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Decision 98-08-033 August 6, 1998

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ARCO Products Company, Mobil Oil Corporation, and Texaco Refining and Marketing, Inc., Complainants, vs. SFPP, L.P., Defendant.	Case 97-04-025 (Filed April 7, 1997)

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OPINION

Summary

SFPP, L.P. (defendant) will be ordered to file a tariff for its gathering enhancement system at Watson station within 60 days of the date of this decision and in all other respects, the complaint of ARCO Products Company (ARCO), Mobil Oil Corporation, and Texaco Refining and Marketing, Inc. (Texaco) (complainants) is dismissed.

Procedural History

Complainants filed this complaint against defendant on April 7, 1997. Defendant filed its answer on May 15, 1997. A prehearing conference (PHC) was held on June 30, 1997. An evidentiary hearing was held January 12-15, 1998. Complainants and defendants filed concurrent opening and reply briefs on March 2, 1998, and March 16, 1998, respectively. On March 17, 1998, the matter was submitted on closing oral argument before Henry M. Duque, the assigned Commissioner, and the assigned administrative law judge (ALJ). A proposed decision (PD) was filed by the ALJ on June 18, 1998. Complainant and defendant filed comments on the PD on July 8, 1998, and they filed reply comments on July 13, 1998.

The Complaint

Defendant is a pipeline corporation, as defined in Public Utilities (PU) Code Section 228, engaged in the business of transporting refined petroleum products. In Decision (D.) 92-05-018, we approved defendant's application for an increase in its rates. That application was uncontested. Complainants allege that (1) defendant's existing tariffed rates are not just and reasonable under PU Code Section 451; (2) defendant has improperly failed to file tariffs for two specific services (a pipeline on its system known as the "Sepulveda pipeline" in the Los Angeles area; and certain facilities referred to as the "Watson initiating facilities") in violation of PU Code Sections 453, 454, 461.5, and 486; (3) defendant's existing rates for the Sepulveda pipeline and the Watson initiating facilities are not just and reasonable and are unduly discriminatory or preferential; and (4) defendant has improperly charged its customers more than the maximum filed rate for service on the Sepulveda pipeline and the Watson initiating facilities. Complainants seek only prospective relief.

Motion to Dismiss

On June 3, 1997, defendant moved to dismiss the complaint. At the PHC, the ALJ ruled that he lacked authority to dismiss the complaint when disputed issues of fact existed and denied defendant's motion without prejudice. Defendant attacks the complaint on several grounds.

Finality of D.92-05-018

PU Code Section 1709 provides that the final orders of the Commission are conclusive in all collateral actions or proceedings. On May 8, 1992, the Commission issued D.92-05-018, which granted a rate increase and approved defendant's rates. Therefore, defendant argues, the complaint, brought five years later, is barred, citing *Gleason v. Del Oro Water Co.*, D.92-03-083 (1992) and *Halloway v. PT&T* (1969) 69 CPUC 272, 274.

Gleason was a complaint against a water utility by three of its customers who were dissatisfied with how a water rationing program had been implemented. The Commission dismissed the complaint because (1) the end of rationing rendered it moot; (2) individual customers lack standing to bring a complaint against a water utility; and (3) the temporary rationing program had been specifically approved by the Commission. *Gleason* is unlike this case in all three respects: the complaint has not become moot; individual customers do have standing to bring a complaint against a pipeline corporation; and rationing is not at issue.

Hallowny was a complaint against a telephone utility by one of its customers who was aggrieved by being charged $15 for the use of two 25-foot extension telephone extension cords worth $5 each new. The Commission dismissed the complaint because (1) PU Code Section 734 prohibits reparation in respect of any charge that the Commission has found to be reasonable, and the extension cord charge had previously been found reasonable; and (2) the complainant had failed to show that the charge is in violation of any provision of law or order of the Commission. Unlike *Hallowny*, complainants in this case seek only prospective relief, not reparations, and complainants have alleged that defendant's charges are in violation of law.

Complainants point to the language of PU Code Section 1702, which expressly authorizes the filing of complaints "setting forth any act or thing done or omitted to be done by any public utility, including any rule or charge heretofore established or fixed by or for any public utility, in violation or claimed to be in violation, of any provision of law or of any order or rule of the Commission."

In setting the rates of a public utility, we seek to establish rates that are just and reasonable and which protect customers, on the one hand, from overreaching by the utility and which provide an equitable return on the utility's investment in facilities that it has dedicated to public use, on the other hand. This is neither a simple task nor one which we can undertake on a continuous basis in response to day-to-day or hour-to-hour changes in facts and circumstances. By the same token, however, rates are not necessarily just and reasonable for all time solely by virtue of having once passed muster with this Commission.

Traditionally, for many utilities the Commission conducted a periodic review of rates, which provided an on-going opportunity to consider rates. For example, in situations in which there is an annual review, a rule that bars revisiting in 1997 the rates approved at the end of 1996 has much to recommend it, because we would be engaged at that time in looking at rates for 1998. Parties to the most-recent rate case could bring to our attention through an application for rehearing or a petition for modification any legal error or minor modification that was required, and others would have an opportunity to join in the debate on what next year's rates should be.

But when the interval between examination of rates stretches to multiple years, the problem of overlapping rate cases does not arise. Rather, we think the situation is best handled with a presumption when it has been a matter of several years since a utility's rates have been found reasonable. Rates that the Commission has previously approved should be presumed to be just and reasonable, and the strength of that presumption should change with time as facts and circumstances change. Immediately following the approval of rates by the Commission, the presumption should be conclusive in the absence of a showing of legal error by someone with standing to apply for rehearing. Consistent with Rule 47(d) of the Rules of Practice and Procedure, the presumption should be strong during the initial year after the Commission's decision, and parties seeking to change established rates should do so through a petition for modification.

After one year, if no Commission rule or order requires the utility to subject its rates to our examination within a stated period, the presumption should not be as strong. But if the utility is so required to participate in a proceeding that will result in our revisiting the reasonableness of its rates, the presumption ought to be a strong one, as there will be an opportunity afforded in that proceeding for anyone who believes the utility's rates are not just and reasonable.

Such a practical rule[1] respects both the literal language of PU Code Section 1702 (permitting challenges to be made to rates) and the intent of PU Code Section 1709 (giving finality to Commission decisions when it can be assumed that the Commission will necessarily revisit the same subject matter in the near-term future). Therefore, defendant's motion to dismiss the complaint as a collateral attack on a final decision should be denied.

The Equitable Defense of Laches

In its motion to dismiss, defendant argues that because complainants waited so long (almost five years) to challenge the rates approved in D.92-05-018, the equitable doctrine of laches should bar the claim, either because of the unreasonable delay and acquiescence on the part of the complainants, or unreasonable delay and the prejudice to the defendant in having to relitigate its 1992 rate case in 1997.

