contribution to the value of the ANS stream. *Id.*

prices of West Coast gasoline in his analysis) is in fact a weakness. *Id.* at p. 327. Exxon asserts that this stems from Petro Star's awareness that any valuation methodology based on the price of West Coast gasoline would lead to values for West Coast Naphtha that were well above the Platts Gulf Coast Naphtha price. *Id.*

2031. Moreover, Exxon argues, Petro Star is unable to cite any evidence that might validate either Dudley's methodology or the reasonableness of the results that it produces. *Id.* It maintains that this omission is a result Dudley's methodology producing results that were far below the Naphtha values that are produced by the Tallett and O'Brien methodologies. *Id.* Exxon also claims that Petro Star cannot simply dismiss the empirical evidence in the record regarding the market value of West Coast Naphtha on the grounds that there is no market. *Id.*

2032. Exxon also argues that Dudley's proposed methodology does not meet the requirements for reasoned decision making established for this proceeding by the Circuit Court in the *OXY* and *Exxon* decisions. *Id.* at pp. 327-28. Exxon states that Dudley presents no evidence supporting his assumption that Gulf Coast and West Coast prices for Naphtha, VGO and LSR should behave similarly because they are supplied from similar sources and are used to produce similar products on both Coasts. *Id.* at p. 328. According to Exxon, Dudley's own analysis showed that the prices of LSR and VGO do not behave similarly on the two coasts for reasons that are unique to each product. *Id.*

2033. Even accepting Dudley's assumption, however, Exxon asserts that his generalized theory of similarity between the West Coast/Gulf Coast price differentials for Naphtha, VGO, and LSR suffers from the same defect as the reasoning that was rejected by the Circuit Court in the *OXY* and *Exxon* decisions. *Id.* It claims that the Circuit Court in *Exxon* stated that there must be more than a generalized claim that two values are similar. *Id.* Rather, explains Exxon, there must be some evidence that the proposed proxy has a consistent correlation within a specific range. *Id.* Therefore, even were it true that the same general relationship exists between the values of Naphtha, VGO, and LSR on the two coasts, Exxon maintains, the resulting similarity of prices assumed by Dudley does not meet the *Exxon* court's test. *Id.* at pp. 328-29.

2034. Exxon argues that Dudley also had no logical or evidentiary basis for valuing Naphtha on the basis of VGO and LSR prices, both of which are almost always priced well below Naphtha. Exxon Initial Brief at p. 312. Indeed, notes Exxon, Dudley admitted that Naphtha prices can change regardless of what VGO and LSR prices are doing. *Id.* Moreover, states Exxon, Dudley conceded at the hearing that, had he selected any of the other Quality Bank cuts which are used to produce gasoline, the results achieved by applying his methodology would have been dramatically different. *Id.* at pp. 312-13.

2035. Further, states Exxon, Dudley acknowledged that the differential between the Gulf

Coast price and the West Coast price for each cut was a function of the specific economics applicable to that cut, that the economics of making Naphtha into gasoline are greatly different from those of LSR, and that there was no relationship between the price differential and the boiling range of a particular cut. *Id.* at p. 313. In particular, notes Exxon, Dudley acknowledged that the prices of both VGO and LSR behaved very differently on the West Coast from the way they behaved on the Gulf Coast because the costs of transforming them into gasoline are much higher on the West Coast. *Id.* Exxon points out that this was confirmed by the fact that the correlation between VGO and LSR prices on the West Coast was substantially lower than the correlation between VGO and LSR prices on the Gulf Coast. *Id.* It states that Dudley also conceded that he had never undertaken any study of the economics of transforming VGO, LSR, or Naphtha into gasoline. *Id.* at pp. 313-14.

2036. Dudley, explains Exxon, could not identify a single example of anyone in the petroleum industry who valued Naphtha or any other cut by looking at the prices of other cuts above or below it in the distillation range. *Id.* at p. 314. Neither, according to Exxon, could Boltz, Petro Star's other witness. *Id.* Similarly, Exxon states, it was undisputed that Petro Star never valued Naphtha by the method proposed by Dudley. *Id.* Indeed, Exxon notes, Dudley conceded that as a consultant in the actual business world he has always valued Naphtha on the basis of the price of gasoline using either a linear programming model or a processing cost deduction. *Id.* Likewise, states Exxon, Culberson conceded that, when he functioned as a refinery consultant, he valued Naphtha as a gasoline feedstock. *Id.*

2037. The illogic of Dudley's proposal can also be demonstrated, in Exxon's view, if one attempts to apply his approach to other Quality Bank cuts. *Id.* For example, explains Exxon, Williams presented an exhibit which set forth West Coast minus Gulf Coast price differentials for four Quality Bank cuts (Isobutane, Butane, LSR, and VGO) for which there are West Coast and Gulf Coast prices. *Id.* Using these price differentials, notes Exxon, it was impossible to predict the price of any other cut. *Id.* Exxon argues that Dudley's approach when applied in this fashion produces nonsensical results. *Id.* at pp. 314-15. For example, states Exxon, if one tried to predict the West Coast price of LSR using the weighted average of the price differentials for the other three cuts, Dudley's approach would predict that the West Coast LSR price would be 40¢/barrel higher than the Gulf Coast LSR price of $20.26/barrel, or $20.66/barrel, whereas in fact the West Coast LSR price during this period was only $17.78/barrel. *Id.* at p. 315.

2038. Exxon also asserts that Petro Star's contention that LSR and VGO are the appropriate cuts to use to value West Coast Naphtha because, like Naphtha, they are intermediate blendstocks used to produce gasoline on both coasts also completely disregards the undisputed evidence in the record that, Exxon reiterates, the West Coast/Gulf Coast price differential for each petroleum product – both finished and intermediate – is based on market dynamics that are unique to the particular product, its usage and its technical characteristics. Exxon Reply Brief at p. 329. For example, Exxon notes that, as Petro Star concedes in its brief, the negative West Coast/Gulf Coast price differential for LSR is a result of the fact that LSR has consistently been priced lower on the West Coast than the Gulf Coast, an unusual situation that is most likely caused by the fact that LSR has a high Reid Vapor Pressure in comparison to Naphtha which constrains LSR's use in summer gasoline production on the West Coast. *Id.* By contrast, Exxon states that because it is undisputed that Naphtha doesn't have the same Reid Vapor Pressure, the LSR differential provides no information on how to value West Coast Naphtha. *Id.* at pp. 329-30. Accordingly, Exxon asserts, even Petro Star must admit that LSR differentials are most probably different from Naphtha differentials. *Id.* at p. 330.

2039. Similarly, Exxon states that the evidence shows that the relatively low West Coast/Gulf Coast price differential for VGO is largely a result of the demand for VGO on the Gulf Coast for use in heating oil production coupled with the stricter West Coast environmental restrictions on sulfur that require more extensive processing of VGO, which makes VGO more expensive to use as a gasoline feedstock on the West Coast. *Id.* Exxon notes that neither of these factors applies to Naphtha, because Naphtha is not used in the production of heating oil and all of the sulfur in Naphtha is removed on both coasts by hydrotreating before the Naphtha is processed into reformate in order to protect the reformer catalyst. *Id.* The evidence thus shows, according to Exxon, that the West Coast/Gulf Coast price differentials for both LSR and VGO are determined by market factors that are unique to each of those cuts and have no application to Naphtha. *Id.* at pp. 330-31.

2040. Further, Exxon argues that the evidence shows that had Dudley used the price differentials for any of the other Quality Bank cuts that are used to produce gasoline, the resulting West Coast Naphtha values produced by his methodology would have been dramatically different. *Id.* at p. 331. Indeed, Exxon asserts that the evidence shows that it is impossible to predict the price of any other cut using the price differentials for any of the other cuts as Dudley proposed. *Id.*

2041. The manner in which Dudley chose to weight the incremental differences between West Coast and Gulf Coast prices for VGO and LSR also, according to Exxon, had no logical basis. Exxon Initial Brief at p. 315. Further, notes Exxon, the weighting factor that he used for LSR was inconsistent with his own explanation. *Id.* Exxon explains that in weighting the VGO and LSR price differentials on the basis of their relative contribution to the value of the ANS stream, Dudley looked only at the ANS crude downstream of the Petro Star and Williams refineries, an approach that would permit those refineries to influence the amount of VGO and LSR in the stream and thereby impact the Quality Bank value of Naphtha on the West Coast. *Id.*

2042. Exxon states that, although Petro Star claims that Dudley's decision to derive his West Coast Naphtha value from an approximately 4 to 1 weighted average of the West

Coast/Gulf Coast price differentials for VGO and LSR was based on the relative contributions of VGO and LSR to the TAPS stream, neither Petro Star nor Dudley has ever provided any logical justification for that weighting as an appropriate way to value West Coast Naphtha. Exxon Reply Brief at p. 331. This failure is the result of a more fundamental problem, in Exxon's view: the VGO and LSR price differentials used by Dudley have nothing to do with the value of Naphtha on the West Coast, with the result that any use of them to derive a value for West Coast Naphtha would be wholly arbitrary. *Id.* at pp. 331-32.

2043. Dudley himself, Exxon claims, testified that the sole objective of his valuation proposal was to create a formula that resulted in West Coast Naphtha being valued at the Gulf Coast Naphtha price, and that was the sole standard by which he judged the results. Exxon Initial Brief at pp. 315-16. It argues that the methodology proposed by Dudley produced nonsensical results, resulted in a substantial undervaluation of West Coast Naphtha as compared to all of the other valuation proposals for that cut, and often valued West Coast Naphtha at levels below even the Gulf Coast Naphtha price. *Id.* at p. 316. Exxon explains that, due to the large negative West Coast/Gulf Coast price differential for LSR, the average West Coast Naphtha price computed by Dudley's proposed methodology was 0.19¢/gallon lower than the Platts Gulf Coast Naphtha price. Exxon Reply Brief at p. 332.

2044. Exxon states that, at the hearing, Sanderson suggested that another alternative method for valuing Naphtha on the West Coast might be to use the market price of ANS crude plus the cost of producing Naphtha from the crude. Exxon Initial Brief at pp. 316-17. It claims that Williams presented no evidence to support this alternative valuation methodology. *Id.* at p. 317. In particular, Exxon states, although Sanderson acknowledged that Naphtha is produced in refineries using three different technologies having different costs, he presented no evidence regarding the cost of producing Naphtha by any of those technologies. *Id.* Instead, explains Exxon, Sanderson suggested that the Commission might use either the $3.60 differential between the average price of Gulf Coast Naphtha and the average price of ANS crude or the same $4.00 that Ross proposed to use as part of his price floor for West Coast Naphtha based on one contract as a proxy for the cost of producing Naphtha from crude. *Id.*

2045. Sanderson's proposed alternative, Exxon argues, is nothing more than a thinly disguised effort to value West Coast Naphtha at the Gulf Coast Naphtha price. *Id.* Indeed, Exxon asserts, this is shown mathematically by Sanderson's suggestion that the differential between the average price of Gulf Coast Naphtha (P_{GCN}) and the average price of ANS crude (P_{ANS}) could be used as the proxy for the cost of producing Naphtha from crude. *Id.* at pp. 317-18. Sanderson's formula for valuing West Coast Naphtha at the price of ANS crude (P_{ANS}) plus the cost of producing Naphtha from crude would then be $P_{ANS}+ (P_{GCN} – P_{ANS})$, which, according to Exxon, equates to P_{GCN}, the price of Gulf Coast Naphtha. *Id.* at p. 318. Sanderson's proposed alternative method for valuing West

Coast Naphtha is thus, in Exxon's opinion, nothing more than an alternative way to reach a preordained result identical to his original – and patently unreasonable – proposal to value West Coast Naphtha at the Gulf Coast Naphtha price. *Id.*

2046. Exxon states that Williams confirms in its brief that this was the preordained objective of the Sanderson proposal. Exxon Reply Brief at p. 334. For that reason, explains Exxon, Williams states that ANS + $4.00/barrel is not only "consistent" with the Platts Gulf Coast Naphtha price quotation, it touts this proposed proxy on the ground that it is "equivalent" to the Gulf Coast Naphtha price. *Id.* Further, continues Exxon, Williams defends the reasonableness of Sanderson's ANS + $4.00 proposal solely on the ground that, because the Gulf Coast Naphtha price is the equivalent of ANS + $4.00, the reasonableness of using ANS + $4.00 as a proxy to value West Coast Naphtha should be judged by the same record evidence that supports the reasonableness of continuing to use the Gulf Coast Naphtha price as a proxy for the value of the West Coast Naphtha cut. *Id.* Exxon asserts that, were that the case, this proposal must be rejected because the evidence overwhelmingly demonstrates that the continued use of the Gulf Coast Naphtha price to value the Naphtha cut on the West Coast is unreasonable and unlawful. *Id.*

2047. Also, Exxon states, Sanderson's proposal to value West Coast Naphtha on the basis of the cost of ANS crude + $4.00 would be inconsistent with the valuation approach that has been adopted for every other Quality Bank cut. *Id.* at pp. 334-35. According to Exxon, all other cuts are valued on the basis of the market value of the products that are produced from that cut with, where appropriate, certain adjustments to ensure the equivalence of the Quality Bank cut and the proxy product. *Id.* at p. 335. It asserts that this is the very essence of the distillation methodology which values the crude oil based on the market price of the cuts produced when the crude is heated. *Id.* Exxon points out that no Quality Bank cut has ever been valued on the basis of the price of ANS crude plus the cost that a refiner would incur to derive that particular cut from the crude oil. *Id.* Accordingly, Exxon maintains, Sanderson's proposal to value the West Coast Naphtha cut at ANS + $4.00/barrel would clearly violate the consistency requirements of the *OXY* decision. *Id.*

2048. The absurdity of Sanderson's proposed ANS + $4.00 valuation for West Coast Naphtha is further demonstrated, in Exxon's view, by the fact that the costs to derive all of the Quality Bank cuts from ANS crude through the distillation process are roughly the same, since all of the cuts are derived from the crude oil through the same distillation process. *Id.* Were Sanderson correct, Exxon asserts, this would mean that the value of all the other Quality Bank cuts should also be ANS plus $4.00/barrel on the West Coast. *Id.* As the evidence makes very clear, notes Exxon, the West Coast market values of the other Quality Bank cuts bear no fixed relation to the price of ANS crude, but vary widely both from the price of ANS crude and from each other. *Id.* at pp. 335-36.

2049. Exxon argues that Sanderson's suggestion also is defective because he presented no evidence regarding the costs that would actually be incurred by a West Coast refinery to produce Naphtha from ANS crude. *Id.* at p. 336. Although he suggested that the Commission might use the differential between the average Platts Gulf Coast Naphtha price and the average price of ANS crude as a proxy, Exxon explains that he provided no explanation for why this differential would serve as a reasonable proxy for the costs of producing Naphtha from crude. *Id.* Nor, continues Exxon, did he even contend that the $4.00 figure, which he borrowed from the price floor used in Ross's proposed governor, actually reflects the cost of producing Naphtha from crude. *Id.* There is a complete failure of proof, concludes Exxon, regarding the essential cost element of Sanderson's proposal to value West Coast Naphtha at ANS + $4.00. *Id.* In Exxon's opinion, Sanderson's proposed ANS + $4.00 proxy thus suffers from the same lack of evidentiary support as the FO-380 less 4.5¢ proxy for Resid that the Circuit Court found to be unsupported by the record evidence in the *Exxon* decision.[671] *Id.* at pp. 336-37.

2050. Furthermore, Exxon notes, as Phillips stated in its brief, Sanderson's suggestion that $4.00 be used as a proxy for the costs that a West Coast refinery would incur to produce Naphtha from ANS crude conceals a wide variation in monthly results. *Id.* at p. 337. Assuming, as Sanderson does, that the cost of producing Naphtha from ANS crude could reasonably be approximated by the difference between the Platts Gulf Coast Naphtha price and the price of ANS crude, Exxon asserts, the evidence shows that difference has fluctuated widely from month to month from as low as 89¢/barrel up to $11.35/barrel. *Id.* It argues that the proposed use of a flat $4.00/barrel adjustment to cover this wide variation in results would therefore also violate the requirement in *Exxon* that the proxy price bear a rational relationship to the value it is supposed to represent. *Id.*

2051. Moreover, Exxon argues, it is revealing that Sanderson's suggestion of ANS + $4.00 for valuation of West Coast Naphtha is the same as the price floor proposed by Ross for West Coast Naphtha. Exxon Initial Brief at p. 318. It points out that this graphically demonstrates what Sanderson's proposed alternative Naphtha valuation was designed to do – to set the West Coast Naphtha price at or below the very minimum level at which suppliers might possibly be willing to sell Naphtha. *Id.*

2052. According to Exxon, neither Ross's testimony nor the one contract upon which he relied provides any justification for Sanderson's use of Ross's proposed price floor as a

[671] Exxon asserts that, in light of the complete lack of evidentiary support for Sanderson's suggestion that ANS + $4.00 might be used as a proxy to value West Coast Naphtha, the wholly unsubstantiated assertion by Unocal/OXY that Sanderson's suggestion "is more objective" than the supposedly "very subjective" valuation methodology presented by Tallett must be rejected as utter nonsense. Exxon Reply Brief at p. 337, n.211.

basis for valuing all West Coast Naphtha. *Id.* Exxon argues that, to the contrary, both Ross's governor proposal and the contract upon which it was based recognize that the price of ANS crude plus $4.00 represents a minimum value below which it would be unreasonable to expect the price of Naphtha to fall, and that the value of Naphtha on the West Coast would ordinarily be expected to exceed that minimum price. *Id.* at pp. 318-19.

2053. During the hearing, Exxon notes, I asked whether it might be appropriate to derive a West Coast Naphtha value using the published prices of two other petroleum products ("Product A" and "Product B") that bracketed the price of Naphtha on both the Gulf Coast and the West Coast. *Id.* at p. 320. Exxon explains that the value of West Coast Naphtha would then be determined by placing it within the range of the West Coast prices for the two bracketing products based on the position of the Gulf Coast Naphtha price within the range of the Gulf Coast prices for the same two products. *Id.* It notes that all parties agreed that there were no two intermediate petroleum products that both met the pricing requirements of bracketing the Naphtha price and could appropriately be used to derive a value for West Coast Naphtha in this fashion. *Id.* However, continues Exxon, the evidence showed that this formula could be applied using regular unleaded gasoline as Product A and crude oil as Product B, since the price of Naphtha generally falls somewhere between the price of regular unleaded gasoline – the chief product produced from Naphtha, and the price of crude oil – the product from which Naphtha is derived. *Id.* at p. 321.

2054. Similarly, explains Exxon, Judge Wilson suggested by her questioning that the value of Naphtha on the West Coast should be expected to be at or above the price of crude plus the cost of processing the crude into Naphtha (like the price floor proposed by Ross), and at or below the West Coast price of gasoline less the cost of processing the Naphtha into gasoline (like the Naphtha value calculated by O'Brien). *Id.* This would strongly suggest, according to Exxon, that the price of Naphtha should be somewhere between an upper bound determined by the West Coast price of gasoline less the cost of producing gasoline from Naphtha on the West Coast, and a lower bound determined by the price of ANS crude plus the cost of producing Naphtha from the crude on the West Coast. *Id.* Exxon suggests that the point within that range at which Naphtha would be appropriately valued might then be estimated on the basis of the relationship between the prices of gasoline, Naphtha, and crude oil on the Gulf Coast. *Id.*

2055. On the Gulf Coast over the 1994-2001 period, states Exxon, the average price of regular unleaded gasoline was $24.66/barrel, and the average price of Isthmus crude was $19.31/barrel. *Id.* During that same period, continues Exxon, the average price of Full Range Naphtha with an N+A of 40 on the Gulf Coast was $22.74/barrel, which means that the average price of heavy Naphtha with an N+A greater than 55, like the Naphtha produced from ANS crude, on the Gulf Coast during that period would have been

$23.79/barrel.[672] *Id.* at pp. 321-22. This means, claims Exxon, that the average differential between the price of regular unleaded gasoline and Isthmus crude on the Gulf Coast was $5.35/barrel, and that the average differential between the prices of ANS-type Naphtha and Isthmus crude on the Gulf Coast was $4.48/barrel. *Id.* at p. 322. It follows from these differentials, asserts Exxon, that, on average, the price of ANS-type Naphtha on the Gulf Coast was equal to the price of Isthmus crude plus 83.74% of the range between the price of gasoline and the price of Isthmus crude on the Gulf Coast. *Id.*

2056. Exxon suggests that this 83.74% figure could then be used to derive the West Coast value of Naphtha using the average published West Coast prices for regular unleaded gasoline and ANS crude. *Id.* It points out that, during the same 1994-2001 period, the average price of regular unleaded gasoline on the West Coast was $27.73/barrel, and the average price of ANS crude on the West Coast was $19.16/barrel. *Id.* This means, according to Exxon, that the average range between the price of regular unleaded gasoline and ANS crude oil on the West Coast was $8.57/barrel, and 83.74% of that range was $7.18/barrel. *Id.* at pp. 322-23. Adding this portion of the range to the price of ANS crude produces, in Exxon's calculations, an average West Coast Naphtha value of $26.33/barrel. *Id.* at p. 323. Exxon notes that this number is somewhat higher than Tallett's average West Coast Naphtha value of $25.48/barrel for the same period, and well above the average Gulf Coast Naphtha price of $22.74/barrel. *Id.*

2057. Similarly, Exxon states that, using the published average Gulf Coast price of Full Range Naphtha of $22.74/barrel with no adjustment for the higher quality of ANS Naphtha, this analysis produces an average West Coast Naphtha value of $24.65/barrel, a number somewhat below Tallett's average of $25.48/barrel. *Id.* It points out, an average of the results of the ANS-type Naphtha analysis ($26.33/barrel) and the Full Range Naphtha analysis ($24.65/barrel) produces a result ($25.49/barrel) that is virtually identical to the result for the same period produced by Tallett's methodology ($25.48/barrel). *Id.*

2058. This similarity of results is not surprising, according to Exxon, because, as Phillips correctly points out, the interpolation process that was suggested during the hearings is conceptually similar to Tallett's regression proposal, though Phillips states that Tallett's

[672] Exxon explains that the Naphtha produced from ANS crude is a more valuable Heavy Naphtha with an N+A over 55. Exxon Initial Brief at p. 322, n.111. It states that Heavy Naphtha is approximately 1¢/gallon more valuable than Full Range Naphtha, and a Naphtha with an N+A greater than 55 is approximately 1.5¢/gallon more valuable than Naphtha with an N+A of 40 (which is the value on which the Platts Gulf Coast Naphtha prices are based). *Id.* It follows, according to Exxon, that ANS Naphtha would be 2.5¢/gallon, or $1.05/barrel, more valuable than the Full Range Naphtha on which the Platts Gulf Coast price was based. *Id.*

proposal gives a more accurate result. Exxon Reply Brief at p. 340. Therefore, Exxon concurs in Phillips's recommendation to adopt the Tallett proposal rather than an interpolation proposal, because Tallett's proposal was fully addressed by all parties at the hearing and would not pose the same risk of lack of record support that the interpolation proposal would. *Id.*

2. Phillips

2059. Phillips supports the West Coast Naphtha methodology proposed by O'Brien, because Phillips believes that, out of all the Naphtha proposals, O'Brien's proposal is a cost-based methodology. Phillips Initial Brief at p. 76. It notes that O'Brien derives the Naphtha value from product prices published on the West Coast less the costs of processing Naphtha into those products. *Id.* Phillips explains that this is the way that all other Quality Bank cuts are valued when there is no published price that applies directly to the cut on the coast on which it is delivered. *Id.*

2060. O'Brien's proposal, Phillips explains, follows his methodology for valuing Resid as a Coker feedstock and is based on the fact that virtually all of the Naphtha produced by refineries on the West Coast is first processed through catalytic reformers to produce reformate, which subsequently is used as a blendstock in the production of gasoline. *Id.* at pp. 76-77. According to Phillips, O'Brien's methodology attempts to replicate the value of Naphtha in this processing. *Id.* at p. 76. It points out that the parties are in general agreement as to the basic Resid methodology, although they differ on certain of the assumptions used in that methodology. *Id.* at p. 77. Because that basic Coker feedstock methodology has been adopted by the Commission and approved by the Circuit Court, Phillips argues, using the same approach for West Coast Naphtha ensures that the Naphtha value is consistent with the Resid value and in compliance with the *OXY* uniformity requirement. *Id.*

2061. Phillips explains that the first step of O'Brien's methodology is to develop a before-cost value of Naphtha on the West Coast by first determining the product yields from running Naphtha through a reformer. *Id.* While about 85.7% of the Naphtha is converted into reformate, Phillips notes, other product yields include hydrogen gas, fuel gas, propane, isobutane, and normal butane. *Id.* As is the case with Resid, Phillips states, the reformer yields are multiplied by their product prices in order to derive a before-cost value of Naphtha. *Id.* Continues Phillips, published prices are available and used for fuel gas, propane, isobutane and normal butane, but further analysis was required to develop the reformate and hydrogen prices, which are not published. *Id.* at pp. 77-78.

2062. According to Phillips, O'Brien developed his reformate value based on the fact that the sole use of reformate is as a gasoline blendstock and derived the value of reformate using the published prices of the other blendstocks used to make gasoline as well as the price of the gasoline itself. *Id.* at p. 78 (citing Exhibit No. PAI-35.) It refers to this as the “three-component blend” formula. *Id.*

2063. Phillips concedes that some judgment is required in selecting the blend of products used to value reformate because gasoline is not uniformly made from a standard blend. *Id.* at p. 79. Instead, explains Phillips, there are a number of different blends of different blendstocks that can be used. *Id.* Notes Phillips, each refinery will choose a different blend or mix of blends depending upon the blendstocks available and the environmental restrictions that are applicable to that refinery. *Id.* In addition, states Phillips, there are a number of different types of gasoline produced on the West Coast ranging from CARB gasoline with its strict emission standards to conventional gasoline which has less strict emission standards. *Id.* Finally, notes Phillips, there are prices reported for regular and premium gasoline for all categories of gasoline differentiated by their respective octane content. *Id.*

2064. O'Brien based his Naphtha value calculation, states Phillips, on conventional regular gasoline using the Seattle reported price. *Id.* It points out that CARB gasoline and reformulated gasoline are more expensive, and are made with more complex blends that include products with no reported prices. *Id.* Further, notes Phillips, conventional gasoline is easier to make because it does not have to meet the California Air Resources Board and reformulated gasoline standards. *Id.* O'Brien chose to use the Seattle price, according to Phillips, because there is a robust market for conventional gasoline in the Pacific Northwest, whereas the California conventional gasoline market is small and shrinking. *Id.* at pp. 79-80.

2065. According to Phillips, O'Brien used a simple three-component blend of butane, LSR and reformate to make conventional regular gasoline, using percentages that allow the blend to meet applicable octane, Reid Vapor Pressure and vapor to liquid ratio specifications. *Id.* at p. 80. While this three-component blend is somewhat simplistic, Phillips claims, it is used by many refineries to make conventional regular gasoline. *Id.* Because there are reported prices for butane and LSR, Phillips argues, use of this blend allows O'Brien to perform a relatively simple calculation to determine the value of the reformate used in the blend. *Id.*

2066. Because there also is no published price for hydrogen on the West Coast, Phillips explains, O’Brien developed a hydrogen value based on the cost of manufacturing hydrogen from natural gas in a hydrogen plant. *Id.* O’Brien’s calculation of the hydrogen value is the same, notes Phillips, as the calculation of the value of hydrogen that O’Brien performed for the Resid and Heavy Distillate valuation calculations. *Id.* However, according to Phillips, O’Brien faced a dilemma with respect to the question of how that hydrogen value should be adjusted to account for changes in the cost of natural gas, which is the primary cost incurred in producing hydrogen. *Id.* This dilemma, notes Phillips, results from the fact that, while hydrogen is produced as a byproduct of the processing of the Naphtha cut, it is consumed in the processing of the Resid and Heavy

Distillate cuts. *Id.* at pp. 80-81. For that reason, according to Phillips, O'Brien could not use the same approach for adjusting the cost of natural gas in calculating the value of the hydrogen produced in the reformer. *Id.* at p. 81. Under the Quality Bank methodology, states Phillips, all products of the various processes modeled by the methodology, including each of the Quality Bank cut values, are adjusted monthly in accordance with changes in published prices for that product. *Id.* Similarly, explains Phillips, the Resid valuation approach to which all parties have agreed provides that each of the Coker product prices is adjusted monthly to reflect changes in the published prices for that product. *Id.* O'Brien also adjusts all other products of the reforming process on a monthly basis in deriving his Naphtha value, notes Phillips. *Id.*

2067. In order to be consistent with how all other products produced from the various Quality Bank processes are adjusted, therefore, Phillips notes, O'Brien adjusted the natural gas component of his calculated hydrogen value on the same monthly basis in accordance with changes in the published price of natural gas. *Id.* at p. 82. Finally, states Phillips, this inclusion of the natural gas component of hydrogen in the Naphtha valuation formula is reflected in the formula shown on Exhibit No. PAI-39. *Id.*

2068. Once O'Brien determined the value of the products of the reforming process, Phillips explains, it was necessary to subtract the costs of the reforming process. *Id.* He used the same approach for this calculation, according to Phillips, as he did for his Resid and Heavy Distillate cost calculations, based on the Baker & O'Brien cost curves and fixed and operating cost data that O'Brien uses in his every day business. *Id.* (citing Exhibit No. PAI-37). Once the costs of reforming are determined, Phillips notes, the final step is to subtract those costs from the before-cost value to arrive at a cost-based value of Naphtha. *Id.* Finally, states Phillips, consistent with the treatment of costs for other cuts, the costs are adjusted annually for changes in the Nelson Farrar Operating Index. *Id.* (citing Exhibit Nos. PAI- 38, 39).

2069. Phillips argues that another reason O'Brien's proposal should be adopted is that a number of tests that have been applied to his results that validate the reasonableness of his methodology. *Id.* at p. 83. It explains that O'Brien was required to make a number of assumptions regarding a representative gasoline blend and about how reformate is valued and parties opposed to use of his methodology have attacked the assumptions underlying his method. *Id.* However, Phillips asserts, it is possible to perform a real world test of the assumptions included in O'Brien's methodology. *Id.* While there clearly are differences between Gulf Coast and West Coast Naphtha values, Phillips explains, there is nothing in the theory underlying O'Brien's cost-based methodology that limits it to West Coast Naphtha. *Id.* Naphtha also is processed into gasoline on the Gulf Coast, notes Phillips, and the three-component blend is one way that conventional gasoline can be made on the Gulf Coast. *Id.* The significant differences between the Gulf Coast and West Coast markets can be accounted for, according to Phillips, by using Gulf Coast product prices in the formula instead of West Coast prices. *Id.*

2070. As a result, states Phillips, it is possible to test O'Brien's formula by substituting Gulf Coast product and gasoline prices into that formula. *Id.* The results of this substitution show, notes Phillips, that not only are the calculated prices close to the actual prices, but O'Brien's methodology very closely follows the Gulf Coast price trends, with an r-squared value of 0.959. *Id.* at p. 84. Phillips asserts that this result means that the values resulting from O'Brien's Naphtha methodology are more than just randomly related to the value of Naphtha, and thus the methodology is in conformance with the Circuit Court's holding in *Exxon*. *Id.*

2071. Further bolstering the validity of O'Brien's method, according to Phillips, is Exhibit No. WAP-132 that shows that, on average, O'Brien's calculated value was 2.1¢/gallon lower than the actual Gulf Coast price. *Id.* Phillips states that this means the costs that O'Brien calculated as required to process Naphtha on the West Coast were on average 2.1¢/gallon higher than what actually was required to match the Gulf Coast price. *Id.*

2072. Further, Phillips explains, the 2.1¢/gallon undervaluation of Gulf Coast Naphtha that results from the application of O'Brien's methodology to the Gulf Coast provides a practical response to a number of the attacks on his methodology. *Id.* For example, to the extent that the arguments are correct that the cost of processing Naphtha is higher on the West Coast than on the Gulf Coast, Phillips claims, the 2.1¢/gallon difference between Gulf Coast prices and the results of O'Brien's methodology on the Gulf Coast shows that O'Brien has provided for greater costs in his Naphtha methodology than occur on the Gulf Coast. *Id.* at pp. 84-85. Phillips also argues that this difference similarly addresses other arguments regarding differences between the Gulf Coast and the West Coast Naphtha markets such as that refiner margins are higher on the West Coast, and that Naphtha has a lower value relative to gasoline prices on the West Coast than on the Gulf Coast. *Id.* at p. 85.

2073. At the same time that O'Brien developed a cost-based Naphtha methodology, Phillips explains, Tallett independently derived a market-based methodology. *Id.* at p. 89. Although the two methodologies come up with somewhat different values, Phillips states, they are in the same general range as can be seen from the analyses presented by Pulliam in Exhibit No. SOA-28. *Id.* Phillips argues that the fact that two completely different approaches to the same problem came up with similar answers provides additional support for each methodology. *Id.* It claims that the testimony of Baumol supports this view, noting that he testified that:

> I've seen two pieces of evidence, which I think do strongly support the transferability of the Gulf Coast derived regression [done by Tallett] to the West Coast. One is the similarity of the results it yields to [O'Brien's] results. . . . And it is essentially an entirely independent result, one I described as, I believe, disaggregation of the final product price, and it comes out with numbers very close to [Tallett's]. Now, the point is that if it

> were true that the naphtha values, for example, for the West Coast entailed earnings materially lower or materially higher than those on the Gulf Coast, I would have expected that the Tallett concluding numbers would also have been correspondingly materially higher or materially lower than the O'Brien numbers.

Id. at pp. 89-90. (quoting Transcript at pp. 5151-52).

2074. Phillips states that one criticism of O'Brien's methodology is that, for a period of several months in 2000 and 2001, the calculated Naphtha price was above the Seattle gasoline price that O'Brien used to calculate the Naphtha price and that it is unrealistic to assign a value to Naphtha that is higher than the price of the gasoline that the Naphtha is made into. *Id.* This criticism, Phillips points out, ignores that Naphtha is made into a number of products other than just gasoline – most notably hydrogen. *Id.* at p. 92. Because the value of hydrogen is highly dependent on the value of the natural gas from which it is principally made, Phillips explains, the calculated value of Naphtha can increase independently of the price of gasoline when the price of natural gas increases. *Id.* At times, notes Phillips, the Naphtha value can even increase above the price of gasoline if natural gas prices are high enough. *Id.* According to Phillips, this is exactly what happened in the case of O'Brien's methodology in 2000 and 2001. *Id.* It notes that when natural gas prices returned to more normal levels, the calculated Naphtha values moved back below Seattle gasoline prices. *Id.*

2075. That high natural gas prices were the cause of the high Naphtha prices resulting from O'Brien's methodology in 2000-2001 is also illustrated, points out Phillips, in Exhibit No. PAI-150, which breaks down each before-cost element of the Naphtha value calculated by O'Brien for each month from 1999-2001. *Id.* It explains that Exhibit No. PAI-150 shows that increases in the price of reformate, which is what is blended into gasoline, never caused the calculated Naphtha value to exceed the gasoline price. *Id.* Instead, continues Phillips, it was when the prices of hydrogen and fuel gas, which also is priced from natural gas, were higher than normal that the calculated value of Naphtha exceeded the price of Seattle gasoline. *Id.*

2076. Phillips asserts that this result is perfectly consistent with economic theory, as Baumol testified. *Id.* It also is consistent, notes Phillips, with what happens from time to time on the Gulf Coast. *Id.* Also, Phillips explains, the price data submitted in this hearing show that there have been occasions when the published price of Naphtha has exceeded the published price of regular unleaded gasoline. *Id.* at pp. 92-93. It further states that this phenomenon has occurred as recently as 2003. *Id.* at p. 93.

2077. According to Phillips, Toof and Tallett nonetheless attacked the use of a Seattle gasoline price as being inconsistent with O'Brien's use of California prices at other points in his calculations. *Id.* at p. 94. It points out that O'Brien recognized this inconsistency, but that he believed that the danger of having the California price disappear in the future justifies using the Seattle price. *Id.* However, notes Phillips, use of the Seattle price is not central to his methodology, and if the Commission believes that the Los Angeles or West Coast gasoline price would be more appropriate for purposes of consistency, such a change could easily be made without doing any harm to the methodology. *Id.*

2078. In contrast to the arguments that it is inconsistent for O'Brien to have used the Seattle gasoline price for his Naphtha value instead of a Los Angeles price, Phillips notes, Williams suggested that O'Brien should not have used the Southern California natural gas price in his Naphtha value. *Id.* Phillips explains that Williams suggested that the Seattle or Green River, Wyoming, price be used instead, and sponsored Exhibit No. WAP-211 to show how the different prices compare. *Id.* It states that that Exhibit shows that, under typical conditions, there is not much difference between using the Los Angeles, Seattle, or Green River prices. *Id.* at p. 95. However, during the natural gas crisis of 2000-01, Phillips explains, the natural gas prices in these locations started to separate, with the Los Angeles prices increasing to levels substantially higher than the Seattle prices, which in turn exceeded the Green River prices. *Id.*

2079. It is Phillips's position that the Los Angeles natural gas price should be used, at least in ordinary circumstances.[673] *Id.* Phillips explains that most of the prices that have been used in cost-based calculations for other cuts have come from the Los Angeles area, and O'Brien used Los Angeles natural gas pricing for his proposed Heavy Distillate and Resid methodologies. *Id.* The reason that O'Brien chose not to use the Los Angeles conventional gasoline price does not, according to Phillips, apply to the Los Angeles natural gas market. *Id.*

2080. Phillips states that it is aware that the Commission has concluded that California natural gas prices were manipulated during the 2000-2001 time frame when Exhibit No. WAP-211 shows a separation between Seattle and Los Angeles prices. *Id.* (citing *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 102 FERC ¶ 61,317 at P 56-63 (2003)). However, Phillips asserts, these manipulation concerns do not apply to the current prices, and the Commission is taking steps to prevent manipulation of the prices in the future. *Id.* at pp. 95-96 (citing *Investigation of Wholesale Rates of Public Utility Sellers of Energy and Ancillary Services in the Western Systems Coordinating Council*, 97 FERC ¶ 61,294 (2001)). To

[673] Phillips explains that the Los Angeles area price that O'Brien uses is based on the reported Southern California price index, plus an additional amount to account for the cost of transporting gas from the hub where the Southern California price is reported to refineries in the Los Angeles area. Phillips Initial Brief at p. 95, n.39 (citing Exhibit No. PAI-1 at p. 13).

the extent that the Commission is concerned about future natural gas price manipulation, Phillips suggests, the Quality Bank Administrator be permitted to propose the use of a different natural gas price in the event that the Commission makes a finding that there is a problem with the reported Southern California natural gas price. *Id.* at p. 96.

2081. The criticism that O'Brien's approach to valuing hydrogen for Naphtha purposes is inconsistent with the way that O'Brien values hydrogen in his cost-based calculations for Heavy Distillate and Resid, Phillips claims, has no merit. *Id.* It argues that it is wrong to say that O'Brien calculated his hydrogen value differently in his Naphtha calculations than he did in his Resid and Heavy Distillate calculations. *Id.* To the contrary, explains Phillips, O'Brien testified that he used the same approach for Naphtha that he used for Resid and Heavy Distillate. *Id.* The only difference, according to Phillips, is in how O'Brien proposes to adjust the value of hydrogen to account for changes in natural gas prices. *Id.*.

2082. Phillips notes that hydrogen is one of many elements of the costs associated with processing Heavy Distillate and Resid. *Id.* Rather than develop separate escalation factors for each cost element, Phillips explains, O'Brien lumps all costs together and adjusts them in accordance with changes in the Nelson Farrar Operating Index. *Id.* It would add considerably to the complexity of the Heavy Distillate and Resid formulæ, states Phillips, if each element of cost were escalated separately. *Id.* at pp. 96-97.

2083. According to Phillips, O'Brien was also concerned that others might find it inconsistent if he were to vary the cost of hydrogen in his Heavy Distillate and Resid cost calculations based on the cost of natural gas, but to escalate all other costs based on the Nelson Farrar Index. *Id.* at p. 97. Nevertheless, Phillips explains, it would be administratively feasible to do so if the Commission was to prefer using an across the board hydrogen valuation method for all purposes in all cuts. *Id.*

2084. Phillips considers O'Brien's approach to the hydrogen issue to be logical. *Id.* It claims that hydrogen is one of the products of the Naphtha reforming process instead of one of the costs. *Id.* O'Brien, Phillips states, varies the value of all products of the Heavy Distillate and Resid processing and of all other products of the Naphtha processing each month based on changes in the market prices of those products, and it would be inconsistent with the way that all other products are treated if, as suggested, O'Brien were to fix the value of hydrogen in calculating the value of Naphtha while allowing all other product values to vary each month based on changes in product prices. *Id.* Phillips asserts that this is not an acceptable way of achieving an across the board hydrogen approach, as it would distort the cut values significantly. *Id.*

2085. Exhibit Nos. WAP-214 and WAP-215, Phillips suggests, show that changing the value of hydrogen so that it is valued as it was on the cost side of the Heavy Distillate and Resid calculations would not have a significant impact on the Naphtha value in most years, but it would prevent the calculated Naphtha value from exceeding the Seattle gasoline price in those months where high natural gas prices caused O'Brien's calculated value to exceed the Seattle gasoline price. *Id.* at pp. 97-98. Far from supporting the use of a fixed value of hydrogen for O'Brien's methodology, Phillips asserts that Exhibit Nos. WAP-214 and WAP-215 show why the hydrogen value should be allowed to vary each month in accordance with the cost of natural gas. *Id.* at p. 98. As explained above, notes Phillips, the high cost of natural gas in those months caused the value of Naphtha to rise above the Seattle gasoline price, as evidenced by the West Coast Naphtha contracts. *Id.* Adopting a pricing methodology that fails to reflect the fact that Naphtha's value is based in part on the price of natural gas would result, in Phillips's opinion, in a calculated Naphtha value that undervalues Naphtha in times of high natural gas prices. *Id.*

2086. Phillips states that Sanderson and Culberson both asserted that the three-component blend used by O'Brien in his methodology was not used to make gasoline and that it failed to meet environmental and industry standards. *Id.* O'Brien disagreed, noted Phillips, but he did acknowledge that this blend is one of the simpler ones used in the industry and that there are more complex blends that also are used to make gasoline. *Id.* Those more complex blends, explains Phillips, are more difficult to model, particularly since they use blendstocks for which there are no published prices. *Id.* Since the three-component blend is used to make gasoline, continued Phillips, O'Brien concluded that it would be an appropriate simplifying assumption to value Naphtha based on the use of reformate in this three-component blend. *Id.* at pp. 98-99.

2087. As an initial matter, Phillips asserts, the tests of O'Brien's methodology are particularly useful for evaluating claims about whether the three-component blend is appropriate for use in developing a value for Naphtha. *Id.* at p. 99. In particular, Phillips believes, the fact that O'Brien's methodology does such a good job tracking the price of Naphtha on the Gulf Coast provides strong evidence that use of his three-component blend does in fact accurately capture the economics of making gasoline from Naphtha. *Id.*

2088. Phillips, referring to Exhibit No. UNO-57, which it describes as a report which purports to show that the three-component blend used in O'Brien's methodology does not meet industry standards, notes that Culberson used it to attempt to show that the three-component blend does not meet Drivability Index specifications required for most gasoline sold in the United States. *Id.* At page one of his report, according to Phillips, Culberson asserts that the blend would exceed the maximum 50% and 90% evaporation points established in the Drivability Index specifications for gasoline. *Id.* at p. 100. However, asserts Phillips, the distillation data produced by O'Brien during discovery, Exhibit No. PAI-237, showed that Culberson's assertion is incorrect. *Id.* Instead, explains Phillips, that Exhibit shows that 50% of the three-component blend evaporates at 236°F, and 90% evaporates at 319°F. *Id.* When these boiling points were compared with the Drivability Index specifications set forth in Exhibit No. UNO-57, continues Phillips, they show that the three-component blend does in fact meet the 50% and 90% evaporation requirements. *Id.* Furthermore, Exhibit No. PAI-237 includes a Drivability Index calculation for the three-component blend which shows, points out Phillips, that the three-component blend has a Drivability Index of 1186, which meets all Drivability Index specifications. *Id.* at pp. 100-01.

2089. Williams also asserted, Phillips states, that the three-component blend cannot meet EPA requirements for gasoline. *Id.* at p. 101. However, Phillips argues, the record evidence shows that the three-component blend does in fact meet the applicable EPA requirements for most of the Pacific Northwest refineries that are the primary producers of conventional gasoline on the West Coast. *Id.* Phillips explains that the general EPA requirements applicable to refiners appear at 40 C.F.R. § 80.101(2004). *Id.* at p. 102. Further, notes Phillips, the requirements that apply to conventional gasoline are in Section 101(b)(3). *Id.* Under section 101(c)(2), states Phillips, refiners have been obligated to satisfy the complex model standards starting in 1998, and there is no real dispute among the parties as to the applicable standards. *Id.* It notes that the primary requirements under this standard apply to annual average exhaust toxic and Nitrogen Oxide emissions, determined pursuant to the "complex model" under 40 C.F.R. § 80.45(2004). *Id.* Further, states Phillips, section 101(b)(3) requires that each refiner must meet its "compliance baseline" for exhaust toxics and Nitrogen Oxide emissions. *Id.* Refineries have two different ways to meet the EPA emissions requirements, according to Phillips: refineries that were in operation in 1990 have an individual baseline based on their 1990 gasoline qualities; while refineries that were not in operation in 1990 must meet the statutory baseline, which is a standardized baseline that applies throughout the United States. *Id.* at pp. 102-03. In order to assist refineries in determining compliance with the complex model, notes Phillips, the EPA has developed a standard spreadsheet to perform the complex model calculations. *Id.* at p. 103. According to Phillips, this model was used by O'Brien, Sanderson and Culberson in the course of their testimony. *Id.*

2090. One of the problems associated with the attempts to determine whether the three-component blend satisfies the EPA standards is the need to have accurate data regarding the quality of reformate made from ANS Naphtha, according to Phillips. *Id.* It notes that this can be seen from page 4 of Exhibit No. PAI-167, which shows both the input and output for the EPA complex model. *Id.*

2091. As Exhibit No. PAI-167 shows, continues Phillips, in order for the complex model to be run, it is necessary to have information regarding the gasoline blend's qualities with respect to Reid Vapor Pressure, distillation information for 200° and 300°, aromatics, olefins, sulfur and benzene. *Id.* It notes that some of this information can reasonably be estimated. *Id.* For example, explains Phillips, because Naphtha must be hydrotreated to essentially zero sulfur content prior to being processed in a reformer, it is reasonable to assume that reformate has no sulfur. *Id.* Similarly, states Phillips, it is well known that butane, LSR and reformate have no olefins. *Id.* at pp. 103-04. However, asserts Phillips, the benzene and aromatics levels of the blend, which are very important to the results of the complex model, are highly dependent on the benzene and aromatics levels of the LSR and reformate in the blend. *Id.* at p. 104.

2092. Use of ANS assays, according to Phillips, can help ascertain the benzene and aromatics levels of the LSR used in the blend, but they only provide the benzene and aromatics levels of the Naphtha that is processed into reformate and not of the reformate itself. *Id.* The whole point of the reforming process, explains Phillips, is to increase the amount of aromatics and naphthenes contained in Naphtha, and, therefore, the benzene and aromatics content of reformate made from ANS Naphtha necessarily will be higher than the benzene and aromatics content of ANS Naphtha itself. *Id.* Phillips points out that exactly how much higher cannot be determined by looking at the qualities of ANS Naphtha. *Id.* It notes that there is no standard correlation available that shows how to calculate the benzene and aromatics content of reformate from the benzene and aromatics content of Naphtha. *Id.* Instead, states Phillips, it is necessary to have that data taken directly from the reformate. *Id.*

2093. Phillips explains that the challenge for the parties in this proceeding, therefore, was to find data providing reasonable approximations of the amount of aromatics and benzene that is contained in reformate made from ANS Naphtha. *Id.* Without reasonable data for these qualities, they contend that any attempt to use the EPA complex model on the three-component blend would not lead to meaningful results. *Id.*

2094. According to Phillips, three different sets of data were presented at the hearing regarding the benzene and aromatics levels of reformate made from ANS Naphtha. *Id.* at p. 105. It notes that two of those were presented by Williams (Exhibit Nos. WAP-136, WAP-140), and the third set was presented by O'Brien (Exhibit No. PAI-167). *Id.* Phillips argues that only O'Brien's data contains a reasonable estimate of the qualities of reformate made from ANS Naphtha. *Id.*

2095. Exhibit No. WAP-136, according to Phillips, shows benzene and aromatics levels of 5.5% and 61.3%, respectively, for ANS reformate, values derived from a table in PIMS model 11.0. *Id.* The problem with using this table, according to Phillips, is that the benzene and aromatics content of the reformate based on the Naphtha feedstock which is used in the PIMS model is not calculated on it. *Id.* Phillips explains that the PIMS table uses a generic level of benzene and aromatics for reformate, regardless of the benzene and aromatics content of the Naphtha that is actually being reformed. *Id.* This is an unrealistic assumption, in Phillips's view, because the benzene content of reformate is directly related to the benzene and aromatics content of the Naphtha that is being processed by the reformer. *Id.* at pp. 105-06. It notes that O'Brien further testified that the PIMS generic reformate quality data included in this table was not linked to the part of the PIMS model that he used in his calculations and that he did not rely on that generic data in any fashion. *Id.* at p. 106.

2096. Phillips notes that Sorenson's testimony, during the N+A phase of the hearing, also addressed the data that was in the PIMS model regarding benzene and aromatics content of reformate. *Id.* It explains that Sorenson confirmed O'Brien's testimony that the PIMS data table does not vary the benzene and aromatics content of reformate based on the benzene and aromatics content of the Naphtha being processed, but rather on the octane level of the reformate into which the Naphtha is being processed. *Id.* Phillips notes that Sorenson also testified that the benzene and aromatics numbers in the PIMS table were "much higher than [he had] typically seen in the reformers [on which he'd] worked." *Id.* (quoting Transcript at p. 13325).

2097. Exhibit No. WAP-136, which it states shows the results of using the above-assumed reformate qualities in EPA's complex model, is the next matter addressed by Phillips. *Id.* It states that the Exhibit shows that the complex model calculates an annual average exhaust toxics level of 210.8 mg/mile for the three-component blend. *Id.* However, it notes that, because that calculation is based on the generic PIMS reformate aromatics and benzene content, not on the actual aromatics and benzene content of reformate made from ANS Naphtha, the calculation does not reflect the exhaust toxics level that would result from using ANS reformate. *Id.* Furthermore, Phillips explains that, because the generic PIMS aromatics and benzene levels are high, the calculated exhaust toxics level of 210.8 mg/mile is too high and does not accurately reflect the exhaust toxics value for the three-component blend. *Id.*

2098. Phillips states that Williams also used Exhibit No. WAP-140 during the hearing. *Id.* at p. 107. It explains that page one of this Exhibit shows somewhat lower benzene and aromatics levels for ANS reformate than the generic PIMS levels, with contents of 4.0% and 63.7% respectively, and that note 2 shows that the source of this data is a 1991 National Petroleum Refiners Association paper, which was entered into the record as Exhibit No. WAP-139. *Id.*

2099. Exhibit No. PAI-167 at p.1, according to Phillips, shows the reformate quality data presented by O'Brien, with benzene and aromatics levels of 2.52% and 60.6% respectively. *Id.* at p. 108. This data, it explains, is somewhat lower than the data in either Exhibit No. WAP-136 or Exhibit No. WAP-140 and comes from the reformate qualities of Phillips Ferndale Refinery for the months June 2001 through December 2002. *Id.* (citing Exhibit No. PAI-167 at pp. 2-3). It states that O'Brien testified that this refinery, which is located in the Pacific Northwest and typically makes conventional gasoline, runs primarily ANS. *Id.* Phillips notes that he also testified that the Ferndale reformate was reformed more severely than the reformate in his assumed blend – to a 98.6 Research Octane instead of the 94 Research Octane assumed in O'Brien's blend. *Id.* at pp. 108-09. This means, according to Phillips, that the Ferndale reformate would have somewhat more benzene and aromatics than it would had it been processed to O'Brien's assumed 94 Research Octane. *Id.* at p. 109. It concludes that the Ferndale reformate qualities, therefore, while not perfect, provide a more reasonable approximation than those presented by Williams. *Id.*

2100. Phillips explains that using the complex EPA model calculations results in annual average exhaust toxics of 133.6 mg/mile using the Ferndale reformate qualities. *Id.* It notes that Exhibit No. PAI-167 at p. 1 also compares this figure with EPA's individual exhaust toxics baselines for the five Pacific Northwest refineries, and states that this comparison shows that the three-component blend exhaust toxics of 133.6 mg/mile are less than the 141.6 mg/mile baseline for the BP Cherry Point Refinery, which is by far the largest refinery in the Northwest, and also are less than the 134.2 mg/mile baseline for the Shell Anacortes Refinery, which is the second largest refinery in the region.[674] *Id.* at pp. 109-110. Therefore, Phillips suggests that either of these refineries could make the three-component blend and satisfy the EPA regulations. *Id.* at p. 110.

2101. According to Phillips, the primary criticism directed at O'Brien's methodology (as well as the methodology proposed by Tallett) is that "it inappropriately attributes the margin or profit refiners receive for their investments and market power in producing their most valuable refined product, gasoline, to the naphtha feedstock." Phillips Reply Brief at p. 55 (quoting Williams Initial Brief at p. 58; also citing Unocal/OXY Initial Brief at p. 28; BP Initial Brief at p. 34). It asserts that this rather vague, and unprovable, theory appears to rest on the assertion that margins between the price of crude and the price of the products sold by the refineries are higher on the West Coast than the Gulf Coast. *Id.* at pp. 55-56. Phillips explains that Exhibit No. WAP-9, which represents the data referred to by Sanderson to support his assertions about margins shows the margins in dollars per barrel of crude run. *Id.* at p. 56 (citing Exhibit No. WAP-8 at p. 5). Similarly, they point out that the "3-2-1 Crack Spread" that Sanderson also uses in his testimony on West Coast refiners's margins, calculates the margin as "a basket of conventional gasoline and low sulfur No. 2 fuel prices minus crude oil prices."[675] *Id.* (quoting Exhibit No. WAP-8 at p. 6).

[674] Phillips explains that data for the size of the Pacific Northwest refineries can be found in the Oil & Gas Journal data for Washington refineries that appears at page 10 of Exhibit No. PAI-262. *Id.* at p. 110, n.48. It states that this data shows that refinery sizes, based on barrels of crude processed per day, are as follows: BP—222,720; Shell – 148,600; Tesoro – 114,500; Phillips – 90,250; U.S. Oil – 44,350. *Id.*

[675] In addition, Phillips states that O'Brien testified that, when he refers to "refinery profit margins," he means the difference between the cost of crude oil and the price of the finished product being sold. Phillips Reply Brief at p. 56, n.25 (citing Transcript at pp. 5983-84).

2102. Thus, Phillips argues, when the advocates of Gulf Coast pricing assert that gasoline margins are higher on the West Coast than the Gulf Coast, what they are really saying is that there is a larger price differential between the price of gasoline and the price of crude on the West Coast than on the Gulf Coast. *Id.* Knowing that the margin between crude oil and gasoline is higher on the West Coast than on the Gulf Coast does not, in Phillips's view, provide an answer to the question of what the differential should be between the values of Naphtha and crude or gasoline prices. *Id.* It explains that the fact that there is a wider spread between crude and gasoline prices on the West Coast than on the Gulf Coast says nothing about where between those prices the West Coast Naphtha value falls, either on an absolute basis or in comparison to where the Naphtha value falls between crude and gasoline prices on the Gulf Coast. *Id.*

2103. Phillips notes that Unocal/OXY argue that, because Naphtha is an intermediate product used to make gasoline, the refiners would have no interest in increasing the margin of Naphtha over cost, since it would only be charging that cost to itself. Phillips Reply Brief at p. 57, n.26. It asserts that this argument is nonsense, and points out that a refiner that uses its Naphtha internally to make gasoline does not charge itself anything for the Naphtha, but simply determines its profits as the difference in price between the crude oil that it purchases and the products that it does sell. *Id.* According to Phillips, such a refiner does not establish a margin for the Naphtha that it uses internally. *Id.*

2104. There are a number of additional errors, Phillips contends, associated with the assertion that O'Brien's methodology assigns the margin associated with gasoline to Naphtha. Phillips Reply Brief at p. 57. Phillips explains that, as Exhibit No. PAI-37 shows, O'Brien has included a 20% capital recovery factor in his cost calculation that is intended to reflect a return on the capital invested in the refinery equipment, and points out that this factor was substantial, equal to 4.6¢/gallon in 1996 dollars. *Id.* It suggests that use of this capital recovery factor means that the entire West Coast gasoline margin is not being assigned to West Coast Naphtha. *Id.* at pp. 57-58. That this is an appropriate portion of the margin to assign to the return on capital is clear to Phillips because it claims that it is the same capital recovery factor that O'Brien used in determining the processing costs for Heavy Distillate and Resid. *Id.* at p. 58. It points out that the same parties complaining that O'Brien has not attributed sufficient margin to capital recovery in his Naphtha analysis (Williams, Unocal/OXY and Petro Star) accepted that as an appropriate allocation for the other three cuts. *Id.*

2105. Furthermore, Phillips maintains, Exhibit No. WAP-132 supports the conclusion that O'Brien's formula allows for a higher margin for West Coast finished products than refiners earn on the Gulf Coast. *Id.* It notes that this Exhibit, which applies O'Brien's methodology to the Gulf Coast, shows that, on average, O'Brien's formula results in a calculated Gulf Coast Naphtha price, after costs, that is 2.1¢/gallon lower than the published Gulf Coast price, and concludes that this indicates that, far from assigning the same margin to Naphtha on the West Coast that applies on the Gulf Coast, O'Brien's formula results in gasoline margins on the West Coast that are 2.1¢/gallon higher than those which prevailed on the Gulf Coast. *Id.*

2106. Phillips calls the argument regarding the relationship between Naphtha values and gasoline prices on the West Coast that is used by the proponents of Gulf Coast pricing "patently illogical." *Id.* at p. 61 (citing Williams Initial Brief at pp. 33-35; Unocal/OXY Initial Brief at p. 22). It suggests that the conclusion that the value of Naphtha on the West Coast, where it is almost exclusively made into gasoline, should not track gasoline prices as well as on the Gulf Coast, where there are other markets for Naphtha, is exactly backwards. *Id.* Phillips points out that, if Naphtha is made only into gasoline in the West Coast market, but is made into several products in the Gulf Coast market, it should track the price of gasoline more closely in the West Coast market where there are no alternative uses for Naphtha, not the Gulf Coast where other alternative uses potentially can influence the price. *Id.*

2107. According to Phillips, the Quality Bank already uses finished product prices to value two other cuts – the Light Distillate and Heavy Distillate cuts. *Id.* It explains that the proxy prices used for these cuts, jet fuel and No. 2 Fuel Oil, also have had significantly higher prices on the West Coast than on the Gulf Coast. *Id.* Phillips notes that the parties attacking O'Brien's methodology have characterized jet fuel – along with gasoline – as being "highly priced finished products." *Id.* at p. 62 (quoting Williams Initial Brief at p. 73, n.58).

2108. Having already chosen to value the Light Distillate and Heavy Distillate cuts based on finished product prices minus processing costs, Phillips asserts, the Commission cannot reject that same approach for Naphtha on the grounds that it transfers West Coast refining margins for finished products to the value of an intermediate product. *Id.* It contends that to do so would be to treat the Naphtha cut value differently from the Light Distillate and Heavy Distillate cuts, in violation of the *OXY* uniformity requirement. *Id.* Nor does it believe it is necessary to treat Naphtha differently from Light Distillate and Heavy Distillate as it points out that, in all three cases, a return on capital component is included in the cost calculation that is designed to provide for margins earned by the refiners on their capital equipment. *Id.* Because O'Brien was consistent in his use of the same 20% capital recovery factor in all his fixed cost calculations, it maintains that his approach allowed all three cuts to be valued consistently, taking into account a return on capital that the Gulf Coast pricing advocates found acceptable in other calculations that they sponsored. *Id.*

2109. Phillips indicates that it disagrees with Williams's argument that O'Brien's methodology is inconsistent with the cost-based methodologies used for the other Quality Bank cuts. *Id.* at p. 63. It states that, while it is true that gasoline is made from other products in addition to Naphtha, Williams makes no effort to explain why this difference has any impact on O'Brien's cost-based calculation. *Id.* Phillips notes that O'Brien's formula explicitly accounts for the fact that other components also are used in making gasoline, and that is why he used a three-component gasoline blend to develop his Naphtha value. *Id.* Further, it explains that O'Brien's formula backs out the value of the other components used in the blend from the price of gasoline, allowing the value of the reformate (made from Naphtha) that is used in the blend to be isolated from the values of the other products. *Id.* at pp. 63-64. Because O'Brien's formula accounts for the distinction identified by Williams, Phillips asserts, it is a distinction without a difference. *Id.* at p. 64.

2110. Williams's assertion that the Resid formulæ use only intermediate feedstock prices to value the products of the coking process while O'Brien's formula uses finished product values is not correct, according to Phillips. *Id.* It notes that both the Eight Parties and the Exxon Resid valuation formulæ use the Quality Bank Heavy Distillate price, which is a finished product price for low sulfur No. 2 Fuel Oil, minus processing costs. *Id.* (citing Exhibit No. PAI-18). Phillips also asserts that Williams's argument is based on the false premise that there is something inherently different about using intermediate product prices instead of finished product prices for proxy products, and points out that the Quality Bank has made no such distinction in the past, and there is no evidence in this record to suggest it must do so here.[676] *Id.* It contends that O'Brien's use of conventional unleaded regular gasoline as a proxy is consistent with the Quality Bank's approach of using a product as a proxy that is as close as possible in specification to the Quality Bank cut so as to minimize the amount of processing that would be required to get the cut to meet the proxy product's specification. *Id.*

2111. In addition, Phillips claims that Williams does not, and cannot, assert that there is some other finished West Coast product price that would be more appropriate to use in valuing Naphtha to make the cost-based Naphtha value more consistent with the cost-based values for Light Distillate, Heavy Distillate and Resid. *Id.* at p. 65. It argues that the record is clear that Naphtha is made almost exclusively into gasoline on the West Coast. *Id.* (citing Exhibit No. PAI-33 at p. 6). Given that, and given that it is possible to account for other products blended with reformate to make gasoline, Phillips concludes, O'Brien's proposal is entirely consistent with the way that the other cost-based adjustments are performed. *Id.*

2112. Phillips asserts that Williams should know better than to combine Exhibit No. PAI-39 and O'Brien's testimony to conclude that O'Brien's Naphtha value is in lock step

[676] While Ross and Sanderson both tried to suggest some consistent differences in West Coast/Gulf Coast price differentials between finished products and intermediate products using graphics that were supposed to show some distinction, Phillips states, the graphics were very misleading and the supposed patterns evaporated under cross-examination. Phillips Reply Brief at p. 64, n.30.

with the price of gasoline plus a premium of 7%. *Id.* (citing Transcript at p. 5390). It states that O'Brien was careful to qualify his answers to the questions about how his formula worked by stating that the formula would follow gasoline prices only assuming that "everything else is equal." *Id.* (quoting Transcript at p. 5390). Later, Phillips notes that O'Brien explained that he gave this qualification, because his formula does not refer just to the price of Seattle gasoline, but also to a number of other products. *Id.* at pp. 65-66. As a result, it states that:

> [I]f one of these commodities or one of these prices changes, they don't change just unilaterally. All of these petroleum products and feedstocks and so forth are all related to energy values and crude oil prices. When one changes, they all tend to change, not necessarily in lockstep, but they do change.

Id. at p. 66 (quoting Transcript at p. 5960). Thus, Phillips explains that everything else is not equal, and that the value of Naphtha does not move in lockstep with the Seattle gasoline price. *Id.* Phillips asserts that this is graphically illustrated by Exhibit No. PAI-150 which shows clearly how the fluctuations in the prices of the various products of the reforming process affect the value. *Id.* It states that is in order to know how the calculated value of Naphtha changes, it is necessary to look at the prices of all the products that are included in the formula shown on Exhibit No. PAI-39, not just the Seattle gasoline price. *Id.*

2113. Furthermore, Phillips contends that Williams's focus on the 1.07 times the Seattle gasoline aspect of the formula creates the false impression that O'Brien is proposing to value Naphtha at 107% of the Seattle gasoline price. *Id.* It explains that O'Brien's formula, shown on Exhibit No. PAI-39,[677] also backs out the value of the LSR and Butane that are used in the three component blend. *Id.* Thus, it notes that, after multiplying the Seattle gasoline price times 1.07, O'Brien's formula then subtracts the LSR and Butane values used in the three-component blend, as well as the calculated processing costs. *Id.* at pp. 66-67. Williams's failure, Phillips argues, to mention these subtractions included in the formula is highly misleading. *Id.* at p. 67.

2114. Therefore, given the number of variables in his formula, Phillips maintains, the record demonstrates that O'Brien's Naphtha price does not "move [in] lockstep" with the Seattle gasoline price and certainly does not increase by $1.07 for every $1.00 increase in the Seattle gasoline price. *Id.* In support, Phillips refers to Exhibit No. PAI-176 which it states shows, among other things, O'Brien's calculated Naphtha values on a monthly basis from 1992-2001, and Exhibit No. EMT-352, which it states shows the monthly Seattle

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[677] Phillips states “Exhibit No. PAI-38” in its Reply Brief. Phillips Reply Brief at p. 66. I am certain, however, that Phillips meant to refer to Exhibit No. PAI-39.

gasoline prices. *Id.* Phillips explains that a comparison of these two values, on a month-to-month basis, reflects that the two prices change at differing rates and that, indeed, on occasion, the Naphtha price can decrease when the gasoline price increases, or vice versa. *Id.* Further, Phillips notes, this is because price changes for the other products included in O'Brien's proposed Naphtha valuation formula offset the impact of the change in the Seattle gasoline price. *Id.*

2115. Phillips asserts that Williams's argument regarding the U.S. Oil refinery's ability to make that three component blend totally misconstrues O'Brien's rationale for choosing the three-component blend.[678] *Id.* at pp. 67-68 (citing Williams Initial Brief at pp. 64-67). It notes that O'Brien testified that he did not assume that his three-component blend was made solely by simple refineries like the U.S. Oil refinery. *Id.* at p. 68. Rather, according to Phillips, he assumed, in using the three-component blend, that it is a simple blend that can be made by every refinery that makes gasoline, from the most simple to the most complex. *Id.* Furthermore, Phillips notes that it is O'Brien's opinion that the three-component blend, in fact, is made by such complex refineries. *Id.* While use of the three-component blend admittedly is a simplifying assumption, Phillips contends that it is also a reasonable assumption. *Id.*

2116. Williams also wrongly points out, according to Phillips, that the U.S. Oil refinery uses isomerate to make gasoline, and asserts that O'Brien's decision not to include isomerate in his blend saved him from having to reduce his Naphtha value by the cost of an isomerization unit. *Id.* It notes that the isomerization unit is not used to process Naphtha, but instead processes LSR into isomerate to improve the octane of the LSR. *Id.* at pp. 68-69. Thus, it explains, the isomerization unit costs would have to be subtracted from the value of isomerate used in the blend, not from the Naphtha. *Id.* at p. 69.

2117. Phillips explains that any Naphtha valuation formula that included isomerate in the blend would have to follow four steps: (1) determine how much isomerate to include in the blend; (2) determine a value for isomerate, since there is no published price; (3) deduct the costs of the isomerization unit from the isomerate value; and (4) back out the isomerate value from the blend in order to determine the contribution of reformate to the gasoline value. *Id.* It asserts that the second and third steps would be complicated and controversial. *Id.* Furthermore, Phillips argues that, because it is unclear what the resulting after-cost isomerate value would be, it is unclear whether the inclusion of

[678] Phillips explains that Williams's assertions about whether the three-component blend meets EPA standards are based on inaccurate data regarding the benzene and aromatics content of reformate made from ANS Naphtha. Phillips Reply Brief at p. 67, n.32. It suggests that Williams presents its discussion of the EPA standards without ever even acknowledging that the more accurate data provided in Exhibit No. PAI-167 was entered into evidence. *Id.*

isomerate in the blend would increase or decrease the calculated value of Naphtha. *Id.*

2118. It was precisely to avoid the additional complication of valuing blending components with no published prices, such as isomerate, contends Phillips, that O'Brien used the simple three-component blend, where there are available prices for all the components except for reformate. *Id.* While it certainly is true that gasoline also is made with more complex blends, including blends with isomerate, Phillips maintains that O'Brien's methodology accurately tracks Gulf Coast Naphtha prices (albeit at a slightly lower price) provides strong evidence that his three-component blend does accurately reflect the economics of using Naphtha to make gasoline. *Id.*

2119. Phillips states that the Unocal/OXY assertion that the three-component blend should be rejected because it will not meet the air quality regulations on the West Coast and, therefore, cannot be used in California, Seattle, Phoenix or Las Vegas is irrelevant. *Id.* at p. 70. It notes that the record is clear that the Seattle conventional unleaded regular gasoline price used by O'Brien is based on a large and robust market. *Id.* (citing Exhibit No. PAI-33 at p. 9). In addition, it points out that Platts publishes both a West Coast and a Los Angeles conventional unleaded regular gasoline price. *Id.* (citing Exhibit No. EMT-349 at pp. 4-5). Therefore, Phillips maintains, there is ample evidence to support the conclusion that there are substantial trades of conventional unleaded regular gasoline on the West Coast. *Id.*

2120. Furthermore, Phillips argues that other Quality Bank cuts are valued based on proxy prices of products that are not necessarily used throughout the entire West Coast. *Id.* As examples, it refers to the use by the Quality Bank of Low Sulfur No. 2 Fuel Oil price to value Heavy Distillate even though California has implemented more restrictive CARB gasoline specifications applicable to sales in California. *Id.* (citing Exhibit No. EMT-349 at pp. 10-11). Phillips contends that the Commission has never considered, in adopting proxy prices for the Quality Bank, whether the proxy products used by the Quality Bank are sold throughout the entire West Coast. *Id.* at pp. 70-71. It asserts that it, therefore, would be inconsistent with the value of the other cuts to reject O'Brien's Naphtha value on this basis. *Id.* at p. 71.

2121. Phillips argues that Exxon’s criticisms of the O’Brien methodology are largely without merit. *Id.* Furthermore, it points out that two of Exxon’s criticisms actually would cause the calculated Naphtha value to increase. *Id.* First, Phillips notes, Exxon criticizes O'Brien's methodology for failing to employ a West Coast location factor to adjust the costs that he employs in his cost calculation. *Id.* Whatever the merits of this argument are with respect to Resid and Heavy Distillate, Phillips asserts, they demonstrably do not apply to O'Brien's Naphtha cost calculation. *Id.*

2122. According to Phillips, when O'Brien's Naphtha methodology is applied to Gulf Coast Naphtha using Gulf Coast product prices, it results in calculated prices that are on average 2.1¢/gallon below the published Gulf Coast Naphtha prices. *Id.* (citing Exhibit No. WAP-132 at p. 1). Phillips claims that this means that the costs used by O'Brien in his calculation were 2.1¢/gallon higher than they should have been if he were calculating the Gulf Coast Naphtha price, or 2.1¢/gallon higher than reflected in the prices charged by Gulf Coast refiners. *Id.* It argues that it is, therefore, wrong for Exxon to characterize O'Brien's Naphtha processing costs as representing Gulf Coast processing costs, and points out that his cost figures are higher than those incurred by Gulf Coast refiners. *Id.* at pp. 71-72.

2123. Phillips also takes exception to Exxon's criticism that O'Brien's value is "based on an outdated semi-regenerative reformer technology that is less efficient and produces lower yields than the continuous reformer technology that would be employed by a refiner today." *Id.* (quoting Exxon Initial Brief at p. 281). It notes that O'Brien explained, however, that he has used the most recent version of PIMS to obtain his yields, and that he believes that it is more appropriate and consistent with the other Quality Bank cut valuations to use the PIMS yields rather than non-PIMS yields, as Tallett has proposed. *Id.* Phillips asserts that O'Brien's use of the PIMS yields instead of Tallett's non-PIMS yields does not cause O'Brien's calculation to overstate the value of Naphtha. *Id.* It also notes that Exxon acknowledges that the more modern technology upon which Tallett relies is more efficient and has better yields than the technology assumed in PIMS. *Id.* Thus, it points out, use of this technology would reduce the assumed costs and increase the value of the products produced, which would in turn increase the calculated value of Naphtha. *Id.*

2124. It also disagrees with Exxon's criticism of O'Brien's choice of the Seattle gasoline price instead of a Los Angeles-based gasoline price, Phillips claims. *Id.* In addition, Phillips states that O'Brien explained he used the Seattle price because the Seattle market for conventional gasoline is robust and growing while the California market is small and shrinking. *Id.* at pp. 72-73 (citing Exhibit No. PAI-78 at pp. 8-9). In any event, Phillips asserts that use of a Los Angeles price would result in a higher Naphtha price since the Los Angeles gasoline prices have been higher than the Seattle prices. *Id.* at p. 73.

2125. While it is the case, concedes Phillips, that the three-component blend satisfies the individual baselines of most Pacific Northwest refineries, it also is the case that the three-component blend's annual exhaust toxics of 133.6 are well above the anti-dumping statutory baseline threshold for annual exhaust toxics, which is 104.5. Phillips Initial Brief at p. 111 (citing 40 C.F.R. § 80.91(c)(5)(iv)(2004)). The fact that the three-component blend does not meet the statutory baseline that applies in the absence of an individual refinery baseline should not make any difference, because, Phillips claims, all of the West Coast refineries were in operation in 1990 and thus have their own individual baselines. *Id.* As a result, contends Phillips, the anti-dumping statutory baseline does not apply to any of them. *Id.*

2126. To the extent that the Commission is concerned about the level of emissions under the three-component blend, Phillips suggests, there is evidence in the record that would allow the Commission to adjust O'Brien's proposal to address that concern. *Id.* Phillips explains that it is possible to install a benzene saturation unit in a refinery in order to reduce the amount of benzene in reformate to levels that will allow the refiner to lower the exhaust toxics resulting from the use of that reformate. *Id.* It notes that Sorenson also testified that use of a benzene saturation unit or another similar treatment facility is common in California. *Id.* Further, states Phillips, O'Brien presented Exhibit No. PAI-148 to show how use of a benzene saturation unit allows the three-component blend to meet the statutory baseline. *Id.* at p. 112.

2127. Phillips notes that Exhibit No. PAI-148 shows there would be two types of costs associated with the addition of a benzene saturation unit. *Id.* The first, explains Phillips, is the additional processing costs associated with the unit; the second is the decreased yield value of the products produced from the reforming process as a result of the use of the benzene saturation unit. *Id.* In combination, states Phillips, these two costs would reduce the value of Naphtha by 1.29¢/gallon in November of 2001. *Id.* Further, according to Phillips, O'Brien also determined how his Naphtha valuation formula should be changed if the Commission decides that the benzene saturation unit should be included in the cost-based calculation. *Id.* The revised formula is set out as Exhibit No. PAI-149. *Id.*

2128. The study that Culberson introduced as part of Exhibit No. UNO-57 also raised issues, states Phillips, regarding the extent to which use of the benzene saturation unit brings the three-component blend within the applicable EPA statutory baseline standards. *Id.* at p. 114. In particular, explains Phillips, the study asserts that the three-component blend would not meet EPA's emission standards even after being treated in the benzene saturation unit. *Id.* The problem with that study, asserts Phillips, is that Culberson applied the Federal Reformulated Gasoline Phase II requirements and the California Air Resources Board requirements to the three-component blend. *Id.* Phillips argues that this is inappropriate, because the three-component blend is a conventional gasoline, not a reformulated gasoline or a CARB gasoline. *Id.* It points out that Culberson conceded as much and that these standards therefore say nothing about whether the three-component blend satisfies the statutory baseline for conventional gasoline. *Id.*

2129. Independently of O'Brien, Phillips states, Tallett took a different, market-based, approach in deriving a value for West Coast Naphtha. *Id.* Phillips explains that he evaluated Gulf Coast prices to establish a relationship between published Naphtha, jet fuel and gasoline prices, and then applied that same relationship to West Coast jet fuel and gasoline prices to develop a West Coast Naphtha price. *Id.* While Phillips believes that the O’Brien methodology is more consistent with the methodologies used to value the other cuts, to the extent that the Commission determines that a market-based approach is preferable to a cost-based approach, Phillips believes, Tallett's proposal represents a rational approach to developing a market-based value. *Id.* at pp. 114-15.

2130. In reply to criticisms of the Tallett methodology, Phillips highlights the inconsistencies between the positions taken by the advocates of Gulf Coast pricing in their attacks on Exxon's proposal and their position that Gulf Coast pricing should be used. Phillips Reply Brief at p. 75. It states that Williams, Unocal/OXY and Petro Star each attack this proposal on the grounds that the Gulf Coast and West Coast markets are too different from each other for the relationship between products on the Gulf Coast to apply to the West Coast. *Id.* (citing Williams Initial Brief at p. 75; Unocal/OXY Initial Brief at p. 42; Petro Star Initial Brief at p. 20).

2131. Phillips argues that it is precisely because of the differences between the Gulf Coast and West Coast markets that the Gulf Coast price of Naphtha cannot accurately represent the West Coast value of Naphtha. *Id.* It contends that, by highlighting these differences between Gulf Coast and West Coast markets in their attacks on the Tallett methodology, Williams, Unocal/OXY and Petro Star are demonstrating why it is not appropriate to continue using the Gulf Coast Naphtha price to value West Coast Naphtha. *Id.* at pp. 75-76.

2132. According to Phillips, Ross has proposed that the Commission adopt either O'Brien's or Tallett's West Coast Naphtha proposal. Phillips Initial Brief at p. 116. However, Phillips points out, Ross would then apply a governor to the calculated West Coast Naphtha value that, in reality, would continue to subject the West Coast Naphtha value to the Gulf Coast price. *Id.* Phillips states that this governor would apply uniquely to West Coast Naphtha and no other cut valuation involves any mechanism at all similar. *Id.*

2133. Phillips asserts that Ross's West Coast Naphtha proposal proved to be a moving target that changed directions several times during the proceeding as the underpinnings of the proposal came under attack. *Id.* It notes that the following changes were made: (1) withdrawal of cost-based calculation, (2) multiple changes to the governor, and (3) change in fundamental theory of what the governor represents. *Id.* at pp. 116-21.

2134. In his first round of testimony, states Phillips, Ross proposed the use of a governor set at \$1.848/barrel. *Id.* at p. 117. Phillips explains that the governor is used to set a ceiling price for West Coast Naphtha, so if the calculated West Coast Naphtha value exceeded the Gulf Coast price plus \$1.848/barrel, then the West Coast value would be reduced to that ceiling level. *Id.* Ross testified, according to Phillips, that his governor was based on a self-evident principle that the price of West Coast Naphtha could never exceed the price of Gulf Coast Naphtha plus the cost of shipping from the Gulf to the West Coast. *Id.* Phillips asserts that this self-evident principle changed through each round of testimony. *Id.* It notes that the value of the proposed governor decreased from \$1.848/barrel to \$1.29/barrel and then increased to \$1.49/barrel. *Id.* Later, states

Phillips, Ross also added a floor equal to the price of ANS plus $4.00/barrel. *Id.* When Ross realized that this floor often exceeded the ceiling, Phillips notes, he added a provision that, in such event, the floor price would prevail. *Id.* Finally, when the use of a fixed governor was challenged, Phillips explains that Ross decided it would be acceptable to develop a governor that varied monthly based on changes in published transportation rates. *Id.* Phillips notes, because of these changes, Ross spent a considerable amount of time at the hearing explaining how his testimony would need to be changed as a result. *Id.* at p. 118.

2135. Phillips points out that Ross's justification for the application of his governor also changed over time. *Id.* Originally, states Phillips, Ross testified that his governor was required because of anomalies in West Coast gasoline prices that would cause the value of Naphtha to be overstated if no adjustment was made. *Id.* Initially, according to Phillips, Ross stated that the anomalous period started in 1999, later he agreed that it started in 1998. *Id.* Still later, asserts Phillips, when it became clear that his governor applied about as frequently before 1999 as it did during the so-called anomalous period, Ross backed away from his reliance on market anomalies from 1999-2001 to support the governor. *Id.* Instead, Phillips notes that, in rebuttal testimony, he refers only to intermittent increases in the price of gasoline on the West Coast that he believes are not attributable to any corresponding increase in the value of West Coast Naphtha. *Id.* at pp. 118-19. Phillips also notes that Ross switched to a definition of anomaly, i.e., any period when his govern would apply, that is clearly circular. *Id.* p. 119.

2136. According to Phillips, during the hearing, when faced with evidence in the form of the Naphtha contracts that higher prices for Naphtha on the West Coast could be sustained, Ross changed his rationale for his governor in a subtle but important way, introducing for the first time the theory that a governor was needed because the market for Naphtha on the West Coast is opaque. *Id.* at pp. 119-20. Phillips states that, prior to the hearing, Ross's governor was a yardstick of transportation costs, but now it had shifted to the theory that his governor was meant to model a transparent market, that is, one with a published price. *Id.* at pp. 120-21.

2137. It was inappropriate for Ross to adjust his calculations or present new theories at the hearing, exclaims Phillips. *Id.* at p. 121. While conceding that almost every witness did this in reaction to the significant amount of new evidence that was made available after all pre-filed testimony had been submitted, Phillips asserts that Ross did more, however, than merely adjust his calculations to take into account new evidence or respond to technical criticisms. *Id.* In Phillips's opinion, no other witness changed his proposal or the justification for his proposal so thoroughly as Ross. *Id.*

2138. Phillips states that, by the end of the hearing, Ross's proposal and the theory underlying it are almost completely unrecognizable when compared with what Ross had initially presented in Exhibit No. BPX-8. *Id.* It notes that the level of the governor is different, the justification of the need for the governor is different, and the explanation of what the governor represents is different. *Id.* That Ross was so willing to change his testimony when the facts became inconvenient to what he had previously proposed strongly suggests to Phillips that there is no fundamental principle underlying his governor proposal. *Id.* Instead, Phillips argues that the governor represents a preferred end-result in search of a theory on which to base it. *Id.*

2139. It is Phillips's position that the effect of Ross's governor would be to preclude the implementation of a West Coast Naphtha value for the Quality Bank. *Id.* Whether it is Tallett's or O'Brien's West Coast Naphtha value that is selected as the base West Coast Naphtha value, Phillips asserts that the governor applies so often that it really replaces the base valuation methodology. *Id.* at pp. 121-22. According to Phillips, Exhibit No. EMT-437 shows that the governor applied in 79 out of the 96 months (82%) between 1994 and 2001 when applied to Tallett's proposal, and 82 out of same 96 months (85%) when applied to O'Brien's proposal. *Id.* at p. 122. Therefore, Phillips points out that this means the actual West Coast value would apply less than 20% of the time. *Id.*

2140. Phillips maintains that Ross's governor is needed in order to simulate a transparent market price on the West Coast and that the Naphtha price in a transparent market will be lower than a price achieved under the West Coast Naphtha contracts is not justified. *Id.* at p. 124. It asserts that Ross is not qualified to give an opinion on economic principles, because he has no formal training and no experience as an economist. *Id.* (citing Exhibit No. BPX-2). Therefore, argues Phillips, Ross's economic testimony regarding opaque and transparent markets and the need for the governor to replicate a transparent market price should not be given much weight. *Id.*

2141. Baumol, by contrast, Phillips notes, is well-qualified to give economic testimony.[679] *Id.* It notes that Baumol contradicted Ross's contention that there must be a published price in order for there to be a market price, noting that most people in most markets have limited information. *Id.* at p. 125.

2142. Moreover, states Phillips, the Quality Bank simply looks to the actual market prices paid for products, not to what the price theoretically might be if conditions were different. *Id.* Phillips points out that no other cut has been valued with an adjustment to reflect a supposedly more competitive market. *Id.* Its position is that Ross's efforts to impose changes on the market value of Naphtha alone violate the *OXY* uniformity

[679] Phillips notes that Baumol testified before Ross and was not able to specifically address Ross's new theory, which had not been presented in the pre-filed testimony and therefore had not been raised at the time of Baumol's testimony. Phillips Initial Brief at p. 124. However, states Phillips, Baumol indirectly did address certain contentions that were later made by Ross. *Id.*

requirement. *Id.*

2143. Furthermore, states Phillips, Ross testified that when there is no published price, contract prices might be above the actual market price or they might be below the actual market price. *Id.* at p. 126. It explains that Ross testified how actual contract prices might compare to those in a transparent, competitive market would depend upon the relative strength of the buyer and seller. *Id.* Further, notes Phillips, he testified that a seller with monopoly power can charge a high price, whereas a buyer with monopsony power can command a low price. *Id.* Phillips asserts that the only evidence in the record as to the relative bargaining positions of Naphtha buyers and sellers on the West Coast falls far short of showing either monopoly or monopsony power. *Id.* If it shows anything, it suggests to Phillips that the buyers might have greater leverage than the sellers, and that would lead to the Naphtha prices being below the purely competitive level – precisely the opposite of what is needed to support Ross's governor. *Id.*

2144. Finally, Phillips argues that Ross ignores the fact that there is a transparent published price for Naphtha on the Gulf Coast. *Id.* at p. 128. As a result, explains Phillips, the participants in the West Coast Naphtha market have all the information they need to know how the prices they are contracting for compare with the Gulf Coast price of Naphtha. *Id.*

2145. Not only is Ross's proposal unsupported as a matter of theory, Phillips asserts, there is also ample empirical data demonstrating that product prices on the West Coast are not constrained by Gulf Coast prices as Ross testified. *Id.* According to Phillips, this data demonstrates that prices between the Gulf Coast and the West Coast routinely diverge to a much greater extent than Ross's $1.49/barrel governor would suggest. *Id.*

2146. Phillips points out that Ross relies upon one contract as being particularly relevant to this proceeding because he claims that this contract has price cap provisions which are very similar to his governor and that the contract thus "validates the price cap concept for valuing West Coast Naphtha." *Id.* at p. 129 (quoting Exhibit No. BPX-67 at p. 15). It disagrees, and points out that of the over three hundred contracts produced in this proceeding, the contract relied upon by Ross is the only contract that has a price cap based on Gulf Coast prices. *Id.* (citing Exhibit No. BPX-67 at p. 18). While a single contract may not have much probative value, Phillips asserts, as hundreds of contracts do not have a price cap based on Gulf Coast prices, it strongly suggests that the West Coast market does not consider Gulf Coast Naphtha prices in establishing prices for West Coast Naphtha. *Id.* Moreover, explains Phillips, the product being sold under the contract is Full Range Naphtha. *Id.* This product will have a lower value than Quality Bank Naphtha, continues Phillips, which is a Heavy Naphtha, and its pricing terms are not probative of how Quality Bank Naphtha will be priced. *Id.*

2147. Furthermore, Phillips notes, this contract caps the price to be paid at the Gulf

Coast price of Naphtha plus \$2.96/barrel (7¢/gallon), even though the product being sold is Full Range Naphtha. *Id.* at p. 130. This, states Phillips, is almost exactly twice as high as Ross's \$1.49/barrel (3.5¢/gallon) governor that applies to the more valuable ANS Heavy Naphtha. *Id.* It points out that use of a price cap this high means that the purchaser under the contract could pay well over Ross's governed price of Gulf Coast Naphtha plus \$1.49/barrel for a much less valuable product. *Id.* Phillips asserts that the contract, therefore, is inconsistent with Ross's theory that a purchaser of Naphtha would purchase Heavy Naphtha from the Gulf Coast and ship it to the West Coast rather than pay a price that exceeded Gulf Coast prices by more than \$1.49/barrel. *Id.*

2148. Faced with the data showing West Coast minus Gulf Coast product price differentials well in excess of his governor, Phillips notes, Ross introduced evidence attempting to create a distinction between finished products and intermediate products. *Id.* at p. 134. It explains that Ross claimed that the market dynamics for finished products are different from the dynamics for intermediate products, and that, therefore, the governor for finished products should be \$1/barrel (2.5¢/gallon) greater than for intermediate products. *Id.* Ross presented Exhibit No. BPX-78, which, according to Phillips, purports to show how price differentials for finished products fit within one range, while price differentials for intermediate products fit into a lower range. *Id.* Exhibit No. BPX-78 also, continues Phillips, purports to show that his governed Naphtha values fit into the intermediate product band while the O'Brien and Tallett differentials fit into the finished product band. *Id.*

2149. Phillips suggests that there are several problems with this argument. *Id.* First, it asserts that, on its face, the data in Exhibit No. BPX-78 is inconsistent with Ross's governor. *Id.* Of the two intermediate products shown on the Exhibit, Phillips points out, the VGO price differential is above \$2/barrel, which is 50¢/barrel over the \$1.49/barrel intermediate product governor, while the price of LSR is over \$3/barrel less on the West Coast than on the Gulf Coast and clearly is subject to different market forces. *Id.* at pp. 134-35. Phillips also notes that all five of the finished product price differentials shown on the Exhibit exceed Ross's finished product governor of \$2.50/barrel (6¢/gallon). *Id.* at p. 135. Only one, states Phillips, Platts Waterborne Jet Fuel, is even close to the finished product shipping differential, and even this price differential slightly exceeds the finished product governor calculated by Ross.[680] *Id.* Thus, asserts Phillips, none of the price

[680] Phillips points out that Exhibit No. BPX-78 is drawn to the same scale as other Ross Exhibits that make it difficult to determine exactly where the points lie on the graph. Phillips Initial Brief at p. 135, n. 54. However, states Phillips, p. 5 of Exhibit No. PAI-176 shows price differentials for the same 1999-2001 time period represented by Exhibit No. BPX-78. *Id.* Exhibit No. PAI-176, according to Phillips, shows that the waterborne jet fuel price differential is 6.48¢/gallon for this time period which, it claims, is above the 6¢/gallon finished product price cap calculated by Ross. *Id.*

differentials shown in Exhibit No. PAI-78 are consistent with either Ross's finished product or intermediate product governor. *Id.*

2150. In addition, Phillips claims, Ross's intermediate/finished product distinction is based on price differentials averaged over a several year period. *Id.* In Phillips's view, his theory breaks down completely when product price differentials are examined on a shorter term basis. *Id.* For example, states Phillips, Exhibit No. PAI-202 shows fluctuations between product price differentials on an annual basis and clearly demonstrates that it simply is not possible to assert that there is any pattern whatsoever between finished and intermediate product differentials when those differentials are viewed on an annual basis. *Id.* at pp. 135-36. The relationship breaks down even further, continues Phillips, when prices are viewed on a monthly or shorter-term basis. *Id.* at p. 136 (citing Exhibit No. PAI-209 at p. 2).

2151. Furthermore, notes Phillips, Exhibit No. BPX-78 leaves out a number of finished and intermediate products that have reported prices on both the Gulf Coast and the West Coast. *Id.* These product price differentials, continues Phillips, as well as the ones shown on Exhibit No. BPX-78, are shown on Exhibit Nos. PAI-175 and PAI-176. *Id.* When all of the products are displayed in the same graphic format as Ross's Exhibit No. BPX-78, Phillips asserts, the patterns he purports to find disappear. *Id.* (citing Exhibit No. PAI-175). Turning then to Exhibit No. PAI-176, Phillips points out, page 1 shows differentials for 1992-2001, page 3 shows differentials for 1992-98, and page 5 for 1999-2001. *Id.* at pp. 136-37. In Phillips's opinion, these charts demonstrate that there is no pattern for the differentials that would show finished price differentials consistently higher than the intermediate product price differentials. *Id.* at p. 137. According to Phillips, the price differentials shown on Exhibit No. PAI-176 are consistently higher than the intermediate and finished product governors calculated by Ross. *Id.*

2152. Phillips states that Ross recognizes that actual price differentials for other products exceed his governor, even after taking into account the higher governor he assigns to finished products. *Id.* It asserts that this undercuts any claim that the governor is based on the cost of transportation between the two coasts, and notes that Ross attempts to explain away at least some of these differentials on the basis that there were abnormal or anomalous conditions for VGO, jet fuel, and conventional gasoline during 1999-2001. *Id.* (citing Exhibit No. BPX-67). Phillips suggests that "it is ironic" that Ross would present such an explanation. *Id.* It states, Ross's justification for imposing a governor in the first place is that it was necessary to address anomalies in the Naphtha marketplace during the 1999-2001 time frame – i.e., that Naphtha was moving in a way that was different from all other gasoline blendstocks and feedstocks. *Id.*

2153. Ross intended, Phillips claims, that the governor prevent the Naphtha price from going too high during these times because he thought imports or the threat of imports would have prevented the West Coast/Gulf Coast Naphtha differential from exceeding his governor. *Id.* at pp. 137-38. It notes that, now, Ross would have the Commission believe that price differentials for other products also exceeded the governor because of anomalies during the very same time period he asserts that the governor must be applied to Naphtha price differentials to prevent them from getting too high. *Id.* at p. 138. However, if West Coast market economics caused other product price differentials to move to high levels in the 1999-2001 time period, then Phillips suggests that it is reasonable to assume that Naphtha price differentials also rose in this time period. *Id.* At the very least, Phillips argues, it is not reasonable to assume that the threat of imports governed Naphtha values alone out of all products on the West Coast. *Id.*

2154. In any event, regardless of the validity of any of the theories underlying Ross's governor, Phillips asserts that it is clear that Ross's calculation of the governor is flawed and leaves out many elements that cause it to be too low. *Id.* Many of these flaws, in Phillips's view, are the same as the flaws in the transportation cost calculations of Culberson and Sanderson. *Id.* Phillips points out that all three transportation cost differential calculations assume that there are no barriers to entry on the West Coast. *Id.* According to Phillips, this assumption is at odds with the independent reports entered into the record detailing severe logistical problems in the California market that limit imports of gasoline and products used to make gasoline. *Id.* at pp. 138-39 (citing Exhibit Nos. EMT-385, EMT-489). It explains that these reports make the following points about barriers to entry: (1) tankage for clean products like gasoline and Naphtha is already constrained, and will be reduced by 10-15% over the next seven years, (2) it is unlikely that additional terminals can be constructed in the future and, in fact, existing terminals may be closed, (3) existing refinery tankage cycles on a frequent basis in the regular course of business and cannot be used for the receipt of imports, which require large tanks to be empty at the planned arrival date of the ship and then be drawn down slowly, (4) tank space is extremely difficult to find, leading to a reduction in the availability of spot tankage that could be used for imports of products, and (5) California is an insular market for petroleum products, separated from world markets not just by geographic distance, but also by product quality aspects, commercial barriers and infrastructure limitations. *Id.* at p. 139 (citing Exhibit Nos. EMT-385 at pp. 16, 51, 53; EMT-489 at p. 101).

2155. Phillips states that the Stillwater report concerning the California Strategic Fuels Reserve (Exhibit No. EMT-489) describes the impact of these barriers to entry on California prices in terms that are directly applicable here. *Id.* It states that the report notes that, as Ross, Culberson and Sanderson have hypothesized, "local prices should be at world market prices plus transport cost" and concludes, explains Phillips, that this is not the case for many California products. *Id.* (quoting Exhibit No. EMT-489 at p. 101). Phillips explains further that the report attributes this to a restraint on import options because of lack of terminal capacity and price volatility. *Id.* Similarly, notes Phillips, Exhibit No. EMT-385 reflects that the extreme price spikes observed in California that occurred over prolonged periods with no importer bringing in Naphtha are a clear indication of the barriers to entry in the California market. *Id.* at pp. 139-40.

2156. Ross, Sanderson and Culberson, Phillips contends, attempted to avoid the impact of these studies by asserting that they applied only to CARB gasoline or California Air Resources Board components, and not to Naphtha. *Id.* at p. 140. It asserts that this is not correct, and states that Exhibit No. EMT-385 specifically indicates that the gasoline blending components studied "include alkylate, Naphtha, reformate, raffinate, and natural gasoline" and that Exhibit No. EMT-489 discusses, "petroleum products" in general, not just CARB gasoline. *Id.* (quoting Exhibit Nos. EMT-385 at p. 24; EMT-489 at p. 101).

2157. Phillips maintains that logistics issues are a fact of life on the West Coast, particularly in California. *Id.* It argues that Ross's calculation of the governor, as well as Culberson's and Sanderson's import cost differential calculations, ignore these barriers to entry and therefore overstate the ability of the potential for imports to moderate West Coast prices. *Id.*

2158. Ross, as well as Culberson and Sanderson, according to Phillips, ignored the so-called "forward price risk," i.e., that the price differential between the Gulf Coast and the West Coast will decrease to a point where the import is uneconomic before the tanker transporting the Naphtha reaches the West Coast. *Id.* Phillips contends that this can be a significant deterrent to a trader considering whether to send a cargo to the West Coast to take advantage of a current price spike. *Id.* It explains that the estimates of the time it takes to transport Naphtha from the Caribbean were two to three weeks (Culberson) and 15 days (Ross). *Id.* at p. 141. Further, continues Phillips, this time potentially can be increased if there are delays getting through the Panama Canal, a not uncommon experience. *Id.* Phillips notes that all of the witnesses who calculated transportation price differentials agreed during the hearing that a price premium above the shipping cost differential would be required in order to compensate for the forward price risk. *Id.* None of them, notes Phillips, included such a premium in their calculations. *Id.* Accordingly, Phillips argues that all their estimates are low. *Id.*

2159. Phillips states that there is no evidence to support BP's assertion that the governor is needed to simulate a transparent market, which is based on a speculative and unsupported theory much like the theories advanced to support the continued use of Gulf Coast prices. Phillips Reply Brief at p. 76. Indeed, it asserts that the evidence in this record proves that West Coast Naphtha prices are not constrained by anything like the proposed governor. *Id.* Phillips points out that there is extensive price data available for markets that are "transparent" by BP's definition in that they have published prices on both coasts. *Id.* at p. 77. This data shows, according to Phillips, that prices on the West Coast in these "transparent" markets are routinely higher than Ross's governor would suggest.[681] *Id.* Clearly, it concludes, the evidence is inconsistent with the governor. *Id.*

[681] Phillips states that this remains true even if one accepts Ross's assertion that

2160. BP's assertion that the O'Brien proposal is like a shadow price is simply wrong, Phillips argues. *Id.* at pp. 77-78. It states that there is an important distinction that Ross admitted in his testimony, but which BP omitted from its brief -- that a true shadow price might overstate the actual value of a product because, as Ross testified, a "shadow price does not reflect a fixed cost." *Id.* at p. 78 (quoting Transcript at p. 9702). Phillips explains that this is because shadow prices represent the marginal value of a product, whereas fixed and capital costs represent sunk costs that have not effect on the incremental supply costs of products. *Id.* It notes that a refiner might be willing to pay up to the shadow price for a feedstock, because the shadow price covers all of the refiner's variable costs even should it not cover the refiner's total costs. *Id.*

2161. By contrast, Phillips notes, O'Brien's methodology includes all fixed and capital costs. *Id.* According to Phillips, Ross conceded that O'Brien's proposal is different from a shadow price because it "includes a capital recovery factor and fixed costs in [the] reformer costs." *Id.* (quoting Transcript at pp. 9703-04). It asserts that O'Brien's capital recovery factor of 20% and his fixed and capital recovery costs combined equal 5.7¢/gallon in 1996 dollars, a significant discount below what a shadow price valuation would be. *Id.* (citing Exhibit No. PAI-37). Therefore, Phillips maintains, BP errs in asserting that O'Brien's methodology reflects the maximum that a refiner would pay for Naphtha. *Id.* In fact, it notes that a refiner could pay up to 5.7¢/gallon more than O'Brien's value and still make a profit on the transaction. *Id.*

2162. According to Phillips, O'Brien's cost-based formula, which includes a return on capital, is consistent with cost-based pricing that the Commission has traditionally implemented. *Id.* at p. 79. It claims that such cost-based calculations which include a profit component are supposed to reflect the prices that would be paid in a competitive market. *Id.* (citing *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, at pp. 692-93 (1923)). Thus, far from reflecting the maximum price that a refiner would pay, Phillips asserts, O'Brien's methodology reflects the price that a refiner *should* pay in a competitive market under traditional regulatory theory in order to recover a reasonable return on its investment. *Id.* It suggests that this price does not need to be governed, and BP's efforts to limit O'Brien's calculated Naphtha value to a much lower level cannot be justified by BP's shadow price theory. *Id.*

2163. Phillips also notes that Ross testified that O'Brien's methodology is like a shadow price in that both are based on the demand side of the market and neither reflects the supply side. *Id.* It states that Ross apparently means that O'Brien does not recognize the

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there are different logistics patterns (and hence different governors) for finished products than for intermediate products. Phillips Reply Brief at p. 77, n.36. It asserts that West Coast prices routinely exceed the governor that Ross claims should be applicable. *Id.*

potential for imports from the Caribbean by using a governor based on Gulf Coast prices plus Ross's view of the cost of imports. *Id.* (citing Transcript at p. 9704). While conceding that Ross is correct that neither a shadow price nor O'Brien's methodology uses a governor, it asserts that this does not transform O'Brien's cost-based methodology into a shadow price. *Id.* Moreover, Phillips contends, the evidence makes clear that imports do not govern the Naphtha market as Ross suggests and there is no reason for O'Brien to take Ross's theory into account. *Id.*

2164. Furthermore, Phillips argues that none of the other Quality Bank cut values would meet Ross's supply side test either. *Id.* at p. 80. It explains that price differential data shows that almost every other Quality Bank cut has Gulf Coast/West Coast price differentials that exceed the Gulf Coast price plus the cost of a governor as calculated by Ross. *Id.* Noting that no governor has been imposed to limit those values, Phillips argues that there is no reason to impose such a governor solely on Naphtha. *Id.* This is especially true, it claims, since O'Brien's methodology already reflects the costs that would be reflected by a competitive market price. *Id.*

2165. According to Phillips, the Quality Bank has consistently used market prices to value the distillation cuts, and the artificial ceiling and floor in Ross's governor are the very antithesis of market values. *Id.* It points out that Ross's governor would preclude the use of the actual market values over 80% of the time. *Id.* (citing Exhibit No. EMT-437).

2166. Phillips theorizes that BP errs in claiming that there are gasoline price spikes which are unrelated to price increases in intermediate products, such as Naphtha, and that use of a gasoline-based Naphtha valuation methodology will result in calculated Naphtha price increases that overstate Naphtha values in a transparent market. *Id.* It contends that BP offers no evidence to support this theory and that evidence in the record makes clear that it is not correct. *Id.* According to Phillips, as is the case on the West Coast, Naphtha is one of several intermediate products on the Gulf Coast which can be blended to make gasoline. *Id.* at p. 81. Therefore, Phillips contends, BP's assertion that "gasoline prices often change due to forces that have nothing to do with naphtha" should apply with equal force on the Gulf Coast. *Id.* (quoting BP Initial Brief at pp. 36-37). Yet, explains Phillips, Exhibit No. EMT-394 shows that Gulf Coast Naphtha prices followed every single gasoline price spike on the Gulf Coast in the 1999-2001 time period when the Gulf Coast gasoline market also was quite volatile. *Id.* It states that Gulf Coast Naphtha prices have closely followed Gulf Coast gasoline prices since 1992, as shown both in Exhibit No. EMT-394 and in Tallett's correlation calculation of a 0.9673 R-squared between Gulf Coast Naphtha and gasoline prices. *Id.* (citing Exhibit No. EMT-11 at p. 18). As a result, Phillips contends, the available evidence about the relationship between Naphtha and gasoline prices during price spikes, on both the West Coast and the Gulf Coast, shows that Naphtha prices consistently follow gasoline price spikes. *Id.* at pp. 81-82.