We agree with complainant that defendant has failed to establish unreasonable delay in challenging the rates which we approved in 1992. Complainants allege that defendant's rates are unreasonable, prospectively, as of April 1997, when the complaint was filed. Defendant does not allege that complainant delayed an unreasonable time after knowing that defendant's rates had become unreasonable. Therefore, defendant's motion to dismiss on the equitable defense of laches should be denied.

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[1] We emphasize that we intend to apply this analysis to complaint cases only in circumstances similar to the present case, in which it has been several years since a ratesetting procedure, no new rate case has been scheduled, and the utility operates under traditional cost-of-service principles.

Whether PU Code Section 1702 Permits the Complaint

In its motion to dismiss, defendant argues that the reasonableness of rates may be examined only (1) in the context of a utility rate proceeding instituted by the application of the utility; (2) in the context of an investigation initiated by the Commission on its own motion; or (3) as permitted by PU Code Section 1702. Defendant argues that PU Code Section 1702 does not allow challenges to the reasonableness of rates charged by public utility oil pipelines.

PU Code Section 1702 permits any corporation to file a complaint with this Commission against any public utility, and such a complaint may allege that charges are in violation of law. Some types of public utilities, not including pipeline corporations, have special rules regarding rate complaints. For example, in the case of an electric utility, among others, a complaint as to the reasonableness of any rates or charges must be brought by proper officials of a city or county or by not less than 25 customers. That limitation does not apply to a pipeline corporation. We agree with complainant that defendant's motion to dismiss on this ground should be denied.

Whether Special Rules Apply to Oil Pipeline Utilities

In its motion to dismiss, defendant cites *City of Long Beach v. Unocal California Pipeline Co.* (1994) 54 CPUC2d 422 (*Unocap*, after the short name of the defendant), as establishing standards for evaluating the reasonableness of rates charged by a public utility oil pipeline, and argues that the complaint does not allege sufficient facts to meet such standards.

In *Unocap*, the utility was organized to assume ownership of a proprietary system of crude oil pipelines as part of a settlement in an antitrust case. (*Id.* at 424.) When the utility filed an advice letter to convert its facilities to public utility status, the City of Long Beach (Long Beach) protested the proposed rates. (*Id.*) Long Beach argued that cost-of-service ratemaking should apply to the utility, rather than its proposed market-based rates. (*Id.* at 426.) We were not convinced that cost-of-service ratemaking should apply. (*Id.* at 431.) We found, instead, that the utility should be permitted to base its initial rates upon market rates, rather than traditional cost-of-service ratemaking, because it had shown that practical alternatives to its services existed such that its initial rates were subject to market discipline. (*Id.* at 432.) We also considered that the utility's principal customers were major oil producers, whose protection required less regulatory oversight than customers of monopoly water companies or electric utilities, and that the utility did not have an exclusive service territory. (*Id.*)

Differences exist between the *Unocap* case and this one. Defendant operates a refined oil pipeline system, rather than a crude oil pipeline system; existing, rather than initial, rates are in dispute; and defendant's rates are cost-of-service based, rather than market-based. Even if considerations involved in *Unocap*, such as the nature of the utility's customers and its lack of an exclusive service territory, among others, might well be shown to exist in defendant's situation, that does not mean that the *Unocap* case establishes the exclusive standards by which all pipeline complaints are to be evaluated. Indeed, we stated in *Unocap* that the "reasonableness of rates is determined as a matter of fact based on the totality of the circumstances." (*Id.* at 432.)

Therefore, we agree with complainant that its allegations are sufficient to withstand defendant's motion to dismiss, inasmuch as complainant has alleged facts that *could* show a totality of circumstances leading us to conclude that defendant's rates are unreasonable.

Whether the Complaint Is Sufficient under Cost-of-Service Analysis

Defendant next argues that the complaint should be dismissed because it fails to allege sufficient facts showing that defendant's rates are unreasonable based upon a cost-of-service analysis. Under the totality of the circumstances test from *Unocap* (*id.*), we disagree. For purposes of testing the legal sufficiency of a complaint, we assume all of the factual allegations to be true. The complaint alleges that defendant's revenues so exceed its permitted cost of service as to result in a return on rate base substantially in excess of the amount found reasonable by the Commission in D.92-05-018. If complainant is able to prove its allegations, we might well find the rates to be unreasonable. For this reason, defendant's motion to dismiss the complaint for failure to allege sufficient facts to show defendant's rates to be unreasonable under a cost-of-service analysis should be denied.

Whether the Complaint Sufficiently Alleges that Certain Facilities are within the Commission's Jurisdiction

Defendant owns and operates line 109, a 3.8 mile long 16-inch pipeline, and line 110, a 10-inch transmix return line (collectively, the Sepulveda pipeline), which connect a location known as the Sepulveda Junction in Carson, California, to another location known as the Watson Station. (Ex. 6, at 3.) At Watson Station, defendant owns and operates a gathering enhancement system, consisting of 20-inch diameter vapor collection piping connected to 10 of the 14 tanks at Watson station, flame arresters, vapor blowers, and flow regulators, a vapor saturation system, and a thermal oxidizer (the Watson initiating facilities). Defendant charges for the use of the Sepulveda pipeline and the Watson initiating facilities and such charges are not in any tariff filed with this Commission.

Defendant argues that complainant has not alleged sufficient facts to show that the Sepulveda pipeline and the Watson initiating facilities have been dedicated to public use. The judicially created doctrine of dedication requires that to be subject to the jurisdiction of the Commission, the property by which services are rendered must have been dedicated to public use. (*See, e.g., Greyhound Lines, Inc. v. Public Utilities Commission*, 68 Cal2d 406, 413 n.4 (1968).) The parties agree that in the absence of the dedication doctrine the Sepulveda pipeline and Watson initiating facilities would be public utility facilities subject to the jurisdiction of this Commission.

Defendant argues that the only allegation that complainants make which addresses the dedication requirement is that defendant has never denied any shipper service on the Sepulveda pipeline or the Watson initiating facilities. Dedication is a factual inquiry. (*Unocap*, 54 CPUC2d 422, 428.) A variety of facts and circumstances may be sufficient to show dedication. (*Pacific Gas & Electric Co. v. Dow Chemical Company* (1993) 49 CPUC2d 614, 622-23.) Some such facts may be exclusively within the possession of a defendant in a particular case, such as records of correspondence. For this reason, we believe that as a matter of pleading, it is not advisable to attempt to decide dedication issues solely on the allegations, but rather to leave for the fuller record the development of the specific facts that will allow us to decide. We do not believe that defendant's motion to dismiss the complaint for failure to allege sufficient facts to show dedication should be granted.

Applicable Legal Standards

Statutes

PU Code Section 451 requires that "[a]ll charges demanded or received by a public utility, ..., for any ... service rendered ... shall be just and reasonable." PU Code Section 453(a) prohibits public utilities from making or granting "any preference or advantage to any corporation or person or subject[ing] any corporation or person to any prejudice or disadvantage." PU Code Section 453(c) forbids any public utility from establishing or maintaining "any unreasonable difference as to rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." PU Code Section 454(a) requires that "no public utility shall change any rate ..., except upon a showing before the [C]ommission and a finding by the [C]ommission that the new rate is justified." PU Code Section 461.5 prohibits "any railroad or other transportation company" from discriminating in charges for transportation between places or persons. PU Code Section 486 requires common carriers to file rates with the Commission.

Discussion

Whether PU Code Sections 461.5 and 486 Apply

Defendant is a pipeline corporation. PU Code Section 461.5 applies to "railroads" or "other transportation companies." Defendant is not a railroad as defined in PU Code Section 229. "Other transportation companies" is not defined. However, the Legislature does distinguish pipeline corporations from railroads, common carriers, and passenger stage corporations, all of which are engaged in "transportation," because pipeline corporations are engaged in "transmission" of "crude oil or other fluids, except water." (PU Code Section 227.) Among hundreds of reported decisions of this Commission, nowhere does there appear an example of a pipeline corporation made subject to PU Code Section 461.5. However, former Article XII, Section 21 of the California Constitution was substantially similar to PU Code Section 461.5, and the Commission has found that oil pipeline corporations are "transportation companies" for purpose of the prohibition against discrimination in charges or facilities. (*San Diego Pipeline Co.* (1971) 71 CPUC 832, 852.)

PU Code Section 486 applies to common carriers. Common carriers are defined in PU Code Section 211: "every person and corporation providing transportation for compensation to or for the public or any portion thereof." Only in PU Code Section 421(a) does the Legislature specifically mention pipeline corporations with common carriers. That statute includes pipeline corporations among the list of entities subject to a fee to be paid for the support of certain Commission programs, along with "other common carriers and *related business*[es]" (emphasis added).

While we have often used the term "common carrier" to refer to pipeline corporations (see, e.g., Rulemaking on the Commission's Own Motion into Implementation of Public Utilities Code Section 455.3, Which Revises the Manner in Which Oil Pipeline Corporations May Change Rates, D.97-08-033) we have usually done so in a manner that is synonymous with "public utility" as a matter of historical usage and custom. One of our decisions, however, makes common carriers out of pipeline corporations. (San Diego Pipeline, at 853.)

Were it not for *San Diego Pipeline*, we would hesitate to conclude that the Legislature intended us to treat pipeline corporations as either an "other transportation company" or as a "common carrier." Respecting the precedent that we have established, however, we conclude that complainants' claims under PU Code Sections 461.5 and 486 should not be dismissed for failure to state a cause of action on which relief may be granted.

Whether the Sepulveda Pipeline Has Been Dedicated to Public Use

Complainants argue that the Sepulveda pipeline has been dedicated to public use for the following reasons: (1) defendant has never denied service to anyone who has requested it; (2) the three customers that defendant built the Sepulveda pipeline to serve constitute a "limited portion" of the public; (3) the Sepulveda pipeline has been a source of substantial revenue; (4) defendant has provided service over Sepulveda pipeline pursuant to long-term contracts;

(5) the Sepulveda pipeline connects to the public terminal of GATX Terminals Corporation (GATX), which does not itself produce petroleum products, but provides terminalling services for others who do, and defendant knows the identity of the various owners whose product is shipped on the Sepulveda pipeline; (6) the Sepulveda pipeline represents an extension of service to customers beyond defendant's normal service area; and (7) defendant's marketing brochures describe the Sepulveda pipeline.

Defendant argues that none of these reasons establish that the Sepulveda pipeline has been dedicated to public use. In particular, the fact that, as of December 1997, defendant has separately billed the owners of product stored at the GATX terminal reflects only the determination of the Federal Energy Regulatory Commission (FERC) that the Sepulveda pipeline is subject to federal jurisdiction.

The evidence shows that the Sepulveda pipeline was constructed in 1982, pursuant to a private agreement among defendant, Texaco, Champlin Petroleum Company (Champlin, later Ultramar), and GATX. (Ex. 6, at 4.) The Sepulveda pipeline was constructed at the request of Texaco, Champlin, and GATX. (*Id.* at 4.) Texaco and GATX own and operate tanks for product storage and the pumping facilities that were needed to move product through the Sepulveda pipeline to Watson station. (*Id.* at 3-4.) GATX stores and transports product for others. (*Id.* at 5.) Champlin/Ultramar used a combination of its own facilities and those of GATX. (*Id.* at 6.). For ten years, only Texaco, GATX, Champlin/Ultramar used the Sepulveda pipeline. (*See id.* at 5.) At the expiration of the agreement, in 1993, defendant established a charge of $0.05/barrel (bbl) for the Sepulveda pipeline. (*Id.*) Currently, only Texaco and GATX have connections to the Sepulveda pipeline. (*Id.*) Ultramar-originated product can reach the Sepulveda pipeline through GATX facilities. (*Id.* at 7.) However, most Ultramar product reaches the Watson station through the facilities of Shell Oil Products Co.'s Carson terminal and pipelines. (*Id.* at 10.) As a result of a FERC order defendant became required to file a tariff for interstate movements of product on the Sepulveda pipeline, and so it bills ARCO as a shipper of record. (Tr. at 327.) Around ten shippers of record use the Sepulveda pipeline (Tr. at 338.) At the Watson station, all of the petroleum product so delivered is transported downstream on defendant's utility pipeline system (Tr. at 339), except for small amounts of gasoline-diesel mix (transmix), which is returned along Line 110 to its origin. (Tr. at 340.) No one has ever been denied service on the Sepulveda pipeline, and no one, other than Texaco, Champlin/Ultramar, and GATX, has ever requested service on the Sepulveda pipeline. (Tr. at 4-5.) Defendant's marketing brochure contains a reference to the Sepulveda pipeline as one of six inbound gathering systems serving defendant's Watson station terminal. (Ex. 12.) The other inbound gathering systems are apparently owned by refineries. (*Id.*)

To find a dedication of private property to public use as a utility, we look for acts that objectively express or imply an unequivocal intent to serve the public, as opposed to particular customers. (*Dow Chemical*, 49 CPUC 2d at 624.) The portion of the public to be served need not be large, but it must be indefinite, in the sense that the identity of any particular customer is not an important consideration to the utility. (*Id.*) Evidence of that intent is missing in this case, and we will find that defendant has not dedicated the Sepulveda pipeline to public use.