2167. BP next argues, Phillips states, that because the 1993 VGO settlement methodology did not do a good job of matching the actual VGO prices, a governor is needed to prevent calculated Naphtha prices from rising to unjustified levels. *Id.* at p. 82. Phillips suggests, in reply, that the 1993 settlement value is not analogous to O'Brien's methodology, and points out that the 1993 settlement value was not a cost-based methodology as is O'Brien's Naphtha methodology. *Id.* Rather, Phillips notes, the 1993 settlement was a negotiated formula that ostensibly was based on "market values" negotiated among the settling parties for periods prior to 1993. *Id.* That the 1993 VGO settlement methodology has not done a good job tracking VGO prices speaks well of the Commission's decision to reject that methodology, but, Phillips suggests, it says nothing at all about whether O'Brien's completely different proposal is just and reasonable or needs to be governed as proposed by BP. *Id.*

2168. Petro Star, Phillips notes, supports the continued use of the Gulf Coast Naphtha price to value West Coast Naphtha. Phillips Initial Brief at p. 141. It explains that Dudley's proposal was submitted by Petro Star as an alternative in the event that the Commission determined that a West Coast Naphtha value should be developed. *Id.* Given that Petro Star sponsors Dudley's methodology, Phillips states, it is not surprising that his methodology reaches results very similar to the Gulf Coast price of Naphtha. *Id.* It explains that Dudley calculated that the average price of West Coast Naphtha for 1992-2001 under his methodology is 0.19¢/gallon below Gulf Coast Naphtha prices. *Id.* Dudley's proposal is severely flawed, argues Phillips, and should not be accepted by the Commission. *Id.*

2169. Dudley's methodology was doomed from the start, Phillips asserts, by the fact that Petro Star asked him "to determine whether [he] could devise a method for determining the value of West Coast Naphtha that does not rely on finished gasoline prices." *Id.* at p. 142 (quoting Exhibit No. PSI-5 at p. 2). It explains that the overwhelming use of Naphtha on the West Coast is to make gasoline, and states that, asking Dudley to develop a West Coast Naphtha price that does not rely on gasoline prices, is asking him to ignore the fundamental value of West Coast Naphtha. *Id.*

2170. Phillips also points out that developing a Naphtha price that ignores its value in making gasoline is inconsistent with Dudley's advice to his other clients in other representations. *Id.* It notes that Dudley testified that he has calculated the value of Naphtha for other clients and that in every instance, that value was based on the value of gasoline. *Id.* According to Phillips, precluding the use of gasoline required Dudley to develop a methodology that, to his knowledge, is not used by any refinery in valuing the products that it produces. *Id.* Certainly, claims Phillips, this method is not used by Petro Star in valuing its own Naphtha, as Boltz testified. *Id.*

2171. It is apparent, according to Phillips, why Petro Star would want Dudley to ignore gasoline prices in developing a West Coast Naphtha price -- West Coast gasoline prices historically have exceeded Gulf Coast gasoline prices, suggesting, it states, a higher value for Naphtha. *Id.* In order to develop a West Coast Naphtha value that is as low as the Gulf Coast price, Phillips explains, Dudley had to move to some other pricing basis. *Id.* at pp. 142-43. Phillips asserts that ignoring gasoline prices, however, required Dudley to ignore a fundamental reality in how Naphtha is valued. *Id.* at p. 143.

2172. According to Phillips, to develop a West Coast Naphtha value without resorting to gasoline prices, Dudley decided to base his value on the West Coast/Gulf Coast price differentials of LSR and VGO. *Id.* Phillips states that his proposal assigns Naphtha a West Coast/Gulf Coast price differential that is between the differentials of LSR and VGO, and then applies that differential to the Gulf Coast Naphtha price to determine the West Coast Naphtha value. *Id.* (citing Exhibit No. PAI-218).

2173. Phillips notes that the price of LSR was 5.4¢/gallon less on the West Coast than on the Gulf Coast for the time period 1992-2001, while the price of VGO was 1.02¢/gallon more on the West Coast than on the Gulf Coast for the same 1992-2001 period. *Id.* (citing Exhibit No. PAI-219). Because Dudley's formula puts the Naphtha West Coast/Gulf Coast price differential between the LSR (-5.4¢/gallon) and VGO (+1.02¢/gallon) price differentials, Phillips states, his calculated Naphtha West Coast/Gulf Coast price differential will be a very wide range, equivalent to $2.70/barrel. *Id.* Implicit in this formula, according to Phillips, is an assumption that the West Coast/Gulf Coast Naphtha price differential should be somewhere above the -5.4¢/gallon LSR price differential and somewhere below the +1.02¢/gallon VGO price differential.[682] *Id.*

2174. All experts, including Dudley, Phillips claims, agreed that the negative 5.4¢/gallon West Coast/Gulf Coast LSR differential results from the fact that LSR has a high Reid Vapor Pressure, which severely limits its value on the West Coast. *Id.* at pp. 143-44. Further, states Phillips, all experts, including Dudley, agreed that Naphtha has a low Reid Vapor Pressure and, therefore, it is unlikely to have such a low value on the West Coast relative to the Gulf Coast. *Id.* at p. 144. It therefore is reasonable, asserts Phillips, for Dudley to conclude that the West Coast/Gulf Coast price differential for Naphtha will be higher than that for LSR. *Id.*

2175. There is no agreement, notes Phillips, that the West Coast/Gulf Coast Naphtha differential will be lower than the VGO price differential, as Dudley's formula assumes. *Id.* Thus, Phillips suggests, there is no purely objective way to determine which product

[682] It must be noted that in its Initial Brief at p. 143, Phillips cites the VGO differential from Exhibit No. PAI-219 as 1.04¢/gallon in two places rather than the correct figure of 1.02¢/gallon.

will have a higher differential, but it asserts that the record evidence suggests that Naphtha should have a higher differential than VGO. *Id.* In any event, Phillips points out, Dudley testified that he has not studied and does not know whether VGO has a higher or lower West Coast/Gulf Coast price differential than Naphtha. *Id.* According to Phillips, this admission is fatal to his methodology, which assigns a lower price differential to Naphtha than VGO. *Id.* In Phillips's opinion, if Dudley does not know whether this is an accurate assumption, he cannot know whether his formula has any validity. *Id.*

2176. Although Dudley did not base his methodology on gasoline prices, Phillips notes, he testified that he chose LSR and VGO differentials because those two products are used in the production of gasoline. *Id.* As there are a number of other products that also are used in the production of gasoline, states Phillips, Dudley's arbitrary choice of LSR and VGO for his formula had a profound effect on his proposed Naphtha value. *Id.* Phillips cites Exhibit No. PAI-219, which, it suggests, shows West Coast/Gulf Coast price differentials for six products used to make gasoline, to illustrate this point. *Id.* at p. 145. As this Exhibit shows, explains Phillips, the differentials for these six products for the time period 1992-2001 range from a positive 9.81¢/gallon for isobutane to a negative 9.57¢/gallon for butane. *Id.* Dudley acknowledged that all of the products in Exhibit No. PAI-219 are gasoline components, yet, notes Phillips, he arbitrarily chose to place the Naphtha differential between LSR and VGO.[683] *Id.*

2177. Phillips points out that, had Dudley chosen to use different products in his formula, the outcome would have been materially affected. *Id.* For example, explains Phillips, LSR and Butane both have high Reid Vapor Pressure levels and therefore are valued lower on the West Coast than the Gulf Coast. *Id.* Since Naphtha does not have any Reid Vapor Pressure problems, Phillips suggests, it is unreasonable to use either of them in estimating a Naphtha price differential. *Id.* Had Dudley used a formula involving VGO and Isobutane price differentials, Phillips states, the result would be a much higher Naphtha price differential – somewhere between 1¢/gallon and 9.8¢/gallon. *Id.* While it does not advocate the use of these products or any other Naphtha valuation formula based on West Coast/Gulf Coast price differentials, Phillips asserts, the point is that Dudley has not presented any compelling reason to use the LSR and VGO differentials instead of any of the other differentials. *Id.* The fact that the potential outcome of his methodology depends so heavily on his unsupported choice of the product prices used demonstrates, in the opinion of Phillips, that the methodology is arbitrary and should not be adopted. *Id.* at pp. 145-46.

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[683] Phillips notes that while the boiling point of Naphtha falls between the boiling points of VGO and LSR, Dudley testified that there is no direct relationship between boiling point and relative market values on the Gulf Coast and West Coast. Phillips Initial Brief at p. 145, n.58.

2178. Once he decided to place the Naphtha price differential between the LSR and VGO price differentials, explains Phillips, Dudley had to decide exactly where to locate Naphtha between these two differentials. *Id.* at p. 146. Given that there is an almost 6.5¢/gallon spread between the LSR differential and the VGO differential, Phillips asserts, this decision, too, had a profound impact on the ultimate Naphtha value which results from Dudley's methodology. *Id.*

2179. In his rebuttal testimony, notes Phillips, Dudley argues that the formula is justified on the grounds that "[d]ifferences in the price of Naphtha between the Gulf and West Coasts are more likely to be similar to differences in the price of VGO of than LSR." *Id.* (quoting Exhibit No. PSI-11 at p. 5). This explanation, according to Phillips, does not support the use of a formula that weights the differentials precisely equal to the percentages of VGO and LSR contained in ANS crude.[684] *Id.*

2180. During the hearing, Phillips points out, Dudley changed rationales. *Id.* at p. 147. It explains that he attempted to justify his formula on the grounds that refineries need to balance their products to produce gasoline, and that, were the amount of VGO or LSR included in the ANS stream to change, "then that affects its ability to deal with the naphtha that comes into it." *Id.* (quoting Transcript at p. 10069). Phillips points out that Dudley never explained how this theory translates into a higher or lower West Coast/Gulf Coast Naphtha price differential; nor does he explain how the differentials relate precisely to the percentage of LSR and VGO in ANS. *Id.* It declares that this is because the formula employed by him has nothing to do with the West Coast/Gulf Coast price differential for Naphtha. *Id.* In Phillips's opinion, this formula is just one more arbitrary aspect of Dudley's proposal. *Id.*

2181. It is not surprising, in Phillips's view, that Dudley's proposal does so poorly when compared to the empirical data. *Id.* at p. 148. It states that this is because Dudley's proposal: (1) is not based on the value of the product into which Naphtha is made; (2) relies on the unsupported assumption that the West Coast/Gulf Coast Naphtha price differential is less than the VGO price differential; (3) is based on the arbitrary choice of VGO and LSR price differentials; and (4) is based on an arbitrary formula to locate the Naphtha differential between the LSR and VGO differentials. *Id.*

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[684] Phillips points out that one effect of this approach is to make the value of Naphtha depend upon the operations of the refineries connected to TAPS. Phillips Initial Brief at p. 146, n.59. Thus, explains Phillips, the proportions of VGO and LSR in the stream passing the Petro Star Valdez Refinery depend upon what the Petro Star refinery takes out and puts back, and Dudley's Naphtha value would vary based on that dynamic rather than on the supply and demand in the West Coast product market. *Id.*

2182. Phillips states that Petro Star's argument in support of Dudley's proposal makes no sense. Phillips Reply Brief at p. 83 (citing Petro Star Initial Brief at pp. 11-15). It asserts that there is no reason to believe that use of a formula that takes an arbitrarily weighted average of one imperfect indication of the West Coast/Gulf Coast Naphtha price differential and another even worse indication of the Naphtha differential somehow would somehow come up with a reasonable approximation of the Naphtha differential. *Id.* at pp. 83-84. Phillips argues, the average of a bad indicator and an even worse indicator cannot possibly be an appropriate proxy for West Coast Naphtha values. *Id.* at p. 84. Further, it contends, this logic could never pass muster under the Circuit Court's *Exxon* decision, which requires that there be a rational relationship between a proxy price and the value of the cut represented by that proxy price. *Id.*

2183. According to Phillips, some alternative proposal could conceivably provide for a reasonable West Coast Naphtha value that would be acceptable to Phillips. Phillips Initial Brief at p. 149. However, it expresses some concern that none of these alternative proposals could satisfy the *OXY* uniformity requirement. *Id.* Phillips has an additional concern with respect to these new Naphtha methodologies that it does not have regarding the Exxon proposal: while there is an extensive record regarding the existing proposals advanced by the parties in their pre-filed testimony, there would be very little, if any, record regarding an alternative methodology, and certainly almost no opportunity for the parties to submit evidence demonstrating the shortcomings of such an alternative. *Id.* This lack of a record regarding an alternative proposal could undermine its validity on appeal, states Phillips, no matter how reasonable the results might turn out to be. *Id.*

2184. Phillips is not suggesting that the Commission must accept an existing proposal without alteration or could not adjust one of the existing proposals if the adjustment were supported by record evidence. *Id.* However, Phillips declares that there is a difference between adjusting a proposal based on sound record evidence and implementing a new proposal that was not tested on the record by the parties, which, it suggests, could lead to problems on appeal. *Id.*

2185. The ANS + $4.00 proposal, Phillips contends, is based on the floor in Ross's governor and Ross testified that this figure represents the cost basis for a supplier. *Id.* at p. 150. It explains that Ross is asserting that it would cost a refiner $4.00/barrel to produce Naphtha from ANS. *Id.* According to Phillips, such an approach is inconsistent with the approach taken for all other cuts, which are valued based not on the cost of producing the cut from ANS, but on the market value of the products made from the cut less the costs, if any, of processing the cut so that it can be sold at the market price. *Id.* As such, Phillips claims, the ANS + $4.00 approach violates the requirement in *OXY* that all cuts be valued on the same basis. *Id.*

2186. Moreover, Phillips explains, the support that Ross provided for his assertion that the ANS + $4.00 floor is cost-based has nothing to do with the costs of producing

Naphtha from ANS. *Id.* Instead, continues Phillips, Ross's support consisted of price differentials between Gulf Coast Naphtha and the price of West Texas Sour crude, as well as a more complex calculation based on Naphtha, VGO and ANS prices. *Id.* It points out that Ross also presented similar calculations based on Isthmus crude prices instead of West Texas Sour crude. *Id.* In Phillips's view, this comparison of crude and product prices is, if anything, a market-based test that does not provide a cost basis for the ANS + $4.00 floor that is consistent with the cost calculations. *Id.* As such, it asserts that the use of an ANS + $4.00 value would violate the *OXY* requirement of consistency, even were it acceptable to base the Naphtha value on the cost of refining ANS into Naphtha instead of the cost of processing Naphtha into a saleable product. *Id.*

2187. Furthermore, according to Phillips, there is a huge variation (anywhere from -79¢/barrel to +$13.68/barrel) in the monthly results shown in Exhibit Nos. BPX-138 and BPX-170. *Id.* at pp. 150-51. Therefore, Phillips's position is that use of a fixed $4.00/barrel to represent this wide variation of results violates the requirement in *Exxon* that the proxy price bear a rational relationship to the value the proxy is supposed to represent. *Id.* at p. 151.

2188. Phillips states that Williams supports the use of the price of ANS plus $4.00/barrel as an alternative to the use of the Gulf Coast Naphtha price, because it is similar to the Gulf Coast Naphtha price. Phillips Reply Brief at p. 84. It asserts that this is not a sufficient justification to support the proposal. *Id.* Phillips argues that there are considerable problems with the merits of that proposal, separate and apart from the fact that its stated goal is to replicate Gulf Coast Naphtha prices. *Id.* To begin, Phillips notes that the ANS plus $4.00 proposal does not follow the typical Quality Bank approach. *Id.* at pp. 84-85. It states that, rather than take the published product prices, minus any processing costs, it takes the price of crude, and adds the costs of processing the crude into the product. *Id.* at p. 85. According to Phillips, Williams attempts to avoid this distinction through the use of semantics, by using the term "feedstocks" to describe both crude and the products of refining crude. *Id.* Phillips concedes that it may be semantically accurate that crude oil and intermediate products both can be called "feedstocks," but suggests that there is a fundamental distinction between a "crude plus" approach (such as the price of ANS + $4.00) and a "product minus" approach (that takes a published product price and subtracts the costs of processing a Quality Bank cut into that product). *Id.* Because the Quality Bank follows a product minus approach for all other cuts, Phillips contends, use of a crude plus approach for Naphtha alone would violate the uniformity requirement of *OXY*. *Id.*

2189. One difference, Phillips states, between the product minus and crude plus approaches is that the crude plus approach eliminates all the profit allowed by the marketplace and is nothing more than the sum of the refiner's costs. *Id.* It claims that such an approach understates the value of the cut by eliminating the differential between the sum of the costs and the market price (i.e., the profit). *Id.* According to Phillips, the product minus approach properly accords the cut its full market value by starting from the product market value and subtracting only the cost of processing required to bring the cut up to the specifications of the product. *Id.*

2190. Phillips asserts that the difference in results between a crude plus and a product minus approach can be significant. *Id.* at p. 86. It notes that Exhibit No. PAI-3, which it describes as a schematic of the processing required to produce each of the Quality Bank cuts, shows that crude is processed the same way to produce Naphtha as it is to produce Light Distillate. *Id.* In each instance, they are produced from crude solely by being run through an atmospheric distillation tower, claims Phillips. *Id.* Thus, under a crude plus approach, Phillips explains, a refiner would incur the exact same cost, which Williams asserts without proof is ANS + $4.00, to process crude into the Naphtha and Light Distillate cuts. *Id.*

2191. The record shows, notes Phillips, that use of an ANS + $4.00 proxy price for Light Distillate would yield significantly different, and lower, values for Light Distillate than the jet fuel minus 0.5¢/gallon price used by the Quality Bank. *Id.* It points out that Exhibit No. PAI-176 shows that the average West Coast Waterborne Jet Fuel Price for 1994-2001 was 63.27¢/gallon. *Id.* (citing Exhibit No. PAI-176 at p. 22). According to Phillips, the average Light Distillate price under the approved Quality Bank methodology for 1994-2001 was, therefore, 62.77¢/gallon. *Id.* Further, Phillips states, the average ANS + $4.00/barrel price for the same time period was $23.16/barrel, which is 55.14¢/gallon. *Id.* (citing Exhibit No. EMT-494 at p. 4). It concludes that the difference in the value of Light Distillate using a crude plus and a product minus approach is thus over 7.5¢/gallon, which is material under anyone's definition. *Id.* Phillips contends that use of a crude plus approach for Naphtha and a product minus approach for every other cut therefore will result in inconsistent valuations, in violation of *OXY*. *Id.*

2192. There is another more general inconsistency with applying the crude plus approach to Naphtha but not to any other products, according to Phillips. *Id.* It explains that the use of a crude plus approach would lead to three general groupings of cuts based on the cost of initial processing of crude into that cut. *Id.* at pp. 86-87 (citing Exhibit No. PAI-3). Naphtha, Light Distillate and Heavy Distillate are processed in the atmospheric distillation tower, states Phillips, while the natural gas liquids are further processed in the light end fractionator and VGO and Resid are further processed in the vacuum distillation tower. *Id.* at p. 87. Viewed this way, Phillips maintains, there would be three groups of products that all received the same basic processing, and the products within each group would all have the same cost of processing when viewed on a crude plus basis.[685] *Id.*

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[685] Phillips notes that, while it is true the Resid, Heavy Distillate, Light Distillate and Naphtha cuts undergo additional processing to be sold as finished products, that processing occurs after the distillation process, and thus is irrelevant to the crude plus approach, which stops calculating costs after the crude is distilled into the Quality Bank

Under the crude plus approach, it points out that all of the products in each group would receive the same price, but in the real marketplace they would each have significantly different product values. *Id.* For example, Phillips notes that Isobutane and Butane would be in the same processing cost group, but the average price difference between Isobutane and Butane on the West Coast from 1994-2001 was over 21¢/gallon. *Id.* (citing Exhibit No. PAI-176 at p. 10).

2193. Phillips asserts that the four factors delineated by Williams do not support the ANS+$4.00 proposal. *Id.* (citing Williams Initial Brief at p. 82). While Phillips agrees with Williams's first factor, that the published ANS price is a robust price with little risk of manipulation, it claims that that fact does not justify the proposal unless the value otherwise is consistent with the valuation of the other cuts and is reasonably related to the actual value of West Coast Naphtha. *Id.* at pp. 87-88. Phillips states that the ANS plus $4.00 proposal does not meet either of those criteria. *Id.* at p. 88. As for Williams's second factor, that the ANS + $4.00 proposal would be simple to implement and administer, while conceding that it also is true, Phillips contends that simplicity alone does not justify the use of a proposal which otherwise is not just and reasonable, as the Circuit Court held in both *OXY* and *Exxon*. *Id.*

2194. According to Phillips, Williams asserts its proposal "is consistent with the philosophy of using feedstock prices to value the intermediate, Quality Bank cuts whenever possible." *Id.* (quoting Williams Initial Brief at p. 82). In Phillips's view, this is where Williams's justification, based on its use of semantics to apply the term feedstock to both crude and intermediate products, truly falls apart. *Id.* Repeating its assertion that the ANS plus $4.00 proposal is a crude plus approach which is inconsistent with the product minus approach that applies to all other cuts, Phillips also claims that it is not the philosophy of the Quality Bank to value cuts based on the cost of producing them from crude oil. *Id.*

2195. Moreover, Phillips expresses amazement that Williams would assert that the proposal "is supported by the largest volume produced Naphtha contract . . . which utilized ANS crude oil plus $4.00 per barrel to value Naphtha." *Id.* (quoting Williams Initial Brief at p. 82). It claims that, as Williams well knows, that contract sets the price at the Gulf Coast Naphtha price plus $2.96/barrel, and employs ANS Plus $4.00 only as a floor below which the Naphtha price can never fall. *Id.* (citing Transcript at pp. 8142, 8433). Phillips maintains that because that particular contract used ANS + $4.00 as a floor does not justify setting the Naphtha market value exactly at that floor, and the contract Ross used certainly does not justify Williams's basic reason for supporting the ANS plus $4.00 proposal in the first place, which is that it reaches results that are similar to the use of the Gulf Coast price. *Id.* at pp. 88-89.

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cuts. Phillips Reply Brief at p. 87, n.37.

2196. During the trial, Phillips notes, witnesses were asked whether a West Coast Naphtha price could be developed by determining where the Gulf Coast Naphtha price fell between the Gulf Coast VGO and Gulf Coast conventional gasoline prices, and applying that same percentage to the West Coast VGO and conventional gasoline prices. Phillips Initial Brief at p. 152. According to Phillips, such an approach could lead to results that are reasonably close to the West Coast value of Naphtha, provided that the correct products are chosen for the analysis. *Id.* For example, explains Phillips, LSR and butane prices are depressed on the West Coast relative to the Gulf Coast due to their Reid Vapor Pressure content, and it therefore would be inappropriate to use these products in such a valuation methodology. *Id.* However, Phillips suggests that the Commission not adopt such an approach for two reasons. *Id.* First, while the concept was discussed with a number of witnesses, Phillips points out, no specific proposal was ever addressed on the record. *Id.* Therefore, according to Phillips, there is no record evidence examining the reasonableness of such a proposal, and this would likely lead to problems on appeal. *Id.* Second, Phillips claims, this proposal is very similar in concept to the Exxon proposal presented by Tallett which, according to it, looks at the relationship between Naphtha, gasoline and jet fuel prices on the Gulf Coast and applies that relationship to gasoline and jet fuel prices on the West Coast. *Id.* The major difference, according to Phillips, between the interpolation method suggested at trial and Tallett's proposal is that Tallett has applied a more well developed regression analysis that should allow his proposal to more accurately capture the existing relationship between these product prices. *Id.* at pp. 152-53. Furthermore, Phillips points out, Tallett's proposal was fully addressed by all parties at the hearing and there is more than enough evidence on the record regarding his proposal. *Id.* at p. 153. Accordingly, Phillips recommends that, if the Commission prefers an approach based on relationships between prices on the Gulf Coast, that they adopt Tallett's proposal rather than the interpolation method suggested at the trial. *Id.*

2197. Phillips states that, in a proposal closely related to the ANS + $4.00 proposal, Sanderson suggested that it would be possible to develop a value for Naphtha based on the cost of processing ANS crude into Naphtha. *Id.* It notes that Sanderson did not, however, provide any cost data from which such a value could be determined; instead suggesting that a proxy for these costs would be the difference between the price of Gulf Coast Naphtha and ANS. *Id.* In Phillips's view, the differential between ANS and Gulf Coast Naphtha prices leads back to a price equal to the Gulf Coast Naphtha price, as Sanderson conceded on the stand. *Id.*

2198. At trial, notes Phillips, Judge Wilson explored with Culberson and Sanderson the possibility that Naphtha should be valued somewhere between two imaginary lines that represent the price of ANS plus the cost of producing Naphtha and the price of gasoline minus the cost of its production from Naphtha. *Id.* at p. 154. Phillips states that both witnesses agreed with Judge Wilson that the value of Naphtha should be within this range. *Id.* While agreeing, in theory, that the value of Naphtha generally should fall somewhere between these two lines, Phillips claims that this will not always be the case because the reforming process results in more products than just reformate – most notably hydrogen. *Id.* As described above, continues Phillips, when the value of hydrogen and/or other products of reforming is high, the value of Naphtha can in fact exceed the price of gasoline. *Id.*

2199. Furthermore, even the hypothesis as a general principle, Phillips asserts, cannot be turned into a Naphtha valuation methodology. *Id.* It states that there is no record evidence that would allow a reasoned decision as to: (1) what the costs are of producing Naphtha from ANS; or (2) where in the range between the two imaginary lines the value of Naphtha might fall. *Id.* While Phillips may believe that a methodology that places a West Coast Naphtha value somewhere between these lines might represent an appropriate value, depending upon where that value is placed, it believes that it would be very difficult for such a value to be sustained on appeal based on the record in this proceeding. *Id.*

3. BP

2200. BP argues that fundamental differences in the Gulf Coast and West Coast Naphtha markets make the use of a West Coast price assessment more appropriate than a Gulf Coast price assessment for valuing the West Coast Naphtha component. BP Initial Brief at p. 28. It notes that Tallett, O'Brien, and Ross all agree that a West Coast value for Naphtha is appropriate, even if a reporting service does not publish an assessment for it. *Id.* Therefore, according to BP, it makes sense to value Naphtha on the West Coast according to its predominant use, which is as a feedstock to make reformate, a gasoline blendstock. *Id.*

2201. Because there is no reported price for Naphtha or reformate on the West Coast, BP explains, an alternate methodology for valuing West Coast Naphtha must be developed and that value must be rooted in West Coast market dynamics and bounded by a ceiling and floor to ensure that it remains in line with the way a transparent market would actually function. *Id.* at p. 29. BP asserts that the West Coast Naphtha value should begin with a methodology that is based on the reported price for West Coast gasoline, adjusted for the cost of transforming Naphtha into a gasoline component, on the same waterborne basis as the other distillation cuts for liquid products in the TAPS Quality Bank methodology. *Id.* It suggests that either O’Brien’s or Tallett’s gasoline-based formula can serve as a starting point for its valuation. *Id.* However, continues BP, valuing Naphtha solely on a gasoline-based calculation has the inherent flaw that it may not reproduce values which would result if there were a transparent market for Naphtha on the West Coast. *Id.* Thus, according to BP, valuing West Coast Naphtha solely on the basis of either the O'Brien or the Tallett approach would interject an error into the calculation, considering the significant West Coast gasoline price spikes in recent years. *Id.* at pp. 29-30.

2202. Exxon does recognize, according to BP, that "[f]ar more than a mere cost adjustment to an existing market price is … required" to properly value the West Coast Naphtha cut. BP Reply Brief at p. 30 (quoting Exxon Initial Brief at p. 270). Nonetheless, BP maintains, Exxon and Phillips each fail to ensure that their proposed gasoline-based formula produces values comparable to the other Quality Bank prices formed in transparent markets. *Id.*

2203. BP notes that Ross has demonstrated that price anomalies have resulted in significantly greater increases in the price for gasoline than can be attributed to an increase in the value of Naphtha and the other significant gasoline feedstocks including, most importantly, VGO. BP Initial Brief at p. 30. If an adjustment is not made to account for this condition, BP suggests, the value of Naphtha will be significantly overstated. *Id.* BP argues that a viable Naphtha-valuation methodology must protect against these potential distortions. *Id.*

2204. Exxon and Phillips, BP acknowledges, have criticized the governor on the grounds that it is a result in search of a theory based on the fact that it has been modified several times since it was originally proposed. BP Reply Brief at p. 43. It asserts that this criticism is not valid. *Id.* Instead, BP notes, details of the proposal were changed only when it became apparent they were needed to meet the goal of representing Naphtha values on a consistent basis with other Quality Bank cuts. *Id.* at pp. 43-44.

2205. In order to simulate the supply-and-demand functions present in a transparent market, BP states, the gasoline-based valuation calculation must include a governor. BP Initial Brief at p. 30. As Ross explained, notes BP, once the gasoline-based calculation is performed, one must adjust the value resulting for Naphtha from a gasoline-minus calculation to cap the price at a level at which Naphtha from other markets otherwise could be imported into the West Coast. *Id.* According to BP, this provides protection against overvaluing Naphtha on the West Coast, as the cap simulates the higher end of the market price that would result in a transparent market where importers and exporters enter into transactions based on publicly available prices. *Id.*

2206. In addition, BP agrees with Ross's view that the governor should also have a floor to prevent under-valuation of Naphtha.[686] *Id.* at pp. 30-31. It explains that Ross's governor provides a floor – the price of ANS crude oil plus $4.00/barrel – to ensure that the Naphtha price never falls below a price that is representative of the cost of local supply. *Id.* at p. 31. The key, notes BP, to proper valuation using a gasoline-minus

[686] BP points out that Ross used the terms floor and ceiling as a shorthand for the local supply component and imported supply component of the governor, respectively. BP Initial Brief at p. 31, n.8. If the floor exceeds the ceiling, the floor applies. *Id.*

formula is to constrain it with a floor and ceiling to ensure that the formula only represents simulated transactions that either would occur, or could occur, in a transparent market. *Id.* According to BP, a governor prevents the Naphtha value from fluctuating wildly because of gasoline price spikes and seeks to create a price similar to what would exist in a transparent market. *Id.* In BP's view, subjecting either the Tallett or O'Brien base Naphtha formula to the Ross governor provides an essential check to prevent over-valuation or under-valuation of West Coast Naphtha by simulating prices that would occur in a transparent market. *Id.*

2207. BP compares the gasoline-based formulæ without a governor to the "shadow prices" used by oil traders in making purchasing decisions.[687] *Id.* The true market value, according to BP, will be different than the shadow price because it will be influenced not only by the demand for the product but also by the availability of supply in the market. *Id.* at p. 32.

2208. Ross suggested, according to BP, that the O'Brien and Tallett gasoline-minus formulæ display some aspects of shadow prices, although, it suggests, they are not true shadow prices. *Id.* BP explains that the O'Brien and Tallett formulæ only consider the demand side of the West Coast market for Naphtha and fail to capture the supply side components such as import opportunities and a local refinery's ability to affect the Naphtha supply. *Id.* For that reason, BP asserts, the gasoline-minus formulæ will predict prices at the maximum that refiners can afford to pay for a product, an inherent flaw in a formula that is intended to simulate a price. *Id.* By contrast, BP states, proponents of using Gulf Coast prices to value West Coast Naphtha focus solely on the supply function when they assert that it costs the same to manufacture Naphtha on the West Coast as on the Gulf Coast. BP Reply Brief at p. 29. BP asserts, both methodologies are incomplete because, without the Ross governor, they do not balance the supply and demand functions to correctly simulate a transparent market. *Id.* According to BP, the Ross governor fixes this aspect of the O'Brien or Tallett formulæ by representing the supply component. BP Initial Brief at p. 32. As a ceiling, explains BP, it limits the price from going beyond the market value in a transparent market by providing a cap at the level that imports would start flooding the market and thereby lowering prices; as a floor, continues BP, it provides a baseline below which the price should not fall as the local suppliers have the ability to influence the Naphtha price with their local supplies. *Id.* at pp. 32-33. Without the Ross governor, it asserts, either the O'Brien or Tallett formula will tend to over-value Naphtha, like an unchecked shadow price. *Id.* at p. 33.

[687] BP notes that shadow prices, which are generated by linear programs, are "the maximum that a refiner should pay in a market," but don't represent an actual market price at which transactions would occur in a transparent market. BP Initial Brief at p. 31 (quoting Transcript at p. 9703).

2209. BP explains that the Ross governor is designed to represent prices which one would see in a transparent market. *Id.* Without a published price, states BP, the Quality Bank must attempt to assess a price under circumstances that do not currently exist. *Id.* According to it, this forces the Quality Bank to make estimates that simulate where the supply and demand curve would cross on the West Coast if the market were competitive with transparent pricing, in keeping with the characteristics of the markets for the other Quality Bank products. *Id.* BP suggests that the Ross governor is based on the realities of the West Coast gasoline market and its relationship to gasoline feedstocks. *Id.* That includes, in the view of BP, limiting the value ascribed to Naphtha based on Ross's conclusion that the price of Naphtha on the West Coast could never exceed the price of (1) Naphtha imported to the Gulf Coast added to (2) the differential cost of transporting Gulf Coast Naphtha to the West Coast market. *Id.* at pp. 33-34. If the price of Naphtha on the West Coast were to exceed the price of imported Naphtha diverted from delivery to the Gulf Coast, BP claims, the West Coast market would react and would cause Naphtha to be imported into the West Coast. *Id.* at p. 34. Thus, notes BP, the potential for importation of Naphtha into the West Coast place a price ceiling on the value of West Coast Naphtha. *Id.*

2210. The proponents of the Tallett methodology, BP contends, claim that the Gulf Coast relationship between Naphtha, gasoline, and jet fuel can be transported to the West Coast in order to predict West Coast Naphtha values. BP Reply Brief at p. 30. The proponents, according to BP, assert that the Gulf Coast and West Coast markets are sufficiently similar because Naphtha is processed into reformate on both coasts and the relationships between the products are structurally identical. *Id.*

2211. Exxon, in defending Tallett's regression formula, BP notes, claims that the Gulf and West Coast markets are similar enough so that the relationship between the prices of Naphtha, gasoline and jet fuel on the Gulf Coast can be transferred and used to value Naphtha on the West Coast based on the price of gasoline and jet fuel. *Id.* BP asserts that Exxon fails to address the marked differences in the Gulf Coast and the West Coast markets. *Id.* For example, it explains that (1) operating margins on the West Coast are higher than on the Gulf Coast, (2) the West Coast is subject to strict CARB restrictions which make it more expensive to process gasoline, (3) the supply and demand dynamics are different on the Gulf Coast than on the West Coast, and (4) the Gulf Coast has a petrochemical market for Naphtha that does not exist on the West Coast. *Id.* at pp. 30-31. It maintains that these differences, along with general flaws in using a gasoline-based formula, make transferring an unadjusted relationship on the Gulf Coast to the West Coast inappropriate. *Id.* at p. 31.

2212. The O'Brien formula, BP argues, cannot be used without application of a governor either, as it also would result in overvaluation. *Id.* It explains that, after 1999, anomalies detailed in the Stillwater report, Exhibit No. EMT-385, caused gasoline prices to rise sharply relative to crude oil on the West Coast. *Id.* While gasoline prices continued to rise, BP maintains, nothing suggests that the cost to transform crude oil to Naphtha changed, nor did the cost to transform Naphtha to gasoline, confirming that the value of Naphtha on the West Coast has not increased along with gasoline prices. *Id.* (citing Exhibit No. BPX-27 at pp. 11-12). As a consequence, it is BP's view that the sum of the production costs no longer had much explanatory value in calculating gasoline prices. *Id.*

2213. BP notes that O'Brien tries to develop an intermediate product price (the West Coast Naphtha value) by subtracting the processing costs from the finished product price (the price of gasoline). *Id.* It points out that such an approach freezes a cost differential between Naphtha and gasoline under the mistaken assumption that all of the difference between the ordinary gasoline price and the elevated gasoline price would flow through to Naphtha. *Id.* at pp. 31-32. Unadjusted, BP argues, the O'Brien formula would overvalue Naphtha, failing to account for the gasoline pricing anomalies that uncoupled Naphtha prices from gasoline prices. *Id.* at p. 32. Thus, BP concludes, the O'Brien formula fails, just as the Tallett formula fails, by not producing prices representative of the prices that would result in a transparent market – unless an appropriate governor is applied. *Id.*

2214. According to BP, a price ceiling is required to avoid overvaluing Naphtha. BP Initial Brief at p. 34. It maintains that Exxon and Phillips err in suggesting that their proposed methodologies properly capture the relationship between Naphtha and gasoline production on the West Coast and produce a just and reasonable results. BP Reply Brief at p. 32.

2215. Without a governor, explains BP, the Tallett and O'Brien gasoline-based Naphtha formulæ track all gasoline price spikes and improperly attribute the entire margin in gasoline, a finished product, to Naphtha, an intermediate product. BP Initial Brief at p. 34. As intermediate products have margins associated with their production and sale that differ from the margins associated with finished products, BP states, attributing finished product margins to Naphtha is inappropriate and would result in Naphtha's overvaluation. *Id.*

2216. BP argues that the basic flaw of the ungoverned gasoline-based formulæ is compounded when a methodology transfers Gulf Coast relationships to the West Coast and assumes no margin changes. BP Reply Brief at p. 32. According to it, refining data confirms that the profitability for finished products is higher on the West Coast than the Gulf Coast. *Id.* For example, it points out that cash operating margins have been consistently higher on the West Coast than the Gulf Coast by a margin of $2.87/barrel – more than 6¢/gallon – over a seven-year period from 1995-2001. *Id.* at pp. 32-33 (citing Exhibit No. WAP-8 at p. 5). Also BP notes, Tallett recognizes that refining margins on the West Coast have been higher than margins on the Gulf Coast. *Id.* at p. 33. Further, it states that the report to the California Attorney General that Pulliam co-authored (Exhibit No. WAP-199) explains that the higher gasoline prices flow through to the benefit of the refinery on the West Coast and not to the intermediate product. *Id.* Consequently, BP maintains, attributing finished product margins to Naphtha is inappropriate and results in overvaluation. *Id.* It states that this flaw is exacerbated when no effort is made to strip out the higher margins on the West Coast from flowing through to the formula-generated Naphtha values. *Id.* For example, BP claims that basing the value of Naphtha only on gasoline would wrongly attribute the full value earned by the gasoline to the Naphtha cut, even when the gasoline price is responding to shortages that have nothing to do with Naphtha supplies.[688] BP Initial Brief at p. 24. According to BP, this would severely overstate the actual value of Naphtha at certain times. *Id.* Therefore, in BP's view, a governor needs to be applied in order to fairly represent how a transparent market price would respond. *Id.*

2217. Exxon acknowledges, according to BP, that disruptions for VGO occurred on the West Coast that would cause VGO to depart from gasoline values.[689] BP Reply Brief at p. 35. However, BP points out, Exxon asserts that factors in the West Coast market, such as the introduction of CARB gasoline, do not prevent the price of Naphtha from moving in lockstep with gasoline. *Id.* at p. 34. BP asserts that, however, there is ample record evidence that intermediate product values – including Naphtha values – have become disassociated from gasoline values on the West Coast. *Id.* Exhibit No. BPX-37, continues BP, detailed disruptions in the West Coast refining industry that impacted gasoline prices, but had no effect on intermediate feedstock prices during the 1999-2001 period. BP Initial Brief at p. 35. For example, explains BP, a series of problems with cat crackers and Cokers affected the value of gasoline but did not necessarily affect the value of intermediate feedstocks. *Id.* In periods after the cat cracker incidents, such as March-April 1999, June-July 1999, and August-September 2001, BP notes, gasoline prices tended to rise, while VGO prices did not rise in parallel, because the demand for VGO as a cat cracker feedstock was reduced. *Id.*

2218. In periods after the Coker incidents, such as June-August 2001, gasoline and VGO prices rose together, comments BP, because the supply of Coker VGO had been reduced. *Id.* In both cases, however, the supply of cat gasoline was reduced, states BP, so the demand for reformate that could be blended within the restrictive West Coast gasoline specifications was reduced. *Id.* Further, continues BP, lower reformate demand meant lower Naphtha demand and lower Naphtha values. *Id.* Thus, refinery disruptions

[688] According to BP, Exhibit No. BPX-12 showed situations where there have been gasoline price spikes that are unaccompanied by price spikes of components that are used to make gasoline. BP Initial Brief at p. 35.

[689] Exhibit No. EMT-443, notes BP, plotted West Coast conventional unleaded gasoline versus West Coast VGO and showed that there has been a disconnect between the spikes in the gasoline price and the movement of the VGO price on at least four occasions from 1999 through 2001. BP Initial Brief at p. 35.

occurred throughout 1999-2001 which caused gasoline prices to spike, but, states BP, would not have caused Naphtha values simultaneously to spike. *Id.* BP concludes that, while gasoline prices were spiking, thereby reducing demand for reformate, Naphtha prices in a transparent market would have fallen. *Id.* at pp. 35-36.

2219. Exhibit No. BPX-37, according to BP, shows some examples of situations where disruptions or other market dynamics can reduce the supply, and drive up the price, of gasoline in the West Coast while the price of the intermediate feedstocks would not see a corresponding increase (and indeed, may move in the opposite direction). *Id.* at p. 36. The reason that the gasoline price spikes should not have flowed through to the intermediate feedstocks is that, in BP's view, if refineries are not functioning at their full capability, the demand for intermediate feedstocks decreases as the amount of gasoline supplied to the West Coast market decreases. *Id.* It acknowledges that the decreased gasoline supply would lead to an increase in the price of gasoline on the West Coast. *Id.* A gasoline price spike in this situation should not, asserts BP, flow through to the value of intermediate feedstocks, which are in lesser demand than they were before the refinery disruptions. *Id.* It states that the O'Brien and Tallett gasoline-based Naphtha valuation approaches would unjustly credit the value of West Coast Naphtha with those gasoline-only price spikes. *Id.* According to BP, this is unjustified and the Ross governor is required in order to correct this unjust result. *Id.*

2220. BP notes that, although essentially all Naphtha is dedicated to gasoline, Naphtha's primary derivative, reformate, accounts for only about one fourth of the gasoline pool. *Id.* Because of Naphtha's limited role in the gasoline pool, explains BP, gasoline prices often change due to forces that have nothing to do with it. *Id.* at pp. 36-37. Further, notes BP, West Coast gasoline prices have become increasingly erratic relative to gasoline prices in other markets since 1998. *Id.* at p. 37. It states that those gasoline price increases would not have affected intermediate products, such as VGO, whose primary use, like Naphtha's, is in gasoline manufacturing. *Id.* This erratic price behavior of West Coast gasoline occurs due to increasing demand on the West Coast for gasoline, claims BP, while stringent quality specifications and restrictive permitting of new refinery process plants are limiting supply on the West Coast. *Id.* Consequently, it states, West Coast finished product markets are increasingly dependent on imports and the markets can be very volatile as prices move into, and out of, import parity. *Id.* BP asserts, however, that these volatile price swings often are not associated with changes in intermediate feedstock values, such as Naphtha. *Id.*

2221. Disruptions and other market dynamics in the West Coast refining industry will continue to impact gasoline prices, according to BP, with no (or non-corresponding) effect on intermediate feedstock prices. *Id.* Consequently, states BP, formulæ, such as Tallett's and O'Brien's, without a governor that did not constrain the impact of these gasoline price spikes would have overvalued Naphtha during the 1999-2001 period. *Id.* It is BP's position that Naphtha values should not get the benefit of gasoline price spikes unrelated to gasoline component feedstock values. *Id.* Additionally, notes BP, any formula that attributes the entire margin of gasoline, a finished product, to Naphtha, an intermediate product, will overvalue it. *Id.*

2222. BP points out that the Tallett and O'Brien gasoline-based formulæ for West Coast Naphtha are not the first gasoline-based formulæ proposed in the Quality Bank proceedings. *Id.* at p. 38. A comparison of the 1993 settlement's proposed VGO formula to actual prices for VGO is instructive, states BP, to understanding the problems with an ungoverned gasoline-based West Coast Naphtha formula. *Id.* It claims that Exhibit No. BPX-166 demonstrates that the 1993 formula did not track the values that OPIS ascribed to that market over time. *Id.* In fact, explains BP, it shows a marked difference between the differential between the calculated price and the OPIS price between the 1994-1998 period and the 1999-2001 period. *Id.* BP notes that, during the 1994-1998 period, before the gasoline price fluctuations, the formula performed relatively well with an average differential from the reported price of $1.26/barrel. *Id.* at pp. 38-39. The 1999-2001 period was far worse, BP points out, with an average differential of $3.33/barrel. *Id.* at p. 39. The OPIS-reported VGO price did not, according to BP, track the gasoline-based 1993 settlement formula price for VGO. *Id.* Moreover, according to BP, the formula settlement price for VGO was consistently high, which would have resulted in a considerable overvaluation of VGO. *Id.* Thus, BP concludes, a gasoline-based formula can depart from prices that would be seen in a transparent market. BP Reply Brief at p. 36. It maintains that the risk that an ungoverned gasoline-based formula will depart from prices present in a transparent market increases when the finished product upon which the formula is based enters an anomalous pricing period. *Id.*

2223. In a similar manner, BP argues, the values produced by a VGO regression formula analogous to Tallett's Naphtha regression formula further illustrate the dangers inherent in relying on an ungoverned gasoline-based formula. *Id.* It explains that the analogous VGO regression formula resulted in values that were significantly higher than the actual West Coast VGO prices. *Id.* For the 1994-2001 period, BP notes, the analogous VGO regression formula would have overvalued VGO on the West Coast by $2.736/barrel. *Id.* In 2001, they continue, the regression formula would have overvalued VGO by over $4.00/barrel. *Id.* In BP’s view, these examples cast further doubt on the ability to use ungoverned gasoline-based formula. *Id.*

2224. Further, BP notes, the O'Brien formula can produce a Naphtha price that would occasionally exceed the price of gasoline. *Id.* It asserts that this “nonsensical” result illustrates that, without a governor, a gasoline-based formula can result in values that are well above prices that would result in a transparent market. *Id.* According to BP, the O'Brien formula produces Naphtha prices that would have exceeded the corresponding gasoline prices for over an eight-month period spanning 2000 and 2001. *Id.* It points out that Phillips now claims that the value of Naphtha could exceed the value of gasoline under circumstances where the price of products made from Naphtha besides reformate skyrocket. *Id.* BP notes that, before it was known that O'Brien's own formula resulted in values for Naphtha that could exceed the price of gasoline, O'Brien criticized Stancil's Naphtha valuation formula for the fact that it could result in a Naphtha price that exceeded the price of gasoline. *Id.* at p. 37. The Ross governor, BP contends, would stop that kind of error from occurring. *Id.*

2225. BP explains that, according to Exxon, the Tallett formula allegedly includes an attenuating factor of approximately 30% jet fuel, touted as protection against gasoline price spikes. *Id.*; BP Initial Brief at p. 39. In reply, BP asserts that including jet fuel in the flawed formula does not check against price spikes in gasoline if (1) jet fuel has corresponding price spikes or (2) the price spikes in gasoline bias the total result. BP Reply Brief at p. 37. BP notes that the 1993 settlement also included what could be called an attenuating factor, 30% distillate; yet, during the 1999-2001 period, the formula price for VGO never would have fallen below the OPIS reported price. BP Initial Brief at p. 39.

2226. Record evidence, according to BP, indicates that the Tallett formula spiked along with gasoline prices from 1999-2001. BP Reply Brief at p. 37 (citing Exhibit Nos. EMT-395, EMT-433). Moreover, it notes that Exhibit No. EMT-417 reflects that the Tallett formula's generated values were not markedly different whether or not jet fuel was included as a component of the formula. *Id.* BP explains that the Naphtha values, when including jet fuel, were less than half a cent per gallon lower on average from 1999-2001. In some months, it claims, inclusion of jet fuel actually resulted in higher values. *Id.* at pp. 37-38 (citing Exhibit No. EMT-417 at p. 2). Thus, BP contends, the evidence suggests that the inclusion of jet fuel is not restraining the formula values from spiking along with gasoline when gasoline prices spike due to factors that would not have affected its intermediate components, like Naphtha. *Id.* at p. 38. Further, BP argues, it is difficult to predict whether the Tallett formula's inclusion of jet fuel would provide any protection against gasoline price spikes, when a similar inclusion of distillate in the 1993 VGO methodology would have failed to attenuate gasoline price spikes included in a gasoline-based formula to ensure appropriate valuation of VGO. BP Initial Brief at p. 39.

2227. Because the attenuation factor may not properly protect against price spikes, BP asserts, an appropriate question would be whether the Ross governor would provide the missing price spike protection. *Id.* It asserts that Ross's analysis showed that the governed approach would have performed better than the ungoverned settlement approach when compared to the actual reported West Coast VGO prices. *Id.* at p. 40 (citing Exhibit No. BPX-169 (a revision of Exhibit No. BPX-167)). BP asserts that Exhibit No. BPX-169 shows that the differential between the OPIS-reported price and the governed approach during the 1999-2001 period is closer than the differential between the OPIS reported price and the ungoverned approach. *Id.* In fact, notes BP, the ungoverned approach would have been 3.3¢/gallon too high for the 1999-2001 time period while the governed approach would have been only 0.72¢/gallon above the actual

VGO value during the same period. *Id.*

2228. Over the entire period, explains BP, the settlement minus the OPIS line would have been $2.04/barrel and the governed price minus the OPIS line would have been $1.15/barrel. *Id.* (citing Transcript at p. 9774). So, over the entire period, concludes BP, the governed, 1993 settlement price for VGO would have performed better than the ungoverned, 1993 settlement price for VGO when compared with the OPIS reported prices for West Coast VGO. *Id.*

2229. BP notes that the opponents of the Ross governor claim that it does not function properly in non-anomalous periods because it would have been active in 1994-1998 before the large gasoline price spikes in 1999-2001. BP Reply Brief at p. 46. These criticisms, according to BP, are based on the misunderstanding that the governor has only a single purpose – to eradicate effects of pricing anomalies. *Id.* Further, BP asserts, during a period without severe gasoline price spikes – such as the West Coast market in the 1990s before 1999 – the governor does no harm. BP Initial Brief at p. 41. Prior to 1999, explains BP, the governor was not essential due to a lack of noticeable gasoline price spikes. *Id.* In BP's view, however, having the governor in place to protect against the potential occurrence of price spikes would have been perfectly appropriate and certainly would have caused no negative impact on valuation. *Id.* It points out that using a governor is essential for periods that resemble the 1999-2001 period, but serves as insurance during periods that resemble the 1994-1998 period. *Id.*

2230. Suggestions that Ross indicated that it would have been inappropriate to apply the governor from 1994-1998 are, according to BP, mistaken. BP Reply Brief at p. 46. It states that Ross agreed that in the 1994-1998 period he would not have recommended a governor because he would not have seen anomalies that signaled the need, but he never departed from his belief that it would still be appropriate to apply the governor in periods that did not appear troublesome on their face. *Id.*

2231. According to BP, strong evidence in the record supports the view that a governor, when properly applied to a gasoline-based formula, more closely reproduces the prices which would be paid for Naphtha in a transparent market. BP Initial Brief at p. 43. It is BP's position that Ross's thesis, that the price of Naphtha would never exceed the price of Naphtha imports, is amply supported. *Id.* First, states BP, there is a continuous flow of Naphtha moving from Caribbean refineries in Venezuela, Trinidad, Aruba, and Curacao to the Gulf Coast. *Id.* BP explains that, as the quality of Naphtha from Venezuelan crude oil, which is widely used in Caribbean refineries, is suitable for reformers, the same Naphtha that is designated for use in petrochemical plants on the Gulf Coast is equally usable as reformer feedstock on the West Coast. *Id.* Second, asserts BP, only two to three import cargoes of Naphtha annually would be required to impact the Naphtha market price. *Id.* BP explains that this is because of the relatively small volume of Naphtha traded compared to the large volume used internally by refiners. *Id.* Third, states BP, there is sufficient port capacity on the West Coast to handle two or three imported cargoes per year. *Id.* Fourth, if the economics supported West Coast imports, then, according to BP, they would occur because traders in a transparent market have information available on their desktops when they are looking for opportunities to trade. *Id.* As a final, but not, states BP, the last example, there are substantial quantities of other gasoline feedstocks imported into the West Coast indicating that where arbitrage opportunities are present and identifiable, they will be exploited and regulate prices. *Id.* at pp. 43-44.

2232. Consequently, in a transparent market, BP argues that West Coast Naphtha prices should never exceed the cost of Naphtha imports for any extended period of time. *Id.* at p. 44. Therefore, it is BP's position that the attacks on the Ross governor are unfounded and unsupported by record evidence. *Id.*

2233. BP asserts that opponents of the Ross governor imply that the governor has changed due to "methodological soul searching" rather than as a logical progression to bring the formula to its most accurate representation of Naphtha prices in a transparent market. BP Reply Brief at p. 44. It argues that this implication is misguided. *Id.* According to BP, although some witnesses have ignored methodological flaws that needed correction, the record of this case is full of refinements and corrections. *Id.* For example, BP notes, O'Brien provided an alternative to his original proposal that includes a benzene saturation unit as a cost component of Naphtha production on the West Coast, and Tallett recognized that his formula may need to be updated if Naphtha market conditions change. *Id.* BP maintains that modifications to a formula do not indicate problems with the formula's underlying economic principles. *Id.* They contend that the modifications made by Ross serve to better ensure that the formula meets its underlying premise. *Id.*

2234. The governor, BP asserts, establishes the alternative cost for a refiner to import Naphtha into the West Coast, which acts as the ceiling component of the governor. BP Initial Brief at p. 44. It explains that the original formula established this imported value by calculating, on a monthly basis, the differential transportation costs to the West Coast and adding these to the value of Gulf Coast Naphtha. *Id.* Because there are no consistent, direct shipments of Naphtha to the West Coast, continues BP, the transportation cost has been calculated using the differential of the costs incurred in shipping Naphtha from a common location, Venezuela's Paraguana Refining Complex, to Houston on the Gulf Coast and Los Angeles on the West Coast. *Id.*

2235. Criticism of Ross, according to BP, for failing to use a Platts published shipping differential fails because: (1) the alternative use of the Platts shipping differential yields an insignificant difference; and (2) the use of the Platts shipping differential was non-viable in the 1994-1997 period. *Id.* at pp. 44-45. A comparison of the differential between the West Coast and Gulf Coast tanker rates demonstrates that, in BP's view, between 1994 through 1997, the Platts shipping differential data was unsound for at least two reasons. *Id.* at p. 45. First, notes BP, the differential between the Gulf Coast and West Coast rates was erratic; second, continues BP, the data during the time period was sporadic. *Id.* Consequently, BP claims that the Platts shipping differential from Venezuela to West Coast is inappropriate. *Id.*

2236. According to BP, the Platts shipping differential is not so substantially different from the shipping differential actually used by Ross as to make a significant impact on his governor nor would it have undercut the support for using his governor. *Id.* It points out that a comparison of the Ross governor using a methodology consistent with that presented in Exhibit No. BPX-72 with a governor derived using the Platts West Coast tanker rate for clean products[690] demonstrates the reasonableness of the Ross governor's transportation differential, the primary component of the ceiling. *Id.* (citing Exhibit No. BPX-148). From 1998 through 2001, when the data for Platts became more consistent and reliable, BP notes, the average difference between the Ross governor's original transportation differential, included in Exhibit No. BPX-72, and the differential using the Platts differential is only -4¢/barrel.[691] *Id.* at pp. 45-46 (citing Exhibit No. BPX-148 at p. 2).

2237. Nonetheless, BP declares, should the Commission decide that it would rather use a rate for the differential that varies over time, since 1997, "the relationship between the West Coast rates and Gulf Coast rates appears to have stabilized, and the Platts Caribbean to West Coast rate would appear on the face of it to have become more reliable." *Id.* (quoting Transcript at p. 9554). There are more data points reported from 1997 forward, BP points out, further supporting the viability of this reported price during the period beginning in 1997 forward. *Id.* Because the Platts rate is published weekly, BP states, it could be used if the Commission prefers to have the rate vary over time. *Id.* Moreover, continues BP, this Platts Caribbean to West Coast shipping rate is similar to other rates used in the Quality Bank. *Id.* Thus, rather than undercutting the Ross governor, BP claims, the analysis of the Platts shipping differential from Venezuela to the West Coast provides further support for the Ross calculations, thereby providing an alternative technique to vary the calculation over time if the Commission so desired. *Id.*

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[690] BP notes that, because Naphtha is a clean product, that rate was the appropriate rate to consider. BP Initial Brief at p. 45, n.10.

[691] BP explains that Platts is the only reporting service identified that publishes a price for this shipping differential; H.P. Drewry, another company that looks at shipping rates, does not. BP Initial Brief at p. 46. Thus, BP claims that the only source that provides such data indicates that the Ross governor's estimate of the shipping differential is completely reasonable and fails to cast any doubt that the importation costs are correctly calculated. *Id.*

2238. BP states that opponents of the Ross governor also criticize it by implying that it was inappropriate for Ross to use a rule of thumb for determining shipping costs through the Panama Canal. *Id.* at pp. 46-47. It claims that an examination of the criticism, however, reveals that what the opponents are actually challenging is whether Ross adequately validated his rule of thumb. *Id.* at p. 47. The critics in turn challenge the transportation rate included in Exhibit No. BPX-72, notes BP, as the Panama Canal charge is a component of the overall governor ceiling calculation. *Id.* In BP's view, the evidence does not support these challenges. *Id.*

2239. According to BP, Exhibit No. BPX-149 demonstrates the appropriateness of the Ross estimate of the Panama Canal charge, which is based on the charge published by Worldscale, a recognized and authoritative source of shipping information. *Id.* Using the Boyd Steamship Quick Reference Guide to Panama Canal Costs, continues BP, Ross compared his calculation to the charges that would apply under the Boyd's Quick Reference Guide approach. *Id.* The result, states BP, is that the difference between the two calculations is slight, with no meaningful impact on the ceiling component of the governor or on the value of Naphtha. *Id.*

2240. Although the Boyd's Quick Reference Guide provides support for Ross's Panama Canal charge, BP maintains, it remains appropriate to base the Panama Canal charge, included within the ceiling component of the governor, on the Worldscale. *Id.* BP notes that Ross explained that he had not had sufficient time to conduct due diligence on the Boyd's guide, saying he could not depend on Boyd's to continue to publish the required Panama Canal charges. *Id.* Consequently, based on industry knowledge, discussions with knowledgeable industry participants, and the support developed by use of the Boyd's Quick Reference Guide, BP asserts that the Ross governor's use of Panama Canal charges is appropriate. *Id.* at pp. 47-48.

2241. BP states that, as originally proposed, the Ross governor does not vary over time, but instead, is fixed at $1.488/barrel. *Id.* at p. 48. In Exhibit No. BPX-171 (which updates Exhibit No. BPX-151), notes BP, Ross provided an alternative approach to the governor that will vary over time as costs and prices change. *Id.* The formula contained in Exhibit No. BPX-171 is comparable to the one in Exhibit No. BPX-72, explains BP, but allows for a monthly calculation. *Id.* According to BP, the only difference is the use of a variable transportation differential. *Id.* Conceptually, states BP, the governor included in Exhibit No. BPX-171 is consistent with governor in Exhibit No. BPX-72. *Id.* The variable transportation differential captures changes in the Platts West Coast and Gulf Coast transportation rates on a monthly basis, notes BP, and captures the annual change in the Panama Canal charge. *Id.* at pp. 48-49. Thus, if the Commission determines that it is more appropriate to use a transportation differential that would float in time according to specific changes in cost components of transportation in the West and Gulf coasts, BP explains, Exhibit No. BPX-171 provides that option. *Id.* at p. 49.

2242. Rejecting criticism of Ross's choice of Venezuela as the starting point for the hypothetical Naphtha shipments to the West Coast for the purpose of calculating the transportation cost, BP states, Ross used the Caribbean price as the basis for his calculations because the Caribbean is likely to be the marginal source of supply to the West Coast. *Id.* It points out that, from time to time, there may be cargoes available from Ecuador or Alaska that might be less expensive, but states that "as these cargoes are inconsistent they could artificially suppress the price of naphtha." *Id.* Moreover, because of the Jones Act, BP states, cargoes can be shipped from the Caribbean less expensively than they can from the Gulf Coast. *Id.* Thus, BP concludes, the most likely source for Naphtha imports are cargoes redirected to the West Coast from the Caribbean. *Id.*

2243. Further, explains BP, Venezuela's Paraguana refinery is the largest refining center in the Caribbean, and therefore can be considered a surrogate for all possible shipment origins in the Caribbean. *Id.* Finally, maintains BP, had the Ross governor used another Caribbean starting point, the costs would have been nearly identical. *Id.*

2244. In BP's view, another misplaced concern raised at the Quality Bank hearing is whether barriers to entry on the West Coast would prevent Naphtha imports from entering the market and being able to restrain prices. *Id.* at p. 50. It notes that Exxon contends that the evidence does not support the premise that imports will check Naphtha prices and claims that there is no reliable evidence that Naphtha is imported to the West Coast sufficient to support the Ross governor. BP Reply Brief at p. 39. BP acknowledges that the Ross governor critics also claim that barriers to entry including tankage and terminal constraints, risks associated with lead time, lack of market liquidity making hedging risky, and costs to change crude slates to accommodate imports would prevent sufficient import quantities from checking West Coast Naphtha prices under the Ross governor theory. *Id.*

2245. In BP's view, this concern is misplaced and incorrect for a number of reasons: (1) the quantities of Naphtha required to move prices in the Naphtha market are not substantial in comparison to the quantities of imports that enter the West Coast each and every year; (2) were it economically attractive, the West Coast participants would find room within existing infrastructure for a few Naphtha imports; (3) even the danger of imports entering the market can restrain price increases in a transparent market; and (4) with the transparency provided by publicly available prices, the price of Naphtha would be held in check by the knowledge that raising prices beyond a certain level would invite imports, as arbitrage opportunities became economically attractive. BP Initial Brief at p. 50.

2246. BP points out that many of the arguments that barriers to entry would prevent Naphtha imports from entering the market were based on the Stillwater report, Exhibit No. EMT-385. *Id.* It argues that the Stillwater report did not conclude that barriers to entry exist in the West Coast which would keep Naphtha from being imported. *Id.*

Instead, notes BP, the report stated that clean products are being imported at a rate of approximately 250,000 barrels/day. *Id.* The Stillwater report, continues BP, did not indicate whether Naphtha imports could enter the market. *Id.* Further BP states, although the Stillwater report highlighted current and anticipated constraints on imports of products into the West Coast, Ross concluded, "there's a lot coming in, and my experience is that these things are generally not insurmountable problems." *Id.* at pp. 50-51 (quoting Transcript at p. 9617). While the constraints discussed in the Stillwater report may pose a challenge to supply managers, BP claims, managers can handle that challenge and can work increasingly well with constrained facilities when necessary to capture financially attractive opportunities. *Id.* at p. 51.

2247. According to BP, record evidence reflects that clean product moves from the Caribbean to the West Coast, specifically VGO[692] and jet fuel.[693] *Id.* (citing Transcript at pp. 9584-86). Further, it points out, evidence in the record shows there were eight importers of VGO and nineteen importers of jet fuel.[694] *Id.* (citing Transcript at p. 9591). Moreover, explains BP, Exhibit Nos. BPX-79, BPX-80, and BPX-147 reflect that gasoline and jet fuel imports continue to enter the West Coast. *Id.* Consequently, according to BP, Ross concluded, were there transparent price signals in the West Coast Naphtha market, Caribbean Naphtha imports would similarly flow into that market, just as they already do for gasoline, VGO, and jet fuel. *Id.* (citing Transcript at p. 9591). Logically, BP asserts, Naphtha could move from the Caribbean to the West Coast if it were economically attractive. *Id.* (citing Transcript at pp. 9583-84). Thus, BP concludes, because any barriers to entry have not prevented imports of VGO or jet fuel from entering the West Coast, there is no rational basis to conclude that they would prevent Naphtha imports. *Id.*

2248. In addition, there are already shipments of Naphtha that come into the West Coast from the Caribbean, notes BP, as demonstrated in Tallett's compilation of contracts, which was supplemented to include contract information about the source of origin and appears at Exhibit No. BPX-153. *Id.* at pp. 51-52. There were seventeen cargoes that have made it through the California port system between 1999-2001. *Id.* at p. 52. Thus, states BP, Naphtha imports are already entering the market. *Id.* If transparent prices were available, asserts BP, they would likely come in greater quantities, and they would be transacted at prices that more accurately reflect prices at equilibrium rather than prices that result from bilateral negotiations. *Id.* Although in a transparent market these Naphtha imports would have to compete with other imported blendstocks for space, BP

[692] BP cites Exhibit No. EMT-444. BP Initial Brief at p. 51.

[693] BP cites Exhibit No. EMT-450. BP Initial Brief at p. 51.

[694] BP cites Exhibit No. BPX-152. BP Initial Brief at p. 51.

maintains the market could accommodate them if they were needed. *Id.*

2249. Furthermore, BP states, there is no need to import a large quantity of Naphtha to have a significant impact on the West Coast market for traded Naphtha because that total quantity traded is quite small. *Id.* Exhibit Nos. BPX-154 and BPX-158 made this point, explains BP, showing that the market for Naphtha reflected in the contract analyses by Pulliam and Tallett is a very small percentage of the overall Naphtha volumes consumed on the West Coast on a given day. *Id.* As the total traded volume amounts to roughly 5,300 barrels/day under the Pulliam contract analysis and 8,700 barrels/day under the Tallett contract analysis, BP claims, imports that amounted to approximately 2,100 barrels/day, representing three additional cargoes, would have a significant impact on the traded Naphtha value. *Id.* (citing Exhibit Nos. BPX-158 at p. 2, BPX-154 at p. 2). BP points out that these 2,100 barrels/day would constitute roughly 40% of the traded Naphtha in Pulliam's contract analysis and roughly 25% of the traded Naphtha in Tallett's contract analysis. *Id.* That amount, which BP argues can be handled by existing infrastructure, it claims, would have a large impact on the traded Naphtha price on the West Coast. *Id.* at pp. 52-53.

2250. BP states that this theory is supported by Ross's industry experience. *Id.* at p. 53. It asserts that small changes in percentages of crude production can have significant impacts on the price of crude. *Id.* For example, explains BP, Venezuela was alleged to have exceeded its proper production of 3.5 million barrels/day in 1998 by roughly 770,000 barrels/day and it was claimed that this influenced prices. *Id.* (citing Exhibit No. BPX-156). According to BP, the estimated world production at the time was roughly 73 million barrels/day. *Id.* (citing Exhibit No. BPX-155). Thus, notes BP, a change of 770,000 barrels/day in comparison to the total market of 73 million barrels/day was significant enough to cause concern about impacts on crude oil prices. *Id.* It points out that Exhibit No. BPX-156 illustrated the significant impact on prices from these minor changes in total production for crude oil, substantially below the percentage change that would occur in the Naphtha market were the hypothetical equivalent of three cargoes of Naphtha to enter the West Coast. *Id.* Thus, states BP, small volume changes in the traded market for Naphtha, volumes that clearly could and would enter the market if the Naphtha market became transparent, would have significant price limiting effects on naphtha. *Id.*

2251. Finally, BP argues, imports need not actually enter the market to limit prices. *Id.* It suggests that basic economics supports this argument. *Id.* Should imported Naphtha become available in a visible and transparent way and should it be cheaper than the Naphtha that was available locally, BP insists, refiners would buy imported Naphtha rather than local Naphtha. *Id.* Further, states BP, should the existing suppliers not lower their prices, then companies would stop buying locally and would import instead. *Id.* This, according to BP, would have the effect of lowering local prices, which would, in turn, push out the imported supplies. *Id.* at pp. 53-54. Thus, concludes BP, the possibility of imports would serve to discipline the local suppliers because, if the local suppliers tried to raise their prices, "then they risk attracting imported supplies again, so the presence of imports or the threat of imports would apply some discipline to their pricing on the local market, whether or not those imports came in." *Id.* at p. 54 (citing Transcript at p. 9982). BP states that this straightforward analysis depends on the existence of a transparent market. *Id.* With an opaque market, explains BP, neither suppliers nor buyers can see the opportunity. *Id.*

2252. BP asserts that criticism that the Ross governor's ceiling does not account for a risk premium to attract cargoes from the Gulf Coast to the West Coast is unfounded and that it is appropriate that the governor does not included a risk premium. *Id.* In a transparent market, which the governor attempts to represent, BP explains, there would be no significant risk premium. *Id.* It notes that Ross explained:

> In a transparent market, companies importing or accessing naphtha would have a price series that they can analyze and use to predict future prices. They would have the ability to do quantitative analysis. They would be able to come up with mechanisms to mitigate their risk through the transparency of the market.

Id. (citing Transcript at p. 9668). Conversely, BP asserts, the price risk is a much greater concern in an opaque market than it is in a transparent market. *Id.* Consequently, as the Ross governor is attempting to simulate a transparent market and not an opaque market, BP maintains, accounting for a risk premium would be inappropriate. *Id.* at pp. 54-55. In addition, BP states, there is no objective way to measure a risk premium. *Id.* at p. 55. It points out that individual businesses have their own risk tolerance and attempting to identify a risk premium appropriate for all the different Naphtha suppliers which could provide imports would require guesswork. *Id.*

2253. Ross considered the criticism that the governor should not apply instantaneously, BP states, and determined, for at least three compelling reasons, that the governor should not have a time lag, but should be applied instantaneously. *Id.* First, notes BP, the single West Coast contract that Ross considers persuasive and which has a governor concept does not have use a time lag. *Id.* Second, it points out, Ross testified that

> the floor helps correct for sudden dips in the Gulf Coast price which may not be reflected instantly to the West Coast price. So if there's a sudden dip in the Gulf Coast price, the ceiling would dip on the West Coast, but the floor is there to protect the cost structure on the West Coast to reflect the fact that that wouldn't happen in reality. So I feel that the floor and the ceiling compliment each other to produce an equitable answer and deal at least in part with the issue of time lag and risk.

Id. (quoting Transcript at p. 9784). Third, BP reiterates, it is not necessary that there actually be imports for prices to be checked in a transparent market. *Id.* Thus, it argues, the effect of a lower available price would be instantaneous in a transparent market with published prices, because local suppliers would be aware of prices that would attract imports and cut into their market share. *Id.* at pp. 55-56. BP claims that the imports would arrive if the local suppliers did not check their prices sufficiently and quickly enough, but the effect of the imports on local prices would already have been felt. *Id.* at p. 56.

2254. Another criticism of the Ross governor noted by BP is the absence of a premium specifically to account for transit complications that may result in traversing the Panama Canal. *Id.* It explains that Ross considered this issue and determined that there was no need for such a risk premium even if it could be calculated. *Id.* In 1999-2000, BP claims, passage required 31 hours, but in 2001-2002 it required only 26 hours. *Id.* (citing Exhibit No. BPX-160). Further, states BP, the Panama Canal is undergoing a modernization program and, therefore, problems with the Panama Canal cited by proponents of a transit risk premium predate the recent improvement to the canal's efficiency. *Id.* BP's position is that the concerns that transit through the Panama Canal will meet with serious delays are unfounded and inapplicable to a formula operating in the modern time period with the Panama Canal constantly increasing its efficiency. *Id.*

2255. Additionally, BP explains, critics of the Ross governor claimed the finished and intermediate products do not exhibit discernible patterns in terms of their West Coast-to-Gulf Coast pricing differentials. *Id.* According to BP, they use this claim to attack Ross's theory that intermediate products and finished products behave differently in terms of pricing and logistic patterns. *Id.* at pp. 56-57. For example, continues BP, Exhibit Nos. PAI-175 and PAI-176 attempt to show that the prices for various products in the finished or intermediate categories do not follow the same pattern of pricing for other finished or intermediate products. *Id.* at p. 57. Further, states BP, the Ross critics emphasized MTBE as illustrating that the product differentials are not following a discernable pattern according to intermediate and finished product classifications. *Id.* BP explains that the critics argued that pricing patterns for MTBE fall more in line with finished products, although MTBE is a feedstock. *Id.*

2256. In BP's view, these criticisms are misplaced. *Id.* It maintains that MTBE is not an intermediate feedstock and has entirely different logistics that account for its product differential between the West and Gulf coasts being more in line with finished products. *Id.* According to BP, Ross explained that MTBE is properly classified as a "fine chemical" and not as a feedstock despite its use in producing gasoline. *Id.* It needs no further processing than Naphtha and VGO require, BP claims, and is directly blended into gasoline. *Id.* Moreover, notes BP, its logistics patterns are more in line with finished products, as illustrated in Exhibit No. BPX-162. *Id.* BP states that the gas liquids do not have the same logistics patterns as the liquid products because they do not ship regularly to the West Coast; it is thus meaningless, it continues, to compare them with the other liquid finished and intermediate products in terms of their differentials between the West and Gulf coasts. *Id.* (citing Exhibit No. BPX-162). When one considers the product differentials between the West and Gulf coasts on a proper basis (as BP asserts Exhibit No. BPX-162 does), BP claims, it becomes clear that finished products (including MTBE) and intermediate products have distinct logistics, devaluing the criticism of the Ross governor based on MTBE 's following finished product patterns rather than intermediate product shipping patterns. *Id.* at pp. 57-58.

2257. In addition, BP points out, the West Coast import infrastructure will get a reprieve from current MTBE imports when, by 2004, it is phased out of gasoline production. BP Reply Brief at p. 40. The phase-out of MTBE, BP claims, will free up import infrastructure for other clean products imports. *Id.* Because MTBE 's primary replacement will be ethanol, which, unlike MTBE, is not exclusively imported by marine, but also by rail car and truck, some additional infrastructure could be used for Naphtha imports were opportunities present and discernible in a transparent market. *Id.*

2258. Nonetheless, BP states, opponents of the Ross governor claim that even a finished product shipping differential still fails to explain why jet fuel, VGO, and conventional gasoline had periods where prices remained above the import price. *Id.* at p. 42. It states that they fail to consider three factors: (1) jet fuel is below the finished product import price the majority of the time and only remained above the import price for short periods of time when the jet fuel market was extremely heated;[695] (2) the conventional gasoline market in the West Coast is unique in that it must compete for components used in its production that are also needed for CARB gasoline; and (3) as imports cannot alleviate the CARB gasoline demand surges, CARB gasoline demand surges can force component prices upward not only for CARB gasoline, but also for conventional gasoline which forces the price of both above import parity for more extended periods of time.[696] *Id.*

2259. BP states that the 20¢/barrel adjustment to the transportation cost in Exhibit No. BPX-72 is supportable, despite what critics of the governor maintain. BP Initial Brief at p. 58. It explains that the 20¢ is added to the transportation cost derived using Gulf Coast freight rates in order to estimate the higher cost of chartering vessels to the less frequented West Coast market and accounts for a host of factors, including backhaul and inventory costs. *Id.* BP points out that the 20¢ was based on Ross's industry experience

[695] BP cites Exhibit No. BPX-67 at pp. 23-24 in support. BP Reply Brief at p. 42.

[696] BP cites Exhibit No. BPX-67 at pp. 24-25 in support. BP Reply Brief at p. 42. It further claims that there were only a few such incidents involving VGO which, it claims, were caused by several short lived incidents involving Cokers which reduced the VGO supply. *Id.* (citing Exhibit No. BPX-37).

and confirmed by a reliable contact in Venezuela. *Id.* (citing Transcript at p. 7966). Moreover, BP claims that it is unlikely that the 20¢ is inadequate, resulting in too low of a governor and undervaluing Naphtha. *Id.* It points out that Ross uses a 10% interest rate calculating the inventory cost component of the 20¢. *Id.* This interest rate is high in the current interest market, states BP, providing further support that the governor calculation under Exhibit No. BPX-72 would not result in undervalued Naphtha and provides an appropriate cap through its transportation cost.[697] *Id.* Finally, BP notes, any concern that this 20¢ differential is subjective should be assuaged by Exhibit No. BPX-171, which uses Platts rates for shipments to the West Coast along with providing for a formula that would float according to transportation costs component changes such as world freight rates. *Id.* at pp. 58-59.

2260. Responding to critics who state that the Ross governor's floor is not supportable as a cost base for suppliers of Naphtha with two arguments, first, BP states, Ross compared the differential between Gulf Coast Naphtha and West Texas Sour, a grade of Gulf Coast crude analogous to ANS. *Id.* at p. 59. Second, continues BP, he calculated the Naphtha-to-VGO differential on the Gulf Coast and combined that with the VGO-to-ANS differential on the West Coast to come up with what the Naphtha-to-ANS differential would have been on the West Coast if the same relationship had applied between VGO and Naphtha as on the Gulf Coast. *Id.* The results of these calculations are consistent with Ross's floor, according to BP, the price of ANS crude plus $4.00/barrel, and indicates that the floor is a reasonable means to represent what the supply side of the Naphtha market would be on the West Coast in a transparent market. *Id.*

2261. Both validations of the ANS + $4.00 floor are contained in Exhibit No. BPX-138, according to BP. *Id.* In addition, in Exhibit No. BPX-170, states BP, Ross performed a validation analogous to the differential between Gulf Coast Naphtha and West Texas Sour, using Isthmus crude, to illustrate that the same validation holds true for a crude that is made into Naphtha on the Gulf Coast. *Id.* at pp. 59-60. The result in Exhibit No. BPX-170 is, according to BP, comparable to the result in Exhibit No. BPX-138. *Id.* at p. 60.

2262. BP asserts that all three of these calculations (Exhibit Nos. BPX-138, BPX-170) support the ANS + $4.00 floor as a reasonable baseline for the supply side of naphtha. *Id.* It points out that the differentials shown in Exhibit No. BPX-138 range from $3.24/$4.06/barrel (1994-2001/1999-2001) to $3.57/$5.21/barrel (1994-2001/1999-

[697] BP points out that, in Exhibit BPX-171, the alternative governor, the interest rate is defined as the Commission monthly interest rate and will vary over time. BP Initial Brief at p. 58, n.11.

2001).[698] *Id.* These four numbers, BP claims, bracket the $4.00 figure. *Id.* Its position is that the validations plainly support the determination that the ANS + $4.00 figure is a reasonable number to use for the Naphtha price baseline in a transparent market. *Id.* at p. 61. BP explains that the ceiling and floor concept is meant to simulate a transparent market, where potential imports act as the ceiling and local manufacture acts as the floor. *Id.* (citing Transcript at pp. 7927-28).

2263. Acknowledging that critics question the appropriateness of the Ross governor because it allows the ANS + $4.00 floor to set the West Coast price when the Gulf Coast Naphtha price plus the transportation differential is lower than the floor, BP explains, the implication is that if Ross truly believes that the price of West Coast Naphtha should never exceed the cost of imports, the floor should never trump the cost of imports. *Id.* According to BP, this criticism is inconsequential. *Id.* First, explains BP, in any situation where the price of Gulf Coast Naphtha became low in relation to the crude oil of comparable quality to ANS on the Gulf Coast, inducing lower prices on the West Coast, the situation could not be sustained and thus would only last a short time. *Id.* Second, continues BP, the lower Gulf Coast Naphtha price would stimulate higher demand, and the price would bounce back up again in short order to crude parity, i.e., a value equal to, or greater than, crude ANS + $4.00. *Id.* at pp. 61-62. It asserts that it would be unfair to allow a temporary drop in Gulf Coast Naphtha prices to immediately affect the governor's simulation of a transparent market. *Id.* at p. 62. In that situation, BP argues, it is more equitable to allow the floor to set the price for what it believes would be a very short period of time. *Id.* To do otherwise, argues BP, would allow unsustainable dips in Gulf Coast Naphtha value to improperly depress West Coast Naphtha values. *Id.*

2264. BP asserts that further support for the ANS + $4.00 floor is found in a contract produced in this proceeding. *Id.* This contract had a governor mechanism that is more complicated than the version Ross uses, but, notes BP, its floor was explicitly listed as ANS + $4.00. *Id.* Ross then tested the floor to determine if the ANS + $4.00 baseline was reasonable, as discussed above, and, states BP, every validation calculation supported his reasonableness conclusion. *Id.* BP concedes that this is not proof for the validity of the ANS + $4.00 floor; however, they assert that it is support of the reasonableness of Ross's methods. *Id.*

2265. Conceding that the Ross governor's ceiling or floor as applied to the gasoline-based formula proposing by Tallett or the one proposed by O'Brien control roughly 80% of the time over the time period from 1994-2001, BP states that, while critics of the Ross governor emphasized that the governor would have controlled, rather than the base

[698] BP notes that the comparable validation using Isthmus instead of West Texas Sour provides similar results. BP Initial Brief at p. 60, n.12 (citing Exhibit BPX-170 at p. 3).

formula, more often during the 1994-1998 period, neither it nor Ross considers this problematic. *Id.* at p. 63 (citing Exhibit Nos. EMT-436 and EMT-437). According to BP, the frequency with which the Ross governor might control the Naphtha price on the West Coast fails to undercut the value of the governor; rather it emphasizes what BP sees as the inherent flaws in a gasoline-based formula. *Id.* It argues that the ungoverned gasoline-minus formulæ incorporate finished product margins and inappropriately attribute them to intermediate products. *Id.* Further, continues BP, the base formulæ fail to capture much of what would be going on in a transparent market. *Id.* In any period, BP claims that the base formulæ fail to provide an accurate representation of what the price of Naphtha would be in a transparent market. *Id.* BP's position is that the governor addresses those flaws. *Id.*

2266. BP states that the Ross governor opponents claim it is inconsistent with the way other Quality Bank cuts are valued. BP Reply Brief at p. 67. In addition, BP notes, the opponents claim that the Ross governor does not represent actual market conditions, but sets the Naphtha price regardless of what transpires in the West Coast Naphtha market. *Id.* It suggests that these arguments are baseless and that the Ross governor ensures that the price of Naphtha on the West Coast does not depart from values comparable to those for the other Quality Bank cuts formed in transparent markets. *Id.*

2267. The Ross governor does not set values, BP asserts, but attempts to constrain Naphtha values to those that would be found in a transparent market. *Id.* If the governor results in values that are not represented currently in the Naphtha transactions on the West Coast, BP declares, that it is because those contract values depart from values that would be present in a transparent market. *Id.* It claims that the governor's opponents fail to acknowledge the absence of a West Coast Naphtha market comparable to the markets for the other Quality Bank cuts. *Id.* at pp. 67-68. Consequently, BP maintains, the actual contracts which the governor opponents assert the Naphtha values should emulate are an inappropriate basis for setting the West Coast Naphtha value. *Id.* at p. 68.

2268. BP contends that the Ross governor opponents fail to acknowledge that it is their methodologies, not the Ross governor, which depart from the consistency standards required by the Circuit Court's *OXY* and *Exxon* decisions. *Id.* In this regard, BP notes, the Ross governor's opponents claim that their methodologies accurately represent market prices consistent with the Circuit Court's requirements. *Id.* BP insists that the Tallett and O'Brien methodologies are not market prices as their proponents believe. *Id.* Its position is that none of the formulæ represent true market prices. *Id.*

2269. Ross's governor, BP states, is designed to correct for flaws associated with each of the gasoline-based formulæ that Exxon's, Phillips's and Alaska's witnesses propose. BP Initial Brief at p. 64. It maintains that the use of a Gulf Coast reference price for valuing West Coast Naphtha no longer is appropriate. *Id.*

2270. According to BP, Exxon, Phillips, and Alaska make circular arguments justifying their proposals. BP Reply Brief at p. 68. Their logic is flawed, it claims, because they do not focus on the true goal which, in BP's view, is to find a method for valuing Naphtha that simulates a transparent market. *Id.* at p. 69. BP argues that, because of the fundamental differences between the Gulf Coast and West Coast markets, any analysis that uses Gulf Coast data in a formula meant to be used on the West Coast produces meaningless results. *Id.* at pp. 69-70. According to it, a formula that works on the Gulf Coast may not accurately predict values on the West Coast. *Id.* at p. 70.

2271. Exxon, BP asserts, challenged the idea that its formula will inflate the Naphtha value on the West Coast by failing to account for differences in the Gulf and West Coast markets. *Id.* BP further notes that Exxon claims there are no structural differences that prevent the use of its Gulf Coast derived formula on the West Coast, and suggests that this argument must be rejected as inconsistent with the testimony Exxon has given on why it is inappropriate to continue to use the Gulf Coast price for Naphtha to value West Coast Naphtha. *Id.* at pp. 70-71. Exxon, BP contends, cannot argue so tenaciously that differences in the markets make the Gulf Coast price for Naphtha unreliable and then dismiss fears that differences in the two coasts undermine the ability to rely on a formula that bases its calculations on transporting Gulf Coast dynamics to the West Coast. *Id.* at p. 71. Moreover, it asserts, Phillips also cannot argue consistently that the ability to predict Gulf Coast values validates a West Coast formula. *Id.* Consequently, BP suggests, a determination that Gulf Coast values plugged into either the O'Brien or Tallett formula match the Gulf Coast Naphtha prices provides no meaningful information about their ability to predict West Coast Naphtha prices formed under completely different market conditions. *Id.*

2272. BP believes that ANS + $4.00 is an appropriate floor, as used in the Ross governor, but does not believe that it is an appropriate method for valuing West Coast Naphtha on a stand-alone basis. BP Initial Brief at p. 64. It asserts that, because the Ross floor and ceiling were designed to work together, they will more accurately produce values that match prices that would be present in a transparent market for Naphtha on the West Coast when used in tandem. BP Reply Brief at p. 74. BP claims that use of the ANS + $4.00 formula only represents a single supply function and produces results inconsistent with those of a transparent market. *Id.*

2273. Furthermore, BP states that Exxon's bracketing proposal raised during the course of the hearing is not an appropriate method for valuing Naphtha on the West Coast. BP Initial Brief at p. 64. It points out that the relationship between the products selected may not be the same on both coasts. BP Reply Brief at p. 75. Fundamental differences exist in the Gulf Coast and West Coast markets which make this type of analysis inappropriate, BP declares. *Id.* Furthermore, it explains that there can be changes in one product or feedstock that are not related to the other products or feedstocks. *Id.* For that reason, BP states, the use of any bracketing formula will inappropriately attribute changes in other products to the value of Naphtha on the West Coast even when they are unrelated to the value of Naphtha. *Id.* Finally, BP points out, using the Exxon "bracket" formula gives over 80% weighting to the West Coast gasoline price that is corrupted by price spike anomalies in recent years that have nothing to do with the value of naphtha. *Id.*

2274. Also, BP states, it is not surprising, given that Exxon made this proposal, that the bracketing formula is very similar to the Tallett proposal. *Id.* It maintains that both the proposed Exxon bracketing technique and the Tallett formula are based on the faulty assumption that relationships that exist on the Gulf Coast can be transferred intact to the West Coast. *Id.* Theoretically, BP suggests, the Ross governor could correct the bracketing formula's deficiencies in the same manner that it corrects the deficiencies in the Tallett and O'Brien generated values. *Id.* at pp. 75-76. Thus, BP states, if the Commission determined that it wants to use the bracketing formula as the starting point for determining a West Coast Naphtha value, this value could then be subjected to the Ross governor to ensure that it produces values that would be found in a transparent market and comparable to the values used to value the other Quality Bank cuts. *Id.* at p. 76.

4. Petro Star

2275. Petro Star supports continued use of Gulf Coast pricing. Petro Star Initial Brief at p. 9. If, and only if, the Commission decides that the current methodology should be discontinued, then Petro Star supports Dudley's proposal as the best alternative available. *Id.* It suggests that Dudley's proposal contains fewer and less severe defects than either Tallett's or O'Brien's proposal. Petro Star Reply Brief at p. 14.

2276. Dudley's methodology, Petro Star explains, follows three basic steps: (1) it determines the price differentials between the Gulf Coast and the West Coast for VGO and LSR; (2) it determines the relative contributions of VGO and LSR to the ANS crude oil common stream; and (3) it applies the volume weighted LSR and VGO price differentials to the reported Gulf Coast Naphtha price to determine an imputed West Coast Naphtha price to be used by the Quality Bank.[699] Petro Star Initial Brief at p. 9.

2277. In Petro Star's view, Dudley's approach has two major strengths: (1) it uses current Gulf Coast Naphtha prices as a starting point; and (2) it avoids reliance on the West Coast finished gasoline market. *Id.* at p. 9-10. While suggesting that there is no perfect way to measure the market value of West Coast Naphtha when there is no such market, Petro Star, however, claims that the virtues of Dudley's proposal exceed those of

[699] If a new Gulf Coast Naphtha reference price is selected by the Commission (or the parties), Petro Star states, it would serve as the input to Dudley's methodology. Petro Star Initial Brief at p. 9, n.8.

the other proposed methodologies. *Id.* at p. 10.

2278. According to Petro Star, the purported need for a new methodology to value West Coast Naphtha arises from the belief that there are significant differences between the West Coast and the Gulf Coast Naphtha markets. Petro Star Reply Brief at p. 15. It states that Dudley explained that, if the Commission decides that a departure from Gulf Coast Naphtha pricing is necessary because the West Coast and Gulf Coast Naphtha markets are different, his methodology seeks to directly answer the question: How different are the markets? Petro Star Initial Brief at p. 10. According to Petro Star, Dudley's methodology uses data already available from the Quality Bank to quantify how differently the West and Gulf Coast markets value crude oil cuts that can be processed into, or used directly as, gasoline blendstocks. *Id.* It explains that VGO, LSR, and Naphtha itself are the only materials that meet Dudley's criteria, and that his methodology uses all of the available Quality Bank data pertaining to these three cuts. *Id.* Petro Star notes that undisputed LSR and VGO Quality Bank reference prices are available for both the Gulf and West Coasts,[700] and an increasing selection of Naphtha prices are available from the Gulf Coast. *Id.*

2279. Like Naphtha, explains Petro Star, LSR and VGO are intermediate products derived from crude oil, are refined on both coasts, and are used to manufacture gasoline blendstocks. *Id.* at p. 11. According to Petro Star, these fundamental similarities mean that the West Coast value of Naphtha will have the same general relationship to the Gulf Coast value that West Coast LSR and VGO values have to their Gulf Coast Values. *Id.* It states that several factors cause this relationship to be imperfect, but claims that the assumptions involved in the Dudley methodology are fewer, more straightforward, and more likely to be valid than those embodied in either Tallett's or O'Brien's proposed methodologies. *Id.*

2280. Petro Star states that the fundamental assumption that Dudley makes is that West Coast and Gulf Coast prices of Naphtha, LSR, and VGO will behave similarly, but not identically, over time. *Id.* It argues that, as either VGO or LSR differentials are very unlikely to exactly duplicate Naphtha differentials, or each other, both should be used. *Id.* Under Dudley's approach, notes Petro Star, the VGO differential provides a good approximation of the Naphtha differential, and the LSR differential provides additional relevant data. *Id.*

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[700] According to Petro Star, all parties agree that the Gulf Coast reference price for VGO should be replaced by the West Coast price. Petro Star Initial Brief at p. 10, n.9. Moreover, Petro Star points out that the parties have stipulated that the West Coast VGO price should have the same effective date as any new West Coast Naphtha value adopted by the Commission. *Id.*

2281. Basic to Dudley's proposal, explains Petro Star, is that LSR and VGO are supplied from similar sources and end up in similar products on both Coasts. *Id.* Petro Star points out that, of the nine Quality Bank cuts, only LSR and VGO share these fundamental similarities to Naphtha. *Id.* at p. 11-12. It lists Dudley's explanation for why he excluded the remaining non-Resid Quality Bank cuts:[701]

- Propane is not included because it is irrelevant to gasoline blending economics.

- Isobutane is not included because it typically comprises less than 1% of ANS crude oil. It is provided almost exclusively from sources outside the refinery.[702]

- Normal Butane is not included because it is also supplied principally by gas plants and is not a major constituent of gasoline pools.

- Light Distillate is not included because it is made directly into jet fuel and plays no part in gasoline manufacture.

- Heavy Distillate is not included because it is made directly into finished products and plays no part in the gasoline manufacture.

Id. at p. 12.

2282. Petro Star also notes that Dudley explained that he would not agree with including two proposed non-Quality Bank candidates for his methodology, MTBE and low sulfur VGO, because MTBE was a manufactured component traded in merchant markets, and low sulfur VGO already was represented by the Quality Bank VGO cut. *Id.* In short, asserts Petro Star, VGO and LSR are the only realistic indicators for Naphtha. *Id.*

2283. Generally, explains Petro Star, Quality Bank cuts other than LSR and VGO also are used in gasoline blending (normal butane) or as feedstocks (Isobutane, to alkylation units), but they differ from LSR, Naphtha, and VGO in that they are present in crude oil in very small quantities and typically are purchased by refineries rather than refined from crude oil. Petro Star Reply Brief at pp. 15-16. It states that Dudley's approach tweaks the current methodology by departing as little as possible from the well-established Gulf Coast price, but it departs enough to address concerns that West Coast markets for

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[701] Petro Star notes that no party has asserted that Dudley should have included Resid in his methodology, and counsel did not question him about Resid. Petro Star Initial Brief at p. 12, n.10.

[702] In addition, according to Petro Star, Isobutane is in very tight supply on the West Coast. Petro Star Initial Brief at p. 12, n.11.

intermediate products are different from Gulf Coast markets. *Id.* at p. 16.

2284. On both the Gulf and West Coasts, according to Petro Star, VGO and Naphtha have similar uses. Petro Star Initial Brief at p. 12. It explains that Naphtha is used primarily as feed for catalytic reformers which produce reformate, a gasoline blendstock, as their primary products. *Id.* at p. 12-13. Further, states Petro Star, VGO is used primarily as feed to cat crackers which produce FCC gasoline and alkylate precursors which end up in gasoline as well as Heavy Distillates. *Id.* at p. 13. Petro Star asserts that the extensive conflicting evidence on the issue of whether and to what extent VGO is processed differently on the Gulf and West Coasts does not undermine Dudley's proposed methodology. *Id.* At most, according to Petro Star, this evidence demonstrates that VGO undergoes more extensive processing on the West Coast than on the Gulf Coast, particularly in connection with the manufacture of CARB gasoline. *Id.* This fact, according to Petro Star, presumably would tend to lower VGO's value to West Coast refiners, except that CARB gasoline is a very high priced product, and that fact presumably would raise its value to West Coast refiners. *Id.* Nevertheless, Petro Star argues that these issues concerning VGO processing do not detract from the premise that VGO use generally is similar on the two Coasts, and that, as a general matter, it is reasonable that the VGO differential can be used to help predict the Naphtha differential. *Id.*

2285. LSR has a relatively high Reid Vapor Pressure and consequently, points out Petro Star, the quantities of LSR that can be blended into summer gasoline on the West Coast is constrained. *Id.* It consistently has been priced lower on the West Coast than the Gulf Coast, Petro Star claims, and this fact appears to be attributable primarily to vapor pressure, although petrochemical demand for LSR on the Gulf Coast (which is virtually nonexistent on the West Coast) may contribute as well.[703] *Id.* at pp. 13-14. Petrochemical demand is relevant, states Petro Star, because Naphtha is used by the Gulf Coast petrochemical industry as feed for catalytic reformers used to produce aromatics, but there is no corresponding demand on the West Coast. *Id.* at p. 14. Similarly, continues Petro Star, at least in the production of CARB gasoline, both Naphtha and LSR can provide feed to C_5/C_6 isomerization units and be processed into higher octane material that can be used in the gasoline pool. *Id.*

2286. In light of the above factors, Petro Star argues, LSR differentials are almost certainly more different from Naphtha differentials than are VGO differentials. *Id.* Nevertheless, it suggests, the relationship between LSR and Naphtha is similar in many ways on the Gulf and West Coasts, and LSR provides valuable additional data relevant to

[703] In addition, notes Petro Star, in blending CARB gasoline, the ability to blend more Normal Butane and LSR in the winter season allows more heavy components to be blended as well. *Id.* at p. 14, n.12.

probable Naphtha differentials. *Id.* at pp. 14-15.

2287. Petro Star notes that Dudley's methodology does not give equal weight to the VGO and LSR differentials when the Naphtha differentials are calculated. *Id.* at p. 15. Rather, according to Petro Star, they are weighted according to their relative percentages in ANS crude at Valdez. *Id.* It explains that Dudley rejected a 50/50 weighting because, the LSR differential is likely to be more different from the Naphtha differential than is the VGO differential. *Id.* Dudley's weighting, states Petro Star, directly reflects the relative contributions of VGO and LSR to the TAPS stream. *Id.* It notes that Dudley's method favors VGO over LSR by approximately 4:1 and is nearly a constant.[704] *Id.* The heavier weighting afforded VGO reflects the ratio of VGO and LSR that can be derived from ANS crude oil, and is a virtue, according to Petro Star, because of VGO's position as the "strongest indicator of gasoline economics." *Id.*

2288. Petro Star notes that Dudley readily acknowledged that the detailed economics of LSR and VGO and Naphtha are different, and that LSR and VGO usage have different economics on the Gulf and West Coast. Petro Star Reply Brief at p. 17. They are not sufficient, in Petro Star's view, to reject Dudley's proposal or to select either Tallett's or O'Brien's instead. *Id.* Rather, explains Petro Star, there are differences in the precise economics governing the three cuts which are the foundation of Dudley's proposal. *Id.* These differences do not, according to Petro Star, detract from Dudley's basic starting point that LSR, Naphtha, and VGO are all used as feedstocks in process units that produce gasoline blendstocks on both coasts. *Id.* It points out that Dudley is, after all, trying to estimate how different Naphtha prices would be based on the differentials between LSR and VGO prices. *Id.* Moreover, states Petro Star, the differences in use between coasts are differences of degree. *Id.*

2289. According to Petro Star, the West Coast/Gulf Coast differentials for LSR comprise one set of data that can be used to estimate what the Naphtha differential is likely to be. *Id.* The differentials for VGO comprise another set of data, continues Petro Star, and provide another estimate. *Id.* Because they are different, Petro Star states, it is necessary to average the two estimates in order to bring both sets of data to bear on the question.

[704] Petro Star acknowledges that month-by-month adjustment of the weighting factor is unlikely to make Dudley's methodology more accurate and believes that this weighting factor could be adjusted at longer intervals. *Id.* at p. 15, n.13. It notes that Exxon also complains that, because the weighting factor would be calculated at Valdez (i.e., downstream of the Williams and the Petro Star refineries), the refineries could "influence the amount of VGO and LSR in the steam and thereby impact the Quality Bank value of Naphtha on the West Coast." Petro Star Reply Brief at p. 20, n.8 (quoting Exxon Initial Brief at p. 315). However, states Petro Star, the composition of ANS crude at Valdez reflects the concentrations of LSR and VGO as the crude is sold in the market. *Id.*

Id. at pp. 17-18. It argues that more data are better. *Id.* at p. 18. For the same reason, asserts Petro Star, Exxon's argument that LSR and VGO prices don't correlate as well on the West Coast as on the Gulf Coast is not persuasive. *Id.* at n.7. Petro Star claims that Dudley didn't contend that the relationship among VGO, Naphtha, and LSR values was the same on both coasts. *Id.* According to Petro Star, his proposal instead rests on the assumption that differences in LSR and VGO prices between the coasts are the best indicators of what differences in Naphtha prices are likely to be. *Id.*

2290. Petro Star maintains that to require that LSR and VGO economics be precisely identical on the West and Gulf Coasts would set an impossible standard for Dudley's methodology, while allowing Tallett to assume that the relationships among Naphtha, gasoline, and jet fuel are identical on the two coasts despite demonstrably different markets, or O'Brien to assume (in the face of the contrary evidence) that the use of Naphtha in the manufacture of his "three component blend" is representative of the use of Naphtha generally on the West Coast. *Id.* at p. 18. Petro Star's position is that, while Dudley's methodology is not perfect, it is better than the alternatives proposed by Tallett or O'Brien. *Id.*

2291. Exxon's complaint that Dudley used LSR and VGO despite the fact that their prices are below Naphtha's is, Petro Star claims, irrelevant. *Id.* It points out that Dudley's proposal relies on the weighted average inter-coast differentials of LSR and VGO prices, and does not depend on the relationship among the absolute prices of the cuts. *Id.* In Petro Star's view, the fact that LSR, Naphtha, and VGO prices can vary independently also does not detract from the logic that underlies Dudley's approach. *Id.* at p. 19. Under his proposal, explains Petro Star, the LSR differential is one piece of evidence and the VGO differential is another. *Id.* By averaging them, states Petro Star, the proposal lessens the impact that will occur if one or the other cut is influenced by factors that do not affect intermediate gasoline feedstocks generally. *Id.*

2292. In Petro Star's view, Phillips errs in arguing that Dudley's proposal relies on an unsupported assumption that the West Coast/Gulf Coast Naphtha differential is less than the VGO differential. *Id.* According to it, Dudley made no such assumption. *Id.* As a matter of arithmetic, Petro Star points out that, because his methodology averages the LSR and VGO differentials to calculate the Naphtha differential, the Naphtha differential will fall between the other two. *Id.* Therefore, continues Petro Star, if LSR differentials are lower than the VGO differentials, calculated Naphtha differentials will be lower than VGO differentials because that's what the data indicate, not because Dudley assumed they would. *Id.* Petro Star asserts, Naphtha differentials are very likely to fall between LSR and VGO differentials. *Id.* It explains that this is because LSR is impacted by Reid Vapor Pressure and other constraints that decrease its value on the West Coast relative to the Gulf Coast, while VGO's importance to CARB gasoline manufacture have made it become more valuable on the West Coast than the Gulf Coast. *Id.* Consequently, states Petro Star, Sanderson's opinion is that the Naphtha differential is very likely to fall between the LSR and VGO differentials. *Id.* at pp. 19-20.

2293. Exxon argues that Dudley's approach should have been able to predict price relationships among Normal Butane and Isobutane, LSR, and VGO, notes Petro Star. *Id.* at p. 20. In fact, asserts Petro Star, the failure of Dudley's proposal to pass Exxon's test simply reflects the fact that the logic he used in selecting cuts did not extend to the butanes. *Id.* Petro Star points out that the butanes are typically purchased from gas plants rather than refined from crude oil, and isobutane in particular is both very high valued and in very short supply on the West Coast. *Id.* It explains that Dudley's proposal is designed to value Naphtha by considering the available data from two cuts that are, like Naphtha, produced from crude oil and used by refiners in gasoline manufacture. *Id.* at p. 21.

2294. Moreover, Petro Star notes, Dudley's critics assert that his proposal is weak because it does not incorporate finished gasoline prices. *Id.* Far from ignoring the products from which 90% or more of West Coast Naphtha derives its value, Petro Star argues, Dudley sought out cuts for his methodology that are similar to Naphtha in their character as feedstocks to process units that produce gasoline components. *Id.* It acknowledges that Dudley does indeed avoid reliance on West Coast gasoline finished product prices, but it maintains that this is a strength, not a weakness, of his proposal. *Id.*

2295. Petro Star argues that Tallett's and O'Brien's methodologies both depend entirely on assumed relationships between finished gasoline prices and West Coast Naphtha values. *Id.* at pp. 21-22. It explains that, as discussed below, Tallett's methodology assumes that the relationship between Naphtha and finished gasoline prices is the same on the West Coast as on the Gulf Coast. *Id.* at p. 22. Similarly, states Petro Star, O'Brien's methodology assumes that his formula precisely captures the gasoline-Naphtha relationship. *Id.* However, it notes, West Coast gasoline markets are more concentrated than Gulf Coast markets and higher gasoline prices and profits flow through to the refineries. *Id.* Moreover, continues Petro Star, West Coast Naphtha typically is refined and used internally by the refiners that produce it. *Id.* Therefore, Petro Star's view is that Tallett's and O'Brien's assumptions are precarious. *Id.* It argues that Dudley's proposal avoids this problem by the simple expedient of looking to other intermediate products with similar uses to determine what the value of West Coast Naphtha is likely to be. *Id.*

2296. For Petro Star, the core question is whether the Naphtha valuation methodology should cause the Naphtha valuation to skyrocket whenever West Coast finished gasoline prices do. Petro Star Initial Brief at pp. 15-16. The Phillips and Exxon sponsored methodologies appear to differ in approach but, according to Petro Star, share one crucial characteristic: they both result in West Coast Naphtha valuations that would closely track West Coast finished gasoline prices no matter how wildly those prices fluctuate. *Id.* at p. 16. Petro Star claims that Tallett's proposal does this because his methodology relies on the relatively steady relationship between Gulf Coast gasoline and jet fuel prices and

Naphtha prices to determine West Coast relationships that are similarly close, and that O'Brien's proposal largely tracks gasoline prices wherever they go. *Id.* While Ross's governor would mitigate these methodologies, Petro Star explains, it nevertheless would still allow consistent overvaluation during periods in which the governor is not in effect. *Id.*

2297. Tallett calculates a regression formula that expresses the relationship of Gulf Coast Naphtha prices to Gulf Coast waterborne conventional unleaded regular gasoline and Gulf Coast waterborne jet fuel prices, explains Petro Star. *Id.* at pp. 16-17. While Petro Star agrees that the logic that underlies this formula is straightforward, Petro Star declares that it is not compelling. *Id.* at p. 17. It points out that the methodology assumes that the relationships are the same on both coasts, and that it, therefore, is appropriate to use the same formula on both coasts. *Id.* However, Petro Star claims that Tallett testified that, if the relationships among the three variables were to change over a period of time, then the regression formula would change. *Id.* By the same token, continues Petro Star, if the relationships among the three variables are different on the West Coast than on the Gulf Coast, Tallett's Gulf Coast formula would not accurately describe the West Coast. *Id.* Further, Petro Star notes, Tallett admitted that the relationship between jet fuel and unleaded regular gasoline was not the same on the West Coast as on the Gulf Coast and that the discrepancy had increased after the introduction of CARB gasoline in 1996. *Id.*

2298. In fact, asserts Petro Star, the evidence suggests that it would be highly unlikely for the same relationship to apply on both coasts. Petro Star Reply Brief at p. 24. According to Petro Star, the factors that Exxon enumerates have only the most general or tangential connections to the supply and demand factors that influence price. *Id.* Indeed, Petro Star asserts that, although he carefully explained his methodology in terms of a portion of the refinery flow diagram, which is similar on the two coasts, Tallett selected inputs for his methodology (finished gasoline and jet fuel prices) that strongly diverge because of very different market conditions. *Id.* Thus, explains Petro Star, gasoline manufacture is the predominant use of Naphtha on both coasts, but the two coasts have very different gasoline markets and the same is true for jet fuel. *Id.* Similarly, Petro Star states, refiners can change their Naphtha/Light Distillate cut points on both coasts to vary the amounts of Naphtha that they make into gasoline or jet fuel, but they base their decisions to do so on the different gasoline and jet fuel market conditions on the two coasts. *Id.*

2299. Petro Star declares that the close correlation on the Gulf Coast between gasoline and jet fuel prices on the one hand and Naphtha prices on the other does not provide any evidence that the same correlation exists on the West Coast. *Id.* at p. 25. At most, according to Petro Star, this factor might support an inference that Naphtha values on the West Coast might be correlated with gasoline and jet fuel prices. *Id.* In Petro Star's view, the profound differences in the gasoline markets on the two coasts, and the lesser differences in the jet fuel markets, however, indicate that, even if such a correlation exists on the West Coast, it almost certainly is different from the correlation observed on the Gulf Coast. *Id.*

2300. According to Petro Star, Tallett offers two principal arguments in support of his methodology: (1) the general process relationships among jet fuel, unleaded regular gasoline, and Naphtha are similar on the West and Gulf Coasts; and (2) that O'Brien's analysis is also consistent with the methodology. Petro Star Initial Brief at p. 18. Petro Star asserts that the first of these arguments rests on Tallett's key assumption that if the process is similar, the economics are similar. *Id.* The key economics to be considered are, according to Petro Star, the relative prices of Naphtha, unleaded regular gasoline, and jet fuel. *Id.* By focusing too narrowly on the similarities within the Naphtha portion of the refining process, Petro Star claims, Tallett neglects the very important questions of how these commodities are obtained and where and how they are sold. *Id.* According to it, the answers to these latter questions frequently are different for the Gulf and West Coast. *Id.* These differences make it unlikely, in Petro Star's view, that simply because West Coast process can be similar to Gulf Coast process, West Coast economics are similar to Gulf Coast economics. *Id.*

2301. On cross-examination, notes Petro Star, Sanderson testified to the many differences between the West Coast and Gulf Coast gasoline markets, such as different supply and demand, and different, and increasingly more stringent, environmental regulations. *Id.* at p. 19. It states that West Coast environmental regulations may make it more difficult to build or expand refineries, and West Coast refineries can't easily expand to meet increasing demand. *Id.* According to Petro Star, the combination of restricted refining capacity, inadequate logistics infrastructure, and commercial barriers have made the California gasoline market increasingly unstable, so that even small supply disruptions cause major price upswings. *Id.*

2302. In contrast, Petro Star points out that, on the Gulf Coast, there is a larger refining base, sometimes different processing configurations, and sometimes a greater ability than on the West Coast to absorb refinery upsets when they occur. *Id.* Under normal circumstances, it states, the Gulf Coast gasoline market is less volatile than the West Coast. *Id.* Finally, Petro Star notes, the Gulf Coast supplies large markets in the Midwest and Northeast. *Id.*

2303. Petro Star states that Tallett's methodology assumes that none of these factors will cause a different relationship to exist between Naphtha and unleaded regular gasoline on the West Coast than exists on the Gulf Coast. *Id.* at pp. 19-20. Instead, explains Petro Star, Tallett assumes that the relationship on the West Coast will be the same as on the Gulf Coast. *Id.* at p. 20.