Whether the Watson Initiating Facilities Have Been Dedicated to Public Use

Complainants argue that the Watson initiating facilities have been dedicated to public use for the following reasons: (1) defendant has never denied anyone the use of the Watson initiating facilities; (2) the Watson initiating facilities are used for all shipments from or through the Watson station, even if a shipper has not contracted for such use; and (3) the Watson initiating facilities are, accordingly, an "integral part" of defendant's public utility intrastate transportation service from or through Watson station.

Defendant argues that none of these reasons establish that the Watson initiating facilities have been dedicated to public use.

The evidence shows that the Watson initiating facilities were constructed after 1989. (Ex. 6, at 15.) Defendant's tariff rules and regulations require that refiners and terminal operators (shippers) into the Watson station meet a specified minimum incoming pumping rate. (*Id.* at 14.) Shippers can do this by installing new pumps and larger diameter pipelines. (*Id.*) However, it is potentially expensive to do so. (*See id.* at 16.) Four shippers requested that defendant develop an alternative that would permit delivery into the Watson station at the rate of 10,000 barrels per hour, rather than 15,000 barrels per hour, as required by defendant's tariff rules and regulations. (*Id.* at 15.) By installing a vapor handling system for each tank at the Watson station, defendant could use each tank for a variety of product. (*Id.*) Previously, tanks could only be used for a specific grade of gasoline, to avoid discharging vapor to the air when the tank was emptied and refilled. (*Id.*) The ability to use tanks for multiple grades of products effectively expanded the operating capacity of Watson station, thereby providing an effective substitute for higher incoming pumping rates. (*Id.*) Shippers who use the Watson initiating facilities are charged $0.032/barrel. (*Id.* at 16.) Any customer can use the Watson initiating facilities. (*Id.*)

The Watson initiating facilities meet the definition of "pipeline" contained in PU Code Section 227 ("all real estate, fixtures, and personal property, owned, controlled, operated, or managed in connection with or to facilitate the transmission, storage, distribution, or delivery of crude oil or other fluid substances except water through pipe lines"). The facts show that the Watson initiating facilities have been dedicated to public use, because defendant permits *any* customer who wishes to use the facilities to do so, not only those customers who originally requested the construction of the Watson initiating facilities.

Whether Defendant's Rates for the Watson Initiating Facilities are Just and Reasonable

Complainants presented evidence that the unit capital and operating costs of the Watson initiating facilities are "relatively small" (Ex. 1 at 15) and that "little or no costs" should be allocable to the Watson initiating facilities (Ex. 9 at 45). Defendant, whose position was that the Watson initiating facilities are not dedicated to public use, presented no cost information regarding the Watson initiating facilities. (*See* Tr. at 231.) There is insufficient evidence[2] to determine whether rates for the Watson initiating facilities are just and reasonable. We will order defendant to file a tariff for the Watson initiating facilities.[3]

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[2] The defendant charges $0.032/barrel for use of the Watson initiating facilities. (Ex. 6 at 15.) Complainants' expert stated that he "had not been provided with any detailed description of [defendant's] facilities and their capital and operating costs" with respect to the Watson initiating facilities. (Ex. 1 at 15.) He stated that he "would further expect that the unit capital and operating costs for the system are relatively small..." without stating whether such costs were "small" relative to the per barrel charge or relative to the cost of the product being shipped. Complainants' expert also testified "[a]s I discuss in [Ex. 1], I believe there should be little or no costs allocable to that service." (Ex. 9 at 45.) This evidence, consisting of a vague characterization of what the expert would expect to find if he had the relevant data, does not tell us anything about what unit capital and operating costs actually consist.

[3] Through the advice letter process, complainants will have an opportunity to challenge defendant's showing on costs.

Whether Defendant's Tariffed Rates are Just and Reasonable

Complainants argue that defendant's tariffed rates are not just and reasonable because they permit defendant to collect in rates an amount of revenue substantially in excess of defendant's costs. Defendant argues that complainants have failed to prove that defendant's revenues and costs are out of balance.

Burden of Proof

Complainants correctly observe that they bear the burden of establishing a *prima facie* case to support the relief they claim in the complaint. In the first instance, that burden is to produce evidence. Complainants met their burden of production through the expert testimony that they presented. Complainants argue that once they have met their initial burden of production, the burden of production shifts to the defendant public utility to rebut the complainant's *prima facie* case, citing *Bill Taylor Photography v. Pacific Gas & Electric Co.*(1991) 42 CPUC2d 233. In complainants' view, defendant failed to meet its burden of production and, as consequence, has not rebutted complainants' showing. Accordingly, complainants conclude, the complainants have met their burden of persuasion.

While it is true that evidence that covers all of the elements of a complainant's case shifts the burden of production to defendant, merely shifting the burden of production does not meet the burden of persuasion. In this case, complainants argue that since defendant did not produce its own cost of service evidence, defendant failed to meet its burden of production. Defendant did, in fact, produce evidence on the reasonableness of the assumptions and methodology used by complainants' witness in deriving complainants' estimates. That evidence consisted of the testimony of defendant's own experts

(Ex. 2, 4, and 6) and defendant's examination at the evidentiary hearing of those witnesses and the complainants' witness.

Complainants came into this case with the burden of persuading the Commission that defendant's rates were not just and reasonable. Complainants produced evidence to show that the rates were not just and reasonable, and defendant produced evidence to rebut complainants' showing. If complainants' evidence is sufficient to outweigh the evidence against it that defendant has presented, complainants will prevail; otherwise, defendant will prevail. Defendant did not need to present its own cost of service study to carry its burden of production. It was sufficient for defendant to produce evidence that cast doubt upon complainants' evidence.

Defendant's 1992 Test Year

In D.92-05-018, the Commission found that defendant's pro forma 1992 test year summary of earnings reasonably reflected the expected operations of the company both at its then-current rates and at the rates proposed. (*Mimeo.* at 3.) Appendix A of D.92-05-018 summarizes defendant's pro forma 1992 test year (in thousands of dollars):

		Adopted Pro Forma Test Year	
	Base Period	*With Increase*	*Without Increase*
Revenue	$ 65,790	$ 71,423	$ 65,545
Expenses	40,778	43,826	43,826
Income Tax	6,281	7,165	4,806
Net Income After Tax	18,731	20,432	16,913
Rate Base	165,089	171,757	171,757
Return on Rate Base	11.35%	11.90%	9.85%
Interest	9,463	9,846	9,846
Equity Return	9,268	10,586	7,067
Equity Rate Base	75,132	78,167	78,167
Return on Equity	12.34%	13.54%	9.04%

NOTES:

Base Period: Actual data from October 1990 through September 1991.

Pro Forma Test Year: Adjusted Base Period data indicating normalized operations.

Complainant's Estimate of Defendant's 1996 Test Year

Complainant prepared an estimate of defendant's 1996 test year, shown in the following table:

Table 1
($000)

	1991 Base Period	1996 Pro Forma Test Year	Source
Revenue	$ 71,423	$ 83,800	Ex. 9 at 14
Expenses	43,826	52,700	Ex. 1 at 25
Income Tax	7,165	0	Ex. 1 at 27
Net Income After Tax	20,432	31,100	calculated
Rate Base	171,757	163,400	Ex. 1 at 27
Return on Rate Base	11.90%	19.03%	calculated
Interest	9,846	9,856	Ex. 1 at 27*
Equity Return	10,586	9,425	Ex. 1 at 27*
Equity Rate Base	78,167	69,608	calculated
Return on Equity	13.54%	13.54%	calculated

* Adjusted from $9.8 million for interest and $9.5 million for equity return to keep return on equity a constant 13.54%.

Thus, complainants view defendant's rates as excessive in that they result in net income after tax in excess of the amount required to meet expenses, pay income taxes, and provide a weighted average cost of capital of 11.8% on the rate base. (*See* Ex. 1 at 27.) Complainants believe that defendant's rates should be reduced by 20-22%. (*Id.*)

Revenue

The parties agree that defendant's 1996 revenues in California were at least $77.04 million. (Ex. 2, unnumbered table at last page; Ex. 9 at 14.) To this amount, complainants would add $2.5 million for military delivery revenues and $1 million for inter-refinery deliveries for a total of $80.5 million. (Ex. 9 at 14.) Complainants would also add revenues for the Sepulveda pipeline and Watson initiating facilities to bring the total to $83.8 million. (*Id.*)

Complainants' witness testified that he derived his estimate of military delivery revenues by computing the difference between a defendant provided data request file with revenues by location and the revenues at those locations contained in the testimony (Ex. 2, unnumbered table at last page) of defendant's witness. (Ex. 9 at 13; Tr. at 45.) Defendant agrees that $2.5 million reflects rates for service including military exclusive use facilities. (Tr. at 318.)

Complainants argue that the jurisdictional status of defendant's transportation services provided to the military is not relevant. Because defendant failed, in complainants' view, to show that all of the *costs* properly allocable to its military service have been taken out of jurisdictional cost of service, the only option left to deal with such costs is revenue crediting, citing *San Diego Pipeline Co. and So. Pacific. Pipe Lines, Inc.*(1971) 71 CPUC 832.

In *San Diego Pipeline*, the issue was "whether any consideration should be given to the military shipments in evaluating applicants' alleged needs for the sought rate increases." (*Id.* at 842.) The facts showed that "the military shipments move...under substantially the same cost conditions as those which apply to the commercial shipments." (*Id.* at 844.) In addition, both the military and commercial shipments moved along the same pipelines for at least part of the movements at issue. (*Id.*) If the utility had collected its full tariff rates for the military shipments it made in 1969, it would have received an additional $39,000, or about 15%. (*Id.* at 845.) There was, however, no dispute that most of the properties used for military transportation were public utility properties. (*Id.* at 846.) Therefore, the Commission included both costs and revenues from military shipments in considering the proposed rate increase. (*Id.*)

As defendants note, the jurisdictional status of the transportation services provided to the military *is* relevant under the standard articulated in the *San Diego Pipeline* case. No evidence in this record indicates that any of the military revenues derived from public utility facilities. (*See* Ex. 6 at 18.) Complainants have failed to show that $2.5 million in military shipments should be added to defendant's $77 million in 1996 revenues.

Complainants' witness testified that discovery information provided by defendant showed approximately $1 million in revenues for "some [defendant] shipments to and/or from certain refineries in northern California." (Ex. 9 at 13.) Complainants advance the same rationale: In the absence of a showing by defendant on the proper allocation of the associated costs, revenue crediting should be applied, on the authority of *San Diego Pipeline.* However, in the absence of any evidence to rebut defendant's testimony (tr. at 317) that the revenues were non-jurisdictional, the claim fails for the same reason as the military shipments. Complainants have failed to show that $1 million in inter-refinery shipments should be added to defendant's $77 million in 1996 revenues.

Complainants' witness testified that revenues of $0.9 million in respect of the Sepulveda pipeline should be added to 1996 revenues. (Ex. 1 at 14.) In light of our determination that the Sepulveda pipeline has not been dedicated, however, it would be improper to do so, for the same reason as stated for the military and inter-refinery shipments.

Complainants' witness testified that revenues of $2.5 million in respect of the Watson initiating facilities should be added to 1996 revenues. (Ex. 1 at 14.) In light of our determination that the Watson initiating facilities have been dedicated, such revenues will be included in the absence of a showing by defendant that it did not begin to welcome the use of the Watson initiating facilities by any and all customers until after 1996. Therefore, we take it as established that defendant's 1996 revenues were $79.5 million.

Expenses

Complainants' witness testified that defendant's 1996 expenses should be estimated at approximately $52.7 million. (Ex. 1 at 25.) This consisted of $32 million that represented a portion of 1992 expenses escalated to 1996, $1.9 million for property taxes, $10.7 million for electric power, and $8.1 million for depreciation and amortization. (*Id.*) Defendant's witness testified that complainants' cost of service analysis was flawed, and provided no meaningful basis for evaluating defendant's rates, but that if certain adjustments were made, the cost of service analysis approach would show that defendant's revenues were not excessive. (Ex. 2 at 3.)

The parties appear to agree that defendant's cost of property taxes is either at least or at most $2.6 million per year. (Complainants' opening brief at 14, Ex. 2, at 13.) And on that basis, complainants' estimate of 1996 expenses should be increased by $0.7 million. (*Id.* at 13.)

Defendant believes that an additional $0.5 million should be added to complainants' estimate of 1996 expenses to account for the cost of this proceeding. (*Id.* at 15.) However, no such costs were incurred in 1996. (*Id.*) Defendant has presented no evidence to show that such costs were even reasonably foreseeable in 1996. Complainants' estimate should not be increased to account for such costs.