2304. It would, in fact, Petro Star argues, be an astounding coincidence if, despite all these differences, the relationships among Naphtha, unleaded regular gasoline, and jet fuel prices were the same. *Id.* It states that Tallett relies principally on the similarities between his results and O'Brien's to support his methodology. *Id.* Nevertheless, points out Petro Star, he acknowledged in his prepared testimony that a refiner with enough Naphtha in its crude supply is not going to purchase any Naphtha, and that only when a refiner is short of Naphtha would he expect it to pay prices approximating the cost of processing deducted from gasoline and jet fuel prices. *Id.*

2305. Petro Star states that Tallett's methodology relies on a regression formula calculated using ten years's data from the Gulf Coast. *Id.* It explains that, even were it assumed that the regression formula would apply on the West Coast, the formula would be used to calculate current values based on the historical relationship among unleaded regular gasoline, Naphtha and jet fuel prices. *Id.* This would, notes Petro Star, put West Coast Naphtha valuation on a different footing than all of the other Quality Bank cuts, which rely on current pricing. *Id.* Nor, according to Petro Star, do those reference prices that contain fixed processing cost adjustments, like that for Light Distillate, provide any support for Tallett's approach. *Id.* at pp. 20-21. Petro Star explains that the Light Distillate processing cost adjustment was calculated for 1996 but is adjusted using Nelson Farrar indices each year. *Id.* at p. 21. Further, states Petro Star, it is true that a new processing cost is not calculated from scratch each year, but current Nelson Farrar indices are used, so that the end result for any given year is an estimate of what the cost is in that year, not during the average of the past ten years. *Id.*

2306. This discordance between Naphtha valuation and the valuations of other cuts could be especially difficult for the refiners, declares Petro Star. *Id.* It explains that refiners continuously make optimization decisions that include whether or not fuels can be sold at a profit, and that it does not help refiners that Naphtha prices will average out over time. *Id.* If the current Quality Bank valuation is unduly high because it reflects historical data, Petro Star asserts, this may make some sales unprofitable and cause the refiner to cut back production. *Id.* The refiner will not necessarily be able to make up those lost profits when the valuation in turn becomes unduly low, Petro Star points out, because market conditions may have changed or the refinery may already be operating at its full capacity. *Id.*

2307. Finally, Petro Star claims, periodically updating the regression formula would ameliorate, but not solve, this problem. *Id.* In 2007, Petro Star states it would definitely be preferable to base valuations on 1997 through 2006 data than on 1992 through 2001 data, but 2007 data would be better still. *Id.*

2308. Petro Star points out that Exxon's argument that O'Brien's methodology validates Tallett's necessarily rests entirely on the validity of O'Brien's analysis. Petro Star Reply Brief at p. 26. It concurs with Williams and Unocal/OXY that O'Brien's methodology is fatally flawed, and asserts that this alone is enough to reject it as validation of Tallett's methodology. *Id.* It states that Tallett's methodology, like O'Brien's, erroneously attributes to Naphtha a great part of the profits to be made by making gasoline on the West Coast. *Id.* Because Tallett's and O'Brien's methodologies share this fundamental shortcoming, Petro Star notes that it is no surprise that they generate Naphtha values that roughly correspond. *Id.*

2309. Exxon argues, according to Petro Star, that Exhibit No. PAI-147, which demonstrates that O'Brien's methodology may be able to predict Gulf Coast Naphtha prices, also confirms that Tallett's approach is sound. *Id.* at p. 27. In fact, argues Petro Star, Exhibit No. PAI-147 conclusively demonstrates that both Tallett's and O'Brien's proposals are fatally flawed, because they reflect the Gulf Coast relationship between gasoline prices and Naphtha values. *Id.* Because under both proposals Naphtha values are very strongly linked to gasoline values, if the proposals accurately describe the Gulf Coast relationship, Petro Star asserts, they cannot describe the West Coast relationship unless conditions on the two coasts are the same. *Id.* Petro Star maintains that they are not. *Id.*

2310. O'Brien proposes, according to Petro Star, to value West Coast Naphtha by: (1) calculating the product yield when Naphtha is processed through a catalytic reformer; (2) determining the value of that product yield; (3) determining the processing costs involved; and (4) subtracting those processing costs from the value of the product yield. Petro Star Initial Brief at p. 22. To perform these calculations, Petro Star explains, he assumes a three component blend, in which the only constituents used in making unleaded regular gasoline are reformate, LSR, and Normal Butane. *Id.*

2311. Petro Star points out that, to approve O'Brien's methodology, it would be necessary to accept (1) his conclusions that the "Three Component Blend" is legal gasoline that can be sold on the West Coast, and (2) the implicit assumption that the economics of processing Naphtha into a "Three Component Blend" fairly represent the economics of processing Naphtha on the West Coast. *Id.* Given the many assumptions that go into the model itself, Petro Star considers it highly unlikely that these conditions could be met. *Id.*

2312. Ross's proposed governor, Petro Star submits, is a common sense approach that would improve the gasoline-based methodologies proposed by Tallett and O'Brien, although it would not completely control overvaluations under either the Tallett or the O'Brien methodology. *Id.* at p. 23. Petro Star explains that, under Ross's ceiling proposal, if there was a transparent Naphtha market on the West Coast, and if refiners needed Naphtha, they would import Naphtha if it were cheaper to import it than to buy Naphtha locally. *Id.*

2313. Petro Star suggests that the concept of the floor to be more problematic. *Id.* It explains that the $4.00 figure is derived from a large volume Naphtha term contract with carefully negotiated pricing provisions and validated by Ross's analysis of crude oil and intermediate product differentials on the Gulf and West coasts. *Id.* According to Petro Star, Ross concluded that the $4.00 average represents the value local suppliers would expect to get for their Naphtha and is, therefore, appropriate to use as a floor for valuing Naphtha. *Id.*

2314. As a refiner, Petro Star states it would like to have its product prices subject to a floor. *Id.* It asserts that it is by no means certain that a Naphtha refiner on the West Coast can find a buyer at a good price. *Id.* In other words, explains Petro Star, even though the $4.00 floor fairly represents the price the refiner might expect, market conditions might preclude it from actually getting that price. *Id.* at p. 23-24. Based on its own experience, Petro Star argues, it has more confidence that imports will hold prices down than production costs will hold prices up. *Id.* at p. 24.

2315. Although ANS + $4.00 is problematic when used as a floor in the Ross methodology, Petro Star states, ANS + $4.00 holds promise as a stand-alone Naphtha valuation method. *Id.* It explains that the term is derived from a sophisticated Naphtha contract and represents the cost (including margin) of refining crude oil into Naphtha. *Id.* Because the lowest cost source of Naphtha to a refiner typically will be to produce it from crude oil itself, and because almost all of the Naphtha used on the West Coast is produced from crude oil by the end-user, Petro states that this measure would be much more representative of the great majority of West Coast Naphtha. *Id.*

2316. Petro Star does not favor valuing West Coast Naphtha by interpolating a value from other prices. *Id.* It agrees with Dudley's explanation of why VGO and LSR are appropriate Quality Bank cuts and why other Quality Bank cuts, as well as non-Quality Bank cuts like MTBE, are not. *Id.* Choosing different products for a similar methodology would be difficult, states Petro Star *Id.* It points out that selecting products by price rather than by functional relationship would make results depend very much on which products were chosen, and such selection would be problematic if the prices of the products chosen turned out to be volatile. *Id.* at pp. 24-25. Moreover, to the extent that finished products were selected, Petro Star asserts, the methodology could commit the error of assuming without support that differentials between finished product prices and intermediate product prices are the same on the West Coast as on the Gulf Coast. *Id.* at p. 25.

2317. According to Petro Star, Exxon suggests that it would be a viable methodology to extrapolate the price relationships of crude oil, finished gasoline, and Naphtha on the Gulf Coast to calculate West Coast Naphtha values based on West Coast crude oil and finished gasoline prices. Petro Star Reply Brief at p. 27. Petro Star notes that Exxon asserts that this approach confirms that Exxon's valuation method is reasonable. *Id.* It states that, in fact, this approach shares the fundamental flaw of Tallett's proposal: it assumes that the relatively low profits that gasoline refiners on the Gulf Coast are able to achieve are mirrored on the West Coast, and that, therefore, West Coast Naphtha values should be relatively close to finished gasoline prices. *Id.* at pp. 27-28. Petro Star asserts that this approach would value Naphtha too highly either on its own merits or as a means of validating Tallett's approach. *Id.* at p. 28.

5. Unocal/OXY

2318. Unocal/OXY submit that the current Naphtha value is just and reasonable and should not be changed. Unocal/OXY Initial Brief at p. 37. Should the Commission disagree, however, Unocal/OXY recognizes that it must adopt a methodology to replace the use of Gulf Coast prices to value West Coast Naphtha. *Id.* They explains that three replacement methodologies were proposed, and a fourth methodology, the Ross governor, was proposed as an add-on to whatever methodology the Commission adopts. *Id.* In addition, continue Unocal/OXY, some hybrids were suggested in the course of the proceedings. *Id.* Among the proposed replacement methodologies submitted at the hearings, they claim, two would produce a value for West Coast Naphtha that is far above its actual value, and it is Unocal/OXY's position that they should be rejected without further consideration. *Id.* at pp. 37-38. Three deserve further consideration, state Unocal/OXY. *Id.* at p. 38.

2319. According to Unocal/OXY, Dudley presented a straight forward proposal that would use price differentials between the West and Gulf Coasts for LSR and VGO (which are Quality Bank cuts with published prices, and which are used as feedstocks for process units that make gasoline blendstocks) to adjust the Gulf Coast Naphtha market price for use on the West Coast. *Id.* (citing Exhibit Nos. PSI-5 through PSI-8 and PSI-11). They explain that each of the two separate differentials is then weighted according to the relative amount of that product in the TAPS common stream, the weighted differentials are then combined, and the Gulf Coast Naphtha price is then adjusted by that amount to determine the West Coast Naphtha value. *Id.*

2320. The Dudley proposal, according to Unocal/OXY, works well because it recognizes that LSR, Naphtha, and VGO are all intermediate feedstock products used to make gasoline. *Id.* Further, they continue, the proposal is consistent with Sanderson's testimony that the West Coast value of Naphtha would lie between the West Coast values of VGO and LSR. *Id.* at pp. 38-39. Additionally, they suggest, it is consistent with Culberson's similar conclusion and his observation that West Coast Naphtha may have a lower value than Gulf Coast Naphtha. *Id.* at p. 39. Unocal/OXY state that it relies on the fact that the Gulf Coast and West Coast markets for intermediate products, unlike the markets for finished products, are similar, and that there are no excess margins assigned to the West Coast intermediate products, no evidence of non-competitive conditions in the intermediate product market, and no excessive volatility or spiking prices for these products. *Id.* Furthermore, Unocal/OXY explain, the record evidence shows there is an active trade in VGO, and there are published prices on both Coasts for VGO and LSR. *Id.* Unocal/OXY suggest that because the method is simple, easy to comprehend, and easy to administer they would recommend its adoption were the Commission to determine that the existing methodology is no longer just and reasonable. *Id.*

2321. According to Unocal/OXY, the Ross governor is a proposal which caps the West Coast price of Naphtha at the cost of importing Venezuelan Naphtha to the West Coast. *Id.* They note that the cost of shipping from the Caribbean to the West Coast has been addressed by Ross, Culberson and Sanderson. *Id.* Unocal/OXY point out that Ross proposes a shipping rate of $1.49/barrel, added to the Gulf Coast Naphtha price, as a governor. *Id.*

2322. The proposal has merit, according to Unocal/OXY, and should be considered. *Id.* They assert that they do not oppose the governor if a decision is made to adopt a West Coast based methodology; and in fact support it if the Commission decides to approve either the O'Brien or Tallett methods. Unocal/OXY Reply Brief at p. 85. However, Unocal/OXY assert, the governor may be set too high. Unocal/OXY Initial Brief at p. 39. They explain that the governor is based on the presumption that the West Coast value of Naphtha should not exceed the cost of imports. *Id.* However, note Unocal/OXY, the cost of imports is likely less than $1.49 above the Gulf Coast price. *Id.* at pp. 39-40. Unocal/OXY point out that not all witnesses were in agreement as to the shipping costs to import Naphtha. *Id.* at p. 40. Further, Unocal/OXY suggest, a more basic issue is whether the origin should be a Pacific origin that does not require a Panama Canal transit, or a Venezuelan or Mexican origin that does. *Id.* As Mexico is now the largest supplier of Naphtha to the Gulf Coast, Unocal/OXY state, the possibility of shipping from Mexico's Pacific port to the West Coast should be investigated to avoid including Panama Canal charges. *Id.* Ecuador's Pacific port is another possibility worthy of consideration, they claim, as Ecuador is now a significant source for VGO imports. *Id.*

2323. Unocal/OXY explains that O'Brien proposes a methodology based on a model gasoline produced by blending reformate, LSR and butane. *Id.* (citing Exhibit Nos. PAI-33, PAI-34, and PAI-35). They assert that there are several problems with this approach, that it is fatally flawed, and should be rejected. *Id.*; Unocal/OXY Reply Brief at p. 79. First, Unocal/OXY state, the three component blend will not meet air quality regulations prevailing on the West Coast and, therefore, it cannot be used in California, the Seattle area, Phoenix, or Las Vegas. Unocal/OXY Initial Brief at pp. 40-41. Unocal/OXY note that even the addition by O'Brien of a benzene saturation unit does not solve this problem. Unocal/OXY Reply Brief at p. 80. Further, they point out, Exhibit No. PAI-237, used by Phillips to support its assertion that O'Brien's three component blend will meet air standards, is outdated, so that all the questioning of Culberson on this Exhibit is irrelevant. *Id.* at pp. 81-82. Instead, they state, the correct information and the correct results for the benzene saturation model is found in Exhibit No. UNO-57. *Id.* at p. 82.

2324. Culberson's testimony that the O'Brien blend produces an unusable gasoline, Unocal/OXY assert, is not undercut by the questions as to the specifications for conventional gasoline as opposed to CARB or reformulated gasoline. *Id.* They note that CARB specifications apply throughout California, and reformulated gasoline specifications apply in the other areas catalogued by Culberson, and state that regular unleaded conventional gasoline cannot be sold in these areas, which comprise virtually all of the populated areas of the West Coast. *Id.* Accordingly, Unocal/OXY suggest, it is disingenuous for Phillips to suggest that the O'Brien blend is a usable grade of gasoline. *Id.* In addition, Unocal/OXY argue, the three component blend is not used by as many refineries as Phillips states. *Id.* They state that O'Brien has provided only one example of a refinery producing such a blend, U.S. Oil & Refining in Tacoma, and the available evidence on this refinery indicates that it does not produce such a three component blend. *Id.*

2325. Second, Unocal/OXY claim, the O'Brien model grossly overstates West Coast Naphtha values. Unocal/OXY Initial Brief at p. 41. Despite the fact that O'Brien himself stated that a predicted Naphtha value should not exceed the price of gasoline, otherwise the refiner would not bother to use the Naphtha to make gasoline, Unocal/OXY point out, O'Brien's model does exactly that. *Id.* They explain that O'Brien's model produces Naphtha values that exceed gasoline prices over an eight month period. *Id.* Third, continue Unocal/OXY, the method would produce Naphtha values significantly higher than the cost of imports from Venezuela even though the absence of such imports indicates that these values have never been attained by West Coast Naphtha. *Id.* Fourth, state Unocal/OXY, the O'Brien model attributes all of the gasoline margin to Naphtha, an entirely unrealistic assumption. *Id.* Fifth, Unocal/OXY point out, the O'Brien method is inconsistent with the cost model sponsored by O'Brien for the Resid valuation. *Id.* Finally, conclude Unocal/OXY, even in comparing the O'Brien predicted values to the West Coast contracts, its Naphtha values are higher than the contract averages for all periods, except for the anomalous 1999-2001 period. *Id.* Accordingly, Unocal/OXY posit that the O'Brien method is unjust and unreasonable and should be rejected. *Id.*

2326. Tallett's proposal is a least squares regression formula that relies on the relationship between the prices of unleaded regular gasoline, jet fuel and Naphtha on the Gulf Coast, according to Unocal/OXY. *Id.* at pp. 41-42 (citing Exhibit Nos. EMT-11 at pp. 17-20, EMT-17, EMT-18). They argue that Tallett's method also is fundamentally flawed and assert that there is no reason to assume that the Gulf Coast relationship between Naphtha and gasoline/jet fuel can be translated to the West Coast and used to derive a West Coast Naphtha price. *Id.* at p. 42. Unocal/OXY note that the relationship relied on is between an intermediate product (Naphtha) and finished products (gasoline and jet fuel), and the evidence discussed above demonstrates that finished products on the West Coast have much higher margins than do finished products on the Gulf Coast. *Id.* Accordingly, Unocal/OXY's position is that a relationship between finished and intermediate products cannot be transferred from one coast to the other without distorting values. *Id.*

2327. The proof of this fact, according to Unocal/OXY, is in the tests of the Tallett method done by Ross (Exhibit Nos. BPX-27, BPX-39), O'Brien (Exhibit No. PAI-52 at pp. 3-4), and Sanderson (Exhibit Nos. WAP-20, WAP-39). *Id.* at pp. 42-43. Unocal/OXY explain that these test showed that Tallett's regression method overvalued West Coast Naphtha by at least \$1.56/barrel (Ross and Sanderson) and as much as \$8.03/barrel (O'Brien). *Id.* These tests demonstrate conclusively, in the view of Unocal/OXY, that the Tallett method would overvalue West Coast Naphtha, and it is therefore not just and reasonable. *Id.* at p. 43.

2328. Unocal/OXY state that one other methodology suggested at the hearings is worthy of consideration. Unocal/OXY Initial Brief at p. 43. They note that Ross proposed to modify his governor by adding a floor set at the price of ANS + \$4.00. *Id.* (citing Exhibit No. at BPX-67 at p. 8). Unocal/OXY explain that there is evidentiary support of the concept for this method in Sanderson's testimony respecting the derivation of Naphtha value from the cost of crude oil. *Id.*

2329. In reply, Unocal/OXY state that Ross's interpolation of a West Coast Naphtha price, as reflected in Exhibit No. BPX-138, would be an acceptable alternative. Unocal/OXY Reply Brief at p. 85. They explain that it involves taking the differential between Naphtha and VGO on the Gulf Coast and adding that to the VGO/crude oil differential on the West Coast. *Id.* The resulting differential is then added to a West Coast crude oil price, such as ANS, to calculate a West Coast Naphtha price, according to them. *Id.* at pp. 85-86. Ross did not sponsor this as a recommended methodology, but rather used it to check the ANS + \$4.00 approach. *Id.* at p. 86.

6. Williams

2330. Williams submits that continued use of the Platts Gulf Coast Heavy Naphtha (waterborne) price is just and reasonable and that that price should continue to be used to value the West Coast Naphtha component of the Quality Bank. Williams Initial Brief at p. 54. However, it states that, if it is determined that the West Coast Naphtha component must be valued on a West Coast basis, then the only other West Coast Naphtha pricing methodology that has the essential characteristics (objective basis using a published price) of the Gulf Coast Naphtha price is ANS + \$4.00 in that it, on average, is closer to the same value as Platts Gulf Coast Heavy Naphtha (waterborne) price quote. *Id.* Because it is essentially the same value as the Platts Gulf Coast Heavy Naphtha (waterborne) price and because the Platts Gulf Coast Heavy Naphtha (waterborne) price has been shown to be just and reasonable and continues to be just and reasonable, Williams contends that the ANS + \$4.00 value is also just and reasonable. *Id.*

2331. None of the other proposals, Williams contends, meet the objective price standard that is preferred for valuing a component of the Quality Bank, although it states that Dudley's proposal comes close. *Id.* at pp. 54-55. Moreover, Williams claims, the two proposals that rely on West Coast gasoline prices as part and parcel of the method, those of O'Brien and Tallett, are fundamentally flawed because the basis of their proposals is to attribute all or most of the higher West Coast gasoline margins to Naphtha[705] in order to drive the value of Naphtha up as high as possible to the benefit of the proponents of their methods. *Id.* at p. 55. It asserts that this results in those two proposals being unjust and unreasonable, and argues that, although Ross's governor attempts to flatten the effects of West Coast gasoline run-ups and, therefore, reduces the amount of West Coast gasoline margin attributable to West Coast Naphtha, because his proposal is tied to O'Brien's and Tallett's proposals and thus West Cost gasoline, it suffers the same fate. *Id.*

2332. Williams states that Phillips and Alaska support the proposal developed by O'Brien which is based on the cost of processing Naphtha into conventional gasoline and which uses the published price of Seattle gasoline. Williams Initial Brief at pp. 55-56. In his zeal to raise the West Coast Naphtha value as much as possible, Williams argues, O'Brien inserted various fatal flaws into his proposal. *Id.* at p. 56. The O'Brien proposal, according to Williams, uses a finished product, gasoline, to try to estimate the value of the West Coast Naphtha component of the Quality Bank. *Id.* It asserts that this is inconsistent with the methods used to value other components even though it concedes that other Quality Bank components, such as Light Distillate and Heavy Distillate, use a finished product to derive the Light Distillate and Heavy Distillate intermediate feedstock values for Quality Bank purposes when there is no reported intermediate feedstock price. *Id.* Williams notes that the finished products which the other Quality Bank cuts use are almost exclusively made from the intermediate feedstock for which they are being used to value and do not require the blending of components manufactured from other Quality Bank cuts like gasoline does. *Id.* at pp. 56-57. For instance, it states that the West Coast Low Sulfur No. 2 Fuel Oil (Diesel) product used in the valuing of the Quality Bank Heavy Distillate component can be and often is made solely from the Heavy Distillate intermediate feedstock. *Id.* at p. 57. Williams claims that such is not the case with the use of gasoline. *Id.* It explains that it is made from multiple Quality Bank components: Isobutane, Normal Butane, LSR, Naphtha, VGO and Resid. *Id.* Thus, asserts Williams, were Naphtha valued using a formula based on gasoline, it would be different than the other Quality Bank cuts and different from the method proposed for Resid. *Id.* at pp. 57-58. Williams notes that Sanderson explained, "[t]his error is particularly acute in the valuation of West Coast naphtha because of the higher refinery margins on the West Coast." *Id.* at p. 58. (quoting Exhibit No. WAP-8 at p. 23).

2333. Phillips's statement that O'Brien's proposal is validated because it accurately predicts Gulf Coast Naphtha values and its argument that the Gulf Coast and West Coast markets are separate cannot both be true, claims Williams. Williams Reply Brief at p. pp.

[705] Williams states that Exhibit No. WAP-221 graphically illustrates this point. Williams Initial Brief at p. 55, n.46.

62-63. It states that, when all the other Gulf Coast prices are substituted into O'Brien's formula, as shown in Exhibit No. WAP-132 at p. 1, the calculated Gulf Coast Naphtha value averages 2.1¢/gallon below the actual Gulf Coast Naphtha value. *Id.* at p. 64. Instead of being a good job, this simply illustrates, in Williams's view, how poorly O'Brien's formula works on the Gulf Coast and how dramatically the Naphtha value calculated by the formula varies with the gasoline price. *Id.* It states that the formula's failure to predict the Gulf Coast Naphtha price, if anything, indicates the Gulf Coast Naphtha price is elevated by the presence of the petrochemical demand for it. *Id.*

2334. Williams argues that O'Brien's proposal suffers from the same fatal flaw that all gasoline and finished product-based formulæ suffer from – it inappropriately attributes the margin or profit refiners receive for their investments and market power in producing their most valuable refined product, gasoline, to the Naphtha feedstock. Williams Initial Brief at p. 58. They note that Sanderson elaborated on this point in his pre-filed answering testimony:

> A West Coast naphtha value calculated this way is unjust and unreasonable because it fails to take into account the contribution made by the processing of other intermediate feedstocks blended into gasoline and arbitrarily assigns all of the profitability associated with the investments in the other gasoline producing process facilities to the naphtha feedstock rather than to the refiner who produces gasoline from a variety of feedstocks rather than simply the reformer, naphtha hydrotreater, saturate gas plant and associated offsites.

Id. (quoting Exhibit No. WAP-8 at p. 15).[706]

2335. Ross, Willaims claims, voiced a similar concern: "In particular, O'Brien's methodology takes values that are peculiar to and isolated to the finished product price for gasoline and passes those through to the value of Naphtha, which is an intermediate product. In my view, that distorts the value of Naphtha on the West Coast." *Id.* at pp. 58-59 (quoting Exhibit No. BPX-27 at p. 3). It explains that Ross further characterized this distortion in the Naphtha value as "overstat[ing] (sometimes significantly) the actual value of Naphtha on the West Coast." *Id.* at p. 59 (quoting Exhibit No. BPX-27 at p. 3).

2336. Thus, Williams argues, the use of gasoline in O'Brien's proposal also distorts any comparison of his Naphtha result with the Gulf Coast published Naphtha price. *Id.* It asserts that the testimony in this proceeding was clear that gasoline prices on the West Coast are higher than on the Gulf Coast. *Id.* More importantly, states Williams,

[706] Williams also refers to Transcript at pp. 10687-88, 11086-88. Williams Initial Brief at p. 58.

refiners's margins on gasoline are higher on the West Coast than the Gulf Coast. *Id.* It notes that O'Brien agrees, stating that he previously testified via an affidavit that

> [t]he fact is that gasoline price differences between the two regions [Gulf Coast and West Coast] are more reflective of gasoline market fundamentals as opposed to any implicit differences in the value of naphtha. The refinery profit margin on gasoline has traditionally been higher on the West Coast than on the Gulf Coast because of the stronger gasoline market on the West Coast.

Williams Reply Brief at p. 65-66 (quoting and citing Exhibit No. WAP-8 at p. 8; emphasis in original omitted).[707]

2337. Williams explains that Pulliam testified that, in 1999, higher gasoline profits flowed through to the refinery. Williams Initial Brief at p. 59. Thus, it contends that attributing these higher margins to Naphtha on the West Coast unreasonably inflates the value of Naphtha calculated using formulæ that rely totally or principally on the West Coast finished product prices, and maintains that this inflation is further exacerbated by the fact that CARB gasoline, which makes up 73% of the West Coast gasoline market, further increases the prices of West Coast gasoline since non-CARB gasoline tends to follow CARB gasoline prices. *Id.*

2338. In Williams's view, the flaws and skewing in O'Brien's proposal are easily illustrated by reviewing the coefficients in the formula, which are set out in Exhibit No. PAI-39, particularly "A = (1.0710) x Seattle Regular Unleaded (SRUL) conventional gasoline price." *Id.* at p. 60. It points out that O'Brien confirmed the fact that, for every $1.00/barrel change in the price of gasoline, O'Brien's Naphtha value increases by $1.07/barrel. *Id.* Thus, Williams explains, O'Brien's Naphtha value moves in lock-step with the finished gasoline price with a 7% premium added on top. *Id.* Williams concludes that this clearly shows that no matter what the refiner's margin is on gasoline, O'Brien is attributing all of that margin to his calculated West Coast Naphtha value. *Id.*

2339. An important part of O'Brien's calculation and distorted result, Williams contends, is the value he attributes to hydrogen. *Id.* It states that his approach is inconsistent, with the inconsistency designed to increase the resulting value of Naphtha, and it points out that within coefficient B of his formula, the hydrogen value is composed of two pieces, both of which are related to the price of natural gas. *Id.* at pp. 60-61. In other words, Williams points out, O'Brien allows the natural gas price in the formula to float with the market price of natural gas. *Id.* at p. 61. It states that this is inconsistent with the valuation in his Resid calculations, because, there, he fixed it at a standard

[707] Williams also refers to WAP-13 at p. 4. Williams Reply Brief at p. 66.

$1.75/standard cubic foot, with the only adjustment to that figure being the Nelson-Farrar escalation. *Id.* Williams notes that O'Brien admitted that he could have used the same approach with his Naphtha calculation, but did not. *Id.* It asserts that Sanderson demonstrated why in Exhibit No. WAP-215, which shows that O'Brien's Naphtha value would not have exceeded the Seattle regular unleaded price a total of nine months if the hydrogen value had been fixed, and point out that, by letting the value of the hydrogen float with the price of natural gas, O'Brien has built in another feature that results in a Naphtha value so high that it can skyrocket to as much as 15¢/gallon higher than the finished gasoline product, in this case, Seattle unleaded regular gasoline. *Id.* Williams maintains, this underscores the skewed result arising from the inconsistent approach O'Brien used to value hydrogen in his Naphtha valuation compared to his Resid approach. *Id.* at pp. 61-62.

2340. Moreover, it claims that a further inconsistency exists in O'Brien's choice of pricing the hydrogen. *Id.* at p. 62. Williams notes that, rather than use a natural gas price in the Seattle area which would be consistent with his use of a Seattle gasoline price, O'Brien elected to use a potentially much more highly volatile Southern California natural gas price. *Id.* It states that Exhibit No. WAP-211 shows that the Seattle area natural gas price was considerably lower than the Southern California natural gas price O'Brien used during last months of 2000 and the first half of 2001, and that Exhibit No. WAP-210 confirms that the price run-up in Southern California was limited to that area and was not a widespread escalation of natural gas prices across the country. Williams Reply Brief at p. 69.

2341. Williams takes exception to Phillips explanation that O'Brien's assumption concerning hydrogen was based on his view that it is one of the products, and not one of the costs, in the Naphtha reforming process. Williams Reply Brief at p. 67. Further, according to Williams, it does not agree with O'Brien's decision not to reflect the cost savings he mentioned from making hydrogen via the reformer process. *Id.* Thus, it asserts, O'Brien's inconsistent choice of natural gas pricing for his Naphtha value calculation formula is but one more area where he has inserted the potential to skew the value Naphtha in Phillips's financial interest.[708] Williams Initial Brief at p. 62.

2342. The "unreasonableness" of O'Brien's approach, formula, and result, according to Williams, is underscored further by the prolonged period of eight consecutive months during which his calculated value of Naphtha would have exceeded the finished gasoline product price. *Id.* Williams argues that a refiner would not continue to make gasoline using Naphtha if the value was higher for nine months, rather, as O'Brien stated, the refiner would sell the Naphtha instead. *Id.* at p. 63. Williams concludes that to allow

[708] Williams states that Exhibit No. WAP-215 supports this view. Williams Reply Brief at p. 68, n.35.

such a formula to be used to value Naphtha on the West Coast would result in an unjust and unreasonable result. *Id.*

2343. O'Brien concurs, Williams notes, that it would make no sense for Naphtha to be valued higher than gasoline for such a period of time when he testified concerning Stancil's proposed methodology. *Id.* Even though O'Brien tried to qualify his pre-filed testimony, it claims, on cross-examination he admitted that the Naphtha price should not exceed gasoline prices for nine months. *Id.* Thus, according to Williams, O'Brien's proposal results in an unjust and unreasonable result for the very same reason as Stancil's previous proposal. *Id.* at pp. 63-64.

2344. In reply, Williams states, the evidence cited by Phillips of instances where Gulf Coast Naphtha prices exceeded gasoline prices for only three separate months does not alter the fact that O'Brien's formula results in an unrealistic and unreasonable Naphtha value. Williams Reply Brief at pp. 70-71. The reason O'Brien's formula is wrong is not because of isolated excursions above the gasoline price, but rather due to the prolonged continuous estimated valuation of West Coast Naphtha above gasoline, claims Williams. *Id.* at p. 71.

2345. According to Williams, it strenuously objects to Phillips suggestion that the Quality Bank Administrator be permitted to suggest a different natural gas price if the Commission is concerned about manipulation. *Id.* at p. 74. It suggests that, in this regard, Phillips's proposal is disingenuous, and note that, under that proposal, the Quality Bank Administrator could not act until the Commission had concluded that a manipulation had occurred, which takes time and occurs long after the actual manipulation takes place. *Id.*

2346. Williams also points out that, under that proposal, Phillips and Exxon would benefit because the Quality Bank Administrator's recommendation could only be prospective. *Id.* at pp. 74-75. It notes that the Commission order responding to the 2000-2001 run up in California natural gas prices was not released until 2003, as cited in Phillips's own brief. *Id.* at p. 75 (citing *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services Into Markets Operated by the California Independent System Operator and the California Power Exchange*, 102 FERC ¶ 61,317 at P 56-63 (2003.

2347. O'Brien's Naphtha calculation, Williams states, and thus Phillips's entire proposal, also hinges on the validity of the three-component blend he chose to use. Williams Initial Brief at p. 64. It explains that O'Brien's premise is that a conventional regular unleaded gasoline can be blended from LSR, Normal Butane, and reformate, and that the value can be calculated because there are published prices for all the components. *Id.* Williams asserts, however, that this three-component blend gasoline is an unrealistic blend to produce Seattle conventional unleaded regular gasoline. *Id.*

2348. According to Williams, O'Brien's "three-component blend of gasoline is inconsistent with the gasoline produced by the coking refinery configuration proposed by all parties as the basis for valuing the resid cut as it does not include gasoline components produced from the VGO cut and the resid cut." *Id.* (quoting Exhibit No. WAP-8 at p. 17). It states that the assumption that the three-component blend can be priced as conventional unleaded gasoline produced by a complex refinery with a Coker, catalytic cracker, and alkylation unit on the West Coast without taking into account the costs or capital recovery contribution of these feedstocks and process facilities defies logic and ignores the evidence that the three-component blend cannot be sold as conforming conventional gasoline by the complex refineries he uses as a basis for his valuation. *Id.* at pp. 64-65. Williams notes that this is not the type of refinery that O'Brien pointed to when forced to identify a refinery that he alleged produces a three-component blend of gasoline that he actually used for his cost calculations. *Id.* at p. 65.

2349. In his pre-filed testimony, Williams notes, Sanderson compared the exhaust toxic emissions from O'Brien's three-component blend with those of the "anti-dumping statutory baseline" or simply the "statutory baseline" set forth in 40 C.F.R. § 80.91 (c)(5)(2004). Williams Reply Brief at p. 76. It explains that the three-component blend does not comply with the EPA standards for the "statutory baseline" and asserts that it is reasonable for the Commission to expect a proposal to value West Coast Naphtha in the Quality Bank to produce gasoline no worse than the national average statutory baseline established by the EPA. *Id.* Williams points out that this baseline applies to all refineries that do not have their own established baselines and to all gasoline produced in excess of any refinery established baseline. *Id.*

2350. Contrary to the claims of Phillips, Williams argues, O'Brien's three-component blend is not even in compliance with all of the refineries he picked. *Id.* at p. 77. It notes that the EPA anti-dumping requirements are a necessary requirement to market conventional gasoline in the U.S. *Id.* Furthermore, Williams assets that the three-component blend meets this condition only were the Commission to accept the position taken by Phillips regarding the cherry-picking of benzene and aromatics levels of reformate outlined by Phillips in its Initial Brief. *Id.* (citing Phillips Initial Brief at pp. 103-11).

2351. Williams states, O'Brien pointed to the U.S. Oil & Refining in Tacoma, Washington in support. Williams Initial Brief at p. 65. However, it notes that, as first shown in Exhibit No. WAP-136, using benzene and aromatics for LSR, which O'Brien agreed represented ANS, and using PIMS aromatics and benzene for Naphtha, U.S. Oil & Refining would fail its EPA exhaust toxics standards. *Id.* It states that, because O'Brien went on to say he believed that indicates a problem with the numbers for benzene and aromatics, Exhibit No. WAP-140 was introduced using benzene and aromatic levels for ANS taken from Exhibit No. WAP-139. *Id.* According to Williams, the result was the same: the U.S. Oil & Refining Tacoma refinery would fail its annual exhaust toxics standard. *Id.* In addition, it states that, because it has an isomerization unit, it would not make the same three-component blend as O'Brien uses. *Id.* Williams claims that, using the ANS benzene and aromatic levels, the same failure to comply with its exhaust toxics limits results for the Kern Oil refinery in the Bakersfield, California area. *Id.* at p. 66.

2352. Phillips attempted, Williams explains, to use the reformate, benzene and aromatics values provided by the Phillips Ferndale refinery to show that O'Brien's blend would meet EPA standards. Williams Reply Brief at p. 77. However, it notes, O'Brien admits that the refinery only runs 75% ANS rather than 100% ANS, and that Phillips rejects the other record evidence provided from independent sources that indicates that the benzene and aromatics levels in reformate are indeed much higher than the values proposed by Phillips from the refinery. *Id.* at pp. 77-78. Moreover, Williams notes that the PIMS model, which O'Brien uses to calculate the reformer yields in his proposal, suggests that the benzene and aromatics levels are much higher than that produced at the Phillips Ferndale refinery – 5.5 vol % benzene and 61.3 vol % aromatics. *Id.* at p. 78. It explains that use of the benzene and aromatics levels from the PIMS model would correspond to annual average exhaust benzene levels of 210.8 mg/mile, making it fail to comply with all of the refinery individual baselines and the statutory baseline. *Id.*

2353. Additional evidence, according to Williams, was provided by the technology licensing firm UOP for a complex refinery processing 100% ANS crude from an NPRA article titled: "Benzene Reduction Alternatives" which indicates the reformate produced from a complex refinery processing 100% ANS crude oil is 4.0 vol % benzene and 63.7 vol % aromatics. *Id.* at pp. 78-79. It notes that Phillips argues that this data is not applicable because O'Brien was not using hydrocracked or Coker Naphtha. *Id.* at p. 79. Williams asserts that, if O'Brien's three-component blend is indeed produced by a complex refinery as he testified, then his reformate feed must contain Coker Naphtha and hydrocracked Naphtha like the reformate characterized by UOP and have comparable benzene and aromatics levels to those in Exhibit No. WAP-139. *Id.* Again, using the benzene and aromatics levels from the UOP article, Williams claims, O'Brien's three-component blend would fail to comply with the statutory baseline and individual refinery baseline standards selected by Phillips. *Id.* at pp. 79-80.

2354. Williams explains that O'Brien did look at the cost of adding a benzene saturation unit to his cost calculation, stating that it would cost about $4,600,000 in capital costs and thereby reduce his Naphtha value by approximately 1.3¢/gallon. Williams Initial Brief at p. 66. However, it notes, O'Brien also testified that he did not think that the benzene saturation unit was necessary. *Id.* In addition, Williams points out, U.S. Oil & Refinery does not have a benzene saturation unit. *Id.* It states that the refinery has an isomerization unit, as O'Brien acknowledged at the hearing, and explains that it is clear that O'Brien did not try to cost out such a unit because he did not include one in his cost estimate. *Id.* Williams notes that Exhibit No. WAP-138 shows that an isomerization unit using the Gary & Handwerk cost curve for a 2,300 barrel/day isomerization unit (the size of the isomerization unit at U.S. Oil & Refining as confirmed by O'Brien) would cost $13.1 million in Year 2001 dollars. *Id.* at pp. 66-67. Thus, Williams claims, it is not surprised that O'Brien did not include an isomerization unit in his costs to make his three-component blend of gasoline as the added cost would have significantly lowered his calculated value of Naphtha on the West Coast. *Id.* at p. 67.

2355. Williams concludes that the net result of O'Brien's being unable to prove that any refiner makes the three-component blend of gasoline which he uses, much less sells it legally on the West Coast, means that, at best, his three-component blend is simply another unfinished gasoline blendstock that does not have any reported published price and that cannot be reliably valued. *Id.* It suggests that this also invalidates O'Brien's entire proposal because his costs are not reflective of a gasoline made on the West Coast and the additional complex and expensive process units needed to make legal gasoline. *Id.*

2356. O'Brien's calculated high Naphtha value, Williams argues, also flies in the face of the evidence indicating that there, allegedly, is idle reforming capacity on the West Coast. *Id.* (citing Exhibit Nos. WAP-135, WAP-47, WAP-48, WAP-226). Williams contends this means that the demand for Naphtha on the West Coast is not high. *Id.*

2357. Williams also asserts that, were West Coast Naphtha valued as high as O'Brien calculates it to be, there should be a flood of imports of Naphtha into the West Coast. *Id.* It notes that "O'Brien's proposed West Coast naphtha price exceeds the price at which West Coast refiners could economically import naphtha supplies from Venezuela, a large-volume supplier of reforming-grade naphtha to the Gulf Coast market by an average of 5.8 cents per gallon despite the availability of excess reforming capacity in California." *Id.* at pp. 67-68 (quoting Exhibit No. WAP-8 at p. 16). Williams asserts that Sanderson came to the same conclusion, and states that there has been no such flood of Naphtha imports into the West Coast. *Id.* at p. 68.

2358. Because O'Brien's processing-based proposal is so subjective, Williams claims, Tallett rejected such an approach, including Stancil's approach, at the outset. *Id.* It states that Tallett also expressed concern that such a methodology could be subject to manipulation. *Id.* Williams notes that, instead of a processing based proposal, Tallett devised a regression-based equation between gasoline and jet fuel, two high priced Gulf Coast finished products, and Full Range Naphtha to estimate the value of the West Coast component of the Quality Bank. *Id.* at pp. 69-70. It states that the Tallett proposal simply takes the Gulf Coast Naphtha price, which Exxon states is unjust and unreasonable to use, and adds approximately a 7¢/gallon premium to it, derived from the full additional margins that refiners earn on producing West Coast gasoline and jet fuel. Williams Reply Brief at p. 83. Despite choosing a different approach from O'Brien, Williams asserts, the result is the same. Williams Initial Brief at p. 70.

2359. Williams argues that the important price relationship between the finished products and feedstock prices on each coast is their price differential or margin rather than whether these products are related to or track each other. *Id.* If Tallett had analyzed margins, Williams states, he would have realized it was improper to transfer the Gulf Coast price relationship between gasoline and jet fuel and Naphtha to the West Coast. *Id.* Instead, it notes, Tallett emphasizes products tracking each other on each coast. *Id.* It asserts that this "sleight-of-hand" results in a proposal which over-values Naphtha on the West Coast. *Id.*

2360. The use of a regression-based formula to transfer the narrow Gulf Coast price relationship to the West Coast results in an inappropriate, implicit assumption that refining margins (i.e., feedstock to product spreads) are the same on the West Coast as they are on the Gulf Coast, posits Williams. *Id.* It states that that is not true, as Sanderson demonstrated in his pre-filed answering testimony where he explained that margins are higher on the West Coast for the conversion of feedstocks into finished products. *Id.* For instance, Williams claims, relying on Muse, Stancil & Company data, "[t]he comparative refining margin data confirms that the refinery cash operating margins have been consistently higher on the West Coast than the Gulf Coast, averaging $2.87 per barrel or 6.8 cents per gallon higher over the seven-year period the refinery margin data was available." *Id.* at pp. 70-71 (quoting Exhibit No. WAP-8 at p. 5).

2361. Williams notes that Sanderson compared "crack spreads"[709] between similar refined product and feedstock prices, because that indicates the price differentials available for refining operations or margins before costs on the two coasts. *Id.* at p. 71. It states that, in his analysis, Sanderson uses "[a] 3-2-1 crackspread between a basket of conventional gasoline and low sulfur No. 2 fuel prices minus crude oil prices. . . because it is sometimes used to approximate the margin before costs for a complex refinery like the hypothetical Quality Bank refinery."[710] *Id.* (quoting Exhibit No. WAP-8 at p. 6). According to Williams, the difference between the Gulf Coast and the West Coast is that this crack spread averages 6.7¢/gallon or $2.81/barrel higher on the West Coast than the Gulf Coast over the seven-year period 1994 through 2001. *Id.* It states that the higher crack spreads are the cause of the higher finished product prices on the West Coast. *Id.*

2362. According to Williams, the averages of the two different methods employed by

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[709] Williams notes that "[a] crack spread is the difference between a refined product price or group of refined product prices sometimes referred to as a 'basket' of prices and a feedstock price." Williams Initial Brief at p. 71, n.55.

[710] Williams notes that the discussion of this 3-2-1 crack spread is in Exhibit No. WAP-8 at pp. 6-7. Williams Initial Brief at p. 71, n.56.

Sanderson are virtually identical 6.8¢/gallon and 6.7¢/gallon, respectively. *Id.* Thus, it claims, the conclusion indicated by the Muse Stancil refinery data that refinery profitability on the West Coast has been higher than on the Gulf Coast is supported by the higher West Coast crack spreads. *Id.* Tallett, Williams indicates, shared this view. *Id.* at p. 72.

2363. Williams states that the record reflects that, during the period 1994-2001, virtually the entire amount by which Tallett's calculated West Coast Naphtha prices exceeds the Gulf Coast Naphtha price used in the Quality Bank is due to the difference in refining margins or profitability that Sanderson calculated. *Id.* It notes that the Muse Stancil refining margin is $2.87/barrel or 6.8¢/gallon higher on the West Coast over the period 1995-2001, and that Tallett's calculated Naphtha price exceeds the Gulf Coast Naphtha price by $2.92/barrel or 7.0¢/gallon over the 1994-2001 period, almost of which represents the difference between the Gulf Coast refiners's margin and the higher West Coast refiners's margin. *Id.* Williams points out that, when that amount is subtracted from Tallett's calculated West Coast Naphtha price, the difference is a "miniscule" 5¢/barrel or a "mere" 0.2¢/gallon, meaning that, when adjusted to put the two coasts on an equivalent basis, the two Naphtha prices are almost identical. *Id.* at pp. 72-73. Thus, Williams asserts, Tallett's own calculation, properly adjusted, shows that the Gulf Coast and West Coast Naphtha prices are the same. *Id.* at p. 73. Therefore, Williams submits, the Gulf Coast Naphtha price is a reasonable proxy for the West Coast Naphtha component of the Quality Bank. *Id.*

2364. Tallett's use of the Gulf Coast relationship between gasoline/jet fuel and Naphtha, according to Williams, cannot possibly be valid because the market characteristics or nature (supply, demand and, therefore, price) of the Gulf Coast and West Coast gasoline market changed during the period he developed his equation. *Id.* at p. 74. It notes that Tallett agreed that, if a major change occurred in one of the markets, he would have to change his regression equation, and noted that Tallett viewed this as a benefit of his approach. *Id.*

2365. The advent of CARB Phase II gasoline in California, Williams claims, imposed a significant and irreversible change on the West Coast (conventional and CARB) gasoline and jet fuel markets that did not occur on the Gulf Coast. *Id.* It maintains that this major market change resulting from the CARB gasoline specifications requires that the coefficients in Tallett's regression-based formula change in 1996, but it claims that he did not change them. *Id.* According to Williams, the reason why this change was not made was because it did not impact the Gulf Coast market, which is the basis for Tallett's formula. Williams Reply Brief at p. 86.

2366. Williams states that another way that the value of Naphtha on the West Coast has been negatively impacted since the introduction of CARB requirements is in the narrowing of the distillation cut range. Williams Reply Brief at p. 93. It states that the record evidence, and the testimony of witnesses Sanderson, Sarna and Tallett, document that the CARB gasoline and specifications have forced West Coast refiners producing CARB gasoline to narrow the distillation range of reforming Naphtha from those similar to the Quality Bank cut points (175°F to 350°F) to a narrower cut range estimated by the witnesses to be approximately 208°F to 330°F. *Id.* at pp 93-94. Williams explains that this has eliminated the volumes of Naphtha boiling from 175°F to 208°F and the volumes boiling from 330°F to 350°F from refineries producing CARB gasoline. *Id.* at p. 94.

2367. Assuming a linear boiling point curve for the Naphtha distillation, Williams asserts that the volume of reforming Naphtha used in CARB gasoline (208°F to 330°F) would be approximately 70% of the Quality Bank cut or a 30% reduction in the volume processed compared to the Quality Bank cut range of 175°F to 350°F.[711] *Id.* Thus, it points out, the predominant West Coast Naphtha cut is different than the Gulf Coast Naphtha cut which Tallett took as the basis for his regression formula, yet he made no adjustment in his formula to reflect this. *Id.* at pp. 94-95. Williams asserts that this is because there is no way he could formulate a regression formula to reflect this difference; so he simply ignored it, rendering his formula worthless. *Id.* at p. 95.

2368. It is obvious, Williams claims, that the narrowing of the Naphtha cut points used for CARB gasoline changes the value of Naphtha on the West Coast compared to the Quality Bank Naphtha cut, and it asserts that Sanderson shared this view at the hearing. *Id.* at pp. 95-96. It explains that the reduction in the value of West Coast reforming Naphtha can be calculated based on the disposition of the 175°F to 208°F cut to LSR and the 330°F to 350°F cut to jet fuel, and that this shows that CARB gasoline's effect on the West Coast Naphtha cut is to reduce its value by 1.3¢/gallon for the period 1996 through 2001. *Id.* at p. 96.

2369. Williams states that the Gulf Coast Naphtha market is an import market which requires the price of Naphtha to be sufficiently elevated to attract supplies from other supply centers such as the Caribbean and Europe. Williams Initial Brief at p. 75. It explains that the petrochemical markets significantly influence Gulf Coast Naphtha demand and, therefore, prices. *Id.* Thus, Williams suggests, the Gulf Coast Naphtha

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[711] Williams notes that the percentage of the 175°F to 350°F Quality Bank Naphtha cut comprised of the narrower 208°F to 330°F cut used in CARB gasoline is calculated assuming as linear boiling point curve as follows:

$$\text{208°F - 330°F Naphtha Cut as a Percent of the Quality Bank Naphtha cut} = \frac{(330 - 208)}{(350 - 175)} = \frac{122}{175} = 70\%$$

Williams Reply Brief at p. 94, n.61.

market is a demand market because there is not enough Naphtha to supply or market without imports. *Id.* In contrast, it asserts that the West Coast Naphtha market is a self-sufficient market with little demand for Naphtha beyond that produced from crude oil and no commercially significant petrochemical market. *Id.* Williams further suggests, Naphtha demand is not even strong enough on the West Coast to fill existing reforming capacity there, despite the often critical shortage of gasoline on the West Coast. *Id.*; Williams Reply Brief at p. 89.

2370. A report published by the American Petroleum Institute (API) and National Petroleum Refiners Association (NPRA) containing a survey of the utilization rates of U.S. operating refineries, according to Williams, shows that, for the survey period of May 1 through August 31, 1996, after the introduction of CARB Phase II gasoline, the reformer utilization rates in California were 66.3%. Williams Reply Brief at p. 89. It notes that the 66.3% utilization figure for California reformers is much lower than that for reformers in other states on the West Coast (PADD V excluding California) of 92.3% and the Gulf Coast region (PADD III) of 86.4%. *Id.* In addition, Williams points out, the Solomon Survey information on reformer utilization for the West Coast clearly shows reformers have operated well below their maximum achievable stream-day utilization rates of 90 to 95%, averaging 76.3%, in the Solomon Surveys published in 1994, 1996, 1998 and 2000. *Id.*

2371. Not only have reformer utilization rates been low on the West Coast, Williams asserts, refiners also have reduced reforming capacity over the 1994 to 2001 period as well, again showing that the demand for Naphtha to reform into gasoline has decreased on the West Coast. *Id.* at pp. 89-90. Williams contends that Sanderson unquestionably established this decrease in reformer utilization at the hearing. *Id.* at pp. 90-91. In light of the huge price run up in gasoline prices during the 1999-2001 period and the imports of gasoline but not Naphtha, during this period,[712] Williams argues, there is no explanation for the decrease of the equivalent of two reformers during this period other than that the demand for straight run naphtha, i.e., the Naphtha that is being valued for Quality Bank purposes, has decreased, and therefore, so has its value on the West Coast. *Id.* at p. 91.

2372. As further evidence that reformer capacity has been reduced on the West Coast (PADD V), Williams cites Exhibit No. EMT-667, which is an excerpt from a Purvin & Gertz table of PADD V process capacity changes from 1992 to 2002 and indicates that total reforming capacity in PADD V, including both Semi-Regenerative and Continuous Reformers, declined by 39,000 barrels/calendar day from 598,000 barrels/calendar day to

[712] Williams cites Exhibit No. WAP-44, showing imports of gasoline and gasoline components compared to the nominal imports of Naphtha during the 1999-2001 period. Williams Reply Brief at p. 91, n.55.

559,000 barrels/calendar day[713] or 6.5% during the period at issue in this proceeding.[714] *Id.* at pp. 91-92. According to Williams, not only does Exhibit No. EMT-667 indicate that actual reforming capacity has declined in PADD V over the 1992 through 2002 period, but Purvin & Gertz also forecasts that no additional reforming capacity will be needed in PADD V through 2015, while additional capacity will be required for other gasoline-producing process units: 42,000 barrels/calendar day more cat cracking capacity will be needed for processing VGO; 27,000 barrels/calendar day more alkylation capacity will be needed for processing VGO and isobutane; 173,000 barrels/calendar day more isomerization capacity will be needed for processing LSR; and 64,000 barrels/calendar day more hydrocracking capacity will be needed for processing VGO and light cycle oil by 2015. *Id.* at p. 92.

2373. The Gulf Coast market for gasoline and jet fuel is also radically different than the West Coast market, Williams maintains. Williams Initial Brief at p. 75. On the Gulf Coast, it notes, supplies of gasoline and jet fuel are produced and shipped to other U.S. locations through both pipeline and waterborne trade. *Id.* It contends that this means that prices for gasoline and jet fuel on the Gulf Coast must necessarily be below that of the destination markets it serves, including the West Coast. *Id.* The West Coast, according to Williams, is an import market for gasoline and jet fuel. *Id.* Since 1998, it notes, the West Coast has been a regular and increasing importer of jet fuel. *Id.* In 2000, Williams explains, imports of jet fuel on the West Coast were approximately 20% of the total jet fuel supplied to PADD V. *Id.* (citing Exhibit No. WAP-191 at p. 2). It argues that the West Coast gasoline market is priced to attract imports of gasoline and gasoline components on a routine basis with occasional periods of notably high prices related to the difficulty refiners from outside California have in producing CARB gasoline. *Id.* at p. 76. Even in that case, states Williams, there are still no significant Naphtha imports. *Id.*

2374. Williams states that Tallett's attempt to use the Gulf Coast regression-based equation to value West Coast Naphtha was shown to be flawed by using his own feedstock-to-product correlation for Gulf Coast VGO as a predictor of West Coast VGO prices. *Id.* It suggests that the result was that his own correlation over-predicted the price of West Coast VGO by 4.4¢/gallon during the period 1994-2001. *Id.* Even if the VGO prices used are changed to reflect a different level of sulfur in the VGO, Williams notes, the result is the same –Tallett's regression equation overstates the actual West Coast

[713] Williams explains that barrels/calendar day refers to the annual operating capacity of a process unit, taking into account the capacity lost due to maintenance activities. Williams Reply Brief at p. 91, n.56.

[714] Williams claims that Exxon, erroneously, introduced Exhibit No. EMT-667 for the proposition that "Sanderson's claim about low utilization levels for West Coast reforming capacity was directly contradicted by a report prepared by [his] own firm." Williams Reply Brief at p. 92, n.57 (quoting Exxon Initial Brief at pp. 233-34).

VGO price. *Id.*

2375. According to Williams, Ross recognizes that the proposals for valuing West Coast Naphtha overstate the actual West Coast Naphtha value because he proposes his governor to correct for situations when the West Coast price of gasoline is high. *Id.* Thus, Williams asserts, Ross acknowledges that any proposal for valuing West Coast Naphtha using a West Coast gasoline-based formula is problematic, so much so that, without a governor to account for gasoline price anomalies, Ross testified, O'Brien's and Tallett's proposals are unsound and should be rejected.[715] *Id.* at pp. 77-78. Williams states that one of Ross's reasons for not relying on ungoverned gasoline prices as a basis for valuing West Coast Naphtha is significant and confirms Sanderson's testimony concerning O'Brien's and Tallett's proposals, to wit: "the results of the formulae proposed by Mr. Tallett and Mr. O'Brien whose formulae grossly inflate the value of Naphtha." *Id.* at p. 78 (quoting Exhibit No. BPX-67 at p. 38).

2376. Thus, Williams argues, the difference between Ross and Sanderson is that Ross suggests that it is preferable to try to devise a way to value West Coast Naphtha on a West Coast basis, hence his advancing the "governor" proposal. *Id.* It notes that Sanderson, by contrast, starts from a "more logical" basis; rather than start with "unjust and unreasonable" proposals to value West Coast Naphtha and try to "cobble-up" an untried and untested fix such as a "governor," a more sound approach is simply to continue using the tried and tested Gulf Coast Heavy Naphtha (waterborne) price quote. *Id.* at pp. 78-79. Williams questions the appropriateness of using convoluted formulæ and governors when Ross has conceded that the advent of the Platts Gulf Coast Heavy Naphtha price and its approximately one-cent increase in the Gulf Coast price used to value West Coast Naphtha lessened his concerns with using a Gulf Coast price. *Id.* at p. 79. Because Ross advocated a preference for a West Coast price basis, if feasible, Williams argues, it would be too much to have expected him to concede that his concerns were completely gone. *Id.* However, it contends that Ross, earlier, did state that it was fair to characterize his testimony as indicating that he would prefer to continue to use the Gulf Coast Naphtha price if the only alternative was one of the ungoverned Tallett or O'Brien approaches. *Id.*

2377. Williams argues that, as Sanderson testified, Dudley's approach has merit because he takes into account feedstock relationships and uses VGO and LSR to value West Coast Naphtha. *Id.* at pp. 79-80. It suggests that Dudley's proposal is based on a good fundamental understanding of the economics of petroleum refining on the West Coast and Gulf Coast, because he avoids the mistake made by Tallett and O'Brien of overvaluing Naphtha by starting with a West Coast gasoline price. *Id.* at p. 80. Dudley

[715] Williams points out that Sanderson expressed the same concerns. Williams Initial Brief at p. 78, n.61.

“correctly” recognizes that, according to Williams, using comparable intermediate feedstock prices such as LSR and VGO, is a more valid basis for valuing Naphtha, another feedstock, than using gasoline, a finished product. *Id.* It maintains that it also is apparent that LSR and Naphtha are produced as co-products due to the wide variety of distillation cut points used in the industry. *Id.* Furthermore, Williams contends that, because Dudley’s percentages are based on the supply percentages of LSR and VGO in ANS, there is some logic to his approach. *Id.*

2378. Williams’s position is not that Dudley’s proposal is the one to pick to replace continued use of Platts Gulf Coast Heavy Naphtha (waterborne) price, rather it claims that its position is that the greatest value of Dudley’s proposal is that it demonstrates the validity of the Gulf Coast Naphtha value being used as the proxy for the West Coast value of Naphtha over the long-term. *Id.* In the event that neither Platts Gulf Coast Heavy Naphtha (waterborne) price nor its feedstock price equivalent on the West Coast, ANS + $4.00, are to be continued, it states that Dudley’s proposal is the next logical choice because it is the only other proposal that attempts to value West Coast Naphtha on an intermediate feedstock basis rather than on a West Coast finished gasoline basis. *Id.* at pp. 80-81.

2379. Should the Commission decide that a West Coast price basis for valuing West Coast Naphtha is a necessity, Williams argues, the only appropriate objective and simple methodology would be to value West Coast Naphtha at the West Coast published ANS crude oil price plus $4.00/barrel. *Id.* at p. 81. It states that using ANS + $4.00 has many merits that are parallel with using the Gulf Coast Heavy Naphtha price quote: (a) it would be based on a published robust, West Coast feedstock price with little risk of manipulation by any one of the Parties to this proceeding; (b) it would be simple to implement and administer; and (c) it is consistent with the philosophy of using feedstock prices to value the intermediate Quality Bank cuts whenever possible. *Id.* at p. 82.

2380. Williams asserts that the record evidence indicates ANS + $4.00/barrel is consistent with the current Quality Bank value for West Coast Naphtha using Platts Gulf Coast Heavy Naphtha (cargo) price quotation until the Commission rules. *Id.* It explains that Sanderson testified that the Gulf Coast Naphtha averaged about $3.60 above ANS from 1994-2002, making that a benchmark. *Id.*

2381. Williams does not recommend the proposed methodology discussed during the course of the Naphtha hearing which performs an “interpolation” between various product prices on the Gulf Coast to impute a Naphtha price on the West Coast be adopted. *Id.* at p. 84. It notes that Sanderson discussed the methodology and identified several problems with the concept. *Id.* The major problem, it posits, stemmed from the choice of Light Distillate and LSR. *Id.* Williams notes that Sanderson described the problem encountered as follows:

> And the problem we ran into was naphtha, because of its price relationships can be higher priced than light distillate, and occasionally, not very often but a couple of times in the period we looked at, it was priced below LSR, so these percentages fluctuated pretty wildly. So you had fairly big variations month to month. Then if you go to the West Coast, the differential – and I don't have the numbers here, but we could provide those – the differential between light distillate and LSR is much wider on the West Coast because jet fuel prices and light distillate prices are somewhat higher and LSR prices are somewhat lower. You have a broader differential. When you apply the percentages from the Gulf Coast ratio to the West Coast, you get a very wildly swinging naphtha price, which I thought was not particularly attractive, and we can show you the results of that. So that concerned me as not being very stable.

Id. (quoting Transcript at pp. 11086-87).

2382. According to Williams, the Exxon interpolation proposal should be dismissed as the "disingenuous" proposal it is. Williams Reply Brief at p. 101. In fact, it asserts that the only valid aspect of the Exxon proposal is that, through this proposal, Exxon concedes that crude oil prices on the two coasts have equalized. *Id.* This proposal, like Tallett's regression analysis, incorrectly assumes that processing margins between feedstocks and finished products (in this case unleaded gasoline and crude oil) are identical (the same interpolation percentage) on the Gulf Coast and West Coast, according to Williams. *Id.* at p. 104. Sanderson testified, it states, that his major problem with Tallett's proposal is that Tallett is using finished products rather than intermediate products. *Id.* at pp. 104-05. In fact, Williams claims, Sanderson went on to testify that the similarity in crude oil prices on the two coasts supports use of the Gulf Coast heavy naphtha value on the West Coast. *Id.* at p. 106-07.

2383. Further, Williams explains, Sanderson considered the possibility of starting with a finished product and LSR. Williams Initial Brief at p. 85. However, it notes, using a finished product has some of the same problems that Sanderson noted in other proposals, primarily that part of the refining margin from the selected product to Naphtha would be inappropriately attributed to the value of Naphtha. *Id.* Thus, Williams states, no satisfactory result was ever achieved using various Quality Bank prices. *Id.*

F. APPLICABILITY OF PLATTS HEAVY NAPHTHA PRICE

1. TAPS Carriers

2384. According to the TAPS Carriers, two decisions of the Quality Bank Administrator regarding Naphtha valuation are at issue: (1) the February 2003 change to the Gulf Coast reference price for Naphtha; and (2) the June 18, 2003 averaging proposal. TAPS

Carriers Reply Brief at p. 2. According to them, the Quality Bank Administrator is an independent neutral expert who attempts to resolve the issues in accordance with his best professional judgment, and the Commission should give due weight to his expertise, neutrality, and "broad authority" to manage the Quality Bank in evaluating criticisms of his decisions by parties with a financial interests in the impact of these decisions. *Id.*

2385. On February 11, 2003, note the TAPS Carriers, the Quality Bank Administrator determined that it was necessary to change the Gulf Coast reference price used to value the Naphtha component. TAPS Carriers Initial Brief at p. 14. They note that both Toof and Sanderson agreed with the Quality Bank Administrator's decision to use the Heavy Naphtha price assessment rather than the Full Range Naphtha price assessment. *Id.* at p. 15.

2386. The TAPS Carriers assert that no evidence was submitted challenging the decision of the Quality Bank Administrator to use Platts Gulf Coast waterborne price assessment for Heavy Naphtha to value the Naphtha component on both the Gulf Coast and the West Coast. TAPS Carriers Reply Brief at p. 2. Nonetheless, state the TAPS Carriers, two parties submitted criticisms of the Quality Bank Administrator's decisions: Unocal/OXY and Petro Star. *Id.* at p. 3. According to the TAPS Carriers, Unocal/OXY oppose the use of the Heavy Naphtha price assessment because: (1) the old Naphtha quote is still available and no implementation problems were presented; (2) the Gulf Coast price overvalues West Coast Naphtha; and (3) the changes have the effect of freezing the prior month's value in place until the issue is resolved. *Id.* at pp. 3-4. They point out that this ignores the fact that the Commission directed the Quality Bank Administrator to use Platts Gulf Coast Naphtha price to value the Quality Bank Naphtha component, and that when Platts began publishing a second assessment for Naphtha in February, 2003, the Quality Bank Administrator had to make a decision as to which price to use. *Id.* at p. 3. Further, the TAPS Carriers state, because the publication of a second Naphtha price assessment was unanticipated and the prior orders of the Commission did not provide guidance to follow, the Quality Bank Administrator used the authority contained in Item III.J. of the Tariff to choose the price that best reflected the value of Quality Bank Naphtha in the Gulf Coast market. *Id.*

2387. By criticizing the Quality Bank Administrator's action for allegedly overvaluing West Coast Naphtha, the TAPS Carriers state, Unocal/OXY are implying that the lower of the two available prices should have been chosen to avoid overvaluing Naphtha. *Id.* at pp. 3-4. They maintain that the Quality Bank Administrator lacks the authority to make that determination. *Id.* at p. 4. Instead, explain the TAPS Carriers, the Quality Bank Administrator was required to pick the price that best matched the specifications of the Quality Bank Naphtha component, and there is no dispute, according to the TAPS Carriers, that he did so. *Id.*

2388. Finally, the TAPS Carriers point out, Unocal/OXY's concern over the freezing in place of the prior month's value would be accurate only if the Quality Bank Administrator had acted under Item III.G.5.b., the provision dealing with a change in the basis for a price assessment. *Id.* In this case, they note, the new price assessment was effective when proposed by the Quality Bank Administrator until changed prospectively by order of the Commission. *Id.*

2389. Petro Star, according to the TAPS Carriers, argues that the Quality Bank Administrator exceeded his authority by acting under Item III.J. *Id.* at p. 5. The TAPS Carriers state that Petro Star does not consider that the publication of the new price by Platts can create an unanticipated implementation issue when the previously used price is still being published. *Id.* They declare that Petro Star is incorrect, and assert that it was clearly unanticipated that Platts would begin to publish two prices and that, even though the Commission had previously approved use of a Gulf Coast Naphtha price, the Quality Bank Administrator clearly had to pick one of the two. *Id.* Further, note the TAPS Carriers, the choice had to be made based on the Quality Bank Administrator's best understanding of the intent of the Commission. *Id.* at pp. 5-6. The TAPS Carriers argue that, by picking Platts Heavy Naphtha assessment, the Quality Bank Administrator fulfilled his obligations, because the Heavy Naphtha specifications more closely match the specifications of Quality Bank Naphtha. *Id.* at p. 6. In the TAPS Carriers's view, the arguments of Petro Star and Unocal/OXY that the Quality Bank Administrator should not have done so would effectively read Item III.J. out of the Tariff. *Id.*

2390. At the June hearing, according to the TAPS Carriers, the principal issue of controversy among the parties was whether Platts Heavy Naphtha assessments should be adjusted by adding 1.5¢/gallon to reflect the higher N+A content of the Naphtha component of ANS. TAPS Carriers Initial Brief at p. 15. They point out that the Quality Bank Administrator did not believe he had authority to make such a change. *Id.* Further, state the TAPS Carriers, the Quality Bank Administrator took no position on whether the Commission should or should not add 1.5¢/gallon to the published Heavy Naphtha price assessment. *Id.*

2391. The TAPS Carriers state that Platts announced on February 5, 2003, that it would begin publishing an assessment for waterborne Heavy Naphtha on the Gulf Coast, with the new price effective February 3, 2003. *Id.* According to them, the Quality Bank Administrator decided to use Platts new Heavy Naphtha price assessment for purposes of the Quality Bank effective March 1, 2003. *Id.* The TAPS Carriers assert that it was not necessary for the Quality Bank Administrator to give serious consideration to postponing use of the Heavy Naphtha price assessment because of Platts's experience in getting prices for Heavy Naphtha transactions on the Gulf Coast and its confidence in its assessments. *Id.* at pp. 15-16. Thus, in the TAPS Carriers's view, it was clearly reasonable for the Administrator to choose March 1, 2003, as the effective date of the change to the Gulf Coast Heavy Naphtha price. *Id.* at p. 16.

2392. The Quality Bank Administrator's June 18, 2003, Notice raises two issues, in the views of the TAPS Carriers, under Item III.G.5.b. of the TAPS Quality Bank Methodology Tariff: (1) was the basis for the Heavy Naphtha price assessment "radically altered" after May 1, 2003; and, if so, (2) is the replacement product price proposed by the Quality Bank Administrator appropriate? TAPS Carriers Supplemental Brief at p. 9. If the answers to those questions are "yes," then the TAPS Carriers assert that the Quality Bank Administrator's proposal should be adopted effective August 17, 2003, to value the Naphtha component (1) on the Gulf Coast and (2) on the West Coast for any period for which a Gulf Coast price assessment is used, either permanently or on an interim basis, to value the Naphtha component on the West Coast. *Id.* at pp. 9-10.

2393. The TAPS Carriers state that parties have offered two criticisms of the Quality Bank Administrator's June 18, 2003, proposal. TAPS Carriers Reply Brief at p. 8. First, they argue that the Heavy Naphtha price assessment has not been "radically altered," and, second, they argue that the Quality Bank Administrator's proposed replacement price is not "appropriate." *Id.* The TAPS Carriers's position is that the Commission should reject the criticisms of the Quality Bank Administrator proposed replacement product price to value the Naphtha component, because they are not consistent with existing Quality Bank methodology or with the parties's pending proposals. *Id.*

2394. It is beyond dispute, state the TAPS Carriers, that the basis for the Heavy Naphtha quotation has been altered. TAPS Carriers Supplemental Brief at p. 10. Prior to May 1, they explain, Platts Heavy Naphtha price assessment was an overall assessment of the waterborne market, which included both cargo and barge transactions. *Id.* This is clear, note the TAPS Carriers, from all three memoranda of conversations with Sharp, an employee of Platts. *Id.* (citing Exhibit Nos. TC-20 through 22). For example, the TAPS Carriers note, in the September 15, 2003, conference call in which representatives of other parties participated in addition to the Quality Bank Administrator, Sharp stated that earlier Heavy Naphtha assessments were a general market assessment, neither solely cargo nor solely barge. *Id.* Indeed, Sharp "stated that during the initial three months of the assessment, he sometimes used barge transactions for the high for the day and cargo transactions for the low." *Id.* (quoting Exhibit No. TC-22 at pp. 1-2). In contrast, assert the TAPS Carriers, it is uncontested that after May 1, despite the fact that the name did not change, the "Heavy Naphtha" price assessment covered only transactions in cargo lots and the "Heavy Naphtha Barge" price assessment covered only transactions in barges. *Id.* at pp. 10-11.

2395. In arguing that there has been no radical alteration of the basis for the Heavy Naphtha price assessment, the TAPS Carriers state, Williams relies on conclusory statements by Sharp that, prior to May 1, the Heavy Naphtha price assessment was "primarily a cargo number" and "consistent with the current cargo assessment." TAPS Carriers Reply Brief at p. 9. When Toof sought clarification from Sharp, it appeared that the principal basis for Sharp's opinion was that he saw little quantitative difference between the Heavy Naphtha price assessment before and after May 1. *Id.* The TAPS Carriers assert that in deciding whether the basis for a price assessment has been "radically altered," the Quality Bank Administrator should not consider the financial impact of the change in the basis for the price assessment. *Id.*

2396. The TAPS Carriers argue that Toof's further questions clarified Sharp's position and made it clear that the basis for the Heavy Naphtha price assessment had in fact been radically altered. *Id.* They note that, prior to May 1, 2003, Platts Heavy Naphtha price assessment reported a range of prices that covered the entire waterborne market for Heavy Naphtha on the Gulf Coast, with barge transactions on the high end and cargo transactions on the low end. *Id.* at pp. 9-10. Further, the TAPS Carriers point out, the Quality Bank methodology uses the average of the daily highs and lows reported by Platts. *Id.* at p. 10. Therefore, they state, the Quality Bank Administrator's proposal to average the Heavy Naphtha assessment (now purely a cargo assessment) and the Heavy Naphtha Barge assessment is a reasonable attempt to approximate the results of the Heavy Naphtha price assessment prior to May 1, 2003. *Id.* Indeed, assert the TAPS Carriers, it is the best available approximation, given the information available. *Id.*

2397. Because it is beyond dispute that the basis for the Heavy Naphtha price assessment was "altered" after May 1, 2003, the TAPS Carriers state, it is difficult to see how an argument that it was not "radically altered" can be successful. TAPS Carriers Supplemental Brief at p. 11. In effect, according to the TAPS Carriers, Platts bifurcated the prior Heavy Naphtha price assessment into two price assessments, each assessing a portion of the market that had been taken into account in the prior Heavy Naphtha assessment. *Id.* Since Platts used the term "Heavy Naphtha" to report prices in different markets before and after May 1 (all waterborne transactions versus only cargo transactions), the TAPS Carriers assert, the change in the basis for those prices is properly characterized as "radically altered." *Id.*

2398. In the two instances in which bifurcation of an existing price assessment has occurred in the past, the TAPS Carrier state, the Quality Bank Administrator also concluded that "the specifications or other basis for the remaining quotation(s)" have been "radically altered" and proposed a replacement product price. *Id.* In both cases, noted the TAPS Carriers, the Commission accepted, subject to the outcome of the pending litigation, the Quality Bank Administrator's conclusion that the bifurcation constituted a radical alteration in the basis for the price quotation and the Quality Bank Administrator's recommended replacement product price. *Id.* at pp. 11-12. For example, note the TAPS Carriers, a similar situation arose with respect to the gas oil component: On December 1, 1997 OPIS announced, through the OPIS overnight fax service, that beginning, January 1, 1998, it would cease to report a single price range for High Sulfur VGO on the Gulf Coast and instead would report separate price ranges for barge and cargo. *Id.* at p. 12. According to the TAPS Carriers, the Quality Bank Administrator concluded that, in that case, the basis for one of the remaining price quotations had been radically altered. *Id.* He, therefore, proposed an appropriate replacement product price, which, state the TAPS Carriers, was accepted by the Commission subject to the outcome of the pending litigation. *Id.* (citing *Trans Alaska Pipeline System*, 83 FERC ¶ 61,083 (1998)).

2399. Similarly, continue the TAPS Carriers, in September 1996 the Quality Bank Administrator concluded that the basis for the quotation used to value the LSR component on the Gulf Coast had been radically altered. *Id.* The TAPS Carriers explain that the Tariff had specified that the LSR component would be valued on the Gulf Coast using Platts Mont Belvieu, Texas, spot quote for natural gasoline. *Id.* Platts began reporting two natural gasoline quotes at Mont Belvieu – Natural Warren and Natural Non-Warren. *Id.* According to the TAPS Carriers, the Commission accepted the Quality Bank Administrator's proposed replacement product price subject to the outcome of the pending litigation. *Id.*

2400. The TAPS Carriers note that Sharp tended to downplay the significance of the change in the Heavy Naphtha assessment. *Id.* at p. 13. Thus, according to the TAPS Carriers, he stated that the difference between the old and the new (0.5¢/gallon) is insignificant. *Id.* Sharp, apparently, based that opinion, state the TAPS Carriers, on what he believed to be the quantitative difference in the size of the old and new Heavy Naphtha price assessments. *Id.* They assert, however, that the financial impact of a change in the basis for a price assessment should not be the ground upon which the Quality Bank Administrator decides whether the basis for a price assessment has been "radically altered." *Id.*

2401. In the first place, argue the TAPS Carriers, the Tariff gives no basis for suggesting that the Quality Bank Administrator should consider the financial impact on one or more shippers when making his decisions under Item III.G.5.b. *Id.* Moreover, they continue, there can be no assurance that the difference between the price of Heavy Naphtha in the Gulf Coast cargo market and the price of Heavy Naphtha in the overall Gulf Coast waterborne market (cargo plus barge transactions) will continue to be half a cent per gallon. *Id.* The TAPS Carriers point out that markets change over time in unpredictable ways in response to changes that cannot be anticipated. *Id.* It would be unreasonable, they assert, to adopt a rule that, in effect, requires the Quality Bank Administrator to predict future price behavior when determining whether the basis for a price quotation has been "radically altered." *Id.* According to them, the fact that prices are being quoted from a different market should be sufficient for the Quality Bank Administrator to conclude that the basis for those price quotations has been "radically altered." *Id.*

2402. Even were the Tariffs interpreted to require the Quality Bank Administrator to undertake a quantitative analysis when deciding whether the basis for a price quotation had been radically altered, they argue, he would be required to conclude that such a radical alteration had occurred with respect to the Heavy Naphtha price assessment. *Id.*

at p. 14. The TAPS Carriers explain that Sharp estimated that the difference in the Heavy Naphtha price assessment before and after May 1 was approximately a 0.5¢/gallon or 21¢/barrel. *Id.* In their opinion, the only comparable benchmark of economic significance in the Quality Bank Methodology Tariff is in Item III.F.3.c.(ii). *Id.* The TAPS Carriers note that one of the tests in the Item for whether the Quality Bank Administrator must investigate the validity of a monthly sample of a stream is whether the volume change in the specific component has resulted in a significant change in the stream's relative value when compared to the prior month's relative value using the prior month's prices. *Id.* If, state the TAPS Carriers, the change results in a price movement of more than ± 15¢/barrel, then the sample's validity must be investigated. *Id.* Thus, according to the TAPS Carriers, a variation in value of 15¢/barrel is apparently considered significant for purposes of the Quality Bank. *Id.* Should quantitative factors be considered, the TAPS Carriers suggest that Sharp's estimate of a 21¢/barrel difference in the value of a barrel of Heavy Naphtha should not be ignored. *Id.*

2403. The TAPS Carriers state that Unocal/OXY's argument, that the basis for the Heavy Naphtha price assessment has not been radically altered because the previous Heavy Naphtha cargo quote has not been discontinued, is not valid either. TAPS Carriers Reply Brief at p. 10. They assert that focusing on the name of the price assessment rather than its content is elevating form over substance. *Id.* It is uncontested, according to the TAPS Carriers, that, prior to May 1, 2003, the price assessment labeled "Hvy Naphtha" reported transactions in both the cargo and barge markets; after May 1, the name did not change, but only cargo transactions were reported under that name. *Id.* In fact, note the TAPS Carriers, the Heavy Naphtha assessment, as it had existed prior to May 1 (an assessment of both cargo and barge transactions), ceased to be reported by Platts on May 1. *Id.* Two new assessments – one for cargo transactions and one for barge transactions – took its place. *Id.* The TAPS Carriers state that the fact that Platts chose to use the name "Hvy Naphtha" to describe the price assessment for cargo transactions does not change the fact that the basis on which it reported price assessments for waterborne Heavy Naphtha had been radically altered. *Id.* at pp. 10-11.

2404. Once the Quality Bank Administrator determined, the TAPS Carriers continue, that the basis for the Heavy Naphtha price assessment had been "radically altered," he was required to "notify the [Commission] . . . and all shippers of this fact and propose an appropriate replacement product price, with explanation and justification." TAPS Carriers Supplemental Brief at p. 14 (quoting Exhibit No. TC-3 at p. 7). They note that Sharp pointed out that transactions for Heavy and Full Range Naphtha, for both barge and cargo lots, exist, although he did indicate that barge transactions may predominate. *Id.* at p. 15. Further, state the TAPS Carriers, Sharp was not able to provide a detailed report of the transactions, although transactions for barge and cargo lots are representative of the market for Heavy Naphtha on the Gulf Coast. *Id.*

2405. According to the TAPS Carriers, it would be arbitrary to choose as the replacement price the assessments for only one of the two markets. *Id.* They claim that there is no logical reason or factual basis for choosing the price assessments for either cargo transactions or barge transactions as representative of the entire market for Heavy Naphtha on the U.S. Gulf Coast. *Id.* A simple average of the prices in both markets will come much closer, in the opinion of the TAPS Carriers, to capturing the value of Heavy Naphtha on the Gulf Coast. *Id.*

2406. When making his recommendation in the June 18, 2003, Notice, the TAPS Carriers state, the Quality Bank Administrator pointed out that there was only a superficial similarity to the bifurcation of High Sulfur VGO prices into barge and cargo transactions by OPIS in 1998. *Id.* at p. 17. In this case, the TAPS Carriers assert, in contrast to that situation, "both the barge and cargo markets appear to be active, and neither appears to be more representative of the Gulf Coast market for Heavy Naphtha." *Id.* (quoting Exhibit No. TC-19 at p. 5). Thus, conclude the TAPS Carriers, there is no reasonable basis for ignoring a major and representative portion of the Gulf Coast market for Heavy Naphtha. *Id.*

2407. The TAPS Carriers assert that, contrary to the views of some of the parties, the use of an average of two prices to value a component is an integral and consistent part of the Quality Bank methodology. TAPS Carriers Reply Brief at p. 11. For example, state the TAPS Carriers, for each reference price the Quality Bank averages the high and low price for each day and then averages the daily averages to obtain a monthly price for each component on the Gulf Coast and the West Coast. *Id.* at pp. 11-12. In addition, note the TAPS Carriers, a location factor is then used to calculate a weighted average of the Gulf Coast and West Coast prices for each component. *Id.* at p. 12. The TAPS Carriers note that the location factor is based on averaging shipment data obtained from the Maritime Administration over a six-month period to determine the percentage of ANS being transported to the Gulf Coast and the West Coast. *Id.* Further, continue the TAPS Carriers, the gravity differential used for the Valdez quality bank is calculated from the averages of the gravity differentials for several companies and then weighted using a location factor to arrive at the overall differential. *Id.* Finally, conclude the TAPS Carriers, the Nelson Farrar Index used to adjust the size of the deductions in the pricing basis for the Light Distillate, Heavy Distillate and Resid components is developed by calculating annual averages of the monthly refinery operating inflation factors. *Id.*

2408. It is true, the TAPS Carriers concede, as some of the opposing parties point out, that prior to the Commission's accepting the Quality Bank Administrator's recommendation with respect to the valuation of the Naphtha component, none of the Quality Bank components was valued by using an average of two reference price assessments in the same region (Gulf Coast or West Coast). *Id.* at pp. 12-13. However, they point out that no decision of the Commission has ever adopted that as a policy. *Id.* at p. 13. Moreover, continue the TAPS Carriers, although Naphtha is currently the only component that is valued using an average of two reported price assessments, all parties support the adoption of a method for valuing the Resid component that will use a weighted average of nine reported price assessments. *Id.* In addition, explain the TAPS Carriers, several of the parties's proposals for valuing the Naphtha component on the West Coast are based on the weighted average of reported prices. *Id.* Thus, in arguing that it is inconsistent with the Quality Bank convention to use a simple average of two price assessments, the TAPS Carriers assert that opponents of the Quality Bank Administrator's proposal are themselves inconsistent with their own proposals to the Commission. *Id.*

2409. Finally, state the TAPS Carriers, Williams and Unocal/OXY argue that approval of the use of an average of two prices would open the door for a continuing series of changes for a component's valuation. *Id.* According to them, this ignores the fact that the Quality Bank Administrator is charged with proposing a replacement price only in the narrow circumstances presented by Item III.G.5.b. – when the basis for an existing price is radically altered. *Id.* The TAPS Carriers point out that the Quality Bank Administrator has no authority to propose a replacement product price (whether an average of two price assessments or a single price assessment) in the many cases in which the Commission has approved the use of a single price assessment to value a component and the basis for that price assessment has not been radically altered. *Id.* at pp. 13-14. Moreover, note the TAPS Carriers, on only one occasion in the ten years that the current methodology has been in effect did the Quality Bank Administrator propose the use of an average of two prices. *Id.* at p. 14. Thus, assert the TAPS Carriers, the great risk of complication that Williams and Unocal/OXY purport to fear is purely imaginary. *Id.*

2410. The TAPS Carriers state that some parties believe that using Platts Heavy Naphtha Barge price assessments is inconsistent with a Quality Bank convention of using only cargo transactions or transactions in the largest parcels available. *Id.* Explain the TAPS Carriers, the Commission has never approved any such "convention," and the price assessments currently being used by the Quality Bank do not support the existence of any such convention. *Id.* For example, they state, the gas oil component is valued on both the Gulf Coast and West Coast using a price assessment for barge High Sulfur VGO. *Id.* Further, note the TAPS Carriers, all parties have agreed that the gas oil component on the West Coast should be valued using the OPIS West Coast High Sulfur VGO price assessment, which includes both barge and cargo transactions. *Id.* In addition, they state, the Resid component is valued on the West Coast using a pipeline price assessment despite the fact that there are West Coast waterborne, i.e., cargo price assessments for heavy (No. 6) fuel oil. *Id.* at p. 15. All parties also agree, according to the TAPS Carriers, that the best base price to use to value the Heavy Distillate component on the West Coast is the pipeline price assessment for Low Sulfur Diesel (formerly Low Sulfur No. 2) despite the fact that there is also a price assessment for waterborne Low Sulfur gasoil on the West Coast, which is essentially the same product. *Id.*

2411. Thus, the TAPS Carriers argue, the convention to which some parties refer simply does not exist. *Id.* In their opinion, the goal should not be to comply with a non-existent convention, but to choose a price assessment (whether a single price assessment or an average) that best represents the market price of the product in question. *Id.*

2412. Some parties, state the TAPS Carriers, suggest that the Quality Bank Administrator's recommendation to average the Heavy Naphtha and Heavy Naphtha Barge price assessments is inconsistent with his prior recommendation with respect to the gas oil component on the Gulf Coast. *Id.* According to them, this is not correct. *Id.* In both the gas oil and LSR situations, the price assessments were bifurcated, explain the TAPS Carriers, and the Quality Bank Administrator concluded that as a result of such a bifurcation "the specifications or other basis for the remaining quotation(s)" had been "radically altered," and the Commission accepted that recommendation. *Id.* at pp. 15-16.

2413. The TAPS Carriers argue that Petro Star expressly conceded the correctness of the Quality Bank Administrator's decision that bifurcation of the prior High Sulfur VGO price assessment constituted a radical alteration of the basis for the price assessment and, therefore, implicitly concedes that the Quality Bank Administrator's decision with respect to the Heavy Naphtha price quotation was also correct. *Id.* at p. 16. In the case of both the High Sulfur VGO price assessment and the Heavy Naphtha price assessment, according to the TAPS Carriers, the reporting service decided to quote separate price assessments for "barge" and "cargo." *Id.* Thus, in both cases, claim the TAPS Carriers, the basis for the preexisting price quotation was radically altered and the Quality Bank Administrator was required to act. *Id.*

2414. Some parties also suggest, according to the TAPS Carriers, that the Quality Bank Administrator was inconsistent in recommending, as the replacement product price, an average of the two new prices following bifurcation rather than recommending only one of them, as he did in the two prior cases. *Id.* In fact, assert the TAPS Carriers, the Quality Bank Administrator has been completely consistent. *Id.* In each of the two prior cases, explain the TAPS Carriers, he considered recommending an average of the two new prices following bifurcation, but rejected that option because it was clear that one of the two new markets being assessed was much more liquid than the other and that price assessments of that market would be more representative of the value of the product at issue. *Id.* at pp. 16-17. In contrast, the TAPS Carriers argue, in this case both markets are active and neither appears to more representative of the Gulf Coast market for Heavy Naphtha. *Id.* at p. 17. Moreover, state the TAPS Carrier, the fact that prior to May 1 the Heavy Naphtha assessment reported "cargo [transactions] typically on the low end and barge transactions on the high end," suggests that an average of the cargo and barge transactions would be the most accurate representation of the market value of Heavy Naphtha on the Gulf Coast. *Id.*

2415. In the view of the TAPS Carriers, there is no basis for any of the allegations of sloppy work that Williams leveled against the Quality Administrator. *Id.* The TAPS

Carriers state that Williams never specifies what additional investigation it believes the Quality Bank Administrator should have undertaken. *Id.* Nor, according to the TAPS Carriers, does it specify what data it considers "necessary," or whether such data are in fact available. *Id.* Moreover, continue the TAPS Carriers, Williams identifies no factual inaccuracies in the Quality Bank Administrator's explanation of the reasons for his recommendation. *Id.* Because Williams waived a hearing on the issues raised by the Quality Bank Administrator's recommendation, the TAPS Carriers point out that he had no opportunity to respond to these allegations. *Id.*

2416. The TAPS Carriers assert that there is certainly no reason to believe that Williams's investigation was more thorough than the investigation undertaken by the Quality Bank Administrator. *Id.* For example, note the TAPS Carriers, as late as August 26, 2003, on the basis of its investigation, Williams apparently believed that prior to May 1, 2003, the Heavy Naphtha price assessment was solely a cargo price, a claim that it abandoned after further conversations with Sharp. *Id.* at pp. 17-18. Moreover, continue the TAPS Carriers, at the time of the final conversation with Sharp, Williams's representative was apparently under the impression, on the basis of his prior investigation, that there was great significance to the code number assigned to the Heavy Naphtha price assessment, a theory that Sharp firmly rejected. *Id.* at p. 18.

2417. In any event, according to the TAPS Carriers, the criticisms of the Quality Bank Administrator's investigation, in addition to being baseless and unfair, are simply irrelevant. *Id.* When Williams requested that there be further conversations with Sharp, the TAPS Carriers point out that the Quality Bank Administrator readily agreed; in the last of those conversations Williams's representative participated and was allowed to ask any questions he wished. *Id.* Following those conversations, note the TAPS Carriers, Williams stipulated that a hearing would not be necessary to resolve the issues raised by the Quality Bank Administrator's June 18, 2003, Notice and that the Commission could resolve those issues based on the record in this proceeding, including the Quality Bank Administrator's notes of the conversations with Sharp. *Id.* Thus, the TAPS Carriers argue, Williams simply has no basis to complain that all facts relevant to a decision on the Quality Bank Administrator's recommendation have not been fully developed. *Id.*

2418. Should the Commission adopt a new methodology for valuing the Naphtha component on the West Coast, the TAPS Carriers state that the Quality Bank Administrator's proposal for valuing the Naphtha component on the Gulf Coast will have effect only as an interim pricing methodology (if the Exxon proposal to adopt a new West Coast methodology retroactively is accepted) or for a relatively brief period until a new methodology is adopted for valuing Naphtha on the West Coast (if one of the proposals for prospective adoption of a West Coast methodology is accepted). TAPS Carriers Supplemental Brief at p. 17.

2419. The TAPS Carriers note that the Commission accepted the Quality Bank

Administrator’s proposed replacement product price to be effective August 17, 2003. *Id.* at pp. 17-18 (citing *Trans Alaska Pipeline System*, 104 FERC ¶ 61,201 at P 9 (2003)). The choice of that date, according to the TAPS Carriers, is consistent with the scheme laid out in the TAPS Quality Bank Methodology Tariff. *Id.* at p. 18. Item III.G.5.b. of the Tariff states that if the Commission “take[s] no action within 60 days of the filing, the replacement product price proposed by the Quality Bank Administrator will become effective as of the sixtieth day.” *Id.* (quoting Item III.G.5.b.; *see also* Exhibit No. TC-3 at p. 7).

2420. There is no reason, declare the TAPS Carriers, to change the August 17, 2003, effective date. *Id.* They maintain that should be the effective date of the Quality Bank Administrator’s proposal for valuing the Naphtha component on the Gulf Coast as well as the effective date of the Quality Bank Administrator’s proposal for valuing the Naphtha component on the West Coast, subject to whether the Commission decides to adopt a new methodology for valuing Naphtha on the West Coast and the effective date they choose for any such new methodology. *Id.*

2. Unocal/OXY

2421. On February 27, 2003, explains Unocal/OXY, pursuant to Item IIIG.5.b. of the TAPS Quality Bank Methodology Tariff, the Quality Bank Administrator filed a “Notice Regarding Proposed Replacement Product Price To Value Naphtha Component on the U.S. Gulf Coast and U.S. West Coast” with the Commission. Unocal/OXY Initial Brief at p. 43. According to them, issues raised by the filing include whether the Quality Bank Administrator should continue to use Platts "Naphtha" price assessment, or whether he should use a new "Heavy Naphtha" assessment, whether, if the "Heavy Naphtha" assessment is used, it should be further modified to include an “N+A" adjustment, and what the effective date of any change should be. *Id.* at p. 44.

2422. Unocal/OXY explain that the Quality Bank Administrator proposed to change the reference price for Gulf Coast Naphtha that currently is used to value both the Quality Bank Naphtha cuts. *Id.* Rather than use the Platts reported price for Full Range Gulf Coast Naphtha as the value for both Gulf and West Coast Naphtha, Unocal/OXY state, the Quality Bank Administrator proposes to use a Platts Gulf Coast price for Heavy Naphtha effective March l, 2003, on the grounds that Heavy Naphtha is closer in quality to the Quality Bank Naphtha cut. *Id.* (citing Exhibit No. PAI-222 at p. 2).

2423. The Quality Bank Administrator, Unocal/OXY claim, acted under the authority of Section III.J of the TAPS Quality Bank Tariff, which states that, in case of an unanticipated issue, the Administrator is authorized to act in accordance with its best understanding of the intent of the Commission. *Id.* at pp. 44-45. According to them, all matters touching upon the Quality Bank methodology and its implementation are contentious, and no TAPS shipper is entirely neutral on even minor matters. *Id.* at p. 45.

Further, state Unocal/OXY, matters concerning Naphtha, the cut at issue with the March 1, 2003, change, are at the forefront of the ongoing disputes. *Id.* Under these circumstances, Unocal/OXY advocate that a conservative reading of Section III.J is warranted. *Id.*

2424. Unocal/OXY oppose the change to the "Heavy Naphtha" price quote for three reasons. *Id.* First, because the old Naphtha quote is still available, Unocal/OXY asserts, no implementation problems are presented by the advent of the new Heavy Naphtha quote. *Id.* They explain that nothing occurred to prevent or frustrate the continued use of the old price so the Quality Bank Administrator did not actually face a problem that required resolution at this time. *Id.* Instead, note Unocal/OXY, the Administrator could have continued use of the old price and thereby left any interested party who preferred the use of the new price the option of initiating a change by filing a complaint with the Commission. *Id.*

2425. Second, Unocal/OXY state, virtually all Quality Bank Naphtha is presently landed on the West Coast, and the Gulf Coast price is used to value the West Coast Naphtha. *Id.* They assert that the record indicates that the Gulf Coast price overvalues West Coast Naphtha. *Id.* Unocal/OXY explain that the overvaluation is caused by the presence of petrochemical demand on the Gulf Coast, but not on the West Coast, and stringent CARB gasoline regulations on the West Coast, but not on the Gulf Coast. *Id.* at pp. 45-46. According to Unocal/OXY, these two facts depress the value of West Coast Naphtha relative to the Gulf Coast price. *Id.* at p. 46. Consequently, Unocal/OXY's position is that the Gulf Coast price should not be adjusted in any manner that would increase the current valuation of West Coast Naphtha. *Id.*

2426. Third, Unocal/OXY note that pricing changes initiated by the Quality Bank Administrator have the effect of freezing in place the prior month's value until the issues raised by the Quality Bank Administrator initiative are resolved by the Commission. *Id.* They maintain that the Quality Bank Administrator should be discouraged from making changes that have this effect unless they cannot be avoided. *Id.*

2427. Unocal/OXY note that a memorandum from the Quality Bank Administrator recording a telephone conversation with Platts states that Platts adjusts prices reported to it to N+A 40, "using a value of .15 cents per % per gallon up to an N+A of 50." *Id.* (citing Exhibit No. PAI-222 at p. 8). In their comments on the Quality Bank Administrator's notice, continue Unocal/OXY, Exxon and Phillips have proposed that the Quality Bank Administrator adjust Quality Bank Naphtha in a similar manner. *Id.* Unocal/OXY point out that the Exxon and Phillips proposal would further increase the price of West Coast Naphtha. *Id.*

2428. According to Unocal/OXY, Sorenson, a refinery engineer with the Phillips's Los Angeles refinery, testified that such an adjustment would be warranted because high N+A

Naphtha is in great demand on the West Coast and the higher N+A that characterizes Quality Bank Naphtha would command a price premium. *Id.* Unocal/OXY contend that Sanderson opposes any N+A adjustment because: (1) an N+A adjustment would afford the Naphtha cut inconsistent treatment as other prices used for Quality Bank cuts are not adjusted for quality parameters; (2) the presence of tight air quality restrictions on aromatics penalizes the production of benzene, and high N+A Naphtha produces benzene; and (3) the market does not normally price adjust for N+A. *Id.* at p. 47. Further, Unocal/OXY note, Sarna, a chemical engineer, testified that high N+A is undesirable because it produces toxic emissions in gasoline, which California Air Resources Board regulations are designed to limit. *Id.*

2429. The record demonstrates, Unocal/OXY assert, that high N+A Naphtha has been devalued by the advent of California Air Resources Board regulations in California. *Id.* They claim that Sorenson's approach to N+A can be explained by the very substantial capital improvements undertaken at his refinery to deal with excess benzene. *Id.* Accordingly, Unocal/OXY argue, from a technical standpoint, adjusting the TAPS Naphtha value upward to account for higher N+A would not be warranted because its high N+A content decreases its value. *Id.* at pp. 47-48. Also, from a legal and procedural standpoint, according to Unocal/OXY, the N+A issue opens up the issue of intra-cut quality that the parties deferred by stipulation. *Id.* at p. 48.

2430. Unocal/OXY note that one of the offsetting cut quality adjustments addressed in testimony that was deferred was an N+A adjustment for Naphtha. *Id.* This and other potential adjustments were raised in order to illustrate that the particular quality adjustments pursued by Exxon were selectively raised to benefit Exxon, assert Unocal/OXY, and they claim that numerous other adjustments were possible. *Id.* In Unocal/OXY's view, the N+A adjustment proposed is simply a back door attempt to get a quality adjustments that was deferred at the front door. *Id.* Unocal/OXY's position is that in order to maintain consistency in the way different cuts are treated, the proposed N+A adjustment must be rejected.[716] *Id.*

2431. Unocal/OXY's position is that any resolution as to the applicability of the Heavy Naphtha price should be implemented as of March 1, 2003, the date that the Quality Bank Administrator made his change effective. *Id.* Further, they assert, any change ordered with respect to an N+A adjustment should be implemented prospectively from the date of decision. *Id.*

2432. To the extent that refunds are ordered back to March 1, 2003, according to Unocal/OXY, the only thing that can be refunded is the amount of any increase over the previously effective rate that the Commission determines to be unjust and unreasonable.

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[716] On reply, Unocal/OXY state that they also adopt the arguments on this point set out in Williams's Initial Brief. Unocal/OXY Reply Brief at p. 86.

Unocal/OXY Reply Brief at pp. 86-87. They assert that there is no authority under Section 15(6) of the Interstate Commerce Act (49 U.S.C. App. § 15(7)(1988)), to order shippers to pay any such refunds. *Id.* Unocal/OXY state that any refund order can be issued to the TAPS Carriers and can only order the refund of amounts collected since the suspension order was issued that are ultimately determined to be excessive. *Id.* That means, according to Unocal/OXY, that the only parties eligible for refunds under Section 15(7) are parties who paid into the Quality Bank, and they are entitled to refunds only of increased assessments they paid subsequent to March 1, 2003. *Id.* Unocal/OXY maintain that there is no authority under Section 15(7) to order a recalculation of Quality Bank debits and credits beyond the limited scope of refunds described above. *Id.*

2433. In the June 18, 2003, Notice, Unocal/OXY explain, the Quality Bank Administrator cited the provision of Section IIIG.5.b that permits him to select a new product price if the "specifications or other basis for the remaining quotation(s) is radically altered." Unocal/OXY Supplemental Brief at p. 2 (citing Exhibit No. TC-19 at p. 3). Further, note Unocal/OXY, the Quality Bank Administrator claimed that Platts quoting of a new price series for “Heavy Naphtha Barge” was a radical alteration. *Id.* at pp. 2-3. Finally, state Unocal/OXY, the Quality Bank Administrator explained that both ship cargo prices, for volumes up to 250,000 barrels, and barge cargo prices, typically 50,000 barrels, were included in the Heavy Naphtha quote prior to May 1, 2003, and that after May 1, the Heavy Naphtha quote was used solely for cargo quotes and the separate Heavy Naphtha Barge quote solely for barge volumes. *Id.* at p. 3.

2434. In Unocal/OXY’s view, the Quality Bank Administrator's averaging proposal is an unnecessary and unwarranted complication to the pricing of the Naphtha cut. *Id.* First, they state, nothing has happened that requires the Quality Bank Administrator to make a change of any kind. *Id.* Unocal/OXY point out that the previously existing price has not been discontinued, and it is not clear that it has been radically altered. *Id.* The previous Heavy Naphtha quote experienced a slight change, but according to Unocal/OXY, certainly not a significant enough change to require that action be taken by the Quality Bank Administrator. *Id.* Second, continue Unocal/OXY, the proposal would treat the Naphtha cut in a manner that is inconsistent with the treatment of other Quality Bank cuts, as averaging of posted prices for different quotes is not done for any of the other cuts. *Id.* Accordingly, Unocal/OXY’s position is that the proposal set forth in the Notice should be rejected, and the Quality Bank Administrator should be required to continue using the “Naphtha” or “Heavy Naphtha” assessment alone, without averaging the “Barge” quote. *Id.*

2435. Prior to March 1, 2003, explain Unocal/OXY, the TAPS Quality Bank used a single price assessment of Platts published as “Naphtha” to value both the Gulf Coast and West Coast portions of the Naphtha cut, which encompasses the boiling range of 175°F to 350°F. *Id.* at pp. 3-4 (citing Exhibit No. TC-3 at p. 11). As a result, continue Unocal/OXY, the Quality Bank Administrator changed the reference price to “Heavy

Naphtha," a new price published in addition to general "Naphtha." *Id.* at p. 4 (citing Exhibit No. PAI-222 at p. 2). They note that the Commission accepted the change and allowed it to take effect subject to refund. *Id.* Thus, state Unocal/OXY, the proposal of June 18, 2003, is the second change in the Naphtha cut reference price by the Quality Bank Administrator in less than four months. *Id.*

2436. The pricing change now proposed is discretionary, in Unocal/OXY's view, and not required by factual changes. *Id.* at p. 5. According to them, the effect of the first change, which substituted the Platts Waterborne Heavy Naphtha price quote for the Full Range Waterborne Naphtha quote, was to increase the value of the Waterborne Naphtha cut by approximately 1¢/gallon. *Id.* (citing Exhibit No. TC-18, Exhibit Nos. EMT-642, WAP-265). The effect of the second change, according to Unocal/OXY, is to add another increase of 0.5¢/gallon. *Id.* (citing Exhibit No. TC-19 at p. 6).