Defendant believes that an additional $2.8 million (based on actual 1996 expenditures of $3.8 million of which 75% is allocated to intrastate service, consistent with the assumption employed by complainants' witness for property tax) should be added to complainants' estimate of 1996 expenses to account for 1996 environmental expenditures at locations that provide California jurisdictional services. (*Id.* at 15.) Complainants' witness testified that he did not know if defendant's estimate eliminated environmental expenses allocated to non-carrier activities. (Ex. 9 at 16.) Complainants' witness also testified that allocating environmental expenses based on the relative barrels delivered for California versus out-of-state deliveries results in a higher proportion of costs than some "other valid mileage-related allocation alternative." (*Id.* at 17.) Complainants' witness testified that a "defensible cost allocation methodology could well be one that is related more to the nature of petroleum product services offered by [defendant] at affected [defendant] terminals or pumping stations, or perhaps length of pipeline." (*Id.*)

Even accepting complainants' argument that the allocation method which the complainant produced for property tax is not ideal for environmental remediation and that defendant failed to come up with its own allocation, it is easy to choose between an estimate of zero and one of $2.8 million as the more accurate number to use for environmental remediation costs in 1996. We are simply not prepared to believe that a refined petroleum pipeline operation incurs no environmental remediation costs at all. As between the two estimates, defendant's should be credited, and complainant's estimate of 1996 expenses should be increased by $2.8 million.

Accordingly, complainants' estimate of 1996 expenses should be increased by $0.7 million for property taxes and $2.8 million for environmental remediation expenses, or by a total of $3.5 million, from $52.7 million to $56.2 million.

Income Tax

Complainants argue that, as a limited partnership, defendant does not incur federal income tax liability and, accordingly, defendant's net income after taxes is identical to its net income before taxes.

Defendant concedes that it is a publicly traded partnership which itself incurs and pays no income tax and that its affiliated corporate unitholders may incur no federal income tax liability on income generated by defendant because of the availability of interest payment offsets under a consolidated income tax return. However, defendant argues, the taxable income that is generated by it as a partnership does not escape taxation: It is taken into income by its partners. Furthermore, defendant argues, while it is the policy of this Commission to include an allowance for federal income taxes a utility would pay at corporate rates, the Commission also recognizes distinctions between federal income tax for ratemaking purposes as compared to tax collection purposes.

Complainants' witness testified that (1) defendant itself pays no income taxes; (2) the master limited partnership that owns 99% of defendant itself pays no income taxes; (3) taxable income is attributed to defendant's partners regardless of any cash distribution to such partners; (4) partnership cash available for distribution to defendant's partners is higher than it would be if defendant were organized as a corporation and paid income taxes; and (5) because defendant does not pay taxes, it is able to retain more cash from operations than would be the case if it were organized as a corporation. (Ex. 9 at 19.)

Reduced to its simplest form, complainants' position is that allowance for federal income taxes should be limited to the amount of taxes actually paid by the utility or, at most, by such of the utility's owners (in the case of a limited partnership organized as the defendant is organized) as are themselves not organized as a "pass-through" entity. The policy reason given by complainants for this position is that the allowance for income taxes is designed to avoid the dual taxation of the same income at both the corporate level and, in the hands of the shareholder when received as dividends, at the personal level. (*See* Ex. 9 at 22.)

Complainants cite *Southern Cal. Gas. Co. v. Public Utilities Comm.*, 23 Cal.3d 470, 476 (1979), in which the California Supreme Court stated: "Permitting rates to be set on the basis of taxes that the utility has not actually paid, ... , in effect forces the ratepayers to contribute capital to be used for utility expansion." That case, however, involved a provision of the investment tax credit: "From the utilities' standpoint, the investment tax credit for public utilities amounts to a federally subsidized source of interest-free capital over and above the return allowed by the state regulatory agency. The utility is expected to invest its tax savings in capital equipment and 'repay' it, in the form of reduced rates, ratably over the life of the investment. From the commission's standpoint, however, the tax credit is like any other reduction in the cost of service, the benefit of which the commission is required by California law to pass on to the ratepayers as fully and immediately as possible.... Insofar as present ratepayers are charged on the basis of taxes the utility does not actually pay, it is they and not the federal government who supply the additional capital for utility expansion, even though the savings may be eventually flowed through ratably to future ratepayers." (*Id.*) Accordingly, *Southern Cal. Gas* does not stand for the proposition that a limited partnership does not incur an income tax expense for ratemaking purposes.

Complainants also cite *San Diego Pipeline Co.* (1971) 71 CPUC 832. The income tax issue in that case concerned the practice, for income tax purposes, of computing depreciation expense on the basis of 22-year service lives for depreciable properties. (*Id.* at 854.) For purposes of that proceeding, the utility had recalculated its depreciation expense and depreciation reserves on the basis of a service life of 40 years. (*Id.* at 847.) The Commission found that the utility's proposal would result in collecting about 14% more than the cost of the properties. (*Id.* at 847-48.) Thus, like *Southern Cal. Gas*, this case does not stand for the proposition that a limited partnership does not incur an income tax expense for ratemaking purposes.

Complainants' cite two FERC cases. In *Lakehead Pipe Line Company, Limited Partnership* (71 F.E.R.C. ¶61,338; 1995 FERC LEXIS 1193; subsequent citations are to LEXIS), the utility was a limited partnership. (*Id.* at 30.) The FERC policy had been, in determining a pipeline's cost-of-service, to include an allowance for state and federal income taxes based on corporate income tax rates to ensure that the pipeline will have the opportunity to earn its allowed after-tax return on equity. (*Id.*) The utility's unitholders included individuals, as well as corporations. (*Id.*) The FERC concluded that the utility was entitled to an income tax allowance with respect to income attributable to corporate partners but not interests held by individuals. (*Id.* at 34.) The reason for disallowing income attributable to interests held by individuals is that individuals incur no corporate income tax. (*Id.* at 35.) As a consequence, even though such individual owners may pay personal income taxes, the effect is to increase the utility's return on its equity. (*Id.* at 36.)

In *SFPP, L.P. Mobil Oil Corporation v. SFPP, L.P. Tosco Corporation v. SFPP, L.P.*, 80 F.E.R.C. ¶63,014), the FERC's administrative law judge found that the same defendant as in this case was organized as a limited partnership. (*Id.* mimeo. at 5.) One percent was owned by a general partner, which was incorporated, and the remaining 99% was owned by a master limited partnership. (*Id.*) The master limited partnership had the same general partner as the defendant and the general partner owned approximately 44% of the shares of the master limited partnership, with the remaining ownership interests being held by investors, from time to time, who are able to trade those interests on the New York Stock Exchange. (*Id.*) The interim decision cited followed *Lakehead* in disallowing a full tax allowance. (*Id.* at mimeo. 140.) The tax allowance in respect of corporate unitholders was approved. (*Id.* at mimeo. 140.) For the remaining unitholders (estates, foreign citizens, mutual funds, trusts, pension plans, other partnerships, exempt organizations, and other entities), no tax allowance was permitted in the absence of evidence that such unitholders would be subject to dual-tier taxation of income derived from the utility. (*Id.* at mimeo. 141.)

The FERC *SFPP* decision specifically rejects the notion that the only relevant corporate ownership interests were those in the utility itself (that is, the single general partner and the single limited partner). (*Id.* at n. 604, mimeo. at 137.) However, due to other factors, only the corporate entity's general partnership interests in the utility and in its limited partner were allowed for tax purposes. (*Id.* at 143.)

Defendant argues that it is the policy of this Commission to include an income tax allowance for ratemaking purposes regardless of whether the public utility actually pays income taxes. In D.92-05-018, the Commission specifically approved an income tax allowance in setting defendant's rates, even though defendant was organized then, as now, as a limited partnership.

Congress has created a number of tax provisions designed to favor utilities, and these may give rise to situations in which the appropriate tax allowance is in excess of the amount that the utility actually pays. (*See, e.g., Southern Cal. Edison Co.*(1984) 16 CPUC2d 721, 801.) Furthermore, because of consolidated returns, liability of the utility may be determined as one member of a consolidated tax return. Thus, income taxes collected through authorized rates may not actually be paid, but may be used to offset tax losses of other nonutility and affiliated members of the consolidated return. (*See Income Tax Expense for Ratemaking Purposes* (1984) 15 CPUC2d 42, 60.) Accordingly, it has not been this Commission's position that there must be a dollar-for-dollar correspondence between the income tax allowance for ratemaking purposes and the payments actually made by a utility to the Internal Revenue Service.

Defendant argues that the FERC's *Lakehead* decision is not a binding precedent upon this Commission and that the Commission would be unwise to adopt it. Before *Lakehead*, FERC appeared to have a policy that allowed a regulated utility an income tax allowance at the rates applicable to a corporation, based on the authorized rate of return. (*See* Ex. 4 at 12-13.) The policy had the advantage of being simple to apply and making ratepayers indifferent to the form of business organization of the utility. (*Id.*) Disallowing the income tax allowance to the extent that a partnership's individual owners do not pay a corporate income tax can be criticized on the grounds that (1) the amounts involved do not escape taxation in the hands of the partners who are individuals; (2) a corporate partner may in fact pay no taxes if it belongs to a consolidated group other of whose members have offsetting losses; (3) rates become dependent on the form of organization of the utility, with customers of partnerships paying lower rates than customers of corporations; (4) it is inconsistent with national tax policy that makes pass-through taxation available as an alternative to treatment as a separate taxable entity; and (5) the policy is extremely difficult to apply in practice.[4] (*Id.* at 14-15.)

Finally, defendant argues, even if the Commission were inclined to change its policy on tax allowances going forward, that would be a decision affecting such a variety of utilities that it should not be decided in the confines of a complaint proceeding.

Whether one views the Internal Revenue Code (IRC) and its implementing Treasury Regulations and the associated body of tax law as one of the towering public achievements of this century or an anachronism that should be replaced, it is difficult to argue that our national tax system is more complex now than it has been in the past. Even though subchapter C of the IRC, dealing with taxation of corporations, is challenging in its complexity, subchapter K, dealing with the taxation of partnerships, is even more mysterious.[5] The complexities multiply in dealing with other types of tax entities, such as limited liability companies, trusts, and other forms of organization that the IRC recognizes and treats differently. For a given test year,

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[4] In particular, for a publicly traded master limited partnership, the composition of the partners can change on a daily basis.

[5] "The distressingly complex and confusing nature of the provisions of subchapter K present a formidable obstacle to the comprehension of these provisions without the expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years experience in the tax field. ... Surely, a statute has not achieved 'simplicity' when its complex provisions may confidently be dealt with by at most only a comparatively small number of specialists who have been initiated into its mysteries." *David A. Foxman*, 41 T.C. 535, 551 n.9 (1964).

the principal determinants of the appropriate tax treatment may well be unknown and unknowable until many years after, when the tax system has settled the applicable law. Were we considering whether to adopt the principles in *Lakehead*, we might well hesitate.

That is not the question we have, however. We adopted rates, including an allowance for income taxes, for defendant in D.92-05-018, in full recognition that defendant was organized as a limited partnership. There have been no relevant factual changes since that time, and the only legal change is the *Lakehead* case. Even if we were persuaded to adopt the principle of that case, moreover, complainants have failed to introduce evidence as to the portion of defendant's limited partner's unitholders that consists of individuals or to provide any other basis for calculating the proper partial income tax allowance. Instead, complainants attempt to shift their burden by seeking to deny any allowance in the absence of a showing that any owner pays income taxes. We conclude that the best evidence on this record for defendant's 1996 tax expense is that given by defendant, $5.4 million (based on defendant's estimated net-to-tax multiplier of 0.69621 on an adjusted equity return). (Ex. 2 at 17.)

Rate Base

Complainants had estimated defendant's rate base at $163,400 million. (*See* Table 1, at 19, above.) However, defendant's witness testified that such estimate should be adjusted to $133,900 million, in order properly to account for the effect of accumulated deferred income taxes (ADIT) consistently with current policies adopted by the Commission. (Ex. 2 at 16.) There appears to be no dispute about using the adjusted amount as the rate base. A consequence of adjusting rate base to account for ADIT is that return on rate base should also be reduced, by $3.5 million. (Ex. 2 at 16.) Defendant accepts complainants' weighted cost of capital, 11.8%.

Recapitulation

The evidence shows that defendant's 1996 revenues were $79.5 million, defendant incurred expenses of $56.2 million, and was entitled to an income tax allowance of $5.4 million and a return on rate base (reduced to account for ADIT) of $15.8 million. This represents an excess of revenues over costs of $2.1 million; however, the costs attributable to the Watson initiating facilities are unknown. Reducing revenue by the amount associated with the Watson initiating facilities, $2.5 million, gives revenues of $77.0 million, which represents a deficit of costs over revenues in the amount of approximately $0.4 million. Since we will order defendant to file a tariff for the Watson initiating facilities, there will be an opportunity in the future to determine whether the costs claimed in relation to the rates requested are reasonable. For present purposes, complainants have failed to carry their burden of showing that defendant's rates are not just and reasonable.

Other Contentions

The parties dispute a number of other issues that are not reflected in the discussion above. Some of these relate to the degree to which defendant does, or does not, possess market power. Others concern complainants' estimate of how defendant's 1998 test year cost-of-service should be calculated. Yet others relate to the 1996 test-year analysis, but are mooted by the lack of dispute between the parties on overall totals. None of these contested issues are relevant to the outcome.