2437. While the magnitude of the difference between barge and cargo price quotes is not large, Unocal/OXY assert, accepting the Notice would impact the parties to this case unequally. *Id.* They explain that parties whose Naphtha cuts are proportionally larger than that in the common stream will benefit, while those whose cuts are smaller will be harmed. *Id.* Unocal/OXY note that they, Petro Star, and Williams are among the parties who will be harmed by allowing the proposed change to take effect, whereas Exxon and Phillips will be benefited. *Id.* at pp. 5-6. Under such circumstances, Unocal/OXY argue, the Quality Bank Administrator should initiate action to change a reference price only when compelled to do so, and the Commission should provide instructions to the Quality Bank Administrator precluding the imposition of entirely discretionary changes that impact shippers non-uniformly. *Id.* at p. 6.

2438. Because they claim that the currently proposed change is discretionary, Unocal/OXY's position is that it should not be approved. *Id.* They argue that the Quality Bank Administrator's proposal is based on an erroneous interpretation of the Tariff. *Id.* Unocal/OXY points out that the language at issue states: "If . . . *the specifications or other basis for the remaining quotation(s) is radically altered*, the Quality Bank Administrator shall notify the [Commission] and all shippers of this fact and propose an appropriate replacement product price, with explanation and justification." *Id.* (quoting Exhibit No. TC-3 at p. 7, Section lII.G.5.b) (emphasis added by Unocal/OXY). Interpreting the italicized phrase in the context in which it appears, Unocal/OXY assert, it is clear that the change in the Heavy Naphtha price referenced by the Quality Bank Administrator was not a radical alteration. *Id.* According to them, accepted maxims of tariff construction, which are summarized in *Trans Alaska Pipeline System*, 57 FERC 63,010 at p. 65,041 (1991), require such a conclusion. *Id.* They note that in *Penn Central Co. v. General Mills, Inc.*, 439 F.2d 1338, at pp. 1340-1341 (8th Cir. 1971) the Circuit Court stated that "a tariff is no different from any contract," and "its true application must sometimes be determined by the factual situation upon which it is sought to be impressed." *Id.*

2439. Further, state Unocal/OXY, tariffs are to be interpreted "strictly against the carrier," and are to be given a reasonable construction "to avoid unfair, unusual, absurd or improbable results." *Id.* at pp. 6-7 (quoting *Penn Central*, 439 F.2d at p. 1341). In interpreting a tariff, Unocal/OXY assert, its terms must be taken in the sense in which they are generally used and accepted, and it must be construed in accordance with the meaning of the words used. *Id.* at p. 7. Unocal/OXY also point out that a tariff is not an abstraction, and the factors and purposes of the terminology must be considered to avoid making adjudication "an exercise in semantics." *Id.* (quoting *United States v. Western Pacific R. Co.*, 352 U.S. 59, at p. 67 (1956)).

2440. Applying these "maxims of tariff construction," Unocal/OXY argue, the language of the highlighted phrase in the Tariff should be construed in the context provided by the phrase preceding it, with due consideration given to the Platts reporting practices. *Id.* In other words, Unocal/OXY claim, the phrase "radically altered" follows, and is used in association with, the phrase "no longer quoted," therefore, it should take a narrowly circumscribed meaning, limited to a change that would be substantial enough to preclude the continued use of the reference price, just as when a price is no longer quoted. *Id.* Accordingly, because the previous Heavy Naphtha price is still published, Unocal/OXY assert, there would be a "radical alteration" only if the values reflected in that price were changed so substantially that the price could no longer be used. *Id.*

2441. Unocal/OXY's position is that the Quality Bank Administrator's showing does not meet this test. *Id.* They note that the Quality Bank Administrator explains that, according to Platts, the Heavy Naphtha assessment prior to May 1, 2003, included both barge and cargo transactions, and that after May 1, 2003, "Platts has now elected to report the barge and cargo transactions separately." *Id.* (quoting Exhibit No. TC-19 at pp. 3-4). Thus, explains Unocal/OXY, the "Heavy Naphtha" assessment is now, according to the Quality Bank Administrator, limited to cargo transactions.[717] *Id.* at pp. 7-8. They state that there is only a one cent difference between cargo and barge assessments, and the remedy proposed by the Quality Bank Administrator (averaging of barge and cargo) would reduce that difference to one half of one cent. *Id.* at p. 8. Furthermore, Unocal/OXY point out that the Quality Bank Administrator has conceded that there are

[717] Unocal/OXY note that they have recommended the continued use of "Naphtha" in lieu of "Heavy Naphtha." Unocal/OXY Supplemental Brief at p. 8, n.3. They explain that what is said here about Heavy Naphtha applies equally to Naphtha. *Id.* As shown on Exhibit TC-19 at 6, explain Unocal/OXY, the Naphtha assessment also has an associated Naphtha Barge assessment. *Id.* Like Heavy Naphtha, Full Range Naphtha has a "Naphtha" price limited to cargo transactions, and a "Naphtha Barge" price limited to barge transactions. *Id.* Thus, should the Commission determine to continue the Naphtha reference price, Unocal/OXY's position is that it should use the cargo price and not the Naphtha Barge assessment. *Id.*

transactions for the sale of Heavy Naphtha in both barge and cargo lots on the Gulf Coast. *Id.* Accordingly, Unocal/OXY argue, there is no showing that the continued Heavy Naphtha assessment has been radically altered, or that it no longer is a viable reference price due to its being based on too few transactions. *Id.*

2442. Lending support to this conclusion, in Unocal/OXY's view, is the evidence that the previously assessed Heavy Naphtha price was already heavily weighted toward cargo transactions, and that the initiation of a parallel barge quote, therefore, did not change the prior Heavy Naphtha assessment to any significant degree. *Id.* at pp. 8-9 (citing Exhibit No. TC-22). Further, Unocal/OXY indicate, the record reflects that, in the earlier Heavy Naphtha assessment, barge transactions were taken into account, and that Sharp stated "there definitely had been a change" in this price after May 1, 2003. *Id.* at p. 9 (quoting Exhibit No. TC-22 at p. 2). Unocal/OXY also assert that evidence related to other cuts shows that the change from barge to cargo pricing is not radical. *Id.* (citing Exhibit Nos. UNO-59, UNO-62; Transcript at pp. 11533-35, 11976-79). While the difference between the Exhibits is not perceptible, Unocal/OXY point out, Exhibit No. UNO-59 carries a table that shows the difference caused by switching from barge to cargo, a difference that ranges from 0 to 0.85¢/gallon.[718] *Id.* Similarly, explain Unocal/OXY, Exhibit No. TC-19 indicates that the differences between the barge and cargo Platts quotes for Heavy Naphtha prices are of the same magnitude. *Id.* Given that the pricing change for the different quotes is not large, that the practice of quoting both barge and cargo prices is not unusual, and that the previous Heavy Naphtha cargo quote has not been discontinued, Unocal/OXY's position is that adding a barge quote for Heavy Naphtha is not a radical change. *Id.* at pp. 9-10. The change proposed by the Quality Bank Administrator should, therefore, be rejected, in the view of Unocal/OXY, and he should be instructed to continue the previous reference price without the proposed change. *Id.* at p. 10.

2443. Unocal/OXY assert that the proposal set forth in the Notice would afford inconsistent treatment to the Naphtha cut. *Id.* They point out that the averaging of different price quotes is not used for any other cut, notwithstanding that there are multiple price postings similar to those published for Naphtha for several other cuts. *Id.* For example, explain Unocal/OXY, VGO has prices assessed for both barge and cargo on the

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[718] More specifically, of the 25 data points shown in Exhibit UNO-59 at p. 2, nine show that the change made no difference, 13 showed that the difference between Gulf Coast and West Coast narrowed because the OPIS Gulf Coast High Sulfur VGO cargo assessment was lower by between .082¢/gallon and 1.034¢/gallon than the previous assessment, and on only two occasions did the Gulf Coast High Sulfur VGO assessment increase, once by .155¢/gallon and once by .855¢/gallon. Unocal/OXY appears to wish to ignore the instances where the replacement reference price caused the value of Gulf Coast VGO to go down relative to its value on the West Coast, perhaps because they do not wish to call attention to the fact that the difference is not as imperceptible as they argue.

Gulf Coast. *Id.* However, the barge and cargo prices for VGO are not averaged; instead, note Unocal/OXY, the barge assessment is used. *Id.* (citing Exhibit No. TC-3 at p. 12). They explain that the current price used for VGO was approved by the Commission in 1998. *Id.* (citing *Trans Alaska Pipeline System*, 82 FERC ¶ 61,343 (1998)). In the notice that preceded that order, state Unocal/OXY, the Quality Bank Administrator also claimed that the addition of a barge price quote, in this case by OPIS instead of Platts, was a radical alteration. *Id.* (citing Exhibit No. TC-23 at p. 4). Unocal/OXY point out, in the case of VGO, the Quality Bank Administrator proposed using only the barge quote because there were only a few, isolated cargo transactions in VGO. *Id.* Thus, note Unocal/OXY, as distinguished from the facts of the Heavy Naphtha situation, the Quality Bank Administrator concluded that the price change was radical because it rendered the previously used price for VGO unreliable, while the new VGO Barge price "would probably be more representative of the High Sulfur VGO market value on the Gulf Coast." *Id.* at pp. 10-11 (citing Exhibit No. TC-23 at p. 4).

2444. The issue of using an average for the VGO price, Unocal/OXY point out, was considered and rejected because there was no data on which to base a weighting of the two prices, and "[t]here is no reason to believe that a simple arithmetic average would accurately reflect the market price." *Id.* at p. 11 (citing Exhibit No. TC-23 at p. 5). In contrast, when it came to Heavy Naphtha, Unocal/OXY note, the same facts applied, but the Quality Bank Administrator reached a different result. *Id.* (citing Exhibit No. TC-19 at p. 4).

2445. In addition to VGO and Naphtha, Unocal/OXY state, there are multiple prices quoted for other cuts, yet the Quality Bank Administrator has not suggested that averaging should be used for the other reference prices. *Id.* They explain that this is true for the Heavy Distillate, Resid, and LSR cuts. *Id.* at pp. 11-12 (citing Exhibit Nos. TC-3, TC-19, WAP-262). Therefore, Unocal/OXY argue, averaging the Heavy Naphtha assessments is inconsistent with the pricing used for these other cuts. *Id.* at p. 12.

2446. Also, Unocal/OXY note, the convention used in the Quality Bank has been to choose the largest available quantities for valuing each cut. *Id.* (citing Exhibit No. BPX-1 at p. 16). They explain that the Heavy Naphtha assessment is the largest quantity for Naphtha, as it is based on cargo lots of up to 250,000 barrels, whereas barge lots are considerably smaller, typically 50,000 barrels. *Id.* (citing Exhibit No. TC-19 at p. 3). In Unocal/OXY's view, averaging the barge and cargo prices breaches this principal and affords inconsistent treatment to the Naphtha cut. *Id.*

2447. It is the position of Unocal/OXY that the Gulf Coast Naphtha price should continue to be used to value the West Coast cut. *Id.* In Unocal/OXY's view, their argument regarding the inappropriateness of averaging barge and cargo quotes applies equally to the West Coast. *Id.* It is their position that the Full Range Naphtha price should be used, as it has in the past, to value both the Gulf Coast and West Coast cuts, and that the barge assessment should not be used. *Id.* In addition, should the Commission approve the switch to the Heavy Naphtha price, Unocal/OXY state, that price should be used without any consideration of the Heavy Naphtha Barge price. *Id.*

2448. Unocal/OXY note that the Commission's order accepting the Quality Bank Administrator's proposal made the proposed change effective August 17, 2003, subject to refund. *Id.* at p. 13. Because the proposal is subject to refund, Unocal/OXY explain that the new averaging proposal took effect on August 17, 2003, and remains in effect until changed by the Commission in the final order resolving this case. *Id.* Hence, according to Unocal/OXY, the effective date for the change, if approved by the Commission, is August 17, 2003. *Id.*

2449. Under section 15(7) of the ICA, 49 U.S.C. App. §15(7)(1988), Unocal/OXY assert, the Commission can grant refunds for that part of a carrier-initiated rate that constitutes an increase over the previously effective rate. *Id.* (citing *OXY*, 64 F.3d at pp. 698-99; *Buckeye Pipe Line Co*., 13 FERC ¶ 61,267 at p. 61,595 (1980)). Accordingly, should the Commission not approve the proposal to average the barge and cargo quotes, Unocal/OXY argue, shippers who paid higher Quality Bank assessments as a result of the change that took effect on August 17, 2003, will be entitled to a refund for the increased amount they paid. *Id.*

3. Petro Star

2450. Petro Star believes that use of the Platts Gulf Coast Heavy Naphtha price is suitable to value Gulf Coast Naphtha, although it suggests that the TAPS Quality Bank Administrator exceeded his authority by unilaterally changing to the new quotation. Petro Star Initial Brief at p. 25. It further states that use of the new quotation would be appropriate for use in Dudley's methodology, which Petro Star has proposed as the best alternative should the Commission determine that Gulf Coast pricing no longer should be used for West Coast Naphtha. *Id.* However, it would be unfair, Petro Star submits, to impose an N+A adjustment on the Gulf Coast, and even more unfair to impose one on the West Coast for the reasons asserted by Williams and Unocal/OXY. *Id.* Moreover, Petro Star asserts, any change to the Naphtha valuation is subject to the Joint Stipulation that the effective date for any new Naphtha price should be the same as the effective date for using the West Coast VGO reference price. *Id.* at p. 26.

2451. According to Petro Star, the specifications for Platts Gulf Coast Heavy Naphtha assessment appear to better match the 175°F – 350°F boiling range of Quality Bank Naphtha. *Id.* However, Petro Star does not agree that it was proper for the Quality Bank Administrator to unilaterally determine to put the new reference price into effect. *Id.* It notes that, in his February 27, 2003, filing, the Quality Bank Administrator explained that he perceived that the Platts announcement of the new Heavy Naphtha quotation created an "unanticipated implementation issue," that he had concluded that "it is more consistent" with the intent of the Commission to use the new quotation rather than the one that had been approved by the Commissions, and that he had determined to make the new quotation effective on March 1, 2003, two days later. *Id.*

2452. There was no evidence, according to Petro Star, that the Full Range Naphtha quotation already in use had changed. *Id.* It notes that the Quality Bank Administrator's telephone conversation with Sharp indicated that it had not, and asserts that the new Heavy Naphtha quotation was an additional quotation that the Quality Bank Administrator believed was more appropriate than the one in use. *Id.*

2453. According to Petro Star, the Quality Bank Administrator took action under Tariff Item III.j, which authorizes him to resolve unanticipated issues concerning implementation of a methodology. *Id.* at pp. 26-27. Petro Star does not agree that mere publication of a new quotation can create an unanticipated implementation issue. *Id.* at p. 27. When the language in Item III.j was drafted, Petro Star states, there had never been a distillation methodology used by the TAPS Quality Banks, all the "facilities and technical and contractual arrangements required to implement the Assay Methodology" had to be put in place, and temporary Quality Bank debits and credits needed to be calculated and then replaced when the new methodology was implemented. *Id.* (quoting *Trans Alaska Pipeline System*, 65 FERC at p. 62,286). Moreover, continues Petro Star, other well-known distillation methodologies had been agreed to rather than imposed, so there was no history to indicate that implementing a distillation methodology would be easy. *Id.* Petro Star asserts that, instead, there was ample reason to be concerned that a truly unanticipated issue could arise that would prevent the new methodology from being implemented unless the Quality Bank Administrator had discretion to deal with it. *Id.* It argues that didn't happen here. *Id.* According to Petro Star, the existing Naphtha reference price continued on unchanged. *Id.* Had the Quality Bank Administrator not acted unilaterally, claims Petro Star, the Quality Bank would have continued to function precisely as it had before. *Id.*

2454. Petro Star recommends that any change in the West Coast Naphtha price (including any change that is accomplished by alteration of the Gulf Coast Naphtha price) should have an effective date consistent with the parties's Joint Stipulation that any new valuations for West Coast Naphtha and West Coast VGO have the same effective date. *Id.* at pp. 27-28. All parties have agreed on the appropriateness of using the OPIS West Coast high sulfur VGO price to value West Coast VGO on the West Coast since the first round of testimony. *Id.* at p. 28. Consequently, Petro Star asserts that it would be unfair to allow the Quality Bank Administrator's action to accelerate the Naphtha timetable relative to the VGO timetable and thereby avoid the parties's Stipulation. *Id.* Petro Star states that the parties's Stipulation thus should control if, and to the extent that, any new Naphtha price is adopted to value West Coast Naphtha. *Id.*

2455. In addition, contrary to the arguments presented by Exxon and Phillips (joined by

Alaska), Petro Star believes that any N+A adjustment to Naphtha prices, if made at all, only can be made prospectively from the date of the final Commission decision. Petro Star Reply Brief at p. 28. It states that both Exxon and Phillips argue that a March 1, 2003, effective date would be consistent with *OXY*, but, according to Petro Star, they appear to base their position on the Commission's acceptance of the TAPS Carriers's tariff filings effective March 1, 2003, subject to refund, in which the TAPS Carriers proposed to apply the newly-reported Platts Gulf Coast Heavy Naphtha price in the valuation of Naphtha in the Quality Bank. *Id.* at pp. 28-29. Petro Star asserts, however, that Exxon and Phillips cannot evade the fact that the N+A adjustment was not requested by the Carriers in their tariff filings as accepted and suspended by the Commission in *BP Pipelines (Alaska) Inc. Id.* at p. 29. Rather, explains Petro Star, Phillips and Exxon requested the N+A adjustment in their protests to the Carriers's tariff filings. *Id.* Therefore, argues Petro Star, Exxon's and Phillips's position is inconsistent with the requirement in Section 15(7) of the Interstate Commerce Act which authorizes the Commission "to require the interested carrier or carriers . . . to refund, with interest . . . such portion of such increased rates or charges as by its decision shall be found not justified." *Id.* at pp. 29-30 (quoting 49 U.S.C. App. § 15(7)(1988)). Thus, explains Petro Star, the statute provides for refunds only in the case of rate changes filed by carriers. *Id.* at p. 30.

2456. When carriers initiate a rate change, Petro Star states, it triggers the Commission's Section 15(7) suspension power; it does not trigger a free-for-all. *Id.* Petro Star notes that the Circuit Court in *OXY* explained by saying that:

> In their 1989 filing, the TAPS Carriers proposed increases in the Quality Bank adjustments; they did *not* propose a change in the gravity methodology. Thus while it was entirely proper for the Commission to consider the proposed adjustments under the provisions of section 15(7) and, if warranted, to order refunds, the gravity methodology could not be subject to those proceedings because it remained the established method of calculating Quality Bank credits and debits.

Id. (quoting 64 F.3d at pp. 699-700) (emphasis in original). In the 1989 proceedings that led to *OXY*, explains Petro Star, the Carriers filed a tariff change increasing the gravity differential. *Id.* Notes Petro Star, OXY and Phillips challenged the new gravity filings and, in addition, sought relief from the Carriers's acceptance of natural gas liquids in the petroleum shipped through TAPS. *Id.* In the instant proceeding, continues Petro Star, the Carriers filed proposed changes to the reference price to be used for Gulf Coast Naphtha, and Exxon and Phillips (although they didn't challenge the proposed changes) sought to institute a wholly new N+A adjustment. *Id.* Thus, according to Petro Star, Exxon's and Phillips's position here is analogous to Conoco's and OXY's request in 1989 for relief from the Carriers's acceptance of natural gas liquids, not Conoco's and OXY's challenge to the Carriers's proposed increase in the gravity adjustment. *Id.*

2457. As a result, Petro Star states, in the *OXY* proceedings, refunds would have been limited to overpayments made because of the increased gravity differential. *Id.* at p. 31. It states that the resulting net payments would have been within the bounds set by the gravity differential in effect before the change and the changed differential. *Id.* Petro Star's position is that this should be the case here. *Id.* It notes that the Commission did not accept the N+A adjustment effective March 1, 2003, nor did it accept it subject to refund. *Id.* Petro Star asserts that refunds back to the March 1, 2003 suspension date should be within the bounds established by the prior Naphtha valuation, Gulf Coast Naphtha, and the change filed by the TAPS Carriers, Gulf Coast Heavy Naphtha. *Id.* It is Petro Star's position that Exxon's and Phillips's N+A position would require refunds well outside these bounds without any justification at all. *Id.* In addition, states Petro Star, retroactive application of the N+A adjustment, if adopted, would be inequitable to refiners for the reasons outlined in Issue 5 of the Eight Parties's Briefs on this issue. *Id.*

2458. On June 18, 2003, states Petro Star, the Quality Bank Administrator filed a notice with the Commission in which he proposed a replacement product price to value the Naphtha component on both the Gulf Coast and the West Coast. Petro Star Supplemental Brief at p. 2. After considering comments, notes Petro Star, the Commission accepted the proposed replacement product price, effective August 17, 2003, subject to the outcome in the pending Quality Bank proceedings. *Id.* Petro Star supports the arguments made by Williams on the proposed replacement product price to value Naphtha. *Id.* In addition, for the following reasons, Petro Star opposes the Quality Bank Administrator's proposal to value Gulf Coast Naphtha, and by extension West Coast Naphtha, as the arithmetic average of the average monthly price for Gulf Coast Waterborne "Heavy Naphtha" and Gulf Coast Waterborne "Heavy Naphtha Barge" as reported by Platts. *Id.* at p. 2-3. Petro Star does not agree that the Quality Bank Administrator has demonstrated there has been a "radical alteration" in the Platts Gulf Coast Heavy Naphtha assessment. *Id.* at p. 3. It states that, according to conversations with Sharp, it appears that the prior "Heavy Naphtha" quote did encompass data pertaining to both cargos and barge lots, but was weighted toward cargos, and that the current "Heavy Naphtha" quote covers only cargos, with barge lots now having their own new quote. *Id.* (citing Exhibit TC-22 at pp. 1-2). Moreover, in Petro Star's view, it appears highly questionable whether the change justifies the solution proposed by the Quality Bank Administrator. *Id.*

2459. Petro Star points out that a situation arose in 1998 with regard to the VGO cut that, "superficially," was similar. *Id.* A comparison to that situation is useful here, states Petro Star, because, at that time, the Quality Bank Administrator provided guidance as to the quality of data that would be needed to justify using an average of two quotes. *Id.* It explains that, while the tariff provided for use of the OPIS U.S. Gulf Coast spot quote for High Sulfur VGO, there was no doubt that the High Sulfur VGO was discontinued when OPIS announced that it would quote separate price changes for barge and cargo High Sulfur VGO. *Id.* at pp. 3-4. Petro Star concedes that, in that case, the Quality Bank

Administrator had to act. *Id.* at p. 4. Because there were significant periods of time when no cargo transactions took place, Petro Star explains, the Quality Bank Administrator decided that the OPIS barge spot quote would best represent the High Sulfur VGO market on the Gulf Coast. *Id.* In reaching that conclusion, Petro Star states, the Quality Bank Administrator considered and rejected the use of both a weighted and a simple average of the two new quotations, because there was not enough data to support a weighted average and an arithmetic average was not considered representative of the market price. *Id.* Thus, in 1998, it explains, the Quality Bank Administrator apparently preferred to use a weighted over an arithmetic average, but the necessary data were not available. *Id.*

2460. Nothing in the Notice which the Quality Bank Administrator filed with the Commission, declares Petro Star, or in the telephone conversation logs submitted as Exhibits TC-20 through TC-22, indicates that, with regard to averaging, the situation is any different today than it was in 1998. *Id.* at p. 5. It points out that, according to Sharp, the unadorned Heavy Naphtha quote previously weighted cargo more heavily and could be correctly described as primarily a cargo assessment. *Id.* (citing Exhibit Nos. TC-21, TC-22 at p. 1). Further, notes Petro Star, Sharp reported having sometimes used barge quotes for the high prices for a day and cargo for the low prices. *Id.*

2461. It is difficult, Petro Star submits, to see how arithmetically averaging the new “Heavy Naphtha Barge” quote with the “Heavy Naphtha” quote is consistent with the descriptions of the Heavy Naphtha quote previously being weighted towards cargo lots. *Id.* According to Petro Star, barge lots – with their higher prices – would have a greater impact than they did before. *Id.* Further, Petro Star contends, the weighted average approach is no more promising: Even though barge transactions may slightly predominate, it maintains, on average, they involve only about 20% of the volume that cargo transactions do, and Sharp was unable to provide any detailed breakdown of the transactions. *Id.* (citing Exhibit TC-20 at p. 1).

2462. Petro Star contends that, like the Quality Bank Administrator’s decision to use the Heavy Naphtha quotation, the decision to average the “Heavy Naphtha” and “Heavy Naphtha Barge” quotations is not required or authorized by the Tariffs. *Id.* at pp. 5-6. Here, explains Petro Star, although the publication of the “Heavy Naphtha Barge” quotation affected the “Heavy Naphtha” quotation by removing the relatively minor influence of barge lot data, it did not radically alter the “Heavy Naphtha” quotation. *Id.* at p. 6.

4. BP

2463. BP notes, it agrees that Platts Heavy Naphtha's specifications are more in line with the specifications for Quality Bank Naphtha. BP Initial Brief at p. 65. Moreover, BP points out, all of the parties have agreed that the Platts Heavy Naphtha price should be used. *Id.* Consequently, it is BP's position that the Platts Heavy Naphtha price is the appropriate price to use for valuing Gulf Coast Naphtha. *Id.*

2464. Exxon and Phillips, BP contends, each argue that Platts Heavy Naphtha assessment should be adjusted upwards by 1.5¢/gallon (based on a 0.15¢ adjustment for each increase in N+A above 40 to a maximum of 50 N+A) to take into account the difference between the N+A content of Platts Heavy Naphtha and the N+A content of naphtha contained in ANS crude. *Id.* (citing Transcript at pp. 13339-40). Using assays in the record, BP explains, the Quality Bank Administrator has stated that the N+A content of ANS is roughly 55 and there has not been a material change in its N+A content since 1993. *Id.* at pp. 65-66 (citing Exhibit No. PAI-222 at p. 7).

2465. BP points out that, whereas Platts in its Naphtha assessment clearly delineates a 40 N+A content, the Platts Heavy Naphtha assessment is silent on its N+A content. *Id.* at p. 66. Without clear proof of the N+A content of the Platts Heavy Naphtha quote, BP argues, assumptions regarding its N+A content and adjustments to the Naphtha price based on those assumptions are inappropriate. *Id.*

2466. It further argues that, because the Quality Bank has used an unadjusted Platts Naphtha assessment to value the ANS Naphtha cut for ten years, it would be inappropriate to now make an N+A adjustment. *Id.* at p. 67. According to BP, there is nothing different about the use of the Platts Heavy Naphtha assessment that leads to the conclusion that an N+A adjustment is needed in the Quality Bank in order to value the naphtha cut. *Id.* Moreover, BP points out that there also has been no material change in the N+A content of ANS Naphtha over time. *Id.* Consequently, it is BP's position that no justification exists for making an N+A adjustment for Naphtha in these proceedings, assuming the current specification, Platts Heavy Naphtha, contains the same N+A as the past specification, Platts Naphtha. *Id.*

2467. BP asserts that an N+A adjustment is unnecessary to ensure that the Quality Bank values Naphtha appropriately nor does it assist in valuing each Quality Bank component at a market price. *Id.* It disagrees with Exxon and Phillips that the N+A adjustment is needed in order to meet the Circuit Court's requirement that the Commission "must accurately value all cuts – not merely some or most of them – or it must overvalue or undervalue all cuts to approximately the same degree." *Id.* (citing *OXY*, 64 F.3d at p. 693); *see also* BP Reply Brief at p. 77. Instead, according to BP, the logic of *OXY* cuts squarely against it. BP Initial Brief at p. 68.

2468. The Circuit Court, BP claims, established a relative standard in its *OXY* decision. *Id.* In order to comply with the Circuit Court's decision, BP states, the Commission must look to the valuation of all of the Quality Bank cuts to determine if they are being overvalued or undervalued to approximately the same degree. *Id.* It maintains that the N+A adjustment that Exxon and Phillips recommend would treat Naphtha differently than any other cut, and asserts that making an adjustment would not lead to consistency in valuation; in BP's view, it would lead to inconsistency. *Id.*

2469. BP explains that the proposed N+A adjustment adds an additional level of analysis to only the Naphtha cut. *Id.* At present, notes BP, there is only one type of adjustment made to reference prices – those cost-based adjustments that are needed to bring finished product reference prices back to the intermediate products that they are intended to value. *Id.* For example, continues BP, the Light Distillate cut is valued using the price of jet fuel, a finished product, minus the cost that would be associated with processing ANS light distillate, an intermediate product, to final product status. *Id.* (citing *Exxon,* 182 F.3d at p. 35).

2470. Similarly, according to BP, the proposed Heavy Distillate cut reference price deductions are designed to account for costs that would be necessary to process the intermediate ANS Heavy Distillate into the quality of finished product that can be sold on the West Coast and Gulf Coast. *Id.* Other than these processing adjustments, however, BP claims, no other adjustments are made to the price assessments used to value the various Quality Bank cuts.[719] *Id.* at pp. 68-69. BP concludes that the proposed N+A adjustment to Naphtha in no way compares to the necessary processing cost deductions associated with the Light Distillate or Heavy Distillate cuts. *Id.* at p. 69.

2471. BP notes that the proposed N+A adjustment would make an adjustment to an intermediate product reference price – Platts Heavy Naphtha – to value a comparable intermediate product. *Id.* It asserts that that kind of adjustment is not made today to any reference price that is used in the Quality Bank, and notes that Exxon and Phillips each suggested that this change is justified because the industry recognizes that there are value differences among Naphthas with varying N+A contents. *Id.* (citing Transcript at pp. 13213, 13340). BP argues that that argument ignores the basic teaching of the Circuit Court's *OXY* decision – that all cuts have to be valued on a consistent basis. *Id.* In a later decision, according to BP, the Circuit Court reinforced the importance of looking at the valuation of the Quality Bank cuts as a whole rather than on an isolated basis. *Id.* In *Exxon*, BP notes that the Circuit Court rejected Exxon's attempt to suggest that the Commission had violated the *OXY* decision by failing to account for quality differences in the distillate cuts of the streams coming from the different ANS oil fields. *Id.* (citing *Exxon*, 182 F.3d at p. 38). BP points out that the Circuit Court reinforced the importance of focusing on the consistent, relative valuation of the Quality Bank cuts:

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[719] BP explains that the Eight Parties's proposed logistics adjustment to the Heavy Distillate cut is different in character than the proposed N+A adjustment, because it does not attempt to value Heavy Distillate according to its individual chemical characteristics, but simply attempts to place Heavy Distillate at a consistent location, waterborne, where the other cuts are valued. BP Initial Brief at p. 69, n.13.

> In *OXY*, we recalled that the goal of the Quality Bank is "to assign accurate *relative* values" to the diverse streams delivered to the pipeline. We vacated in part the last order because the methodology approved therein had favored one class of cuts above others. We remanded in order that [the Commission] might provide a methodology with a reasoned relative uniformity, knowing that absolute precision at any level of the cuts was unachievable. That is, we did not remand because the old method was inaccurate, but because it was unfairly nonuniform.

Id. at pp. 69-70 (quoting *Exxon*, 182 F.3d at p. 38)(emphasis in original, citation omitted).

2472. Were an N+A adjustment made to Naphtha, BP suggests, it would inject another level of analysis and administrative complication into the Quality Bank. *Id.* It points out that those parties who claim that this is not true (for example Phillips) have failed to consider that other intermediate products whose reference prices are used to value Quality Bank cuts also can have variations in value depending on changes in specifications associated with the particular cut. *Id.*; BP Reply Brief at p. 78. To apply the type of approach to other cuts that Exxon and Phillips seek to apply to Naphtha, BP asserts, the Commission would need to examine whether there are differences between the specifications for the reference prices used and the ANS quality for each of the Quality Bank cuts. BP Initial Brief at p. 70. For example, there are other adjustments that could be made to LSR, Naphtha, Light Distillate, Heavy Distillate, VGO, and Resid that would, in BP's opinion, add an entirely new level of complexity to the proceedings. *Id.* at pp. 70-71. Moreover, maintains BP, these other adjustments would need to be considered or the Quality Bank would depart from the consistency in valuation required by *OXY* and *Exxon*. *Id.* at p. 71.

2473. BP disagrees with Phillips's arguments that there is no evidence that Platts makes similar adjustments to other Quality Bank cuts and thus no need to be concerned that an N+A adjustment to Naphtha would require a similar analysis for the other cuts. BP Reply Brief at p. 79. First, BP notes, the only evidence allowed on this point was a listing of other cuts that may need adjustment. *Id.* It asserts that, even standing alone, that list indicates that, were an N+A adjustment made, review of almost all of the remaining cuts will be required to see if similar adjustments should be made. *Id.* Second, as the N+A proposed adjustment occurred mid-hearing, BP explains, a full analysis of the other cuts regarding potential adjustments like an N+A adjustment has not been performed. *Id.* Third, BP points out, the parties opposing the N+A adjustment are not seeking any other adjustments, they simply note that, were an N+A adjustment made, others will need to be considered. *Id.* BP agrees and suggests that if the proposed N+A adjustment was made, it would encourage the parties to seek other adjustments that would be economically advantageous which would lead to prolonged litigation to resolve all the multitude of adjustments that could be made to the other Quality Bank cuts. *Id.*

Finally, even assuming there is no record evidence indicating that other cuts may require similar adjustments, BP contends, it does not mean that such evidence does not exist. *Id*.

2474. Further, BP notes that Platts does not now publish, and never has published, an N+A adjustment. BP Initial Brief at p. 71. It points out that the Quality Bank Administrator's notice, Exhibit No. PAI-222, does not suggest that Platts makes it a practice to survey the market periodically to determine if the N+A adjustment is appropriate or remains appropriate over time; nor is there any suggestion that this is a cost-based adjustment. *Id.* at pp. 71-72. Further, explains BP, Platts does not recommend that its customers apply this, or any other, N+A adjustment when using any Platts Naphtha assessment. *Id.* at p. 72.

2475. The only evidence provided that Platts makes this adjustment, maintains BP, comes from conversations the Quality Bank Administrator, Mitchell, had with Sharp in which Mitchell learned that Sharp makes this adjustment as a rule of thumb. *Id.* BP notes that if Sharp was replaced Mitchell did not know whether his replacement would make the same N+A adjustment. *Id.*

2476. BP asserts that this information is entirely different from the kind of price quotation information that is used to value any of the Quality Bank cuts. *Id.* It states that there is no conclusive proof that Platts includes an N+A adjustment each time a Naphtha price assessment is made, and argues that the record contains only a references to one man's rule of thumb that is not part of the official specifications for Platts. *Id.* BP maintains that this is not the kind of evidence that underlies the other cuts's valuations and is too speculative to justify a departure from past practice by making a new N+A adjustment to the price of Naphtha. *Id.* Accordingly, it is BP's position that it is not appropriate to use this information to make an adjustment to the reference price used to value naphtha. *Id.*

2477. In its reply brief, BP notes, proponents of the N+A adjustment claim that N+A adds value on the West Coast in the same manner that they claim it does on the Gulf Coast and that the N+A adjustment may be needed as a correction. BP Reply Brief at p. 81. BP argues that the proponents of a potential West Coast N+A adjustment fail to recognize that making such an adjustment would be inappropriate on the West Coast for the same reasons it would be inappropriate on the Gulf Coast. *Id.* at pp. 81-82; BP Initial Brief at p. 72.

2478. BP notes that Phillips argues that the N+A adjustment should be made retroactive to March 1, 2003, and that the overall methodologies should be retroactive to March 1, 2003. BP Reply Brief at p. 82. It asserts that both a new Naphtha methodology and any N+A adjustment should be applied only prospectively for the reasons explained regarding Issue Nos. 5 and 9 in the Eight Parties's Initial Brief. BP Initial Brief at p. 73; BP Reply Brief at p. 82. In BP's view, making the Naphtha value retroactive to March 1, 2003, would deviate from the effective date for VGO. BP Reply Brief at p. 82. It notes that the parties have stipulated that the Naphtha and VGO valuations should be effective as of the same date and that it would be inappropriate to have their effective dates differ. *Id.*

2479. On June 18, 2003, BP acknowledges, the TAPS Quality Bank Administrator filed a Notice explaining that there had been a change in the way that Platts provides assessments for its Heavy Naphtha quotations on the Gulf Coast. BP Supplemental Brief at p. 1. Previously, noted BP, Platts had a single assessment for Heavy Naphtha that it called "Heavy Naphtha," which the Quality Bank has used to value naphtha since March 1, 2003, subject to the outcome of the hearing. *Id.* (citing *BP Pipelines (Alaska) Inc.*, 102 FERC ¶ 61,345 at P 13). Now, states BP, Platts has added a second Heavy Naphtha assessment that it calls "Heavy Naphtha Barge."[720] *Id.*

2480. BP claims that, notwithstanding that Platts continues to quote the Heavy Naphtha price that the Quality Bank previously used to value Naphtha, the Quality Bank Administrator has proposed a new Naphtha valuation approach that uses both the Heavy Naphtha and Heavy Naphtha Barge quotations, to wit: taking the average of the Heavy Naphtha and Heavy Naphtha Barge prices each month and using that average as the price for valuing Naphtha on the Gulf Coast and on the West Coast, pending the ultimate resolution of the valuation of West Coast Naphtha. *Id.* at p. 2 (citing Exhibit No. TC-19 at p. 4). It notes that Exxon, Phillips and the TAPS Carriers agree with the use of the averaging proposal, and Williams and Unocal/OXY do not agree. BP Reply Brief at p. 83. BP's position is that the proposed averaging approach is inconsistent with the approach used to value other Quality Bank components in two ways, and therefore, should be rejected. BP Supplemental Brief at p. 2.

2481. First, BP asserts that no other cut in the Quality Bank is valued using the average of more than one reported price. *Id.* If there is a price that can be used to value a Quality Bank component, explains BP, a single price is used. *Id.* It reiterates that choosing to introduce an averaging approach to the valuation of one Quality Bank component, and

[720] BP claims that there has been no change in the specifications of the Heavy Naphtha product. BP Supplemental Brief at p. 1, n.3. Based on the information available at this time, notes BP, it appears that the specifications of the Heavy Naphtha and Heavy Naphtha Barge products are the same. *Id.* Previously, explains BP, the Heavy Naphtha price was based on both waterborne and barge deliveries, although the evidence does not identify the exact influence that each had on the overall price. *Id.* (citing Exhibit Nos. TC-19 at pp. 3-4, TC-20 at p. 1, TC-21 at p. 1, TC-22 at pp. 1-2). BP states that the change separates the price reported for each. *Id.* According to BP, the Quality Bank Administrator has stated that the Heavy Naphtha assessment reports on the cargo deliveries and the Heavy Naphtha Barge assessment reports on the barge deliveries. *Id.* (citing Exhibit No. TC-19 at pp. 3-4).

not to any other, introduces an unnecessary inconsistency into the Quality Bank. *Id.* Further, BP maintains, it would result in one more issue for the Commission to consider whenever there is a change to a reported price. *Id.*

2482. Second, BP argues, the Platts Heavy Naphtha price is now an assessment of the price of the largest cargoes available, while the Heavy Naphtha Barge price assesses smaller-sized shipments. *Id.* The Quality Bank methodology previously has chosen the largest available quantities for valuing each cut, explains BP, which minimizes possible marketing margins that might be added to prices at lower levels of aggregation. *Id.* BP sees no reason to act differently here. *Id.*

2483. BP's position is that, as Platts continues to publish the Heavy Naphtha price, it sees no reason for a change. *Id.* at pp. 2-3. According to it, the Heavy Naphtha price is consistent with other published prices used in the Quality Bank and the averaged price proposed by the Quality Bank Administrator is not. *Id.* at p. 3.

2484. Supporters of the averaging proposal claim, BP states, that the Quality Bank Administrator was justified in using the averaging proposal, because creation of the new Heavy Naphtha Barge assessment constitutes a radical change. BP Reply Brief at p. 83-84. In its reply brief, BP asserts that this support for the averaging proposal is misplaced. *Id.* at p. 84. Although the Quality Bank Administrator reports that there has been a change in the way Platts does its Heavy Naphtha assessment, BP asserts, the Heavy Naphtha reference price that the Quality Bank Administrator previously had supported as appropriate to value Naphtha continues to be reported and Sharp himself characterized the change as insignificant. *Id.*; BP Supplemental Brief at p. 3. BP alleges that none of the parties challenges the view that the Platts Heavy Naphtha assessment as previously done remains a viable price.[721] BP Reply Brief at p. 84. While the basis is somewhat different now because it reports only cargoes, BP states, the change does not impact the viability or appropriateness of the use of the assessment and is not the type of radical change that should cause a change in the Quality Bank procedure. *Id.*; BP Supplemental Brief at p. 3.

2485. BP asserts that an approach that results from the averaging of two different reference prices is inconsistent with the valuation approach used for other components, and, therefore, is unacceptable. *Id.* As the Circuit Court repeatedly has made clear, argues BP, consistency is an important factor in fashioning the prices used for the various Quality Bank cuts. *Id.* Most recently, for example, BP states the Circuit Court expressed

[721] This claim is somewhat confusing as it is clear that Platts no longer is publishing a Heavy Naphtha assessment as it previously did and is in conflict with BP's recognition that this assessment now only relates to cargoes and not cargo and barge transactions.

the importance of consistency in the TAPS Quality Bank methodology in *Exxon*, explaining that "[a]lthough we recognized that we could not require [the Commission] to achieve a perfect method of valuing petroleum streams . . . we nonetheless held that [the Commission] must be consistent in its methodological choices." *Id.* at pp. 4-5 (quoting *Exxon*, 182 F.3d at p. 35).

2486. Additionally, BP asserts, there is no reason to introduce additional, unnecessary complexity to the Quality Bank when there is a viable reported price. *Id.* at p. 5. BP states that moving away from the use of a single reported price would introduce a potential new issue each time there is a reference price change. *Id.* Adding that complication will impair the consistency of the methodology, BP claims and, in its view, increase the likelihood that issues will be raised in the future related to this and other reference prices, as shippers consider whether the adoption of similarly "averaged" prices may also work to their advantage for other cuts. *Id.*

2487. BP asserts that Exxon recognizes that the averaging proposal is not consistent with how the other Quality Bank cuts are valued. BP Reply Brief at p. 85. It states that Exxon tries to skirt the issue by claiming that this is not important and arguing that the average best represents the market value and that to find otherwise would impose an unduly rigid consistency standard. *Id.* In reply, BP asserts, there is no evidence in the record that indicates that the averaging proposal would be a better representation of the price of Naphtha on the Gulf Coast than using the Heavy Naphtha price alone. *Id.* at p. 86. Second, it states that these arguments fail to justify a departure from the Quality Bank valuation consistency requirements as espoused repeatedly by the Circuit Court. *Id.* Clearly, a minor change in the price assessment for Heavy Naphtha is not a change that would justify departing from the consistency standards emphasized by the Court. *Id.*

2488. BP acknowledges that the Quality Bank Administrator noted that, in an earlier proceeding, the Commission decided to use the barge assessment for Gulf Coast VGO when a cargo assessment also existed. BP Supplemental Brief at p. 6 (citing Exhibit No. TC-19 at pp. 4-5; Exhibit No. TC-23). It states that the situation presented there was different than the one that faces the Commission here. *Id.* In that case, according to BP, the Quality Bank Administrator was told by OPIS that "cargo transactions were infrequent and that barge transactions were more representative of High Sulfur VGO market value." *Id.* (quoting Exhibit No. TC-19 at pp. 4-5).

2489. At that time, BP supported the Quality Bank Administrator's decision to use the reported price, which the Quality Bank Administrator stated was the only accurate and viable measure of the market. BP Supplemental Brief at pp. 6-7. (citing Exhibit No. EMT-257 at p. 7). Here, however, BP claims, there is a choice between two robust, useable price quotations. *Id.* at p. 7. BP argues that the Quality Bank should look to the quotation that will be the truest, and most consistent, measure of the value of Naphtha with the lowest possible marketing margins that would impact the overall value of the product. *Id.* BP's position is that use of the Heavy Naphtha assessment, which focuses on cargoes of Heavy Naphtha, meets that goal. *Id.*

2490. Should the Commission determine that the averaging proposal is appropriate for the valuation of Gulf Coast Naphtha, BP states, the new pricing methodology should become effective on a date consistent with the date on which the claimed change occurred, that is, August 17, 2003. *Id.* It explains that this is because that is the date on which the Commission placed the Quality Bank Administrator's averaging proposal into effect, subject to refund. *Id.* at pp. 7-8 (citing *Trans Alaska Pipeline System,* 104 FERC ¶ 61,201 at P 9).

2491. BP maintains that, should a change be found necessary, this effective date issue becomes largely indistinguishable from the Heavy Distillate effective date issue. *Id.* at p. 8. In each case, explains BP, the Commission will have determined that there was a need to change the valuation of a Quality Bank component based on a change in the reference price used to value the relevant Quality Bank cut. *Id.* In the case of Heavy Distillate, all parties agreed and stipulated to an effective date that corresponds to the date that the reference price change took effect. *Id.* (citing Exxon Initial Brief at p. 151; Eight Parties Initial Brief at p. 133). Should the Commission determine that a change to the Gulf Coast Naphtha reference price is needed, BP states, the implementation of this new Gulf Coast Naphtha reference price should be accomplished in a manner comparable to the implementation of the new Heavy Distillate reference price. *Id.*

5. Williams

2492. Williams notes that Sanderson testified at the hearing that the Platts Gulf Coast Heavy Naphtha (waterborne) price is a suitable price to be used for the Quality Bank Gulf Coast Naphtha component, and it is also a suitable proxy for the Quality Bank West Coast Naphtha component. Williams Initial Brief at p. 85. Further, it asserts that the consistency of the Platts Gulf Coast Heavy Naphtha price is an additional reason for its suitability for Quality Bank purposes. *Id.* at p. 86.

2493. On reply, Williams asserts that it agrees with Unocal/OXY's reasons for opposing use of the Platts Gulf Coast Heavy Naphtha price. Williams Reply Brief at pp. 107-08. It states, while it would agree to using the higher priced assessment, because the increase in value of approximately 1¢/gallon should dispel all issues concerning whether use of the Gulf Coast Naphtha price assessment undervalues the West Coast Naphtha component, the record is clear that it does not. *Id.* at p. 108.

2494. Williams argues that there is no basis for making an N+A adjustment to the Gulf Coast or West Coast Naphtha component for several reasons. Williams Initial Brief at p. 86. First, it states that it would create inconsistency in valuation among the cuts because no other Quality Bank component price is adjusted for a particular quality characterization. *Id.* Second, it contends that the N+A adjustment Platts makes on the Gulf Coast is not a hard and fast formula. *Id.* Third, it maintains that the high levels of benzene, benzene precursors and heavy aromatics make ANS Naphtha less desirable for manufacturing finished gasoline with restriction on benzene content, particularly by the environmentally restricted CARB gasoline on the West Coast. *Id.* Williams notes that the first two reasons apply equally on both coasts, while the latter is more applicable on the West Coast. Williams Reply Brief at p. 109.

2495. Sanderson, Williams argues, testified that, should the Commission approve an N+A adjustment for the Naphtha cut, then, in his opinion, credible arguments could be made for secondary quality adjustments to all the liquid cuts, such as LSR, Naphtha, Light Distillate, Heavy Distillate, VGO and Resid in the Quality Bank and potentially endless litigation. Williams Initial Brief at p. 87. Williams believes that the formulæ proposed in the ExxonMobil Settlement Agreement in 1997 provide the basis for this result. *Id.* It notes that the Settlement contained complicated equations for measuring various quality characteristics of certain cuts, including Naphtha and LSR. *Id.*

2496. The premise, according to Williams, cited by Mitchell from his discussion with Sharp that Platts makes a uniform and consistent N+A adjustment is incorrect based on Sanderson's detailed discussions with Sharp, and thus are not a foundation for an N+A adjustment. *Id.* at p. 88. It notes that Mitchell's own testimony indicated some ambiguity as to whether this adjustment was always made. *Id.* Specifically, Williams claims that Mitchell testified that Platts makes an N+A adjustment, but failed to ask Sharp a number of key questions, such as whether Platts makes this N+A adjustment on every Naphtha price indication at which it looks. *Id.* It notes that Mitchell did state that an N+A adjustment was the only one Sharp indicated ever was made. *Id.* at p. 89.

2497. On the other hand, Williams states, Sanderson specifically asked Sharp questions regarding Platts's practice related to the N+A adjustment during the week before the N+A hearing. *Id.* It points out that Sharp stated, at that time, that the N+A adjustment was not a hard and fast rule, but only an industry rule of thumb, and that he also said that he considers specifications, other than N+A, in making his price assessments, if he can get the information from his industry contacts. *Id.* pp. 89-90. When asked about the range of any N+A adjustment by Platts, Williams indicates, Sharp consistently indicated to Sanderson that the N+A adjustment made by Platts is in the range of 35 to 48. *Id.* at p. 90. It notes that his answer was consistent with the first conversation Sanderson had with Sharp. *Id.*

2498. Furthermore, if the Platts N+A adjustment was an adjustment that was consistently applied by Platts, Williams argues, there would be an objective mention of it in the Platts Guide to Specifications, but there is not. *Id.* In fact, unlike its Full Range Naphtha assessment, Williams states that, for the Heavy Naphtha quote, Platts does not even mention, much less document, that the base N+A level for Heavy Naphtha is 40. *Id.*

The bottom line, according to Williams, is that the Quality Bank Administrator chose not to make any N+A adjustment. *Id.* Further, Williams claims that it appears that the Quality Bank Administrator believes he lacks the authority under the tariff to do so without a Commission order. *Id.* at p. 90-91.

2499. Williams contends that the parties proposing an N+A adjustment for the ANS Heavy Naphtha have ignored the very specific problems with processing ANS Naphtha, its high levels of benzene and benzene precursors. *Id.* at p. 92. It argues that repeated generic technical arguments have been made, or industry "rules-of-thumb" cited, for an N+A adjustment for the Quality Bank Naphtha without regard to the high levels of benzene and benzene precursors in ANS Heavy Naphtha. *Id.* Williams notes that Sanderson clearly described the problem with assigning an N+A adjustment based upon an industry rule-of-thumb to ANS Naphtha with high levels of benzene and benzene precursors on the West Coast. *Id.* According to it, Sanderson's view is that refiners would choose the Naphtha with low or no benzene and benzene precursors, because the yield of aromatics would go up. *Id.* Sarna, Williams adds, likewise described the problems N+A can present for making CARB gasoline as one where there can be excess benzene stemming from an excess of the C_{10} aromatic. *Id.* at p. 93. Thus, Williams contends that refiners try to operate with low levels of benzene in their reformulated gasoline formulations, because taking out the benzene gives a better return on their investment. *Id.*

2500. The record, Williams states, reflects that ANS Heavy Naphtha contains high levels of benzene and benzene precursors compared to other crudes is overwhelming based upon Sarna's testimony and industry articles. *Id.* It states that this is documented by UOP, a well-known technology licensor, in a 1991 technical article titled: "Benzene Reduction Alternatives," which states that it chose a refinery processing ANS crude as a worst case scenario for analyzing benzene reduction strategies. *Id.* at pp. 93-94. Williams notes that Sarna testified that ANS has substantially higher levels of benzene than other commonly processed West Coast crude oils. *Id.* at p. 94.

2501. Except for the change from Platts Gulf Coast Full Range Naphtha price quote that had been used to Platts Gulf Coast Heavy Naphtha (waterborne) price quote that was effective March 3, 2003, by action of the TAPS Carriers through the Quality Bank Administrator, Williams argues, any N+A adjustment can be effective only from the date, if ever, it is adopted by the Commission. *Id.* at pp. 94-95. Williams notes that it was not a change recommended by the TAPS Carriers, and the Quality Bank Administrator chose not to include such an adjustment. *Id.* at p. 95. Therefore, it is Williams's position that it only can have prospective application. *Id.*

2502. In Williams's view, the effect of the Quality Bank Administrator's averaging proposal is to increase the value of the Naphtha component of the Quality Bank. Williams Supplemental Brief at p. 2. It states that, because the Quality Bank

Administrator's notice was simply a recommendation, Section III.G.5.b. of the Tariff provides for shippers to comment on the Quality Bank Administrator's recommendation, and point out that Exxon and Phillips, the two principal advocates of skewed higher West Coast Naphtha price proposals, supported the Quality Bank Administrator's recommendation. *Id.* at pp. 2-3. Williams notes that BP, Petro Star, Unocal/OXY, and Williams opposed the Quality Bank Administrator's proposal. *Id.* at p. 3. Its position is that there is no justification for accepting the Quality Bank Administrator's recommendation on either the Gulf Coast or the West Coast. *Id.*

2503. Williams asserts that there is no valid reason for averaging the two Platts price quotes. *Id.* In fact, it contends, there are compelling reasons why the Quality Bank Administrator's recommendation should be rejected. *Id.* First, it states, Platts's adding the new Gulf Coast Heavy Naphtha Barge price quote does not constitute a "radical alteration" of the pre-existing price quote used to value the Naphtha Component. *Id.* Second, Williams submits, the Quality Bank Administrator's recommendation is inconsistent with the valuation of the other Quality Bank cuts. *Id.* Third, it notes that the Quality Bank Administrator's recommendation introduces a valuation that does not reflect Platts's assessment of the Gulf Coast Naphtha market. *Id.* Fourth, it explains that the Quality Bank Administrator's recommendation is premature at best, because it was not based on any independent analysis of the Gulf Coast naphtha market. *Id.*

2504. The Quality Bank Administrator's rationale for proposing yet another increase in the valuation of the Naphtha component of the TAPS Quality Bank, according to Williams, is that the introduction of the new Platts Heavy Naphtha barge quote constituted a "radical alteration in the basis for reporting one of the products used to calculate the TAPS Quality Bank adjustments." *Id.* (quoting Exhibit No. TC-19 at p. 1). It notes that the Quality Bank Administrator states that the situation seems to be covered by Section III.G.5.b. of the Tariff. *Id.* at pp. 3-4.

2505. Williams explains that the Quality Bank Administrator's notes regarding his conversations with Sharp indicate that the existing Heavy Naphtha price quote is an assessment of cargo transactions. Subsequently, it notes that, in a further conversation, Sharp confirmed that the Heavy Naphtha price quote from the outset "was intended to reflect a cargo basis and that the old number weighted barge a lot less and therefore was considered primarily a cargo number." *Id.* at p. 4 (quoting Exhibit No. TC-22 at p. 1). More significantly, according to Williams, Sharp confirmed that "he considered the old naphtha quote basis to be consistent with the current cargo assessment." *Id.*

2506. Williams asserts that a key premise of the distillation methodology is to use a single intermediate feedstock price quoted by an independent price reporting service without modification whenever possible. *Id.* It states that the averaging proposal introduces an internal inconsistency into the Quality Bank methodology which is neither necessary nor reasonable. *Id.*

2507. No other Quality Bank component, Williams argues, is valued by averaging price quotations for different classes of sale for the same commodity. *Id.* Therefore, Williams states, introducing a Quality Bank component valuation using an average of available price quotations for a commodity of different classes of sale would set a dangerous precedent which opens the door for perpetual attempts to change a component's valuation by advocating averaging two or more published price quotes for the same product. *Id.* On the Gulf Coast, it points out, price quotations for more than one class of sale exist for Light Distillate (waterborne and pipeline jet fuel), Heavy Distillate (waterborne and pipeline diesel fuel) and VGO (cargo and barge high sulfur VGO). *Id.* at pp. 5-6. Similarly, it notes that, on the West Coast, price quotations for more than one class of sale exist for Light Distillate (waterborne and pipeline jet fuel)[722] and Heavy Distillate (waterborne and pipeline diesel fuel.)[723] *Id.* at p. 6.

2508. Williams contends that averaging the Gulf Coast Heavy Naphtha (cargo) and Heavy Naphtha Barge price quotes would also contravene the Quality Bank pricing convention of using waterborne prices when available. *Id.* It notes that, in supporting the Eight Parties's inclusion of a logistics adjustment to convert the Platts Los Angeles Pipeline Low Sulfur No. 2 Fuel Oil [Diesel] price to a waterborne basis, Ross testified that the convention has been to choose the largest available parcels to value each cut, because this minimizes the marketing margins. *Id.* at pp. 6-7. Further, it notes that Ross stated that waterborne cargoes are larger and more representative of the value of the streams at the refinery. *Id.* at p. 7.

2509. The Quality Bank Administrator's averaging recommendation, according to Williams, is even inconsistent with his recommendation in 1998 concerning what pricing should be used to value the Gulf Coast High Sulfur VGO price for the Gulf Coast Quality Bank VGO component, a pricing which also has served as the valuation for the West Coast Quality Bank VGO component. *Id.* On December 1, 1997, Williams notes, OPIS announced that, effective January 1, 1998, it was going to cease publishing its existing

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[722] In support, Williams cites Exhibit No. TC-19 at p. 6. Williams Supplemental Brief at p. 6.

[723] Williams notes that there are separate quotes for West Coast pipeline LS No. 2 in both Los Angeles and San Francisco, Northwest for Portland and Seattle, plus West Coast Waterborne Gasoil 0.05%. Williams Supplemental Brief at p. 6, n.5 (citing Exhibit No. TC-19 at p. 6). Thus, Williams asserts, for any proposal that attempts to draw a comparison or establish a Naphtha value comparing an alleged relationship between products such as gasoline and/or jet fuel, were Naphtha price quotes averaged on the Gulf Coast, then other product prices used in the comparison arguably would need to be compared on a product price averaged basis. *Id.* at p. 6, n.6.

single high sulfur price quote and start publishing separate price quotes for barge and cargo lots. *Id.* At that time, explains Williams, the Quality Bank Administrator referred to a "radical alteration" under Item III.G.5.b. of the Tariff and issued a notice similar to the averaging proposal under consideration here. *Id.* at pp. 7-8. However, it notes that, unlike the instant case, with respect to VGO, the Quality Bank Administrator did not recommend averaging; rather, he recommended that a single price, the Gulf Coast barge price quote, be used in lieu of the cargo price quote because "[t]his assessment appears to be the most representative indicator of High Sulfur VGO market value and therefore seems to be the best single price to reflect the market for High Sulfur VGO on the Gulf Coast." *Id.* at p. 8 (quoting Exhibit No. TC-23 at ¶ 7).

2510. In addition, Williams argues, the reason for the two VGO price quotes is completely the opposite of why Platts added a barge quote for Naphtha. *Id.* With respect to VGO, Williams notes, the Quality Bank Administrator explained that OPIS split the High Sulfur VGO price into two price quotes because there were only occasional cargo transactions and it was concerned that these transactions would distort the price range reported for a particular day. *Id.* With respect to the Platts Heavy Naphtha price quote, Williams maintains, there is no problem with volumes of cargo transactions. *Id.* It states that Sharp told the Quality Bank Administrator that "there are numerous transactions for both full range and heavy naphtha in both barge and cargo lots, although for heavy naphtha, barge transactions may slightly predominate." *Id.* (citing Exhibit No. TC-20 at p. 1). The initial Heavy Naphtha price quote, Williams continues, was not exclusively a cargo assessment, even though it was weighted toward cargo. *Id.* at pp. 8-9. It states that the reason for Platts adding the new barge quote was because "Sharp's customer feedback had encouraged a minimization of barge quotes since it was used for cargo contract pricing and therefore he considered the old heavy naphtha quote basis to be consistent with the current cargo assessment." *Id.* at p. 9 (Exhibit No. TC-22 at p. 1).

2511. Williams asserts that the Quality Bank Administrator's recommendation to use the arithmetic average of Platt's Gulf Coast Heavy Naphtha Cargo and Barge quotations by definition assigns an equal numerical weighting of 50% to both the cargo and barge quotations. *Id.* It states that this proposed equal weighting is contrary to Platts's weighting of the Heavy Naphtha price quote being used to value the Gulf Coast and thus West Coast Quality Bank Naphtha component before Platts introduced the Heavy Naphtha Barge quotation. *Id.* Williams believes that it is this equal weighting which represents a "radical alteration" should the phrase be applicable in this proceeding. *Id.*

2512. From a review of the three sets of notes that the Quality Bank Administrator compiled of the conversations with Sharp, Williams claims that, prior to May 1, 2003, Platts waterborne Naphtha quotes on the Gulf Coast for both Full Range and Heavy Naphtha did not equally weight cargo and barge quotations. *Id.* It asserts that Sharp's repeated statements to the Quality Bank Administrator, and in the joint conversation with Mitchell, Toof and Jones, made it clear that the single price quote was predominantly a cargo assessment. *Id.* at pp. 9-10 (quoting Exhibit Nos. TC-21, TC-22). Consequently, Williams concludes, there is no factual basis upon which to support the Quality Bank Administrator's proposed equal weighting of the two price quotes. *Id.* at p. 10. Moreover, it argues that, to do so, without any factual basis, totally contravenes the Quality Bank Administrator's rejection of averaging the two High Sulfur VGO prices in 1998 due to the lack of data. *Id.* at pp. 10-11 (quoting Exhibit No. TC-23 at ¶ 8). Williams contends that the same lack of volumetric data for weighting purposes exists with respect to the two Heavy Naphtha price quotes. *Id.* at p. 11. Yet, inexplicably to Williams, in this instance, the Quality Bank Administrator recommends that an arithmetic average be used. *Id.*

2513. In his reports, as well as in his recommendation filed with the Commission, Williams believes, the Quality Bank Administrator failed to provide any quantification whatsoever with respect to the robustness of the Gulf Coast waterborne trade by cargo and barge lots. *Id.* It states that all he provided was the statement that Sharp "said that there are numerous transactions for both full range and heavy naphtha in both barge and cargo lots, although for heavy naphtha, barge transactions may slightly predominate." *Id.* (quoting Exhibit No. TC-20 at p. 1). Williams asserts that the fact that the number of barge transactions may "slightly predominate" tells us absolutely nothing about the relative volumes of naphtha trade between barge and cargo transactions.[724] *Id.*

2514. Williams notes that the Commission, in its Order Accepting Replacement Product Price and Consolidating Issues with Hearing Procedures, issued August 13, 2003, accepted the Quality Bank Administrator's recommended replacement price effective August 17, 2003, "subject to refund and the outcome of the proceeding." *Id.* at p. 13. Therefore, Williams argues, the earliest date that this averaging of prices would be effective is August 17, 2003. *Id.* However, Williams contends that to allow August 17, 2003, to be the effective date should the ultimate decision be to adopt the averaging concepts sets a bad precedent especially when, in a similar type of situation in 1998, Mitchell expressly stated that the he could not recommend averaging of the barge and cargo prices because he did not have sufficient data. *Id.*

[724] Williams notes that Platts has indicated that typical sizes for barges are 50,000 barrels and cargoes are up to 250,000 barrels, so the volume of each barge transaction can be as little as 20% of each cargo transaction. Williams Supplemental Brief at p. 12, n.10. Were the number of barge and cargo transactions equal and because the volume of barge sales could be as little as 20% of the cargo Naphtha trade, Williams asserts, on this basis, this would indicate that the price weighting would be 80% cargo and 20% barge. *Id.* In Williams's view, this weighting certainly does not support that the initial, single Platts Gulf Coast Heavy Naphtha price quote was radically altered by the advent of a separate Gulf Coast Heavy Naphtha Barge price quote resulting in barge prices no longer being used in the Gulf Coast Heavy Naphtha (cargo) price quote. *Id.*

2515. Moreover, in Williams's view, the Quality Bank Administrator appears to be substituting his judgment for the Commission's in deciding what action to take. *Id.* at p. 14. It argues that the Commission has never stated or authorized use of more than a single product price quote. *Id.* Therefore, Williams states, the effective date should not be before a decision is made by the Commission on how to value a Quality Bank component. *Id.*

6. Phillips

2516. Phillips notes that the February 27, 2003, filing by the TAPS Carriers, which was entered into the record as Exhibit No. PAI-222, raised a number of additional issues, the first of which is whether the Platts Heavy Naphtha price is more suitable than the Platts Naphtha price for use in valuing ANS Naphtha. Phillips Initial Brief at p. 155. It claims that Mitchell testified that the Heavy Naphtha price was intended to apply to a reforming grade Naphtha that is similar in quality to Quality Bank Naphtha, while the Platts Naphtha price quote relates to a Full Range Naphtha that also includes the Quality Bank LSR cut. *Id.* Further, it states that all the witnesses, including Mitchell, agreed that the specifications for Platts Heavy Naphtha best fit the qualities of the Quality Bank Naphtha cut. Phillips Reply Brief at p. 89.

2517. It is Phillips's position that use of the Platts Gulf Coast Heavy Naphtha price on the Gulf Coast instead of the Platts Gulf Coast Naphtha price is supported by the record and is just and reasonable, subject to the imposition of an N+A adjustment. Phillips Initial Brief at p. 156. At the hearing, notes Phillips, no party entered any evidence to suggest that the Heavy Naphtha price is not more appropriate for use in the Quality Bank than the Naphtha price. *Id.*

2518. Nonetheless, Phillips notes that Unocal/OXY take the position in their brief that it is not appropriate to use the Heavy Naphtha price to value Quality Bank Naphtha. Phillips Reply Brief at p. 90. It states that they do so notwithstanding the unanimous agreement among the witnesses, including their own expert Culberson, as to the suitability of the Heavy Naphtha price. *Id.*

2519. Unocal/OXY assert, Phillips maintains, that, because of the existence of the petrochemical industry on the Gulf Coast, the existing Gulf Coast price overvalues West Coast Naphtha and, as a result, "the Gulf Coast price should not be adjusted in any manner that would increase the current valuation of West Coast naphtha." *Id.* (quoting Unocal/OXY Initial Brief at p. 46). That Unocal/OXY would take such a position highlights the extent to which they will take results-oriented positions, according to Phillips, without regard to the merits of the position or the evidence in the record. *Id.* It asserts that, not only is Unocal/OXY's position inconsistent with the testimony of their own expert, but it is inconsistent with their position that the Gulf Coast Naphtha price should be used to value West Coast Naphtha. *Id.* Phillips points out that Unocal/OXY cannot argue, on the one hand, that the Commission should not apply the best available published Gulf Coast price because the differences between the Gulf Coast and West Coast markets are too great, and, on the other hand, argue that the considerable differences between the Gulf Coast and West Coast markets should be ignored because the Gulf Coast price represents the best available price. *Id.*

2520. In addition, Phillips points out that Unocal/OXY and Petro Star assert that the TAPS Carriers lacked the authority under their Tariff to implement the change, even if the Heavy Naphtha price better reflects Quality Bank Naphtha. *Id.* at p. 91. It disagrees with this argument for two reasons. *Id.* First, Phillips states that Unocal/OXY and Petro Star argue that the publication of a new Heavy Naphtha price cannot be considered an unanticipated issue. *Id.* According to Phillips, that argument is untenable. *Id.* It explains that the Commission ordered the use of the Gulf Coast Naphtha price in 1993 because, under the approach it was following at that time, that Naphtha price most closely reflected Quality Bank Naphtha. *Id.* In the view of Phillips, the Commission could not have anticipated, in 1993, that a new Gulf Coast Naphtha price would be published ten years later that better reflected the quality of Quality Bank Naphtha. *Id.* at pp. 91-92. It states that, if the Commission knew that a more appropriate price would be published, it is clear that the Commission would have ordered that it be used. *Id.* at p. 92. Therefore, Phillips asserts, the Quality Bank Administrator's action appears to be the appropriate action to have taken under the Quality Bank Tariff's provisions. *Id.*

2521. Also, Phillips argues that it does not matter whether or not Section III.J of the Quality Bank Tariff expressly authorizes the change to the Heavy Naphtha price. *Id.* Under the Interstate Commerce Act, Phillips asserts, the TAPS Carriers clearly are authorized to unilaterally make revisions to their Tariffs, subject to review by the Commission to ensure that the revisions are just and reasonable. *Id.* (citing 49 U.S.C. App. § 15(7)(1988)). Thus, it concludes, the Commission has no authority to prevent the TAPS Carriers from making the change, which clearly is just and reasonable, regardless of whether or not it was authorized by the existing Quality Bank Tariff. *Id.*

2522. Phillips notes that Platts assesses Naphtha based on a standard N+A content of 40%. Phillips Initial Brief at p. 156. When Platts sees an actual transaction for the sale of Naphtha with a higher N+A content, Phillips explains, Platts adjusts the price of that transaction downward by 0.15¢/gallon per 1% of N+A above 40, up to a maximum adjustment of 1.5¢/gallon for Naphtha with an N+A of 50 or higher. *Id.* For example, continues Phillips, if Platts knew of a transaction where Naphtha with an N+A of 55 was sold for 91.5¢/gallon, Platts would reduce that price by 1.5¢/gallon to 90¢/gallon for reporting purposes in order to put the sale on its standard 40 N+A basis. *Id.* at pp. 156-57.

2523. It is uncontested, according to Phillips, that ANS Naphtha has a high N+A. *Id.* at

p. 157. Phillips points out that page 7 of the TAPS Carriers's February 27, 2003, filing summarizes the N+A data from the assays that were entered into the record in this proceeding. *Id.* (citing Exhibit No. PAI-222 at p. 7). It notes that this Exhibit shows that ANS Naphtha N+A content has varied from 55.3% to 58.3% and that all of these percentages are well above the 50 N+A maximum threshold that Platts uses in evaluating Naphtha transactions. *Id.*

2524. Phillips also states that the Quality Bank Administrator testified that he did not read the Quality Bank Tariff as giving him the authority to unilaterally implement an N+A adjustment. *Id.* It notes that he did not take any position as to whether the Commission should order that such an adjustment be made. *Id.*

2525. An N+A adjustment of 1.5¢/gallon, according to Phillips, should be applied to the published Platts Heavy Naphtha price in valuing Gulf Coast Naphtha for the simple reason that Platts actually applies such an adjustment in assessing Naphtha contracts. *Id.* at p. 158. In Phillips's view, both the memo that is attached at page 8 of Exhibit No. PAI-222 and Mitchell's testimony make clear that the published Platts price is based on a Naphtha with a 40 N+A, and that Platts adjusts the price of reported transactions for Naphtha with a higher N+A to put it on a 40 N+A basis. *Id.* Because Mitchell is a neutral third party with no interest in whether any N+A adjustment should be implemented, Phillips states there is no reason to doubt his testimony on this issue. *Id.* This means, continues Phillips, that when Platts publishes a Gulf Coast Heavy Naphtha price of 90¢/gallon, that price applies to Naphtha with an N+A of 40, and that Platts would value ANS Naphtha on the Gulf Coast at 91.5¢/gallon. *Id.* If the Quality Bank were to use the unadjusted 90¢/gallon price reported by Platts, Phillips points out, the Quality Bank would be valuing the ANS Naphtha at a value lower than would be assigned to it by Platts. *Id.* Use of a 1.5¢/gallon N+A adjustment on the Gulf Coast, asserts Phillips, is, therefore, necessary to give ANS Naphtha the value that Platts would assign to ANS Naphtha on the Gulf Coast. *Id.* Further, Phillips notes, Sanderson agreed with this view at trial and this result is in keeping with the requirement that the Quality Bank assign published prices to cuts when those prices are available. *Id.* at pp. 158-59.

2526. Furthermore, Phillips states, it is undisputed that Platts is correct that higher N+A has a higher value on the Gulf Coast. *Id.* at p. 159. It notes that Culberson, who opposes the use of an N+A adjustment on the West Coast, testified that an N+A adjustment would be appropriate on the Gulf Coast. *Id.* In addition, continues Phillips, Sanderson agreed that an N+A adjustment "might be appropriate on the Gulf Coast but not the West Coast" based on the value of N+A on the Gulf Coast, although Sanderson also asserted that use of an N+A adjustment for the Gulf Coast would be inconsistent with the rest of the Quality Bank. *Id.* (quoting Transcript at pp. 13570-72).

2527. According to Phillips, Sanderson elaborated on his view that use of an N+A adjustment on the Gulf Coast was inconsistent by noting that, were such an N+A adjustment implemented, then similar adjustments would be appropriate for other cuts, including the LSR, Naphtha, Light Distillate, Heavy Distillate, VGO and Resid cuts. *Id.* at pp. 159-60. According to Phillips, this argument is a red herring. *Id.* at p. 160. It points out that the proposed N+A adjustment is not based on the judgment of Phillips or any other party to this proceeding that an adjustment should be made to the Platts reported price, rather, explains Phillips, the proposed adjustment is based on the testimony of the Quality Bank Administrator that Platts makes this adjustment in developing its Gulf Coast Heavy Naphtha price. *Id.* Therefore, states Phillips, applying it is simply locating ANS Naphtha at the correct level on the scale published by Platts. *Id.* Further, notes Phillips, the only quality that Platts takes into account in developing its published price is the N+A content. *Id.* Thus, concludes Phillips, providing for an N+A adjustment would not open the door for further adjustments to the Naphtha price used for the Quality Bank. *Id.*

2528. Because the N+A adjustment is made solely on the basis that it reflects the actual Platts price, Phillips asserts that adoption of this adjustment is not inconsistent with the rest of the Quality Bank and does not open the floodgates for other changes. *Id.* There is no evidence, according to Phillips, that Platts makes a similar adjustment in reporting its Heavy Naphtha price or the price for any other product. *Id.*

2529. Phillips states that a second argument raised against the use of an N+A adjustment for the Gulf Coast is that Platts does not state in its posted prices or in its other published materials that it assumes a 40 N+A for its Heavy Naphtha quote or otherwise that it is employing the N+A adjustment in its valuation and, therefore, the adjustment should not be made by the Quality Bank. *Id.* at p. 161. Whatever force this argument may have as a general proposition, Phillips asserts, it does not apply here, where there is undisputed record evidence that Platts in fact does adjust the prices of the transactions that it reviews for N+A content. *Id.* Phillips points out that Mitchell, who has absolutely no interest in the outcome of this issue, reported at trial that he confirmed that Platts does use the N+A adjustment. *Id.* Because it has been established on the record that Platts does make this adjustment, Phillips's position is that the record also establishes that use of the Heavy Naphtha price without adjustment would undervalue the Platts ANS Naphtha assessment. *Id.*

2530. Sanderson made a related argument, Phillips claims, when he testified that Platts does not make the adjustment in every case, but rather applies it as a rule of thumb for the industry. *Id.* Phillips explains that this testimony provides corroboration of Mitchell's testimony that Platts does make an N+A adjustment, and the corroboration is stronger, in Phillips's view, because it comes from someone who opposes use of the adjustment. *Id.* It points out that, unlike Mitchell, Sanderson had every incentive to cast his conversation with Sharp in such a light as to undermine the need for an adjustment. *Id.* Nonetheless, notes Phillips, Sanderson did concede that the adjustment is applied as a rule of thumb. *Id.* Therefore, in Phillips's view Sanderson's testimony does not undercut the proposition that Platts typically would value ANS Naphtha at a price higher than the published Gulf Coast Naphtha price. *Id.*

2531. Culberson and Sanderson err in suggesting, Phillips argues, that N+A does not have value on the West Coast. *Id.* at pp. 164-65. According to Phillips, the Commission does not need to reach that question. *Id.* at p. 165. Should the Commission determine that the Gulf Coast Naphtha price should be used to value West Coast Naphtha notwithstanding the differences in the two markets, then Phillips asserts that the Commission must apply the same price to each market. *Id.* It declares that the Commission cannot ignore differences in the two markets in requiring the imposition of the Gulf Coast price to the West Coast, but conversely implement an N+A adjustment on the Gulf Coast and not on the West Coast because of differences in the two markets. *Id.* Moreover, Sorenson who, unlike any of the other witnesses who testified on the West Coast Naphtha issue, actually is employed by a West Coast refinery that processes Naphtha, testified as to the value of N+A on the West Coast.[725] *Id.*

2532. Sorenson, Phillips claims, explained that N+A has value to a refiner in reforming Naphtha, because, the higher the N+A of the Naphtha, the more valuable reformate it will yield. *Id.* It explains that a higher N+A in the Naphtha allows the same octane to be produced at a lower cost than if the Naphtha had a lower N+A. *Id.* at p. 166. Phillips points out that Sorenson explained how Exhibit No. PAI-254 demonstrates this yield effect of having a higher N+A by showing that increasing the N+A of Naphtha from 40 to 55 would increase the reformate yield by 5% when reformed to a 95 octane. *Id.* According to Phillips, this is a significant benefit to a refinery. *Id.*

2533. Phillips states that the witnesses asserting that N+A does not have value on the West Coast do not disagree with Sorenson's testimony that higher N+A improves reforming yields. *Id.* According to Phillips, Culberson defined good Naphtha as Naphtha with an N+A "somewhere in the 50 range" because of "how it would perform in a reformer." *Id.* (quoting Transcript at p. 11330). Further, notes Phillips, Sanderson also agreed that higher N+A has the yield impact described by Sorenson. *Id.* Finally, states Phillips, Sarna, Williams's other witness, similarly agreed that higher N+A will give a higher yield of reformate from a Naphtha. *Id.*

2534. Rather than dispute the beneficial impacts of N+A, Phillips explains, Sanderson and Sarna argued that the California Air Resources Board specifications, with strict limits on benzene in gasoline, have created a benzene penalty offsetting any benefit that might

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[725] Phillips explains that Sorenson's job is to evaluate the economics of the various feedstocks used by Phillips's Los Angeles refinery, and thus he is uniquely qualified to testify as to the value of N+A in Naphtha on the West Coast. Phillips Initial Brief at p. 165.

be obtained from the higher yields. *Id.* Further, notes Phillips, Sarna also presented Exhibit No. WAP-275 showing that unfavorable N+A comes out of the reformer as benzene. *Id.* Using the Phillips refinery as an example, Phillips continues, Sorenson explained that these concerns are not valid because his refinery found, regardless of the crude slate, that equipment is needed to address the California Air Resources Board benzene specifications. *Id.* at p. 167. As a result, Phillips explains, the refinery made extensive investments in benzene processing equipment in 1994 to allow it to process any Naphtha regardless of its benzene content. *Id.* Therefore, concludes Phillips, the refinery has "the capability to handle both benzene and aromatics without that being a limitation to it." *Id.* (quoting Transcript at p. 13255).

2535. Phillips concedes, however, that Sorenson has less knowledge about other refineries in California. *Id.* Yet, states Phillips, he observed that all ANS refined in California has to meet the California Air Resources Board specifications, which indicates to him that those refineries that process ANS had made similar investments in benzene handling equipment. *Id.* Because the production of ANS has declined since the California Air Resources Board specifications went into effect in 1996, Phillips asserts, California refiners should be able to continue handling the benzene in ANS, even under the California Air Resources Board III specifications. *Id.*

2536. According to Phillips, Sorenson's testimony about the other California refiners is supported by Exhibit Nos. PAI-259 through PAI-262. *Id.* It explains that these Exhibits contain surveys, based on Oil & Gas Journal data, of benzene handling capacity on the West Coast as of January 1, 1998 (Exhibit No. PAI-259), and January 1, 2003 (Exhibit No. PAI-261), as well as backup for these surveys. *Id.* Phillips states that the surveys show that all but two California refineries had benzene handling equipment in both 1998 and 2003, and that the two refineries without such equipment do not process ANS. *Id.*

2537. Furthermore, Phillips states, Sorenson presented a study in Exhibit Nos. PAI-255 and PAI-256 that showed the impact on a California refinery of reforming Naphtha with a higher N+A. *Id.* at p. 168. It explains that the study used different scenarios, some of which involved solely conventional gasoline production and some of which involved combined CARB and conventional gasoline production. *Id.* In this study, notes Phillips, Sorenson looked at both the impact of substituting 1000 barrels of 55 N+A Naphtha for 1000 barrels of 40 N+A Naphtha and of decreasing the amount of N+A in the ANS being refined. *Id.* Additionally, continues Phillips, the refinery had benzene reduction equipment included, so Sorenson's study considered the impacts of this equipment on Naphtha value. *Id.* (citing Transcript at pp. 13226-235).

2538. Phillips asserts that the bottom line result of the study is that refinery economics were more favorable when running Naphtha with a higher N+A under all cases. *Id.* According to Phillips, this is true even though the refinery is operating to meet the CARB II specifications which are in effect in California. *Id.* Phillips claims that, while

Sorenson did not claim that his study showed the exact value of N+A in California, it does, however, illustrate that a higher N+A has value to a refinery in California operating under California Air Resources Board specifications. *Id.*

2539. In Phillips's view, Sarna's testimony challenging Sorenson's study was tainted by at least three serious deficiencies: (1) Sarna misrepresented Sorenson's work; (2) Sarna failed to recognize that certain costs are constant across all scenarios; and (3) Sarna himself was extremely evasive during his testimony. *Id.* at p. 169. It asserts that Sarna misrepresented Sorenson's work. *Id.* For example, explains Phillips, Sarna criticized Sorenson for not using the correct cost curves in his reformer calculations. *Id.* According to Phillips, he testified that Sorenson should have used cost curves for 150 psig and not 300 psig. *Id.* Phillips maintains that Sarna should have realized that Sorenson did in fact assume a 150 psig reformer in his work. *Id.*

2540. Second, states Phillips, Sarna's criticisms of Sorenson that certain costs were not accounted for failed to recognize that these costs remained constant across all scenarios and thus would not affect Sorenson's calculation of the differences between the scenarios. *Id.* For example, notes Phillips, Sarna criticized Sorenson for not including the capital cost of a benzene saturation unit in his calculations, even though Sorenson explained "that fixed cost [of a benzene saturation unit] would have been identical in each case," and "when you subtracted the one case from the other, the net effect would be zero." *Id.* (quoting Transcript at pp. 13330-31). Finally, Phillips notes that Sarna's testimony was extremely evasive to the point where the court questioned the utility of having him testify at all. *Id.*

2541. Phillips notes that Williams alleges that the high benzene content in Naphthas, such as ANS Naphtha, that have a high N+A content cause problems. Phillips Reply Brief at p. 94. In reply, it asserts that Williams completely ignores the testimony of Sorenson that a refiner with benzene reduction equipment does not discount the value of Naphtha with high benzene levels, because the benzene reduction equipment addresses the problems that high benzene content causes. *Id.* Phillips states that this failure to even acknowledge, much less address, the primary reason why benzene content is not a problem on the West Coast is a fatal flaw that requires Williams's arguments to be dismissed. *Id.*

2542. Unocal/OXY acknowledge Sorenson's testimony, states Phillips, but it argues that Sorenson ignores the substantial capital costs of the benzene reduction equipment that refiners have installed. *Id.* Phillips states that Unocal/OXY's argument that the need for this expensive equipment has caused the value of higher N+A to have decreased misses the point of Sorenson's testimony. *Id.* at pp. 94-95. It concedes that it is true that the benzene reduction equipment installed on the West Coast has a significant capital cost. *Id.* at p. 95. However, Phillips explains that most California refiners have already installed the necessary equipment and incurred the cost.[726] *Id.* As a result, Phillips continues, when these refiners are comparing a purchase of ANS Naphtha with an N+A of 55 and a purchase of Naphtha with an N+A of 40, they will not have to incur any additional cost to process the ANS Naphtha. *Id.* Phillips maintain it would be foolish of them to pay the same price for Naphtha with an N+A of 40 as for ANS Naphtha when the ANS Naphtha will yield more gasoline without incurring any more costs. *Id.* In Phillips's view, to do so would be to deprive themselves of the benefits of the benzene reduction equipment that they have already installed. *Id.*

2543. It is clear from the Commission order consolidating the TAPS Carriers's February 27, 2003, filing into this hearing, according to Phillips, that the effective date of the Commission's decision regarding that filing is to be March 1, 2003. Phillips Initial Brief at p. 170 (citing *BP Pipelines (Alaska) Inc.,* 102 FERC ¶ 62,345 at P 13).[727]

2544. In Phillips's view, the authority of the Commission to order retroactive application of its decision on this issue also is clear. *Id.* Phillips points out that Section 15(7) of the Interstate Commerce Act provides that the Commission can, when a new rate such as the one at issue here is filed, set the rate for hearing subject to refund. *Id.* Further, states Phillips, the Circuit Court held, in *OXY,* that Section 15(7) would authorize a retroactive application of a change in rates initiated by the TAPS Carriers. *Id.* at pp. 170-71 (citing *OXY*, 64 F.3d at pp. 698-99).

2545. Phillips states that the effective date of the TAPS Carriers's filing is important to this proceeding. *Id.* at p. 171. Before that filing, explains Phillips, the West Coast Naphtha price was being reviewed as a consequence of complaints filed by Exxon and Tesoro. *Id.* For the reasons set forth in the Eight Parties's Joint Brief (which Phillips joined) on Issue No. 5, Phillips notes, it is clear that the Commission could not implement a change in the Naphtha value retroactively in response to those complaints. *Id.*

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[726] Phillips states that the benzene reduction equipment was generally installed as part of the modifications that were made when the California Air Resources Board regulations came into effect in 1996. Phillips Reply Brief at p. 95, n.39. It notes that Sorenson testified those regulations made such investments necessary as a practical matter regardless of the crude processed by the refinery. *Id.*

[727] Phillips does not assert that the TAPS Carriers are obligated to make refunds from their own funds, because they redistribute the Quality Bank payments that they receive to other shippers. Phillips Initial Brief at p. 170, n.62. Rather, according to Phillips, the TAPS Carriers should be obligated to recalculate Quality Bank payments and receipts and implement a retroactive redistribution of those payments and receipts. *Id.*

2546. The TAPS Carriers filing, according to Phillips, changes the dynamic of the Commission's review of the West Coast Naphtha price. *Id.* It explains that the Commission did not limit the investigation of the February 27 filing simply to the issue of whether it is more appropriate to use the published Gulf Coast Heavy Naphtha price than the published Gulf Coast Naphtha price. *Id.* Instead, notes Phillips, the Commission found that the protests raised the broader issue of "the value of, and appropriate Quality Bank pricing basis for the Quality Bank Naphtha cut on the West Coast." *Id.* (quoting *BP Pipelines (Alaska), Inc.*, 102 FERC ¶ 62,345 at P 11). Because the Commission held that the issue of the appropriate West Coast Naphtha value is raised by the TAPS Carriers filing, it is Phillips's position that the March 1, 2003, effective date for the TAPS Carriers's filing also is the effective date for any holding by the Commission that a West Coast based Naphtha value is required. *Id.* at pp. 171-72. For example, explains Phillips, if the Commission concludes, based on the record, that O'Brien's proposed Naphtha value should be implemented, the effective date of that change should be the March 1, 2003, date specified in the Commission's Order. *Id.* at p. 172.

2547. Phillips explains that the Circuit Court held, in *OXY,* that Section 15(7) of the Interstate Commerce Act does not permit retroactive treatment of a change in methodologies when the TAPS Carriers filing was made in accordance with an approved existing methodology. *Id.* (citing *OXY,* 64 F.3d at pp. 699-700). In that case, Phillips explains, the Circuit Court held that Section 15(7) did not authorize the Commission to retroactively apply a change from the previously approved gravity methodology to a distillation methodology as a consequence of the TAPS Carriers doing nothing more than making the semiannual filing that was required by the gravity methodology, updating the amount to be paid per degree of API gravity. *Id.* (citing *OXY,* 64 F.3d at pp. 699-700).

2548. The Circuit Court in *OXY,* according to Phillips, put great importance on the issue of notice to shippers as to whether retroactive implementation of a change will be required. *Id.* First, explained Phillips, the court noted that "Section 15(7) procedures do not undermine the rule against retroactive ratemaking because all parties are placed on notice that the agency has the authority to order a refund of any part of the increase that it finds to be unjustified." *Id.* (quoting *OXY*, 64 F.3d at p. 699). Phillips explains further that the Circuit Court then relied heavily on the fact that the Commission, in setting the justness and reasonableness of the gravity methodology for hearing, had stated that any change in the methodology would be prospective only. *Id.* (citing *OXY,* 64 F.3d at p. 700; *Trans Alaska Pipeline System*, 49 FERC ¶ 61,349 at pp. 62,264-65 (1989); *Trans Alaska Pipeline System*, 51 FERC ¶ 61,062 at p. 61,137 (1990)). Indeed, the Commission could not have been any clearer on this point, maintains Phillips, holding that "because the TAPS owners have not proposed to change the existing methodology, any change in methodology should be effected prospectively." *Id.* (quoting *Trans Alaska Pipeline System*, 49 FERC at pp. 62,264-65).

2549. Here, by contrast, states Phillips, the Commission has given notice that any change in the value of Naphtha filed by the TAPS Carriers, whether on the Gulf Coast or the West Coast, will be made retroactive to March 1, 2003, as the language quoted above demonstrates. *Id.* at p. 175. Certainly, maintains Phillips, there is nothing in this proceeding remotely like the language in the Commission's 1989 and 1990 Orders that led the Circuit Court to hold that the distillation methodology could not be implemented retroactively. *Id.*

2550. Phillips notes that Williams argues that any imposition of an N+A adjustment to the Heavy Naphtha price can only be made prospective from the date it is adopted by the Commission. Phillips Reply Brief at p. 98. It asserts that Williams does not provide any citation to cases or statutes to support this position and that the sum total of Williams's argument on this point is as follows: "It [the N+A adjustment] was not a change recommended by the TAPS Carriers; indeed . . . the [Quality Bank Administrator] chose not to include such an adjustment. Therefore, it can have only prospective application." *Id.* (quoting Williams Initial Brief at p. 95). Phillips argues that Williams's argument is directly at odds with the controlling statutes regarding changes in rates, and claims that Section 15(7) of the Interstate Commerce Act makes clear that the Commission can require the TAPS Carriers to refund any amount of its "rates or charges as by its decision shall be found not justified." *Id.*

2551. Williams's argument, Phillips suggests, would gut the very reason for allowing a rate to go into effect subject to refund in the first place: to allow the Commission to adjust a proposed rate after hearing in order to implement the just and reasonable rate determined in the hearing retroactively to the effective date of the proposed rate. *Id.* at p. 99. By definition, it states, the just and reasonable rate determined by the Commission at the hearing may be different from what the TAPS Carriers proposed. *Id.* Should the Commission not implement any changes to what was proposed by the TAPS Carriers retroactively, it notes, the Commission could never order any refunds. *Id.* Phillips argues that this would render the Commission's statutory refund authority a nullity. *Id.*

2552. According to Phillips, BP's argument that any N+A adjustment can be made only prospectively is, like Williams's argument, without any merit. *Id.* It notes that BP urges this result "for the reasons explained regarding Issue Nos. 5 and 9 in the Eight Parties' Initial Brief." *Id.* (quoting BP Initial Brief at p. 73). Phillips contends that Issue 5 deals with the question of whether the Commission should, as a matter of equity, implement changes made to the Resid, Heavy Distillate, and Light Distillate issues remanded by the *OXY* Court retroactive to December 1, 1993. *Id.* It maintains that there were no rate changes filed by the TAPS Carriers that were made effective on that date, and the Commission issued no orders making the collection of rates from 1993 forward subject to refund, and argues that the equitable issues involved in Issue 5 are completely distinct from the question of whether the Naphtha value should be made retroactive to March 1, 2003, as a consequence of the TAPS Carriers's Heavy Naphtha filing and the Commission's order providing that the change was to be implemented subject to refund.

Id. at pp. 99-100.

2553. Phillips notes that Petro Star cites to the Stipulation that the parties reached with respect to the effective date for Issue No. 4, VGO, which provides as follows: “The Parties disagree as to the effective date of the new West Coast VGO value. However, the Parties agree that if a different West Coast Naphtha valuation methodology is adopted in this proceeding, it and the new West Coast VGO value should have the same effective date.” *Id.* at pp. 100-01 (quoting Joint Stipulation at p. 4). It suggests that Petro Star argues that it would be unfair to allow the TAPS Carriers's Heavy Naphtha filing, which was made several months after the stipulation, to cause the Naphtha and VGO prices to have a different effective date. *Id.* at p. 101. Phillips states that Petro Star argues that any effective date that the Commission adopts for Naphtha should also apply to VGO. *Id.*

2554. According to Phillips, Petro Star's argument should not be accepted. *Id.* It claims that the TAPS Carriers's Heavy Naphtha filing impacted the stipulation on the VGO effective date as a matter of law in a way that prevents the stipulation from being applied to the Heavy Naphtha filing. *Id.* Prior to that filing, when the stipulation was entered into, Phillips explains, the only way that new Naphtha and VGO prices could be made to have retroactive effect was as a consequence of Exxon's claim for reparations under Section 16 of the Interstate Commerce Act. *Id.* In agreeing to the Stipulation, Phillips maintains, the parties were agreeing that, whatever merits the reparations claim had with respect to Naphtha, the same factors applied to VGO. *Id.* Phillips claims that the parties’s position is that either reparations were appropriate for both, or they were appropriate for neither. *Id.*

2555. The Heavy Naphtha filing, Phillips argues, changed the equivalency between the legal standard applicable to the effective date for the two cuts. *Id.* It argues that, under the controlling statute, the Heavy Naphtha filing involved a change in rates under Section 15(7) of the Interstate Commerce Act which triggers a refund obligation back to March 1, 2003. *Id.* Further, it notes that the TAPS Carriers did not file any similar change in the VGO cut valuation. *Id.* As a result, Phillips asserts, the only way that the VGO valuation can, as a matter of law, be made retroactive is under Exxon's reparations claim and under a different statutory provision. *Id.* Phillips states that the record does not support a finding that reparations for VGO are required as of March 1, 2003 – indeed, it suggests, the record does not support any award of reparations for either VGO or Naphtha. *Id.* at pp. 101-02.

2556. The proposed new Naphtha price is appropriate for the Gulf Coast, provided that an N+A adjustment also is implemented, according to Phillips. Phillips Supplemental Brief at p. 7. It requests that this new price, as adjusted, be made effect August 17, 2003. *Id.*

2557. Phillips explains that, on June 18, 2003, the Quality Bank Administrator made a filing proposing a second substitute price for the Heavy Naphtha price that previously had been used. Phillips Supplemental Brief at p. 3. The proposed new price, according to Phillips, is the average of the cargo price and the barge price. *Id.* It notes that the Quality Bank Administrator stated that there are substantial cargo and barge transactions, and that both the cargo and barge prices therefore are representative of the Gulf Coast Heavy Naphtha value. *Id.* at pp. 3-4. Furthermore, continues Phillips, the Quality Bank Administrator stated that there is no data available that would allow the use of a volume weighted average of the cargo and barge prices. *Id.* at p. 4.

2558. It is Phillips's position that the proposed new price should be adopted for Gulf Coast Naphtha. *Id.* Phillips agrees with the Quality Bank Administrator's finding that there are significant barge and cargo Naphtha transactions conducted on the Gulf Coast, and nothing in the record supports a conclusion that one type of transaction is more representative of the Gulf Coast Heavy Naphtha market than the other. *Id.* In the absence of any data that would allow the calculation of a volume weighted average, Phillips further concurs with the Quality Bank Administrator's proposed arithmetic average of the two prices as reasonable. *Id.*

2559. Furthermore, states Phillips, the record indicates that the proposed average of the cargo and barge prices most likely is representative of the single Heavy Naphtha category whose prices Platts quoted before May 1. *Id.* This is because, notes Phillips, Sharp stated that the Heavy Naphtha prices that were published from March through April of 2003 typically included prices for cargo sized lots on the low end of the reported price and prices for barge sized lots on the high end. *Id.* This means, according to Phillips, that the calculation of the mid-point of the high and the low prices performed by the Quality Bank Administrator before May 1, 2003, in essence, represented the average of Gulf Coast cargo prices - which were reported by Platts as the low Heavy Naphtha price - and barge prices - which were reported by Platts as the high Heavy Naphtha price. *Id.* The Quality Bank Administrator's proposal to use the average of the barge price and the cargo price thus, in Phillips's view, approximates the way that the Quality Bank Administrator calculated the Heavy Naphtha price before the split in reported prices commenced. *Id.* at pp. 4-5.

2560. While Phillips supports the proposed averaging of the barge and cargo prices for use on the Gulf Coast, Phillips does believe that the Quality Bank Administrator's filing is deficient in one respect. *Id.* at p. 5. It notes that filing does not include an N+A adjustment. *Id.* Such an adjustment is required, asserts Phillips, for the reasons previously discussed. *Id.*

2561. Phillips agrees with the TAPS Carriers and Exxon that the decision by Platts to split the Heavy Naphtha price into Heavy Naphtha (Cargo) and Heavy Naphtha Barge prices constitutes a radical alteration of the previously published Heavy Naphtha price, in accordance with the Quality Bank Tariff. Phillips Reply Brief at p. 102 (Citing TAPS Carriers Supplemental Brief at pp. 10-14; Exxon Supplemental Brief at pp. 5-7). Ultimately, however, they assert that it does not matter whether there has been a radical alteration of the Gulf Coast Heavy Naphtha price or not. *Id.*

2562. As an initial matter, Phillips notes that the TAPS Carriers have the authority under the controlling statute to propose changes to their Tariff regardless of whether the changes are authorized by the existing Quality Bank Tariff. *Id.* It claims that the standard imposed by the controlling statutes is whether the change is just and reasonable, and, if a proposed change is just and reasonable, then it must be permitted. *Id.* at pp. 102-03. Furthermore, Phillips asserts that the Commission previously set for hearing, here, the justness and reasonableness of the TAPS Carriers's February 2003 filing that proposed the use of the Platts Heavy Naphtha price for the Quality Bank. *Id.* at p. 103. In the context of reviewing that filing, it argues that it is entirely appropriate for the Commission to consider intervening events since the time the TAPS Carriers's filing was made in February – indeed the Commission is required under the statutes to determine the just and reasonable rate to be charged in the future by the TAPS Carriers, and the fact that there now are both cargo and barge prices published for Heavy Naphtha certainly must be considered by the Commission in evaluating the TAPS Carriers's proposal that the Heavy Naphtha price should be used. *Id.* As a result, Phillips's position is that the Commission must consider the impact of the publication of separate Heavy Naphtha cargo and barge prices in the context of the TAPS Carriers's February 2003 Heavy Naphtha filing regardless of whether the TAPS Carriers's averaging proposal is justified under the Quality Bank Tariff. *Id.*

2563. Phillips notes that Unocal/OXY assert that the impact of the Quality Bank Administrator's averaging proposal is "to increase the value of the Waterborne Naphtha cut by approximately one cent per gallon." *Id.* at p. 104 (quoting Unocal/OXY Supplemental Brief at p. 5). It states that Williams similarly suggests that the proposal represents an increase in Naphtha value prices, arguing that it represents a "skewed higher West Coast naphtha price" proposal. *Id.* (quoting Williams Supplemental Brief at p. 2). This characterization of the impact of the Quality Bank Administrator's proposal, Phillips argues, is highly misleading. *Id.* It claims that the record makes clear that before May 1, 2003, the Platts Heavy Naphtha price quotes included both cargo and barge prices and asserts that the Quality Bank Administrator's averaging proposal does not represent an attempt to increase Naphtha values above what they were prior to the May 1, 2003, change by Platts in its reporting, but instead is an effort to maintain the use of a Quality Bank price that continues to be based on both cargo and barge prices. *Id.*

2564. Contrary to Williams's assertion, Phillips maintains that it is the opponents of the Quality Bank Administrator's proposal who are attempting to skew the Quality Bank Naphtha value to be lower than it was before. *Id.* It suggests that the record reflects that the cargo prices that they propose to use tend to be lower than the barge prices. *Id.*

Therefore, Phillips states that use of the cargo price alone will result in a lower Naphtha value than would have been the case before May 1, 2003, when Platts Heavy Naphtha price quote included both cargo and barge transactions. *Id.* at pp. 104-05.

2565. Phillips claims that the Quality Bank Administrator's averaging proposal represents an effort to keep the Quality Bank Naphtha value at the same level that it would have been had Platts not divided the Heavy Naphtha price into cargo and barge price quotes. *Id.* at p. 105. It contends that this is a reasonable goal that does not favor either those who want a higher Naphtha price or those who want a lower Naphtha price, and states that the assertions of Unocal/OXY and Williams that the proposal favors parties who want higher Naphtha prices are incorrect and should be rejected. *Id.*

2566. Williams also attacks, Phillips states, the proposal to weight cargo and barge prices equally in calculating an average of the Heavy Naphtha and Heavy Naphtha Barge prices. *Id.* It asserts that Williams is wrong to argue that there is no factual basis for the averaging proposal. *Id.* Rather, Phillips claims, Sharp made clear that there are numerous barge and cargo transactions and, further, while he was not able to give a precise breakdown of the transactions, he said the "barge transactions may slightly predominate." *Id.* (quoting Exhibit No. TC-20 at p. 1). According to Phillips, it thus appears there is a rough equivalence between the two types of transactions, even if the barge transactions slightly predominate. *Id.* While it would be preferable to have more detailed data on how much of each type of Naphtha is sold, Phillips argues, Sharp's description of the market provides an adequate factual support for the reasonableness of using a simple average in the absence of more detailed data. *Id.* at p. 106. It asserts that it is certainly more reasonable to use a simple average than to use only the cargo price, which represents the low end of the price range for Gulf Coast Naphtha without any allowance whatsoever for barge transactions. *Id.*

2567. Williams's argument that the weighting proposal is inconsistent with the decision not to weight cargo and barge prices for Gulf Coast VGO prices, according to Phillips, should be rejected. *Id.* It argues that Exhibit No. TC-23 makes clear that "[t]here are often periods of several weeks or more in which there are no actual [VGO] cargo transactions." *Id.* (quoting Exhibit No. TC-23 at p. 3). Under those circumstances, where there are substantially more barge transactions than the often non-existent cargo transactions, it contends, the record would not have supported using a simple average of cargo and barge prices. *Id.* at pp. 106-07. Here, it notes that, by contrast, the record supports the conclusion that there is a rough equivalency between cargo and barge transactions, and that a simple average of the two prices represents the most reasonable approach. *Id.* at p. 107.

2568. In its order setting the Quality Bank Administrator's June 18, 2003, filing for hearing, Phillips notes, the Commission made the replacement price effective August 17, 2003, subject to refund. *Id.* at p. 6 (citing *Trans Alaska Pipeline System*, 104 FERC at P

9). Given this explicit holding in the Commission's order, Phillips argues, the effective date for the new averaged Gulf Coast Naphtha price should be August 17, 2003. *Id.* To the extent that the Commission applies the new Gulf Coast Naphtha price to West Coast Naphtha, however, Phillips's position is that the West Coast Naphtha price should have the same effective date as the Gulf Coast Naphtha price, i.e., August 17, 2003. *Id.* Should the Commission adopt a West Coast-based Naphtha value, however, Phillips asserts, the value should have an effective date of March 1, 2003. *Id.*

2569. The N+A adjustment to the new Naphtha price should also apply as of the August 17, 2003, effective date established by the Commission, according to Phillips. *Id.* To the extent that a Gulf Coast Naphtha price is applied to West Coast Naphtha, then Phillips states, there also should be an N+A adjustment to the West Coast effective August 17, 2003. *Id.* On reply, Phillips attempted to clarify its position by stating that it now believes that there should also be an N+A adjustment to the Heavy Naphtha price effective March 1, 2003, which is the effective date of the Heavy Naphtha price established by the Commission. Phillips Reply Brief at p. 108.

7. Exxon

2570. In response to the February 3, 2003, Platts decision to begin publishing a new waterborne Heavy Naphtha price on the Gulf Coast in addition to the Full Range Gulf Coast Naphtha price, explains Exxon, the Quality Bank Administrator determined that the properties of the ANS Naphtha cut used by the TAPS Quality Bank are far closer to the Platts Heavy Naphtha specifications than they are to the Platts Full Range Naphtha specifications. Exxon Initial Brief at pp. 323-24. More specifically, states Exxon, the Quality Bank Administrator pointed out that the 175°F initial boiling point of the Quality Bank Naphtha cut is much closer to the initial boiling point of the Platts Heavy Naphtha price assessment (180°F) than to the initial boiling point of the Platts Full Range Naphtha price assessment (130°F). *Id.* at p. 324. Similarly, continues Exxon, the average 53°API gravity of the Quality Bank Naphtha cut is much closer to the API gravity of the Platts Heavy Naphtha price assessment (52-53°API) than to the API gravity of the Platts Full Range Naphtha price assessment (56-60°API). *Id.*

2571. Based on the fact that the properties of Quality Bank Naphtha cut are much closer to the Platts Heavy Naphtha specifications than to Platts Full Range Naphtha specifications, notes Exxon, the Quality Bank Administrator concluded that the Platts Heavy Naphtha price should be used to value the Quality Bank Naphtha cut rather than the Platts Full Range Naphtha price. *Id.* at pp. 324-25. Accordingly, on February 27, 2003, states Exxon, the Quality Bank Administrator filed tariff revisions with the Commission notifying the Commission and all parties that effective March 1, 2003, the Quality Bank would use the Heavy Naphtha price published by Platts to value all Quality Bank Naphtha. *Id.* at p. 325. By order dated March 28, 2003, continues Exxon, those Tariff revisions were accepted by the Commission effective March 1, 2003, subject to refund, and the issues raised by those tariff revisions were consolidated with this proceeding. *Id.* (citing *BP Pipelines (Alaska) Inc.,* 102 FERC ¶ 61,345).

2572. Exxon asserts that the decision by the Quality Bank Administrator to use Platts Heavy Naphtha price to value the Quality Bank Naphtha cut as of March 1, 2003, on the Gulf Coast (and the West Coast until such time as the Commission establishes a new methodology for valuing West Coast Naphtha) is strongly supported by the evidence and was not opposed at the hearing by any party. *Id.* at pp. 325-26. It is undisputed, according to Exxon, that the properties on which the Platts Heavy Naphtha assessment is based, including the initial boiling point and API gravity, more closely resemble ANS Quality Bank Naphtha than do the properties of the Platts Full Range Naphtha price. *Id.* at p. 326. Further, continues Exxon, the average differential between the Heavy Naphtha and Full Range Naphtha prices reported by Platts since February 2003 of approximately 1¢/gallon is approximately the same differential one would expect to find given that, on the basis of the Quality Bank cut points, the Platts Full Range Naphtha is approximately 5/6ths Quality Bank Naphtha and 1/6th Quality Bank LSR. *Id.*

2573. Unocal/OXY and Petro Star, Exxon claims, now raise a procedural objection to the actions taken by the Quality Bank Administrator to implement the change to the Heavy Naphtha quote. Exxon Reply Brief at p. 341. It notes that, although Petro Star agrees that the new quote is suitable, both parties assert that the Quality Bank Administrator exceeded his authority. *Id.* at pp. 341-42. In addition, Unocal/OXY object to the use of the new Gulf Coast Heavy Naphtha price assessment to value West Coast Naphtha based on Unocal/OXY's contention that the use of any Gulf Coast price overvalues West Coast Naphtha and, therefore, advocates no adjustment to the Gulf Coast price that would raise the value of West Coast Naphtha. *Id.* at p. 342. Exxon argues that both contentions are without merit. *Id.*

2574. In Exxon's view, the procedural objection raised by Petro Star and Unocal/OXY is based on an untenably narrow reading of the Quality Bank Administrator's authority under the Tariff to deal with unanticipated implementation issues. *Id.* According to Exxon, the 1993 order of the Commission provided that the Quality Bank Naphtha cut would be valued based on Platts quoted price for Gulf Coast spot waterborne Naphtha. *Id.* At that time, notes Exxon, there only was one Platts price assessment for Gulf Coast spot waterborne Naphtha. *Id.* As a result of Platts February 2003 decision to publish two Naphtha prices, continues Exxon, the Quality Bank Administrator was confronted with the need to pick one of the two prices. *Id.* It argues that this situation falls squarely within the provision in Section III.J. of the TAPS Tariff authorizing the Quality Bank Administrator to resolve unanticipated implementation issues, and states that the Tariff provision makes clear that the Quality Bank Administrator is expressly authorized to resolve such implementation issues in accordance with the Administrator's best understanding of the intent of the Commission subject to review by the Commission. *Id.* at pp. 342-43.

2575. Exxon asserts that it was clearly not anticipated that Platts would begin to publish two separate assessments, and the Quality Bank Administrator's conclusion that the intent of the Commission was to select the Platts Gulf Coast Naphtha price assessment that best reflects the market value of the Quality Bank Gulf Coast Naphtha cut is not challenged. *Id.* at pp. 343-44. Further, Exxon notes, no party disagrees with the conclusion of the Quality Bank Administrator that the specifications for Platts Heavy Naphtha price assessment are closer to the specifications of the Quality Bank Naphtha cut. *Id.* at p. 344.

2576. In these circumstances, Exxon maintains, there is plainly no merit to the claim of Petro Star and Unocal/OXY that the publication of the new Platts Heavy Naphtha quotation did not present an unanticipated implementation issue under Section III.J. of the Tariff because Platts continued to publish the original Full Range Gulf Coast Naphtha price assessment and the Quality Bank Administrator could have continued to use that price. *Id.* Exxon argues that the discontinuance of a proxy price is plainly not a prerequisite to action by the Quality Bank Administrator under Section III.J. of the Tariff. *Id.* at pp. 344-45. In fact, notes Exxon, the discontinuance of a proxy price is specifically addressed in a completely different section – Section III.G.5. – of the TAPS Tariff. *Id.* Therefore, it concludes, the provisions of Section III.J. for dealing with unanticipated implementation issues do not even apply to the discontinuance of a proxy price, and they cannot be limited to that situation as Petro Star and Unocal/OXY suggest. *Id.*

2577. Exxon asserts that Unocal/OXY's further argument that, because the evidence allegedly indicates that the Gulf Coast price overvalues West Coast Naphtha, the Gulf Coast price should not be adjusted in any manner that would increase the current valuation of West Coast Naphtha is based on an obviously incorrect premise. *Id.* It states, the evidence in this case is overwhelming that the Platts Gulf Coast price assessment in fact substantially undervalues West Coast Naphtha, and there is absolutely no credible evidence that it has ever overvalued West Coast Naphtha. *Id.* Accordingly, Exxon declares, there is no valid basis whatsoever for Unocal/OXY's opposition to the use of the Platts Heavy Naphtha price assessment on the Gulf Coast. *Id.*

2578. In his discussions with Sharp at Platts, states Exxon, the Quality Bank Administrator also learned that, in assessing Naphtha prices, Platts bases its published Gulf Coast Naphtha prices on the assumption that Naphtha has an N+A of 40, and that Platts adjusts for higher values of N+A by adjusting the price by 0.15¢/gallon per percent N+A above 40 up to an N+A of 50 (or an adjustment of 1.5¢/gallon for any Naphtha with an N+A over 50). Exxon Initial Brief at p. 327. In light of this new information, Exxon and Phillips propose that the Quality Bank Administrator add 1.5¢/gallon to the Platts Heavy Naphtha price to reflect the higher N+A of Quality Bank Naphtha. *Id.* Further, states Exxon, although the Quality Bank Administrator took the position that he was not authorized to adjust the published Platts price without Commission authorization, and he took no position either for or against the proposed 1.5¢/gallon adjustment, he testified that it would be administratively feasible to add 1.5¢/gallon to the Platts Gulf Coast Heavy Naphtha price in order to reflect the higher value of the N+A content of Quality Bank Naphtha. *Id.* at p. 328. It notes that Williams, Unocal/OXY, BP, and Petro Star oppose this proposal. Exxon Reply Brief at p. 346.

2579. Exxon asserts that both the factual evidence and relevant legal principles reveal that the Commission should adopt the proposed N+A adjustment to the Platts published price to reflect the higher value of Quality Bank Naphtha. *Id.* It asserts that the evidence clearly establishes that the Gulf Coast Naphtha prices published by Platts are based on an N+A of 40. Exxon Initial Brief at p. 328. It is also undisputed, according to Exxon, that the Naphtha produced from ANS crude has an N+A that is greater than 55. *Id.* It therefore follows, claims Exxon, that the Quality Bank Naphtha, which has an N+A substantially higher than 50, would receive the maximum Platts N+A adjustment of 1.5¢/gallon. *Id.*

2580. The evidence is also overwhelming, Exxon claims, that Naphtha with a higher N+A is more valuable than Naphtha with a lower N+A. *Id.* at p. 329. It explains that this is because naphthenes are easily transformed into aromatics in the reforming process and because aromatics have a very high octane and produce high octane gasoline, which sells for a higher price because it is not prone to knocking. *Id.* Exxon goes on to suggest that a higher N+A permits the reformer to be operated at a lower level of severity, or lower temperature, to produce a reformate of a given octane, which both reduces the cost of operation and significantly increases the yield or volume of gasoline that is produced from a barrel of Naphtha feed. *Id.* In addition, notes Exxon, a higher N+A increases the yield of valuable hydrogen and extends the life of the catalyst used in the reforming process. *Id.* As a direct result of the many benefits of high N+A Naphtha, Exxon states, it is more profitable to operate a refinery using Naphtha with a higher N+A, and refineries pay a higher price for such Naphtha. *Id.* at pp. 329-30. It states that this viewpoint is corroborated by Sorenson's studies which were presented at the hearing. Exxon Reply Brief at pp. 347-48. His studies prove, in Exxon's view, that high N+A improves refinery economics under all scenarios, including the California Air Resources Board specifications. *Id.* at p. 348.

2581. Despite this overwhelming evidence, Exxon states, Williams claims that the high levels of benzene, benzene precursors, and heavy aromatics make ANS Naphtha less desirable for manufacturing finished gasoline, particularly in California's restrictive California Air Resources Board regime.[728] *Id.* at p. 348. It asserts that Williams has presented no credible evidence to support its contention. *Id.* Most importantly,

[728] Exxon notes that Unocal/OXY also make this argument, although it asserts they provide little or no analysis supporting it. Exxon Reply Brief at p. 348, n.218.

according to Exxon, its witnesses, Sanderson and Sarna, presented no counter-study in response to Sorenson's analysis, despite their extensive experience running linear programming models and their having had access to Sorenson's model. *Id.*

2582. Instead, explains Exxon, Williams relies only on its witnesses's unsubstantiated hypotheses about N+A. *Id.* at p. 349. For example, Exxon notes that Williams cites Sanderson's view that West Coast refiners would prefer Naphtha with lower or no benzene or its precursors. *Id.* This supposition is squarely contradicted by Sorenson's testimony and study, yet, Exxon states, Williams cites no evidence to back up Sanderson's view and Williams's brief does not even discuss Sorenson's study. *Id.* Moreover, Exxon suggests, this alleged importance of benzene is contradicted by the fact that much of the data at Sanderson and Sarna's firm, Purvin & Gertz, does not include benzene. *Id.* If West Coast refiners were as severely limited by benzene restrictions as Williams now contends, Exxon asserts, one would certainly expect that Sanderson and Sarna's firm would have an abundance of this information. *Id.*

2583. Furthermore, Exxon argues, directly contrary to Williams's claim, Purvin & Gertz published a Global Petroleum Market Outlook study in 2001 that states that N+A is highly valued by gasoline producers in the reforming process. *Id.* at pp. 349-50. The evidence clearly shows, according to Exxon, that Purvin & Gertz specifically advises its refining industry clients that a high N+A content adds significant value to Naphtha. *Id.* at p. 350. Exxon notes that Williams ignores this study in its brief. *Id.*

2584. Although Sanderson claimed on redirect examination that this Purvin & Gertz study supported his position because it also recognized that there are U.S. environmental restrictions that limit the amount of aromatics in gasoline, Exxon asserts, that fact does not support his position. *Id.* It maintains that, while no party disagrees that there are restrictions on aromatics and benzene in gasoline, these restrictions, even in California, do not erase the significant value that high N+A content brings to CARB gasoline producers, as shown by Purvin & Gertz.[729] *Id.*

2585. Exxon asserts that Sarna's testimony suffered from several shortcomings that were exposed at the hearing. *Id.* at pp. 350-51. First, Exxon argues that Sarna was not a credible witness, was evasive during his testimony, and for that reason his testimony should not receive much weight. *Id.* at p. 351. Second, Exxon states, Sarna's exhibits

[729] Exxon states that Sanderson's claim that low utilization levels for West Coast catalytic reformers demonstrate that stringent benzene and aromatics requirements have lowered N+A values in California is also refuted by a report prepared by Purvin & Gertz which states that reforming capacities in California were utilized approximately 90% on average during 2000. Exxon Reply Brief at p. 350, n.219. It points out that Williams does not mention this Purvin & Gertz report in its initial brief either. *Id.*

were shown to contain several errors and unwarranted assumptions. *Id.* For example, Exxon explains, Sarna's list of what he called desirable and undesirable N+A components in Exhibit No. WAP-275, which Williams cites in its brief, had boiling points listed that are highly misleading. *Id.* In particular, notes Exxon, the depiction of undesirable C_6 components incorrectly suggests that all this material would boil off at 176°F, when in fact substantial portions (possibly as much as 50%) would boil off at temperatures below the Quality Bank Naphtha cut range. *Id.* Further, continues Exxon, Sarna admitted that he could not quantify how much of the undesirable C_{10} components would fall within the Quality Bank Naphtha cut range and that he had done no investigation of the evidence in the record to support his assumptions on this point. *Id.* at pp. 351-52. Exxon also suggests that the only point that Exhibit No. WAP-275 clearly demonstrates is that, as Sarna agreed, the Quality Bank Naphtha cut range of 175-350°F contains all of the desirable N+As. *Id.* at p. 352. It argues that this exhibit actually cuts squarely against Williams's position and instead supports the need for an N+A adjustment.[730] *Id.*

2586. Third, Exxon claims, the 1991 article contained in Exhibit No. WAP-278 undermines Williams's position. *Id.* Using an approach similar to Sorenson's study, explains Exxon, the article sets forth an economic analysis of refining margins which shows that the benzene saturation process discussed in the article is the best option on the West Coast. *Id.* Thus, according to Exxon, UOP, a major supplier of reformer technology, was marketing technology to mitigate substantially whatever negative impact so-called undesirable C_6 N+A components might have on the value of West Coast Naphtha at least five years in advance of the introduction of California Air Resources Board specifications in 1996. *Id.* at pp. 352-53. Exxon points out that Sorenson's testimony and Exhibit Nos. PAI-259 through PAI-261 demonstrate that mitigation of this nature is exactly what nearly all West Coast refiners have done within the last decade.[731] *Id.* at p. 253.

[730] Exxon notes that another shortcoming with Exhibit No. WAP-275 is that it erroneously suggested that all of the so-called "undesirable" N+A components actually go into a reformer; whereas, as Sarna conceded, refiners do not run all of these components into a reformer, but rather only a small percentage. Exxon Reply Brief at p. 352, n.220.

[731] Exxon contends that Williams's reliance on a quote in Exhibit No. WAP-278 regarding ANS's benzene content in connection with Sarna's exhibit comparing ANS to other crudes is weak. Exxon Reply Brief at p. 354, n.222. Exxon notes that Sarna admitted that he did not know the date of the assay utilized for the March 1991 article nor what changes in benzene content might have occurred in the intervening twelve-plus years resulting from, for example, the addition of the Alpine and Northstar fields. *Id.* Indeed, states Exxon, Sanderson conceded that the properties of ANS crude have been changing over time as new fields have been added to the TAPs stream. *Id.*

2587. Exxon asserts that another reason Sarna's exhibit, comparing ANS to other crudes, is entitled to no weight is because it is riddled with unwarranted assumptions. *Id.* At the hearing, notes Exxon, it was demonstrated that Sarna selected the crudes for his chart in such a manner as to render this exhibit totally unreliable. *Id.* In the first place, states Exxon, Sarna had virtually no understanding regarding the information contained in the database (Exhibit No. WAP-281) on which he based his calculations. *Id.* It explains that, according to Sarna, there were no directions as to how the database works, and he made no further efforts to either inquire or understand the nature and source of the data. *Id.* In Exxon's view, this fact weighs heavily because Sarna admitted that he did not know, for example, why multiple data-entry dates appeared for the same crudes or at what temperature all of the benzene boiled off in the sample tests. *Id.* Furthermore, continues Exxon, Sarna used this database despite finding data for some crudes that he knew were inaccurate and he also did not verify the database against any other available assay information. *Id.* at p. 354.

2588. As for the four specific crudes listed in Exhibit No. WAP-279, which Sarna selected from the ETC database of approximately 450 crudes, Exxon notes, he could not say that they were representative of all the crudes contained in the database; nor could he say how many of the 450 total were processed in California. *Id.* It states that Sarna also did not know crucial information about the specific assays for the crudes that he selected for inclusion in his analysis. *Id.* For example, according to Exxon, Sarna admitted that he did not know how long before 1993 the Arabian Light sample was taken. *Id.* Further, notes Exxon, Sarna also conceded that he did not know if the Oriente assay was taken before or after the Oriente composition changed significantly in the mid-1990s, and thus he did not know if the Oriente data is representative of Oriente in 2002, when the comparison to 2002 ANS crude was done. *Id.* Finally, Exxon points out that Sarna further admitted that he did not know when the sample was taken for the Point Arguello Light crude on his exhibit. *Id.* at pp. 354-55.

2589. It was also demonstrated, according to Exxon, that, even looking past the serious deficiencies in Exhibit No. WAP-279, the exhibit provides no useful comparison for purposes of resolving the N+A question at issue in these proceedings. *Id.* at p. 355. For example, explains Exxon, Exhibit No. PAI-258 demonstrates that, if Sarna had chosen other marker crudes to compare to ANS, he would have found that there are some well known crudes in the world market which have benzene contents that are higher than ANS and considerably higher than the three crudes he did choose.[732] *Id.* Additionally, notes

[732] Exxon comments that Williams attempted to explain away Exhibit No. PAI-258 by contending that the additional marker crudes listed were not processed in California and therefore not relevant to Sarna's analysis. Exxon Reply Brief at p. 355, n.223. It asserts that the weight of this claim is significantly undercut by the fact that Sarna could not say that the crudes he chose were representative of all the crudes

Exxon, Exhibit No. EMT-661 demonstrates that, on both a total crude and Quality Bank Naphtha basis, ANS has significantly more toluene and xylene (as well as benzene) than the three crudes (Arabian Light, Oriente, and Port Arguello Light) that Sarna chose for comparison.[733] *Id.* Exxon contends that it is undisputed that toluene and xylene are valuable properties, a fact which Sarna ignored in his analysis. *Id.* at p. 356. Thus, Exxon's position is that Exhibit No. WAP-279 provides no useful comparison of ANS to these other crudes. *Id.*

2590. Exxon claims that the Circuit Court already has held that the Quality Bank should adjust reported price assessments used to value Quality Bank cuts where there are differences between the qualities specified for the product valued by the reported price assessment and the qualities of the Quality Bank cut. Exxon Initial Brief at p. 330. For example, Exxon asserts that, in *OXY,* the Circuit Court directed that adjustments be made to the reported price assessments for jet fuel and No. 2 fuel oil to reflect differences in the quality of those products versus the Light Distillate and Heavy Distillate Quality Bank cuts, and the Commission established such adjustments. *Id.* (citing *OXY,* 64 F.3d at pp. 693-94; *Trans Alaska Pipeline System*, 81 FERC at pp. 62,462-63). Exxon also contends that the Circuit Court further found that a failure to take into account the quality differences between the Quality Bank cuts and the products underlying the published reference prices would unfairly distort the Quality Bank valuation. *Id.* (citing *OXY,* 64 F.3d at p. 693).

2591. For the same reasons, Exxon advocates adjusting the Gulf Coast Naphtha price assessments reported by Platts to reflect what it considers the undisputed fact that Quality Bank Naphtha has a significantly higher N+A than the Naphtha priced by Platts, which Exxon asserts renders Quality Bank Naphtha more valuable than the Naphtha on which the Platts price is based. *Id.* at pp. 330-31. As in *OXY*, Exxon views a failure by the Commission to take into account the higher quality of Quality Bank Naphtha would unfairly distort the Quality Bank valuation by penalizing some producers and providing a

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contained in the database or how many of the 450 total crudes were processed in California. *Id.* Exxon also notes that this concern is substantially mitigated by the fact that Sarna admitted that the five additional crudes added in Exhibit No. PAI-258 are marker crudes, i.e., crudes which traders use to price other crudes. *Id.* This is particularly significant, Exxon argues, as the crudes Sarna did select were not large volume crudes in California. *Id.*

[733] Exxon points out that although Sarna attempted to argue that there was a distinction between the total crude and Quality Bank Naphtha basis, he admitted that he had done no calculations to support this claim even though he had been provided a version of Exhibit No. EMT-661 in advance of his appearance at the hearing. Exxon Reply Brief at p. 356, n.224.

windfall to others. *Id.* at p. 331.

2592. Exxon notes that BP argues, on the other hand, that *OXY* counsels against the adjustment, stating that using an adjustment would treat the Naphtha cut differently than all other cuts. Exxon Reply Brief at p. 356. This argument is without merit, Exxon claims and notes that the Circuit Court stated, in *OXY*: "The goal of the Quality Bank valuation methodology, as all parties agree, is to assign accurate relative values to the petroleum that is delivered to TAPS and becomes part of the common stream." *Id.* (quoting *OXY*, 64 F.3d at p. 693). According to Exxon, the Quality Bank already makes quality adjustments to the Light and Heavy Distillate cuts based on *OXY*'s holding that a failure to take into account quality differences between the Quality Bank cuts and the products underlying the published reference prices would unfairly distort the Quality Bank valuation. *Id*. Here, according to Exxon, it is known – by virtue of the Quality Bank Administrator's testimony and Exhibit No. PAI-222 – that Platts makes specific adjustments for N+A in developing its Gulf Coast Naphtha and Heavy Naphtha price assessments. *Id.* at p. 357. Exxon notes that no other evidence of similar adjustments has been presented by any party. *Id.* Thus, Exxon contends, the Commission should adjust the Gulf Coast Naphtha price assessments reported by Platts to reflect the undisputed fact that Quality Bank Naphtha has a significantly higher N+A than the Naphtha price assessments reported by Platts. *Id.* As is clear from the evidence, asserts Exxon, the N+A content of the Platts price assessments is not close enough to the known actual value of higher N+A content of Quality Bank Naphtha to justify ignoring the proposed adjustment. *Id.* Because that is true, Exxon maintains that, as in *OXY*, a failure by the Commission to take into account the higher quality of Quality Bank Naphtha would unfairly distort the Quality Bank valuation by penalizing some producers and providing a windfall to others. *Id.*

2593. Exxon asserts that there is also no merit to BP's argument that, because other processing cost adjustments relate to proxy prices for finished products, the N+A adjustment would be inconsistent because it would be an adjustment to an intermediate product reference price to value a comparable intermediate product. *Id.* at p. 358. It argues that the important thing is that the value of the proxy price be adjusted to reflect the quality of the Quality Bank product. *Id.* In Exxon's view, it makes no difference whether that proxy price is characterized as a product for a finished product or an intermediate product, and BP presents no basis for making that distinction. *Id.*

2594. The evidence, Exxon argues, also strongly supports the reasonableness of the adjustment used by Platts of 1.5¢/gallon for Naphtha with an N+A over 50. Exxon Initial Brief at p. 331. First, it notes that the 1.5¢/gallon N+A adjustment is supported by the increased value of the higher octane gasoline produced by Naphtha with an N+A of 55 as compared to Naphtha with an N+A of 40 as assumed by Platts. *Id.* For example, continues Exxon, when the higher market value of the higher octane gasoline that results from a higher N+A is calculated on the basis of cents per gallon per N+A, the evidence shows that each additional N+A point is worth about 0.27¢/gallon on the Gulf Coast and about 0.51¢/gallon on the West Coast. *Id.* According to Exxon, both of these numbers exceed the value of 0.15¢/gallon per N+A (with a cap of 1.5¢/gallon) used by Platts, thus demonstrating that the N+A adjustment used by Platts is conservative. *Id.*

2595. Similarly, explains Exxon, if one holds the octane level constant and values the resulting differences in yields produced by Naphthas with different levels of N+A, the evidence shows an increase in value in going from an N+A of 40 (the Platts specification) to an N+A of 57 (Quality Bank Naphtha) ranging from 1.24¢ to 2.06¢/gallon on the Gulf Coast, and from 1.27¢ to 2.63¢/gallon on the West Coast, depending on what period is used and how the reformate is valued. *Id.* at pp. 331-32. Exxon notes that these numbers are consistent with the 1.5¢/gallon adjustment that Platts applies, which is near the lower end of the range of added values for higher N+A. *Id.* at p. 332. The 1.5¢/gallon adjustment used by Platts was also validated by Sorenson, states Exxon. *Id.*

2596. The evidence further shows, according to Exxon, that the proposed N+A adjustment necessary to bring the published Platts Naphtha prices to the quality level of the Naphtha produced from ANS crude would have a sufficient dollar impact on the parties to the Quality Bank to justify the proposed N+A adjustment. *Id.* Further, notes Exxon, the evidence also shows that the proposed N+A adjustment is consistent in magnitude and impact with other adjustments that either are made by the Quality Bank or have been proposed for other Platts reference prices. *Id.* In particular, claims Exxon, the evidence shows that the proposed N+A adjustment for Naphtha is comparable to the 0.5¢/gallon price deduction that is made to the Light Distillate reference price and to the 1.1¢/gallon logistics adjustment that has been proposed by the Eight Parties for the Heavy Distillate cut. *Id.* at pp. 332-33.

2597. Exxon argues that the additional criticisms presented by those parties which oppose the N+A adjustment are equally without merit. Exxon Reply Brief at p. 360. It notes that Williams and BP both argue that the information in Exhibit No. PAI-222 is not sufficient evidence upon which the Commission can accept the proposed N+A adjustment. *Id.* at p. 361. Exxon asserts that this contention is clearly incorrect. *Id.*

2598. According to Exxon, page 8 of Exhibit No. PAI-222 provides sufficient grounds for the Commission to accept the N+A adjustment, especially in light of the Quality Bank Administrator's testimony as to its accuracy. *Id.* Specifically, notes Exxon, the Quality Bank Administrator stated that N+A adjustments had been done in the past for Full Range Naphtha and this practice would be continued for the new adjustments. *Id.* Therefore, states Exxon, BP is incorrect in arguing that no adjustment is appropriate now because adjustments had never been made before. *Id.* at n.228. Given the Quality Bank Administrator's testimony at the hearing that he confirmed this practice with Sharp and the testimony of Sanderson that he also confirmed this practice in a later telephone conversation with Sharp, Exxon contends there is more than enough proof to establish that Platts makes this adjustment and that, consequently, the Quality Bank should also make an N+A adjustment. *Id.* at pp. 361-62.

2599. Exxon also finds it ironic that, in its discussion of the Naphtha contracts, BP lauds the editorial discretion exercised by Platts in formulating its assessments, yet it refuses to accept Sharp's report to the Quality Bank Administrator that Platts makes this kind of editorial adjustment.[734] *Id.* at p. 362. It suggests that the inconsistency of these positions is highlighted by the fact that BP urges the Commission to adopt Ross's governor which is purportedly designed to simulate a transparent market, but dismisses Sharp's real-world adjustment as too speculative. *Id.*

2600. Similarly, Exxon notes, Williams contends that the Commission should take the word of its witness, Sanderson, over that of the Quality Bank Administrator because some key questions were not asked of Sharp. *Id.* It asserts that the record makes it clear that greater weight should be given to the testimony of the Quality Bank Administrator. *Id.* at pp. 362-63. Exxon explains that the Quality Bank Administrator twice confirmed at the hearing that Sharp, in answer to an open ended question on quality adjustments, mentioned only the N+A adjustments to Naphtha and Heavy Naphtha. *Id.* at p. 363. By contrast, Exxon states, Sanderson claims to have asked Sharp leading questions about the Platts assessment during conversations which occurring between March 2003 and June 2003, but did not take any notes or otherwise memorialize these conversations. *Id.* Moreover, Exxon asserts that Sanderson, apparently, did not attempt to verify Exhibit No. PAI-222's accuracy with Sharp during those conversations. *Id.* Furthermore, Exxon notes, Sharp did not give Sanderson any indication of adjustment factors for specifications other than N+A even when pressed.[735] *Id.* at pp. 363-64. In Exxon's view, therefore, Sanderson's testimony strongly corroborates the Quality Bank Administrator's memorandum and testimony regarding the N+A adjustment made by Platts. *Id.* at p. 364. There is nothing in the record, asserts Exxon, to support Sanderson's speculation that

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[734] Exxon takes exception to BP's description of Sharp as merely a Platts's employee. Exxon Reply Brief at p. 362, n.229. It explains that Sharp is the person at Platts who does the price assessment for the Naphtha quotes utilized by the Quality Bank. *Id.* Further, Exxon believes that the Commission should ignore BP's speculative argument concerning the consequences of Sharp's being replaced and should, instead, rely on the regular course of business in which Sharp does set the price and applies the N+A adjustment he discussed with the Quality Bank Administrator. *Id.*

[735] Exxon disagrees with Williams's argument that the Commission should not adopt this proposal because Sharp does not apply his N+A adjustment to all Naphtha transactions. Exxon Reply Brief at p. 364, n.231. It points out that the Quality Bank Administrator stated the adjustment was always applied unless Sharp did not know the N+A content of the Naphtha being sold. *Id.*

Sharp also considers specifications like Reid Vapor Pressure, sulfur, sometimes mercaptans and distillation, and certainly nothing to suggest that he makes any specific adjustment to the Platts price based on anything other than N+A. *Id.*

2601. Exxon states that Williams, Unocal/OXY, and BP also claim, erroneously, that adopting the N+A proposal here would open the Quality Bank up to another level of overly-complicated analysis. *Id.* at pp. 364-65. It asserts that this argument is belied by the fact that no other quality adjustments have been proposed by, or are apparently known to, any party. *Id.* at p. 365. According to Exxon, Sharp told the Quality Bank Administrator he only made an N+A adjustment (as well as the Heavy Naphtha adjustment discussed above). *Id.* Thus, in Exxon's view, this "Pandora's Box" argument is nothing more than an unsubstantiated doomsday scenario designed to discourage the Commission from adopting this known quality adjustment.[736] *Id.* For the Pandora's Box to open, Exxon contends, a party would have to gather information that is not currently known, bring it to the Commission's attention, and carry its burden to prove that an adjustment is required. *Id.* By virtue of Exhibit No. PAI-222, the Quality Bank Administrator's testimony, and the overwhelming evidence discussed above, Exxon believes that it and Phillips have carried this burden. *Id.*

2602. The use of the Platts Heavy Naphtha price on the Gulf Coast and the need for the proposed N+A adjustment to that price to accurately reflect the value of the Quality Bank Gulf Coast Naphtha cut, Exxon claims, does not change its position that Quality Bank Naphtha should be valued on the West Coast in accordance with the regression formula presented by Tallett.[737] Exxon Initial Brief at p. 333.

2603. In accordance with the Commission's order of March 28, 2003, Exxon states that the Quality Bank Administrator began valuing Quality Bank Naphtha on both the Gulf Coast and the West Coast using the new Platts Heavy Naphtha price rather than the Platts Full Range Naphtha price on March 1, 2003, subject to refund. *Id.* at pp. 333-34 (citing

[736] Exxon claims that this argument clearly is a red herring. Exxon Reply Brief at p. 365, n.233. It explains that, while Williams contends that implementing the proposed N+A adjustment is not simply a matter of adding 1.5¢/gallon to the quoted price, the dispositive answer is that the Quality Bank Administrator testified that it was exactly that simple and making an N+A adjustment would not affect the feasibility elements. *Id.*

[737] Exxon asserts that a strong argument could be made that Tallett's regression formula undervalues West Coast Naphtha by 2.5¢/gallon (or $1.05/barrel) because his regression analysis was based on the Platts Gulf Coast price assessment for Full Range Naphtha rather than the Platts Heavy Naphtha price assessment, and because the Gulf Coast Naphtha price that he used was predicated on an N+A of 40, far below the N+A of Quality Bank Naphtha. Exxon Reply Brief at p. 366, n.234.

BP Pipelines (Alaska) Inc., 102 FERC ¶ 61,345 (2000)). Exxon asserts that this change to the use of the Platts Heavy Naphtha price to value the Quality Bank Naphtha cut on the Gulf Coast – a step that is supported by overwhelming evidence and was not opposed by any party – should be approved by the Commission with an effective date of March 1, 2003. *Id.* at p. 334. Exxon also states that the proposal to value the Quality Bank Naphtha cut on the Gulf Coast by adding 1.5¢/gallon to the Platts Gulf Coast Heavy Naphtha price to account for the higher N+A of the Quality Bank Naphtha cut should also be made effective as of March 1, 2003. *Id.*

2604. Exxon states that Williams agrees that the Platts Heavy Naphtha price should be effective on March 1, 2003.[738] Exxon Reply Brief at p. 367. It notes that Unocal/OXY also agrees that any resolution to the Heavy Naphtha price should be implemented as of March 1, 2003, and BP does not address the effective date issue regarding the Heavy Naphtha issue. *Id.* Petro Star, Exxon continues, appears willing to agree to a March 1, 2003, effective date so long as the effective date for the change in the West Coast VGO reference price is also March 1, 2003. *Id.* Exxon indicates that it has no problem with Petro Star's position so long as the issue of what price is to be used for valuing West Coast Naphtha is resolved and made effective as of March 1, 2003. *Id.* It suggests that it would not be appropriate to allow a West Coast VGO reference price to become effective in advance of resolution of the issue of whether a West Coast based price is going to be used to value West Coast Naphtha. *Id.* Accordingly, Exxon would object to a decision in which the West Coast VGO reference price became effective on March 1, 2003, but West Coast Naphtha continued to be valued on the basis of a Gulf Coast price (whether it be a Full Range Naphtha price or a Heavy Naphtha price) pending resolution of all the issues presented in this proceeding. *Id.* at pp. 367-68.

2605. According to Exxon, Williams, Unocal/OXY, and BP argue that, if an N+A adjustment is adopted by the Commission, it only should be implemented prospectively. *Id.* at p. 368. According to Exxon, Williams, the only party that provided a basis for this position, argues that this change was not recommended by the TAPS Carriers and that the Quality Bank Administrator chose not to include this adjustment; but Williams provides no substantive analysis of this position. *Id.* As an initial matter, Exxon points out that the Quality Bank Administrator did not make the proposed adjustment only because he believed that he did not have authority, absent an order from the Commissions, to make any adjustment to the published prices. *Id.*

2606. Further, Exxon argues, the fact that the Quality Bank Administrator made no recommendation on this matter is of no legal significance. *Id.* It contends that the Commission plainly has the authority under Section 15(7) of the Interstate Commerce

[738] Exxon notes they assume that Williams's statement of the date in its initial brief as March 3, 2003, is a typographical error. Exxon Reply Brief at p. 367.

Act, 49 U.S.C. § 15(7)(1988), to allow challenged rate increases to take effect while it investigates their reasonableness. *Id.* Accordingly, Exxon maintains, there is no statutory impediment to the use of a March 1, 2003, effective date for all of the proposed revisions to the Naphtha valuation. *Id.* at p. 369.

2607. On June 18, 2003, states Exxon, the Quality Bank Administrator filed with the Commission a "Notice of TAPS Quality Bank Administrator Regarding Proposed Replacement Product Price To Value Naphtha Component On The U.S. Gulf Coast And U.S. West Coast." Exxon Supplemental Brief at p. 2. In that Notice, explains Exxon, the Quality Bank Administrator informed the Commission that the Platts Gulf Coast "Heavy Naphtha" assessment -- which he had previously recommended be adopted as the Quality Bank reference price on February 27, 2003 – had been "radically altered" under the TAPS Carriers's Tariff, thereby requiring him to "propose an appropriate replacement product price, with explanation and justification." *Id.* According to Exxon, the specific change that prompted this filing was that "beginning on May 1, 2003, Platts began publishing two Gulf Coast waterborne assessments for Heavy Naphtha," one entitled "Heavy Naphtha" and the other entitled "Heavy Naphtha Barge." *Id.*

2608. As part of this Notice, continues Exxon, the Quality Bank Administrator indicated that he had discussed the two new Heavy Naphtha assessments with Sharp, the analyst responsible for Platts various Naphtha assessments, and that Sharp had confirmed that: (1) in May 2003 Platts had begun to report Heavy Naphtha barge and cargo price assessments separately; and (2) "numerous transactions" supported both assessments. *Id.* at pp. 2-3. Based on this information, states Exxon, the Quality Bank Administrator concluded that using a simple average of the separate cargo and barge assessments would best represent the market value of Heavy Naphtha and, for this reason, he "propose[d] that the replacement price for the Naphtha component on both the Gulf Coast and the West Coast be the arithmetic average of the average monthly price for Gulf Coast Waterborne 'Heavy Naphtha' and Gulf Coast Waterborne 'Heavy Naphtha Barge' as reported by Platts." *Id.* at p. 3.

2609. According to Exxon, there are two basic matters at issue: first, was the Quality Bank Administrator's June 18, 2003, decision to propose a replacement price for the valuation of Gulf Coast Naphtha justified?; second, does his proposal to use the arithmetic average of the average monthly price assessments for Platts Gulf Coast Waterborne "Heavy Naphtha" and Gulf Coast Waterborne "Heavy Naphtha Barge" assessments produce a just and reasonable result? Exxon Supplemental Brief at p. 5. Exxon argues that the Quality Bank Administrator's decision to propose a replacement price was justified and that his averaging proposal produces a just and reasonable result for valuation of the Quality Bank Naphtha cut on the Gulf Coast. *Id.*

2610. Exxon agrees with the Quality Bank Administrator's determination that the change that occurred in the Platts assessments on May 1, 2003, constituted a radical alteration under Section III.G.5.b of the Tariff. *Id.* According to it, the evidence clearly establishes that prior to May 1, 2003, the Platts "Heavy Naphtha" assessment was based on prices from both cargo and barge transactions and that the resulting price assessment constituted neither a cargo assessment nor a barge assessment. *Id.* at p. 6. For example, notes Exxon, on September 15, 2003, Sharp told the Quality Bank Administrator, Toof and Jones that Platts pre-May 2003 Heavy Naphtha assessment was not solely a cargo and not solely a barge assessment, but was influenced by both types of transactions. *Id.*

2611. According to Exxon, BP, Unocal/OXY, Williams, and Petro Star take issue with the Quality Bank Administrator's decision to recommend a new reference price and argue that the existing reference price was not radically altered under the TAPS Carriers's Tariff.[739] Exxon Reply Brief at p. 372. It states that BP and Unocal/OXY go so far as to suggest that no change at all occurred to the Platts Heavy Naphtha assessment that was in place between February-April 2003. *Id.* This latter assertion, Exxon declares, is clearly false. *Id.* It contends that the evidence plainly demonstrates there definitely had been a change in the Platts Gulf Coast Heavy Naphtha assessment on May 1, 2003, and that the combined cargo-barge Heavy Naphtha assessment ceased to exist after May 1, 2003, when Platts split the cargo and barge transactions into separate assessments. *Id.*

2612. Similarly lacking in merit, in Exxon's view, is Williams's argument that the existing Heavy Naphtha (cargo) assessment is consistent with the pre-May 2003 combined cargo-barge assessment. *Id.* at p. 373. Exxon states that, contrary to Williams's claims, this contention is not supported by statements made by Exxon's counsel at the August 26, 2003, status hearing. *Id.* at p. 373. As is clear from the Transcript, notes Exxon, the matter being discussed at that hearing was whether, in fact, there had been a change in the Platts Heavy Naphtha assessment. *Id.* Exxon points out that the reason the Quality Bank Administrator was directed to again contact Sharp was to ensure that, in fact, a change had occurred. *Id.*

2613. Exxon also charges that the suggestion that the change in the Heavy Naphtha assessment was not radical is deficient. *Id.* It notes that the Tariff itself recognizes that the magnitude or financial impact of a change is not a legitimate ground upon which to assess whether or not a reference price change is radical. *Id.* Moreover, Exxon characterizes the idea that parties would assert that they will be injured by the Quality Bank Administrator's proposal while at the same time arguing that the change should not

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[739] Exxon asserts that the fact that Platts did not alter the name of its new Heavy Naphtha cargo assessment to make clear that it was different from its earlier assessment of the same name (which included both cargo and barge assessments) does not undermine this conclusion. Exxon Supplemental Brief at p. 7, n.7. It states that one of the purposes of the September 15, 2003, call was to make sure that in fact the pre- and post-May 2003 assessments were different. *Id.*

be implemented because it is not large enough as ridiculous. *Id.* at pp. 373-74.

2614. Furthermore, Exxon asserts, the claim that the change in the Platts assessment is too small is not consistent with the valuation of other Quality Bank cuts which have similarly-sized adjustments. *Id.* at p. 374. For example, Exxon notes, the reference price for the Light Distillate cut is Platts West Coast Waterborne Jet Fuel assessment minus approximately 0.5¢/gallon. *Id.* It is also worth noting, in Exxon's view, that a number of the specific adjustments that are at issue in this proceeding with regard to the Resid and Heavy Distillate cuts involve amounts comparable to the difference in the Platts "Heavy Naphtha" assessments before and after May 1, 2003. *Id.*

2615. Finally, even were the change in the Platts Heavy Naphtha assessment to not constitute a radical alteration under the TAPS Carriers Tariff, Exxon argues, the Quality Bank Administrator's actions would still be appropriate. *Id.* According to Exxon, on February 27, 2003, the Quality Bank Administrator recommended that the Commission adopt Platts new Gulf Coast Heavy Naphtha assessment as the reference price for Naphtha in the Quality Bank. *Id.* at pp. 374-75. While the Commission accepted this recommendation on an interim basis, it did not issue a final order accepting that price on a permanent basis. *Id.* at pp. 374-75 (citing *BP Pipelines (Alaska) Inc.*, 102 FERC at p. 62,160). Consequently, Exxon states, the Quality Bank Administrator was under a clear duty to inform the Commission when, less than three months after his recommendation, the Platts Heavy Naphtha assessment changed again. *Id.* at p. 375 (citing 18 CFR § 385.403(d)(2)(2004)). Furthermore, Exxon suggests, the Quality Bank Administrator's action here could have been justified under the Tariff's provision governing "unanticipated Implementation Issues." *Id.* (citing Exhibit No. TC-3 at p. 8).

2616. Exxon asserts that the Quality Bank Administrator's proposal to use the arithmetic average of the average monthly price for Platts Gulf Coast Waterborne "Heavy Naphtha" and "Heavy Naphtha Barge" assessments produces a just and reasonable result. Exxon Supplemental Brief at p. 7. According to it, the Quality Bank Administrator's averaging proposal best reflects Heavy Naphtha's market value on the Gulf Coast. *Id.* Exxon points out that both the Commission and the Circuit Court have stated several times that market value is the standard to be applied under the distillation methodology. Exxon Reply Brief at p. 376.

2617. Furthermore, according to Exxon, the Quality Bank Administrator's proposal is consistent with his previous recommendations regarding VGO and LSR, which both focused on choosing an assessment which best represented the market value for the proxy product. *Id.* at pp. 376-77. It states that the evidence clearly establishes, that Sharp told the Quality Bank Administrator that "there are numerous transactions for both full range and heavy naphtha in both barge and cargo lots, although for heavy naphtha, barge transactions may slightly predominate." Exxon Supplemental Brief at pp. 7-8 (quoting Exhibit No. TC-20 at p. 1). Based on this information, explains Exxon, the Quality Bank

Administrator reasonably concluded that "[b]oth markets are therefore representative of the market for Heavy Naphtha on the Gulf Coast" and recommended that an average of the two assessments be used. *Id.* at p. 8 (quoting Exhibit No. TC-19 at p. 4). Given past precedent establishing that each cut should reflect its market value, Exxon states that the Quality Bank Administrator's recommendation plainly produces an appropriate result on the Gulf Coast. *Id.*

2618. Exxon also states that the Quality Bank Administrator's proposal to use an average of the two post-May 2003 Heavy Naphtha assessments also constitutes the best way of replicating the values produced by the single "Heavy Naphtha" assessment that existed prior to May 1, 2003, which the Quality Bank Administrator earlier proposed be adopted by the Commission. *Id.* As noted above, states Exxon, that assessment included both cargo and barge transactions. *Id.* Exxon points out that Sharp indicated that, in making the earlier assessment, he "sometimes used barge transactions for the high for the day and cargo transactions for the low." *Id.* (quoting Exhibit No. TC-22 at p. 2). Moreover, notes Exxon, no party objected at the hearings to the Quality Bank Administrator's proposal that the pre-May assessment be used. *Id.* at pp. 8-9. Consequently, Exxon concludes, the Quality Bank Administrator's new proposal — which attempts to replicate Platts pre-May 2003 "Heavy Naphtha" assessment — produces a reasonable result. *Id.* at p. 9.

2619. In addition, Exxon asserts, there is no merit to the claim by Williams, Unocal/OXY, and BP that use of an average of the two Heavy Naphtha assessments is not consistent with the Commission's purported policy of choosing "the largest available quantities" to value each cut. *Id.* at p. 9; Exxon Reply Brief at p. 377. According to it, the Commission has never adopted such a policy. Exxon Supplemental Brief at p. 9. Exxon points out that, to the contrary, Ross testified at the hearing that the VGO cut is currently valued on both the West Coast and Gulf Coast on the basis of OPIS's Gulf Coast High Sulfur VGO barge price assessment, which is associated with transactions that are much smaller than the transactions associated with OPIS's Gulf Coast High Sulfur VGO cargo assessment. *Id.* It notes that Ross further acknowledged that the barge price was selected for VGO because on the day it was picked it was a more reliable indication of the actual spot market. *Id.* at pp. 9-10.

2620. Exxon notes that the same observation applies to the Quality Bank Administrator's proposal to average Platts two separate Heavy Naphtha assessments, both of which are supported by numerous transactions. *Id.* at p. 10. Consequently, Exxon states, the Quality Bank Administrator's proposal better captures the market value of Heavy Naphtha on the Gulf Coast than simply using one assessment or the other and, as such, constitutes the most "acceptable [indicator] of market value." *Id.* (quoting *Tesoro*, 234 F.3d at p. 1289).

2621. Williams, Unocal/OXY, BP, and Petro Star, Exxon states, make a number of arguments in opposition to the Quality Bank Administrator's averaging proposal, none of which are valid. Exxon Reply Brief at p. 377. It contends that the evidence clearly refutes these parties's assertions. *Id.* In 1998, notes Exxon, the Commission adopted the Quality Bank Administrator's recommendation that the OPIS High Sulfur VGO barge assessment be used as the reference price rather than the OPIS High Sulfur VGO cargo assessment notwithstanding the fact that the VGO cargo assessment was for much larger parcels. *Id.* at pp. 377-78. While BP and the other parties seek to distinguish that decision, it is revealing, Exxon maintains, that, in supporting the Quality Bank Administrator's VGO barge recommendation in 1998, none of those parties mentioned the supposed convention upon which they now rely or sought to distinguish it.[740] *Id.*

2622. Exxon asserts that Williams's attempt to suggest that the Quality Bank Administrator's 1998 recommendation somehow supports use of only the Heavy Naphtha (cargo) assessment is also misplaced. *Id.* It points out that Williams misquotes the Quality Bank Administrator's 1998 VGO notice by substituting the word "the" for the word "neither" in the sentence describing the liquidity of the Gulf Coast market for High Sulfur VGO, thereby completely mischaracterizing the factual context supporting the Quality Bank Administrator's proposal in that case. *Id.* Furthermore, Exxon asserts, resolution of the VGO issue in 1998 cuts squarely against the position that only the Heavy Naphtha (cargo) assessment should be used. *Id.* at pp. 378-79. It argues that, if anything, the VGO case – which used the barge price – indicates that the more predominant Heavy Naphtha Barge assessment should be the Quality Bank reference price if the Commission rejects the Quality Bank Administrator's averaging proposal. *Id.* at p. 379. In any event, Exxon agrees with the TAPS Carriers who point out that to ignore one assessment over the other where a number of transactions support both assessments would be arbitrary in the circumstances presented here. *Id.*

2623. The Quality Bank Administrator's averaging proposal, according to Exxon, also is simple and straight-forward: it takes an arithmetic average of the average monthly prices of the two Platts Heavy Naphtha assessments. Exxon Supplemental Brief at p. 10. Thus, Exxon asserts, BP's concern regarding the additional complexity of the proposal is misguided. *Id.*

2624. Moreover, Exxon states, it is not significant that no other Quality Bank cut is valued using an average of two separate prices. *Id.* As noted above, points out Exxon, the Quality Bank Administrator's averaging proposal best represents the market value of Gulf Coast Heavy Naphtha. *Id.* at pp. 10-11. Consequently, explains Exxon, his proposal is entirely consistent with the "goal of the Quality Bank valuation methodology .

[740] Exxon suggests that Williams's further argument, that the Quality Bank Administrator's proposal would contravene the convention of using waterborne prices when available, is baseless since both of the Platts assessments are waterborne. Exxon Reply Brief at p. 378, n.246.

to assign accurate relative values to the petroleum that is delivered to TAPS and becomes part of the common stream." *Id.* at p. 11 (quoting *OXY*, 64 F.3d at p. 693). Further, Exxon argues, an unduly rigid interpretation of the Circuit Court's expression of the value of consistency would elevate form over substance if it prevented the Quality Bank from using an easily-ascertainable and well-documented market value of a product. *Id.* (quoting *Exxon*, 182 F.3d at p. 42). Also, notes Exxon, the Quality Bank Administrator's proposal is consistent with his previous recommendations regarding VGO and LSR, which both focused on choosing an assessment which best represented the market value for the proxy product. Exxon Reply Brief at pp. 376-77.

2625. Similarly lacking in merit, in Exxon's view, is the claim that such an approach would not be consistent with the so-called key premise of using a single intermediate feedstock price from an independent reporting service that, whenever possible, has not been modified. *Id.* at p. 379. According to Exxon, Williams, the primary advocate for this position, points to no authority in support of this premise. *Id.* Furthermore, Exxon argues, such an aspiration does not trump the clear goal of the Quality Bank that each cut should reflect the market value of the reference product price. *Id.*

2626. Exxon also argues that the claims that adopting the Quality Bank Administrator's averaging proposal will unduly complicate the Quality Bank are completely baseless. *Id.* at p. 380. It points out that there are no administrative feasibility problems with the Quality Bank Administrator's averaging proposal, and argues that this averaging methodology is quite similar to how the Quality Bank Administrator already uses the Platts and OPIS high and low price assessments under the Tariff. *Id.* Exxon also notes that the claim that adoption of the Quality Bank Administrator's averaging recommendation could result in future proposals that other product prices should be averaged is, at best, exaggerated. *Id.* It points out that no party has made any such proposal, and, even should they, they would still have to meet their burden to show that their averaging proposal better reflects the market value of the product than does the use of a single assessment. *Id.*

2627. Exxon's position is that, on the West Coast, the Quality Bank value of Naphtha should be based on the methodology proposed by Tallett in the ongoing Quality Bank proceedings, and that refunds should be provided based on that methodology back to March 1, 2003. *Id.* at pp. 380-81. Further, it asserts that the Commission should grant reparations for the period prior to March 1, 2003, back to June 19, 1994, based on Tallett's methodology. *Id.* at p. 381.

2628. Exxon states that the Quality Bank Administrator and most of the other parties take the position that the effective date should be August 17, 2003, the date on which the Commission accepted the Quality Bank Administrator's proposal on an interim basis subject to refund. Exxon Reply Brief at p. 381. Exxon also notes that Williams argues that the effective date should be when the Commission finally determine whether to accept the Quality Bank Administrator's averaging proposal rather than August 17, 2003, because to adopt the August 17, 2003, date would encourage the Quality Bank Administrator to make a recommendation without conducting a thorough investigation first. *Id.*

2629. According to Exxon, there is no merit to Williams's position. Exxon Reply Brief at p. 382. It points out that Williams has not cited any authority to support its proposal that there must be delay in order to teach the Quality Bank Administrator some sort of lesson. *Id.* Furthermore, delaying implementation of the averaging proposal would not have any impact on the Quality Bank Administrator, who has no financial stake in the Quality Bank. *Id.* Exxon also argues that the real punishment would be inflicted upon those parties who are penalized by the continued undervaluation of the Naphtha cut on both the Gulf Coast and West Coast. *Id.* Conversely, Exxon states, the party with the most to gain by such a delay would be, not surprisingly, Williams. *Id.*

2630. As to the proposal supported by most of the parties that the effective date should be August 17, 2003, Exxon agrees that this date would be appropriate under the TAPS Carriers's Tariff had the Commission previously approved the change in the Quality Bank reference price on a permanent basis. *Id.* at p. 383. Exxon notes that that is not the case here. *Id.* Because no final order on this matter has been issue, it does not make sense to allow for a period in which an interim price is frozen under the Tariff.[741] *Id.* Instead, Exxon advocates that the more sensible approach would be for the Commission to adopt an effective date of March 1, 2003, to April 30, 2003, for the pre-May 1, 2003, Platts Gulf Coast "Heavy Naphtha" assessment. *Id.* at pp. 383-84. Then Exxon argues, the effective date for the arithmetic average of the new Platts reported Gulf Coast "Heavy Naphtha" (cargo) and "Heavy Naphtha Barge" price assessments for the U.S. Gulf Coast should be May 1, 2003, and that refunds for the period May 1, 2003, to August 17, 2003, should be provided.[742] Exxon Supplemental Brief at pp. 11-12. For the West Coast, Exxon's position is stated above. *Id.* at p. 12.

[741] The situation here is distinguishable from the Heavy Distillate case in 2000, according to Exxon. Exxon Reply Brief at p. 383, n.255. There, states Exxon, the Commission ordered the continued use of the previously-approved reference price, the West Coast High Sulfur (0.5%S) Waterborne Gasoil price, "until the final decision on the appropriate processing cost adjustment." *Id.* (quoting *Trans Alaska Pipeline*, 97 FERC at p. 61,650).

[742] Exxon points out that the Platts Gulf Coast "Heavy Naphtha" assessment for April 2003 was frozen in place by the Quality Bank Administrator from May 1, 2003, until the Commission accepted the Quality Bank Administrator's proposal on August 17, 2003. Exxon Supplemental Brief at p. 12, n.14.

G. IMPACT OF POTENTIAL PUBLICATION OF A WEST COAST NAPHTHA PRICE

1. TAPS Carriers

2631. The TAPS Carriers state that it would be desirable if a reliable West Coast price assessment suitable for valuing the Naphtha component of ANS were published. TAPS Carriers Initial Brief at p. 16. To date, explain the TAPS Carriers, no West Coast Naphtha price assessment is available. *Id.* At my request, note the TAPS Carriers, the Quality Bank Administrator contacted Platts and OPIS, the two principal reporters of price assessments, to determine if they would consider publishing a Naphtha price assessment for the West Coast. *Id.* As of the date of the hearing and as of the date of their brief (September 2003), state the TAPS Carriers, neither company had made a decision. *Id.*

2. Williams

2632. Williams notes that, at the hearing, Sanderson was asked a hypothetical question about the substitution of a published West Coast Naphtha price for valuing the Quality Bank West Coast Naphtha Component. Williams Initial Brief at p. 95. It states that the key to Sanderson's answer was the qualification contained in the hypothetical "assume you've had enough time" to do an analysis of a West Coast Platts price assessment and determined, based on your analysis, that it is "a good price." *Id.* Assuming those conditions had been met, Williams points out, Sanderson answered that, at that point in time, the substitution could be made. *Id.* Williams notes that what Sanderson was not asked was were there any details about what would be "enough time" and what would constitute a "good price." *Id.* It also suggests that Sanderson testified at one point during the hearing, regarding the Mars crude oil quotation on the Gulf Coast, that he believed that it was necessary to look at the reliability of the quotation over some period of time and look at its liquidity and relationship to other materials before it was adopted. *Id.* at pp. 95-96. Williams suggests, therefore, should either Platts or OPIS publish a West Coast Naphtha price, there should not be a rush to immediately utilize it for Quality Bank purposes; rather, there likely would be a considerable period of time lapse before all shippers were comfortable that a sufficiently liquid spot Naphtha market existed on the West Coast so that the quoted prices were not notional and the published prices were reliable. *Id.* at pp. 98-99. In other words, Williams argues, the publishing of a West Coast Naphtha price likely would not, and should not, have an immediate impact on the TAPS Quality Bank and the valuation of its West Coast Naphtha component. *Id.* at p. 99.

3. BP

2633. At the moment, BP states, there is no available reported West Coast price for Naphtha. BP Initial Brief at p. 73. As a result, explains BP, there is a need to develop a replacement price to value Naphtha on the West Coast. *Id.* The Quality Bank Administrator has advised the parties that OPIS and Platts are actively considering publishing a West Coast price assessment for Naphtha. *Id.* Should Platts or OPIS commence reporting such a price assessment, BP's position is that the Commission should use the published West Coast naphtha price assessment. *Id.*

2634. Currently, explains BP, the value of all of the Quality Bank cuts on the West Coast, with the exception of the VGO and Naphtha cuts, are based on West Coast price assessments. *Id.* BP notes that VGO shortly should also be based on a West Coast price assessment, however. *Id.* All of the parties, BP notes, have taken the position that the value of the VGO cut on the West Coast should be based on an existing West Coast price assessment for that product. *Id.* In this light, BP asserts that, should a published price assessment for Naphtha on the West Coast also become available, that price should be used to value the Naphtha cut so that all of the cuts are valued on a consistent basis. *Id.* Further, BP notes that none of the parties has challenged this position. BP Reply Brief at p. 88.

2635. BP states, in reply, that although none of the parties have challenged the notion that the preferred method of valuing Quality Bank cuts is by reference to published prices, not all of the parties have recommended immediate adoption should a West Coast Naphtha price be published by a reputable pricing service. BP Reply Brief at p. 89. It states that all of the record evidence, however, establishes that, were a reputable price reporting service to publish a price for West Coast Naphtha, it would be the appropriate reference price to use for its West Coast valuation. *Id.* A number of the witnesses, such as Pulliam, Ross, and Sanderson, according to BP, stated at the hearing that the use of a published price would make sense and is preferable. BP Initial Brief at pp. 73-74 (citing Transcript at pp. 7556-59, 9740-41, 11237-40). Consequently, should Platts, OPIS, or another reputable reporting service commence reporting such a price assessment, BP's position is that the Commission should use the published West Coast Naphtha price assessment. *Id.* at p. 74.

4. Petro Star

2636. Petro Star recommends that a hearing should be held on whether or not to adopt any West Coast Naphtha price, if and when Platts or OPIS announce that they will publish one. Petro Star Initial Brief at p. 28.

5. Exxon

2637. Exxon also points out there is a possibility that either Platts or OPIS might publish a West Coast Naphtha price at some time in the future, but neither company has as yet reached any decision on whether or not to do so. Exxon Initial Brief at p. 337. It asserts that it is clear that the existence of such a price assessment would make continued reliance on the Platts Gulf Coast price assessment to value West Coast Naphtha wholly unreasonable. *Id.* Exxon does agree with Phillips that such a development would constitute an unanticipated implementation issue within the scope of Section III.J. of the TAPS Tariff, and grounds for the Quality Bank Administrator to begin valuing West Coast Naphtha on the basis of the new West Coast price assessment, pending resolution of the matters at issue in this proceeding. *Id.* at pp. 337-38; Exxon Reply Brief at p. 384.

2638. According to Exxon, it also strongly disagrees with Williams's attempt to postpone indefinitely any future use of such a published West Coast Naphtha price assessment on the ground that no such published assessment of the value of West Coast Naphtha could possibly be reliable and, therefore, the Commissions must allow a significant period of time before adopting any such price assessment as a Quality Bank proxy. Exxon Reply Brief at pp. 384-85. Although Williams does not state what might be an appropriate length of time, Exxon believes that its lengthy discussion of the West Coast VGO pricing history in which nine years elapsed before the parties agreed to use the OPIS West Coast High Sulfur VGO weekly price assessment suggests that Williams wants to stall any possible adoption – or even consideration – of any new West Coast Naphtha price assessment for a long number of years. *Id.* at p. 385.

6. Phillips

2639. Phillips's position is that any published West Coast Naphtha price should be employed as soon as possible after it is published. Phillips Initial Brief at p. 176. It suggests that the Quality Bank Administrator would be obligated to implement the use of a published West Coast Naphtha price under Section III.J of the Quality Bank Tariff which requires the Quality Bank Administrator to resolve "unanticipated issues" that may arise "in accordance with the best understanding of the intent of the [Commission] that the Quality Bank Administrator can derive from [its] orders regarding the Quality Bank methodology." *Id.* (quoting Section III.J of the Quality Bank Tariff). However, in order to make this completely clear, Phillips asserts, the Commission should order the Quality Bank Administrator to switch to the use of a published West Coast Naphtha price by a reputable, independent entity as soon as is reasonably practicable. *Id.* To the extent that any party believes that the published West Coast price is not reliable, Phillips believes they will be able to raise this claim in a protest of the Quality Bank Administrator's action filed with the Commission. *Id.* at pp. 176-77. Phillips believes that Williams's recommendation for a long time lag before any new Naphtha price goes into effect has no merit and appears to be intended to preserve the use of a lower Gulf Coast Naphtha price for as long as possible. Phillips Reply Brief at p. 110.

H. ADMINISTRATIVE FEASIBILITY

1. TAPS Carriers

2640. According to the TAPS Carriers, the Quality Bank Administrator found that all four proposals for valuing West Coast Naphtha were administratively feasible. TAPS Carriers Initial Brief at p. 16. They point out that Petro Star modified its proposal (which is an alternative to its fundamental position that the valuation basis for West Coast Naphtha should not be changed) to eliminate certain administrative problems that would have arisen if the proposal were implemented as originally proposed. *Id.* at pp. 16-17. During the course of the hearing, state the TAPS Carriers, BP also modified its proposal so that it is now proposing only a cap and a floor. *Id.* at p 17. The TAPS Carriers explain that the Quality Bank Administrator concluded that BP's modified proposal for a cap and floor was administratively feasible. *Id.*

2641. There was also some evidence, note the TAPS Carriers, suggesting that Phillips's proposal might be modified by inclusion of a benzene saturation unit, or by subtracting a certain number of cents per gallon from the Naphtha value. *Id.* According to the TAPS Carriers, the Quality Bank Administrator concluded that Phillips's proposal would still be feasible to administer with such modifications. *Id.*

2642. Finally, state the TAPS Carriers, the Quality Bank Administrator confirmed that it would be administratively feasible to add 1.5¢/gallon to Platts Heavy Naphtha price assessment to reflect the higher N+A content of ANS crude in order to value ANS on either the West Coast or Gulf Coast. *Id.*

2. BP

2643. According to BP, the Quality Bank Administrator stated that the proposal BP submitted for the valuation of Naphtha is administratively feasible. BP Initial Brief at p. 74. It asserts that no party has suggested it is not. *Id.* Further, in reply, BP asserts that there is no record evidence that would support a conclusion that it would not be administratively feasible to implement the Ross governor. BP Reply Brief at p. 90. Therefore, BP states, the Quality Bank could use BP's proposal on a going-forward basis to value Naphtha on the West Coast. *Id.*; BP Initial Brief at p. 74.

3. Phillips

2644. Phillips agrees with Mitchell's view that all of the Naphtha valuation proposals presented in this proceeding are administratively feasible (including the N+A adjustment), equally objective, and approximately equal in terms of implementation cost. Phillips Initial Brief at p. 177.

4. Exxon

2645. Exxon states that the Quality Bank Administrator testified that its proposal to value the West Coast Naphtha cut on the basis of the regression formula presented by

Tallett is administratively feasible, and that that conclusion was not disputed by any party. Exxon Initial Brief at p. 338. Further, states Exxon, the Quality Bank Administrator has testified that the proposal of Phillips and Alaska for valuing the West Coast Naphtha cut on the basis of O'Brien's proposed valuation methodology is administratively feasible. *Id.* It notes that, although Williams quotes the testimony of the Quality Bank Administrator that any change in methodology might require a little more work each month, Williams also concedes that any additional costs would probably not be significant. Exxon Reply Brief at p. 386, n.256.

5. Williams

2646. Williams notes that Mitchell testified that there would be no impact to the Quality Bank Administrator's costs to administer the Quality Bank if the current methodology is left in place; however, if any of the other methodologies are adopted by the Commission, the Quality Bank would "require some reprogramming and perhaps a little more work each month to do the calculations" although probably not a significant amount more than the current costs. Williams Initial Brief at pp. 99-100.

2647. Mitchell concluded, according to Williams, that Exxon's proposal for West Coast Naphtha valuation is administratively feasible. Williams Initial Brief at p. 100. As to whether it would be administratively feasible to implement Exxon's proposal retroactively, it notes, Mitchell testified that it would be feasible only for the shippers of record. *Id.* As to them, Williams states that Mitchell noted that there are probably some legal issues regarding changes in shippers of record, albeit noting that not many changes occurred over the course of the retroactive period. *Id.* Additionally, it explains, Mitchell testified that performing the retroactive calculations could be considerably expensive on a one-time basis adding to the fees charged by the Quality Bank Administrator but perhaps not significant when considering the dollars exchanged in the Quality Bank from month to month. *Id.*

2648. Williams points out that O'Brien is no longer recommending Exhibit No. PAI-149 (the benzene saturation proposal) as his proposed valuation and continues to stand by his proposal in Exhibit No. PAI-39. *Id.* at p. 101. It states that Mitchell testified that O'Brien's proposal in Exhibit No. PAI-39 is administratively feasible and notes Mitchell testified that the hypothetical proposal including the cost of processing benzene in a saturation unit as set forth in Exhibit No. PAI-149 is also administratively feasible. *Id.* Additionally, Williams asserts that Mitchell testified that if "O'Brien's proposed methodology could be adjusted by subtracting a certain number of cents per gallon from the naphtha value and the amount subtracted might be a fixed amount or the amount adjusted by the Nelson-Farrar index," it would be administratively feasible as well. *Id.*

2649. Because BP's proposal changed during the course of the proceeding, Williams states, Mitchell sought clarifications from Ross regarding how Ross proposed the governor would work. *Id.* It notes that Mitchell testified that, although the BP proposed governor as amended and described in Exhibit No. TC-16 is more complicated than BP's previous proposal, the proposal is nevertheless administratively feasible. *Id.*

2650. Williams explains that Dudley on behalf of Petro Star proposed an alternative Naphtha valuation to be used only should the Commission determine that the West Coast Naphtha valuation be West Coast-based. *Id.* at p. 102. It notes that Mitchell testified that Petro Star's alternative proposal set forth in Exhibit No. PSI-7 is administratively feasible.[743] *Id.* Initially, Williams notes, Mitchell explained that this methodology might result in a delay finalizing the pricing each month. *Id.* However, it continues, Dudley advised that the methodology could be revised to use prior month ratios. *Id.* Williams states that this modification alleviates Mitchell's concerns regarding the administrative feasibility of Dudley's proposal. *Id.*

ISSUE 3 - DISCUSSION AND RULINGS

A. LEGAL STANDARD AND BURDEN OF PROOF

2651. Exxon concedes that, in a complaint case such as this is, the complainant bears the burden of proving that the existing rate is unjust or unreasonable. Exxon Initial Brief at p. 191. It errs, however, in suggesting that the *Tesoro* court held that the Gulf Coast Naphtha price is not an appropriate proxy for valuing West Coast Naphtha.[744] Rather, the Circuit Court's ruling merely was that there was sufficient evidence presented by Exxon and Tesoro to avoid summary disposition of their complaints.[745] *See Tesoro*, 231 F. 3d at p. 1294. In any event, as I previously indicated,[746] nothing which took place in a previous proceeding has any bearing on this Initial Decision; rather, here, the ruling is based on the record established here. Exxon, also, appears to concede that it, as a complainant, carries the burden of establishing changed circumstances warranting a conclusion that the existing value is not just or reasonable.

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[743] Williams notes that Exhibit No. PSI-7 was modified and substituted in the record and additionally was clarified by Exhibit Nos. PSI-13 and PSI-14. Williams Initial Brief at p. 102, n.68. It notes that the changes were typographical errors and/or errors in calculation which do not effect the substance of the proposal. *Id.*

[744] Exxon Initial Brief at p. 192.

[745] Contrary to Exxon's bold assertion that the Court held that the complainants established a *prima facie* case, the Court held that their *prima facie* case was "supported." *See Tesoro* 234 F.3d at p. 1294.

[746] Transcript at pp. 22-23, 114-15.

2652. Phillips also concedes that the complainant in these proceedings has the burden of proving that the existing rate should change. Phillips Initial Brief at pp. 11-12. It goes on to argue that the *OXY* decision requires that West Coast Naphtha be valued on a West Coast basis so that it is valued on a consistent basis with the method for valuing the remaining cuts on the West Coast. *Id.* at pp. 6-7. Phillips concedes, however, that use of a Gulf Coast price would be an acceptable proxy were that price shown to match Naphtha's West Coast value over time. *Id.* at p. 7. It adds that, under *Exxon*, the Gulf Coast price must be shown to have a rational relationship with the West Coast value of Naphtha. *Id.* at p. 9.

2653. Williams, correctly, notes that, in *OXY,* the Circuit Court affirmed the Commission's determination to change from the gravity method to the distillation method for Quality Bank calculation. Williams Initial Brief at p. 4. It is also correct that the Circuit Court only disapproved the Commission's determination as to the method for valuing the Distillates and Resid. *Id.* Accordingly, Williams suggests, and I agree, that the Circuit Court approved the Commission's determination that Naphtha ought to be valued on both the Gulf Coast and the West Coast using a reported Gulf Coast price. *Id.*

2654. Williams and Unocal/OXY agree with Exxon and Phillips that the complainants have the burden of proving that changed circumstances warrant a conclusion that the current method for valuing West Coast Naphtha is unjust or unreasonable. Williams Initial Brief at p. 7; Unocal/OXY Initial Brief at pp. 2-3. According to them, however, the complainant must go further and prove that the changed circumstance requires a change in methodology. Williams Initial Brief at p. 10; Unocal/OXY Initial Brief at p. 3.

2655. Based on the above brief summary of the parties positions, it is clear that they all agree that the complainants have the burden of proving that it is no longer just or reasonable to value West Coast Naphtha on a Gulf Coast basis. Once that level of proof is reached, the parties agree that any party suggesting a new methodology must establish that its proposal is just and reasonable. In other words, consistent with the Circuit Court's rulings in *OXY, Exxon* and *Tesoro*, the new manner of valuing West Coast Naphtha must be shown to be consistent with the manner of valuing the remaining eight cuts.

B. STIPULATED MATTERS AND AREAS OF DISPUTE

2656. Exxon notes that Petro Star, Williams and Unocal/OXY submit that no change in the current manner of valuing West Coast Naphtha is necessary; while the remaining parties contend it should be valued on a West Coast basis. Exxon Initial Brief at p. 194. It also acknowledges that even those who agree that West Coast Naphtha should be valued on a West Coast basis disagree on how that should be accomplished. *Id.* All of the parties agree with this summary. *See* Phillips Initial Brief at p. 14; BP Initial Brief at

p. 4; Williams Initial Brief at p. 15; and Unocal/OXY Initial Brief at p. 4.

C. IS THE CURRENT NAPHTHA VALUE JUST AND REASONABLE?

2657. Leaving aside, for the moment, the questions regarding the 2003 changes in the Platts Gulf Coast Naphtha assessment which are addressed below, the issue here, more precisely, is whether it is appropriate to continue valuing West Coast Naphtha on the basis of Platts Gulf Coast Naphtha price report. As noted by the parties, in 1993, the Commission determined that West Coast Naphtha should be valued on the basis of Platts Gulf Coast Naphtha assessment when it adopted the distillation method to value the Quality Bank.[747] Whether this determination continues to be appropriate is the next question which must be decided. Exxon, Phillips, BP and Alaska contend that it is not, while Unocal/OXY, Williams and Petro Star support continuation.

2658. In its 1993 Order in which the current manner of valuing Naphtha was established, the Commission laid out these broad principles:

> We will, therefore, require the use of unadjusted quoted market prices, as generally provided in the settlement or as specified in this order, as the valuation basis for all of the specified refinery cuts. Nothing in the broad authority granted to the Quality Bank Administrator by the proposed settlement will authorize him to deviate from this use of unadjusted market prices as the valuation basis for the quality bank [sic] distillation streams. However, if or when market prices for a given product are not posted in one of the two markets rather than making the adjustments specified in the settlement, we will require the use of prices quoted in the single market to value the entire cut.

Trans Alaska Pipeline System, 65 FERC at p. 62,289. As there was no West Coast Naphtha price assessment, the Commission determined that the Gulf Coast assessment would be used for both coasts.[748] *Id.* In 1997, the Commission moved away from the no

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[747] The Commission's 1993 determination regarding Naphtha was not challenged on appeal. *See OXY*, 64 F.3d at p. 679. Consequently, Exxon's sub-rosa attack on the Commission's holding regarding West Coast Naphtha, *see, e.g.,* Exxon Reply Brief at p. 214, is an impermissible collateral attack on the Commission's 1993 order. *Dynegy Power Marketing, Inc.*, 101 FERC ¶ 61,369 at P 18-19 (2002).

[748] The Commission acknowledged that the settlement proposed that West Coast Naphtha be valued on the basis of a ratio of the Gulf Coast prices of Naphtha gasoline applied to the Platts Los Angeles pipeline spot quote for gasoline. *Trans Alaska Pipeline System*, 65 FERC at pp. 62,288-89.

adjustment policy. *See Trans Alaska Pipeline System*, 81 FERC ¶ 61,319 (1997).[749] Thus, it appears, the primary basis on which the Commission ruled that West Coast Naphtha should be valued on the basis of Gulf Coast prices no longer provides it support.

2659. As a preliminary matter, it must be decided whether there are changed circumstances warranting a review of the current manner of valuing West Coast Naphtha.

2660. Williams suggest that there is no change in circumstances. Williams Initial Brief at p. 22. It claims that neither Exxon nor Phillips provided evidence of changed circumstances and that O'Brien, in fact, testified that there were not.[750] It does acknowledge that Tallett testified that the Commission had abandoned its "no adjustment" policy,[751] but claimed that Tallett did not "characterize" this as a changed circumstance. Moreover, it claims that Tallett testified that there have been no changed circumstances since October 2000.[752] Whether or not there have been changed circumstances since October 2000 is irrelevant, as is how Tallett "characterized" the Commission's policy change. The simple truth is that there has been a change in the policy on which the Commission based its 1993 holding.

2661. In response to the arguments of Phillips and Exxon that the cessation of ANS deliveries to the Gulf Coast represent a changed circumstance, Williams claims that the evidence reflects that Platts Gulf Coast Heavy Naphtha (cargo) price assessment is the equivalent of the West Coast ANS price plus $4.00. Williams Reply Brief at p. 25. From this point, Williams claims that, therefore, the evidence reflects that the Gulf Coast Naphtha price is linked to the West Coast ANS price. *Id.* Its argument, however, is a non sequitur. It is a fact that shipments of ANS are no longer being made to the Gulf Coast, and it is clear that this is a circumstance which has changed since 1993. That Platts Gulf Coast Heavy Naphtha (cargo) price assessment may be the equivalent of the West Coast ANS price plus $4.00 also may be true. It is interesting, no doubt, but it clearly is totally unrelated to the fact that ANS no longer is being shipped to the Gulf Coast. And, just as clear, is that the fact that ANS is no longer being shipped to the Gulf

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[749] *See also Tesoro*, 234 F.3d at pp. 1292-93.

[750] Actually, O'Brien stated, in the testimony cited by Williams, that "there have been no material changes in the West Coast or Gulf Coast Naphtha markets since the time the Commission held that all Naphtha should be valued on the Gulf Coast price." Exhibit No. PAI-33 at p. 6.

[751] *See* Exhibit No. EMT-11 at p. 13.

[752] *See* Transcript at pp. 6654-57. It should be noted that Unocal/OXY makes the same argument. *See* Unocal/OXY Initial Brief at p. 22.

Coast represents a circumstance which has changed since 1993.

2662. Unocal/OXY argue that merely because the Commission abandoned its "no adjustment" policy is no reason to conclude that there are changed circumstances as the Commission has not changed the policy, according to Unocal/OXY, requiring the Quality Bank Administrator to use one coast's price assessment to value the other coast's Quality Bank cut when the latter has no published price assessment. Unocal/OXY Reply Brief at p. 17. In support, it cites *Trans Alaska Pipeline System*, 66 FERC at p. 61,418. There, the Commission was specifically discussing the valuation of Heavy Distillates, not Naphtha. Thus, the policy cited by Unocal/OXY does not appear to be applicable to Naphtha. In any event, that matter was decided in 1994 at a point when ANS was still being shipped to the Gulf Coast. As it no longer is, I cannot find that the 1994 ruling, even were I to believe that it was applicable to Naphtha, and I do not, would still control.

2663. According to Unocal/OXY, which concedes that the CARB gasoline requirements may be a changed circumstance, these requirements decrease Naphtha's value and, therefore, do not constitute a changed circumstance warranting reconsideration of the Commission's 1993 holding. Unocal/OXY Reply Brief at p. 20. Their argument, perhaps, may have a bearing on whether or not the use of the Platts Gulf Coast Naphtha assessment continues to be just and reasonable as a proxy for the value of West Coast Naphtha, but it does not impact the question of whether changed circumstances exist.

2664. Based on the witnesses's testimony at the hearing, as well as the exhibits submitted through them, I am satisfied that there have been material changes in circumstance since the Commission determined, in 1993, that West Coast Naphtha should be valued on a Gulf Coast basis. The Commission has changed its policy and no longer refuses to consider adjusted proxy prices for ANS cuts. Moreover, virtually no ANS is being shipped to the Gulf Coast any longer; in fact, on the whole, ANS production has greatly diminished since 1993. Furthermore, the parties have agreed that West Coast VGO will no longer be valued on a Gulf Coast basis, rather, it will be valued using published OPIS West Coast High Sulfur VGO weekly price.[753] Thus, after that change takes place, West Coast Naphtha would be the only ANS cut valued on a Gulf Coast basis. Moreover, it is clear that the restrictive CARB and reformulated gasoline specifications have impacted the West Coast market. All of these together, if not any one, compel a holding that circumstances have changed since the Commission's 1993 holding.

2665. Having decided that circumstances sufficiently have changed since 1993 to warrant a review of the 1993 Commission holding, the question now becomes whether,

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[753] *See* Issue 4, below; *see also* Eight Parties Initial Brief at p. 161; Exxon Initial Brief at p. 340.

despite the changed circumstances, the use of Platts Gulf Coast Naphtha assessment to value West Coast Naphtha continues to be just and reasonable. Exxon notes that all of the parties agree that continuing to value West Coast VGO, the only other West Coast cut valued on a Gulf Coast basis, on a Gulf Coast basis is no longer just or reasonable. Exxon Initial Brief at p. 203. It submits, therefore, that continuing to base West Coast Naphtha's value on a Gulf Coast basis would no longer be consistent with the Circuit Court's *OXY* ruling.[754] *Id.* at p. 204; Exxon Reply Brief at p. 213.

2666. According to Exxon, the Gulf Coast and West Coast markets are entirely different. Exxon Initial Brief at p. 198. In support it claims that, during the 1994-2001 period, not only was the gasoline price significantly different on both coasts, but so were the prices of intermediate products. *Id.* at p. 204. Exxon argues that this is caused by the different supply and demand factors in existence on the two coasts. *Id.* at pp. 205-06. On the West Coast, it points out, Naphtha is used to make gasoline and jet fuel, while on the Gulf Coast it also is used as a petrochemical feedstock.[755] *Id.* at pp. 206-07. Moreover, Exxon notes, West Coast gasoline is, for the most part, more expensive than that on the Gulf Coast because of the more stringent environmental controls on CARB gasoline in California and reformulated gasoline in Nevada and Arizona. *Id.* at pp. 207-08. Further, it suggests that West Coast Naphtha is of a higher quality than that on the Gulf Coast. *Id.* at pp. 209-10.

2667. Exxon claims that the Commission and all interested parties have agreed, since implementation of the distillation method, that Quality Bank cuts ought to be valued on a market basis. Exxon Initial Brief at p. 203. Recognizing that the Gulf Coast market and the West Coast market have different supply and demand factors and prices, Exxon urges, the parties have proposed coast-specific proxies for each of the cuts except for VGO and Naphtha, both of which were valued only on a Gulf Coast assessment. *Id.* Exxon notes that the parties now have agreed that West Coast VGO should be valued on a West Coast basis.[756] *Id.* Referring to *OXY*, Exxon suggests that when all of the West Coast ANS cuts, except for Naphtha, are valued on a West Coast basis, use of the Platts Gulf Coast Naphtha assessment for West Coast Naphtha no longer is just and reasonable because it would be "inconsistent" with the manner in which the other cuts are valued. *Id.* at p. 204; Exxon Reply Brief at p. 213.

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[754] Many of the arguments that follow attributed to Exxon were also made by Phillips and BP. Their arguments are more fully detailed above.

[755] Exxon also claims that its use as a petrochemical feedstock on the Gulf Coast does not affect its price as the Naphtha used for this purpose is a lighter product than the reformer grade Naphtha used to make gasoline. Exxon Initial Brief at p. 207.

[756] *See* Issue 4 below.

2668. In addition, Exxon notes the following other differences:

- On the West Coast, Naphtha solely is used to make gasoline and jet fuel; while, on the Gulf Coast, it also is used as a petrochemical feedstock.[757]

- The Naphtha used as a petrochemical feedstock is a lighter Naphtha than the reformer grade Naphtha used on the West Coast in the production of gasoline and, therefore, this use does not impact the price of Quality Bank Naphtha.[758]

- Virtually all of the gasoline made on the West Coast is CARB or reformulated gasoline and must meet more stringent environment standards than exist on the Gulf Coast and, therefore, West Coast gasoline prices consistently have been higher than those on the Gulf Coast by several cents per gallon.[759]

- The Gulf Coast gasoline market is much larger than that on the West Coast and, therefore, is less volatile and better able to absorb supply shortages caused by refinery outages.[760]

- Gulf Coast refineries routinely import Naphtha from the Caribbean, while virtually no Naphtha is imported on the West Coast because refineries supply their needs from internal sources.[761]

- West Coast refineries have a higher capacity (in terms of percentage of capacity) to hydrocrack crude than those on the Gulf Coast giving them an ability to produce a higher percentage of Naphtha from crude.[762]

Id. at pp. 207-10.

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[757] *See* Exhibit Nos. EMT-11 at p. 16, PAI-33 at p. 4, BPX-8 at p. 3; Transcript at pp. 5286-7, 6041, 6488, 8318, 8817, 9028, 11593.

[758] *See* Transcript at pp. 6703, 7123-24, 7215, 12067-68, 12112.

[759] *See* Exhibit Nos. PAI-33 at pp. 8-9, WAP-224; Transcript at pp. 8820, 8823-24.

[760] *See* Transcript at pp. 8821-22.

[761] *See* Exhibit Nos. BPX-8 at p. 3, PAI-33 at p. 4, PAI-52 at p. 16, PAI-53 at pp. 7-8, UNO-1 at pp. 13-14; Transcript at pp. 7232-34, 7356, 9804, 11041-42, 11045, 12069.

[762] Exhibit No. WAP-244; Transcript at pp. 11159-62, 11477-79.

2669. Exxon also discusses the quality of ANS Naphtha in comparison with the Gulf Coast Naphtha assessed by Platts and asserts that the N+A of ANS Naphtha is 55+, while the N+A of the Heavy Naphtha and Full Range Naphtha assessed on the Gulf Coast by Platts was 40 making ANS Naphtha a higher quality. *Id.* at pp. 209-10.

2670. According to Exxon, Sanderson's theory, that because, he believed, the price of crude oil was similar on both coasts,[763] that the prices of Naphtha and its other components ought to be similar. *Id.* at p. 219. However, Exxon notes, Sanderson admitted that this theory did not prove true for VGO or LSR, the two cuts at which he looked, or any other Quality Bank cut.[764] *Id.* at pp. 223-24. Also, Exxon states, the evidence reflects that crude oil prices, as well as prices for intermediate and finished petroleum product prices widely vary between the two coasts.[765] *Id.* at p. 224. In addition, citing Exhibit No. PAI-176, Phillips asserts that there are significant differences between the two coasts on a wide variety of petroleum products. Phillips Initial Brief at p. 38. From this, it argues, Sanderson has failed to explain why only the value of Naphtha would be the same on both coasts. *Id.*

2671. As noted above, Phillips agrees with Exxon that continuing to value West Coast Naphtha on a Gulf Coast basis, when all other West Coast cuts are valued on a West Coast basis, violates the consistency requirement of *OXY*. *Id.* at p. 15. It adds that, were the Commission to continue to value West Coast Naphtha on a Gulf Coast basis, it must find that such a manner of valuing it was "consistent" with the valuation of the other cuts. *Id.* at p. 16. Phillips contends that the West Coast Naphtha market is subject to different forces, different supply and demand factors, and different environmental standards

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[763] In fact, Sanderson admitted that he did not compare all crude oils on both coasts, he only compared ANS on the West Coast and Isthmus on the Gulf Coast. Transcript at p. 9030. He also admitted that the qualities of the two crude oils are not the same, that the percentages of Quality Bank cuts in the two crudes are not the same, and that the properties of the Naphtha in the two crude oils are not the same. *Id.* at pp. 9030-31. Moreover, Sanderson also admited that the N+A of Isthmus crude is considerably lower than that of ANS. *Id.* at pp. 9047-48. Furthermore, he also admited that, while the quality of Isthmus crude has been constant, the quality of ANS has varied over time as new fields have joined the TAPS common stream. *Id.* at pp. 9038-42, 11126-27; Exhibit No. PAI-205.

[764] *See* Transcript at pp. 9019-23, 9062, 9071, 9073-81, 10626-27, 11135-37; Exhibit Nos. EMT-533, EMT-534, PAI-201, PAI-202, PAI-210 at p. 3, PAI-211 at p. 3.

[765] *See* Exhibit Nos. BPX-35, EMT-14, EMT-453, EMT-477, EMT-478, EMT-479, EMT-480, EMT-481, EMT-482, PAI-176; Transcript at pp. 10721-22.

affecting the supply of gasoline and intermediate products (like Naphtha) than the Gulf Cost. *Id.* at pp. 16-17. Also, Phillips notes, gasoline prices on the West Coast average 2.5-18¢/gallon more than those on the Gulf Coast. *Id.* at p. 17.

2672. The TAPS Carriers, Phillips maintains, presented evidence that there has been no delivery of ANS to the Gulf Coast since July 1999, and that, during the period January 1998 through the end of July 1999, less than 3% of ANS production was delivered to the Gulf Coast. *Id.* at p. 23. It also points out that the Commission has abandoned the no adjustment policy it previously had followed. *Id.*

2673. BP admits that, when the Commission decided to value West Coast Naphtha on a Gulf Coast basis, the decision made sense. BP Initial Brief at p. 5. It contends, however, that, with the decision to no longer value West Coast VGO on a Gulf Coast basis, it no longer is just and reasonable to continue to base West Coast Naphtha's value on a Gulf Coast reported price. *Id.* According to BP, as the values of both Naphtha and VGO are driven by their use in making gasoline, both should be valued consistently. *Id.*

2674. Williams argues that the Commission ought to continue requiring that West Coast Naphtha be valued on the basis of Platts Gulf Coast price assessment.[766] Williams Initial Brief at p. 17. It states that the Gulf Coast Naphtha price is representative of a robust market, and is reasonable and reliable. Williams Initial Brief at p. 23. Further, Williams notes, no one challenges its use to value Gulf Coast Naphtha. *Id.* at p. 24. Therefore, it suggests, there is no reason for anyone to question its use in establishing a value for West Coast Naphtha.[767] *Id.* Williams also argues that Platts Gulf Coast Naphtha assessment provides an objective, rather than a subjective, basis on which to value West Coast Naphtha.[768] *Id.* at pp. 26-27. It suggests that the use of an objective price assessment is a basic tenet of the Quality Bank. *Id.* at p. 26. Moreover, Williams argues, as it is the only Naphtha price assessment made by an industry-wide accepted source, use of Platts Gulf

[766] Unocal/OXY makes some of the same arguments as are made by Williams.

[767] This argument lacks logic. There are no Gulf Coast deliveries of ANS crude. Consequently, there is no reason why any party would waste its time in challenging that Tariff provision. But, more importantly, it does not follow that the appropriateness of using the Platts Gulf Coast Naphtha assessment for Gulf Coast deliveries of ANS also makes it appropriate for use in valuing West Coast ANS deliveries.

[768] This argument, however, is based on Sanderson's testimony. Williams Initial Brief at p. 26. In arguing this, Williams fails to acknowledge that, on cross-examination, Sanderson admitted that, while he contended that the Platts assessment was objective, he exercised his "subjective judgment that the Gulf Coast Platt's assessment would be a suitable proxy for the West Coast value." Transcript at pp. 8836-37.

Coast Naphtha price assessment is consistent with the manner in which other Quality Bank components are valued. *Id.* at p. 28.

2675. My analysis began with a review of the Circuit Court's *OXY* ruling which Exxon and Phillips claim requires, in the context of this issue, that West Coast Naphtha be valued on a West Coast basis as all of the other West Coast ANS cuts (after implementation of the parties's agreement on West Coast VGO) will be valued on a that basis. I am not as sure as they are that the Circuit Court's ruling mandates that conclusion. What the Court was addressing in *OXY* was the value of a cut, i.e., whether or not its value involved processing costs;[769] it was not addressing the geographical location where the Commission found an appropriate proxy. In my opinion, therefore, the question raised by *OXY* is not, as argued by Exxon and Phillips, answered solely by reference to geography, but must be answered by a more substantive look at whether Platts Gulf Coast Naphtha assessment values West Coast Naphtha in a manner consistent with the value of the other West Coast ANS cuts.

2676. The record, which has already been amply discussed in this section as well as in other areas of this Initial Decision, contains more than sufficient evidence to establish that the West Coast market for gasoline and intermediate petroleum products differs greatly from that on the Gulf Coast. On the West Coast, for example, Naphtha is used almost exclusively to manufacture gasoline and jet fuel, while on the Gulf Coast it also is used as a petrochemical feedstock. Furthermore, it appears that not all of the Naphtha assessed by Platts on the Gulf Coast matches the quality of that derived from ANS. Under these circumstances, it is difficult to see how a Gulf Coast Naphtha assessment could be said to represent the value of West Coast Naphtha.

2677. Moreover, it is clear that, while at least some ANS was shipped to the Gulf Coast in the early 1990s, by 1999, this trade had totally ended. Also, the record reflects that virtually no Naphtha is imported into the West Coast, while substantial imports are being made into the Gulf Coast from the Caribbean. In other words, while there is a robust trade in Naphtha on the Gulf Coast, there is virtually no trade in Naphtha on the West

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[769] The Circuit Court states:

> [I]f the agency chooses to value some cuts of petroleum at the prices they command in the market without the benefit of processing, as it appears to have done, it must attempt, to the extent possible, to value all cuts at the price they would command without processing. It cannot, consistent with the requirement of reasoned decisionmaking, value some cuts precisely and other haphazardly.

OXY, 64 F.3d at p. 694.

Coast as refiners there supply their own needs from internal sources. These facts further add to the difficulty of concluding that a Gulf Coast Naphtha assessment is representative of the value of West Coast Naphtha.

2678. I give no credence whatsoever to the theory espoused by Williams and Unocal/OXY that use of Platts Gulf Coast Naphtha assessment to value West Coast Naphtha is just and reasonable because the West Coast and Gulf Coast markets are linked by transportation factors.[770] Their evidence on this point relates to the ability of West Coast refiners to import crude oil, and the increasing amounts of crude oil being imported, to the West Coast as production of ANS declines.[771] For example, Culberson claims that the cost of shipping crude oil from foreign sources to each coast is about the same.[772] However, even while this may be true, and I note that its accuracy is vigorously disputed by other parties,[773] as the parties all are aware, virtually no Naphtha is imported to the West Coast because West Coast refineries satisfy their needs for it from internal sources. Thus, I conclude, Williams and Unocal/OXY have failed to establish a connection between the importation of crude oil and the question of whether Platts Gulf Coast Naphtha assessment is a reasonable approximation of the value of West Coast Naphtha.[774]

2679. The position espoused by Williams and Unocal/OXY is supported by the testimony of Sanderson and Culberson and the exhibits submitted through them, while the testimony of Tallett, Toof, Baumol, Pulliam, Ross, and O'Brien supports the positions of Exxon, Phillips, Alaska and BP. On the whole, I find the latters's testimony on this point more logical and, therefore, more credible. I find, too, that many of the arguments made by Williams and Unocal/OXY go to the question of how West Coast Naphtha should be valued rather than as support for their claim that Platts Gulf Coast Naphtha assessment is a just and reasonable proxy for West Coast Naphtha.

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[770] *See* Exhibit Nos. UNO-1 at pp. 2-6, WAP-1 at pp. 5-9.

[771] *See, e.g.,* Exhibit Nos. WAP-1 at p. 6, WAP-4.

[772] Exhibit No. WAP-1 at p. 7.

[773] *See, e.g.,* Exxon Initial Brief at pp. 226-27.

[774] There was a significant amount of testimony at the hearing, as well as a number of exhibits, surrounding the cost of importing crude oil and petroleum products to the West Coast, including discussions of the costs of transportation, the cost of storage, etc. I find that none of this evidence is relevant or material to the question of whether Platts Gulf Coast Naphtha assessment continues to be a suitable proxy for the value of West Coast Naphtha.

Based on the record, therefore, I find that there is substantial evidence that continuing to base the value of West Coast Naphtha on the basis of Platts Gulf Coast Naphtha assessment no longer is just or reasonable.

D. THE RELEVANCE OF THE WEST COAST NAPHTHA CONTRACTS

2680. One of the most contentious issues litigated involved West Coast Naphtha contracts discovered by the parties. Exxon, Phillips and Alaska vigorously argued that the contracts were reflective of the value of West Coast Naphtha, and their view was just as strenuously opposed by the remaining parties. During the hearing, listening to the witnesses's testimony, I became skeptical of the probative value of the contracts; subsequent to the hearing, after reviewing the testimony, the parties's exhibits, and their arguments, that skepticism became conviction.

2681. As I previously stated, and as the parties are well-aware, there is virtually no trade in Naphtha on the West Coast. Rather, refiners supply their own needs from internal sources. No reporting service assesses Naphtha's West Coast value because the trade is not robust and not transparent. Indeed, the West Coast trade is so secret that the parties had to disguise the names of buyers and sellers when presenting evidence related to purchases and sales of Naphtha.

2682. After a diligent search by the parties of each other and of third parties, they only were able to discover about 350 contracts involving the purchase and sale of West Coast Naphtha. When duplicates were removed, that number dwindled. Then, each person who analyzed the contracts removed those (s)he did not believe matched Quality Bank Naphtha specifications,[775] or those for which (s)he could not establish a price,[776] and at least one removed small, trucklots, which he considered too small to reflect a true market value.[777] The result was that each analysis involved around 200 contracts spread over an eight year period[778] – an average of fewer than 25 each year or no more than two per

[775] The contracts contained at least 38 different descriptions of the product purchased and sold. *See* Exhibit No. UNO-7 at pp. 38-39.

[776] Even so, there still remained difficulties in establishing the price of certain contracts in which the price was tied to delivery dates which the parties did not have.

[777] See Exhibit No. UNO-7 at pp. 33-34.

[778] Despite the fact that the 200 contracts were spread over 1994-2001 period, 61% of the Naphtha volumes included were traded in the last two of those years (1999-2001). Exhibit No. SOA-1 at p. 7. The parties have disagreed as to whether this two year period

month.[779] It strains credulity to suggest that these few contracts could represent anything, much less the value of the Naphtha which refiners supplied to themselves.

2683. While Exxon and Phillips argue that the number of contracts and the amount of Naphtha involved are no less than a statistician would use when sampling data, they miss the point. This wasn't a random sampling of a larger number, rather, these were ALL the contracts which the parties could discover.[780] Moreover, the "experts" could not even agree on which of the contracts were representative of the whole; each used a different subset in his/her analysis.

2684. It also is true that the West Coast Naphtha contracts "discovered" by the parties are not the equivalent of a Platts or OPIS assessment. The latter assessments are made based on spot sales; the former represent, for the most part, term contracts. Moreover, the reported price assessments are based on purchases and sales of a product in a robust market, while there is no market for Naphtha on the West Coast.

2685. I must say that I find that the testimony of all of the witnesses who suggested that the contracts represented the value of West Coast Naphtha to be strained and not quite credible. The testimony of those who stated that the contracts did not reflect the value of

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was anomalous, but there is no need for me to reach that question.

[779] Besides the number of contracts being small, it appears that four buyers dominated the market. *See* Exhibit Nos. WAP-200, WAP-202, SOA-34 through SOA-37. This is further evidence that the marketplace is less robust than one would find acceptable to represent a product's value.

[780] A random sample consists of items that have been selected from the entire population in such a way that *each* item in the population had an equal opportunity to be selected. Am. Statistical Ass'n, *What is A Margin of Error?* 7 (1998) *available at* http://www.amstat.org/sections/srms/brochures/margin.pdf; Michael S. Lewis-Beck et al., *The SAGE Encyclopedia of Social Science Research Methods* 913 (2004); David J. Sheskin, *Handbook of Parametric and Nonparametric Statistical Procedures* 1 (3rd ed. 2004); United States General Accounting Office, Program Methodology Division, *Using Statistical Sampling* 34 (rev. 1992).

The sample must be representative of the population to be useful in making "inferences about the larger population from which it was drawn." David J. Sheskin, *Handbook of Parametric and Nonparametric Statistical Procedures* 1 (3rd ed. 2004). No item or items can be completely excluded from the selection process or the results of the sample will be biased. Michael S. Lewis-Beck et al., *The SAGE Encyclopedia of Social Science Research Methods* 913 (2004).

Naphtha was much more believable. I agree with Unocal/OXY that, at best, the contracts "provide isolated or anecdotal evidence respecting West Coast naphtha transactions, particularly for the pre-1999 time period." Unocal/OXY Initial Brief at p. 35. Based on this evidence, and for the specific reasons stated above, I find that the contracts do not reflect the value of West Coast Naphtha and are unusable for any purpose in this proceeding.

E. IF CURRENT NAPHTHA VALUE IS NOT JUST AND REASONABLE, WHAT METHODOLOGY SHOULD BE USED

2686. From the record, it is clear that there were two focal points for the litigation. The first was Resid and the second is West Coast Naphtha. Resid was previously addressed; here the question of how West Coast Naphtha should be valued for Quality Bank purposes will be addressed. I am convinced that, while there is no perfect way to establish its value, continuing to value West Coast Naphtha on the basis of a Gulf Coast assessment, as I previously indicated, is not appropriate. Consequently, I am left to choose the best from among the parties's proposals.[781] For clarity sake, each will be individually discussed.

1. Petro Star

2687. While it supports continued use of the Gulf Coast Naphtha assessment to value West Coast Naphtha, Petro Star, through Dudley, offered an alternative should the Commission determine that its continued use was no longer just or reasonable.[782] Petro Star Initial Brief at p. 9. According to Petro Star, Dudley's proposed methodology contains three steps: (1) the price differentials between West Coast and Gulf Coast VGO and West Coast and Gulf Coast LSR are determined; (2) the percentages of VGO and LSR in the ANS common stream are determined; and (3) the volume weighted LSR and VGO price differentials are applied to the reported Gulf Coast Naphtha price assessment to determine the imputed West Coast price to be used by the Quality Bank. *Id.* It explains that Dudley's proposal uses Quality Bank data already available to quantify how differently the West Coast values gasoline blendstocks in comparison with the Gulf

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[781] During the course of the hearing, other possible methods for valuing Naphtha were discussed with the witnesses by me, Judge Wilson, and counsel for various parties. In this comment, I include, though I am not limiting my comment to it, the proposal by Williams's witness Sanderson to value West Coast Naphtha at the price of ANS plus $4.00. As I conclude that the record does not contain substantial evidence supporting any of these proposals, there is no need to discuss them any further.

[782] Unocal/OXY, on brief, also support the Dudley proposal. Unocal/OXY Initial Brief at p. 38.

Coast, and suggests that only Naphtha, VGO and LSR qualify to meet those criteria.[783] *Id.* at p. 10.

2688. Petro Star concedes that LSR has a high Reid Vapor Pressure and, consequently, is much less valuable on the West Coast than on the Gulf Coast for use as a gasoline blendstock. *Id.* at p. 13. LSR's value as a petrochemical, Petro Star also admits, may contribute to its higher Gulf Coast value. *Id.* at p. 14. Moreover, Petro Star agrees that the economics surrounding LSR and VGO are different when comparing the West Coast and the Gulf Coast, and that their usages on both coasts have different economics as well. Petro Star Reply Brief at p. 17.

2689. Williams claims that it does not support the substitution of the Dudley proposal for the Gulf Coast Naphtha assessment to value West Coast Naphtha, but that the Dudley proposal demonstrates the validity of continuing to use the Gulf Coast assessment as a proxy for it.[784] Williams Initial Brief at p. 80. It does add that, of all of the remaining proposals, Dudley's should be adopted were the Commission to hold that the Gulf Coast Naphtha assessment can no longer be used and should it reject the ANS plus $4.00 proposal. *Id.* at pp. 80-81.

2690. Exxon describes the Petro Star proposal as being based on the relationship between the prices of Gulf Coast Naphtha and a weighted incremental differential between the prices of Gulf Coast and West Coast VGO and the prices of Gulf Coast and West Coast LSR. Exxon Initial Brief at p. 311. According to it, the structure of the proposal ignores the fact that over 90% of West Coast Naphtha is made into gasoline. *Id.* at 312. Exxon correctly claims that Dudley did nothing to establish the validity of the proposal he made on Petro Star's behalf. *Id.* at p. 312.

2691. According to Phillips, Dudley's proposal was doomed from the start because he was asked to derive a method for valuing West Coast Naphtha which did not rely on the price of finished gasoline. Phillips Initial Brief at p. 142. As did Exxon, it correctly notes that the fallacy of this approach arises from the simple fact that, as virtually all West Coast Naphtha is used to make gasoline, doing so ignores the value of the resulting finished product. *Id.* Phillips also points out that Dudley admitted that this approach is contrary to the advice he gives other clients, and caused him to create a methodology for valuing West Coast Naphtha which is not used by any refinery, not even by Petro Star.

[783] Petro Star notes that, like Naphtha, LSR and VGO are intermediate products derived from crude oil, refined on both coasts, and used to make gasoline blendstocks. Petro Star Initial Brief at p. 11.

[784] I believe that this reflects the fact that the Dudley proposal results in a value virtually the same as the Gulf Coast Naphtha assessment.

Id.

2692. In essence, the major challenge which Phillips makes to the Dudley proposal concerns the subjective nature of the choices he made in the cuts with which to compare the values of West Coast and Gulf Coast Naphtha.[785] Phillips notes that Dudley chose to compare the differential between Naphtha, LSR and VGO. *Id.* at p. 143. Dudley testified, Phillips declares, that he choose LSR and VGO because, as is Naphtha, they are used to make gasoline. *Id.* at p. 144. It states that LSR has a lower West Coast than a Gulf Coast value because of its high Reid Vapor Pressure which severely limits its use on the West Coast. *Id.* at pp. 143-44. On the other hand, Phillips points out, Naphtha has a low Reid Vapor Pressure and all of the experts agree would not have as great a differential in a Gulf Coast/West Coast comparison. *Id.* at p. 144. Therefore, suggests Phillips, though I am not sure that I follow the reasoning, Dudley has failed to establish a compelling reason to use LSR in his formula. *Id.* at p. 145. I find, however, because of the Reid Vapor Pressure variance, that Dudley has failed to establish a nexus linking the differential between West Coast and Gulf Coast LSR and the differential between West Coast and Gulf Coast Naphtha.

2693. Had Dudley chosen to use a combination of other cuts, VGO and Isobutane for example, Phillips points out, his formula would have assigned Naphtha a higher West Coast value. *Id.* at p. 145. It argues that the outcome of the choices Dudley made, in comparison with those he could have made, demonstrates that his proposal is arbitrary. *Id.* at pp. 145-46. In fact, it is unlikely that Dudley's choice of LSR and VGO was arbitrary; rather, more likely, his choice was outcome driven to satisfy the needs of his client. While I do not fault him (or it) in this regard, I do not find his testimony convincing.

2694. As I indicated at the hearing, I am sympathetic to the simplicity of the approach taken by Dudley. However, as noted above, I am not convinced that the specifics of the choices he made accurately reflect the value of West Coast Naphtha. As a consequence, therefore, I cannot find it to be either just or reasonable.

2. Phillips

2695. Phillips explains that its proposal for valuing West Coast Naphtha, put forth by O'Brien, is premised on the fact that virtually all of the Naphtha produced by refineries on the West Coast is first processed through catalytic reformers to produce reformate, which subsequently is used as a blendstock in the production of gasoline. Phillips Initial Brief at pp. 76-77. It explains that the first step of O'Brien's methodology is to develop a

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[785] Exxon agrees with Phillips. *See* Exxon Initial Brief at pp. 312-15; Exxon Reply Brief at pp. 329-31.

before-cost value of Naphtha on the West Coast by first determining the product yields from running Naphtha through a reformer. *Id.* at p. 77. The product yields are then multiplied by their published prices to derive a before-cost Naphtha value. *Id.* Phillips concedes that O'Brien had to develop prices for reformate[786] and hydrogen[787] because no published prices are available. *Id.* at pp. 77-78.

2696. While, Phillips concedes, O'Brien had to make assumptions regarding the three-component blend as well as regarding the value of reformate, it argues that his proposal has been subjected to a number of tests which validate its reasonableness. *Id.* at p. 83. Moreover, it argues that, applying his formula to Gulf Coast prices indicates that it is more than just randomly related to the value of Naphtha. *Id.* at p. 84. Thus, it suggests, O'Brien's proposal satisfies the *Exxon* requirement that the proxy price be rationally related to West Coast Naphtha's actual market value. *Id.* at p. 90.

2697. Answering the charge that, for several months in 2000-2001, O'Brien's calculated Naphtha price exceeded the published Seattle regular gasoline price,[788] Phillips notes that such criticism ignores the fact that Naphtha is used to make products other than gasoline, such as hydrogen. *Id.* at p. 92. Thus, it contends, the price of Naphtha is affected by the value of products other than gasoline, and that, in 2000-2001, the price of natural gas, from which hydrogen is normally made, increased which, in turn, increased the value of hydrogen. *Id.* When the natural gas price normalized, Phillips argues, so did the price of hydrogen. *Id.*

2698. Phillips also defends O'Brien's three-component gasoline blend as a simple blend while recognizing that more complex blends are used. *Id.* at p. 98. It adds that the more complex blends are more difficult to model, particularly since not all of their blendstocks have published prices. *Id.* However, O'Brien has failed to convince me that his three-component blend adequately represents even West Coast conventional gasoline,

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[786] O'Brien, as reformate is solely used to make gasoline, derived its value using the published prices of other gasoline blendstocks based on a three-component gasoline blend. Phillips Initial Brief at p. 78. Phillips concedes that it is necessary to use some judgment in selecting the gasoline blend. *Id.* at p. 79.

[787] O'Brien based his hydrogen value on the cost of making it from natural gas in a hydrogen plant. Phillips Initial Brief at p. 80. He adjusted the cost of natural gas on a monthly basis as the published price changed. *Id.* at p. 82.

[788] In its reply brief, Phillips defends O'Brien's use of the Seattle regular unleaded gas price stating that the Seattle market for conventional gasoline is robust and growing while the Los Angeles market for it is small and shrinking. Phillips Reply Brief at pp. 72-73.

much less CARB or reformulated gasoline. I would reject his proposal on this one factor alone, but there are other reasons as well.

2699. Even Phillips concedes that the annual exhaust toxics (133.6) which it claims for O'Brien's three-component blend's far exceeds the statutory baseline threshold for annual exhaust toxics (104.5).[789] Phillips Initial Brief at p. 111. While it suggests that this is irrelevant because all of the West Coast refineries were in operation in 1990 and, therefore, have their own baselines,[790] Phillips fails to cite any record evidence in support of its claim. However, a review of the record indicates that Phillips admits that the three-component blend's annual average exhaust toxic (133.6) it claims is higher than at least three West Coast refineries.[791] Exhibit No. PAI-167 at p. 1. As a result, Phillips's defense of the three-component blend fails.[792]

2700. Ross suggests that O'Brien's[793] methodology only considers the demand side of the supply/demand curve as it does not consider the opportunities for imports to affect the value of Naphtha on the West Coast. Transcript at pp. 9703-04. The record, however, fails to establish that the opportunity for importing Naphtha into the West Coast exists anywhere but in Ross's imagination.

2701. Exxon contends that O'Brien's approach appropriately treats the West Coast and the Gulf Coast as different markets. Exxon Initial Brief at p. 279. However, it

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[789] Williams, on brief, challenges this figure noting that it is based on Phillips Ferndale Washington refinery in which only 75% of the crude processed is ANS. Williams Reply Brief at p. 77 (citing Transcript at p. 5996). It suggests that, had Phillips used the true values of O'Brien's three-component blend based on the PIMS model, the benzene level would have increased to 210.8 mg/mile, far exceeding all of the West Coast refineries. *Id.* at pp. 77-78.

[790] Phillips Initial Brief at p. 111.

[791] The baselines for Phillips Ferndale (WA) refinery is noted as 129.8; that for the Tacoma (WA) U.S. Oil refinery is listed as 122.6; and that for the Tesoro Anacortes (WA) refinery is 114.9. Exhibit No. PAI-167 at p. 1.

[792] Phillips also suggests that, if emissions are a problem, a benzene saturation unit could be installed in the conceptual refinery and further suggests how the costs of such a plant could be computed. Phillips Initial Brief at p. 112. Doing so would make O'Brien's complex formula even more complicated and would add more subjectivity to it. I do not find this acceptable in any regards.

[793] Ross makes the same charge regarding Tallett's proposal.

suggests,[794] and I agree, that his methodology is rampant with subjective determinations and is, besides, highly complex. *See* Exhibit No. EMT-76 at p. 15; Transcript at pp. 7206-7. Moreover, as I noted he did with regard to Resid, by failing to use a West Coast location factor, O'Brien understates the cost of reforming gasoline. Exhibit Nos. EMT-84 at pp. 12-13, EMT-76 at p. 16; Transcript at pp. 5315, 6164, 6411, 6570-72, 7217.

2702. In view of the above, I am convinced that O'Brien's proposal is so rampant with subjective determinations that it cannot meet the objectivity standard set out by the Circuit Court in *Exxon*, 182 F.3d at p. 42. Moreover, I find that it is too complex. Consequently, it cannot be considered either just or reasonable.

3. Exxon

2703. Exxon's proposal was put forth by Tallett. The record reflects that, after discarding several other methods, Tallett focused on the "relationship between the value of Naphtha and the published prices of the products that are made from Naphtha – namely gasoline and jet fuel – to value Naphtha on the West Coast." Exxon Initial Brief at p. 252. After determining, through the use of a standard regression formula,[795] that there was a relationship between the prices of Naphtha and unleaded regular gasoline, he further concluded that, when the price of jet fuel was added to the equation, "the price of Naphtha is almost entirely explained." *Id.* at p. 253. For the 1992 through 2001 period, Tallett established that the value of West Coast Naphtha averaged \$24.91/barrel or \$2.44/barrel higher than the average Gulf Coast value. *Id.* at p. 257.

2704. Tallett's analysis is supported, Exxon suggests, and I agree, by O'Brien's independent analysis, and by the rule of thumb used by an experienced Naphtha trader. *Id.* at pp. 267-68 (citing Transcript at pp. 10213-14; Exhibit Nos. UNO-9 at p. 1, EMT-76 at pp. 12, 14, EMT-77 at p. 6). Exxon correctly states that

> the reasonableness of Mr. Tallett's methodology is also confirmed by the results derived when Naphtha's value is calculated as a function of gasoline and crude oil prices. Thus, . . . if the price of Naphtha is determined as a percentage of the range between the price of gasoline and the price of crude oil using Gulf Coast prices, and this same percentage is then used to calculate a West Coast price of Naphtha using the price of gasoline and the price of ANS crude oil on the West Coast, the result is very close to Mr.

[794] Exxon Initial Brief at p. 281.

[795] Baumol explained, for the record, how a regression analysis works. Transcript at pp. 5085-5106.

Tallett's average West Coast Naphtha value for the same period.

Id. at pp. 269-70.

2705. Contrary to the criticism of other parties, it appears that Tallett did not use Gulf Coast prices to value West Coast Naphtha. Exhibit No. EMT-11 at pp. 16-21. Rather, the record reflects that Tallett used his regression formula to establish relationships between Gulf Coast Naphtha's value as a feedstock and the prices of end-products derived from it. *Id.* at p. 18; Transcript at pp. 7204-06. He then used those relationships and *West Coast* prices for those same end-products to calculate the value of West Coast Naphtha. Exhibit No. EMT-11 at p. 19. It does not appear that West Coast refining margins skew the results, as the record contains no evidence supporting this claim.

2706. In connection with Tallett's proposal, Williams claims that Tallett assumes that refining margins are the same on both coasts. Williams Initial Brief at p. 70. In fact, it claims, they are different, that the margins on the West Coast are higher. *Id.* at pp. 70-72 (citing Exhibit Nos. WAP-8 at p. 5-7, WAP-9, WAP-10, WAP-11, WAP-12 at p. 2). It cannot be argued that Tallett's proposal does not apply the Gulf Coast margin relationship between Naphtha and gasoline and jet fuel to the calculated value for Naphtha on the West Coast. However, the question is whether imputing that same relationship to the higher prices of finished products on the West Coast prevents the calculation of a West Coast Naphtha value which is just and reasonable.

2707. William's argument focuses on the differences in the refining margin between conventional gasoline and low sulfur No. 2 fuel oil minus the price of crude oil on the two coasts. *Id.* at p. 71. However, as Exxon points out,[796] all of the evidence on which Williams relies[797] relates to the higher West Coast price differential of those products relative to the price of crude oil, assuming crude oil prices on both coasts are the same, as Williams apparently does, and does not provide any information regarding the West Coast value of Naphtha. Exhibit No. EMT-133 at pp. 32-34. In other words, Williams assumes that the relationship between the price of crude oil and the cost of these finished products fully explains the difference in the refining margin between the coasts with regard to gasoline and jet fuel. Williams fails, however, to consider that, in doing so, it attributes none of the finished product margin on the West Coast to Naphtha.[798]

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[796] Exxon Reply Brief at pp. 280-82.

[797] *See* Williams Initial Brief at pp. 70-71 (citing Exhibit Nos. WAP-8 at pp. 5-7, WAP-9, WAP-10).

[798] In addition, the record indicates that some of the increased margin associated with the relative higher prices for gasoline and jet fuel on the West Coast may not be fully captured by the refiners, contrary to Williams's assertion. Transcript at pp. 12056,

2708. In his Rebuttal Testimony, Tallett admitted that the West Coast margin between the prices of finished products and the price of crude oil was higher that that on the Gulf Coast, but added that this did not conflict with his "proposal to use West Coast gasoline and jet fuel prices to value West Coast Naphtha." Exhibit No. EMT-133 at pp. 32-33. He stated that what is relevant to his proposal "is whether the relationship between unleaded gasoline, jet fuel and Naphtha prices on the Gulf Coast is similar to the relationship among those same prices on the West Coast." *Id.* at p. 33. Tallett notes that, therefore, while the margin between unleaded gasoline prices and Naphtha prices have some relevance, the margin between finished product prices and the price of crude oil does not. *Id.* According to him, though it was alleged, neither Ross nor Sanderson provided evidence that the margin between gasoline prices and Naphtha values on the West Coast exceeded that on the Gulf Coast. *Id.* at pp. 33-34. On the other hand, Tallett did provide evidence that Gulf Coast Naphtha values tracked Gulf Coast gasoline prices. *Id.* at pp. 34-35, Exhibit Nos. EMT-11 at pp. 17-22, EMT-16, EMT-17, EMT-18, EMT-19, EMT-84 at p. 38. Further, he theorized that, citing Exhibit No. EMT-15, as the primary use of Naphtha on both coasts was to make gasoline and jet fuel, "one would expect Naphtha prices to be strongly correlated with the prices of gasoline and jet fuel on both the West Coast and the Gulf Coast" and created a regression formula which proved his theory. Exhibit No. EMT-11 at pp. 16-17.

2709. I find that the evidence submitted by and through Tallett satisfactorily proves that his regression formula establishes the relationship between gasoline, jet fuel and Naphtha on the West Coast. Williams has failed to convince me that the appropriate margin which ought to be attributed to Naphtha on the West Coast is anything other than that assumed by Tallett.[799] Moreover, it is clear to me that, of all the proposals put forth by the parties, only the Tallett method establishes a reasonable relationship between the values of gasoline, jet fuel and Naphtha on the Gulf Coast and applies that relationship to the same finished product prices on the West Coast. Consequently, it is more than satisfactory for Quality Bank purposes.

2710. Moreover, contrary to Williams's assertion, we have seen throughout this hearing that certain finished petroleum products are more closely associated, on a value basis, with their intermediate feedstock substances than to crude oil prices. *See* Exhibit No. EMT-476; Transcript at pp. 11037-38. This evidence demonstrates that the Gulf Coast

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12101. Moreover, although I do not apply any weight to the contract analyses contained in the record as evidence of the value of West Coast Naphtha, I do note that the overwhelming majority of Naphtha sellers on the West Coast tied the price of their sales to the price of gasoline on the West Coast. Exhibit No. EMT-133 at pp. 44-45; Transcript at pp. 6639, 7521-22, 7642-46, 8299, 11066-67, 11142.

[799] *See* Exhibit No. EMT-133 at p. 32.

value of Naphtha tracks more closely the cost of Gulf Coast gasoline than it does crude oil. *Id.* The same pattern of significance is shown from results of Tallet's West Coast calculated Naphtha values against the prices of West Coast gasoline and crude oil. Exhibit Nos. EMT-541, EMT-542. However, the record reflects that this pattern was not found when the Gulf Coast Naphtha price was tracked against the prices of West Coast gasoline and crude oil. Exhibit No. EMT-536; Transcript pp. 11058–59.
2711. Accordingly, what all this evidence does, contrary to Williams's assertions, is support the application of the Gulf Coast relationship of the refining margins inherent in the Tallett proposal to the prices of West Coast finished products to derive a West Coast value for Naphtha. In others words, both the higher West Coast gasoline and jet fuel prices and the resulting higher West Coast refining margins have been shown to contribute directly to higher West Coast Naphtha values.[800] This conclusion is consistent with the Tallett proposal.

2712. Moreover, the record reflects that Naphtha is not, contrary to Ross's claim, less valuable because of the introduction of CARB gasoline. Rather, it appears, Naphtha is more attractive because its aromatics have a high octane rating; and because it has a low Reid Vapor Pressure, no olefins and virtually no sulfur. Transcript at pp. 5997-98, 13218-19.

2713. It does not appear that Tallett's calculated value for West Coast Naphtha is subjective as it is entirely based on West Coast gasoline and jet fuel prices published by Platts. Exhibit Nos. EMT-397, EMT-17 at p. 11. In connection with this allegation, Exxon states that Tallett's regression formula "is derived by a standard statistical formula that can be run on any computer, with the result that no 'judgment' is required to calculate the formula, and anyone running the same analysis will 'come up with exactly the same answer'" and, therefore, it cannot be said to be subjective. Exxon Reply Brief at p. 280 (citing Transcript at pp. 5088-91). I agree with Exxon that the record supports its comment.

2714. Contrary to allegations[801] that Tallett's formula should have been based on current prices, not prices for the 1992 through 2001 period, it appears that he uses the formula to calculate the current value of West Coast Naphtha using current prices for unleaded gasoline and jet fuel. Moreover, as Exxon notes,[802] there is, apparently, no significant

[800] Supporting this conclusion, further, is the evidence that there is no structural difference in the market relationships between the coasts. Exhibit Nos. EMT-11 at pp. 16–17, 20– 21, EMT-133 at pp. 19, 28–29; Transcript at pp. 6772–73, 7242–43.

[801] *See* Petro Star Initial Brief at pp. 20-21.

[802] Exxon Reply Brief at p. 287.

difference in whether Tallett's formula is derived using ten years of Gulf Coast price data or a smaller portion of that period. Exhibit No. EMT-398; Transcript at pp. 7108-13. In any event, Tallett's regression analysis can be updated periodically to ameliorate such a circumstance. Transcript at p. 6768.

2715. Answering charges that the demands of the petrochemical industry on the Gulf Coast affect the value of Naphtha there, Exxon accurately states that, as its value as a gasoline and jet fuel feedstock is higher than its value as a petrochemical feedstock, the former use creates a ceiling on its use for the latter. Exxon Initial Brief at pp. 274-75 (citing Exhibit Nos. EMT-123 at p. 33, EMT-133 at pp. 30-31, UNO-9 at p. 3). Tallett's regression analysis, Exxon also correctly argues, confirms this by showing that "over 98% of the variation in Gulf Coast Naphtha prices can be explained by changes in gasoline and jet fuel prices." *Id.* at p. 275 (citing Exhibit Nos. EMT-11 at pp. 18-19, EMT-17, EMT-343). Furthermore, it appropriately notes that the "Naphtha used as a petrochemical feedstock on the Gulf Coast is a different, lighter Naphtha than the heavier reformer-grade Naphtha and is used in steam crackers to produce ethylene." *Id.* at p. 276 (citing Transcript at pp. 7122-23, 12067-69, 12112-13).

2716. BP claims that Tallett has failed to take differences in the Gulf Coast and West Coast markets into consideration. BP Reply Brief at p. 30. In particular, it notes that West Coast operating margins are higher, and that supply and demand factors differ because of the demands of the petrochemical market on the Gulf Coast. *Id.* at pp. 30-31. Answering the former charge, Exxon accurately asserts that the higher West Coast refining margin has no bearing on the margin between unleaded regular gasoline and the value of Naphtha. Exxon Initial Brief at pp. 272-73 (citing Exhibit No. EMT-133 at pp. 32-35). Exxon further notes that, in any event, every witness has agreed that, on the Gulf Coast, the price of Naphtha closely tracks the price of gasoline and it concludes that this same relationship exists on the West Coast.[803] *Id.* at p. 273 (citing Transcript at pp. 11170-71, 12082; Exhibit No. EMT-476). In response to the latter charge, Exxon correctly notes, the record reflects that most of the Naphtha used by Gulf Coast petrochemical plants is not comparable to the heavy reformer grade Naphtha made from ANS crude as it is a lighter Naphtha used in steam crackers to produce ethylene. *Id.* at p. 276 (citing Transcript at pp. 7122-23, 12067-69, 12112-13). Moreover, as Exxon claims, even the benzene produced on the Gulf Coast by the heavier Naphtha does not impact the price of Gulf Coast Naphtha.[804] *Id.* at p. 277 (citing Transcript at pp. 7119-20). Therefore, based on the record, I cannot find that BP's claim regarding the West Coast refining margin and the demands of the Gulf Coast petrochemical industry has any merit.

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[803] *See also* Transcript at pp. 12085-86; Exhibit Nos. EMT-84 at p. 22, EMT-89, EMT-123 at p. 33, EMT-133 at p. 34, EMT-541, EMT-542, PAI-214 at p. 4.

[804] *See* Transcript at pp. 5287, 7116-19.

2717. Petro Star suggests that Tallett's regression formula would not accurately describe the West Coast relationship between Naphtha, jet fuel and gasoline if that relationship was different from the relationship between the same variables on the Gulf Coast. Petro Star Initial Brief at p. 17. However, it fails to cite to any evidence in the record which proves that the relationships are different.[805] In any event, even were relationships to change, and were such change verified through testing, Tallett suggests that modifying the coefficients in his regression formula would rectify that circumstance. Transcript at p. 6768.

2718. Phillips compares O'Brien's cost-based proposal with Tallett's, which it classifies as market-based. Phillips Initial Brief at p. 89. It states that the value derived from each is in the same general range. *Id.* (citing Exhibit No. SOA-28). Phillips further states that Tallett's proposal represents a rational approach to developing a market-based value for West Coast Naphtha. *Id.* at pp. 114-15.

2719. Turning around the argument that Tallett's proposal is faulty because the West Coast market is too different from the Gulf Coast market to support the kind of correlation done by him, Phillips notes that this is precisely the reason why the Gulf Coast Naphtha price cannot be used as a proxy for West Coast Naphtha. Phillips Reply Brief at pp. 75-76. While I cannot say that this argument supports Tallett's proposal, I certainly can agree that it is inconsistent for a party to argue in favor of continuing to use the reported Gulf Coast Naphtha price to value West Coast Naphtha and also to argue that Tallett's proposal is faulty for using Gulf Coast prices in a correlation to value West Coast Naphtha.

2720. Baumol's testimony regarding regression formulae has convinced me that they may be used to establish the approximate value of West Coast Naphtha, and Tallett's testimony convinced me that his regression formula did just that. I do not find that the testimony of witnesses who challenged Tallett's support for his proposal convincing; nor, I find, are the arguments made by parties opposing it persuasive. Therefore, of all the proposals presented by the parties, I am compelled by the record to hold that, because of its relative simplicity and lack of subjectivity, Tallett's proposal, which, as noted above, is supported by substantial record evidence,[806] and is a just and reasonable manner in

[805] Petro Star does cite to evidence that Tallett admitted that the relationship between jet fuel and unleaded regular gasoline differed on the two coasts (Transcript at p. 6857; Exhibit No. WAP-180 at p. 1), but fails to explain how that establishes that the relationship between Tallett's three variables (Naphtha, jet fuel and gasoline) is different on the two coasts. *See* Petro Star Initial Brief at p. 17.

[806] While some of the evidence supporting Tallett's proposal is discussed here and in the section summarizing Exxon's argument, it is more than amply discussed in the

which to establish the value of West Coast Naphtha. I further hold that the Quality Bank Administrator should have the discretion to re-compute the value of West Coast Naphtha whenever circumstances require, but not less than once each year.

4. BP

2721. While agreeing with Phillips and Exxon that it is not appropriate to value West Coast Naphtha on other than a West Coast basis, BP claims that the O'Brien and Tallett proposals overvalue it as a result of spikes in the West Coast gasoline market. BP Initial Brief at pp. 29-30. Consequently, it suggests that a governor and a floor are required to protect against these market distortions.[807] *Id.* at p. 29.

2722. According to BP, while the value of West Coast Naphtha initially may be based on the reported West Coast gasoline price, such a valuation may not reproduce the same value Naphtha would have in a transparent market. *Id.* In support of this assertion, BP points to West Coast gasoline price anomalies which it claims cannot be attributed to a rise in the value of Naphtha or other gasoline feedstock. *Id.* at p. 30. The cap should represent, it claims, the value of Naphtha from other markets which could be imported into the West Coast were there a transparent market. *Id.* However, BP also concedes that the governor needs a floor to prevent the price from falling below the value of the local supply. *Id.* at p. 31.

2723. Phillips notes that Ross's governor proposal was a "moving target" that changed directions any number of times during the course of the litigation; besides abandoning his initial proposal for a cost-based Naphtha value, Ross made multiple changes to his governor value and also changed theories supporting it. Phillips Initial Brief at p. 116-21.[808] By the end of the hearing, Phillips points out, the level of Ross's governor had changed, the justification of why it was needed had changed, and the explanation of why it was needed had changed. *Id.* at p. 121. It argues that, as Ross was so willing to make changes to his proposal as his inability to defend his proposal against criticism increased, it suggests that there really was no principle underlying it and, therefore, it represents an end result looking for a theory on which to be based.[809] *Id.* BP claims that the changes

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evidence section of this Initial Decision.

[807] On brief, Unocal/OXY state that they do not oppose the use of a governor should a decision be made to adopt a West Coast Naphtha valuation. Unocal/OXY Reply Brief at p. 85.

[808] *See also* Exxon Initial Brief at pp. 284-85.

[809] In my mind, this is the most significant of Phillips's critique of Ross's proposal. A fuller summary of its criticism of the proposal is contained above. That I find no need to mention the others again here is no indication that they are not

were made only where necessary to meet the goal of placing the value of West Coast Naphtha on a basis consistent with that of other ANS cuts. BP Reply Brief at pp. 43-44. I cannot agree. The record clearly reflects that Ross changed his proposal whenever it became apparent that he could not continue to justify it in the face of the criticism of other parties.

2724. Exxon correctly notes that, despite the fact that Ross's governor is theoretically based on the value of Gulf Coast Naphtha plus the cost of diverting Caribbean shipments from the Gulf Coast to the West Coast, the record is devoid of any evidence that such diversions ever had occurred.[810] Exxon Initial Brief at p. 283. It also discussed Ross's claim, during the hearing, that his governor was an attempt to model a transparent market stating, correctly, that there was no evidence to support it. *Id.* at p. 291; Exxon Reply Brief at p. 305. Moreover, Exxon also accurately points out that Ross ignored certain cost factors (transportation costs as well as the costs of switching crude slates, and terminal and storage costs) which would have affected the amount of his governor. Exxon Initial Brief at pp. 300-04.

2725. It is clear to me that Ross and BP miss the point. There is no opportunity to attract imports of Naphtha to the West Coast because the West Coast supply and demand for Naphtha is in balance as West Coast refiners provide all of the Naphtha they need from internal sources.[811] As a result, there is virtually no trade in Naphtha on the West Coast and, consequently, there is no transparent market. Nor will there be so long as West Coast refineries continue, internally, to meet their own demand for it. Ross's testimony that his governor/floor proposal simulates a transparent market is simply not credible.

2726. The suggestion that, were the price of West Coast Naphtha high enough, imports would flow into the West Coast and West Coast refiners would buy that Naphtha rather than produce their own also is unsupported by any credible evidence. In point of fact, as there is no reported West Coast Naphtha price, there is no way for importers to know

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meritorious. It is clear from what I state below that repeating them here would amount to overkill.

[810] As with Phillips, I am highlighting Exxon's criticism of the Ross proposal here, but have more fully discussed it above. That I am not discussing Exxon's further comments is not an indication that they are invalid. Rather, it is an indication that they are additional justifications for my rejection of Ross's proposal which do not add to my discussion.

[811] While I have rejected the use of the West Coast Naphtha contracts for any purpose, I feel safe in commenting that, if they do have any probative value, it is to establish that only an insignificant amount of Naphtha is traded on the West Coast.

what price they would receive for the Naphtha they have available for sale were it shipped to the West Coast rather than the Gulf Coast.[812] Moreover, the suggestion that West Coast refiners would buy that Naphtha and somehow change their crude slate so that they would produce none, or less, of their own Naphtha also is unsupported by credible evidence. Ross simply has failed to convince me that this is a logical progression.[813]

2727. I also find that Ross's argument is self-defeating. Were West Coast refiners to purchase and import Naphtha because its cost was less than their cost to produce it, they would be competing for Naphtha on the world market. The record does not support a conclusion that such purchases could be made without affecting the world market price for Naphtha. It follows that, unless there were a significant surplus of Naphtha for sale on the world market, and the record also does not support such a conclusion, sales of Naphtha to West Coast refiners would cause the price of Naphtha on the world market to rise. Were that to happen, those same refiners, undoubtedly, would begin distilling their own Naphtha once again. Thus, Ross's cap proposal is an unworkable solution to the theoretical conundrum he created.

2728. As noted, Ross also proposed, in response to criticism of his cap proposal, that a floor price be set for West Coast Naphtha to be calculated by averaging the high and low of Platts West Coast ANS assessment plus $4.00. He derived the $4.00 figure from one of the contracts discovered by the parties. His attempt to validate this figure on the basis of the difference between the price of Gulf Coast Naphtha and West Texas sour crude (based on his theory that the latter was comparable to ANS crude) and the difference between Gulf Coast Naphtha and VGO (on the theory that West Coast Naphtha and VGO would have the same relationship) was not convincing. Moreover, even were I to have given any weight whatsoever to the Naphtha contracts discovered by the parties, I could not find that a term in one contract over a 10 year period was meaningful.[814]

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[812] Thus there is no transparent market for Naphtha on the West Coast and, I find that Ross's claim that his proposal will create a virtual transparent West Coast Naphtha market not credible. Moreover, were there, in fact, a transparent market on the West Coast, a reporting service undoubtedly would report the market price ending our difficulty of having to calculate one.

[813] I find Ross's background in economics, at best, to be superficial. *See* Transcript at pp. 8034-37.

[814] In any event, the contract referred to as support by Ross did not even involve Heavy Naphtha comparable to the Naphtha derived from ANS, but was for the purchase and sale of Full Range Naphtha, which is not its equivalent. Exhibit Nos. EMT-133 at pp. 39, 44, SOA-1 at pp. 16-17; Transcript at pp. 8405-06. Moreover, the cap in that contract was twice as high as Ross's proposed cap for a product that was less valuable

2729. As I find that neither the Ross governor nor his floor proposal is supported by credible record evidence for the reasons just stated, they are rejected.[815]

5. Conclusion

2730. As indicated above, based on the record as a whole, of all the proposals presented by the parties, I am compelled to hold that, because of its relative simplicity and lack of subjectivity, Tallett's proposal, which, as noted, is supported by substantial record evidence, should be used to value West Coast Naphtha.

2731. The formula suggested by Tallett should be implemented on a prospective basis. While there have been suggestions that it be implemented at an earlier date, substantial evidence does not support such a determination.

2732. I further hold that the Quality Bank Administrator should have the discretion to re-compute the value of West Coast Naphtha whenever circumstances require, but not less than once each year.

F. APPLICABILITY OF PLATTS HEAVY NAPHTHA PRICE

2733. Two decisions of the Quality Bank Administrator are at issue, both involve changes made by Platts regarding its Gulf Coast Naphtha assessment. Each of these decisions will be addressed on their individual merits. In addition, Exxon and Phillips have proposed that the Gulf Coast Naphtha assessment be adjustment for N+A content. This suggestion also will be separately addressed.

2734. The TAPS Carriers claim,[816] and I agree, that the Quality Bank Administrator is an independent neutral expert who attempts to resolve issues in accordance with his best professional judgment to whose expertise the Commission ought to show great deference.

1. February 2003

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than ANS Naphtha. *See* Transcript at p. 8142.

[815] It should be noted that I agree with many, if not all, of the criticisms of the Ross proposals made by the other parties which are described above. However, as I rejected it because his basic premise is unsupported by credible evidence, there is no need for me to address them.

[816] TAPS Carriers Reply Brief at p. 2.

2735. On February 27, 2003, the TAPS Carriers filed Tariff revisions amending their TAPS Quality Bank Methodology Tariffs. *BP Pipelines (Alaska), Inc.*, 102 FERC ¶ 61,345 at P 1. In the Tariff filings, the TAPS Carriers indicate that they are seeking to implement a determination of the Quality Bank Administrator that the Gulf Coast Naphtha value should be determined by using Platts newly reported Gulf Coast *Heavy* Naphtha assessment rather than its Gulf Coast Naphtha assessment. *Id.* at P 2, 11. The TAPS Carriers stated, in their notice to the Commission, that the Quality Bank Administrator determined that the API gravity and initial boiling points of the Quality Bank Naphtha cut are more similar to the Heavy Naphtha assessed by Platts than to the Naphtha it assesses. Exhibit No. PAI-222 at p. 2. They further declared that, because Platts informed the Quality Bank Administrator that as there were "plenty of [Heavy Naphtha] transactions, [it] had no trouble assessing [the] price and expected . . . to do it for the future," it was clearly reasonable for him to determine that the effective date of the change to the Gulf Coast Naphtha price should be March 1, 2003. TAPS Carriers Initial Brief at pp. 15-16 (citing and quoting Transcript at pp. 13174-75).

2736. Petro Star does not disagree with the TAPS Carriers's determination to use Platts Heavy Naphtha assessment to value Gulf Coast Naphtha, but claims that the Quality Bank Administrator exceeded his authority in doing so because, when the Quality Bank Administrator implemented the change on March 1, 2003, there was no evidence that the Full Range Naphtha assessment previously used had changed. Petro Star Initial Brief at pp. 25-26. However, it cited no record evidence in support of this claim.[817] In any event, the record establishes that Petro Star errs. It is clear that Platts had altered the manner in which it assessed Gulf Coast Naphtha. Petro Star's suggestion that Platts was still publishing the same Full Range Naphtha assessment which it previously had is simply not based on fact.

2737. Unocal/OXY make a similar argument to Petro Star's and cite to Mitchell's agreement with its counsel that the "price that was previously used was still employed, was still published by Platts."[818] Unocal/OXY Initial Brief at p. 45. In reply, the TAPS Carrier's point out that the Quality Bank Administrator was required by the Tariff to use Platts Gulf Coast Naphtha assessment to value ANS Naphtha. TAPS Carriers Reply Brief at p. 3. They further assert that, once Platts started publishing two different Gulf Coast Naphtha price assessments, the Quality Bank Administrator had to decide which of the two assessments to use. *Id.* The TAPS Carriers add:

[817] In fact, the only evidence offered on this matter supported the TAPS Carriers's position. *See* Transcript at pp. 13339, 13341-43, 13551; Exhibit Nos. EMT-640, EMT-641.

[818] Transcript at p. 13186.

> Because the publication of a second naphtha price assessment was unanticipated, the prior orders of the Commission[] did not expressly answer that question, and therefore the [Quality Bank Administrator] was forced to use his authority under Item III.J. of the Quality Bank tariff, Ex. TC-3 at 8, to choose the price that best reflects the value of the Quality Bank naphtha component in the Gulf Coast market.

Id. This argument is clearly supported by substantial evidence.[819]

2738. Moreover, there also was no error in the TAPS Carriers's decision to implement the change on March 1, 2003, as the Commission approved the implementation subject to refund and subject to further order of the Commission. *BP Pipelines (Alaska), Inc.*, 102 FERC P 13.

2739. I find, therefore, that substantial record evidence supports the TAPS Carriers's determination to replace the previously used Platts Gulf Coast Naphtha assessment with Platts Gulf Coast Heavy Naphtha assessment for all Quality Bank purposes, that such a substitution is just and reasonable, and that such determination should be implemented effective March 1, 2003.

2. June 2003

2740. On June 18, 2003, the Quality Bank Administrator filed a notice with the Commission that, effective May 1, 2003, Platts intended to publish two Gulf Coast Heavy Naphtha assessments, one for "Heavy Naphtha" and the other for "Heavy Naphtha Barge." Exhibit No. TC-19 at p. 2.[820] He further stated that he determined that Platts was assessing two separate markets – the Heavy Naphtha assessment is an assessment of ship's cargo transactions (up to 250,000 barrels) while the Heavy Naphtha Barge transactions are for the contents of barges (up to 50,000 barrels). *Id.* at p. 3. The Quality Bank Administrator further stated that there are numerous transactions for each and that no available data will allow for a volume-weighted or transaction-weighted average to be calculated. *Id.* at p. 4. Therefore, he recommended that "the arithmetic average of the

[819] Unocal/OXY also argue that use of Platts Gulf Coast Heavy Naphtha assessment overvalues West Coast Naphtha and that the "pricing changes initiated by the [Quality Bank Administrator] have the effect of freezing in place the prior month's value until the issues raised by the [Quality Bank Administrator] initiative are resolved by the Commission." Unocal/OXY Initial Brief at p. 46. They do not cite to any evidence in the record to support either claim nor do they sufficiently explain either of them. Consequently, I must reject both their arguments out-of-hand.

[820] *See Trans Alaska Pipeline System*, 104 FERC ¶ 61,201(2003).

average monthly price for Gulf Coast Waterborne 'Heavy Naphtha' and Gulf Coast 'Heavy Naphtha Barge' as reported by Platts" replace Platts Gulf Coast Waterborne Heavy Naphtha for Quality Bank calculations. *Id.* at p. 5.

2741. BP suggests that, as Platts continues to publish the Heavy Naphtha assessment, it ought to continue to be used. BP Supplemental Brief at pp. 2-3. That argument, however, ignores the fact that Platts has split what previously was the Heavy Naphtha assessment into a Heavy Naphtha assessment that relates to cargo sized transactions and a Heavy Naphtha Barge assessment that only relates to barge-sized transactions. That it failed to change the name of the Heavy Naphtha assessment is irrelevant; after the change, it simply was not the same as before. Ergo, BP's argument has no merit.

2742. Williams argues that introduction of the barge quote does not constitute a "radical alteration in the basis for reporting one of the products used to calculate the TAPS Quality Bank adjustments."[821] William's Supplemental brief at p. 3 (citing Exhibit No. TC-19 at p. 1). It notes that Mitchell reported that Sharp, an employee of Platts, stated that the Gulf Coast Heavy Naphtha assessment was "an assessment of cargo transactions." *Id.* at p. 4 (citing Exhibit No. TC-20 at p. 1). Williams also notes that, in a subsequent conversation, Sharp, when asked about the foregoing, repeated that the Heavy Naphtha assessment was "primarily a cargo number" and that barge quotes were minimized. *Id.* at p. 4 (citing Exhibit No. TC-22 at p. 1).

2743. Exhibit No. TC-22 reflects, however, that Williams fails to note the following follow-up to the discussion to which it refers. Mitchell states as follows:

> I reiterated what I had told him in my earlier call that while we were interested in the types of transactions that he took into account in making the assessment, we were primarily interested in how he would describe the nature of the resulting assessment. I asked him about the responses he had

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[821] Petro Star indicates that it agrees with Williams, admitting that there has been a change, but claiming that it wasn't "radical." Petro Star Supplemental Brief at pp. 2-3. In doing so it refers to a 1998 Quality Bank Administrator determination not to use an arithmetic average to value the VGO cut because it would not "accurately reflect the market price." *Id.* at pp. 3-4. BP and Williams also refer to the Quality Bank Administrator's VGO decision. BP Supplemental Brief at pp. 6-7; Williams Supplemental Brief at pp. 7-8. I find, however, that just because the Quality Bank Administrator made that decision in 1998, under the facts involved in those circumstances, does not bar him from making a different determination in 2003 (or, in fact, anytime) under different circumstances. In other words, a factual determination does not establish any precedent prohibiting a different decision with a different fact situation.

> given to my questions two weeks ago regarding the nature of the assessments. I read his previous answer to my question as to whether the earlier assessment was meant to be a cargo assessment or an overall assessment of the market. His reply had been that, "the assessment was weighted toward cargo but was not exclusively a cargo assessment." He had also said that the assessment, "was not exclusively one or the other." He responded that those earlier responses were correct. Mr. Sharp further stated that not all barge deals were included in the assessment.

Exhibit No. TC-22 at p. 1. Mitchell also quotes Sharp as saying that the "Heavy Naphtha assessment was a, 'general market assessment'; it was neither solely cargo nor barge but was, 'influenced by both' although cargo transactions predominated." *Id.* Sharp also stated, according to Mitchell, that he "sometimes used barge transactions for the high for the day and cargo transactions for the low." *Id.* at pp. 1-2.

2744. Based on the above, it is clear to me that Williams's claim that the manner in which Platts assessed Gulf Coast Naphtha was not radically changed by its decision to report barge and cargo transactions separately has no basis in fact.[822]

2745. Williams also argues that the Quality Bank Administrator's averaging proposal is inconsistent with the way other cuts are valued.[823] Williams Supplemental Brief at p. 5. This is disputed by the TAPS Carriers who note the following:

> - For each reference price the Quality Bank averages the high and the low price for each day. The Quality Bank then averages the daily averages to obtain a monthly average price for each component on the Gulf Coast and the West Coast.
>
> - A location factor is then used to calculate a weighted average of the Gulf Coast and the West Coast for each component. (In recent years the weighting has been 100 percent West Coast and zero percent Gulf Coast.)

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[822] Unocal/OXY also suggest that the splitting of the Heavy Naphtha assessment into cargo and barge assessments was not a radical change because the pricing change is not significant. Unocal/OXY Supplemental Brief at pp. 9-10. They do not explain, however, why the range of the change in values is relevant and material. In any event, I find that Sharp's comments to Mitchell, Toof and Stephen Jones, referred to above, clearly reflect that the change was significant and I, consequently, also find that the Unocal/OXY argument has no merit.

[823] Unocal/OXY and BP make virtually the same argument. Unocal/OXY Supplemental Brief at pp. 10-12; BP Supplemental Brief at pp. 4-5.

- The location factor is based on averaging shipping data obtained from the Maritime Administration over a six-month period to determine the percentage of ANS being transported to the Gulf Coast and the West Coast.

- The gravity differential used for the Valdez quality bank is calculated from the averages of the gravity differentials for several companies. The overall differential is a weighted average using the location factor.

- The Nelson Farrar Index used to adjust the size of the deductions in the pricing basis for the Light Distillate, Heavy Distillate and Resid components is developed by calculating annual averages of the monthly refinery operating inflation factors.

TAPS Carriers Reply Brief at pp. 11-12 (citations omitted). They also note that the Commission has not adopted a policy against using an average of two reference price assessments in the same region. *Id.* at pp. 12-13. In addition, the TAPS Carriers note that, in the current litigation, "all parties support the adoption of a method for valuing the resid component that will use a weighted average of *nine* reported price assessments." *Id.* at p. 13 (emphasis in original).

2746. Finally, I note that the Quality Bank Administrator's determination is supported by Phillips and Exxon. Phillips Supplemental Brief at pp. 4-5; Exxon Supplemental Brief at pp. 5-11.

2747. I find that the TAPS Carriers argument is compelling, and the weight of the evidence supports a conclusion that averaging the cargo and barge assessments would not be alien to the manner in which Quality Bank cuts are valued.

2748. Based on the record as a whole, as indicated in the above discussion, I find that the Quality Bank Administrator's determination is supported by substantial evidence and establishes a just and reasonable Naphtha value. I further find that that the replacement price proposed by him should be made effective on August 17, 2003.[824] *Trans Alaska Pipeline System*, 104 FERC ¶ 61,201 at P 9.

3. N+A Adjustment

2749. Exxon and Phillips have suggested that Platts Gulf Coast Naphtha assessment be

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[824] I find that Williams's argument that the Quality Bank Administrator's determination was premature and based on a superficial examination, and that, therefore, it ought to be made effective only on a prospective basis to be specious. *See* Williams Supplemental Brief at pp. 11-14.

adjusted by 1.5¢/gallon (based on a 0.15¢ adjustment for each increase in N+A above 40 to a maximum of 50 N+A). The other parties are opposed to this adjustment. I have sufficiently detailed the evidence adduced by the parties regarding the N+A issue, as well as their arguments in favor of it or opposed to it, in prior discussions. Suffice to say, here, that the N+A adjustment is similar to other intra-cut quality issues which the parties have agreed to defer until the next phase of this proceeding. Accordingly, I find that it would be unjust and unreasonable to consider such an adjustment at this time. It will be considered, if at all, at the same time as all other intra-cut quality issues are addressed.

2750. Moreover, as all of the evidence relating to whether Platts makes an N+A adjustment and, if so, what the amount of that adjustment is and how it is applied consists of hearsay reports of comments by one employee of Platts, which comments have been interpreted differently by various witnesses, I am not in a position, at this time, to find that substantial evidence in the record supports a conclusion that such an adjustment should be made.

2751. In view of the above, at this time I am rejecting the Exxon/Phillips proposal that the Platts Gulf Coast Naphtha assessment be adjusted for N+A content. They are free to raise it again during the next phase of these proceedings when other intra-cut quality issues will be addressed.

G. IMPACT OF POTENTIAL PUBLICATION OF A WEST COAST NAPHTHA PRICE

2752. While the parties briefed this matter, their arguments for and against the use of such an assessment are purely speculative as no such assessment is being published. Consequently, there is nothing on which a ruling is required.

H. ADMINISTRATIVE FEASIBILITY

2753. There is no dispute regarding the conclusion reached by the Quality Bank Administrator[825] that all of the proposals put forth by the parties to establish a West Coast Naphtha value are administratively feasible.

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[825] *See* TAPS Carriers Initial Brief at pp. 16-17.

ISSUE NO. 4: IS THE CURRENT METHOD FOR VALUING THE WEST COAST VACUUM GAS OIL CUT JUST AND REASONABLE, AND IF NOT, WHAT IS THE APPROPRIATE METHOD FOR VALUING THE VACUUM GAS OIL CUT? WHAT SHOULD BE THE EFFECTIVE DATE OF ANY CHANGE TO THE WEST COAST VACUUM GAS OIL CUT?

A. STIPULATED MATTERS

2754. All parties agree that West Coast Vacuum Gas Oil should be prospectively valued based on the published Oil Price Information Service West Coast High Sulfur VGO weekly price. Eight Parties Initial Brief at p. 161; Exxon Initial Brief at p. 341. Further, the Eight Parties note, all parties also agree that, if a new West Coast Naphtha valuation methodology is adopted in this proceeding, both it and the new West Coast VGO value should have the same effective date. Eight Parties Initial Brief at p. 161.

B. AREAS OF DISPUTE

2755. The area of dispute with respect to Issue No. 4 is the effective date for the new West Coast VGO value. According to the Eight Parties, this new value only should have a prospective application from the date the Commission issues its final order in this proceeding. *Id.* They disagree with Exxon's position that the value should be applied retroactively to June 19, 1994. *Id.* at pp. 161-62. Exxon's reasoning that the damages can be recovered for a period of two years prior to the filing of a complaint, the Eight Parties argue, is an inappropriate reason for retroactively applying the new valuation. *Id.* at p. 162. They also note that Exxon argues that damages should at least be retroactively applied back to August 1998 when Tesoro filed its complaint challenging the VGO price. *Id.* The Eight Parties believe that nothing in the analysis of the past and present circumstances underlying the VGO market on the West Coast suggests that anything other than prospective application of the new, agreed upon, VGO value is appropriate. *Id.*

2756. VGO valuation became an issue, according to the Eight Parties, in May of 1994 when the Commission determined there was record evidence which suggested that the OPIS West Coast high sulfur VGO price, utilized for a short period to value West Coast VGO, was thinly traded and could be subject to manipulation.[826] *Id.* Consequently,

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[826] The Eight Parties acknowledge that, in 1994, their own witness Ross did not share the Commission's concern about potential manipulation, but that, nonetheless, the Commission had those concerns and ordered that a Gulf Coast price be used to value

explain the Eight Parties, the Commission ordered that the West Coast VGO cut be valued using the OPIS Gulf Coast VGO price. *Trans Alaska Pipeline System*, 67 FERC ¶ 61,175 at p. 61,531 (1994). They note that this order has never been appealed. Eight Parties Initial Brief at p. 163.

2757. The Eight Parties argue, however, that, since 1994, and especially between 2000 and 2002, changed circumstances in the West Coast VGO market should dispel the concerns which the Commission previously had regarding the potential for market manipulation. *Id.* They point out that a redistribution of refining assets has taken place on the West Coast with the result that the three major ANS producers and Tesoro all now have direct access to West Coast VGO markets. *Id.* According to the Eight Parties, this was not so in 1994. *Id.* When the Commission issued its 1994 order expressing concern about potential manipulation, they note, there were just a limited number of Quality Bank participants who also participated in the West Coast VGO market. *Id.* (citing Exhibit No. BPX-26 at p. 4). The recently broadened presence in the West Coast VGO market of Quality Bank participants and those who own refineries and trade in VGO should, in the opinion of the Eight Parties, remove any concerns the Commission had regarding the potential for manipulation. *Id.* at pp. 163-64. Thus, under these newly realized market conditions, the Eight Parties argue, the West Coast VGO price is appropriate to use in the Quality Bank, but only on a prospective basis. *Id.* at p. 164.

2758. Exxon provides no justification, assert the Eight Parties, for retroactive application of the new reference price to June 19, 1994, except that it is two years before the filing of the Tesoro complaint. *Id.* They take the position that Exxon's recommendation for retroactive application is not proper. *Id.* Since 1994, the Eight Parties argue, Quality Bank participants have relied upon the use of the Gulf Coast VGO price to value West Coast VGO in making pricing and other business decisions. *Id.* Indeed, they note, the Commission's order valuing West Coast VGO using Gulf Coast prices has neither been appealed nor subject to remand. *Id.* Thus, the Eight Parties explain, prudent business practices since 1994 would, and did, reasonably lead companies to rely on the Gulf Coast price in making irreversible business decisions. *Id.*

2759. It was still reasonable to rely on the existing valuation, argue the Eight Parties, and not a proposed valuation in making business decisions even after Tesoro filed its complaint in August 1998 challenging the VGO price. *Id.* To make irreversible business decisions using a value other than what was ordered by the Commission simply because that value is being challenged would be unwarranted according to the Eight Parties, because it would require speculation: (1) that the challenge would be successful; (2) that the new value would be applied retroactively; and (3) that the new value is known. *Id.* at pp. 164-65. Taking all of these uncertainties together, the Eight Parties assert that the

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West Coast VGO. Eight Parties Initial Brief at p. 162, n.97.

only reasonable course of action for a business was to continue to rely on the existing Gulf Coast reference price as the value for their West Coast VGO. *Id.* at p. 165.

2760. Further, the Eight Parties point out, application of the new reference price back to June 19, 1994, would result in the implementation of a revised West Coast VGO price to take effect just one month after the Commission ordered, in May 1994, that the Gulf Coast price should be used for both the Gulf Coast and the West Coast. *Id.* In the Eight Parties's opinion, Exxon presents no evidence to justify essentially overturning the Commission's final order, which was not appealed, so soon after it took effect. *Id.*

2761. Moreover, there is no evidence, according to the Eight Parties, that the West Coast VGO price now to be used has been valid since 1994. *Id.* What the Eight Parties believe is known is that no stress was placed on this price because it was not used as a Quality Bank reference price. *Id.* If it had been, the Commission's concern for potential manipulation could have proven justified. *Id.*

2762. In conclusion the Eight Parties argue that prospective application only of the West Coast High Sulfur VGO weekly price is the appropriate course of action. *Id.*

2763. Exxon points out that the VGO cut is being valued on both the West Coast and the Gulf Coast at the OPIS Gulf Coast price for high sulfur VGO because of Commission decisions issued in 1994.[827] Exxon Initial Brief at p. 340. It claims that all parties to the proceeding agree that the current method of valuing the West Coast VGO cut on the basis of the OPIS Gulf Coast price for high sulfur VGO does not produce a just and reasonable result and should be changed. *Id.* Further, Exxon asserts, all parties agree that the West Coast VGO cut should be valued based on West Coast market prices, rather than on the basis of a Gulf Coast proxy price.[828] *Id.* at pp. 340-41. This is especially true, according to Exxon, in view of the undisputed facts that none of the ANS streams are currently delivered to the Gulf Coast, and that deliveries to the Gulf Coast have been less than three percent since 1998. *Id.* at p. 341. Further, Exxon argues, the evidence demonstrates that, historically, the value of VGO on the West Coast has been

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[827] Exxon notes that on February 11, 1994, the Commission ordered that the VGO cut should be valued on the Gulf Coast at the OPIS Gulf Coast price for high sulfur VGO and on the West Coast at the OPIS West Coast price for high sulfur VGO. Exxon Initial Brief at p. 340. Three months later, however, on May 12, 1994, Exxon notes, the Commission concluded that the OPIS Gulf Coast price for high sulfur VGO should be used as the proxy price for the VGO cut on *both* the Gulf Coast and the West Coast. *Id.*

[828] Exxon points out that it has agreed that West Coast, rather than Gulf Coast, market prices should be used to value VGO on the West Coast, even though such a change is contrary to Exxon's economic interest. Exxon Initial Brief at p. 341, n.120.

significantly different from its value on the Gulf Coast, thereby requiring that an appropriate West Coast proxy price be used to value the West Coast VGO cut. *Id.* According to Exxon, all parties have also stipulated that the VGO cut should be valued on the West Coast on the basis of the OPIS West Coast High Sulfur VGO weekly price. *Id.* at pp. 341-42.

2764. The evidence strongly confirms, in Exxon's view, that the OPIS West Coast High Sulfur VGO price is a reliable and appropriate indicator of the value of the VGO cut on the West Coast. *Id.* at p. 342. Further, Exxon states, the parties agree that there is no longer any reason to be concerned that the OPIS West Coast High Sulfur VGO price might be somehow subject to manipulation. *Id.* According to Exxon, the following is true: (1) Sulfur VGO price has always been a valid indicator of the value of VGO during the entire 1994-2002 period; (2) VGO has never been manipulated; and (3) no party has ever even had any incentive to engage in manipulation of the price of VGO. *Id.* Under these circumstances, then, Exxon argues that the Commission should find that the OPIS West Coast High Sulfur VGO weekly price is the appropriate reference price to be used by the Quality Bank to value the VGO cut on the West Coast. *Id.*

2765. Exxon agrees that the only dispute between the parties concerns the effective date for this change in the valuation of the West Coast VGO cut. *Id.* at pp. 342-43. Its position is that the effective date for the new West Coast VGO valuation should be March 1, 2003,[829] whereas, Exxon notes, it is the position of the Eight Parties that the change to the OPIS West Coast VGO price should be implemented only prospectively. *Id.* at p. 343. Exxon suggests, however, that in individual briefs addressing the Naphtha valuation issue, certain of the Eight Parties appear to agree with the use of March 1, 2003, as the effective date for valuing both the West Coast VGO and Naphtha cuts. Exxon Reply Brief at p. 390 (citing Phillips Initial Brief at pp. 170-75; Unocal/OXY Initial Brief at p. 48; Petro Star Initial Brief at p. 28). However, Exxon notes, the parties have agreed that, if a different West Coast Naphtha valuation methodology is adopted in this proceeding, it and the new West Coast VGO value should have the same effective date. Exxon Initial Brief at p. 343.

2766. The TAPS Carriers point out that all parties support use of the OPIS West Coast High Sulfur VGO weekly assessment as the value for the gas oil component on the West Coast. TAPS Carriers Initial Brief at p. 17. The only dispute, according to the TAPS

[829] Exxon believes refunds should be awarded for the period between March 1, 2003, and the date of the Commission's decisions in these proceedings. Exxon Initial Brief at p. 343, n.121. It also believes that reparations equal to the difference between the valuations that have previously been in effect for the VGO cut and the new, revised, valuation for West Coast VGO should be ordered for the period June 19, 1994, to March 1, 2003. *Id.*

Carriers, is with regard to the effective date of the implementation of the revised gas oil valuation. *Id.* at pp. 17-18. They note that the Quality Bank Administrator has testified that either prospective implementation of this proposal, as the Eight Parties propose, or a June 19, 1994, effective date, as Exxon proposes, would be administratively feasible. *Id.*

ISSUE 4 - DISCUSSION AND RULING

2767. The parties have stipulated that West Coast VGO ought to be valued on the basis of the OPIS West Coast High Sulfur VGO weekly price. They disagree as to the effective date. The Eight Parties argue that the new price should be put into effect on a prospective basis. Eight Parties Initial Brief at p. 165; Eight Parties Reply Brief at p. 130. Exxon, on the other hand, suggests that the effective date for the new price should be March 1, 2003. Exxon Initial Brief at p. 408; Exxon Reply Brief at p. 389.

2768. In support of its position, Exxon points out that the parties have stipulated that the effective dates for any new Naphtha value and the agreed upon VGO value should be the same. *See* "Joint Stipulation of the Parties," filed October 3, 2002, at p. 4. Further, it refers to the Commission's March 28, 2003, "Order Accepting and Suspending Tariffs, Subject to Refund and Conditions, and Consolidating Proceeding for Hearing." *BP Pipelines (Alaska), Inc.*, 102 FERC ¶ 61,345 (2003). In that Order, the Commission addressed the TAPS Carriers request for permission to change their Tariffs to "change the TAPS Quality Bank pricing basis used to value the Quality Bank Naphtha cut from Platts Oilgram Price Reports (Platts) reported Gulf Coast Naphtha price assessment to Platts newly reported Gulf Coast Heavy Naphtha price assessment." *Id.* at P 2. The Commission "accept[ed] the filings to be effective March 1, 2003." *Id.* at P 3.

2769. Unless Exxon was conceding that the Naphtha issue should be resolved in favor of the continued use of the Gulf Coast Heavy Naphtha price assessment to value West Coast Naphtha, I cannot fathom how it can suggest that the Commission's March 28, 2003, Order supports its suggestion that the stipulated VGO price be effective on March 1, 2003. But, Exxon was not doing so![830]

2770. I cannot find any evidence in the record which supports making the agreed upon West Coast VGO price effective retroactively, and Exxon cites none in its brief. Therefore, I hold that West Coast VGO ought to be valued on the basis of the OPIS West Coast High Sulfur VGO weekly price only on a prospective basis. As I have determined that the new West Coast Naphtha value also should be made effective on a prospective basis, my ruling coincides with the parties's October 3, 2002, Stipulation.

[830] *See* Exxon Initial Brief at p. 253.

ISSUE NO. 5: SHOULD THE REVISED VALUES FOR THE CUTS SUBJECT TO THE D.C. CIRCUIT REMAND IN *OXY USA, INC. v. F.E.R.C.*, 64 F.3d 679 (D.C. CIR. 1995) (RESID, FUEL OIL, HEAVY DISTILLATE AND LIGHT DISTILLATE) BE MADE RETROACTIVE TO DECEMBER 1, 1993?

A. LEGAL AND EQUITABLE STANDARDS

2771. The Eight Parties, citing *Exxon*, 182 F.3d at pp. 49-50, argue that the Commission has the discretion to determine whether and when a new rate should be applied retroactively. Eight Parties Initial Brief at pp. 166-67. Further, the Eight Parties assert, this discretion, which comes from the Interstate Commerce Act, 49 U.S.C. § 101, *et seq.* (2000), as well as analogous requirements of the Federal Power Act, 16 U.S.C. § 791a, *et seq*. (2000), and the Natural Gas Act, 15 U.S.C. § 717, *et seq.* (2000), is rooted in equitable considerations. *Id.* They also note that the Circuit Court stated that there is a "strong equitable presumption in favor of giving" the 1997 TAPS settlement a retroactive effect so as to "make the parties whole," but that the Court nonetheless cautioned that "[t]his is not to say that [the Commission] must [order a retroactive effect] in every case if the other considerations properly within its ambit counsel otherwise." *Id.* (citing *Exxon*, 182 F.3d at p. 49). The Eight Parties urge that the Commission make use of this equitable discretion when determining whether retroactive refunds are appropriate in this proceeding. *Id.*

2772. In exercising its discretion, the Eight Parties state that, according to the Circuit Court, "when the Commission commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made." *Id.* at p. 167 (quoting *Public Utilities Com'n of State of Cal. v. F.E.R.C.*, 988 F.2d 154, 168 (D.C. Cir. 1993)). This discretion, note the Eight Parties, must also be exercised reasonably and in accordance with the doctrine, outlined in *Towns of Concord, Norwood, & Wellesley v. FERC*, 955 F.2d 67, 76 (D.C. Cir. 1992), that characterizes customer refunds as a type of restitution to be ordered only when "money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it." Eight Parties Initial Brief at pp. 167-68. Further, continue the Eight Parties, because this aspect of an agency's role is intertwined with its core regulatory function, no presumption of refunds has been imposed by the Circuit Court. *Id.* at p. 168.

2773. Accordingly, the Eight Parties argue, refunds are not automatic, but are discretionary, and should be ordered only when they would advance the core purposes of the regulatory statute. *Id.* Further, in determining the propriety of refunds, the Eight Parties point out, "the agency need only show that it 'considered relevant factors and . . . struck a reasonable accommodation among them,'. . . and that its order granting or denying refunds was 'equitable in the circumstances of this litigation.'" Eight Parties Initial Brief at pp. 168-69 (quoting *Towns of Concord*, 955 F.2d at p. 76).

2774. The Eight Parties argue that case law, including *Exxon*, indicates that the Commission must balance all relevant interests, including the public interest, when it determines whether to grant or deny equitable restitution. *Id.* at p. 169. This is particularly true in proceedings such as this one, state the Eight Parties, which is not a rate case within the meaning of the Interstate Commerce Act, where the core purpose is to ensure just and reasonable rates charged by a carrier to its shipper customers. *Id.* Instead, the Eight Parties note, this is a proceeding to adjust the valuation of oil streams in the Quality Bank to balance rights among TAPS shippers and not to determine the rate charged the shippers by the TAPS Carriers. *Id.* Further, the Eight Parties point out, the Commission has characterized this proceeding as the settlement of a private conflict among Quality Bank participants which will not impact consumers. *Id.* Therefore, the Eight Parties argue, the Commission must recognize that the Quality Bank proceeding is different from the rate provision portion of the TAPS tariff. *Id.*

2775. According to the Eight Parties, if the 1993 values for the Resid and Distillate cuts are not changed, this will not result in the TAPS Carriers being unable to recover transportation costs incurred in moving shippers's barrels. *Id.* at p. 170. In addition, the Eight Parties argue, because the transportation rates on TAPS that are the primary focus of the Interstate Commerce Act are unrelated to the Quality Bank assessments, declining to give retroactive effect to the new cut values will not be contrary to statutory design. *Id.*

2776. A similar analysis guided the United States Court of Appeals for the First Circuit, in *Sithe New England Holdings, LLC v. F.E.R.C.*, 308 F.3d 71 at p. 76 (1st Cir. 2002), according to the Eight Parties, when it affirmed the Commission's decision not to impose higher charges retroactively for certain capacity requirements in a power pool governed by the rate provisions of the Federal Power Act. *Id.* In *Sithe*, explain the Eight Parties, the Circuit Court based its holding, in part, on the fact that the issues in dispute did not involve core ratemaking principles under the Federal Power Act. *Id.* Because the court in *Sithe* was concerned with transactions between utilities, the Eight Parties argue, the filed rate doctrine's corollary prohibition against retroactive ratemaking would not necessarily apply to transactions between utilities. *Id.* at pp. 170-71.

2777. The primary purpose of the corollary, according to the Eight Parties, is to assure that buyers who paid the tariff rate for a service are not surprised by subsequent regulatory decisions requiring them to pay more for past services. *Id.* at p. 171. Therefore, the Eight Parties explain, claims for retroactive restitution as a result of agency error are typically granted when that error has imposed losses on customers served by the regulated entity, and that entity was on clear notice that the precise rates being charged were under challenge before the agency. *Id.*

2778. Because the issue before the Commission in this proceeding is equity among shippers, not relationships between shippers and the carrier, the Eight Parties advocate for the Commission to exercise its equitable discretion by considerations of equity using Justice Cardozo's guidance found in *Atlantic Coast Line Railroad v. Florida*, 295 U.S. 301 (1935). Eight Parties Initial Brief at p. 171. Specifically, the Eight Parties argue, retroactive payments should only be ordered if equity and the conscience would be offended by a failure to order retroactive payments. *Id.* at p. 172. Here, equity and good conscience, in the opinion of the Eight Parties, call for examination of the entire history of the effort to achieve a just and reasonable adjustment of Quality Bank payments among TAPS shippers. *Id.*

2779. Arguing that the issue of distinguishing the value of one shipper's oil from another shipper's oil is difficult and complicated, the Eight Parties note that both the Commission and the courts have recognized that there is no one right way to draw that distinction. *Id.* Not surprisingly, explain the Eight Parties, the determination of the relative values of crude streams among TAPS shippers has been contentious since the inception of the Quality Bank. *Id.* Each time this issue has been before the Commission, the Eight Parties point out, the Commission has applied a change in valuation prospectively unless the parties agreed otherwise. *Id.* at pp. 172-73.

2780. The Eight Parties explain that the current dispute began in 1989, when OXY and Philips challenged the gravity valuation methodology of determining the relative values of each shipper's oil in the stream.[831] *Id.* at p. 173. In 1993, the Commission determined that the gravity methodology was no longer just and reasonable, state the Eight Parties, and required the adoption of the distillation methodology, to be effective on a prospective basis only. *Id.* Following that order, the Eight Parties note, the Circuit Court twice reversed and remanded the Commission's valuation of the Resid cut, while affirming other aspects of the Commission's rulings. *Id.*

2781. Under the applicable legal and equitable standards discussed above, the Eight Parties argue, heavy oil producers and refiners should not be required to make refunds resulting from the retroactive adjustment of the remanded cuts. *Id.* Refunds that would result from a retroactive application of the Resid revaluation and Fuel Oil, Light Distillate, and Heavy Distillate 1998 valuations would not, in the Eight Parties's opinion, serve the purposes of the Interstate Commerce Act, would inequitably impact the parties that would be required to pay the retroactive Quality Bank adjustments, and would not "make the parties whole." *Id.* In other words, a determination that the Resid revaluation and Fuel Oil, Light Distillate, and Heavy Distillate 1998 valuations should be applied prospectively would, the Eight Parties advocate, strike a reasonable accommodation among the relevant factors and would be equitable in the circumstances of this litigation.

[831] *OXY*, 64 F.3d. at p. 679.

Id.

2782. The Eight Parties argue, however, that Exxon's contention that the Commission must order refunds is not supported by law or the circumstances of this case. Eight Parties Reply Brief at p. 132. They point out that both the courts and the Commission have refused to order retroactive remedies when it was impossible or difficult to return the parties to the positions in which they would have been absent agency error. *Id.* at pp. 132-33. The Eight Parties assert that that is the case here. *Id.* at p. 133. They maintain that the retroactive application of the new valuations of the remanded cuts to December 1, 1993, would not put the parties in the positions in which they would have been had error not been made. *Id.*

2783. Moreover, note the Eight Parties, as the Circuit Court recognized in *Exxon*, the Commission is not required to attempt to put the parties in the position in which they would have been absent Commission error, "if the other considerations properly within the ambit counsel otherwise." *Id.* (quoting *Exxon*, 182 F.3d at p. 49). Thus, continue the Eight Parties, the Circuit Court firmly rejected a claim that, after Commission error, refunds equal to the difference between the newly-established lawful rate and the last lawfully established rate must be automatically ordered. *Id.* In this case, explain the Eight Parties, no party obtained money in such circumstances that the possessor will "give offense to equity and good conscience" if permitted to retain it. *Id.* Therefore, the Eight Parties's position is that a proper weighing of the equities in this case precludes the retroactive application of the new valuations of the remanded cuts and the ordering of refunds. *Id.*

2784. Exxon argues that the Resid and Distillate cut valuations that were remanded in *OXY*, and the Resid valuation that was remanded in *Exxon*,[832] constituted legal error. Exxon Initial Brief at p. 344. According to Exxon, the proper remedy for legal error is one that places parties where they would have been if the error had not been committed. *Id.* Exxon asserts that the Circuit Court has explicitly stated that there is a presumption in favor of retroactive application of refunds to make the parties whole as an equitable principle. *Id.*

2785. The *Exxon* court, Exxon relates, did not identify any factors – equitable or other – that might overcome this presumption in favor of retroactivity. *Id.* at p. 345. However, it explains, the court did address the list of equitable factors on which the Commission had

[832] Exxon claims that, although not mentioned in Issue 5, the "Fuel Oil" (or "Light Resid") cut – i.e., the material that boils between 1000° and 1050°F – was also remanded in *OXY*, 64 F.3d at p. 696, and is thus covered by Issue 5. Exxon Initial Brief at p. 344, n.122. It also points out that, in addition to being remanded in *OXY*, the valuation of the Resid cut was remanded a second time in *Exxon*. *Id.* at p. 344, n.123.

relied in its decision to apply prospectively the revised valuations the Commission had ordered on remand from *OXY*. *Id*. Those factors included: (1) that parties supported the Nine Party Settlement only if it were implemented prospectively, (2) that all prior TAPS cases resolved by settlements have been on a prospective basis, (3) that the changes adopted by the Settlement Order only modify limited aspects of the distillation methodology put in place in 1993, and (4) that the TAPS Quality Bank is *sui generis*. *Id.* Exxon notes, however, that the court found that these factors have no bearing on the decision and do not explain the Commission's decision not to make parties whole who are clearly injured by undervaluation. *Id.* Thus, if there are any equitable factors in this case that could outweigh the presumption in favor of retroactivity, Exxon asserts that none has been identified to date by either the Commission or the Circuit Court. *Id.* at pp. 345-46.

B. STIPULATED MATTERS

2786. The Eight Parties assert that the parties stipulated as follows: "The Parties agree that the effective date for the new West Coast Heavy Distillate price will be February 1, 2000." Eight Parties Initial Brief at p. 174. Hence, the Eight Parties argue that with respect to the resolution of Issue No. 2, the parties agree that the new Heavy Distillate value established thereby will be retroactive to February 1, 2000. *Id.*

2787. With respect to the Light Distillate, Heavy Distillate, and Light Resid (Fuel Oil) cut values approved by the Commission in 1998 and affirmed by the *Exxon* court, the area of dispute, according to the Eight Parties, is whether retroactive effect should be given to these previously approved values for the period December 1, 1993, to February 1, 1998. *Id.* The Eight Parties contend that there should be no retroactive adjustments for these three cuts, while noting that Exxon proposes to give them retroactive effect. *Id.* With respect to the Resid cut, the area of dispute, according to the Eight Parties, is whether the Resid value to be determined here should be given retroactive effect from the date of a final decision to December 1, 1993. *Id.* They assert that the revised value for the Resid cut should be implemented prospectively only from the date that it is adopted by the Commission. *Id.* Exxon takes the position, according to the Eight Parties, that the revised Resid value should be made retroactive to December 1, 1993. *Id.* They add that neither the TAPS Carriers nor the Commission Trial Staff takes a position on Issue No. 5. *Id.*

2788. According to Exxon, the parties have not stipulated as to any matters concerning Issue No. 5. Exxon Initial Brief at p. 348. It points out that errors in Quality Bank invoices, whether arising from errors in valuation methodology or in the implementation of the methodology, are routinely corrected and the Quality Bank accounts of shippers are credited or debited on a retroactive basis to reflect those corrections. *Id.* For example, notes Exxon, all parties to this case have agreed that, when the valuation of the Heavy Distillate cut in Issue No. 2 is finally resolved, that valuation should be made effective retroactive to February 1, 2000 (when the proxy product changed), and that refunds should be awarded for the period February 1, 2000, to the effective date of a decision in this case. *Id.* Exxon asserts that this correction alone will result in refunds, with interest, totaling about $70 million through December 2002. *Id.*

2789. Exxon notes that the retroactive application of the new Heavy Distillate reference price is consistent with past and current Quality Bank practice. Exxon Reply Brief at p. 402. For example, Exxon explains that, in 1984, the Commission awarded substantial refunds to compensate certain shippers for differences between the newly-approved methodology and the methodology that had been in place since the Quality Bank was first implemented in 1979.[833] *Id.* Similarly, continues Exxon, in orders implementing the distillation methodology in 1994, the Commission held that changes in the valuation bases for the Resid and VGO cuts should be applied retroactively to December 1, 1993, when the distillation methodology was first implemented.[834] *Id.* Thus, Exxon maintains that there is no basis for the Eight Parties's claim that the Commission has "consistently required" that methodological changes be applied only on a prospective basis. *Id.* at pp. 402-03.

2790. The parties's dispute with respect to Issue No. 5, Exxon explains, focuses on the effective date to be assigned the corrected values for the cuts remanded in *OXY*. Exxon Initial Brief at p. 349. Exxon takes the position that the corrected values for such cuts should be made retroactive to December 1, 1993, while the Eight Parties propose a prospective only implementation based on the effective date of a decision in this case. *Id.* If the Commission concludes that the revised values for the cuts remanded in *OXY* should be made retroactive to December 1, 1993, Exxon contends, then refunds, with interest, should be ordered for the periods during which the remanded cut values were in effect.[835]

[833] Exxon cites *Trans Alaska Pipeline System*, 29 FERC ¶ 61,123 at pp. 61,238-40 (1984). Exxon Reply Brief at p. 402, n.266.

[834] Exxon cites *Trans Alaska Pipeline System*, 66 FERC ¶ 61,188 at pp. 61,419-20, 61,423 (1994) and *Trans Alaska Pipeline System*, 67 FERC ¶ 61,175 at pp. 61,531-33 (1994). *Id.* at n.267.

[835] Exxon notes that the refund periods for each of the remanded cuts are as follows: For the Light Distillate and Heavy Distillate cuts, the refund period runs from December 1, 1993, to February 1, 1998, when revised valuations for those cuts were put into effect pursuant to a 1997 settlement and not later challenged; for the Fuel Oil or Light Resid cut, the refund period also runs from December 1, 1993, to February 1, 1998; as of the latter date, the Light Resid cut was folded into the VGO cut (as part of the 1997 settlement), and that action was later upheld on appeal. Exxon Initial Brief at p. 349, n.127. Exxon states the refund period applicable to the Resid cut begins on December 1, 1993, and is currently open-ended; that is, because a lawful valuation for the Resid cut

Id.

C. SHOULD REFUNDS BE AWARDED?

2791. The Eight Parties argue that the revised values for the remanded Resid, Fuel Oil, Heavy Distillate and Light Distillate cuts should not be made retroactive to December 1, 1993, and that, therefore, refunds should not be awarded. Eight Parties Initial Brief at p. 175. They note that all of the parties who would receive refunds, except Exxon, agree that it would be inequitable to heavy oil producers and refiners to award them. *Id.* According to the Eight Parties, Exxon claims refunds from retroactive application which would total about $141 million, including interest, through 2002. *Id.* Combined with its reparations claim, the Eight Parties claim, the amount of retroactive payments that Exxon claims totals $176 million, including interest, through 2002. *Id.*

2792. According to the Eight Parties, the retroactive adjustment is unlike a claim for refunds in a typical rate case. *Id.* They point out that the TAPS Carriers have not collected excessive charges for a regulated service that, after the passage of time, have been found to be unjust and unreasonable. *Id.* Were that the case, the Eight Parties explain, the regulated carriers could be required to refund the portion of their rates deemed to be excessive. *Id.* Instead, the refunds claimed here would be paid through retroactive assessments against the in-State refiners connected to the Pipeline – Williams and Petro Star – and certain heavy oil producers, including Unocal and OXY. *Id.* The actual mechanism for making the retroactive adjustments involves a complex recalculation of Quality Bank assessments and payments which is described, according to the Eight Parties, in Exhibit No. PAI-230. Eight Parties Initial Brief at pp. 175-76.

2793. The Eight Parties explain that the retroactive adjustment issue is further complicated by the different cuts and different time periods impacted. *Id.* at p. 176. They state that the 1997 Settlement achieved a final resolution respecting the values of three cuts that had been remanded in the *OXY* decision: Light Distillate, Heavy Distillate, and Fuel Oil. *Id.* With respect to these three cuts, the Eight Parties note, the retroactive issue only affects the time period from December 1, 1993, to February 1, 1998, the date that the 1997 Settlement was approved, and involves adjusting for only one value for each cut. *Id.* The question, according to the Eight Parties, is whether the final resolution of cut values as of February 1, 1998, should be made retroactive to December 1, 1993, a period of a little over four years.[836] *Id.*

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has never been established, the refund period for that cut will run until a just and reasonable valuation is established. *Id.* Exxon cites Joint Exhibit No. 11 at p. 2 for a graphic illustration of the Issue 5 refund periods. *Id.*

[836] The Eight Parties explain that there is an additional retroactive adjustment affecting the Heavy Distillate cut that is not a disputed issue. Eight Parties Initial Brief at

2794. The Resid cut, as the Eight Parties explain, is different. *Id.* No final valuation was achieved in 1998, because the Commission's approval of the 1997 Settlement value for Resid was reversed and remanded. *Id.* For Resid, according to the Eight Parties, the question is whether to make the valuation that is determined in this proceeding retroactive to December 1, 1993. *Id.* Furthermore, the Eight Parties note, Resid is valued as a coker feedstock based on prices used for nine different products produced by coking, three of which are being litigated in this case—Naphtha, Heavy Distillate and VGO. *Id.* Additionally, the Eight Parties point out, the issues in dispute with respect to calculating Resid value include valuation issues affecting the coker model product outputs and the costs of the coking process. *Id.* at pp. 176-77. Depending on how these issues are resolved, they explain, impacts on different parties affected by retroactive adjustments will vary widely. *Id.* at p. 177.

2795. The Eight Parties state that the *Exxon* court remanded the Commission's decision to apply the valuations of the remanded cuts prospectively because, in the Circuit Court's view, the Commission had not adequately justified its decision. *Id.* They note that the Commission unquestionably has the discretion to decide, on equitable grounds, that revaluations of the cuts not be given retroactive effect. *Id.* The Eight Parties strongly believe that the equities weigh in favor of the prospective only application of the new valuations for the following four reasons: (1) the heavy oil producers would be unfairly disadvantaged by the retroactive application of the revaluations, (2) the refiners would be unfairly disadvantaged, and retroactive adjustments would not make the parties whole, (3) retroactive adjustments would be contrary to the public interest, and (4) there is no evidence in the record that the imposition of the new Resid valuations is just and reasonable as applied during the period December 1, 1993, through 2004. *Id.*

2796. According to them, the record in this case demonstrates that the gravity methodology remained in place during the four years of litigation that led to its replacement in 1993. *Id.* at p. 178. During that period, according to them, heavy oil producers paid excessive Quality Bank assessments, ultimately determined to be unjust and unreasonable, due to natural gas liquids blending. *Id.* Having paid more prior to 1993 because refunds were not available, the Eight Parties contend they would again pay more if refunds are ordered for the period after 1993. *Id.* By contrast, the Eight Parties point out, light oil producers, particularly Exxon, enjoyed a windfall from their Quality Bank receipts due to the natural gas liquid effect prior to 1993. *Id.* Because of the

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p. 176, n.99. According to them, the Heavy Distillate price approved in 1998 was discontinued in 2000, and the Quality Bank Administrator was forced to select a replacement. *Id.* They add that the parties have agreed as to a replacement price, but not how to adjust that price. *Id.* As a result, the Eight Parties note, the price adjustment issue will be determined in this case, and the parties have stipulated that the revised valuation will apply retroactively to February 1, 2000. *Id.*

windfall benefits that Exxon realized prior to 1993 while challenges to the gravity methodology were pending, the Eight Parties argue, refunds are not now necessary to make Exxon whole. *Id.* Instead, the Eight Parties maintain, refunds, if imposed in this proceeding, would only aggravate an existing inequity. *Id.*

2797. The Eight Parties take exception to Exxon's argument that, even if it did not have to pay refunds for the period up to December 1, 1993, it should nevertheless be entitled to refunds for the portion after December 1, 1993. *Id.* at pp. 178-79. They maintain that this would not be fair. *Id.* at p. 179. Light oil producers retained tremendous benefits, in the Eight Parties's view, because the gravity methodology continued in place during the litigation that led to the 1993 settlement, and heavy oil producers absorbed corresponding detriments. *Id.* The Eight Parties explain that these impacts stemmed from the practice of natural gas liquid blending that began in 1986 at Prudhoe Bay. *Id.* According to them, the Commission did not find any changed circumstance or practice that made December 1, 1993, the line of demarcation. *Id.* Rather, the Commission determined, properly in the Eight Parties's view, that it lacked the authority to order refunds prior to that date. *Id.* Consequently, the Eight Parties note, those who benefited from the natural gas liquid blending were permitted to keep this financial gain from a valuation method that was subsequently determined to be unjust and unreasonable. *Id.*

2798. Dayton, according to the Eight Parties, analyzed the impact of possible refund scenarios by dividing the litigation period into a First Period, from January 1990 through November 1993, when the gravity methodology remained in place, and a Second Period, from December 1993 onward, after gravity had been replaced by the distillation methodology.[837] *Id.* at p. 180. They note that Dayton compared the impacts that refund orders would have had in the First Period (when refunds were not available) to the impacts that refund orders would have in this proceeding (i.e., the Second Period) under both the Eight Parties's and Exxon's methodologies. *Id.* According to the Eight Parties, Dayton's calculations are straightforward. *Id.* They note that Dayton compared the results that would have been obtained in both periods with retroactive application of the proposals to the actual results under whatever Quality Bank methodology was in place both by field and producer for Pump Station 1, the Golden Valley Electrical Association connection, and the Petro Star Valdez Refinery connection. *Id.*

2799. According to the Eight parties, Dayton's analysis shows that light oil producers benefited, because refunds were not available in 1993, in the following ways: (1) under the Eight Parties's Resid proposal, producers from the light oil fields – Prudhoe Bay and Lisburne – would have owed $381.9 million without interest during the First Period, while Exxon, which produces light oil predominantly, would have owed over $88

[837] Dayton testified on behalf of Phillips, but her testimony is supported by the remainder of the Eight Parties. Exhibit No. PAI-22 at p. 2.

million, (2) under Exxon's Resid proposal (which assigns lower values to heavy oil and therefore higher relative values to light oil), the light oil fields would have owed $288.1 million, and Exxon would have owed $68.7 million, (3) Unocal and OXY, which produce heavy oil exclusively, together would have received refunds of $19.3 million under the Eight Parties's proposal and $13.9 million under Exxon's proposal (BP and Phillips, which produce both light and heavy oil, would also have received refunds), and (4) when the refinery connections are taken into account, Exxon would have owed overall refunds of $83.6 and $58.3 million (without interest) under the Eight Parties's and Exxon's proposals, respectively, and Unocal and OXY, together, would have received $19.6 and $14.7 million under the respective proposals.[838] *Id.* at pp. 180-81.

2800. If refunds are granted in this proceeding (i.e., for the Second Period under Dayton's analysis), the Eight Parties argue, they will amplify the impacts of refunds being unavailable in the prior proceeding in the following ways: (1) under the Eight Parties's proposal, Exxon would receive $13.9 million at Pump Station 1 and $18.9 million overall in addition to the windfall associated with not having had to pay refunds during the First Period, (2) Unocal and OXY together would have to pay an additional $3.8 million at Pump Station 1 or $3.4 million overall, and (3) there would be additional payments to Exxon of $62.7 and $92.4 million at Pump Station 1 overall, and additional bills to Unocal and OXY of $13.9 and $12.8 million at Pump Station 1 and overall.[839] *Id.* at pp. 181-82.

2801. The Eight Parties disagree with Pavlovic's and Toof's assertions that there were a number of flaws in Dayton's analysis. *Id.* at p. 182. First and foremost, the Eight Parties insist, Dayton's focus on ownership rather than shipped barrels is a major strength of her analysis, not a weakness. *Id.* Producer data, in their opinion, are necessary to show equitable relationships, and shipper data can obscure these relationships. *Id.* The Eight

[838] The Eight Parties note that refiners would owe refunds for both the First Period and the Second Period under either the Eight Parties's or Exxon's methodology. Eight Parties Initial Brief at p. 181, n.102. Consequently, the position of each of the producers becomes more favorable when the refinery connections are considered. *Id.*

[839] The Eight Parties also note that producers such as BP and Phillips whose production is more balanced between light and heavy oil would experience impacts according to their precise interests. Eight Parties Initial Brief at p. 182, n.103. Under either the Eight Parties's or Exxon's proposal, the Eight Parties argue, both would have been owed significant refunds at Pump Station 1 during Period 1 and would pay smaller, but significant amounts, during Period 2. *Id.* Receipts at the refinery connections would make them overall refund payees under either proposal in Period 2, although the effects of interest would cause Phillips to owe a small amount under the Eight Parties's proposal. *Id.*

Parties note that shippers may or may not ultimately bear or enjoy the Quality Bank adjustments on the barrels they ship. *Id.* at pp. 182-83. They cite two examples: Quality Bank adjustments affect Alaska through its royalty provisions, although the State is never a shipper and Petro Star is heavily impacted by the Quality Bank, but reimburses assessments made against return oil shipped by its crude supplier. *Id.* at p. 183.

2802. Second, contrary to Pavlovic's assertion, the Eight Parties assert that Dayton had ample data to do the First Period calculations which were necessary to her analysis. *Id.* The Eight Parties concede that systematic data comparable to those obtained by the Quality Bank Administrator for Period 2 were not available, but they assert that sufficient production data were available to enable Dayton to extrapolate back in time from the May 1, 1994, through April 30, 1995, period and achieve the accuracy necessary to demonstrate her basic point that it would be unfair to award refunds to Exxon for the Second Period. *Id.*

2803. Third, the Eight Parties argue, Pavlovic's and Toof's waiver arguments have no merit. *Id.* They disagree with Pavlovic's assertions that ANS heavy oil producers's active participation in natural gas liquid blending meant they were not its "unwitting victims." *Id.* In fact, although they concede that Exxon's experts are correct that heavy oil producers were aware of natural gas liquid blending (the Eight Parties state that Dayton never contended they were not), the Eight Parties assert that Pavlovic was wrong in his conclusion that heavy oil producers acquiesced in the gravity methodology's treatment of natural gas liquid blended streams. *Id.* According to the Eight Parties, Phillips and OXY were not able to anticipate how natural gas liquid blending would distort their Quality Bank assessments. *Id.* Other producers, the Eight Parties explain, expressed concern and Phillips and OXY filed protests in 1989. *Id.* at pp. 183-84. Moreover, according to the Eight Parties, Quality Bank issues and impacts were not considerations in the ultimate decision whether or not to proceed with the natural gas liquid blending project at Prudhoe Bay. *Id.* at p. 184. Once the producers determined that the project would enhance economic recovery from the field, the Eight Parties assert, they were obligated to Alaska to undertake it. *Id.* at p. 184.

2804. Toof's arguments are no more persuasive, in the view of the Eight Parties. *Id.* In his direct testimony, he pointed out that some producers owed First Period refunds would also be owed Second Period refunds. *Id.* Moreover, although many producers were aware of the impacts of natural gas liquid blending, the Eight Parties point out, only two sought First Period refunds, and they used a "bendover" methodology to calculate them, rather than a distillation methodology. *Id.* Furthermore, the Eight Parties assert, nothing in the Interstate Commerce Act required any party to seek refunds either now or during the First Period. *Id.* Moreover, after Phillips's and OXY's unsuccessful attempt to get First Period refunds, the Eight Parties state, they have consistently advocated the position that Quality Bank methodology changes should be prospective except in very unusual circumstances.[840] *Id.*

2805. The Eight Parties note, Pavlovic argued that, under Exxon's Resid valuation methodology, refunds owed to Exxon for the Second Period would be greater than its excess receipts for the First Period. *Id.* They suggest that, for at least two reasons, substitution of Exxon's Resid valuation proposal for that of the Eight Parties does not undermine Dayton's conclusion that having been overpaid during the First Period, Exxon should not be awarded refunds for the Second Period. *Id.* First, the Eight Parties note, Dayton's calculations start in January 1990. *Id.* at p. 185. However, the Eight Parties assert that Exxon began to benefit from the impact of natural gas liquid blending on Quality Bank gravity calculations in 1986, when natural gas liquid blending began. *Id.* Therefore, according to them, Dayton's calculations understate the excess payments that Exxon received because of natural gas liquid blending during the First Period. *Id.* Second, the Eight Parties acknowledge that Toof is correct that, under every Second Period scenario, the bulk of the money that Exxon would be paid in refunds would come from refiners. *Id.* They explain that the refiners are likely to have refund obligations under any retroactive scenario, because they will not have had a chance to optimize[841] against Exxon's methodology in either the First or the Second Period. *Id.* According to the Eight Parties, because more money from the refiners always helps Exxon, using the Exxon methodology in Dayton's calculations increases the refunds that Exxon would receive in the Second Period and decreases the refunds Exxon would owe in the First.[842] *Id.*

2806. According to Exxon, the Eight Parties state, Dayton's analysis is little more that a repetition of an argument already made and rejected by the Circuit Court, and that the *Exxon* decision therefore eliminates any argument that the Eight Parties might make based on that analysis. Eight Parties Reply Brief at p. 152. They note that the *Exxon*

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[840] The Eight Parties note that the frozen reference price for Heavy Distillate presented one such unusual circumstance. *Id.* at p. 184, n.104.

[841] The Eight Parties explain that refiners optimize their operations by running their facilities efficiently and making those fuels that they can place in the market at profitable prices. Eight Parties Initial Brief at p. 186. According to the Eight Parties, refiners consider Quality Bank impacts when they determine what products to make as well as when they decide how much product they can sell at a profit. *Id.*

[842] The Eight Parties note that Toof criticizes Dayton's conclusions because the refiners would owe refunds for both the First and Second Periods. Eight Parties Initial Brief at p. 185, n.105. But, according to the Eight Parties, this result is not surprising because refiners normally optimize to current conditions. *Id.* Thus, they always will lose if the rules are changed after the game is played. *Id.*

court found that the four reasons enunciated by the Commission in support of prospective application of the settlement were insufficient to explain its action.[843] *Id.* In the Eight Parties view, however, nothing in *Exxon* precludes the Commission from considering all of the evidence adduced on remand, hearing any arguments based upon it, or deciding in its discretion that the evidence supports prospective only application of the new methodology. *Id.* Further, the Eight Parties assert, Dayton's analysis has not yet been before either the Commission or the Circuit Court. *Id.* Moreover, continue the Eight Parties, there is no reference to similar testimony in the *Certification of Contested Settlement and Ruling on Motion to Omit the Initial Decision*, 80 FERC ¶ 63,015 (1997), the *Order Approving Contested Settlement*, 81 FERC ¶ 61,319 (1997), or *Exxon* itself. *Id.* Therefore, they assert that Dayton's analysis can be considered in this proceeding. *Id.*

2807. According to the Eight Parties, none of Exxon's arguments designed to undercut Dayton's analysis are persuasive, and none detract from the conclusion that, in light of the history of the litigation, refunds are not necessary to make Exxon whole. *Id.* at p. 156. First, the Eight Parties claim, even if Exxon's argument that the refiners would owe refunds in both the First and Second Period under Dayton's analysis were true, absent extraordinary circumstances, the refiners optimize their operations to whatever Quality Bank methodology is in effect. *Id.* Therefore, according to them, if a different methodology had been in effect during the First Period, the refiners would have optimized differently. *Id.* Consequently, explain the Eight Parties, the "glaring inequity" that Exxon describes is nothing more than a demonstration of the fact that, if a distillation methodology is applied to the refiners while they are optimizing to a gravity methodology, their Quality Bank payments will go up. *Id.*

2808. Second, the Eight Parties maintain, the fact that certain producers who might receive refunds nevertheless acknowledge that refunds would be inequitable underscores, not undermines, the inequity of awarding refunds. *Id.* at p. 157.

2809. Third, continue the Eight Parties, the fact that producers other than OXY and Phillips did not seek refunds in the past does not detract from their position that refunds should not be awarded now. *Id.* They claim that parties other than Exxon consistently have favored prospective application for Quality Bank methodology changes and argue that Exxon's characterization of these parties as "aggrieved by the Commission['s] past decisions not to award refunds" is misleading. *Id.* (quoting Exxon Initial Brief at p. 369).

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[843] According to the Eight Parties, the four reasons were (1) the Nine Parties supported the settlement only if it were implemented prospectively, (2) prior TAPS settlements had applied prospectively, (3) the settlement only modified limited aspects of the original distillation methodology put in place in 1993, and (4) the TAPS Quality Bank is *sui generis*. Eight Parties Reply Brief at p. 152, n.67 (citing *Exxon*, 182 F.3d at pp. 48-49).

2810. Fourth, explain the Eight Parties, BP and Phillips (or their predecessors) were constrained under their leases with Alaska to approve any project (including the natural gas liquid blending project) that enhanced economic recovery from the field. *Id.*

2811. Fifth, contrary to Exxon's assertions, the Eight Parties declare that Dayton's analysis is accurate and based on ample, reliable data. *Id.* According to the Eight Parties, Exxon misses the point in its attempts to demonstrate that the data available to Dayton were inadequate to allow her to do a rigorous "apples to apples" comparison. *Id.* The Eight Parties claim that she was not attempting to calculate Exxon's receipts during the First Period so that they can be set off against Second Period refunds in a "dollars to dollars" comparison. *Id.* Instead, state the Eight Parties, what Dayton's analysis shows is simply that, because these proceedings began in 1989, it would be inequitable (and would unfairly benefit Exxon) to have the Second Period subject to refund when the First Period could not be. *Id.*

2812. In light of this, the Eight Parties state, Exxon's more detailed attacks are either irrelevant or inaccurate. *Id.* at p. 158. Thus, they note that, although systematic samples like those used by the Quality Bank Administrator are available only from the Second Period, production and other data from the First Period are easily sufficient for Dayton's analysis. *Id.* The Eight Parties explain that Exxon's assertion that use of such data for the First Period is in conflict with her testimony that the Caleb Brett assays were indispensable to determining stream qualities is misleading because those assays were used to determine the inputs to the PIMS Coker Feedstock Model, while the First Period data were used to approximate stream compositions. *Id.* Each, they state, "is reliable for the use to which it was put." *Id.*

2813. Similarly, the Eight Parties argue, Exxon is wrong to accuse Dayton of "simply *assum[ing]* that the yield for the year May 1, 1994, to April 30, 1995, would be the same as the yield for each of the months in the period January 1, 1990 to the end of 1993." *Id.* (quoting Exxon Initial Brief at p. 372, n.147) (emphasis in original). They explain that Dayton was referring solely to the Endicott and Kuparuk streams, and that she immediately explained why her assumption was reasonable and, in the case of Kuparuk, confirmed by assay data and her own experience as a field manager. *Id.*

2814. The Eight Parties, referring to Exxon's claims that they did not account for the fact that Exxon does not sell crude oil to the refiners and that they should have corrected the "misvaluation" of Naphtha and VGO values in the Second Period, state that separating Exxon out from other producers and Alaska in Dayton's analysis would not have made a significant difference. *Id.* at pp. 158-59. While, as they note that Exxon acknowledges, and the Eight Parties explain, data showing the impact of Naphtha and VGO valuations are available, it sheds little light on the question of whether it is equitable to have refunds available for the Second Period when they are not available for the First Period. *Id.* at p. 159.

2815. Resid valuation is a major part of these Quality Bank considerations, according to the Eight Parties. Eight Parties Initial Brief at p. 187. They point out that Dayton testified that changing the Resid valuation has a leveraged impact on the refiners's cost structures because, if a refiner returns all the Resid it receives, its return stream contains a higher percentage of Resid than the common stream. *Id.* Moreover, the Eight Parties note, Resid is both a relatively high volume constituent of ANS crude and a very low priced part of it. *Id.* They assert that lower Resid valuations greatly increase Quality Bank assessments against the refiners. *Id.*

2816. The Eight Parties note that Boltz, a Petro Star executive, explained that, because assessments against refinery return oil must be borne by products made from the much smaller volume of oil that the refinery retains, increased Quality Bank assessments have a great impact on a refinery's business operation. *Id.* at pp. 187-88. According to the Eight Parties, Petro Star retains approximately 25% of the crude it receives, or about one barrel for every three it returns. *Id.* at p. 188. Consequently, explain the Eight Parties, the \$1.00/barrel assessment against return oil illustrated in Exhibit No. PSI-17 translates into a \$3.00/barrel (or approximately 7¢/gallon) cost added to products that Petro Star makes for sale or its own use.[844] *Id.*

2817. Costs of this magnitude directly affect a refiner's ability to make a profit, the Eight Parties suggest. *Id.* They point out that refining "is a business of fractions of a penny per gallon" and that, if costs increase relative to prices, it can become unprofitable for Petro Star to sell to some of its customers. *Id.* As Quality Bank costs are a significant part of Petro Star's overall cost, the Eight Parties explain, it must consider them when it decides whether fuel can be manufactured and sold at a profit. *Id.* In the real world, margins on jet fuel can be very small, and high volume jet fuel customers are likely to be the first ones to become unprofitable. *Id.* When this happens, and it does, the Eight Parties note, Petro Star adjusts by retaining less crude and making less product. *Id.* at pp. 188-89.

2818. The Eight Parties state that ordering refiners to pay refunds would not, as Exxon asserts, put them in the position in which they would have been had the new valuations of the remanded cuts been in effect since 1993. Eight Parties Reply Brief at p. 163. This is so because, state the Eight Parties, there is no mechanism to determine what payments into and out of the Quality Bank would have been if the new valuations had been in effect on December 1, 1993. *Id.* Even if there were, they point out that the refiners could not

[844] The Eight Parties note that the assessment against Petro Star's return oil is calculated from the data presented in Exhibit No. PSI-17 by subtracting the stream value of the Petro Star Valdez Refinery return stream (\$18.22371) from \$19.22516, which is the weighted average of the return stream and the Petro Star Valdez Refinery passing stream value. Eight Parties Initial Brief at p. 188, n.107. They state that \$3.00/barrel is converted to cents/gallon by dividing by 0.42. *Id.*

now seek to recover the cost of the refunds from their current customers under current market conditions. *Id.*

2819. Under the circumstances of this proceeding, the Eight Parties argue, the Commission cannot recreate the optimization opportunities that would have been available to the refiners if the new valuation had been in effect as of December 1, 1993, because no one knows what they would have been. *Id.* at pp. 165-66. Therefore, according to the Eight Parties, the refiners had no choice but to plan and run their operations based on the known Quality Bank valuations in effect at the time. *Id.* at p. 166. Based on this fact and on the Commission and court precedents, they argue that refunds are not appropriate. *Id.*

2820. Refiners cannot, the Eight Parties suggest, optimize to a Quality Bank methodology unless they know in advance what the methodology will be and when it will be effective. Eight Parties Initial Brief at p. 189. Then, the Eight Parties explain, they can decide whether to change product slates or fuel usage, to reduce their production runs because they will no longer make a profit selling to some of their customers, or to increase production to better manage their costs or sell to wider markets. *Id.* Dayton explained how this is a crucial, continuous process with the refiners's goal always to minimize to the maximum extent possible their Quality Bank assessments. *Id.* If a new methodology is imposed retroactively, the Eight Parties point out, the refiners will have no chance to make any of the adjustments that Dayton describes. *Id.*

2821. Further, the Eight Parties point out, refiners do not have the ability to recoup retroactive Quality Bank assessments from their customers except in very unusual circumstances. *Id.* They note that Boltz testified that Petro Star sells most of its fuel to the major airlines, the Armed Forces, and the fishing industry, and its customers would not enter into agreements that provided for future price increases on fuel already delivered and paid for. *Id.* at pp. 189-90. The Eight Parties point out that Boltz also testified that Petro Star only has a single contract with a local public utility which provides for a limited pass-through of retroactive Quality Bank adjustments. *Id.* at p. 190. They further state that Dayton similarly testified that, in her experience, except in the case of public utilities, fuel sales contracts do not typically allow for retroactive adjustments. *Id.* In addition, they note that Toof, Exxon's witness, acknowledged that the likelihood of building such provisions into sales contracts was limited. *Id.*

2822. The Eight Parties argue that the refiners cannot recover the ground they lose if they forego opportunities, because there might be retroactive Quality Bank assessments in the future. *Id.* For example, the Eight Parties reiterate that Petro Star's larger customers tend to have the thinnest margins, and a few pennies difference in cost can be the difference between profit and loss. *Id.* Thus, they conclude, should Petro Star mistakenly predict that a future methodology will significantly increase costs and be imposed retroactively, and on that basis foregoes sales that otherwise would be profitable, those sales — both their profits and their contributions to fixed cost burdens — will be lost for good. *Id.* They cite Dayton's testimony as support for this conclusion. *Id.* at pp. 190-91.

2823. Moreover, the Eight Parties assert, it is disingenuous for Exxon to suggest that any attempt by the refiners to resolve the controversy over the valuation of the remanded cuts through settlement negotiations is relevant to the Commission's weighing of the equities. Eight Parties Reply Brief at p. 161. After the *OXY* remand, explain the Eight Parties, the Commission responded to the request of a number of parties that settlement discussions be held before any further hearings were ordered. *Id.* The 1997 Settlement was, according to the Eight Parties, a direct and good faith result of the Commission's clear preference for settlement in this case. *Id.* at p. 162. However, they argue, the terms of the 1997 Settlement have no substantive relevance to the Commission's determination of the equities of ordering refunds. *Id.*

2824. The Eight Parties state that, contrary to Exxon's assertion, testimony filed by the parties in litigation resulting from the Commission's orders on remand from the *Exxon* court also is irrelevant to a determination of the equities of ordering refunds. *Id.* They explain that the development of litigation strategy, like settlement strategy, requires the balancing of many competing factors. *Id.* Further, note the Eight Parties, the fact that the refiners, like the other parties, including Exxon, have changed positions regarding the appropriate valuation of the remanded cuts reflects their attempt to balance all of the relevant factors to reach a workable resolution. *Id.* at pp. 162-63. It should not, argue the Eight Parties, provide any basis for a determination that, as a matter of equity, the refiners should pay refunds. *Id.* at p. 163.

2825. According to the Eight Parties, none of the events that led up to the current proceeding provided useful foreknowledge of what Resid valuation the Commission ultimately will adopt in this proceeding. Eight Parties Initial Brief at p. 192. They note that the 1993 settlement and associated orders established the distillation methodology, and that the Commission selected FO-380 as the Resid reference price. *Id.* According to the Eight Parties, Exxon, among others, had complained that the Commission's proposed methodology would overvalue Resid, but proposed as alternatives either the unmodified 1993 settlement (i.e., viscosity blending) or a return to the gravity methodology as alternatives. *Id.* They note that the Commission rejected both of these approaches. *Id.* On rehearing, as on appeal in *OXY*, state the Eight Parties, the range of choices consisted of: (1) the FO-380 valuation selected by the Commission, (2) the discarded gravity methodology, or (3) the unmodified 1993 settlement – the latter two already rejected by the Commission. *Id.* at p. 192-93.

2826. In the opinion of the Eight Parties, the 1997 settlement proposals presented a choice between the Nine Party Settlement, ultimately approved by the Commission, and the Exxon position, which continued the Resid blending argument. *Id.* In its own unilateral settlement proposal, according to the Eight Parties, Exxon proposed a modified gravity methodology for Pump Station 1 but a distillation methodology based in part on Resid viscosity for the return streams. *Id.* The Eight Parties point out that, once again, the Exxon alternatives to the Commission-approved methodology did not survive. *Id.*

2827. The Eight Parties explain, the Circuit Court in *Exxon* accepted the coker feedstock value approach but found an insufficient correlation between the Resid proxy price (FO-380, 4.5¢) and calculated coker feedstock values. *Id.* Therefore, the Eight Parties state, it remanded for determination of a valuation method that better tracked Resid's value as a coker feedstock, and the 2000 settlement proposals followed. *Id.* at pp. 193-94.

2828. Contemporaneously with the *Exxon* decision, according to the Eight Parties, Exxon filed its complaint challenging the distillation methodology in its entirety and advocating a return to gravity. *Id.* at p. 194. They state that the Commission dismissed Exxon's complaint; however, its decision was reversed and remanded on appeal. *Id.* This, according to the Eight Parties, left the way clear for Exxon to resuscitate its argument for the gravity methodology. *Id.*

2829. Against this history of the parties's shifting positions and legal uncertainty, the Eight Parties argue, it was reasonable for the refiners to optimize against the methodologies in effect. *Id.* This is so, according to the Eight Parties, because, except for Exxon, no other participant in the Quality Bank was seeking retroactive application of any proposed valuation methodology change and to base operational actions on a mistaken prediction on how a change would be imposed would not have been prudent. *Id.* In the Eight Parties view, it would have led producers to incur needless losses which they would be unable to recover. *Id.* The Eight Parties conclude, therefore, that refiners thus had no reasonable choice other than to optimize based on the valuation methodologies in place. *Id.* at p. 195.

2830. According to the Eight Parties, Exxon witnesses offered up three suggestions as to how the refineries should have operated since 1993. *Id.* First, they suggested that the refiners should have made better contracts with their crude suppliers and thereby reduced the risk of retroactive Quality Bank assessments. *Id.* Second, they asserted the refiners should have reserved against either the worst case or most likely outcome of this proceeding. *Id.* Finally, the Exxon witnesses suggested that the refiners should have optimized their operations to either the worst case or most likely outcome. *Id.* According to the Eight Parties, none of these suggestions is realistic. *Id.*

2831. With respect to the first suggestion, the Eight Parties assert, refiners are in no position to pass Quality Bank risks on to their crude oil suppliers. *Id.* They point out that the Petro Star and Williams refineries receive all their crude from TAPS. *Id.* Thus, according to the Eight Parties, they must either buy their crude oil from the ANS producers (whether or not through intermediaries) or from the State. *Id.* Their sellers, the Eight Parties note, produce a fungible product that can be sold on the open market or used at their own West Coast refineries. *Id.* They suggest that this is not a buyer's market. *Id.*

2832. Moreover, the Eight Parties explain, the refiners's Quality Bank liability is not incurred on the barrels that the refiners buy, but on barrels they borrow. *Id.* The Eight Parties note that refiners need to process significantly more crude than they retain – in Petro Star's case, about four times as much. *Id.* at pp. 195-96. In essence, according to the Eight Parties, they borrow this oil and then reimburse their suppliers for the Quality Bank assessments that result when they return it to TAPS. *Id.* at p. 196. The Eight Parties assert that, although Exxon witnesses may be correct in assuming that the agreements that govern these arrangements are bargained for, they have adduced no shred of evidence that the refiners did not get the best bargain they could. *Id.*

2833. Contrary to Exxon's second suggestion, the Eight Parties argue, establishing reserves would not have kept the refiners whole. *Id.* According to the Eight Parties, both Pavlovic and Toof testified that, had the refiners been prudent, they would have set up reserves. *Id.* However, the Eight Parties point out Pavlovic and Toof are inconsistent in whether they would have recommended that the refiners reserve against some undefined worst case or most likely case scenarios. *Id.* Nonetheless, the Eight Parties argue, the Commission-determined methodologies reasonably appeared at the times in which they were in effect to be the most likely, and reserves against most likely case scenarios therefore would not have been necessary. *Id.* More importantly, however, the Eight Parties assert that neither Pavlovic nor Toof address the fact that reserves cannot remedy the effects of optimizing to the wrong methodology. *Id.*

2834. The Eight Parties also argue that reserves cannot address cash flow impacts. *Id.* at p. 197. From a cash standpoint, the Eight Parties point out that it is not possible for a seller of crude oil or refined petroleum products to recover the years of refunds prospectively in the marketplace. *Id.* Its only option to "hedge" on the cash side, according to the Eight Parties, is to have tried to charge higher prices over the years to cover the possibility of having to pay refunds, thereby prematurely passing the risk of refund costs to primarily Alaskan consumers. *Id.* However, the Eight Parties argue that, even then, there is no assurance that the marketplace would allow the charging of higher prices. *Id.*

2835. Moreover, the Eight Parties state, Exxon misattributes the sentiment to Boltz that Petro Star "could have established a reserve to protect itself from retroactive liability with respect to the Resid valuation." Eight Parties Reply Brief at p. 161 (quoting Exxon Initial Brief at p. 377 n.152). They claim that Boltz was answering the question whether "at no point in the last 10 years has Petro Star been in a position to set any sort of reserve associated with the resid issue" when he stated that "[w]ith the Eight Party settlement position that we have come out with for this hearing, that put us certainly in a position that we could start to reserve resid impacts." *Id.* (quoting Transcript at pp. 11718-19).

2836. The Eight Parties argue that the public interest would not be served by the imposition of retroactive refunds. Eight Parties Initial Brief at p. 198. According to them, prospective implementation of Quality Bank methodologies facilitates efficient economic planning while retroactive implementation frustrates it. *Id.* They disagree with Exxon's claim that refunds are necessary for efficiency because, without them, parties would delay and "game the system." *Id.* at p. 199. According to the Eight Parties, Exxon failed to adduce any evidence that gaming the system is a real problem. *Id.* They point out that, in this very proceeding, all parties agreed to retroactive implementation of the Heavy Distillate valuation despite the enormous magnitude of the refunds that must be paid by the refiners. *Id.* The Eight Parties explain that this allowed Petro Star to accrue a reserve against its refund liability, but only because the price had been frozen and the parties agreed to within a penny on the correct price. *Id.* Moreover, because the new price would be consistent with the old one, the Eight Parties point out that it was unnecessary to re-optimize Petro Star's refineries.[845] *Id.* at pp. 199-200.

2837. In addition, the Eight Parties argue that retroactivity would have a negative impact on consumers. *Id.* at p. 200. They state that, as discussed above, inefficiency is inherent in the uncertainty that attaches to the possibility of refunds except in unusual circumstances. *Id.* To the extent that parties could trigger a serious danger of refund obligations simply by filing a complaint or appeal, the Eight Parties argue that an aggressive competitor could attempt to cause its rivals to cut production or forego sales that would be profitable unless there were refunds. *Id.* This would be particularly true, in the opinion of the Eight Parties, if Exxon's views on refunds were adopted and refiners were obliged to plan for worst-case outcomes. *Id.*

2838. Contrary to the argument of Exxon,[846] the Eight Parties state, refiners do not claim to be entitled to rely on the Commission's 1993-94 valuation orders. Eight Parties Reply Brief at p. 160. Instead, argue the Eight Parties, the refiners acted reasonably by basing their operations on the methodologies ordered by the Commission. *Id.* They maintain

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[845] Toof noted, the Eight Parties point out, that Exxon's Heavy Distillate receipts from the refiners would approximately balance payments that Exxon would make to other producers at Pump Station 1. Eight Parties Initial Brief at p. 200, n.111. They state that Toof considered the Heavy Distillate issue to be "very similar" to the issues surrounding Resid valuation after 2000 and hinted that the parties's alignments, not the frozen price, distinguished the Heavy Distillate and Resid issues. *Id.* The Eight Parties, on the other hand, believe that the Heavy Distillate issue is unique for the reasons stated by Boltz and that the situation in 2000 was uncertain. *Id.*

[846] Exxon Initial Brief at pp. 376-78.

that to act otherwise would have caused the refiners to forego sales that they would have no way of ever recouping. *Id.* Further, the Eight Parties argue, Exxon's position that the mere possibility of reversal should prompt the refiners to optimize their refineries to guard against the possibility of higher Quality Bank assessments would create the policy nightmare where a competitor could cause its rivals to cut production or forego sales merely by filing a notice of appeal. *Id.*

2839. A decision giving retroactive effect to the new Resid value would have to rest, according to the Eight Parties, on a finding that the new value determined in this proceeding is also the just and reasonable value for the Resid cut from December 1, 1993, through 2004 (and that the 1998 values for Light Resid, Light Distillate, and Heavy Distillate were the just and reasonable values for the period December 1993 through January 1998). Eight Parties Initial Brief at p. 201. In the usual refund case, the Eight Parties state, this is not a problem because the just and reasonable rate is determined based on the cost of service for the serving utility. *Id.* They note that, in such a case, the utility is a party to the proceeding and can submit actual cost evidence for all prior years that are subject to a refund order. *Id.*

2840. The Eight Parties argue that a Quality Bank case is different. *Id.* Here, they state, the Commission is attempting to set cut values based on prices used as proxies, adjusted by costs used by an entire industry or industry segment. *Id.* According to the Eight Parties, industry practices change over time, and change in different ways for different types of costs. *Id.* Further, they note that all industry participants are not parties to this case and there is not an agreed or accepted approach to cost analysis. *Id.* Accordingly, the Eight Parties argue, the Commission cannot merely decide what is just and reasonable today and project that outcome retroactively over some hypothetical refund period. *Id.*

2841. By far the most contentious and complex of these effective date issues, according to the Eight Parties, is that related to Resid. *Id.* at p. 202. In the period since December 1, 1993, the Eight Parties note that three different sets of values have been in place for the Resid cut: (1) Platts West Coast Waterborne FO 380 for both the West Coast and Gulf Coast from December 1, 1993 through February 9, 1996, (2) Platts Pipeline West Coast FO 380 for both coasts from February 10, 1996 through January 31, 1998, and, since February 1, 1998, (3) the values used in the 1997 Nine Party Settlement of Platts West Coast Pipeline FO 380 minus 4.5¢/barrel, and Platts Gulf Coast FO #6 3% Sulfur minus 4.5¢/barrel. *Id.*

2842. The Eight Parties argue that Exxon has not met its burden of proving that retroactive application of its new Resid value would be just and reasonable. *Id.* at p. 203. According to the Eight Parties, what is at issue here is not really refunds, as that term is used in the utility industry. *Id.* at p. 205. They state that the term "refunds" refers to a pay back of some amount of an increased rate that is over and above what the previously effective rate was. *Id.* In the Eight Parties's opinion, that is not what is claimed by

Exxon here. *Id.* Rather, in their view, Exxon is demanding a complete recalculation of debits and credits between and among all shippers on TAPS that covers, with respect to the Resid cut, a period of time exceeding ten years. *Id.* The Eight Parties assert that such wholesale rate recalculations are not favored as a remedy, and Exxon's request for what the Eight Parties call an extraordinary remedy is not warranted by the equities of this case. *Id.*

2843. In the cases cited by Exxon,[847] the Eight Parties maintain, when courts ordered the application of rates retroactively to correct the Commission's legal error, the positions that the parties would have been in absent agency error were readily ascertainable. Eight Parties Reply Brief at p. 135. According to the Eight Parties, in contrast, both the courts and the Commission have declined to order the imposition of rates retroactively when such order would not return the parties to the positions they would have held absent Commission error, or when it would be difficult or impossible to determine what those positions were.[848] *Id.*

2844. Similarly, the Eight Parties state that, in *ANR Pipeline Co.*,[849] the Commission reversed a prior decision in which it had determined that ANR Pipeline Company should be allowed to recover certain costs related to service it received from another pipeline from November 1, 1993, through April 30, 1994, even though ANR had no tariff provision in effect to authorize such recovery during that period. Eight Parties Reply Brief at p. 137. On rehearing of its prior decision, however, the Eight Parties point out, the Commission found this approach to be "inappropriate and unworkable," based in part on the realization "that it is fruitless to attempt to reconstruct ANR's prior filings as they might have appeared in the absence of the Commission's legal error." *Id.* at p. 138 (quoting 88 FERC at pp. 61,539-40). The Commission further noted that there was no erroneously rejected rate proposal that can now be put in effect, state the Eight Parties, and what would have happened had the error not been committed would be mere speculation. *Id.*

2845. In this case, the Eight Parties state, there is no erroneously rejected cost-based rate schedule that can be put into effect to put the parties in the same positions in which they

[847] *Natural Gas Clearinghouse v. F.E.R.C.*, 965 F.2d 1066 (D.C. Cir. 1992); *Public Utilities Com'n of State of Cal. v. F.E.R.C.*, 988 F.2d 154 (D.C. Cir. 1993) ("*CPUC*"); *National Fuel Gas Supply Corp. v. F.E.R.C.*, 59 F.3d 1281 (D.C. Cir. 1995); *Public Service Co. of Colorado v. F.E.R.C.*, 91 F.3d 1478 (D.C. Cir. 1996).

[848] In support, the Eight Parties cite *Panhandle Eastern Pipeline Co. v. F.E.R.C.,* 907 F.2d 185 (D.C. Cir. 1990).

[849] 88 FERC ¶ 61,160 (1999).

would have been had the rate schedule not been erroneously rejected. *Id.* at p. 140. Further, note the Eight Parties, there are no quantifiable taxes, take-or-pay payments, or demand charges the recovery of which the Commission previously erroneously denied. *Id.* at pp. 140-41. Here, the Eight Parties argue, the payments into or out of the Quality Bank would have been different if the new valuations had actually been in effect on December 1, 1993, and it would be difficult, if not impossible, now to determine what those payments would have been. *Id.* at p. 141. In any event, the Eight Parties assert that the application of the new valuations of the remanded cuts would not put the Quality Bank participants back in the same positions they would have been absent Commission error. *Id.*

2846. According to the Eight Parties, Exxon has offered no evidence to support its argument that ordering refunds is necessary to put the parties in the position in which they would have been and to make the parties whole. *Id.* Specifically, the Eight Parties assert, Exxon has offered no evidence demonstrating that, if the Commission had adequately supported its Distillate and Resid valuations in 1993, Exxon would have received payments from the Quality Bank equal to the refunds Exxon is demanding now. *Id.* at pp. 141-42.

2847. The Eight Parties state that the closest Exxon comes is its argument that "there is virtually no evidence to support the assertion that the refiners in fact optimized their operations in light of Quality Bank valuation decisions." *Id.* at p. 142 (quoting Exxon Initial Brief at p. 376). They explain that, in support of this interpretation of the evidence, Exxon asserts that Boltz testified that Petro Star's refinery operations were not driven by Quality Bank decisions. *Id.* However, the Eight Parties point out, this statement rests on Boltz's testimony that Petro Star expanded its North Pole operations despite the decrease in Resid valuation effected by the Nine Party Settlement in 1997. *Id.* They argue that Exxon overlooks the fact that the decreased Resid valuation was partially offset by changes to the other Remand Cuts contained in the Nine Party Settlement; elimination of the 1000° - 1050°F Light Resid cut and classifying that material as VGO (effectively raising the value of material that the refiners return) and adjusting Light and Heavy Distillate valuations to reflect processing costs (decreasing the values of materials that the refiners retain). *Id.*

2848. Exxon similarly relies on Dayton's purported inability to identify any actions the refiners actually took to optimize their operations, the Eight Parties claim. *Id.* They assert that that Dayton actually explained that her knowledge was limited to what she could observe without being privy to the refiners's internal decisions. *Id.* According to the Eight Parties, it is more decisive that Dayton testified that, as an executive of a company that received Quality Bank payments from the refiners, she had observed that the refiners regularly were successful at mitigating Quality Bank impacts. *Id.* at pp. 142-43.

2849. The Eight Parties maintain that they have introduced extensive evidence demonstrating that, if the new valuations of the remanded cuts had been in effect in 1993, the payments to Exxon out of the Quality Bank would not have been equal to the difference between the Commission's 1993 cut valuations and the values that were/are ultimately found to be just and reasonable. *Id.* at p. 143. To the contrary, the Eight Parties assert, the payments into and out of the Quality Bank would have been different. *Id.* Further, according to the Eight Parties, under every scenario the bulk of the refunds that would be paid to Exxon would be paid by the refiners. *Id.* at pp. 143-44. Because the Quality Bank assessments paid by the refiners are shared among the producers, including Exxon, the Eight Parties assert that Exxon's Quality Bank receipts also would have been different. *Id.* at p. 144. Under these circumstances, the Eight Parties maintain that refunds would not put the parties in the positions they would have been in and should not be ordered. *Id.*

2850. Exxon correctly states that the Quality Bank "attempt[s] to place each [shipper on TAPS] in the same economic position it would enjoy if it received the same petroleum at Valdez that it delivered to TAPS on the North Slope," according to the Eight Parties. *Id.* at p. 145 (quoting *OXY*, 64 F.3d at p. 684). However, the Eight Parties state that this undisputed premise sheds little light on the refund issue as the only testimony that Exxon offers to show what its economic interest would have been had it received the same crude oil out that it placed into TAPS only reflects that, were a different Quality Bank methodology in effect, Exxon would have received different payments. *Id.* at pp. 145-46. The Eight Parties argue that this restatement of the obvious offers no support for Exxon's assertion that this goal of the Quality Bank requires the award of refunds. *Id.* at p. 146.

2851. In the opinion of the Eight Parties, Exxon ignores the fact that both the Quality Bank's own history of settlement and the filed rate doctrine establish the general rule that changes in Quality Bank methodology are prospective. *Id.* Instead, state the Eight Parties, Exxon argues that examples of instances in which shippers have agreed to the retroactive adjustments of Quality Bank valuations require the retroactive application of the new valuations of the remanded cuts here. *Id.* Further, they assert that Exxon is wrong when it states that the remanded cuts have been found to be unjust and unreasonable. *Id.* at n.62. The Eight Parties claim that the Commission is not required to find that the valuations of the remanded cuts are just and reasonable. *Id.* Far from supporting Exxon's contentions, the Eight Parties argue that Exxon's examples are simply exceptions that prove the rule that the standard practice is to implement Quality Bank methodology changes prospectively. *Id.* at p. 146.

2852. The Eight Parties also disagree with Exxon's attempt to use the stipulated February 1, 2000, effective date for the replacement Heavy Distillate valuation and the parties's agreement to refunds retroactive to that date as justification for the general applicability of refunds in this proceeding. *Id.* at p. 147. The Eight Parties note that the Commission has recognized that the Heavy Distillate valuation represented a unique situation. *Id.* Moreover, they point out, the parties reached a quick agreement on the replacement price, the processing costs in dispute differed by less than a penny a gallon, and the adjusted replacement price would be in the same ballpark as the discontinued price. *Id.* at p. 148. Finally, the Eight Parties assert, Exxon ignores the most crucial fact – all of the parties have agreed on the effective date and the Eight Parties speculate that this agreement may be a requirement for retroactive implementation of distillation methodologies. *Id*. at n.63.

2853. Exxon's third example, the Eight Parties contend, the retroactive application of the VGO valuations contained in the Commission's May 1994 Order on Rehearing, also provides no support for ordering refunds in this proceeding. *Id.* The Eight Parties point out that the 1993 settlement provided for a December 1, 1993, effective date, but the settling parties had agreed that the new methodology could not physically be implemented on that date. *Id.* Therefore, explains the Eight Parties, the settlement provided for a test period during which any Quality Bank adjustments made would be temporary. *Id.* Consequently, they continue, the settlement provided that final adjustments, which could not be made until after the implementation period, would be "retroactive" to December 1, 1993. *Id.* The Eight Parties assert that the Commission, in that ruling, did not order a retroactive change; instead it declined to change an effective date contained in a settlement which it already had approved. *Id.* at p. 149.

2854. Given the long history of shifting positions by the complainants, lack of precise notice of potential liability, and the consequent inability of the parties to alter their operations or make provision for the potential liability, the Eight Parties argue, the equities in this case do not support giving retroactive effect to revised cut valuations. Eight Parties Initial Brief at p. 205. According to them, the primary beneficiary of retroactivity, Exxon, did not change its position or take any action in reliance on the Commission's 1993 valuations of the Resid cut. *Id.* at pp. 205-06. They assert that there is no doubt that Exxon was aware of the Commission's history of doing exactly what it objects to here: applying changes to the Quality Bank only prospectively. *Id.* at p. 206. Further, the Eight Parties claim that Exxon has neither abandoned options that would otherwise have been available to it nor made any commitments in reliance on the prior erroneous ruling. *Id.* They note that Toof admitted that both reparations and refunds were calculated in the same way, and that any recovery by Exxon would be all profit. *Id.*

2855. In contrast, the Eight Parties explain, some of parties who oppose retroactive correction – the in-State refiners connected to TAPS, Williams and Petro Star – had no choice but to make commitments and to change positions in reliance on the Commission's prior rulings, and would be prejudiced by a retroactive correction of the prior orders. *Id.* Further, according to them, were the new valuations in place as of December 1, 1993, the refiners would have optimized differently than they actually did. *Id.* Therefore, the Eight Parties conclude that retroactive imposition of the new valuations now would allow Exxon to collect more from the refiners in refunds than it would have if the valuations had been in place as of December 1, 1993. *Id.*

2856. The Eight Parties [850] position is that the same equitable considerations that preclude the ordering of any refunds in the circumstances of this case also preclude the award of interest. Eight Parties Reply Brief at p. 166. They state that there is ample authority that, where the Commission determines that it cannot put the parties in the positions in which they would have been had there been no Commission error, it can craft an equitable remedy or it can deny retroactivity. *Id.*

2857. According to them, Exxon argues that the Eight Parties's position violates the filed rate doctrine and the rule against retroactive ratemaking. *Id.* at p. 153. They assert that neither the filed rate doctrine nor its corollary, the rule against retroactive ratemaking, prohibit the Commissions from weighing the excess profits that Exxon reaped under the gravity methodology as it considers the equities of awarding refunds. *Id.* The Eight Parties do not contend that payments that Exxon received from the Quality Bank under the gravity methodology should be considered in any way in determining the appropriate prospective valuations of the remanded cuts. *Id.* Nor do they claim that Exxon's gravity methodology receipts should be set off against payments otherwise due Exxon from the Quality Bank under re-determined valuations for post-1993 deliveries. *Id.*

2858. The Eight Parties claim that, contrary to Exxon's argument, the Commission exercises fundamentally different authority when it fashions remedies than it does when it approves or prescribes prospective rates. *Id.* at p. 155. When it prescribes rates, according to the Eight Parties, the Commission's authority is precisely defined by statute. *Id.* In deciding whether or not to order refunds, continue the Eight Parties, the Commission acts within broad equitable discretion. *Id.* Correspondingly, state the Eight Parties, the filed rate doctrine, as well as its corollary, the rule against retroactive ratemaking, apply with full force to prevent the Commission from adjusting what otherwise would be just and reasonable rates to account for past over- or under-collections by a carrier. *Id.* They point out that these are legal constraints, not blinders, however, and the reach of the filed rate doctrine is precisely prescribed by statute. *Id.*

2859. In contrast, the Eight Parties assert, it is well established that the Commission's power to order refunds, while limited by statute, is inherently equitable. *Id.* The Eight Parties note that the Circuit Court made this distinction quite clear in *Towns of Concord*. *Id.* at pp. 155-56. First, explain the Eight Parties, the court inspected the underlying statute to determine the consequences of the utility's having violated its filed tariffs by passing through spent nuclear fuel disposal costs to its customers in fuel adjustment charges. *Id.* at p. 156 (citing *Towns of Concord*, 955 F.2d at pp. 71-72). Having found

[850] The Eight Parties note that Phillips does not join in the section of their Reply Brief regarding payment of interest. Eight Parties Reply Brief at p. 166, n.73.

that the statute did not mandate refunds, the Eight Parties state that the Circuit Court rejected the argument that the Commission must order refunds and that "denying refunds equals the Commission's authorizing the utility to violate the filed rate doctrine (or retroactively approving a different rate)." *Id.* (quoting 955 F.2d at p. 73).

2860. As indicated above, reiterate the Eight Parties, four different cuts are affected by the retroactivity issue. Eight Parties Initial Brief at p. 207. They state that:

> • With respect to the proper cost deduction for the replacement West Coast Heavy Distillate price which is the subject of Issue No. 2 in this case, the parties have stipulated that the effective date is February 1, 2000, the date that the Quality Bank Administrator implemented a replacement for the previously approved Heavy Distillate price. According to the Eight Parties, the Gulf Coast Heavy Distillate price is unaffected.
>
> • With respect to the Light Distillate and Fuel Oil cuts valuations, and with respect to the price used for the West Coast Heavy Distillate cut prior to February 1, 2000, the Eight Parties explain that the revised valuations for these three cuts were implemented and approved as of February 1, 1998. Both West Coast and Gulf Coast prices are affected, according to the Eight Parties, and there is no dispute as to their value. According to the Eight Parties, the only issue for resolution here is whether the values approved and implemented as of February 1, 1998, should be given retroactive effect to December 1, 1993. They submit that the effective date for these cuts should remain as February 1, 1998, with no retroactive effect given. However, in the event the Resid cut is made retroactive to December 1, 1993, the Eight Parties advocate that these cuts should also be made retroactive to December 1, 1993.
>
> • With respect to the Resid cut, both the West Coast and Gulf Coast values are at issue. The proper valuation of this cut is the subject of Issue No. 1 in this case. *Id.* According to the Eight Parties, the issue to be resolved is whether the valuation for Resid determined here should be given retroactive effect to December 1, 1993. They submit that no retroactive effect should be given, and that the effective date for the evaluation determined here should be the date of the Commission's final decision in this case.

Id. at pp. 207-08.

2861. In *Exxon*, state the Eight Parties, the Circuit Court remanded the Commission's decision to apply the new valuations of the remanded cuts prospectively, because the record before the court failed to provide adequate explanation of the Commission's decision not to make the new valuations retroactive to 1993. Eight Parties Reply Brief at p. 168. It is the Eight Parties position that the current record shows that the circumstances of this case support the prospective application of the new valuations and they do not warrant the retroactive application of the new valuations to 1993, because:

- Retroactive application of the new valuations of the remanded cuts would not put the parties back in the positions in which they would have been in 1993. Were the new valuations in effect in 1993, the payments into and out of the Quality Bank would have been different. It would be difficult if not impossible now to determine what those payments would have been.

- Here, there is no erroneously rejected rate schedule that the Commission can now simply put in place retroactively.

- There is no record evidence that new valuations would have assigned accurate relative values among all of the cuts beginning in 1993.

- The refiners's reliance on the Commission's 1993 and 1997 valuations was not discretionary; they had no choice but to optimize their operations based on those valuations.

- In the context of the history of the Quality Bank, a decision to award refunds to Exxon would result in a windfall profit to Exxon to the detriment of the heavy oil producers and the refiners.

- The heavy oil producers and refiners acted in good faith in entering into settlement agreements in 1993 and 1997 in which they (like all the parties) gave up valuable benefits in order to reach settlement. There is no charge that they have "unclean hands" or are in any way at fault for the Commissions "errors."

- A decision by the Commission not to order refunds would offend neither equity nor good conscience.

Id. at pp. 168-70.

2862. Exxon submits that, with respect to each cut valuation that was remanded in *OXY*, as well as the Resid valuation later remanded in *Exxon*, the Commission should award refunds equal to the difference between the cut values that were remanded by the Circuit Court and the values that were/are ultimately found to be just and reasonable. Exxon Initial Brief at p. 350. It asserts that this would have the effect of making the revised cut values retroactive to December 1, 1993, and further asserts that the remedy for legal error – putting parties in the position in which they would have been had the errors not been made – is controlling here. *Id.* Moreover, Exxon continues, equitable considerations likewise support the awarding of refunds, because there is a presumption in case law in favor of retroactivity that would make the parties whole. *Id.*

2863. The Commission, Exxon explains, in its order implementing the distillation methodology for the TAPS Quality Bank, valued the Fuel Oil ("Light Resid") cut at the price of No. 6 Fuel Oil, and the Resid cut ("1050°+F Resid") at the price of Fuel Oil 380, without any adjustments to those prices. *Id.* at pp. 350-51. Further, according to Exxon, the Commission also valued the Light Distillate and Heavy Distillate cuts at the unadjusted prices for Jet Fuel and No. 2 Fuel Oil, respectively. *Id.* at p. 351. On judicial review of the Commission orders, notes Exxon, the Circuit Court held, in *OXY,* that the Light and Heavy Distillate valuations and the Resid valuations were arbitrary and capricious and remanded them to the Commission for further consideration. *Id.* With respect to the Commission's valuation of Resid, states Exxon, the Circuit Court found that "the record demonstrates no more than that the price of FO-380 bears some remote relationship to the value of 1050+ resid as a feedstock." *Id.* (quoting *OXY*, 64 F.3d at p. 695).

2864. On remand, claims Exxon, the Commission adopted a settlement (the 1997 Settlement) that, *inter alia*: (1) adjusted the reference prices for Light and Heavy Distillate to account for processing costs; (2) folded the Fuel Oil cut into the VGO cut by raising the final cut point for the VGO cut from 1000°F to 1050°F; and (3) for the Resid cut, subtracted 4.5 ¢/gallon from the reference prices for Fuel Oil 380 (West Coast) and No. 6 fuel oil (Gulf Coast). *Id.* The Circuit Court in *Exxon*, on review of the Commission's order, it states, upheld the valuations of the Light Distillate, Heavy Distillate and Fuel Oil cuts, but again set aside the Resid valuation. *Id*. at pp. 351-52. In remanding the Resid valuation, notes Exxon, the Circuit Court ruled that the Commission still had not demonstrated more than a remote relationship between FO-380 and 1050°+ F Resid. *Id.* at p. 352.

2865. Based on the foregoing, Exxon argues, there can be no doubt that the Commission committed legal error in valuing the Resid and Distillate cuts in its 1993-94 orders. *Id.* That is evident, in Exxon's opinion, because the *OXY* court granted the petitions for review on these issues and because it is explicit in the *Exxon* court's treatment of the valuations set aside in *OXY* as legal error. *Id.* Exxon asserts that the Commission again committed legal error in 1997 in valuing the Resid cut, because the *Exxon* court "grant[ed] the petition for review in part and vacate[d] and remand[ed] for further proceedings [that] part … of [the Commission's] order approving the use of proxies for the market valuation" of Resid. *Id.* at pp. 352-53 (quoting *Exxon*, 182 F.3d at p. 34). It concedes that neither the *OXY* nor *Exxon* decisions foreclosed the Commission from providing, on remand, a reasonable explanation for their prior valuations. *Id.* at p. 353. However, on remand from *OXY*, Exxon points out, the Commission declined to provide such an explanation, and abandoned its initial valuation approach (at the request of the Nine Parties) in the 1997 Settlement. *Id.* Moreover, on remand from *Exxon*, Exxon notes that no party has even attempted to defend the valuation set aside by the *Exxon* court. *Id.*

2866. Following the Commission's 1993 valuations of the Resid and Distillate cuts, Exxon explains it moved for a stay on the ground that it could suffer economic loss if the Commission's valuations were later found to be erroneous and set aside on judicial review. *Id.* But, notes Exxon, in 1994, the Commission declined to stay the effectiveness of its newly-adopted distillation methodology "because of the possible economic loss Exxon could suffer if a court set aside the [November 30, 1993] order. In that event the Commission could correct any legal error." *Id.* (citing *Trans Alaska Pipeline System*, 66 FERC ¶ 66,188 at p. 61,423 (1994)). Even though the Commission's valuations of the Distillate and Resid cuts were later set aside, Exxon notes, the Commission nevertheless ruled on remand that the revised valuations for those cuts should be applied only prospectively – resulting in precisely the economic loss, according to Exxon, that their motion to stay was designed to prevent and which the Commission had promised to "correct" in denying the stay. *Id.* at pp. 353-54.

2867. Exxon argues that the Commission's initial inclination in 1994 – to correct the adverse effects of its error on the parties – was the proper one. *Id.* at p. 354. It asserts that the Supreme Court has confirmed that this is a proper course of action when an order of an agency that never became final is later overturned by a reviewing court. *Id.*

2868. Moreover, Exxon argues, in a line of cases dating back to at least *Tennessee Valley Mun. Gas Ass'n v. Federal Power Com'n*, 470 F.2d 446, 452 (D.C. Cir. 1972), the Circuit Court has consistently ruled that the proper remedy for legal error is to place the parties in the position in which they would have been had the error not been committed. *Id.* It claims there is no dispute that there has yet to be a final decision on the just and reasonable valuation of the Resid cut for the period December 1, 1993, through the present date. Exxon Reply Brief at p. 393. Nor is there any disagreement, in Exxon's view, over the question of whether Resid has been or continues to be overvalued. *Id.* Exxon points out that both the Eight Parties's and Exxon's proposed valuations of Resid produce values for Resid that are substantially lower than the values for Resid previously and currently in place. *Id.* As a result, Exxon asserts, there can be no legitimate dispute that parties who have injected crude oil streams with higher than average proportions of Resid have been enriched by the prior over-valuations and that parties that have injected crude oil streams with lower than average proportions have been economically harmed. *Id.* at pp. 393-94. Applying the *Exxon* court's legal standard to these circumstances, Exxon argues, the only way to put the parties in the position in which they would have been is to require the parties who have benefited financially from the over-valuation of Resid to refund those benefits, and make whole the parties who have been harmed from the over-valuation. *Id.* at p. 394.

2869. Exxon also asserts that the Circuit Court has applied this principle even where the resulting retroactive relief goes back more than a decade. Exxon Initial Brief at pp. 354-55. For example, notes Exxon, the Circuit Court has ordered retroactive refunds for a period commencing almost 13 years prior to the date of its decision requiring such refunds.[851] Exxon Initial Brief at p. 355.

2870. The Commission itself, Exxon contends, in the past, has changed orders as a result of their being overturned by a reviewing court. *Id.* Exxon cites several examples to substantiate this point. First, it cites *Natural Gas Clearinghouse v. F.E.R.C.*, 965 F.2d 1066 (D.C. Cir. 1992) in which the Circuit Court cited Commission decisions ordering the retroactive recoupment of refunds that were found on judicial review to have been improperly ordered, as well as decisions where the Circuit Court said the commission invoked a remedial authority to impose retroactive surcharges upon purchasers of pipeline transport service in order to allow the pipeline to collect a rate that was erroneously disallowed by the Commission. *Id*. Second, Exxon notes, in a recent order in a California electric rate refund proceeding, the Commission included an analysis of its authority to order retroactive refunds under the Federal Power Act, and noted that it can order retroactive refunds to correct legal error in order to put consumers in the same position in which they would have been had no error had been made. *Id.* at pp. 355-56.

2871. In addition, Exxon argues that the Eight Parties do not address the necessary implications of that *Exxon* standard. Exxon Reply Brief at p. 394. Instead, according to Exxon, they contend that, for two reasons, the Commission need not put the parties in the position in which they would have been had the error not been made. *Id.* First, notes Exxon, the Eight Parties argue that equitable considerations control whether or not refunds are granted. *Id.* Second, continues Exxon, they argue that "refunds are . . . discretionary and should be ordered only when they would advance the core purposes of the regulatory statute." *Id.* (quoting Eight Parties Initial Brief at p. 168). In advancing these arguments, Exxon argues that the Eight Parties misstate and ignore the pertinent legal and equitable standards. *Id.*

2872. The core purpose of the Quality Bank, according to Exxon, is to assign accurate relative values to the petroleum that becomes part of the TAPS common stream. Exxon Initial Brief at p. 356. It asserts that, based on the *OXY* ruling, the Commission must value all cuts in the stream accurately or over or undervalue them all to the same extent, and concludes that this necessarily requires retroactive application of the corrected valuations for the Resid and Distillate cuts; otherwise, streams rich in these cuts will be

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[851] Exxon notes that, in *Public Service Co. of Colorado v. F.E.R.C.*, 91 F.3d 1478 (D.C. Cir. 1996), the court stated: "Absent detrimental and reasonable reliance, anything short of full retroactivity . . . allows [some parties] to keep some unlawful overcharges without any justification at all. The court strongly resists the Commission's implication that the Congress intended to grant the agency the discretion to allow so capricious a thing." Exxon Initial Brief at p. 355, n.132 (quoting 91 F.3d at p. 1490).

overvalued and their owners will receive a windfall in Quality Bank credits. *Id*. at p. 356-57. Exxon asserts that, unless lawful valuations are applied as of the date on which the Commission adopted the prior, unlawful valuations, shippers will not be placed in the economic position in which they would have been had they received the same petroleum from the pipeline at Valdez that they deliver to the pipeline on the North Slope. *Id.*

2873. Consistent with the above principles, Exxon points out, errors in Quality Bank invoices, whether arising from errors in valuation methodology or in the implementation of the methodology, are routinely corrected and parties's Quality Bank accounts are trued up (that is, the accounts are credited or debited on a retroactive basis) to reflect those corrections. *Id.* For example, Exxon explains, all parties to this case have agreed that, when the valuation of the Heavy Distillate cut in Issue No. 2 is finally resolved, that valuation should be made effective retroactive to February 1, 2000, (when the proxy product changed), and that refunds should be awarded for the period February 1, 2000, to the effective date of a decision in this case. *Id.*

2874. In addition, Exxon argues, the Commission has ordered retroactive application of changes in Quality Bank cut valuations on other occasions. *Id.* For example, notes Exxon, in May 1994 – more than five months after the Commission had ordered the distillation methodology put into effect – the Commission, on rehearing of its original distillation order, decided to use the Gulf Coast high-sulfur VGO price to value the VGO cut on both the West and Gulf Coasts (rather than use the West Coast high-sulfur VGO price to value the West Coast VGO cut). *Id.* at pp. 357-58. Exxon explains that the reason the Commission ordered the change made retroactively was to avoid allowing a prior methodology that it had found was unjust and unreasonable to continue to govern after it had put parties on notice of the prior effective date of the discarded method. *Id.*

2875. Exxon contends that, because the cut valuations remanded in *OXY* were abandoned by the Commission in favor of other valuations in the 1997 remand proceedings, the remanded valuations have, as a practical matter, been found unjust and unreasonable as well. *Id.* Similarly, Exxon notes that, although the Resid valuation remanded in *Exxon* has not yet been formally abandoned on remand, no party presented any evidence in support of that valuation in the remand hearings just completed. *Id.* Thus, according to Exxon, under the logic of the May 1994 order described above, the valuations ultimately found lawful for the cuts remanded in *OXY* and *Exxon* should be applicable as of December 1, 1993. *Id.* To do otherwise Exxon argues, would, in effect, allow unlawful valuations to continue to govern. *Id.*

2876. According to Exxon, the Circuit Court in *Exxon* expressly stated there is a presumption of retroactivity that is applicable to claims for refunds based on agency error in valuing an ANS crude cut, a strong presumption in favor of making parties whole, and a resulting incentive for parties to litigate agency errors and for agencies to correct those errors. *Id.* at pp. 358-59. In this case, Exxon argues that this equitable presumption should apply with particular force, where Exxon sought a stay of the 1993 valuation orders based on the economic harm it would suffer – and now has suffered – from erroneous valuation orders set aside after judicial review. *Id.* at p. 359. It notes that the Commission denied a stay on the ground that it could correct any such errors. *Id.* In Exxon's view, the Eight Parties's position that a balancing of the equities leads to the conclusion that no refunds can be ordered is directly controverted by the result in *Exxon*. Exxon Reply Brief at p. 395. Further, Exxon argues, the Eight Parties should not have ignored the fact that the Circuit Court rejected the Commission's four grounds for applying the new valuations at issue in the *Exxon* case on a prospective basis only. *Id.*

2877. Furthermore, Exxon asserts, neither of the two cases cited by the Eight Parties – *CPUC,* 988 F.2d at p. 168 and *Towns of Concord,* 955 F.2d at p. 76 – supports their position. *Id.* (citing Eight Parties Initial Brief at pp. 167-68). Exxon points out that, in *CPUC*, the Circuit Court, after reciting the equitable considerations that informed the Commission's judgment, nevertheless held that the Commission cannot substitute use of equitable considerations for adherence to the law. *Id.* at pp. 395-96. Further, notes Exxon, in *Towns of Concord*, the Circuit Court stated that the exceptional facts of that case meant there was little potential for unjust enrichment making the Commission's exercise of its discretion to refuse to award refunds acceptable and that the refusal did not involve the filed rate doctrine or contravene any statutes. *Id.* at p. 396, n.262. In the instant case, by contrast, Exxon states, the Eight Parties were on notice that the Quality Bank valuations in question were subject to modification, and there is no question that the prior erroneous valuations are unfair to Exxon and that some refiners have been unjustly enriched. *Id.*

2878. Exxon explains that the equitable presumption in favor of retroactivity is buttressed by at least two other factors in this case. Exxon Initial Brief at p. 359. First, as noted above, Exxon states, it has been the practice in the Quality Bank to correct errors in valuations or invoices in order to make participants in the Quality Bank whole. *Id.* Second, in considering any equities here, Exxon asserts that there is no issue of "unclean hands." *Id.* Exxon avers that its conduct with respect to Quality Bank matters has at all times been beyond reproach. *Id.* During the relevant time period, Exxon states that its Quality Bank debits and credits have been assessed strictly in accordance with the TAPS Carriers's tariffs. *Id.* According to Exxon, no party has even alleged that it has engaged in any fraud or other untoward conduct that would justify withholding refunds otherwise owed to Exxon. *Id.* In fact, Exxon notes the Eight Parties's witness on Issue No. 5 – Dayton – could not identify any inequitable conduct on the part of Exxon that would justify withholding refunds. *Id.* at pp. 359-60.

2879. According to Exxon, the Eight Parties advance two equitable arguments – one asserted by the producers, the other by the refiners – in support of their contention that the Commission's erroneous Resid and Distillate valuations should not be corrected on a retroactive basis. *Id.* at p. 360. First, it explains, the producers identify two time periods, a First Period (from January 1, 1990 through November 30, 1993), during which the gravity methodology was in effect; and a Second Period (from December 1, 1993 through December 31, 2002),[852] during which the distillation methodology was in effect. *Id.* Exxon notes that, because retroactive relief for the First Period was precluded as a matter of law, the Eight Parties argue that, as a matter of equity, there should be no retroactive application of the revised cut values for the Second Period. *Id.* Similarly, Exxon states that, based on their calculations of alleged overpayments received by Exxon and other parties during the First Period (alleged overpayments Exxon was not required to refund), the Eight Parties argue that it would be inequitable for Exxon to receive refunds in the Second Period. *Id.* Second, states Exxon, the Eight Parties argue that it would be inequitable to order the refiners to pay refunds because they optimized their operations based on the 1993-94 valuation orders (as well as subsequent valuation orders), and cannot now go back and adjust past operations to fit a new valuation methodology. *Id.* at pp. 360-61.

2880. Exxon suggests that these arguments are legally and factually flawed. *Id.* at p. 361. Accordingly, Exxon asserts they plainly provide no basis for overcoming the equitable presumption in favor of retroactivity. *Id.*

2881. In approving the 1997 Settlement, Exxon points out, the Commission adopted revised valuations for the Distillate and Resid cuts remanded in *OXY*. *Id.* It notes, in making those revised valuations effective only prospectively – and in rejecting the arguments of Exxon and Tesoro that such valuations should apply retroactively to December 1, 1993 – the Commission advanced four equitable factors in support of its decision, including that prior TAPS settlements were implemented on a prospective basis. *Id.*

2882. On appeal, according to Exxon, the Circuit Court rejected all of the arguments advanced by both the Commission and the settling parties in support of prospective only application. *Id.* Exxon states that, of particular relevance here, the Circuit Court held that the Commission's reliance on the fact that all prior TAPS cases were resolved on a prospective basis did not support its decision regarding the effective date of the 1997 Settlement.[853] *Id.* at pp. 361-62 (citing *Exxon*, 182 F3d at pp. 48-49).

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[852] Exxon notes that the Eight Parties extended the end-point of this "Second Period" through December 2002 in exhibits introduced during the hearing. Exxon Initial Brief at p. 360, n.135.

[853] Exxon misstates the Court's holding as its reference is to the Court's description of the Commission's litigation position. In fact, the Circuit Court held that the Commission "does have a measure of discretion in determining when and if a rate should apply retroactively." *Exxon*, 182 F3d at p. 49. It did indicate, however, that, under the circumstances presented, the Commission "abused its discretion when it failed

2883. Moreover, claims Exxon, even if not already precluded by the *Exxon* opinion, the Eight Parties's two-period argument runs counter to the filed rate doctrine and the rule against retroactive ratemaking.[854] *Id.* at pp. 363-64. According to Exxon, the rule against retroactive ratemaking prohibits adjustment of past rates by the Commission to make up for a utility's over or under collection in prior periods. *Id.* at p. 364. Moreover, asserts Exxon, it is a logical conclusion of the filed rate doctrine that the Commission is prohibited from doing indirectly what it cannot do directly. *Id.* Therefore, argues Exxon, by seeking to avoid paying refunds in the Second Period because of alleged overpayments in the First Period, the Eight Parties are urging the Commission to do indirectly what it cannot do directly. *Id.*

2884. On November 30, 1993, according to Exxon, the Commission issued an order adopting, with modifications, a proposed settlement to change the Quality Bank methodology from a gravity-based formula to a distillation formula. *Id.* Among other things, notes Exxon, the Commission ruled that its modification of that formula in the 1993 Settlement was governed by the filed-rate doctrine, because it viewed the Quality Bank formula as a rate charged under a tariff. *Id*. In addition, states Exxon, the Commission recognized the filed rate doctrine also precluded any retroactive changes and therefore ruled that the 1993 settlement would be applied only prospectively. *Id.* Further, explains Exxon, recognizing that the filed-rate doctrine prevents any retroactive changes to a rate, the Commission concluded that the 1993 Settlement could be applied only prospectively. *Id*. at pp. 364-65.

2885. On appeal, contends Exxon, the Circuit Court affirmed the Commission's ruling that the 1993 Settlement should apply only prospectively. *Id.* at p. 365. According to it, the Circuit Court agreed with the Commission that the Quality Bank methodology was an integral element of the TAPS tariff structure and that the filed-rate doctrine governed modification of that methodology. *Id*. Therefore, claims Exxon, because of the filed-rate doctrine, the Circuit Court held that the Commission properly determined that the new methodology could not be applied retroactively. *Id.* Further supporting this conclusion, according to Exxon, was the fact that, in their 1989 filing initiating the earlier litigation, the TAPS Carriers did not propose a change in the methodology and thus the filing did not act as notice that a change to the assay methodology was possible.[855] *Id.* Under these

without adequate explanation to make the revaluation and concomitant Quality Bank adjustments retroactive to 1993, when the distillation method was adopted." *Id*. at p. 50.

[854] Exxon explains that the rule against retroactive ratemaking is a corollary of the filed rate doctrine. Exxon Initial Brief at p. 364, n.138.

[855] By contrast, Exxon asserts that the Circuit Court has already found that all the parties to the current Quality Bank litigation have been on notice, since 1993, that valuations of certain cuts were contested and that reliance on the rates in effect was

circumstances, declares Exxon, the *OXY* court held that it was proper for the Commission to apply the 1993 Settlement prospectively, because to do otherwise would have constituted retroactive rulemaking. *Id.*

2886. Here, Exxon argues, the producers are seeking to avoid payment of refunds for the Second Period that would otherwise be owed based on alleged overpayments during the First Period. *Id.* This amounts to, according to Exxon, an indirect, post-hoc modification of the rates charged and collected during the First Period in contravention of the filed-rate doctrine. *Id.* at p. 366. Exxon points out that, despite the fact that the filed-rate doctrine required the Commission to apply the 1993 Settlement only prospectively, the Eight Parties argue that, as a result of this prospective application during the First Period, they made hundreds of millions of dollars of overpayments into the Quality Bank during the First Period, and that Exxon received substantial overpayments during the First Period. *Id.* This argument is legally erroneous, in Exxon's opinion, because both the Commission and the Circuit Court have ruled that the payments made during the First Period were compelled by the requirements of the filed rate doctrine. *Id.* But, more importantly, according to Exxon, this argument also asks the Commission to adjust the rates that would otherwise apply during the Second Period to make up for a possible over collection in prior years. *Id.* Exxon asserts the law is clear that, even had there been an over collection in the First Period, this kind of post-hoc modification proposed by the Eight Parties is unlawful under the filed rate doctrine. *Id.*

2887. According to Exxon, the Circuit Court's decision in *Public Utilities Com'n of State of Cal. v. F.E.R.C.*, 894 F.2d 1372 (D.C. Cir. 1990), is particularly instructive in this case. In that case, the Commission ordered El Paso, a natural gas company, to refund to its customers, through reduced current rates, a tax fund, which was composed of rate revenue that El Paso had already collected. 894 F.2d at p. 1383. Exxon states that the Circuit Court rejected that approach because it would require El Paso to return a portion of rates approved by the Commission and collected by El Paso and held that the Commission's action would undermine the predictability which the filed rate doctrine seeks to protect. *Id.* In addition, the Circuit Court rejected the notion that the Commission's position could be justified on equity grounds, saying that earlier opinions were not intended to give the Commission the authority to ignore the rule against retroactive ratemaking even if the Commission thought that was necessary in order to achieve an equitable result. *Id.*

2888. The argument rejected in *Public Utilities Com'n of State of Cal.* is the same argument, according to Exxon, based on the same theory (equity), advanced by the Eight Parties in this case. Exxon Initial Brief at p. 367. That is, in the name of equity, Exxon contends that the Eight Parties seek to retain increased Quality Bank revenues for the

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unwarranted. Exxon Initial Brief at p. 365, n.139 (citing *Exxon*, 182 F.3d at p. 49).

Second Period with which to offset what they, erroneously according to Exxon, contend were overpayments made by some of them during the First Period. *Id.* Exxon argues that this action is prohibited by the filed rate doctrine and its corollary, the rule against retroactive ratemaking. *Id.* at p. 368.

2889. Even assuming that the producers's two-period equitable argument was not barred as a matter of law, Exxon insists it is riddled with inconsistencies and founded on erroneous factual premises. *Id.* According to Exxon, it cannot overcome the presumption in favor of retroactivity that Exxon believes is required to make it whole. *Id.* Further, Exxon asserts that the two period argument actually supports a claim for refunds because approximately 90% of the requested refunds are to be paid by the refiners. Exxon Reply Brief at p. 407.

2890. First, the Eight Parties's two-period argument underscores a glaring inequity that, according to Exxon, would be aggravated if refunds are not awarded: the refiners owe refunds in both periods under the Eight Parties's analysis, a fact that Exxon notes was conceded at the hearing by the Eight Parties's witness, Dayton. Exxon Initial Brief at p. 368. This is so, Exxon points out, because the refiners benefited significantly from the gravity methodology in the First Period, and would now benefit if refunds are not assessed in the Second Period. *Id.*

2891. Second, according to Exxon, the Eight Parties have not shown why equity requires that heavy oil producers should be relieved from paying refunds associated with the over-valuation of Resid since 1993. Exxon Reply Brief at p. 408. Exxon notes that, although the two-period analysis is advanced by the Eight Parties, several producers (including BP and Phillips) do not owe refunds, but, rather, are owed refunds for the Second Period. Exxon Initial Brief at p. 369.

2892. Third, Exxon asserts that, with two exceptions (OXY and Phillips), the parties that now claim to have been aggrieved by the Commission's past decision not to award refunds in the First Period did not even seek such refunds at that time. *Id.* For example, explains Exxon, neither BP nor ARCO, the predecessor of Phillips, sought refunds for the First Period, nor did they seek judicial review of the Commission's ruling that the 1993 Settlement (implementing the distillation methodology) should not be applied retroactively. *Id.* Thus, Exxon argues, they are now in no position, as a matter of equity, to argue for relief because of the alleged harm they suffered from that ruling. *Id.*

2893. Fourth, neither BP nor Phillips, in the opinion of Exxon, is in a position to complain now about the effects of applying the gravity valuation methodology after natural gas liquid blending began at Prudhoe Bay, when those parties (or their corporate predecessors) explicitly approved such blending with the knowledge it could significantly impact the Quality Bank. *Id.* Exxon explains that the event that led to the gravity methodology's being discarded at the end of the First Period was the large-scale blending of natural gas liquids with crude from the Prudhoe Bay Unit. *Id.* However, notes Exxon, both ARCO (Phillips's corporate predecessor) and BP explicitly approved this program knowing full well its impact on the Quality Bank. *Id.* at pp. 369-70. Exxon's witness, it states, explained (Exhibit No. EMT-102 at pp. 25-26) that natural gas liquid blending could be undertaken only with the approval of both BP and ARCO, companies that collectively owned a majority interest in the Prudhoe Bay Unit. *Id.* at p. 370.

2894. Moreover, Exxon asserts, the record evidence confirms that these companies knew that blending could significantly impact Quality Bank debits and credits under a gravity methodology. *Id.* For example, Exxon cites Exhibit No. PAI-72 and argues that this exhibit leaves no doubt that ARCO was aware of the impact of natural gas liquid blending in the mid-1980s, and that ARCO had concluded that the benefits of natural gas liquid blending offset any detriment and made ARCO whole. *Id.*

2895. Additionally, states Exxon, the Eight Parties's two-period analysis conflicts with the principle that, "when the Commission commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made." Exxon Reply Brief at p. 410 (quoting *Exxon*, 182 F.3d at p. 49). According to Exxon, if the Commission had not over-valued Resid beginning in 1993, (i) for the First Period, all of the parties would have been left with Quality Bank accounts calculated pursuant to the gravity methodology; and (ii) for the Second Period, all of the parties would have been left with Quality Bank accounts calculated pursuant to a just and reasonable Resid valuation. *Id.* If refunds are provided, Exxon asserts, the parties will be in an identical position. *Id.* It argues that the Eight Parties simply have no answer to this point. *Id.*

2896. Fifth, the Eight Parties's calculations of purported under- and overpayments are, in the opinion of Exxon, seriously flawed. Exxon Initial Brief at p. 371. To begin with, Exxon asserts, there is no basis for suggesting that the methodology used by the Eight Parties's to calculate over- and underpayments for the First Period – that is, using the cut values from the 1997 Modified Nine Party Settlement, and the Resid value proposed by the Eight Parties witness O'Brien – is the method the Commission would have used had they applied a distillation methodology retroactively.[856] *Id.* Thus, one can only speculate, in the opinion of Exxon, as to whether the Eight Parties's calculations bear any similarity to the relief the Commission would have granted had they attempted to apply a distillation method retroactively to the First Period. *Id.*

[856] Exxon states that its witness, Pavlovic, explained that the use of O'Brien's valuation overvalues Resid by understating coking costs and, thus, that Dayton's refund calculation is biased in favor of shippers of heavier crude. Exxon Initial Brief at p. 371, n.144. As a result, according to Exxon, Dayton's calculation overstates refunds for the First Period, and understates refunds for the Second Period. *Id*. In fact, Exxon claims, shippers of lighter crude (such as Exxon) are owed more in the Second Period than they owe for the First Period when the proper values are used. *Id*.

2897. There is also, in Exxon's view, no basis for the Eight Parties's assertion that there was ample data for the First Period calculation. Exxon Reply Brief at p. 411. It states that the Eight Parties's support for this assertion rests on about 45 pages of testimony, but that the Eight Parties fail to state how this testimony supports their position. *Id.*

2898. For example, Exxon points out that the methods and data the Eight Parties used to calculate over- and underpayments for the First Period differ from those they used to do calculations for the Second Period. Exxon Initial Brief at p. 371. This prevents a reliable comparison between the calculations in the two periods, according to Exxon. *Id.* Specifically, Exxon explains that in calculating over- and underpayments for the Second Period, the Eight Parties rely on the Caleb Brett assays to measure stream qualities. *Id.* By contrast, Exxon claims, because the individual streams that comprise the TAPS common stream were not assayed during the First Period, the Eight Parties's calculations for this Period are based on numerous assumptions about the composition of those streams.[857] *Id.* at pp. 371-72. For example, Exxon states, Dayton acknowledges that, in the case of the Lisburne field, she used multiple data sources to build the data for a single stream. *Id.* at p. 372. Exxon asserts that some of the assumptions relied upon to build the data for the First Period are in direct conflict with the Eight Parties's position on assays for use in valuing Resid,[858] and many are demonstrably flawed, as shown on cross-examination.[859] *Id.*

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[857] According to Exxon, such assay data is lacking for the First Period because Caleb Brett did not begin to perform the monthly assays now used by the Quality Bank to determine the characteristics of the TAPS common stream until after the distillation methodology was adopted in 1993. Exxon Initial Brief at p. 372, n.145.

[858] Exxon asserts that Dayton's testimony, with respect to Issue No. 5, that there are a lot of data besides assay data that can be used to measure the petrochemical properties of the production streams during the First Period, conflicts with her testimony concerning what constitutes reliable assays for Issue No. 1. Exxon Initial Brief at p. 372, n.146. For Issue No. 1, Exxon states she testified the Caleb Brett assays were indispensable to determining the characteristics of the streams. *Id.*

[859] On cross-examination, according to Exxon, Dayton admitted that she had simply assumed that the yield for the period May 1, 1994, to April 30, 1995, would be the same as the yield for the period January 1, 1990, to the end of 1993. Exxon Initial Brief at p. 372, n.147. However, Exxon asserts that there were significant changes in stream composition during the 1993-94 time period, a period which straddles the end of the First Period and the beginning of the Second Period, and that Dayton's analysis fails to account for these changes. *Id.* According to Exxon, five new streams came on line during this straddle period, and throughout the entire period the Prudhoe Bay crude and condensate production was in decline while natural gas liquid production was increasing.

2899. Yet another flaw, in the opinion of Exxon, in the Eight Parties's calculations of over- and underpayments is their erroneous assumption that Exxon sells crude oil at the Golden Valley Electrical Association and Petro Star Valdez Refinery connections. *Id.* at pp. 372-73. It explains that the Eight Parties assumed that all producers sell on a pro rata basis to the refiners and, therefore, that the return stream, as well as the diverted stream, are shared pro rata among the producers that have production in the passing stream. *Id.* at p. 373. In fact, asserts Exxon, this assumption is not true with respect to Exxon, which does not sell at either the Golden Valley Electrical Association or the Petro Star Valdez Refinery connections. *Id.* According to Exxon, this flawed assumption leads to additional inaccuracies in the Eight Parties's calculations. *Id.* It adds that Dayton admitted during the hearing that her calculations will be inaccurate if her pro rata assumption is not valid. *Id.*

2900. In addition to their allegedly flawed "First Period" calculations, Exxon notes, the Eight Parties also take the erroneous position that the calculation of "Second Period" refunds should ignore the impact of the incorrect valuation of Naphtha and VGO during that period. *Id.* However, Exxon asserts that, to the extent that equity plays any role in deciding whether the revised cut valuations should be applied retroactively, any fair balance of the equities as between the First and Second Periods should account for all the benefits and harms the parties received from all of the cuts whose valuations are at issue in this proceeding. *Id.* at pp. 373-74.

2901. In Exxon's view, Exhibit No. EMT-609 provides a more complete assessment of the First Period versus the Second Period under- and overpayments on which the Eight Parties's equitable theory is based, because it includes an analysis of the total amounts each party would owe, or be owed, for Naphtha, VGO, Resid and Heavy Distillate combined.[860] *Id.* at p. 374. With VGO and Naphtha included, Exxon notes that it would be owed $172.2 million for the Second Period,[861] while it would owe $122.9 million for

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Id. Exxon argues that the Eight Parties's questionable assumptions regarding yields during the First Period have a large impact, because even small differences between estimated and actual distillation yields for the streams can have very large impacts on the over- and underpayments calculated for the streams and the parties shipping the streams. *Id.*

[860] Exxon notes that these calculations assume that Exxon's proposals for the valuation of all of those cuts were applied during both the First and Second Periods. Exxon Initial Brief at p. 374, n.148.

[861] Exxon states that Exhibit No. EMT-589 illustrates that it would be owed an even larger amount – $188.3 million – in the Second Period if O'Brien's Naphtha valuation methodology were employed as of July 1, 1994. Exxon Initial Brief at p. 374, n.149.

the First Period. *Id.* Thus, points out Exxon, it would be owed approximately $40 million more in the Second Period than it would have owed in the First Period.[862] *Id.* Exxon claims, therefore, that Dayton's assertion that the overpayments in the First Period far exceed the amounts claimed for the Second Period is undermined. *Id.* By wrongly ignoring Naphtha and VGO, Exxon contends, the Eight Parties's First Period/Second Period calculations distort the balance of the equities and drastically underestimate the considerable amount of harm that Exxon has suffered in the Second Period. *Id.* at pp. 374-75. It concludes that this casts serious doubt on the Eight Parties's claim that refunds are unnecessary to make Exxon whole and that refunds would exacerbate an already inequitable situation. Exxon Reply Brief at p. 414.

2902. Exxon notes that, despite the *Exxon* case, the Eight Parties argue that equitable principles should shield them from the regulatory and business risks stemming from the uncertainty associated with the valuation of Resid over the past decade. Exxon Reply Brief at p. 417. However, Exxon asserts, the Eight Parties can cite no legal authority supporting their argument because there is none. *Id.* In addition to its decision in *Exxon*, which Exxon states should govern this case, Exxon states that the Circuit Court has made clear that only "reasonable" reliance on subsequently overturned decisions should be considered as a basis for rejecting retroactive relief. *Id.* (quoting *Public Service Co. of Colorado*, 91 F.3d at p. 1490).

2903. In the instant case, according to Exxon, there was clear and unmistakable notice that relying on the 1993-1994 valuation decisions (and subsequent valuation decisions) was unreasonable. *Id.* Exxon points out that Boltz acknowledged that the refiners were on notice from 1993 onward that the agency orders upon which they relied in allegedly "optimizing" their operations were being challenged on judicial review. *Id.*

2904. Moreover, Exxon notes, subsequent to 1994, the refiners – by their own actions – acknowledged that the 1993-94 and subsequent Resid valuations were erroneous. Exxon Initial Brief at p. 378. For example, Exxon points out, both Petro Star and Williams were signatories to the 1997 Settlement, in which they effectively agreed that the 1993-94 valuation orders overvalued Resid by 4.5¢/gallon. *Id.* Similarly, states Exxon, both in 2000 and 2003, the refiners sponsored testimony that not only shows that Resid continues to be overvalued, but also quantifies the range of potential refunds that would required if

[862] Exxon points out that Dayton's calculations produce similar results. Exxon Initial Brief at p. 374, n.150. It explains that with VGO and Naphtha included, Dayton calculated that Exxon is owed $168.7 million for the Second Period and that Exxon received overpayments of $127.8 million for the First Period (assuming Exxon's Resid methodology.) *Id.* Thus, Exxon notes, according to Exhibit Nos. PAI-235 and PAI-236, Exxon would be owed approximately $40 million more in the Second Period (including VGO and Naphtha) than it was overpaid in the First Period. *Id.*

a new Resid valuation were applied retroactively.[863] *Id.* Under these circumstances, Exxon maintains, it is entirely fair that the refiners bear the financial consequences of their continued reliance on the Commission's valuations. *Id.*

2905. Exxon also takes exception to the Eight Parties's claim that retroactive application of the revised valuations would not put Exxon in the position it would have been in had the Commission not erred. Exxon Reply Brief at p. 418. It notes that the Eight Parties claim that, had revised valuations been in place as of December 1, 1993, the refiners would have optimized differently than they did. *Id*. Thus, the Eight Parties contend, states Exxon, that retroactive imposition of the new valuations "would allow [Exxon] to collect more from the refiners in refunds than it would have if the valuations had been in place as of December 1, 1993." *Id.* (quoting Eight Parties Initial Brief at p. 206). Exxon argues that the Eight Parties's argument again conflicts with clear legal authority, including the Commission's orders in *Tarpon Transmission Company*, 51 FERC ¶ 61,310 (1990), and the decision of the Circuit Court affirming those orders in *Natural Gas Clearinghouse v. F.E.R.C.*, 965 F.2d 1066 (D.C. Cir. 1992). *Id*. at pp. 418-19.

2906. Exxon notes that the Circuit Court agreed with the Commission that Tarpon's shippers had been on notice that the lower rate was subject to an appeal, and that Tarpon was entitled to recoup the revenues it would have collected were it not for the Commission's earlier erroneous decision. *Id.* at p. 419. In upholding these orders, Exxon explains, the Circuit Court concluded, "the open-access shippers [on which the surcharge was imposed] had the necessary notice that they might end up paying the originally filed rate." *Id.* at p. 420 (quoting *Natural Gas Clearinghouse*, 965 F.2d at p. 1075).

2907. The instant case, according to Exxon, presents a situation very similar to the one that was before the Commission and the Circuit Court in the *Tarpon/Natural Gas Clearinghouse* litigation. *Id.* Here, explains Exxon, all parties were on notice that the Commission's orders (here, the 1993, 1994 and 1997 valuation orders) were being appealed. *Id.* In this case, states Exxon, the Commission itself notified all parties in February 1994 that, in the event a court set aside its valuation orders, it "could correct any legal error," citing the *Natural Gas Clearinghouse* decision. *Id.* (quoting *Trans Alaska Pipeline System*, 66 FERC at p. 61,423). Under these circumstances, it is Exxon's view that all TAPS shippers, including the refiners, assumed any risks of reliance on the valuation orders when the validity of those orders was contingent on court review. *Id.* (citing *Exxon*, 182 F.3d at p. 49). Therefore, according to Exxon, it makes no difference that the refiners might have optimized differently had different valuations been in place as of December 1, 1993. *Id.* Given notice that the 1993 Resid valuation might be disallowed, Exxon asserts that there is nothing unfair about imposing revised valuations

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[863] Exxon cites the following in support of this point: Exhibit Nos. EMT-586, pp. 17-24, PAI-28 through PAI-31, PAI-48. Exxon Initial Brief at p. 378, n.153.

as of that date and ordering refunds consistent with such valuations. *Id.* at pp. 420-21.

2908. In Exxon's view, the Eight Parties's position boils down to the erroneous contention that parties such as Exxon, who had no control over the refiners's operating decisions, should nonetheless pay for the refiners's unwarranted reliance on incorrect valuations. *Id.* at p. 421. It asserts that, if the refiners's equity argument is accepted, it would perpetuate over a decade of inequity stemming from erroneous Quality Bank valuations. Exxon Initial Brief at p. 379. The result, according to Exxon, would be a windfall for the refiners, who would be permitted to retain the competitive advantages they realized simply as a result of Quality Bank cuts being wrongly valued.[864] *Id.* Again, Exxon argues that this is manifestly contrary to the purpose of the Quality Bank. *Id.* There is certainly nothing equitable, in Exxon's view, about permitting one set of parties to retain the financial fruits associated with erroneous administrative decisions and requiring another set of parties to continue to bear the adverse financial consequences of such decisions. *Id.*

2909. Further underscoring the inequity of denying refunds for the Resid cut, according to Exxon, is the fact that the Eight Parties, who vigorously oppose those refunds, have agreed to refunds (now totaling over $70 million[865]) attributable to the incorrect valuation of the Heavy Distillate cut. *Id.* There is no lawful basis in Exxon's view for distinguishing between these two sets of refunds, as they arise in both instances from erroneous Quality Bank valuations. *Id.* at pp. 379-80. No one has suggested that BP or Phillips forego the refunds due them for incorrect valuation of the Heavy Distillate cut, nor have they argued that Williams and Petro Star should be spared from paying Heavy Distillate refunds because of the resulting financial impact on those parties. *Id.* at p. 380. Under these circumstances, Exxon argues, equity does not require honoring the Eight Parties's agreement that refunds arising from the prior incorrect valuations of the Resid cut should be denied Exxon. Exxon Reply Brief at p. 422.

2910. Exxon states that, even if the refiners could show that they optimized their operations to reflect the Quality Bank Resid valuation in place in 1993 and took reasonable steps to mitigate the risk that this valuation would change, any reliance on such valuations was not warranted. *Id.* Moreover, Exxon argues, the Eight Parties clearly have not borne the burden of proving either of the two factual predicates which

[864] Exxon points out that Exhibit No. EMT-590 illustrates that Petro Star would avoid paying from $14.56 million to $58.76 million, while Williams would avoid paying from $71.99 million to $267.13 million, as a result of a no-retroactivity decision in both the First and Second Periods. Exxon Initial Brief at p. 379, n.154.

[865] Exxon cites Exhibit No. EMT-610 in support of this point. Exxon Initial Brief at p. 379, n.155.

underlie their equitable claims. *Id.*

2911. First, Exxon asserts, there is virtually no evidence to support the Eight Parties's claim that "the refiners continuously optimize their operations to reflect the Quality Bank." *Id.* (quoting Eight Parties Initial Brief at p. 186). It states that it bears emphasis that Williams did not even present a company witness to describe its operations or present any evidence to explain how it had relied on Quality Bank valuations to its detriment. *Id.* Exxon reiterates its assertion that the Eight Parties bear the burden of proving that equitable considerations should overcome the presumption in favor of retroactivity contained in *Exxon*. *Id.* at pp. 422-23. It states that the Eight Parties, in general, and Williams, in particular, have failed to meet this burden. *Id.* at p. 423. Instead, notes Exxon, the Eight Parties merely assert that they optimized their operations to the later-invalidated valuations. *Id.*

2912. Boltz's testimony provides no better support for the refiners's claim that they optimized their operations in reliance on the valuations then in effect, according to Exxon. *Id.* at p. 424. Although Boltz testified that Petro Star changed its product mix and maximized its through-put in light of changes in the Quality Bank, Exxon points out, he also conceded that Petro Star's refinery operations were not driven by Quality Bank decisions. *Id.* Likewise, continues Exxon, in the wake of the Commission's 1997 decision, Williams expanded its refinery notwithstanding the alleged uncertainty created by Quality Bank proceedings. *Id.* at pp. 424-25. Exxon maintains that this evidence shows that the Eight Parties have not borne their burden of proving that different Quality Bank valuations would have driven different refinery optimizations. *Id.* at p. 425. In Exxon's view, the above-cited evidence regarding plant expansions suggests the exact opposite. *Id.*

2913. Second, Exxon declares, the Eight Parties have not proven that they took any reasonable steps to mitigate the risks created by the pending appeals and administrative litigation over the 1993 Quality Bank valuations. *Id.* To the contrary, according to Exxon, it is undisputed that both Williams and Petro Star aggravated those risks by expanding their plants. *Id.* Faced with this evidentiary record, Exxon points out, the Eight Parties do not even argue that they attempted to mitigate their risks, claiming instead that mitigation would have been impossible or, alternatively, would have required that the refiners bear costs which they would have avoided if they had known in 1993 what the final, lawful Resid valuation methodology would be. *Id.*

2914. Exxon's position is that the Eight Parties have plainly failed to carry their burden of proving that any mitigation would have been impossible, while at the same time distorting the meaning of the term, implying that it involves conduct taken after an event and not during the happening of an event. *Id.* In the face of uncertainty, states Exxon, Boltz conceded that Petro Star could have established a reserve to mitigate the possible financial impact of having to pay refunds with respect to the Resid valuation, such as the one done for Heavy Distillate. *Id.* at pp. 425-26. Exxon also points out that the refiners could have opted not to expand their operations or they could have declined to participate in settlement agreements.[866] *Id.* at p. 426, n.283.

2915. Alternatively, according to Exxon, the Eight Parties assert that mitigation steps might have raised their costs and that, in competitive markets, they could not bear such additional costs. *Id.* at pp. 426-27. In advancing these arguments, Exxon asserts that the Eight Parties rely on the very premise rejected in *Exxon* – that the refiners were entitled to rely on the valuations in the Commission's 1993-1994 orders. *Id.* at p. 427. Under *Exxon*, the issue is not, states Exxon, whether mitigation would have kept the refiners perfectly whole or would have addressed all cash flow impacts. *Id.* It states that the *Exxon* finding necessarily means that reasonable parties in the refiners's position (i.e., parties not entitled to rely on the 1993-1994 valuation orders) would have to take some steps to mitigate the risk of an award of refunds; that the refiners's failure to take any such steps was therefore unreasonable; and that the refiners's conduct does not deserve to be rewarded now in the name of equity. *Id.* Exxon argues that the Eight Parties identify no legal authority to support the proposition that they, as an equitable matter, should be shielded from regulatory risk or spared the costs of taking reasonable steps to mitigate such risks. *Id.*

2916. Exxon asserts that the Eight Parties's arguments that the Interstate Commerce Act should be interpreted as a bar to refunds in this case are misguided. *Id.* at p. 397. To begin with, Exxon states, they represent just a repackaged version of the Commission's argument before the Circuit Court in the *Exxon* case that the TAPS Quality Bank is "*sui generis*." *Id.* Exxon points out that the court held that this argument (along with others) "ha[d] no bearing on the decision and do[es] not explain [the Commission's] decision not to make whole parties who are clearly injured by undervaluation." *Id.* (quoting *Exxon*, 182 F.3d at p. 49).

[866] Exxon notes that the refiners attack Toof's assertion that the refiners should have established a reserve against worst case or most likely scenarios, claiming that "the Commission-determined methodologies reasonably appeared at the times they were in effect to be the most likely, and reserves against most likely case scenarios therefore were unnecessary." Exxon Reply Brief at p. 426, n.283 (quoting Eight Parties Initial Brief at p. 196). However, Exxon states that the *OXY* and *Exxon* decisions clearly foreclosed any claim that the continuation of the existing Resid valuations was the "most likely" scenario by remanding those valuations and holding that reliance on those valuations was "unwarranted." *Id.* In Exxon's opinion, the refiners unreasonably optimized their operations to the least likely outcome, because they relied on the continuation of the Distillate and Resid valuations found to be "arbitrary and capricious" in *OXY*, and the Resid valuation found to be "arbitrary and capricious" for a second time in *Exxon*. *Id.*

2917. Moreover, Exxon argues, the Interstate Commerce Act does not have different standards for transportation rates and Quality Bank assessments; both of which are required to be "just and reasonable." *Id.* (quoting 49 U.S.C. App. §1(5)(1988)). In addition, Exxon maintains, the Quality Bank addresses the core statutory purpose of preventing unlawful preferences and rebates to TAPS shippers because some shippers may take out higher quality crude than they insert, in violation of Sections 3(1) and 2 of the Interstate Commerce Act. *Id.* at pp. 397-98 (citing *Trans Alaska Pipeline System*, 23 FERC ¶ 63,048 at pp. 65,144-45 (1983)).

2918. Exxon also maintains that the Eight Parties's claim that declining to give retroactive effect to the new cut values would not violate the statute also flies in the face of the Circuit Court's three decisions – *OXY, Exxon,* and *Tesoro* – that have addressed the TAPS Quality Bank. *Id.* at p. 398. Each of those decisions, notes Exxon, has relied on prior decisions interpreting and applying the Interstate Commerce Act and its analogs, the Federal Power and Natural Gas Acts. *Id.* According to Exxon, none of those decisions suggested that Quality Bank cut valuations have a legal status, insofar as ratemaking is concerned, that is different from pipeline or electric transmission rates. *Id.* at pp. 398-99. Indeed, asserts Exxon, the Eight Parties's "statutory design" claim is clearly refuted by the *Exxon* court's "hold[ing] that [the Commission] abused its discretion when it failed without adequate explanation to make the [Resid] revaluation and concomitant Quality Bank adjustments retroactive to 1993, when the distillation method was adopted." *Id.* at p. 399 (quoting *Exxon*, 182 F.3d at p. 50).[867]

2919. There also is no support whatsoever, argues Exxon, for the Eight Parties's claim that a ratepayer is entitled to "notice of the precise nature of its potential [refund] liability" before refunds may be ordered, or that "whether the regulated entity is able to assess its risks and alter its operations or contingency planning appropriately" is a "major factor" governing whether revised rates may be retroactively applied. *Id.* at p. 400 (quoting Eight Parties Initial Brief at p. 171). To the contrary, Exxon explains, all that is required for retroactive application of revised rates is that ratepayers have "adequate notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service." *Id.* (quoting *Exxon*, 182 F.3d at p. 49 (internal citations omitted)). Exxon also points out that one of the cases cited by the Eight Parties – *Public Service Co. of Colorado v. F.E.R.C.*, 91 F.3d 1478, 1490 – specifically held that, to avoid refunds in a case of agency error, a ratepayer's reliance on the prior, erroneous rates must be "reasonable." *Id.* Any claim that reliance on the lawfulness of the Commission's 1993 valuations was reasonable must necessarily be rejected, asserts

[867] Exxon claims that the decision cited by the Eight Parties, *Sithe*, in which the court upheld the Commission's decision not to apply retroactively an increase in an "installed capacity deficiency charge," is readily distinguishable from the case at bar. Exxon Reply Brief at p. 399, n.264.

Exxon, because the *Exxon* court has already held that any reliance on those valuations was not warranted. *Id.*

2920. In advancing their public interest balancing test, Exxon asserts, the Eight Parties fail to consider the public interest considerations identified in *Exxon*, including: (i) that "when the Commission commits legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made"; (2) the "strong equitable presumption in favor of retroactivity that would. . . . make whole parties who are clearly injured by undervaluation," and (3) "the incentive that [this strong presumption] creates for the parties to litigate regarding past errors and for the agency to correct those errors." Exxon Reply Brief at p. 429 (quoting *Exxon*, 182 F.3d at p. 49).

2921. Instead, Exxon claims, the Eight Parties advance the following public interest justifications for denying imposition of refunds: (1) that retroactive implementation of changes in valuation "frustrates efficient economic planning", (2) that Exxon has not shown that denial of refunds would provide incentives for parties to "game the system," and that, in any event, any suggestion of "gaming" is refuted by the Eight Parties's agreement to retroactive implementation of the revised Heavy Distillate valuation, and (3) that "retroactivity would have a negative impact on consumers." *Id.* at pp. 428-29 (citing Eight Parties Initial Brief at pp. 198-200). Exxon's position is that none of these considerations provides a justification for the denial of refunds. *Id.*

2922. Exxon asserts that the first public interest factor identified by the Eight Parties, the alleged economic inefficiency arising out of regulatory uncertainty, directly conflicts with the *Exxon* decision. *Id.* at p. 429. It maintains that the principle set forth in *Exxon* – that parties should be put in the position they would have been in had an administrative error not been made – cannot reasonably be overridden by the alleged uncertainty associated with the judicial and administrative review processes. *Id.* Exxon notes that, during the period when the merits of an administrative decision are being litigated, there is always uncertainty over whether that decision will be affirmed. *Id.* An "uncertainty" exception, in their view, would thus immediately swallow the legal principle and the equitable presumption set forth in *Exxon*. *Id.* at pp. 429-30. Indeed, the court in *Exxon* made this point in stating: "The goals of equity and predictability are not undermined when the Commission warns all parties involved that a change in rates is only tentative and might be disallowed." *Id.* at p. 430 (quoting *Exxon*, 182 F.3d at p. 49).

2923. With respect to the contention that it has not shown that a denial of refunds would provide an incentive for parties to game the system, Exxon states, the Eight Parties again ignore a fundamental aspect of the *Exxon* decision: its creation of a presumption in favor of retroactivity. *Id.* As a result, Exxon argues that it does not bear the burden of proving that the absence of retroactivity would provide an incentive for gaming. *Id.*

2924. Nonetheless, Exxon argues, the record strongly suggests that the settlement process in this litigation was seriously gamed. *Id.* In its view, the fact that the Eight Parties agreed to retroactive implementation of the Heavy Distillate valuation highlights the inequity of their opposition to retroactive implementation of the Resid valuation, and it is further evidence of a compromise among the Eight Parties to advance their economic interests at the expense of Exxon's. *Id.* Exxon also claims it is undisputed that, while Williams and Petro Star are the largest potential payers of both Heavy Distillate and Resid refunds, BP and Phillips are the principal beneficiaries of Heavy Distillate refunds, but relatively minor beneficiaries of Resid refunds. *Id.* at pp. 430-31. By contrast, explains Exxon, Exxon is the largest potential recipient of Resid refunds, but is virtually unaffected by Heavy Distillate refunds. *Id.* at pp. 431. Under these circumstances, continues Exxon, Williams, Petro Star, BP, and Phillips have agreed to pay and receive Heavy Distillate refunds, but have opposed the payment of Resid refunds. *Id.* As the Circuit Court recognized, concludes Exxon, all of these parties benefit from this arrangement, at the expense of Exxon. *Id.* (citing 182 F.3d at 50).

2925. Further, states Exxon, the Eight Parties view that retroactive refunds are acceptable when their amount can reasonably be estimated in advance (Heavy Distillate), but unacceptable when their amount is uncertain (Resid) can hardly be viewed as sound ratemaking policy. *Id.* at p. 432. Such a theory, argues Exxon, ignores the fundamental purpose of refunds, both in general (i.e., to compensate those who have paid excessive rates) and in instances where refunds are necessary to correct legal error (i.e., putting parties in the position in which they would have been but for the error). *Id.* It maintains that there can certainly be no equity in having an award of refunds depend on whether, in the subjective view of the potential refund payers, the amount of refund exposure is reasonably certain (as the Eight Parties claim with respect to the Heavy Distillate refunds) or uncertain (as they claim with respect to the Resid refunds). *Id.*

2926. Exxon notes that the Eight Parties assert that it "has not submitted evidence that would allow the [Commission] to determine the just and reasonable values for the Resid cut for every year covered by [Exxon]'s refund request." *Id.* (quoting Eight Parties Initial Brief at p. 201). According to Exxon, the Eight Parties argue that the Quality Bank is different from the typical refund case. *Id.* While the Eight Parties acknowledge that all parties used the same general approach to derive a Resid value, Exxon points out, they claim that disputes over the adjustments to be made to the coker outputs and over valuations of other cuts render the resulting Resid valuations unusable for retroactive application. *Id.* at pp. 433-34. Thus, states Exxon, the Eight Parties conclude the Commission "cannot merely decide what is just and reasonable today and project that outcome retroactively over some hypothetical refund period." *Id.* at p. 434 (quoting Eight Parties Initial Brief at p. 201).

2927. According to Exxon, this argument suffers from at least three serious defects. *Id.* First, states Exxon, if adopted, the argument would leave in place, for the period 1993 to the date of the decision in these proceedings, Resid valuations which have been found to be unlawful and which all parties now agree were too high. *Id.* Thus, notes Exxon, adoption of this argument would require that Quality Bank payments made and received pursuant to those erroneous valuations remain settled on an erroneous basis. *Id.* Second, continues Exxon, the Eight Parties's argument is undermined by the fact that, under the distillation methodology with respect to cuts other than Resid, processing costs based on any given year's technology and costs are routinely applied by the Quality Bank in other years, including for the purpose of calculating refunds. *Id.* Third, Exxon argues, there is no merit to the Eight Parties's contention that, because Exxon's refund calculations for the Resid cut incorporate (in the before-cost Resid value) Exxon's proposed valuations for Naphtha, VGO, and Heavy Distillate, and because such valuations are in dispute in this proceeding, there is a "conflict in the evidence as to the justness and reasonableness of the before-cost coker value." *Id.* (quoting Eight Parties Initial Brief at p. 204). Exxon asserts that such refund calculations are necessarily illustrative. *Id.* at pp. 434-35. Ultimately, states Exxon, the Quality Bank Administrator will take the cut values determined by the Commission and, if refunds are awarded, apply those valuations to each shipper's stream composition for the refund period in question. *Id.* at p. 435.

2928. Exxon states that the parties agree that there has yet to be a final decision on the just and reasonable valuation of Resid for the period December 1, 1993, through the present date. *Id.* The parties also agree, notes Exxon, that "[i]n the instant matter, the issue is to find a proxy for the Resid component that bears a rational relationship to the actual value of resid." *Id.* (quoting Eight Parties Initial Brief at p. 9); *see also Trans Alaska Pipeline System*, 97 FERC at pp. 61,151-52. Further, continues Exxon, there is no disagreement over the question of whether Resid is overvalued. Exxon Reply Brief at p. 435. Both the Eight Parties's and Exxon's proposed valuations of Resid produce values for Resid that are substantially lower than values for Resid in place between 1993 and 2002. *Id.*

2929. Because the Commission's prior attempts at Resid valuations have failed, Exxon explains, all Quality Bank accounts have been settled for the past decade on the basis of Resid valuations that have been found to be erroneous. *Id.* In attempting to fashion a just and reasonable Resid valuation in the instant proceeding, it should be clear, according to Exxon, that neither of the prior remanded valuations can be used. *Id.* at pp. 435-36. The first approach (valuing Resid based on the unadjusted price of F.O. 380) is unacceptable, asserts Exxon, because it was abandoned by the Commission itself on remand from *OXY;* and the second approach (valuing Resid at the price of F.O. 380 minus 4.5¢/gallon) is unacceptable because, on remand from *Exxon*, it has not been defended or advocated by any party. *Id.* at p. 436. Thus, Exxon argues that there is no evidentiary support in this record for either of those Resid valuations. *Id.* Accordingly, it is Exxon's position that the Commission must find a different approach to Resid valuation based on the record compiled in this proceeding. *Id.*

2930. Consistent with the foregoing, Exxon advocates that the corrected values for the cuts subject to remand in *OXY* – the Light Distillate, Heavy Distillate, Fuel Oil and Resid cuts – should be made retroactive to December 1, 1993. Exxon Initial Brief at p. 380. Refunds, with interest, should be ordered for the periods during which the remanded cut values were in effect. *Id.*

2931. The TAPS Carriers explain that the Quality Bank Administrator serves as stakeholder for the Quality Bank, collecting money from one set of shippers and redistributing it (after deducting expenses) to another set of shippers in accordance with the Commission's orders. TAPS Carriers Initial Brief at p. 18. They point out that they neither receive nor distribute Quality Bank adjustments. *Id.* Because they retain none of the Quality Bank adjustments, the TAPS Carriers state, it makes little sense to refer to their paying "refunds" of such adjustments. *Id.* Any refunds in their view must come from the shippers who allegedly received amounts in excess of what they would have received under a just and reasonable Quality Bank methodology. *Id.* While they take no position on whether any such refunds should be made by shippers, the TAPS Carriers note, however, that were such refunds to be ordered, they recommend that the Commission simply direct the Quality Bank Administrator to recalculate the Quality Bank adjustments for the period at issue, collect any amounts owed to the Quality Bank, and redistribute such collected monies to those shippers owed money as a result of the recalculations. *Id.*

2932. According to the TAPS Carriers, Common Carriers, their agents, and employees are required by the Interstate Commerce Act to comply with Commission orders. TAPS Carriers Initial Brief at p. 19 (citing, *inter alia*, 49 U.S.C. App. § 16(7)(1998)). Should a carrier not comply with the orders of the Commission, they point out, it is subject to significant penalties. *Id.* In this case, explain the TAPS Carriers, the Commission issued a series of orders prescribing the Quality Bank methodology to be implemented by the TAPS Carriers and finding that methodology to be just and reasonable. *Id.* at p. 20. The TAPS Carriers also assert that it is uncontested that they have complied with the orders of the Commission prescribing the Quality Bank methodology. *Id.* at p. 21. Thus, the TAPS Carriers argue, case law supports their contention that their compliance with those orders cannot be the basis for holding them liable for the payment of refunds or any other form of retroactive relief. *Id.* Specifically, the TAPS Carriers cite *OXY*, 64 F.3d at pp. 697-700, for the proposition that a new Quality Bank methodology can only be applied prospectively. TAPS Carriers Initial Brief at p. 22.

2933. The Commission has confirmed, according to the TAPS Carriers, that as long as a carrier "operates the [quality] bank in accordance with the tariff provisions, it is not subject to any independent obligations, nor to any claims for violations of the [Interstate Commerce Act]." *Id.* (quoting *All American Pipeline Co*., 67 FERC ¶ 61,094 at p. 61,267 (1994)). According to the TAPS Carriers, the *All American Pipeline* decision clarified that the TAPS carriers are not financially responsible for any refunds arising from quality bank adjustments. *Id.* Instead, the TAPS Carriers assert, the moneys will come from funds collected from shippers who have repaid amounts to which they were not entitled. *Id.*

2934. This conclusion, according to the TAPS Carriers, is based on the self-evident fact that a carrier operating a quality bank does not participate in the Quality Bank and therefore has not retained any funds to be refunded. *Id.* Thus, according to the TAPS Carriers, any refunds must be assessed against the shippers and not the TAPS Carriers. *Id.*

2935. Although the TAPS Carriers cannot lawfully be required to pay refunds, the TAPS Carriers note, orders requiring the recalculation of Quality Bank adjustments for past periods are not necessarily precluded. *Id.* at p. 23. The TAPS Carriers assert that, if a prior order was in error and needed to be corrected, an agency may do so without violating *Arizona Grocery* or the rule against retroactive ratemaking. *Id.* According to the TAPS Carriers, legal errors in a prior order may be corrected as long as the parties affected by that order are on adequate notice that resolution of some specific issue may cause a later adjustment to the amount being collected under the prior order. *Id.* In such circumstances, the TAPS Carriers point out, the remedy available is for the agency to retroactively redesign the rate or program that it had previously imposed in error. *Id.* at pp. 23-24. They take no position on whether this exception should be applied under the circumstances in this case. *Id.* at p. 24.

2936. A necessary corollary, explain the TAPS Carriers, is that adoption of a new Quality Bank methodology retroactively would not necessarily assure that a given shipper would receive every dollar of refunds to which it might believe it was entitled under the new methodology. *Id.* This is so, according to the TAPS Carriers, because they would pay out only those funds that they were able to collect from shippers that were required to pay money into the Quality Bank under the new methodology. *Id.* Thus, if for some reason the TAPS Carriers were unable to collect funds from a shipper, the TAPS Carriers explain, they would simply distribute the funds they were able to collect pro rata, in accordance with the TAPS Carriers's rules and regulations tariffs. *Id.* Each tariff, notes the TAPS Carriers, contains a provision providing for the distribution only of funds that have actually been collected. *Id.* Such tariff provisions are, according to the TAPS Carriers, consistent with the TAPS Carriers's role, acting through the Quality Bank Administrator, as stakeholders for, and not participants in, the Quality Bank. *Id.* at pp. 24-25.

ISSUE 5 -DISCUSSION AND RULING

2937. In *OXY*, 64 F.3d at pp. 692, 695, the Circuit Court, after finding no fault with the Commission's decision to change from the gravity methodology to the distillation methodology for valuing the ANS common stream, found that the Commission had failed to have good grounds for valuing Light and Heavy Distillate, Fuel Oil and Resid.

Subsequently, the Commission approved new proxies for each of these cuts and, with the exception of that for Resid, they were affirmed by the Circuit Court in *Exxon*. In the instant case, a new proxy for Resid has been determined.

2938. The question to be answered in Issue 5 is what should be the effective date of the proxy values approved by the Circuit Court in *Exxon* and what should be the effective date of the Resid proxy determined here. According to the Eight Parties, the parties agree that, if the new Resid proxy "is made retroactive to December 1993, the Nine Party Settlement valuations of the other three Remanded Cuts [i.e., those which were approved in *Exxon*] should be retroactive for the period between December 1993 and implementation of the Nine Party Settlement in 1998." Eight Parties Reply Brief at p. 131, n.58. *See also* Exxon Reply Brief at p. 401, n.265; Eight Parties Initial Brief at p. 176.

2939. Based on the parties's agreement, we need only analyze the situation regarding the Resid cut. As to Resid, it is beyond dispute that, since the adoption, by the Commission, of the distillation methodology for calculating cut values for Quality Bank purposes, that the Circuit Court has not accepted the Commission's designated Resid valuation. The Circuit Court, in disapproving the Commission's determination that 1050°+F Resid should be valued at the price of FO-380, stated:

> [T]he record demonstrates no more than that the price of FO-380 bears some remote relationship to the values of 1050+ resid as a feedstock. FERC offers two arguments in defense of its use of FO-380 as a proxy, neither of which is convincing. First, relying on expert testimony, the Commission claims that FO-380 can substitute for the 1050+ resid as a feedstock. Notably, neither the witness who so testified nor any other stated that it was a common industry practice to use FO-380 as a feedstock when resid would do the job. Consequently, although the cited testimony supports the conclusion that FO-380 and the 1050+ resid share some physical properties, it in no way suggests the two materials have equal or even near-equal market values. . . . The Commission's conclusion simply does not follow from its premise.
>
> The Commission's alternate justification is that it has assigned, as a proxy for this least valuable component of the common stream, the petroleum product having the lowest published price. The fact that FO-380 is cheaper than other petroleum products with active markets, however, in no way demonstrates that its value is even remotely commensurate with that of resid. . . . We therefore find the 1050+ resid portion of the assay methodology arbitrary and capricious and remand it to the Commission for further consideration.

OXY, 64 F.3d at p. 695.

2940. After the Commission, on remand, adjusted the Resid proxy prices,[868] the Circuit Court once again reversed and remanded the Commission's decision on Resid:

> We remand FERC's decision to value resid at the price of FO-380 less 4.5 cents on the West Coast and Waterborne 3% sulfur No. 6 fuel oil less 4.5 cents on the Gulf Coast. The figures derived from the use of these proxies with a subsequent adjustment do not bear a demonstrated relationship to the value of resid, either as a coker feedstock or as a blending agent for fuel oil.

Exxon, 182 F.3d at p. 40.[869] In doing so, the Circuit Court affirmed the Commission's determination "that resid is best valued based on the market value of its constituent products." *Id.* at p. 41. In all other regards, the Circuit Court upheld the Commission's order regarding calculation of the ANS Quality Bank. *Id.* at p. 50.

2941. As there never has been a Resid proxy since the Commission implemented the distillation method on December 1, 1993,[870] it follows that the value of the Resid proxy established by this order should be made effective on that date as well. However, the Eight Parties strenuously argue in support of a prospective only implementation.

2942. While recognizing that there has not been a value for Resid ordered by the Commission and approved by the Circuit Court, the Eight Parties suggest "equitable" grounds for implementation only on a prospective basis: (1) Exxon benefited from the manner in which Natural Gas Liquids were treated prior to 1993 while the gravity method was challenged, and would benefit again were the Resid proxy valuation be made effective on December 1, 1993; (2) the affected refiners were not able to arrange their operations to mitigate the impact of the new valuation; (3) allowing refunds is not in the public interest; and (4) the evidence does not reflect that the new proxy values were "just and reasonable" for the whole period from December 1, 1993, forward. Eight Parties Initial Brief at pp. 178, 186, 198, 201.

2943. On reply, they argue that, making the new Resid valuation effective on December 1, 1993, would not put the parties in the same position in which they would have been

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[868] *Trans Alaska Pipeline System*, 81 FERC ¶ 61,319 (1997).

[869] The Circuit Court also stated that the 4.5¢ adjustment was as arbitrary and capricious as was the Commission's choice to use FO-380 as the proxy price. *Exxon*, 182 F.3d at p. 41.

[870] *Trans Alaska Pipeline System*, 65 FERC at pp. 62,280, 62291-92.

had the Commission made a determination approved by the Circuit Court. Eight Parties Reply Brief at pp. 135, 143-45. Moreover, according to the Eight Parties, Exxon has failed to show that it would have received the monies it claims as refunds had the Commission previously made the determination which is made herein regarding the value of a Resid proxy. *Id.* at pp. 141-43.

2944. At first blush, the Eight Parties's argument has appeal. After all, on face value, their evidence makes a strong case, based on equitable considerations, for holding that the values of the remand cuts should be made effective on a prospective basis only. However, a closer analysis reflects that their argument is not well grounded.

2945. Where the Eight Parties argument fails is that they were unable to establish that, at any time since December 1, 1993, there was a Resid proxy which was determined to be, or could be determined to be, just and reasonable. While the Circuit Court found that the Commission properly replaced the gravity method with the distillation method, and while the Circuit Court has approved, in either *OXY* or *Exxon*, the Commission's ruling as to all of the remaining cuts, the two different proxies it determined were appropriate for valuing Resid were found to be arbitrary. Analyzed, these rulings indicate that the Commission determined that shippers's streams valued under the gravity method were no longer just and reasonable when it instituted the distillation method and this determination was affirmed by the Circuit Court. However, until now, there has been no proxy to value Resid which has been determined to be just and reasonable. Ergo, the proxy which is determined herein for Resid is the only just and reasonable value for it since December 1, 1993, and it must be made effective on that date notwithstanding any equitable considerations.[871]

2946. In any event, after first glance, the Eight Parties's argument is not convincing. First, their calculations of what financial benefits accrued during the period when replacing the gravity method was under consideration (which they designate the First Period) and the period since December 1, 1993, when the distillation method replaced it (which they designate the Second Period) are questionable.[872] Second, I am not

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[871] I am satisfied, based on a reading of the entire record, that the Resid value established in this Initial Decision is just and reasonable, and was just and reasonable throughout the period from December 1, 1993, forward.

[872] Exxon, on brief, greatly details these problems. *See* Exxon Initial Brief at pp. 371-75. Among other things, it notes that

> [T]he methods and data the Eight Parties used to calculate over- and underpayments for the First Period differ from those they used to do calculations for the Second Period. . . . In calculating over- and underpayments for the Second Period, the Eight Parties rely on the Caleb

convinced that there is a clear delineation between them (as a group) and Exxon with regard to being benefited during the period when the Commission was considering replacing the gravity method. For example, Exxon notes that Dayton agreed that Williams (one of the Eight Parties) as well as Exxon greatly benefited under the gravity method.[873] Moreover, were the Resid proxy determined here only made effective prospectively, Williams also would greatly benefit as well.[874] Furthermore, while Exxon will be owed a refund from the Quality Bank as a result of making December 1, 1993, the effective date of the Resid value established here, so will at least Alaska, BP and Phillips (three more of the Eight Parties).[875] Consequently, contrary to the Eight Parties's assertion, I find it difficult to see how equity demands a decision one way or the other.[876]

> Brett assays to measure stream qualities. By contrast, because the individual streams that comprise the TAPS common stream were not assayed during the First Period, the Eight Parties' calculations for this Period are based on numerous assumptions about the composition of those streams.

Id. at pp. 371-72 (footnote omitted).

[873] At the hearing, Dayton stated that Williams "had a significant benefit as a result of the gravity base" and agreed to characterize that benefit as a "windfall." Transcript at pp. 11884-85.

[874] *See* Exhibit No. EMT-590.

[875] *See* Transcript at pp. 12561-62.

[876] The First Period referred to by the Eight Parties involved the time during which the Commission investigated claims that the API gravity tariff mechanism for the Quality Bank was unlawful. While the Commission eventually determined that it was no longer just and reasonable, it further determined that, as no party violated the previously Commission-approved tariff, the distillation method was made effective on a prospective basis. Here, all parties have been on notice that, under the newly effective distillation method, there has never been a lawful proxy price for the Resid cut. In this decision, the vacuum of uncertainty created by the failure of the Commission to approve an appropriate proxy for the Resid cut from the inception of the distillation method, is filled. Consequently, what is being addressed here is not the replacement of a methodology which is currently in effect and which has been determined to be unjust and/or unreasonable, as during the First Period described by the Eight Parties. Instead, it is a proxy value for Resid to fill in an unknown in the formula used by the Quality Bank under the distillation method previously determined (and unchallenged) to be just and reasonable to value the individual streams which comprise ANS passing through TAPS. Ergo, the Eight Parties's argument that, because refunds were not awarded for the First

2947. In addition, I find unconvincing the Eight Parties's claim that they relied on the Commission's previous orders to operate their businesses and that, as a result, they should not be required to pay refunds into the Quality Bank because they might have operated their businesses differently had the Resid value ordered here been in effect throughout the period. The Eight Parties were aware, from the beginning,[877] that Exxon and Tesoro challenged the Commission's initial determination as to how Resid would be valued for Quality Bank purposes.[878] While they might not have known exactly how Resid eventually would be valued, they were on notice that it probably would not be valued as the Commission first did in 1993 since, at least, the issuance of the *OXY* decision by the Circuit Court in 1995. Under these circumstances, the prudent businessman would have taken steps to protect his business.[879] While the record does not reflect what they did, I assume that the affected members of the Eight Parties are operated by prudent businessmen.[880]

Period, equity requires that they not be awarded for the period since the distillation method became effective amounts to a non sequitur.

[877] Boltz agreed that Petro Star was aware that the Commission's 1993 and 1994 orders were being appealed, and that the Commission denied Exxon's request for a stay stating that it "could subsequently correct any legal errors." Transcript at p. 11711. *See also id.* at pp. 12400-02.

[878] *See Trans Alaska Pipeline System*, 65 FERC at pp. 62,283 and 62,284, n.29.

[879] Toof testified that "a prudent course of action would have been to establish a reserve against such a contingency as Petro Star has done for the Heavy Distillate cut." Exhibit No. EMT-123 at p. 44. *See also* Transcript at pp. 12394-410. I am not suggesting that this course was the only one available to Petro Star, but it certainly is one road that Petro Star could have taken.

[880] The Eight Parties also suggest that implementing the Resid value ordered here as of December 1, 1993, would not put the parties in the same position in which they would have been had the value been determined in 1993. Eight Parties Reply Brief at pp. 143-45. Inasmuch as about 15 years of litigation has passed since this matter first was initiated, and that, over that period, there have been multiple changes in the circumstances involving the ANS fields, the participants, and local, national and worldwide economic conditions, it is hard to argue with their claim. On the other hand, there may be parties injured by the Commission's failure to determine a Resid value which can be judged to be just and reasonable and there may be parties who benefited from those circumstances who should not have. Under these circumstances, the Commission has an obligation to do what it can to put salve on the wounds of those who were injured. It follows, therefore, that refunds, if warranted, must be paid to those who paid too much into the Quality Bank and that those who paid in too little must be billed

2948. As the facts do not support them, neither does the law sustain the Eight Parties's argument. They rely on *Towns of Concord, Norwood & Wellesley v. FERC*, 955 F.2d 67 (D.C. Cir. 1992), to support their claim that refunds are not appropriate here.[881] In that case, the Circuit Court was reviewing a Commission decision not to order refunds to the Towns after Boston Edison unlawfully passed on spent nuclear fuel storage and disposal charges. *Towns of Concord*, 955 F.2d at p. 67. The Circuit Court noted that the Commission found that Boston Edison, for the most part, was not aware that it was passing through unlawful charges. *Id.* at pp. 69, 75. It held that the rule against retroactive ratemaking did not compel the ordering of refunds. *Id.* at p. 75. Moreover, as noted by the Eight Parties, the Circuit Court stated:

> Customer refunds are a form of equitable relief, akin to restitution, and the general rule is that agencies should order restitution only when "money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it." Because the "equitable aspects of refunding past rates are . . . inextricably entwined with the [agency's] normal regulation responsibility," absent some conflict with the explicit requirements or core purposes of a statute, we have refused to constrain agency discretion by imposing a presumption in favor of refunds. The agency need only show that it "considered relevant factors and . . . struck a reasonable accommodation among them," and that its order granting or denying refunds was "equitable in the circumstances of this litigation."

Id. at pp. 75-76 (internal citations omitted).

2949. In the instant case, as noted above, there never was a lawful value for Resid under the distillation methodology. No party was at fault for this. The TAPS Carriers simply administered the Quality Bank using the best information they had available, and everyone was aware that the formula which was being used might be changed through voluntary settlement between the parties, or might not be upheld either by the Commission or by the Circuit Court. Under these circumstances, I find that the equities lean in favor of granting refunds to those who overpaid into the Quality Bank. *See Tarpon Transmission Co.*, 51 FERC ¶ 61,310 at p. 62,028 (1990), *aff'd*, *Natural Gas Clearinghouse v. F.E.R.C.*, 965 F.2d 1066 (1992); *Exxon*, 182 F.2d at p. 49.

2950. Lastly, I acknowledge that the Eight Parties argue that the public interest requires that the Commission not order refunds here. Eight Parties Initial Brief at p. 198.

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for their underpayments.

[881] Eight Parties Initial Brief at pp. 167-69.

However, the public has no interest in this case which solely involves how a pool of money is to be divided amongst multi-billion dollar corporations.

2951. The parties have agreed that, if the new Resid value "is made retroactive to December 1993, the Nine Party Settlement valuations of the other three Remanded Cuts should be retroactive for the period between December 1993 and implementation of the Nine Party Settlement in 1998." Eight Parties Reply Brief at p. 131, n. 58. *See also* Exxon Reply Brief at p. 401, n.265. Furthermore, as noted by the Eight Parties, the West Coast "Heavy Distillate price approved in 1998 was discontinued in 2000, and the [Quality Bank Administrator] was forced to select a replacement." Eight Parties Initial Brief at p. 176, n.99. The parties agreed that "West Coast Heavy Distillate will be valued at the published Platt's West Coast price for Los Angeles Pipeline low sulfur (0.05%) No. 2 Fuel Oil," less the deductions determined in this proceeding, and that the new value shall be effective on February 1, 2000. Joint Stipulation of the Parties, filed October 3, 2002, p. 3.

2952. From the above, it is clearly appropriate that the Quality Bank Administrator re-calculate the Quality Bank from December 1993 forward and make appropriate refunds.[882] However, as it is clear that the TAPS Carriers are not liable for payment of such refunds, in the event that collections, less costs, do not equal the refunds due, such refunds are to be made on a pro rata basis. *See* Joint Exhibit No. 12 at P 1, 2. This procedure was suggested by the TAPS Carriers and not objected to by any party. *See* TAPS Carriers Initial Brief at pp. 23-24; Joint Exhibit No. 12 at P 3.

ISSUE NO. 9: ARE REPARATIONS AN ISSUE IN THIS PROCEEDING? IF SO, WHAT REPARATIONS, IF ANY, ARE APPROPRIATE?

A. LEGAL STANDARD

2953. According to the Eight Parties, Issue No. 9 is based on Exxon's claim for money damages, or reparations, for the period beginning June 19, 1994, two years before the filing of Exxon's complaint in Docket No. OR96-14-000, and extending to the date of a decision in this case. Eight Parties Initial Brief at p. 209. They explain that Exxon's witnesses calculated the difference between Exxon's actual Quality Bank receipts and what those receipts would have been had the Naphtha and VGO cuts been valued during the relevant time period using prices for Naphtha and VGO which Exxon now claims

[882] Such a holding is consistent with the commitment the Commission made in 1994 to correct any errors it made in replacing the gravity method with the distillation method. *See Trans Alaska Pipeline System*, 66 FERC at p. 61,423.

should have been used. *Id.* The reparations claim, explain the Eight Parties, is limited to the Naphtha and VGO cuts and is based on the reparations provisions of the Interstate Commerce Act. *Id.* Exxon's reparations claim for Naphtha totals some $64 million through 2002, offset by a negative $30 million (credit) for VGO reparations, for a net of some $34 million. *Id.*

2954. It is the Eight Parties's position that reparations are not properly at issue in this case because Exxon failed to establish a legal basis for the Commission to consider such a claim. *Id.* at pp. 209-10. In the first place, the Eight Parties assert, the Commission's prior rulings respecting the Naphtha and VGO cuts preclude any retroactive adjustment to those cuts. *Id.* at p. 210. Second, the Eight Parties point out that Exxon has not filed a complaint which qualifies under Section 13(1) of the Interstate Commerce Act for a reparations award for improper valuation of the Naphtha and VGO cuts. *Id.* Third, the award of reparations is an equitable remedy, and the Eight Parties believe that equitable considerations preclude granting Exxon's reparations claim. *Id.* Accordingly, the Eight Parties urge that reparations be denied. *Id.*

2955. The Eight Parties explain that the TAPS Quality Bank in its current form uses Gulf Coast prices to value West Coast volumes for both the Naphtha and VGO cuts. *Id.* In setting these values, state the Eight Parties, the Commission ruled that it was determining these issues as its own resolution of the Quality Bank, based on the hearing record and pursuant to its authority under the Interstate Commerce Act. *Id.* The Eight Parties point out that the Commission's ruling as to these two cuts was not disturbed on appeal, and no party appealed either valuation. *Id.*

2956. Such previously approved cut valuations in the existing TAPS Quality Bank methodology enjoy the protection of the filed rate doctrine, according to the Eight Parties. *Id.* The filed rate doctrine, assert the Eight Parties, precludes any retroactive change to a rate that has been previously approved by the Commission. *Id*. Accordingly, were the Commission to adopt Exxon's proposals for valuing the Naphtha and VGO cuts, the Eight Parties argue, it could not make those changes effective retroactively from the date of its decision. *Id.* at pp. 210-11. They urge that any change to the previously approved methodology be made only on a prospective basis. *Id.* at p. 211.

2957. The Eight Parties point out that the *OXY* court explained that the Interstate Commerce Act reflects the filed rate doctrine and the rule against retroactive ratemaking. *Id.* Under Section 15(1) of the Interstate Commerce Act, note the Eight Parties, the Commission is empowered to hold hearings upon a complaint to review a rate, and to set a new rate if it finds the existing rate to be unjust and unreasonable or unduly discriminatory. *Id.* However, it can only set the rate "to be thereafter observed." *Id.* (quoting 49 U.S.C. App. § 15(1)(1988)). Therefore, the Eight Parties assert, the Commission cannot order a retroactive rate change. *Id.* Similarly, the Eight Parties explain, the Commission may proceed under Section 13(2) of the Interstate Commerce

Act by its own motion to investigate rates, but it is prohibited from issuing "orders for the payment of money." *Id.* (quoting 49 U.S.C. App. § 13(2)(1988)). Section 15(7) authorizes the Commission to order refunds, but the Eight Parties assert that authority applies only to rate increases proposed by a carrier that are suspended by the Commission pending an investigation. *Id.* According to the Eight Parties, Section 15(7) does not apply to previously approved rates. *Id.*

2958. Recognizing that refunds are not available for the Naphtha and VGO cuts, the Eight Parties point out, Exxon has characterized its claim for retroactive relief for these cuts as reparations, thereby distinguishing them from the Resid and Heavy Distillate cuts. *Id.* The Eight Parties explain that a claim for reparations arises under Sections 8, 9 and 13(1) of the Interstate Commerce Act. *Id.* Sections 8 and 9 allow a person injured by a carrier's violation of the Act to sue the carrier for damages sustained as a result of the violation, according to the Eight Parties, while Section 13(1) allows such complaints to be filed with the Commission. *Id.* The Eight Parties note that the statute provides that a carrier can avoid liability under Section 13(1) by making reparation for the injury alleged, 49 U.S.C. App. § 13(1)(1988), hence the name for this type of relief. *Id.* at pp. 211-12. Under Section 13(1), state the Eight Parties, a shipper bears the burden of proof to show that the rate paid violated the Interstate Commerce Act and that the shipper suffered damage as a result. *Id.* at p. 212. If the shipper meets that burden, then, the Eight Parties explain, the Commission has discretion to order the carrier to pay reparations. *Id.*

2959. The Eight Parties note that the Interstate Commerce Act indicates that a reparations claim has the following elements: (1) an allegation that a carrier has violated the Act; (2) proof that the claimant has sustained injury as a result of the violation; and (3) reparation for the injury paid by the carrier. *Id.* With respect to showing a violation of the Act, the Eight Parties assert that, if the rate that the shipper challenges is a carrier-initiated rate on file with the Commission, it may nevertheless be unlawful if it is proven in the reparations hearing to be an unjust and unreasonable rate or an unduly discriminatory or preferential rate. *Id.*

2960. According to the Eight Parties, the required elements of a Section 13(1) claim are not present in this case. *Id.* at p. 213. They explain that neither Toof nor Pavlovic make any claim in their testimony that the TAPS Carriers have violated any provisions of the Act or any terms of their tariffs. *Id.* Further, note the Eight Parties, neither witness asserts that Exxon has suffered damages as a result of such a violation. *Id.* Instead, point out the Eight Parties, the claim is based on the assertion that the rate itself is not just and reasonable, even though it was previously approved by the Commission. *Id.* They maintain, however, that Section 13(1) of the ICA does not allow this type of collateral attack or end-run around the filed rate doctrine. *Id.*

2961. The Eight Parties state that Exxon relies primarily on *I.C.C. v. United States*, 289 U.S. 385 (1933) for its assertion that it need only show that the rate complained of is not just and reasonable and that reparations flow automatically as an entitlement from such a showing. Eight Parties Reply Brief at p. 171 (citing Exxon Initial Brief at pp. 382-83, 388). According to the Eight Parties, while Exxon's proposition provides the measure of damages for certain types of reparations claims, it does not provide a complete or accurate description of the law of reparations under the Act, nor is it applicable to the claim made here. *Id.* First, the Eight Parties declare that *I.C.C. v. United States* is inapplicable to the facts of this case, because it did not involve a claim that a rate paid by the claimant was not just and reasonable. *Id.* at pp. 171-72.

2962. More on point, according to the Eight Parties, is *Louisville & Nashville R.R. Co. v. Sloss-Sheffield Steel & Iron Co*., 269 U.S. 217, 235 (1925). *Id*. at p. 172. The Eight Parties state that this case makes sense out of apparently inconsistent holdings in various cases by explaining that a different standard for proof of damages applies depending on which section of the Interstate Commerce Act gives rise to the reparations claim. *Id*. (citing 269 U.S. at p. 235). They explain that, if a claimant sues for reparations because of rebates, or discrimination in rates, or violation of the longhaul/short-haul rule, special proof of specific injury arising from the violation is required. *Id*. If, continue the Eight Parties, the claim arises under Section 1(5), 49 U.S.C. App. § 1(5)(1988), which requires that all rates be just and reasonable, then the measure of damages is the difference between the rate paid and the just and reasonable rate that should have been paid and further proof of loss is not required. *Id*. at pp. 172-73; Eight Parties Initial Brief at pp. 216-17.

2963. Nonetheless, according to the Eight Parties, even correctly identifying the measure of damages for a potential reparations claim does not establish an entitlement to those damages. Eight Parties Reply Brief at p. 173. They state that the primary case barring any reparations claim for the Naphtha and VGO cuts is *Arizona Grocery* and assert that neither Exxon's contention that the Commission has yet to prescribe lawful rates for all features of the distillation methodology, nor its contention regarding the quality of the record underlying its previous rulings on the Naphtha and VGO cuts, renders *Arizona Grocery* inapplicable. *Id.* at pp. 173-74.

2964. The Eight Parties note that Exxon argues that the Commission will not have prescribed rates within the meaning of *Arizona Grocery* until all of the issues remanded for legal error are resolved. *Id.* at p. 174. They assert that there are several defects to this argument. *Id.* In the first place, the Eight Parties point out, the *OXY* court has explicitly ruled that the Commission's Quality Bank rulings made after hearing amount to Commission prescribed rates. *Id.* (citing *OXY*, 64 F.3d at p. 699). Secondly, the Eight Parties note that the *Exxon* court has already rejected the argument that the TAPS Quality Bank methodology is *sui generis*, an argument used by the Commission to attempt to justify its decision not to make certain changes to the method retroactive. *Id.* (citing *Exxon*, 182 F.3d at p. 49). Exxon cites this holding in support of its position, state the Eight Parties, and claims that the *sui generis* argument has no bearing on the issue of retroactive relief. *Id.* at pp. 174-75 (citing Exxon Initial Brief at p. 345).

2965. Exxon, the Eight Parties state, is making the same argument in advocating for reparations in an attempt to avoid the effect of *Arizona Grocery*. *Id.* at p. 175. They assert that Exxon's attempt fails because its argument ignores the explicit wording of *Arizona Grocery* and proceeds from a misunderstanding of the holding in that case. *Id.* In *Arizona Grocery*, state the Eight Parties, the Interstate Commerce Commission, acting on a complaint and after a hearing, set a maximum rate for the carrier. *Id.* They note that the carrier, in response, set a new rate below the maximum which was also challenged. *Id.* In proceedings on the new complaint, continue the Eight Parties, the Interstate Commerce Commission determined that the just and reasonable rate, both for the past and future, was lower than the previously ordered maximum and ordered that reparations be paid for the difference between what had been paid, 84¢, and the just and reasonable rate of 71¢. *Id.* The Eight Parties explain that the Supreme Court reversed and held that reparations could not be awarded under the facts of the case. *Id.* (citing *Arizona Grocery*, 284 U.S. at p. 390). They assert that the Supreme Court stated that the Interstate Commerce Commission has two different functions, legislative and judicial, and that when it prescribes rates, it is acting in a legislative function. *Id.* at p. 176. If the Interstate Commerce Commission later, in its judicial function, reviews those rates, it can repeal them and prescribe new rates for the future, but, note the Eight Parties, it cannot repeal its prior legislative enactment with retroactive effect. *Id.* (citing 284 U.S. 389).

2966. Further, the Eight Parties point out, the Supreme Court made no distinction between rate methodologies that have been fully worked out and those that are only partially finalized. *Id.* According to them, Exxon cites no authority for the proposition that *Arizona Grocery* is inapplicable if all aspects of a methodology have not been finally determined. *Id.* Rather, explain the Eight Parties, the critical element relied upon by the Supreme Court is that the prior rate be prescribed by the Commission after a hearing, so that the Commission's legislative function is triggered. *Id.* When the Commission acts in its legislative function, they state, its determination of the legal rate has the force of a statute and cannot be later challenged any more than could an act of Congress setting those rates. *Id.* (citing 284 U.S. at pp. 386, 388).

2967. According to the Eight Parties, that is exactly what happened in this proceeding. *Id.* They assert that the Commission was exercising its legislative function when it prescribed the Naphtha and VGO rates after a hearing. *Id.* The Eight Parties point out that the Commission explicitly declared that it was setting these rates as "the Commission's own independent resolution of the matters at issue." *Id.* at pp. 176-77 (65 FERC at p. 62,290). Whether or not the Naphtha and VGO valuations are part of a larger methodology that is not final is therefore irrelevant, argue the Eight Parties, because the Commission adopted these specific rates in the exercise of its legislative function. *Id.* at p. 177.

2968. The Eight Parties suggest that the non-final argument is not persuasive because the basic methodology, and all but one of its elements, has been approved, implemented, and sustained on judicial review. *Id.* According to the Eight Parties, the result of the *Exxon* and *OXY* cases is that the valuation of eight out of nine cuts, all cuts except Resid, has been finally approved. *Id.* Moreover, note the Eight Parties, in *Exxon*, the Circuit Court did not remand the Resid cut along with instructions to reexamine the entire methodology in light of any changes made to the Resid valuation. *Id.* To the contrary, assert the Eight Parties, the Circuit Court upheld the Commission's decision on all other cuts and remanded only those portions of the Commission's order dealing with the Resid cut and the issue of retroactive effect for remanded cuts. *Id.* Further, explain the Eight Parties, the two appeals of the Commission's implementation decisions did not disturb or remand the Naphtha and VGO cuts. *Id.* Thus, the Eight Parties maintain that arguing that the methodology has not been finally resolved is inconsistent with the *OXY* and *Exxon* rulings, which have treated the methodology as having been finally resolved for all cuts except the Resid cut. *Id.*

2969. Exxon states the reparations issue relates solely to the valuation of the West Coast Naphtha and VGO cuts. Exxon Initial Brief at p. 380. It notes that all parties agree that the current method of valuing the West Coast VGO cut on the basis of the OPIS Gulf Coast spot price for high sulfur VGO does not produce a just and reasonable result, and that the proxy price for valuing the VGO cut on the West Coast should be changed to the OPIS West Coast spot price for high sulfur VGO. *Id.* at pp. 380-81. It is also undisputed, according to Exxon, that this West Coast VGO price has been significantly different from the OPIS Gulf Coast High Sulfur VGO price that has served as the Quality Bank proxy price for West Coast VGO since December 1993, with the West Coast price at times being $9 per barrel higher than the Gulf Coast price.[883] *Id.* at p. 381. Exxon states that it, along with Alaska and Phillips, contend that West Coast Naphtha prices over the past decade have differed substantially from Gulf Coast Naphtha prices and, indeed, generally have been significantly higher than Gulf Coast Naphtha prices.[884] *Id.* As a result, these parties, Exxon states, maintain that the Quality Bank has substantially undervalued West Coast Naphtha. *Id.* According to Exxon, the issue of reparations must be evaluated with this background in mind. *Id.*

2970. These parties, Exxon asserts, have demonstrated that they are entitled to an award of reparations based on the difference between the West Coast Naphtha and VGO values that have been in effect and the values for those cuts ultimately determined to be lawful.

[883] Exxon cites Exhibit Nos. EMT-11 at p. 25, and EMT-25 to support this statement. Exxon Initial Brief at p. 381, n.157.

[884] Exxon cites Exhibit Nos. EMT-380 and SOA-28 in support. Exxon Initial Brief at p. 381, n.158.

Exxon Reply Brief at pp. 442-43. According to Exxon, the Eight Parties acknowledge that the Commission has awarded reparations in the past. *Id.* at p. 443. It notes that the Eight Parties nonetheless advance four arguments in support of their contention that reparations should not be awarded in this case: (1) that reparations claims have not been properly raised; (2) that reparations are barred by *Arizona Grocery*; (3) that there are other legal defects in the claims for reparations; and (4) that equity should bar an award of reparations. *Id.* Exxon asserts that none of these arguments is correct. *Id.*

2971. Furthermore, Exxon states, the Eight Parties have wholly failed to address an independent ground for retroactive relief with respect to the Naphtha and VGO valuations. *Id.* Even if reparations are not awarded, Exxon argues, the Circuit Court's decision in *Tennessee Valley Mun. Gas Assoc. v. Federal Power Com'n*, 470 F.2d 446 (D.C. Cir. 1972), requires retroactive application of the revised Naphtha and VGO values to compensate Exxon for the financial loss it suffered arising from the erroneous dismissal of the Exxon and Tesoro complaints. *Id.* Exxon's position is that it is clear that the Commission has both the legal authority and compelling evidence to award reparations for the West Coast Naphtha and VGO cuts. *Id.*

2972. According to Exxon, reparations is the term given to relief provided under Section 16 of the Interstate Commerce Act, in response to a complaint filed by a shipper under Section 13(1) of the Act, for damages sustained for payment of existing rates that are ultimately found not to be just and reasonable.[885] Exxon Initial Brief at pp. 381-82. Further, Exxon states, the parties are in agreement that the Commission has in the past awarded reparations based on the difference between rates actually paid and rates that should have been paid. Exxon Reply Brief at pp. 443-44. The basic standard for an award of reparations, in Exxon's view, is well-settled. Exxon Initial Brief at p. 382. It asserts that this standard is found in *I.C.C.*, 289 U.S. at p. 390, where the Supreme Court said recovery of the difference between the unlawful rate and the lawful is the measure of damages and no other evidence of loss need be shown.[886] *Id.* Exxon cites three cases that

[885] By contrast, according to Exxon, where a new or changed rate is initiated by a pipeline carrier, Section 15(7) of the Interstate Commerce Act authorizes the Commission to suspend the effectiveness of the proposed rate for up to seven months, and to order refunds, with interest, of that portion of the rates not justified. Exxon Initial Brief at p. 382, n.159.

[886] Exxon also cites the following cases in support of this point: *Louisville & Nashville R.R. Co. v. Sloss-Sheffield Steel & Iron Co.*, 269 U.S. 217, 235 (1925); *Chicago, Milwaukee, St. Paul & Pacific R.R. Co. v. Alouette Peat Products*, 253 F.2d 449, 455 (9th Cir. 1957) (holding that "if this filed rate was proved to be unreasonable upon complaint to the Commission, the shipper was entitled to recover the difference between what he had paid and what the Commission found to be the reasonable rate"). Exxon Initial Brief at p. 382, n.160.

it asserts reflect this standard.[887] *Id.* Thus, according to Exxon, the predicate for a successful claim for reparations is a showing that the rate complained of is not just and reasonable. *Id.* at pp. 382-83. The burden of proof as articulated in court cases, explains Exxon, is on the shipper. *Id.* at p. 383.

2973. Under Section 16 of the Interstate Commerce Act, as interpreted by Exxon, a shipper may be awarded reparations for up to two years prior to the date on which a complaint was filed. Exxon Initial Brief at p. 383; Exxon Reply Brief at p. 444 (citing 49 U.S.C. App. § 16(3)(b)(1998)). In addition, notes Exxon, the reparations period may extend to the date revised rates are put into effect prospectively. Exxon Initial Brief at p. 383 (citing *SFPP, L.P.*, 86 FERC ¶ 61,022 at p. 61,113 (1999)).

2974. Exxon points out that reparations have traditionally been considered an equitable remedy, within the Commission's discretion. *Id.* It notes that, in deciding whether to award reparations, the Commission cannot exercise its discretion in an arbitrary or capricious manner. *Id.* Among other things, the Commission must adhere to guidelines set down in other reparations cases, or explain why those guidelines are inapplicable in the instant case. *Id.*

2975. Although there is agreement on these fundamental legal standards, Exxon asserts, each of the four arguments advanced by the Eight Parties rests on demonstrably erroneous legal contentions and factual misrepresentations. Exxon Reply Brief at p. 445. First, explains Exxon, the Eight Parties's argument that reparations claims have not been properly raised is belied by the plain language of Exxon's and Tesoro's complaints and the *Tesoro* decision, and is founded on a clear misinterpretation of the *SFPP* cases and the *Exxon* decision. *Id.* Second, continues Exxon, the Eight Parties's *Arizona Grocery* argument is founded on a misapplication of that case to the circumstances presented here, in which the Commission has yet to prescribe lawful rates through a distillation methodology. *Id.* Third, comments Exxon, the Eight Parties's argument that there are other legal defects in the claims for reparations ignores the plain language of several Interstate Commerce Act provisions (notably §§ 1(5), 8, 9 and 13(1)) and the Commission's consistent decisions awarding reparations under those provisions, and rests on patent misinterpretations of the Commission's decisions in *Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 at p. 62,292 (1993) and *Conoco, Inc. v. Trans Alaska Pipeline System*, 72 FERC ¶ 61,007 at p. 61,013 (1995). Exxon Reply Brief at p. 445. Fourth,

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[887] *Union Oil Co. of California v. Cook Inlet Pipe Line Co.*, 71 FERC ¶ 61,300 at p. 62,184 (1995); *see also Kerr-McGee Refining Corp. v. Williams Pipe Line Co*., 63 FERC ¶ 61,349, at p. 63,224 (1993); *see also SFPP, L.P.*, 96 FERC ¶ 61,281, at p. 62,071 (2001). Exxon Initial Brief at p. 382, n.161. In light of these decisions, claims Exxon, the Eight Parties are flatly wrong when they suggest (Exhibit No. PAI-47 at p. 7) that it must prove lost sales and profits to make out a claim for reparations. Id.

concludes Exxon, the Eight Parties's argument that equity should bar an award of reparations is based on a demonstrably false premise – that the Eight Parties were not on notice until 2002 that Exxon was seeking reparations. *Id.* at pp. 445-46.

2976. The TAPS Carriers state that no retroactive relief, including reparations, may be awarded against the TAPS Carriers. TAPS Carriers Initial Brief at p. 26. In addition, they note, the complainants in this proceeding have clarified that they do not seek the assessment of reparations against the TAPS Carriers. *Id.* So long as the reparations sought by Exxon consist of payments from other shippers, the TAPS Carriers take no position on whether, against whom, or in what amount such reparations should be assessed. *Id.* With respect to the assessment of reparations against them, the TAPS Carriers assert, the Commission has no authority to award such reparations in these circumstances. *Id.* They maintain that they are required to comply with Commission orders and, as long as they comply with such orders, *Arizona Grocery*[888] supports their contention that they cannot be subject to liability for such compliance. *Id.* Because the Commission has prescribed the Quality Bank methodology, the TAPS Carriers state, they cannot be required to pay reparations unless they had violated their tariffs. *Id.* at pp. 26-27. (quoting *Conoco, Inc. v. Trans Alaska Pipeline System*, 72 FERC at p. 61,013. The TAPS Carriers state there is no evidence of any such violation. *Id.* at p. 27.

2977. Commission Staff points out that Section 13(1) of the Interstate Commerce Act provides for the resolution of complaints concerning "anything done or omitted to be done by any common carder subject to the provisions of this chapter in contravention of the provisions thereof." Staff Initial Brief at p. 4 (quoting 49 U.S.C. App. §13(1)(1988)). Therefore, notes Staff, the section provides for reparations by recognizing that a carrier will be relieved from liability for a complaint if the carrier "shall make reparation for the injury alleged to have been done." *Id.* (quoting 49 U.S.C. App. §13(1)(1988)). Further, notes Staff, Sections 8 and 9 of the Interstate Commerce Act permit suits against common carriers subject to the act for damages; however, Section 9 requires an election as to whether to sue or pursue a complaint before the Commission. *Id.*

2978. Staff further explains that the right to reparations is of statutory origin. *Id.* There can be no recovery of reparations, continues Staff, without damage to the claimant from the unreasonable rate or conduct of a carrier. *Id.* Consequently, Staff asserts, in order to recover reparations, a claimant must show some loss caused by a carrier's rates, practices or conduct that is unlawful. *Id.* In the present case, notes Staff, "for reparations to be awarded, there would have to be a finding of conduct in violation of the quality bank [sic] tariff." *Id.* at pp. 4-5 (quoting *Conoco*, 72 FERC at p. 61,013).

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[888] *Arizona Grocery,* 284 U.S. at pp. 387-90.

B. STIPULATED MATTERS AND AREAS OF DISPUTE

2979. The Eight Parties explain that all parties stipulated that Exxon's reparations claim shall apply only to the West Coast VGO and Naphtha cuts. Eight Parties Initial Brief at p. 213. However, they argue that the December 14, 2001, stipulation signed by Exxon and the TAPS Carriers is inconsistent with the elements of a reparations claim. *Id.* In it, point out the Eight Parties, the signatories state that the TAPS Carriers have not violated the Interstate Commerce Act except to the extent that any implementation of Quality Bank changes ordered by the Commission may be a violation of the Act. *Id.* Further, note the Eight Parties, Exxon has stipulated that the Carriers have not violated their tariffs. *Id.* Clearly, in the Eight Parties view, Exxon has, by these stipulations, conceded that the TAPS Carriers have not violated the Interstate Commerce Act. *Id.* at pp. 213-14. Rather, according to the Eight Parties, their complaint appears to be that the Commission has violated the Interstate Commerce Act by putting in place an unjust and unreasonable rate, a matter that does not come within the scope of Sections 8, 9 and 13(1) of the Act. *Id.* at p. 214. In addition, the Eight Parties note that Exxon has stipulated that it is not seeking relief from the TAPS Carriers but instead is seeking a retroactive rate adjustment, to the extent that the TAPS Carriers can implement such an adjustment. *Id.*

2980. The Eight Parties note that Exxon contends that *Arizona Grocery* does not apply to the Naphtha and VGO valuations, because the Quality Bank methodology is not a Commission prescribed rate. Eight Parties Reply Brief at p. 178 (citing Exxon Initial Brief at pp. 393-396, 404). However, the Eight Parties point out, by stipulation entered into evidence in this case, Exxon has conceded that the Naphtha and VGO values are a Commission prescribed rate. *Id.* (citing Joint Exhibit No. 12 at ¶ 1). Clearly, state the Eight Parties, a rate that the Carriers were directed to implement is a Commission-prescribed rate. *Id.* The Eight Parties explain that the TAPS Carriers were legally obligated to abide by the Commission orders to implement the Naphtha and VGO valuations. *Id.* (citing *Arizona Grocery*, 284 U.S. at p. 387; *Atl. Coast Line R.R. Co. v. Florida*, 295 U.S. 301, 311 (1935)).

2981. Having stipulated that the TAPS Carriers have not violated the Commission approved Quality Bank tariff, that relief against the TAPS Carriers is not its goal, and because the Naphtha and VGO rates are final within the meaning of *Arizona Grocery*, the Eight Parties assert, there can be no basis for a reparations claim under the Interstate Commerce Act. Eight Parties Initial Brief at p. 214; Eight Parties Reply Brief at p. 178.

2982. According to Exxon, the parties have stipulated that Exxon's and Tesoro's claims for reparations shall apply only to the West Coast Naphtha and VGO cuts. Exxon Initial Brief at p. 384. It also notes that the parties have stipulated that, if a West Coast Naphtha valuation is adopted in this proceeding that is different from the West Coast Naphtha valuation that was put into effect in December 1993, such revised West Coast Naphtha valuation and the revised West Coast VGO valuation to which the parties have stipulated should have the same effective date. *Id.* In addition, Exxon states that it and Tesoro also have executed a separate stipulation with the TAPS Carriers to clarify the nature and scope of the reparations relief the two companies are seeking in their complaints. *Id.*

2983. In particular, Exxon states, it has stipulated that its contention that the TAPS Carriers have violated the Interstate Commerce Act is limited to the TAPS Carriers's implementation of the Quality Bank methodology, which has not produced just and reasonable results. Exxon Reply Brief at p. 446. It asserts that, contrary to the Eight Parties's argument (Eight Parties Initial Brief at pp. 213-14), this stipulation does not constitute a concession by it that there is no basis for a reparations claim. *Id.*

2984. Exxon argues that the Eight Parties's claim in this regard is based on several misstatements of law and misrepresentations of fact. *Id.* First, notes Exxon, the Eight Parties assert that there is no basis for a reparations claim because Exxon allegedly conceded in the stipulation that the TAPS Carriers have not violated their Quality Bank tariffs. *Id.* at pp. 446-47. However, it maintains, a tariff violation is not an essential element of a reparations claim, like Exxon's, which is based upon payment of unjust and unreasonable rates. *Id.* at p. 447. Second, Exxon states, the Eight Parties claim that reparations should not be awarded here because Exxon's goal is not relief against the Carriers is baseless. *Id.* In fact, Exxon points out that the captions of Exxon's complaints make clear that each complaint expressly seeks relief against the TAPS Carriers. *Id.*

2985. Further, Exxon argues, the Eight Parties misrepresent this stipulation as a concession on the part of Exxon that the TAPS Carriers have not violated the Interstate Commerce Act, and they misrepresent Exxon's complaints as contending only that the Commission has violated the Act, a matter which is outside the scope of a reparations claim. *Id.* In fact, states Exxon, both of the complaints and the stipulation clearly state that the TAPS Carriers have violated the Act by implementing a Quality Bank methodology, and specific elements thereof, that are not just and reasonable. *Id.* Moreover, continues Exxon, any doubt about whether this matter is within the scope of the Interstate Commerce Act is removed by Section 1(5), 49 U.S.C. App. § 1(5)(1988), which declares that "every unjust and unreasonable charge . . . or any part thereof is . . . declared to be unlawful," and Section 8, 49 U.S.C. App. § 8 (1988), which provides that a carrier is liable for a violation of the ICA every time it "shall do, cause to be done, or permit to be done any act . . . declared to be unlawful" or "omit[s] to do any act, matter, or thing in this chapter required to be done." *Id.* at pp. 447-48. It follows, according to Exxon, that the TAPS Carriers would be liable for violating the Act where, as alleged here, they charged an unreasonable rate, caused an unreasonable rate to be charged, or permitted an unreasonable rate to be charged. *Id.* at p. 448.

2986. There is also no dispute, according to the TAPS Carriers, over the fact that they have fully complied with the terms of their interstate tariff and prior Commission orders in their implementation of the various Quality Bank methodologies. TAPS Carriers Initial Brief at p. 28. They assert that all prior allegations that the TAPS Carriers had not complied with their respective tariffs have been settled and are no longer at issue in these proceedings. *Id.* (citing *Trans Alaska Pipeline System, Letter Orders Regarding Uncontested Partial Settlement* Filed May 13, 1997, (Aug. 4, 1997)). In fact, the TAPS Carriers point out, that Exxon has stipulated that the only violations of the ICA that it is alleging consist of compliance with the Commission's orders. *Id.* (citing Joint Exhibit No. 12 at p. 1).

2987. The TAPS Carriers deny that they have violated the Interstate Commerce Act by implementing a Quality Bank methodology that they have been ordered by the Commission to implement. *Id.* at p. 29. The Interstate Commerce Act requires that the TAPS Carriers comply with the Commission's orders. *Id.* (citing 49 U.S.C. app. §§ 16(7)-(8)(1988)). That issue is moot, according to the TAPS Carriers, given the stipulation by Exxon and Tesoro that they are not seeking any payments from the TAPS Carriers themselves. *Id.* (quoting Joint Exhibit No. 12 at P 3).

2988. The TAPS Carriers note that any party could have pursued a claim that reparations were due from them but chose not to do so. *Id.* at p. 30. As a result, they argue, there is no issue among the parties regarding any claim for reparations from them. *Id.* The TAPS Carriers take no position as to whether Exxon or Tesoro may recover reparations from other shippers. *Id.*

2989. According to Staff, Joint Exhibit No. 12 is a stipulation among the parties which limits the applicability of any reparations claims to the West Coast VGO and Naphtha cuts. Commission Staff Initial Brief at p. 5. Further, explains Staff, the Joint Exhibit also provides that there is no contention "that the TAPS Carriers have violated the Interstate Commerce Act except to the extent that implementation of the Quality Bank methodology that the [Commission] has directed the TAPS Carriers to implement constitutes such a violation." *Id.* at p. 5 (quoting Joint Exhibit No. 12 at P 1). In addition, the Staff points out that paragraph 3 of Joint Exhibit No. 12 clarifies that any reparation claims are for any over collections by other shippers under the Quality Bank methodology in effect during the relevant period if the Commission finds that methodology was unjust and unreasonable and that a different methodology should have been in effect during that period. *Id.* It adds that paragraph 3 of the stipulation further clarifies that reparations are not sought from the TAPS Carriers's own funds. *Id.*

C. SHOULD REPARATIONS BE AWARDED?

2990. The position of the Eight Parties is that reparations should not, and cannot, be awarded in this case. Eight Parties Reply Brief at p. 191. They assert that there is no legal basis under the Interstate Commerce Act to award the reparations sought by Exxon.

Id. Furthermore, even if there were no clear legal impediment to reparations, the Eight Parties argue, reparation relief should be denied for equitable reasons. *Id.*

2991. According to the Eight Parties, Exxon asserts that there was no evidentiary support for the Commission's 1993 and 1994 determinations of the Naphtha and VGO values, and that *Arizona Grocery* does not apply if the prior rate determination lacked evidentiary support. Eight Parties Reply Brief at p. 179. They state that this is a misstatement of both the law and the facts. *Id.* In the Eight Parties's view, if Exxon wanted to attack the underlying evidentiary support for those rulings, it should have filed an appeal in 1994. *Id.* As no such appeal was filed, they claim, therefore, the time to dispute the Commission's ruling on Naphtha and VGO has long passed. *Id.* (citing *Trans Alaska Pipeline System*, 57 FERC at pp. 65,040-41). Instead, note the Eight Parties, the Commission's decision was appealed on other grounds and affirmed by the Circuit Court on the Naphtha and VGO cut valuations. *Id.*

2992. In lieu of appealing the propriety of the Commission's 1993-1994 rulings on the Naphtha and VGO cuts, the Eight Parties explain that Exxon recommended, in various proposals, that Gulf Coast prices be used to value West Coast products. *Id.* They note that Exxon argued in sworn testimony, in 1997, that Gulf Coast natural gas liquid prices should be used to value West Coast natural gas liquids. *Id.* According to the Eight Parties, Exxon proposed in sworn testimony in 1996 and 1997 a distillation methodology for the Golden Valley Electrical Association interconnection that employed Gulf Coast prices for West Coast Naphtha, West Coast VGO and all other cuts of the methodology. *Id.* The Eight Parties point out that Exxon maintained this position as late as the year 2000. *Id.* at pp. 179-80. For Exxon to now claim that "no party had even suggested — much less presented any evidence — that the price for a product on one Coast was a reasonable basis for valuing that product on the other Coast," is, in the Eight Parties's view, entirely disingenuous. *Id.* at p. 180 (quoting Exxon Initial Brief at pp. 396-97).

2993. In addition, the Eight Parties argue that Exxon's collateral attack on the Commission's 1993-1994 rulings is legally impermissible and that *Arizona Grocery* explicitly so held. *Id.* In that case, state the Eight Parties, the Interstate Commerce Commission had argued that it was free to revisit its earlier determination that the 96.5¢ rate was just and reasonable, because the doctrine of *res judicata* did not apply to its earlier determination. *Id.* The Supreme Court held that the Commission was confused, note the Eight Parties, and that, while the Commission was not bound by *res judicata*, it was nevertheless "bound to recognize the validity of the rule of conduct prescribed by it and not to repeal its own enactment with retroactive effect." *Id.* (quoting 284 U.S. at p. 389). Here, assert the Eight Parties, the entire thrust of Exxon's argument is to do exactly that: to show that the earlier record was inadequate and that new evidence shows that "single market pric[ing]" is invalid. *Id.* (quoting Exxon Initial Brief at pp. 397-98). In the Eight Parties opinion, this is precisely the type of collateral attack that *Arizona Grocery* should prevent. *Id.*

2994. Finally, the Eight Parties state, Exxon suggests that *Arizona Grocery* allows a reopening of the prior determination of a rate if the evidence upon which it is based "clearly fails to support it." *Id.* (quoting Exxon Initial Brief at p. 397 n.179). The Eight Parties assert that this is wrong and that Exxon is using the cite from *Arizona Grocery* incorrectly. *Id.* at pp. 180-81. They believe that, while the quote does appear in the case, it is clear from the context of the cite that the Supreme Court was referring to judicial review in a direct appeal of a final agency determination and not to revisiting the issues underlying the prior rate determination in a subsequent agency proceeding. *Id.* at p. 181. In a footnote in *Arizona Grocery*, state the Eight Parties, the Supreme Court explained that when the Commission speaks in its legislative capacity, its rate could be declared void for violating the Constitution, just as a statute can, and that there is an additional element "that the courts will examine the question whether the administrative agency of the legislature has exceeded its statutory powers . . . or has based its order upon a finding without evidence or upon evidence which clearly fails to support it." *Id.* (quoting 284 U.S. at p. 386, n.15). Clearly, according to the Eight Parties, the Supreme Court was referring to judicial review of an agency decision pursuant to a timely appeal of the decision, and was not legitimizing the type of collateral attack being launched by Exxon some eight years after the rate was set. *Id.* It is the Eight Parties's position that, because Exxon chose, in 1994, not to appeal the Commission's Naphtha and VGO rulings, it gave up the right to challenge the evidentiary support for those rulings. *Id.*

2995. The Eight Parties state that Exxon's claim is something other than a reparations claim because (1) it is based on an allegation that a Commission mandated rate violates the Interstate Commerce Act, not on an allegation that the TAPS Carriers have violated the Act, and (2) the relief requested is not from the TAPS Carriers but from other shippers. *Id.* They note that Exxon argues that it has satisfied the first element because the Naphtha and VGO cut valuations can violate Section 1(5) of the Interstate Commerce Act even if they were established by the Commission and that it has satisfied the relief element because the TAPS Carriers act as a "conduit for Quality Bank payments among TAPS shippers." *Id.* (quoting Exxon Initial Brief at p. 400). According to the Eight Parties, neither point is valid. *Id.*

2996. Exxon has stipulated, according to the Eight Parties, that the only Section 1(5) violation at issue is that the TAPS Carriers "implemented the valuations for the West Coast Naphtha and VGO cuts that were ordered by the Commissions." *Id.* (quoting Exxon Initial Brief at p. 400). In the Eight Parties's view, this stipulation means that Exxon has conceded that the Naphtha and VGO cut valuations are protected by the *Arizona Grocery* holding that reparations are unavailable. *Id.* at pp. 182-83.

2997. In arguing that the Commission-mandated rate can be in violation of Section 1(5), the Eight Parties claim, Exxon again ignores the holding in *Arizona Grocery* that a rate initially established by the Interstate Commerce Commission became for the future the lawful, reasonable rate, and the carrier had no choice but to adopt a conforming rate. *Id.* at p. 183. The Eight Parties acknowledge that, while that rate did not preclude the Commission from revisiting the issue and setting a new rate for the future, it did preclude the Commission from changing that initial rate retroactively. *Id.* Hence, explain the Eight Parties, Exxon is simply wrong as a legal matter when it argues that the Commission-mandated rate for Naphtha and VGO can be retroactively declared unjust and unreasonable, in violation of Section 1(5) of the Interstate Commerce Act. *Id.*

2998. Further, state the Eight Parties, authority cited by Exxon to support its claim regarding retroactive violation is inapposite. *Id.* They point out that cases holding that reparations may be awarded for a rate declared to be unjust and unreasonable concern rates that were initiated by carriers, not rates that were set by the Commission.[889] *Id.* The Eight Parties explain that carrier-initiated rates remain subject to challenge by affected shippers and post-implementation review by the Commission pursuant to Section 13(1) complaint procedures. *Id.* If the rates are found to be unjust or unreasonable, state the Eight Parties, then retroactive relief may be awarded as reparations. *Id.* at pp. 183-84. They state that the *Arizona Grocery* court recognized this. *Id.*

2999. The Eight Parties point out that the relief sought by Exxon is not against the TAPS Carriers, rather, the money to pay the reparations would be recovered from other shippers through retroactive assessments in amounts sufficient to pay Exxon. *Id.* at p. 185. As a legal matter, according to the Eight Parties, this kind of relief is not available under the reparations provisions of the Interstate Commerce Act. *Id.* Under Section 8 of the Act (49 U.S.C. App. § 8), the Eight Parties claim, a person injured by a carrier's violation of the Act may be awarded damages sustained as a result of such a violation. *Id.* The Eight Parties also note that, under Section 9 (49 U.S.C. App. § 9)(1988), the carrier is made liable for such damages. *Id.* They point out that there is no provision in the Act that makes shippers liable for damages sustained by the carrier or by other shippers and court decisions have so held. *Id.*

3000. In prior litigation over the Quality Bank, the Eight Parties state, the Commission has consistently required that changes in the methodology be applied on a prospective basis only and that reparations will not be awarded absent a violation of the tariff. Eight Parties Initial Brief at p. 214. In 1993, notwithstanding its determination that the then existing methodology was unjust and unreasonable, the Eight Parties explain, the

[889] According to the Eight Parties, carrier-initiated rates are distinguished from Commission-prescribed rates because they are not the product of a legislative function. Eight Parties Reply Brief at p. 184. They suggest that it is inexcusable for Exxon to confuse carrier-initiated rates with Commission-ordered rates when *Arizona Grocery* and other decisions have clearly distinguished these rates and the relief available for each. *Id.* at pp. 184-85.

Commission refused to order refunds or reparations. *Id.* Further, note the Eight Parties, in affirming the Commission on this issue, the Circuit Court opined that the Commission had no authority to apply the new rate retroactively because of the filed rate doctrine. *Id.* When Phillips subsequently argued that it should nevertheless be awarded reparations for the difference between the old, unjust and unreasonable rate and the new distillation-based rate, the Commission, explain the Eight Parties, again rejected the claim. *Id.* In rejecting Phillips's claim, the Eight Parties state, the Commission clearly reaffirmed that violation of the quality bank methods and/or tariff would be required in order for reparations to be awarded. *Id.* at p. 215. Because Exxon has stipulated that the TAPS Carriers have not violated the TAPS Quality Bank tariffs, the Eight Parties argue, there is no legal basis to award reparations. *Id.*

3001. Moreover, according to the Eight Parties, the Commission did not "announce a general rule of law to the effect that a tariff violation must be proven in all reparations cases" and the Eight Parties do not contend that it did. Eight Parties Reply Brief at p. 187 (quoting Exxon Initial Brief at p. 402). Rather, assert the Eight Parties, a tariff violation must be proven in order to obtain reparations under a Commission-prescribed rate, as opposed to a carrier initiated rate. *Id.*

3002. According to the Eight Parties, Exxon concedes that reparations cannot be sought for a Commission prescribed rate. Eight Parties Reply Brief at p. 190. They claim that Exxon's argument rests on the proposition that the Naphtha and VGO cut valuations are not the product of a Commission-prescribed rate. *Id.* As noted previously, the Eight Parties believe that this proposition is just plain wrong. *Id.* However, even if the Commission were to conclude that Exxon is correct on this point, the Eight Parties argue, it still would not resolve the problem that reparations against shippers cannot be awarded under the Interstate Commerce Act. *Id.*

3003. The Eight Parties also note that Exxon relies on the fact that the Commission, in a decision allowing a change to the Gulf Coast VGO price, has previously ruled that reparations would be available to Exxon "to correct any inaccuracies that have occurred." *Id.* (quoting *Trans Alaska Pipeline System*, 82 FERC at p. 62,352). To the extent that the Commission has previously intimated that reparations relief would be available, the Eight Parties assert that representation is explainable based on (1) the allegations set forth in Exxon's complaint filed in Docket No. OR96-14-000, which included allegations that the TAPS Carriers had violated their tariffs, and (2) the potential availability under Section 13(1) of the Interstate Commerce Act of reparations against a carrier for damages suffered as a result of a violation of the Act, including a tariff violation. *Id.* at pp. 190-91. The Eight Parties take the position that Exxon has voluntarily given up that potential remedy by stipulating that it does not seek reparations from the TAPS Carriers, but from the other shippers and by conceding that the TAPS Carriers have not violated their tariffs or the Act. *Id.* at p. 191. Denial of reparations here, according to the Eight Parties, would not be inconsistent with the Commission's prior rulings in this case. *Id.*

3004. The Eight Parties also argue that Exxon is wrong in its belief that it need only show that the Naphtha and VGO cut valuations are unjust and unreasonable and its right to reparations will follow as an entitlement. Eight Parties Initial Brief at p. 216. They acknowledge that Exxon can point to Commission decisions awarding reparations based on the difference between rates actually paid and the just and reasonable rates that should have been paid. *Id.* However, the Eight Parties assert, those decisions are distinguishable from the facts of this case. *Id.*

3005. The leading Commission decision awarding reparations, according to the Eight Parties, is *SFPP, L.P.*, 86 FERC ¶ 61,022 (1999), *modified*, 91 FERC ¶ 61,135 (2000), *reh'g denied*, 96 FERC ¶ 61,281 (2001). In that case, explain the Eight Parties, the Commission found that rates for SFPP's East Line were unjust and unreasonable, and that SFPP had violated the Interstate Commerce Act. *Id.* at pp. 216-17. They state that the East Line rate had not previously been reviewed and approved by the Commission, so it enjoyed no filed rate doctrine protection. *Id.* at p. 217. The Eight Parties further state that the Commission ordered SFPP to develop a cost of service for the East Line, and to pay reparations for the difference between the just and reasonable cost-based rate and the rate that had actually been paid. *Id.* Thus, assert the Eight Parties, all three elements of a reparations claim mentioned above were found to be present. *Id.*

3006. Of even greater significance, in the opinion of the Eight Parties, are the Commission's holdings in *SFPP* that a reparations claim is shipper specific and must be raised in an appropriate complaint filed by the injured shipper. *Id.* The Eight Parties explain that, in *SFPP*, the Commission found initially that only one shipper qualified for reparations because only one had filed a complaint respecting East Line rates, while the other shipper parties had filed complaints against the West Line rates.[890] *Id.* The basic rule to be gleaned from the *SFPP* case, according to the Eight Parties, is that only parties who file complaints are eligible for reparations if that rate is found unjust and unreasonable, and the complaining party has the burden of proving that the rate is unjust and unreasonable. *Id.* Further, the Eight Parties explain, in a later order in the case, the Commission rejected claims that merged entities could assert reparations claims initiated by a merged party, and ruled that each entity must file its own, specific reparations claim under Section 13(1) of the Interstate Commerce Act and Rule 206 of the Commission's

[890] According to the Eight Parties, the West Line complaints did not qualify for reparations because the West Line rates were grandfathered under the Energy Policy Act of 1992, and the complainants failed to show changed circumstances. Eight Parties Initial Brief at p. 217, n.116. The Eight Parties also cite *Big West Oil, LLC v. Alberta Energy Co., Ltd.*, 100 FERC ¶ 61,171, at p. 61,610 (2002) for the proposition that reparations complaints do not lie against rates that have been protested and suspended. *Id.*

regulations. *Id.* The Commission has also held, according to the Eight Parties, that one entity cannot piggyback on the claims filed by another entity. *Id.* at pp. 217-18.

3007. In this case, the Eight Parties argue, Exxon's reparations claim falls far short of the *SFPP* requirements. *Id.* at p. 218. Specifically, the Eight Parties point out, the complaint does not specifically challenge the rates at issue, does not mention the Naphtha and VGO cuts, and does not seek damages predicated on the use of Gulf Coast prices to value these cuts. *Id.* If there was any question, the Eight Parties explain, the Circuit Court made clear, in the *Exxon* decision, that VGO and Naphtha were not part of the remand. *Id.* Consequently, in the Eight Parties view, Exxon is relying on Tesoro's raising of the Naphtha and VGO issues in a later-filed Tesoro complaint, even though no reparations damages have been asserted by Tesoro. *Id.* They assert that *SFPP* not only precludes Exxon's attempt to piggyback on the Tesoro complaint, but also may preclude Mobil from joining Exxon on the complaint. *Id.*

3008. The Eight Parties contend that *SFPP* is instructive on other aspects of the reparations claim as well. *Id.* at p. 219. According to them, the Commission did not hold in *SFPP* that reparations are an entitlement brought to life by a showing of unjustness and unreasonableness in the rates. *Id.* To the contrary, the Eight Parties explain, the Commission observed that the reparations remedy is an equitable remedy, and the complaining shipper was denied reparations for the two-year period preceding the filing of the complaint on the grounds that the shipper and the pipeline were parties to a settlement during that time. *Id.* Therefore, state the Eight Parties, the Commission reasoned that, during the settlement period, the carrier was not on notice that its rates could be subject to challenge in a reparations complaint. *Id.* The Eight Parties assert that, in this case, Exxon is seeking reparations for a period of time during which Exxon itself, at the least, did not oppose the use of Gulf Coast pricing for the Naphtha and VGO cuts. *Id.* It would be inequitable, in the Eight Parties's view, to award reparations to Exxon for a period of time during which it did not oppose the use of Gulf Coast pricing for the two cuts at issue, and in fact affirmatively supported the use of Gulf Coast pricing, because neither the Carriers nor other shippers were on notice that Exxon would demand reparations for the cuts now at issue. *Id.* at pp. 219-20.

3009. While the Eight Parties argue that reparations are clearly inappropriate in this case, they also point out that the *SFPP* decision states how reparations should be calculated, if it were appropriate to award them. *Id.* at p. 220. They point out that the proper measure is the difference between the new lawful rate and the old rate that has been determined to be unjust and unreasonable. *Id.* The Eight Parties also point out that actual damages, such as lost customers and actual additional costs, are not relevant as damages are fixed as the difference in the rates for the amount of product affected. *Id.* Thus, they note, *SFPP* applies a standard that is more lenient than earlier case law and Interstate Commerce Commission precedent, which required proof of actual damage by the complainant, not just a difference in rates paid as compared to the just and reasonable rate. *Id.* The Eight Parties point out that Exxon did not submit any evidence of actual damage that could satisfy the burden of proof of damages from these earlier cases. *Id.*

3010. But even under the *SFPP* formula, the Eight Parties argue, serious questions arise. *Id.* at p. 221. They claim that Exxon has submitted no evidence that would prove what the just and reasonable rate in the years prior to 1999 would have been. *Id.* The *SFPP* damages formula, according to the Eight Parties, is based on a cost-of-service for a test year using the ratemaking standard of Opinion No. 154-B. *Id.* They explain that the just and reasonable rate for SFPP was developed for a 1994 test year using actual cost data from SFPP's records, and the 1994 cost of service was then indexed for years after 1994, modified with actual cost adjustments for specific cost categories. *Id.* The Eight Parties point out that the TAPS Quality Bank is not based on a carrier cost-of-service, but on evidence of costs and industry practices submitted by the parties to litigation. *Id.* Thus, note the Eight Parties, there is no agreed cost model similar to Opinion No. 154-B, and not all industry participants are parties to this case. *Id.* Consequently, the Eight Parties assert, the basis for applying the *SFPP* reparations model is not present in this case. *Id.* Furthermore, they argue, Exxon, the party with the burden of proof on reparations, has not submitted evidence of actual costs or actual price values for Naphtha and VGO on the West Coast for years prior to 1999. *Id.* Accordingly, in the view of the Eight Parties, there is no basis for calculating reparations or awarding them for the period requested by Exxon. *Id.*

3011. The Eight Parties also point out that the Interstate Commerce Act makes no provision for requiring a party other than a carrier to pay reparations, so there is no statutory basis for requiring retroactive assessments against other shippers, even if Exxon were deemed to be entitled to damages. *Id.* Moreover, according to the Eight Parties, because reparations are an equitable remedy, the Commission must weigh the impact of reparations on those who would pay. *Id.* They note that their arguments respecting these equitable considerations have been made in the section on refunds and apply here as well. *Id.* In the view of the Eight Parties, they are reinforced by the testimony of Sanderson, who stated that the refiners were never put on notice respecting reparations for Naphtha and VGO, and therefore had no opportunity to adjust their business practices. *Id.* at pp. 221-22. Accordingly, the Eight Parties conclude, any award of reparations would be unlawful and inequitable. *Id.* at p. 222.

3012. In its brief, according to the Eight Parties, Exxon raises for the first time the argument that, if a reparations award is denied, retroactive effect to a new Naphtha and VGO price should nevertheless be given in order to correct the legal error committed when the Commission denied the Tesoro complaint without a hearing. Eight Parties Reply Brief at p. 192. They state that Exxon relies on the decision in *Tesoro* which reverses the Commission for summarily dismissing the Exxon and Tesoro complaints and cites *Tennessee Valley* as authority for retroactive application of the new Naphtha and VGO valuations "to compensate for its erroneous dismissal." *Id.* (quoting *Tennessee*

Valley, 470 F.2d at p. 453).

3013. The Eight Parties state that *Tennessee Valley* is not on point. *Id.* They claim that, first, *Tesoro* did not involve a remand to the Commission with an instruction to retroactively correct a prior legal error. *Id.* Rather, explain the Eight Parties, the decision required the Commission to hold a hearing on the issues raised by the respective complaints and grant appropriate relief. *Id.* Further, the Eight Parties note that, in its complaint, Exxon did not request reparations for improper valuation of the Naphtha and VGO cuts, and they assert that Exxon cannot piggyback on the Tesoro complaint in order to obtain such relief in this proceeding. *Id.*

3014. Second, state the Eight Parties, although the *Tesoro* court did not reach the issue of whether retroactive relief would be available on remand, Exxon raised that issue on brief, and the Circuit Court intimated that relief would be prospective only. *Id.* at pp. 192-93 (citing *Tesoro*, 234 F.3d at p. 1286).

3015. Third, the Eight Parties state that *Tennessee Valley* is distinguishable on its facts from the present case. *Id.* at p. 193. They explain that this proceeding concerns a remand of Commission prescribed rates for the Naphtha and VGO cuts that were previously determined by the Commission to be just and reasonable. *Id.* In *Tennessee Valley*, note the Eight Parties, the 1969 dismissal of a complaint filed in 1966 was vacated and set for hearing in 1970. *Id.* Further, according to the Eight Parties, the utility had filed, in 1970, to change its rates, and the rates had been suspended subject to refund. *Id.* (citing *Tennessee Valley*, 470 F.2d at p. 449). The Eight Parties point out that the Circuit Court in *Tennessee Valley* ordered that the time gap between the erroneous dismissal of the complaint and the Commission's vacating and reopening order, 112 days, be used to measure the extent of retroactive relief granted in order to remedy the prior legal error. *Id.* They state that, in *Tennessee Valley*, whatever filed-rate protection existed for the preexisting rates was obviated by the gas company's filing in 1970 to change its rates. *Id.* Finally, the Eight Parties explain, the remand that required the Commission to make its determination of just and reasonable rates take effect 112 days earlier than they otherwise would have overlapped the period covered by the rate increase proceeding. *Id.* at pp. 193-94.

3016. Fourth, the Eight Parties state, the Circuit Court has described the relief approved in *Tennessee Valley* as "extraordinary" and as relief that "cuts to the heart of the concerns and values which inform 'the filed rate' doctrine." *Id.* at p. 194 (quoting *Northwest Pipeline Corp. v. F.E.R.C.*, 863 F.2d 73, 78 (D.C. Cir. 1988)). They assert that this kind of retroactive relief is equitable in nature and should not be awarded in this case, because the equities of this situation do not warrant it. *Id.* Specifically, the Eight Parties argue, a *Tennessee Valley* delay calculation of 920 days proposed by Exxon is tied to the dismissal of the Exxon and Tesoro complaints, neither of which sought the reparations for the Naphtha and VGO cuts to benefit Exxon that Exxon now demands. *Id.* The Eight

Parties position is, therefore, that legal error cannot be used as grounds for the grant of retroactive relief in this case. *Id.*

3017. Because Exxon has not filed a complaint claiming reparations for an incorrect valuation of the Naphtha and VGO cuts, the Eight Parties argue, reparations are not available and should not be awarded. Eight Parties Initial Brief at p. 222. Were the Commission, however, to conclude that reparations should be awarded, the Eight Parties note, an effective date for reparations would have to be determined. *Id.* In deciding on a reparations effective date, the Eight Parties state, the Commission would be applying an equitable remedy, as acknowledged in *SFPP*. *Id.* Notwithstanding the statute's provision for availability of reparations for two years prior to the filing of a complaint, the Eight Parties explain, *SFPP* states that the Commission must fashion an equitable remedy and cannot simply award the statutory maximum automatically. *Id.*

3018. The Eight Parties view two points as critical to the question of setting an effective date for reparations. *Id.* First, the Eight Parties assert, because no party was put on notice that reparations could be demanded for the Naphtha and VGO cuts until Tesoro filed its complaint, under *SFPP,* the date of that filing is the earliest possible date that reparations could be ordered. *Id.* They note that even Exxon suggests this date, which is August 1998, as an alternative to the 1994 date on the grounds that all parties were on notice as of the 1998 date. *Id.* at pp. 222-23.

3019. Second, the Eight Parties argue that, even if the date of the Tesoro complaint is the earliest that the potential for reparations relief for the Naphtha and VGO cuts became known, that date should not be used for Exxon's reparations. *Id.* at p. 223. Again, the Eight Parties point out, Exxon never mentioned the Naphtha and VGO cuts in its own complaint, and Tesoro did not request reparations in its complaint. *Id.* Indeed, according to the Eight Parties, no damage claims or evidence were ever submitted on behalf of Tesoro. *Id.* Instead, the Eight Parties urge the Commission to choose a date that takes into account when the parties were first put on actual notice as to Exxon's position with respect to its claim for reparations. *Id.* They assert that notice did not occur until Exxon filed its testimony in this case in February of 2002. *Id.* Hence, in keeping with the Commission's emphasis on the importance of notice, the Eight Parties believe that February 2002 would be the earliest date from which reparations could be ordered, but only if Tesoro had sought them. *Id.* According to the Eight Parties, Tesoro did not seek reparations and, therefore, Exxon cannot seek reparations from any date because it has not filed the requisite complaint. *Id.*

3020. Exxon states that the parties have stipulated to a new basis for valuing the West Coast VGO cut – namely, the OPIS West Coast High Sulfur VGO weekly price quote. Exxon Initial Brief at p. 385. If, as Exxon and Tesoro contend, the current valuation of the West Coast Naphtha cut is found to be unlawful in this proceeding, then Exxon asserts that any new lawful valuation of West Coast Naphtha should be implemented on the same date as that on which the new West Coast VGO valuation is implemented. *Id.* at pp. 385-86. Similarly, Exxon asserts that, if reparations are ordered with respect to the West Coast Naphtha valuation for any past period, then reparations should also be ordered for the same period with respect to the West Coast VGO valuation. *Id.* at p. 386.

3021. The Eight Parties, according to Exxon, raise four arguments as to why reparations should not be awarded in this case: (1) that reparations claims have not been properly raised; (2) that reparations are barred by *Arizona Grocery*; (3) that there are other legal defects in the claims for reparations; and (4) that equity should bar an award of reparations. *Id.* Exxon asserts that each of these arguments is demonstrably incorrect. *Id.*

3022. Any assertion by the Eight Parties that reparations are not an issue in this case should be dismissed, in the view of Exxon, on at least two grounds. *Id.* First, Exxon states, claims for retroactive relief were made in both the Exxon and Tesoro complaints and that this contributed to the Commission's setting these cases for hearing. Exxon Initial Brief at p. 386. Indeed, in setting the Exxon complaint for an investigation "into the lawfulness of the present quality bank methodology," Exxon states, the Commission invoked Section 13(1) of the Interstate Commerce Act,[891] which entitles a complainant to reparations (assuming it satisfies its burden of proof).[892] *Id.* at pp. 386-87. Moreover, Exxon notes that, in an order issued subsequent to its order initiating an investigation into its complaint, the Commission noted that, "If Exxon should prevail in its complaint case, then relief will be prospective from the date of the finding and reparations are available to correct any inaccuracies that have occurred." *Trans Alaska Pipeline System,* 82 FERC at p. 62,352.

3023. Similarly, states Exxon, the plain language of the Tesoro complaint flatly belies the Commission Trial Staff's contention that Tesoro's complaint did not request reparations. Exxon Reply Brief at pp. 449-50. To the contrary, Exxon asserts, Tesoro's complaint sought retroactive relief, for example, when it asked to have revised valuations of the West Coast VGO and Naphtha cuts applied retroactively to December 1, 1993. *Id.* at p. 450.

3024. Second, Exxon points out, in its November 2001 order setting several related TAPS Quality Bank matters for hearing, the Commission directed that all issues remanded by the Circuit Court in the *Exxon* and *Tesoro* decisions be taken up in this

[891] See Trans Alaska Pipeline System, 76 FERC at p. 61,621.

[892] Exxon maintains that Commission decisions confirm that reparations are part and parcel of complaints brought under Section 13(1) of the Interstate Commerce Act. Exxon Initial Brief at p. 387, n.167

hearing. Exxon Initial Brief at p. 387 (citing *Trans Alaska Pipeline System,* 97 FERC at p. 61,652). In *Tesoro,* notes Exxon, the Circuit Court declined to address the reparations issue, finding that it was premature because there was no finding that the prevailing methodology for valuing West Coast Naphtha and VGO was not just and reasonable. *Id.* The Circuit Court therefore remanded to the Commission for further consideration the claims that the West Coast Naphtha and VGO valuations are not just and reasonable, according to Exxon, and the Commission, in turn, set those issues for hearing in the instant proceeding. *Id.* at pp. 387-88. Thus, in the event the Commission concludes that the West Coast Naphtha and VGO valuations are not just and reasonable, Exxon argues it must necessarily determine, in light of the *Tesoro* remand, what reparations, if any, are appropriate. *Id.* at p. 388.

3025. Exxon argues that federal courts have long held that the act of charging an unreasonable rate is itself a violation of the Interstate Commerce Act, and that a complainant who has paid a rate afterwards declared to be unreasonable is entitled to an order for reparations in the amount by which the rate paid exceeds a just and reasonable rate, without further proof of injury.[893] *Id.* Consistent with these holdings, Exxon notes, the Commission and the Interstate Commerce Commission have ordered reparations equal to the difference between the rates complained of and the just and reasonable rate determined by the Commission in the complaint proceeding.[894] *Id.* Thus, in the instant case, Exxon asserts, reparations should be awarded for the differences between the valuations determined to be lawful for the West Coast Naphtha and VGO cuts and the valuations that were in effect for those cuts in the past. *Id.* at pp. 388-89.

3026. In its complaint filed on June 19, 1996, Exxon stated that it requested reparations for the period beginning two years prior to the filing of its complaint – that is, for the period beginning on June 19, 1994. *Id.* at p. 389. It asserts that this "reach-back" period is provided in the Interstate Commerce Act itself (49 U.S.C. App. §16 (1988)), and has been acknowledged by the Commission in numerous orders. *Id.* Accordingly, Exxon believes, the request in its complaint for reparations back to June 19, 1994, is solidly

[893] Exxon cites two decisions in support of this argument: *I.C.C. v. United States,* 289 U.S. 385 at p. 390 (1933) and *Chicago, Milwaukee, St. Paul & Pacific R.R. Co. v. Alouette Peat Products, Ltd.*, 253 F.2d 449 at p. 455 (9th Cir. 1957). Exxon Initial Brief at p. 388, n.169.

[894] Exxon cites the following decisions in support of this statement: *SFPP, L.P.,* 80 FERC ¶ 63,014 at p. 65,202 (1997); *Thomson Phosphate Co. v. Atlantic Coast Line R. Co.,* 291 I.C.C. 1, 4 (1953); *Kerr-McGee Refining Corp. v. Williams Pipe Line Co.,* 63 FERC ¶ 61,349, at p. 63,224 (1993); *Union Oil Co. of California v. Cook Inlet Pipe Line Co.*, 71 FERC ¶ 61,300 at p. 62,184 (1995); *SFPP, L.P.,* 91 FERC ¶ 61,135 at p. 61,516 (2000). Exxon Initial Brief at p. 388, n.170.

grounded on statutory language and judicial and Commission precedent. *Id.*

3027. Exxon also believes that the record in this case clearly establishes justification for paying reparations back to June 19, 1994. *Id.* In support, Exxon cites Exhibit No. SOA-28 that it believes demonstrates that, for the period 1994-2001, the Gulf Coast Naphtha price used as the proxy price for West Coast Naphtha (denominated "Sanderson/Culberson") was, on average, 6.5¢/gallon (or about $2.73/barrel) lower than prices at which West Coast Naphtha sold under contract for the same period. *Id.* at pp. 389-90. Even if one focuses solely on the earliest years of this period, 1994-1998, Exxon notes that the Gulf Coast-based proxy price for Naphtha, on average, lagged 1.6¢/gallon (67.2¢/barrel) below the West Coast Naphtha contract prices for the same period. *Id.* at p. 390.

3028. Moreover, states Exxon, for the period 1994-2001, the Gulf Coast-based Naphtha proxy price was, on average, $3.82/barrel below the Naphtha price that most of the parties agreed to in the 1993 Settlement (which would have set the West Coast Naphtha price based on the adjusted price of West Coast conventional unleaded gasoline). *Id.* (citing Exhibit No. EMT-430 at p. 5). Further, Exxon states, Exhibit No. SOA-28 demonstrates that the Gulf Coast-based proxy price (denominated "Sanderson/Culberson" on SOA-28) falls well below every other valuation proposed in this case (i.e., below Tallett, O'Brien, Tallett Governed, O'Brien Governed, Dudley Governed and Sanderson/Culberson Governed) except the Dudley ungoverned proposal, for the entire period 1994-2001, as well as the earlier years 1994-1998.[895] *Id.*

3029. According to Exxon, even these comparisons tend to understate significantly the degree to which the Gulf Coast-based proxy price has fallen below the actual market value of West Coast Naphtha. *Id.* Exxon points out that the Quality Bank Administrator has proposed, and no party has opposed, using the Platts quote for Heavy Naphtha, rather than the Platts quote for Full Range Naphtha that has been used as the proxy price on both coasts, because the properties of the Quality Bank Naphtha cut are much closer to the Platts Heavy Naphtha specifications than to the Platts Full Range Naphtha specifications. *Id.* at pp. 390-91. The record shows, in Exxon's opinion, that the price of Heavy Naphtha has exceeded the price of Full Range Naphtha on the Gulf Coast, on average, by about 1.3¢/gallon, and on the West Coast by about 2.7¢/gallon, for the period 1994-2002.[896] *Id.* p. 391.

[895] According to Exxon, the record "clearly establishes" that, for the period 1994-2001, the Gulf Coast-based proxy price for VGO consistently has been different from the published price for West Coast VGO that the parties have now agreed should be used as the proxy price for West Coast VGO. Exxon Initial Brief at p. 390, n.173 (citation omitted).

[896] In addition, Exxon states there is at least one additional reason the current

3030. Exxon states that the Eight Parties assert that Exxon's claims do not qualify under Section 13(1) of the Interstate Commerce Act for a reparations award. Exxon Reply Brief at p. 451. Specifically, according to Exxon, the Eight Parties contend that Exxon's claim falls short of the requirements delineated in the Commission's decisions in the *SFPP* cases, namely that (1) a reparations claim must assert a claim against a specific shipper, and (2) to be eligible for reparations a complaint must be filed. *Id.* Exxon notes that the Eight Parties claim this is so because Exxon's complaint does not discuss the Naphtha and VGO cuts and these cuts are not part of the *Exxon* remand. *Id.* Finally, Exxon explains that the Eight Parties argue that Exxon must thus rely on the fact that Tesoro raised Naphtha and VGO issues in a later complaint, but that *SFPP* does not allow Exxon to use Tesoro's complaint to assert a claim for reparations in this proceeding. *Id.* at pp. 451-52.

3031. In making each of these arguments, states Exxon, the Eight Parties have grossly misrepresented the required elements of reparations claims in general, and have inaccurately described Exxon's complaint, in particular. *Id.* at p. 452. First, notes Exxon, their claim that Exxon's complaint failed to mention Naphtha and VGO is belied by the complaint, which specifies that the Commission's decision to value these cuts on the basis of Gulf Coast prices caused (along with other defects) the distillation methodology to be unjust and unreasonable. *Id.*

3032. Second, continues Exxon, the Eight Parties erroneously contend that any doubt that Exxon's complaint failed to challenge the valuation of the VGO and Naphtha cuts is removed by the *Exxon* decision which, they claim, stated that those cuts were not part of the remand. *Id.* Exxon asserts that this claim is false. *Id.* According to Exxon, the *Exxon* remand rendered no judgment whatsoever on the scope or merits of Exxon's complaint or the legality of the current valuation of the West Coast Naphtha and VGO cuts, except to note that those issues were beyond the scope of its decision. *Id.* at pp. 452-53.

3033. Third, Exxon asserts, there is no basis to the Eight Parties's contention that a party

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Naphtha proxy price further understates the actual market value of Naphtha on both coasts. Exxon Initial Brief at p. 391, n.174. It asserts that the evidence clearly establishes that the Naphtha prices published by Platts are based on an N + A of 40. *Id.* It is also undisputed, according to Exxon, that the Naphtha produced from ANS crude over the past decade has an N + A that is greater than 55. *Id.* Because Quality Bank Naphtha has an N + A content that is substantially higher than 50, Exxon states, it would receive the maximum proposed N + A adjustment of 1.5¢/gallon. *Id.* This means, explains Exxon, that the existing Naphtha proxy prices have likely understated the market value of Naphtha by an additional 1.5¢/gallon. *Id.* (citations omitted) cannot "piggyback" on the claim of another. *Id.* at p. 453 (citing Eight Parties Initial Brief at pp. 217-18). Rather, Exxon asserts, *Texaco* makes clear that this doctrine does not bar a claim by a party, like Exxon, which has "filed its own complaint and has fully participated throughout the hearings." *Id.* (quoting *Texaco Refining and Marketing, Inc.*, 99 FERC ¶ 63,009, at P 22 (2002)). More specifically, Exxon states, this doctrine applies only in narrow circumstances not present in this case, i.e., where a tardy complainant seeks to piggyback on the original complaint of another entity, after having failed to file a complaint until nearly the end of proceeding and who had remained passive throughout several years of a case. *Id.* Thus, Exxon argues that the anti-piggybacking doctrine does not apply here, because Exxon filed its own complaint in 1996 seeking damages (reparations) under Section 13(1) of the Interstate Commerce Act, has actively participated in the entirety of these proceedings, and was certainly not tardy or passive in any respect. *Id.* at pp. 453-54.

3034. Finally, Exxon suggests, the Eight Parties's assertion that Exxon's complaint fails the requirements of the *SFPP* cases is without merit as the claim rejected in *SFPP* is distinguishable from Exxon's claims in several respects. *Id.* at p. 454 (citing Eight Parties Initial Brief at p. 218). Exxon also states that the Eight Parties cannot deny that, in its complaint filed on June 19, 1996, it requested reparations for the period beginning two years prior to the filing of its complaint – that is, for the period beginning on June 19, 1994. *Id.* The Eight Parties concede (Eight Parties Initial Brief at p. 222), according to Exxon, that this "reach-back" period is provided in the Interstate Commerce Act itself (49 U.S.C. App. § 16 (1988)) and has been acknowledged by the Commission in numerous orders. Exxon Reply Brief at pp. 454-55 (citing *SFPP, L.P.*, 96 FERC at p. 62,071).

3035. Accordingly, Exxon asserts, the request in its complaint for reparations back to June 19, 1994, is solidly grounded in statutory language and judicial and Commission precedent. *Id.* at p. 455. It also argues that its request is supported by sound policy considerations as the Commission has acknowledged that a policy of not awarding reparations – as advocated by the Eight Parties here – "removes much of the incentive for [parties] to settle or to act with restraint in the litigation." *Id.* (quoting *SFPP, L.P.*, 86 FERC at p. 61,113).

3036. Moreover, Exxon argues, by 1998, it should have been perfectly clear to all parties that the West Coast valuations of Naphtha and VGO were being challenged. Exxon Initial Brief at p. 392. Specifically, Exxon notes, on August 20, 1998, Tesoro filed its complaint challenging the use of Gulf Coast prices to value the West Coast Naphtha and VGO cuts. *Id.* In particular, notes Exxon, Tesoro asked the Commission to value West Coast Naphtha based on West Coast gasoline prices, and argued that such new valuations should be made effective as of the effective date of the *OXY* remand cuts; and that a just and reasonable Quality Bank methodology must be put in place effective December 1, 1993. Exxon Reply Brief at pp. 467-68.

3037. Exxon states that case law makes clear that notice of a dispute concerning cut valuation is an important factor in guiding the Commission's discretion as to whether to award reparations. *Id.* (citing *SFPP, L.P.*, 86 FERC at p. 61,113). Additionally, notes Exxon, a comparison of Platts Gulf Coast Naphtha quotes with West Coast Naphtha contract prices demonstrates that Naphtha values on the two coasts began to diverge even more substantially in the late 1998 timeframe. *Id.* at pp. 392-93. For example, states Exxon, citing Exhibit No. SOA-28, an Alaska study shows that, for the period 1994-1998, West Coast Naphtha sold under contract at a price, on average, about 1.6¢/gallon higher than Platts Gulf Coast Naphtha price for the same period, while from 1999-2001 that differential widened to 14.2¢/gallon.[897] *Id.* at p. 393. Exxon asserts that this divergence further supports the appropriateness of awarding reparations. *Id.*

3038. Finally, Exxon asserts that it is impossible to argue that notice is even an issue following issuance of the *Tesoro* decision in December 2000. *Id.* In *Tesoro*, claims Exxon, the Circuit Court found that sufficient new evidence had been presented to establish a prima facie case that the Commission's practice of valuing West Coast Naphtha on the basis of Platts Gulf Coast Naphtha price was not just and reasonable, and that such evidence required the Commission to reexamine how West Coast Naphtha should be valued.[898] *Id.* Indeed, Exxon adds, the Circuit Court commented, in its *Tesoro* decision, that the Commission's reliance on the Gulf Coast Naphtha price to value West Coast Naphtha "is more dubious now than in 1993." *Id.* (quoting 234 F.3d at p. 1292).

3039. According to Exxon, the Eight Parties argue that, even were reparations an issue in this proceeding, reparations cannot be awarded in this case because of the principle established in *Arizona Grocery*. *Id.* at pp. 393-94. Exxon explains that *Arizona Grocery*

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[897] Exxon notes that the Alaska study is consistent with studies submitted by it and Unocal. Exxon Initial Brief at p. 393, n.177. According to Exxon, Unocal's study shows that, for the period 1993-1998, West Coast Naphtha sold under contract at a price, on average, about 1.48¢/gallon higher than Platts Gulf Coast Naphtha price for the same period, while from 1999-2001 that differential widened to 11.63¢/gallon. *Id.* (citing Exhibit No. UNO-52 at p. 5). Exxon notes that its study shows that, for the period 1994-1998, West Coast Naphtha sold under contract at a price, on average, about 2.07¢/gallon higher than Platts Gulf Coast Naphtha price for the same period, while from 1999-2001 that differential widened to 12.0¢/gallon. *Id.* (citing Exhibit No. EMT-380).

[898] In making this claim, Exxon overstates the Circuit Court's finding. Rather than holding that Tesoro established a prima facie case that it was not just and reasonable to continue valuing West Coast Naphtha on the basis of Platts Gulf Coast Naphtha assessment, the Court held that Tesoro "at the least establish[ed] a prima facie case that new evidence warrants re-examination of how West Coast Naphtha should be valued." *Tesoro*, 234 F.3d at p. 1293. That holding is significantly different than Exxon's claim.

held that, where an agency has prescribed a just and reasonable rate, it may subsequently find that rate unlawful and order it changed prospectively, but it may not award retroactive relief. *Id.* at p. 394. It argues that, contrary to the Eight Parties's contention, the principle of *Arizona Grocery* is not a bar to an award of reparations in this case, because the Commission's adoption in 1993 of Gulf Coast-based prices to value West Coast Naphtha and VGO did not amount to a prescription of those valuations. *Id.* Such is the case, states Exxon, because: (1) neither the distillation methodology as a whole, nor its West Coast Naphtha and VGO components, has ever produced a final, lawful rate; and (2) neither record evidence nor sound regulatory policy supported use of Gulf Coast prices to value West Coast cuts when those valuations were adopted in 1993. *Id.*

3040. Exxon points out that the principles for establishing a lawful Quality Bank methodology were set forth in *OXY*. *Id.* There, explains Exxon, the Circuit Court held that, in order to be lawful, a Quality Bank methodology must "assign accurate relative values to the petroleum that is delivered to TAPS," and that, "[i]n order to achieve this goal, [the Commission] must accurately value all cuts." *Id.* (quoting *OXY*, 64 F.3d at p. 693). It further explains that given the comparative nature of the distillation methodology, the valuation of any single component is integrally related to the value of all other components, and to the lawfulness of the methodology as a whole. *Id.* at pp. 394-95. Accordingly, Exxon asserts, the Commission will not have finally "prescribed" rates, within the meaning of *Arizona Grocery,* using a distillation methodology, until all of the methodology's components are accurately valued. *Id.* at p. 395.

3041. Yet, Exxon notes, the Eight Parties's brief sheds little, if any, light on this critical point because neither *Arizona Grocery* nor any other case cited by the Eight Parties addressed how a rate is prescribed in a situation similar to the one presented by the distillation methodology. Exxon Reply Brief at p. 457. Indeed, Exxon asserts, the Eight Parties's analysis of this critical issue is limited to their single statement, devoid of any analysis or supporting case law, that "[i]t is no answer that a final Quality Bank methodology with all cuts resolved and not subject to judicial review has not been attained." *Id.* (quoting Eight Parties Initial Brief at p. 216). Exxon states that this statement is no substitute for analysis of this very important and novel issue. *Id.* Instead, notes Exxon, the Eight Parties assume that the valuations of West Coast Naphtha and VGO were prescribed in the 1993-1994 timeframe notwithstanding the Commission's continued failure to accurately value all cuts as required by *OXY*. *Id.*

3042. Although the Commission has been working to prescribe a complete, accurate Quality Bank methodology since the 1993 change to a distillation methodology, Exxon asserts that it has not yet succeeded. Exxon Initial Brief at p. 395. Instead, since its initial implementation in December 1993, the distillation methodology has been the subject of three appeals in which various aspects of the methodology have been challenged, found to be deficient, and remanded to correct legal error. *Id.* Exxon argues that, because these legal errors remain unresolved, the Commission has not yet prescribed a final, lawful methodology for Quality Bank assessments using the distillation approach. *Id.* at p. 396. As a result, the principle of *Arizona Grocery* does not yet apply. *Id.*

3043. Exxon states that the parties to the 1993 settlement had proposed that West Coast Naphtha be valued on the basis of an adjustment to West Coast gasoline prices. *Id.* It explains that the Commission rejected that valuation on grounds that market prices, without adjustments, were more reliable than adjusted market prices. *Id.* For that reason, notes Exxon, the Commission used Gulf Coast prices to value Naphtha and VGO on both the West Coast and the Gulf Coast. *Id.*

3044. *Arizona Grocery* is inapplicable here for at least two other reasons, continues Exxon. Exxon Reply Brief at p. 458. First, it argues, the Commission's adoption of single coast pricing to value both West Coast and Gulf Coast components was made up of "whole cloth," because, it asserts, there was no evidentiary support whatsoever for the Commission's 1993 decision to use Gulf Coast Naphtha prices to value West Coast Naphtha. Exxon Initial Brief at p. 396. Indeed, in the five-year proceeding that led to that decision, Exxon notes, no party had even suggested – much less presented any evidence – that the price for a product on one Coast was a reasonable basis for valuing that product on the other Coast. *Id.* at pp. 396-97. Thus, concludes Exxon, the absence of any evidentiary support for the 1993 decision to use Gulf Coast prices to value West Coast Naphtha further undermines any claim that that valuation enjoys the retroactive protection of *Arizona Grocery*. *Id.* at p. 397.

3045. Exxon states that the Supreme Court explained in *Arizona Grocery*, 284 U.S. at p. 386, n.15, that the claim that a rate "has the force of a statute" and is therefore prescribed may be undermined where "the administrative agency . . . has based its order upon a finding without evidence or upon evidence which clearly fails to support it." Exxon Initial Brief at p. 397, n.179. Yet, notes Exxon, the Eight Parties assume that the Commission established the use of Gulf Coast pricing to value West Coast Naphtha and VGO based on the record, without ever specifying any evidence that supported this decision. Exxon Reply Brief at p. 459. Nor, according to Exxon, have the Eight Parties cited a single case holding that a rate is prescribed in the *Arizona Grocery* sense even where it is not supported by any record evidence. *Id.* Thus, Exxon argues, the absence of any evidentiary support for the 1993 decision to use Gulf Coast prices to value West Coast Naphtha further undermines any claim that such valuation enjoys the retroactive protection of *Arizona Grocery*. *Id.*

3046. Second, the use of Gulf Coast prices to value West Coast Naphtha was also based, in the opinion of Exxon, on an ill-founded and ultimately ill-fated regulatory policy. Exxon Initial Brief at p. 397. In *OXY*, Exxon states, the Circuit Court held that the policy on which use of Gulf Coast prices to value West Coast components was based lacked an adequate foundation and was "arbitrary and capricious."[899] *Id.* (quoting 64 F.3d at pp. 693, 695) On remand, according to Exxon, the Commission abandoned its no adjustment policy, adopting instead adjusted market prices for the remanded cuts on both Coasts. *Id.* at pp. 397-98. And in *Tesoro*, states Exxon, the Circuit Court relied in part on the Commission's abandonment of the no adjustment policy in holding that the Commission must reconsider the use of Gulf Coast pricing to value West Coast Naphtha. *Id.* at p. 398. (citing *Tesoro*, 234 F.3d at p. 1293).

3047. Exxon asserts that the Eight Parties offer no other grounds which could possibly support the Commission's use of single market pricing. Exxon Reply Brief at p. 460. Thus, Exxon argues, the only grounds that ever existed for the Commission's use of single-market prices were discredited by the Circuit Court and ultimately abandoned by the Commission. Exxon Initial Brief at p. 398. Under these circumstances, claims Exxon, the Commission's 1993 valuations of West Coast Naphtha and VGO cannot be deemed to have been prescribed within the meaning of *Arizona Grocery*. *Id.* Accordingly, Exxon concludes there is no bar to retroactive relief in the form of reparations for past valuations of the West Coast Naphtha and VGO cuts once lawful valuations for those cuts are finally established. *Id.*

3048. Exxon further states that the Eight Parties argue that "[a] reparations claim must . . . satisfy the following elements: (1) there must be an allegation that a carrier has violated the [Interstate Commerce Act]; (2) the claimant must allege it has sustained injury as a result of the violation; and (3) the relief sought must be against the carrier." *Id.* at p. 399. It also states the Eight Parties claim that none of these elements is present in this case. *Id.* Even assuming that each of these elements is, in fact, a prerequisite to a successful reparations claim, Exxon asserts, both the Exxon and Tesoro complaints clearly satisfy each element. *Id.*

3049. As to the first element, Exxon asserts, both it and Tesoro allege that the TAPS Carriers have violated § 1(5) of the Interstate Commerce Act to the extent that they have placed in effect a Quality Bank methodology, and specific elements thereof, that are not just and reasonable. *Id.* It points out that Section 1(5)(a) of the Act declares that "every unjust and unreasonable charge . . . or any part thereof is prohibited and declared to be

[899] Exxon's claim in this regard appears, at a minimum, to be overstated. In fact, the Circuit Court did not address the "policy" of valuing West Coast cuts on the basis of the value of Gulf Coast cuts. At the places cited by Exxon, it found that the Commission's justification for using the price of jet fuel to value light distillate and the price of No. 2 fuel oil to value heavy distillate to be arbitrary and capricious and the use of FO-380 as a proxy for Resid also to be arbitrary and capricious. *OXY*, 64 F3d at pp. 693, 695. Thus, Exxon's contention that the Court even addressed the question of valuing West Coast cuts on the basis of the value of Gulf Coast cuts is without merit.

unlawful." *Id.* (quoting 49 U.S.C. App. §1(5)(a)(1988)). Thus, to the extent that the Commission finds that use of Gulf Coast prices to value West Coast Naphtha and VGO is unjust and unreasonable, Exxon asserts that a violation of Section 1(5) will have been established. *Id.*

3050. With respect to the second element, Exxon points out, both the courts and the Commission have held that a complainant who has paid a rate afterwards declared to be unreasonable is entitled to an order for reparation in the amount by which the rate paid exceeds the just and reasonable rate, without other evidence of loss. *Id.* at pp. 399-400. Thus, asserts Exxon, the allegation of injury sustained not only has been made, but also will have been proven in the event the Commission concludes that use of Gulf Coast prices to value West Coast products is not just and reasonable. *Id.* at p. 400.

3051. Finally, Exxon notes that, as reflected in the caption of the complaints, both complainants seek relief against the TAPS Carriers, as they must in light of the fact that the TAPS Carriers administer the Quality Bank. *Id.* at p. 400. Because the Quality Bank is the vehicle through which debits and credits are assessed for differences in the quality of crude oil transported by the Carriers, Exxon argues that it follows that complaints lodged for the purpose of effecting changes in the Quality Bank methodology are directed to the TAPS Carriers. *Id.* Accordingly, Exxon's stipulation with the TAPS Carriers simply recognizes that the TAPS Carriers (1) implemented the valuations for the West Coast Naphtha and VGO cuts that were ordered by the Commissions, and (2) serve merely as conduits for Quality Bank payments among TAPS shippers. *Id.*

3052. The Eight Parties assertion that there is no legal basis for reparations because Exxon failed to provide evidence of a violation of any Quality Bank tariffs is, in Exxon's view, a misstatement of law. *Id.* at pp. 400-01. Exxon argues that no case has held that a tariff violation is an element of a reparations claim. *Id.* at p. 401. Rather, as both case law and the text of the Interstate Commerce Act make clear, a rate may be found unjust and unreasonable, and reparations awarded, absent a tariff violation. *Id.* It points out that its claim is predicated on §1(5) of the Interstate Commerce Act, which clearly states that charging an unjust and unreasonable rate is itself a violation of the Act. *Id.* Thus, Exxon asserts, proof of a tariff violation is not necessary to proving a violation of §1(5). *Id.* Moreover, Exxon maintains that case law[900] confirms its view that reparations may be awarded on the basis that the rate provided in a carrier's tariff is unjust and unreasonable. *Id.*

3053. Contrary to the Eight Parties's position, according to Exxon, the Commission's decisions in *Trans Alaska Pipeline System* and *Conoco* do not hold that reparations

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[900] Exxon cites *Chicago*, 253 F.2d at pp. 455-56.

cannot be awarded absent proof of a tariff violation.[901] *Id.* Rather, according to Exxon, the Commission held that a tariff violation needed to be proven in those cases because relief was sought (refunds in *Trans Alaska Pipeline System* and reparations in *Conoco*) on the theory that there was a tariff violation, i.e., the carriers allegedly had violated limits in their tariffs regarding API gravity by allowing shipments of crude oil contaminated with Natural Gas Liquids. *Id.* at p. 401-02. Exxon maintains that the Commission did not announce a general rule of law to the effect that a tariff violation must be proven in all reparations cases. *Id.* at p. 402.

3054. The Eight Parties invoke what Exxon views as inapplicable Interstate Commerce Act provisions and ignore the text of other, also in Exxon's view, more pertinent provisions, when they "erroneously" suggest that the Commission lacks statutory authority to award reparations. *Id.* For example, Exxon asserts that the Eight Parties wrongly suggest that §15(1) of the Interstate Commerce Act prohibits the Commission from ordering retroactive rate changes. *Id.* The Eight Parties also note, erroneously according to Exxon, that the Commission is prohibited from ordering the payment of money under §13(2) of the Interstate Commerce Act, and also point to §15(7) of the Act, which applies to an award of refunds. *Id.* In invoking all of these statutory provisions, Exxon states, the Eight Parties fail to focus upon the statutory provisions under which reparations are sought here, including §13(1) of the Interstate Commerce Act, which expressly provides for the award of damages, and §16(3)(b) of the Act, which explicitly, according to Exxon, provides for reparations for up to two years prior to the filing of a complaint. *Id.* at pp. 402-03. The Eight Parties also ignore decades of case law construing the Commission's authority to award reparations, it claims. *Id.* at p. 403.

3055. In Exxon's view, the Eight Parties misinterpret the Commission's decisions in *Trans Alaska Pipeline System* and *Conoco* by arguing that those decisions mandate that Quality Bank changes can only be applied prospectively. *Id.* Here again, Exxon claims, the Commission did not announce such a broad rule. *Id.* Rather, explains Exxon, it announced a much narrower holding based on the facts of those cases – namely, that the gravity methodology had been prescribed by the Commission, and that its ruling that changes to that methodology could be made only prospectively had been upheld on judicial review. *Id.* It was in this context that the Commission held, notes Exxon, that, notwithstanding its determination that the gravity methodology was unjust and unreasonable, it had no authority to apply the rate retroactively because of the filed rate doctrine (and its corollary, the rule against retroactive rate-making). *Id.*

3056. In contrast, asserts Exxon, the distillation methodology has yet to be prescribed in its final form, as it remains the subject of legal errors remanded by the Circuit Court. *Id.*

[901] Exxon cites, in support, *Trans Alaska Pipeline System*, 65 FERC at p. 62,292 and *Conoco*, 72 FERC at p. 61,013.

at p. 404. In these circumstances, Exxon maintains, the rule against retroactive ratemaking does not apply. *Id.* Moreover, in Exxon's view, there is nothing inconsistent about the Commission's prescribing a methodology to be applied prospectively from the date of its order, and, at the same time, awarding reparations for past periods. *Id.* (citing *Trans Alaska Pipeline System*, 82 FERC at p. 62,352).

3057. Exxon asserts that, after eliminating the Eight Parties's unsubstantiated arguments, the Commission clearly has both the legal authority and compelling evidence in this record to award reparations for the West Coast Naphtha and VGO cuts. *Id.* Accordingly, Exxon and Tesoro request that the Commission award reparations back to June 19, 1994, (or at least August 20, 1998, the date Tesoro's complaint was filed) for the difference between the West Coast Naphtha and VGO values that have been in effect since those dates and the values for those cuts ultimately determined to be lawful. *Id.*

3058. Moreover, Exxon argues that, even if the Commission were to decline to award reparations based on the Exxon and Tesoro complaints, retroactive application of any revised West Coast Naphtha and VGO values adopted in this proceeding would still be required for some period of time to compensate for the Commission's erroneous dismissal of those complaints in 1999. Exxon Initial Brief at p. 405. According to Exxon, this is the principle laid down in *Tennessee Valley*. *Id.* It states that the Eight Parties's brief does not even mention this important remedial consideration. Exxon Reply Brief at pp. 471-72. According to Exxon, application of this principle to the facts of this case would require the Commission to make its decision on the complaints effective as of a date 920 days prior to the conclusion of the complaint proceedings, even if the Commission were to deny the request for reparations. *Id.* at p. 472.

3059. Exxon explains that *Tennessee Valley* involved a complaint, filed pursuant to Section 5 of the Natural Gas Act, alleging that existing rates of a natural gas pipeline company were excessive. Exxon Initial Brief at p. 405. It notes that the Federal Power Commission dismissed the Section 5 proceeding, but that, on review, the Circuit Court held that dismissal of the proceeding, rather than reopening it for further hearings, constituted legal error. *Id.* In so ruling, notes Exxon, the Circuit Court observed that the policy of the Natural Gas Act could not be defeated by allowing Commission error to remain uncorrected. *Id.* Therefore, explains Exxon, the Circuit Court held that the injured party must be placed in the same position it would have occupied had the error not been made; in this case, by granting reparations for the period of time between the Commission's wrongful dismissal of the case and the time it cured that error by reopening the hearings. *Id.* at pp. 405-06.

3060. In the instant case, Exxon notes that the Commission dismissed Exxon's and Tesoro's complaints on April 30, 1999,[902] but reinstated hearings on the complaints on

[902] *Exxon Co., U.S.A. v. Amerada Hess Pipeline Corp., et al.,* 87 FERC ¶ 61,133 at

November 7, 2001,[903] after the Circuit Court held that the dismissals were arbitrary and capricious and reversed and remanded the cases for further proceedings.[904] *Id.* at p. 406. Thus, Exxon calculates, a period of 920 days elapsed between the date of the Commission's erroneous dismissal of the complaints and the date of the Commission's order on remand setting those complaints for hearing. *Id.* Accordingly, Exxon claims that, under the principle established in *Tennessee Valley,* the Commission must compensate for its erroneous dismissal of the Exxon and Tesoro complaints – even if it were to decline to award reparations based on those complaints – by making its decision on the complaints effective as of a date 920 days prior to the conclusion of the complaint proceedings. *Id.* at pp. 406-07.

3061. Exxon states that the Eight Parties contend that equity precludes granting Exxon's reparations claim because they were never put on notice, until Exxon filed testimony in February 2000, that reparations were a possibility for the Naphtha and VGO cuts. Exxon Reply Brief at p. 467. It suggests that this claim is implausible. *Id.* In 1993, Exxon states, it co-sponsored a settlement proposal valuing the Naphtha and VGO cuts on a West Coast basis and, in 1996, it filed its complaint explaining that the distillation methodology, including the use of Gulf Coast pricing to value certain West Coast products (including West Coast Naphtha), produced unjust and unreasonable results. *Id.*

3062. The Eight Parties erred, according to Exxon, when they suggested that, because Tesoro has not sought reparations for itself, it has not suffered any damages. *Id.* at p. 469. Exxon states that Tesoro has a strong interest in competing on a level playing field with other TAPS shippers, particularly other Alaskan refineries (such as those operated by Williams and Petro Star). *Id.* at pp. 469-70. It contends that the TAPS Quality Bank plays an indispensable role in ensuring that a level playing field is maintained when it values Quality Bank cuts at market values. *Id.* at p. 470. In addition, according to Exxon, the evidence in this case demonstrates that, for the last decade, Alaskan refiners have paid less than West Coast market values for their use of Naphtha from the TAPS common stream. *Id.* Exxon asserts that Tesoro plainly has been, and continues to be, damaged by its competitor's access to Naphtha at a cost below the West Coast market value for Naphtha. *Id.* In these circumstances, it argues, the appropriate remedy is for the improper financial benefits accruing to Williams and Petro Star to be disgorged and for West Coast Naphtha to be valued at the West Coast market value for Naphtha. *Id.*

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p. 61,531 (1999); *Tesoro Alaska Petroleum Co. v. Amerada Hess Pipeline Corp., et al.,* 87 FERC ¶ 61,132 at p. 61,520 (1999).

[903] *Trans Alaska Pipeline System,* 97 FERC ¶ 61,150 at p. 61,652 (2001).

[904] *Tesoro*, 234 F.3d at pp. 1294-95.

3063. Also, Exxon finds no merit to the Eight Parties's argument that it would be inequitable to award Exxon reparations for a period in which it supported – or at least did not oppose – Gulf Coast pricing for Naphtha and VGO on which its reparations claims are based. *Id.* The Eight Parties attempt to support this plea for equity, states Exxon, by noting that Exxon offered proposals in the 1997 and 2000 settlement proceedings that included Gulf Coast pricing for these cuts. *Id.* This argument is plainly wrong, maintains Exxon, as those proceedings were limited to the issues remanded in *Exxon* and *OXY,* which (as the Eight Parties concede) never reached the issue of how to value the West Coast Naphtha and VGO cuts. *Id.* As noted above, states Exxon, it joined Tesoro before the Circuit Court in advocating that retroactive relief be granted with respect to the Naphtha and VGO cuts. *Id.* at pp. 470-71.

3064. Exxon notes that the parties have stipulated that, if a revised West Coast Naphtha valuation is adopted in this proceeding, the revised West Coast VGO valuation to which the parties have stipulated should have the same effective date. Exxon Initial Brief at p. 407. When the TAPS Carriers amended their Quality Bank tariffs to change the pricing basis used to value the Naphtha cut from Platts reported Gulf Coast waterborne Naphtha price assessment to Platts newly-reported Gulf Coast waterborne Heavy Naphtha price assessment, Exxon points out, they requested special permission to allow the tariff revisions to be effective on March 1, 2003, with one day's notice. *Id.* In the Commission's March 28 Order, notes Exxon, it accepted use of the Platts Gulf Coast Heavy Naphtha price assessment to value the Naphtha component, subject to further investigation and refunds back to March 1, 2003. *Id.*

3065. In light of these orders, Exxon contends that a new West Coast Naphtha valuation should be applied by the Quality Bank effective March 1, 2003, with refunds awarded for the period between March 1, 2003, and the date of the Commission's decisions in these proceedings. *Id.* at p. 408. If refunds are awarded, Exxon urges that reparations equal to the difference between the valuations that have previously been in effect for such cuts and such new, revised valuations, be ordered for the period June 19, 1994 (or, at the latest, August 20, 1998) to March 1, 2003. *Id.*

3066. Finally, in light of the parties's stipulation in this case covering the effective dates of new valuations for the West Coast Naphtha and West Coast VGO cuts, Exxon believes that the new valuation for West Coast VGO should also be made effective March 1, 2003, with refunds ordered for the period between March 1, 2003, and the date of the Commission's decision in these proceedings, and reparations ordered for the period June 19, 1994 (or August 20, 1998) to March 1, 2003. *Id.*

3067. According to the TAPS Carriers, several parties have proposed that Quality Bank adjustments among the shippers be recalculated to take account of a new methodology for valuing one or more components of the Quality Bank streams. TAPS Carriers Initial Brief at p. 30. In some cases, note the TAPS Carriers, they have characterized these retroactive adjustments as refunds and in others as reparations. *Id.* However they are characterized, the TAPS Carriers state, the retroactive calculations that have been proposed are administratively feasible. *Id.* So long as the data are available to recalculate the value of the component in question for some past period, it is administratively feasible, explain the TAPS Carriers, for the Quality Bank Administrator to recalculate Quality Bank adjustments, send out new invoices and redistribute the funds collected (less Quality Bank expenses). *Id.* Of course, in doing so, point out the TAPS Carriers, the Quality Bank Administrator would be functioning purely as a stakeholder and would incur no liability if, for example, it proved impossible to collect amounts owed by a shipper as a result of the revised Quality Bank invoices. *Id.*

3068. The TAPS Carriers note that Mitchell qualified his opinion regarding the administrative feasibility of making retroactive adjustments to Quality Bank calculations by stating that his opinion was based on his understanding that the Quality Bank would continue to deal only with shippers of record, not others, such as royalty owners or customers of the shippers, with which a shipper might have some contractual relationship. *Id.* at p. 31. The TAPS Carriers explain that it would not be administratively feasible for the Quality Bank either to collect money from or to pay money to parties other than the shippers of record. *Id.* They note that the Quality Bank has no information on the identity of entities other than shippers of record, or of any contractual or other legal obligations that a shipper might have to such entities. *Id.* In addition, the TAPS Carriers claim that, even if the Quality Bank had information on the contractual or other arrangements between shippers and third parties, it would have no way of knowing whether the third party agreed with the shipper's interpretation of any such agreement. *Id.* Finally, they state, the Interstate Commerce Act regulates the legal relationship between a pipeline carrier and its shippers. *Id.* It is not apparent to the TAPS Carriers what legal authority they would have to compel payment from an entity that was not its shipper. *Id.*

3069. The TAPS Carriers do not see that the necessity of dealing with shippers would cause a problem for the Quality Bank. *Id.* According to them, there have been a relatively small number of shippers on TAPS and either the shippers or their corporate successors are still in existence. *Id.*

3070. Commission Staff notes that reparations in this case are not being sought from a carrier, i.e., the TAPS Carriers. Staff Initial Brief at p. 6. Rather, in conjunction with a proposal to establish new West Coast VGO and Naphtha cut valuations effective back to June 19, 1994, that, if adopted, would increase its revenue entitlement, Staff explains Exxon seeks refunds retroactively from other shippers based on the difference between the new and old valuations. *Id.* Thus, Staff argues that, because there is no claim for damages from the TAPS Carriers, the Exxon reparations claim is really a claim for refunds from other shippers that might result if the Naphtha and VGO valuation methods are retroactively changed. *Id.*

3071. The Staff's position is that Exxon's witnesses, Pavlovic and Toof, attempt to confuse reparations and refunds by: (1) repeatedly referring to the refund amounts sought as damages, (2) suggesting that the effective date of the proposed Naphtha and VGO changes should be June 19, 1994, because of the Interstate Commerce Act's limit on reparations to a two-year period prior to the date of filing of complaints, and (3) then limiting their refund calculations to that two-year period.[905] *Id.* In Staff's view, their attempt fails to overcome the fact that there is no evidence that the TAPS Carriers violated their tariffs[906] and that Joint Exhibit No. 12 states that Exxon does not seek payment from the TAPS Carriers's own funds, but only seeks a pass-through by the TAPS Carriers of any refund overpayments by other shippers. *Id.* at pp. 6-7. Inasmuch as there are no damages being sought from the TAPS Carriers and no showing of a violation of the TAPS tariffs, Staff argues there is no basis for an award of reparations. *Id.* at p. 7. Staff recommends that the claims against other shippers should be considered in connection with Issues 3 and 4 concerning the effective dates for any changes in the valuation methodologies for the Naphtha and VGO cuts and any refunds that may result, issues which Staff is not addressing. *Id.*

3072. According to Staff, neither of Exxon's arguments in support of reparations has merit. Staff Reply Brief at p. 3. First, Staff states, Exxon suggests that the issue of reparations is valid here because of the retroactive relief claims in the Exxon and Tesoro complaints, reference to section 13(1) of the Interstate Commerce Act in the Commission's 1996 hearing order on the Exxon complaint, and the statement in *Trans Alaska Pipeline System,* 82 FERC at p. 62,352, that, if Exxon's complaint is successful, "reparations are available." *Id.* (citing Exxon Initial Brief at pp. 386-87). These complaints and the Commission's responding orders referenced by Exxon, must, in Staff's view, be put in the proper context. *Id.* Staff points out that Exxon's Prayer for Relief in its 1996 complaint at page 22, paragraph (4), requests a finding that the TAPS Carriers "failed to comply with the [Quality Bank Methodology] Tariff's requirements for administering the distillation methodology and determining payment to, and receipts from, the Quality Bank in violation of Sections 6(1) and 6(7) of the [Interstate Commerce Act]." *Id.* Thus, explains Staff, an allegation of violations of the Act by the TAPS Carriers was an important element of the Exxon complaint. *Id.*

3073. Staff asserts that the Commission, in its 1996 hearing order, noted that Exxon's complaint alleged a failure to comply with the Quality Bank tariff, and that the TAPS Carriers had responded by denying the allegations. *Id.* (citing *Trans Alaska Pipeline*

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[905] Staff cites the following in support of this position: Exhibit Nos. EMT-68 at pp. 7-18, l3-14, EMT-1 at pp. 28, 32-33.

[906] Staff cites Exhibit No. PAI-47 at p. 7 in support of this statement.

System, 76 FERC at p. 61,621). It explains that the subsequent order's reference to section 13(1) and statement concerning the availability of reparations reflects the Commission's recognition that Exxon's complaint had requested relief in the form of reparations and is not a pre-approval for the payment of reparations. *Id.* at pp. 3-4. Staff argues that, until execution of Joint Exhibit No. 12, which resolved any real claims against the TAPS Carriers for damages, Exxon appeared to be pressing a genuine claim against the Carriers for Interstate Commerce Act violations that would justify the Commission invoking section 13(1) and paying reparations. *Id.* at p. 4. Staff asserts that the referenced Commission orders, therefore, provide no support for finding that reparations are an issue in this proceeding subsequent to the execution of Joint Exhibit No. 12. *Id.*

3074. Exxon's second argument for recognizing reparations in this case, states Staff, is its assertion that, in *Trans Alaska Pipeline System*, 97 FERC at p. 61,652, the Commission directed that all matters remanded in *Exxon* and *Tesoro* be taken up in the present hearing, including reparations related to Naphtha and VGO valuations. *Id.* (citing Exxon Initial Brief at p. 387). However, Staff notes, the Commission's order did not discuss reparations claims and identified only the following as central issues to be resolved: (1) valuation of the Resid cut and the retroactive application of the modifications in the settlement approved by the Commission in 1997 (*Exxon* remand); (2) valuation of the Naphtha and VGO cuts and the continued just and reasonableness of the distillation methodology (*Tesoro* remand); and (3) sulfur processing adjustment (replacement product proceeding). *Id.* (citing 97 FERC at p. 61,650). Staff argues that the focus in the Commission's order on issues other than reparations (and the absence of any reference to reparations) means that that order lends no strength to Exxon's argument. *Id.* It concludes that, although Exxon's 1996 complaint passed the threshold prima facie test for raising a claim for reparations, the execution of Joint Exhibit No. 12 removed that claim. *Id.* at p. 5. There is an absence in the resulting record in this case of any basis for claiming damages under ICA section 13(1) against a carrier, Staff concludes, and it recommends that Exxon's claim for reparations be denied. *Id.*

DISCUSSION AND RULING

3075. The first question raised concerns whether reparations are an issue in these proceedings. Staff's analysis, summarized above, correctly indicates that they are not. According to Staff, Exxon "seeks retroactive Quality Bank methodology changes and refunds that may result from such changes from refiners and other shippers, not reparations from any carrier." Staff Reply Brief at p. 2. That this is an accurate statement is made clear by the Joint Stipulation of the Parties, filed October 3, 2002. Since Exxon has agreed that it is not seeking reparations from the TAPS Carriers, the Commission lacks jurisdiction to hear its complaint.

3076. In any event, even were reparations to be an issue here, I would not award reparations to Exxon. While other arguments have been made, Exxon's claim for reparations focuses on the question of what the effective date for the new West Coast Naphtha value should be.[907] For reasons stated above, I have determined that the new West Coast Naphtha value should be effective on a going-forward basis only. It follows that Exxon is, therefore, not entitled to reparations.

3077. Moreover, Exxon's argument regarding reparations fails on other grounds as well. As noted by the Eight Parties,[908] the Interstate Commerce Act, in pertinent portion, provides as follows:

> Whenever, after full hearing, upon complaint made as provided in section 13 of this Appendix, . . . the Commission shall be of [the] opinion that any individual or joint rate, fare, or charge whatsoever demanded, charged, or collected by any common carrier or carriers subject to this chapter for the transportation of persons or property, as defined in section 1 of this Appendix, or that any individual or joint classification, regulation, or practice whatsoever of such carrier or carriers subject to the provisions of this chapter, is or will be unjust or unreasonable or unduly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any provisions of this chapter, the Commission is empowered to determine and prescribe what *will be* the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, *to be thereafter* observed in such case or the maximum or minimum, . . . *to be charged* . . . .

Title 49 App. § 15(1) (1988) (emphasis supplied). According to the Eight Parties, in this language, the Act only allows for prospective rate changes. Eight Parties Initial Brief at p. 211. Exxon did not directly reply to this argument.

3078. Exxon does argue that the Commission never has established "lawful rates through a distillation methodology" because the Circuit Court has not accepted the Commission's determination as to the value of each of the nine cuts for both the Gulf Coast and the West Coast. Exxon Reply Brief at pp. 456-57. While I suspect that it is not so, a review of the factual situation regarding Naphtha might cause one to think that Exxon made this argument tongue in cheek. In 1993, the Commission modified and adopted a contested

[907] The parties have agreed that West Coast VGO should be valued as the OPIS West Coast High Sulfur VGO weekly price and that, "if a different West Coast Naphtha valuation methodology is adopted in this proceeding, it and the new West Coast VGO value should have the same effective date." Joint Stipulation of the Parties, filed October 3, 2002, at p. 4; Exxon Initial Brief at p. 384.

[908] Eight Parties Initial Brief at p. 211.

settlement in which it determined that the gravity method should be replaced by the distillation method for calculating the Quality Bank. *Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 (1993). The Commission, in that order, decided that, both the West Coast and the Gulf Coast Naphtha values should be determined using the Platts U.S. Gulf Coast spot quote for Waterborne Naphtha. *Id.* at p. 62,289. Its order was appealed to the Circuit Court which affirmed it except as regarding the Distillate and the Resid cuts. *OXY*, 64 F.3d at p. 701.

3079. It is totally clear to me that both the Commission and the Circuit Court found that it was just and reasonable for the TAPS Carriers to use Platts U.S. Gulf Coast spot quote for Waterborne Naphtha as a component of its Quality Bank formula. I see nothing in either ruling which indicates that either believed that, until the Commission and the Courts were satisfied with the valuation of each and every cut on each coast, the TAPS Carriers could not use the distillation methodology to calculate the Quality Bank. Unlike its argument regarding Resid, I conclude that Exxon's argument that there is no "lawful [rate] through a distillation methodology," therefore, has no merit.

3080. In addition, Exxon challenges the Eight Parties's reliance on *Arizona Grocery*. It states that *Arizona Grocery* is not pertinent because there was no evidentiary support for the Commission's 1993 decision regarding Naphtha and because "the use of Gulf Coast prices to value West Coast Naphtha was based solely on a 'No Adjustment Policy' that was discredited on appeal and then abandoned by the" Commission. Exxon Reply Brief at pp. 458-60. Exxon's argument, however, ignores, once again, the simple truth – the Commission's 1993 holding determining the Naphtha values set forth in its ruling to be just and reasonable was affirmed by the Circuit Court. *OXY*, 64 F.3d at p. 701. Exxon's claim here, therefore, amounts to an impermissible collateral attack on these rulings. *See Dynegy Power Marketing, Inc.,* 101 FERC ¶ 61,369 at P 18-20 (2002).

3081. The Supreme Court, in *Arizona Grocery,* considered whether the Interstate Commerce Commission properly awarded reparations "with respect to shipments which moved under rates approved or prescribed by it." *Arizona Grocery*, 284 U.S. at p. 381. It noted, when that Commission determined that a rate was just and reasonable, that it acted in its legislative capacity and that its decision had "the force of a statute." *Id.* at p. 386. The Supreme Court further noted that the Commission was forbidden, by statute, from approving a rate which was not just and reasonable and that it could not "retroactively repeal its own enactment as to the reasonableness of the rate it has prescribed." *Id.* at pp. 387, 389. The Interstate Commerce Commission, the Supreme Court added, could repeal the rate setting order, but it could only do so prospectively, and noted that its ruling only affected rates established by the Interstate Commerce Commission and not "carrier-made rates." *Id.* at pp. 389-90; *see also Aquila Energy Marketing Corp. v. Natural Gas Pipeline Co. of America*, 66 FERC ¶ 61,284 at pp. 61,810-11 (1994).

3082. In the instant case, as was discussed above, while the Commission previously determined that it was just and reasonable for both the Gulf Coast and the West Coast Naphtha values to be determined using a Gulf Coast reference price, the instant record has made it clear that the use of a Gulf Coast reference price for West Coast Naphtha no longer is just and reasonable. The proxy which I ordered to replace it only can be made effective on a prospective basis. Therefore, no party is entitled to reparations.[909]

CONCLUSION

3083. It is concluded that the rates, and the Tariff provisions affecting those rates, which are in conformance with the findings and conclusions of this Initial Decision are just and reasonable.

ORDER

3084. IT IS ORDERED, subject to review by the Commission on exceptions or on its own motion, as provided by the Commission's Rules of Practice and Procedure, that within thirty (30) days of the issuance of the final order of the Commission in this proceeding, the TAPS Carriers shall file revised Tariff sheets in accordance with the findings and conclusions of this Initial Decision, as adopted or modified by the Commission.

EDWARD M. SILVERSTEIN
Presiding Administrative Law Judge

[909] I feel compelled to note that, in essence, Exxon really is not seeking "reparations" which, in this case, would be damages awarded against the TAPS Carriers for violating their Tariff. As all parties have agreed that the TAPS Carriers did not violate the terms of their Tariff, that there are no damages sought from them, and that what is sought is an order requiring the Quality Bank Administrator to re-calculate the Quality Bank for a period of time, it is clear that what is sought is refunds, not reparations.