Market Power

While maintaining that its rates were not unreasonable under a cost-of-service analysis, defendant offered evidence to show that its rates were reasonable because (1) available competitive alternatives to defendant's pipeline system exist; (2) defendant's rates are comparable to other pipeline rates in other jurisdictions; (3) complainants are sophisticated businesses who have elected to use defendant's facilities; (4) the competitive nature of the market for transportation services in California makes it unnecessary to evaluate defendant's rates solely under a cost-of-service analysis; and (5) defendant is not a monopoly and should not be treated as one. Complainants take the position that (1) in the relevant market, indicia of market power by defendant exist; (2) the supposed competition from other pipelines, trucks, barges, rail, exchange arrangements, and possible future competition do not constitute adequate substitutes for defendant's services; (3) the comparisons made with rates of out-of-state competitors fail properly to take into account differences in the services offered; and (4) continued cost-of-service regulation of defendant is needed to restrain its market power.

These questions should be resolved if we were considering whether to permit defendant to use market-based rates. (*See, e.g., City of Long Beach v. Unocal California Pipeline Co.* (1994) 54 CPUC2d 422.) But that is not what we are doing. We are considering whether defendant's approved rates, which are based on its cost-of-service as previously approved in D.92-05-018, are no longer just and reasonable. We have concluded that complainants have failed to show that defendant's rates are not just and reasonable. For that reason, the market-power suite of issues is irrelevant to our decision, and the conflicting factual and legal claims will not be resolved here.

1998 Test Year

Complainants undertook an analysis of defendant's 1998 test year to show that defendant's rates would not be just and reasonable in the future. A complaint is not a vehicle by which to establish proper rates for the future. Rather, its function is to correct existing rates, based on existing conditions. We will not permit a complaint to be used as a vehicle to force a general rate case. The 1998 test-year evidence is irrelevant to the complaint as a matter of law.

1996 Test Year Remaining Issues

Complainants claim that defendant "should be required to reduce [property tax expense] to reflect any continuing or future pipeline right-of-way or land parcel assessment reductions" because of evidence that "there may be a basis for a further reduction" in the property tax expense. This would be a contention that requires resolution in a general rate case. Complainants in this proceeding, however, are required to do more than identify the possibility of a basis for a reduction; they have the burden of proving how much the reduction should be. This is especially true in the light of the acceptance by complainants' witness of the estimate of defendant's witness of the property tax expense. (Ex. 9 at 15.)

Complainants' witness testified that he estimated that 1992 expenses (other than property taxes, electric power, and depreciation and amortization) totaled $24.1 million. (Ex. 1 at 23.) The witness estimated that in 1996 the comparable amount would be $32.0 million. (*Id.* at 25.) Yet complainants argue that the 1992 expenses should be applied because defendant failed to provide any testimony of its own to establish the 1996 amount. As discussed above, the complainants cannot shift their burden of persuasion in this way.

Complainants' witness testified that defendant's general partner provided services to defendant and that those services accounted for a major portion of defendant's operating expense. (*Id.* at 10.) Because defendant assigned 85% of expenses incurred on its behalf by the general partner to carrier operations, although the witness estimated that carrier operations account for only 78% of defendant's revenues, the witness identified a "serious question" about the validity of the assignment. (*Id.* at 11.) Complainants argue that defendant has failed to present evidence to justify the allocation of such expense between carrier and non-carrier operations. The allocation of administrative and general costs used in the 1992 test year, in particular, complainants argue, has become outdated, resulting in the shift of costs from interstate customers to intrastate customers.

This represents another attempt by complainants to shift the burden to defendant. In addition, complainants present no reasoned basis to believe that the allocation of general partner expense to interstate and intrastate components is necessarily *pro rata* to the respective revenues. Finally, complainants did not include any related adjustment in their testimony to show the appropriate amount of an adjustment. Complainants admit that they choose not to do so because of the possibility that some portion of the adjustment might be related to litigation expense, environmental expense, or depreciation and amortization expense. Consistent with our resolution of similar situations above, it is not sufficient for complainant to raise issues to enable it to carry its burden of showing that defendant's rates are not just and reasonable.

Complainants claim that as a result of a May 1997 decision in Superior Court in San Francisco, defendant's accrued reserve to reflect anticipated rental charges for certain rights-of-way is not warranted. (Ex. 1 at 36.) As a result, complainants' witness "urges the Commission not to overlook such matters during this or other relevant [defendant] rate proceedings." (*Id.*) We repeat that a complaint which alleges that a utility's rates are not just and reasonable is not a "rate case" in which the utility has the burden of proving that its rates are reasonable. The purpose of a complaint proceeding is not to establish what defendant's rates *should* be, rather it is to determine whether the existing rates are not just and reasonable in light of the evidence concerning revenues and allowable costs. Again, that is not a burden that can be met by simply by indicating that events may have a bearing on *how* an element should be calculated. Rather, complainants must provide proof of the actual amount under the standards that are claimed to apply.

Whether Discrimination Has Been Shown

With respect to the Watson initiating facilities, complainants argue that defendant discriminates against the shippers compared to shippers at other origin points, who are not required to pay an additional charge for the privilege of delivering product for shipment.

Defendant argues that discrimination by a public utility does not mean simply that the utility does not provide the identical service to all customers, but that discrimination involves partiality in treatment of those in like circumstances who seek a class of service offered to the public.

The evidence shows that defendant's tariff requires shippers to deliver into the Watson station at a rate of 15,000 bbl/hour. No evidence shows that any other origin station has a similar regulation. For discrimination to exist as between customers who use the Watson initiating facilities and customers who deliver to other origin points, complainants would have to show that such other origin points have minimum delivery rates but that defendant has installed facilities similar to the Watson initiating facilities that it permits customers shipping through other origin points to use without additional charge.

Comments of the Parties on the PD

Complainants

Burden of Proof

Complainants claim that the PD errs in adopting an unreasonable burden of proof: To rebut the complainants' *prima facie* case, the defendant needs only cast doubt upon complainants' evidence. Complainants confuse the burden of production (which the PD concluded that defendant had met by casting doubt upon complainants' evidence) with the burden of proof by a preponderance of the evidence, which complainants retained.

Complainants also claim that they have met their burden of proof, by showing that defendant's jurisdictional revenues exceeded its jurisdictional costs by at least $2.1 million. That amount represents the revenues associated with the Watson initiating facilities that the PD determined had been dedicated to public use. However, the PD also found that the associated costs were unknown. Therefore, it cannot be concluded that jurisdictional revenues exceed jurisdictional costs, because the costs associated with the Watson initiating facilities may be equal to, less than, or greater than the revenues. The PD provided for defendant to file a tariff for the Watson initiating facilities, which will provide a forum to determine the proper costs.

Complainants argue, for the first time, that defendant's positions on income tax allowance and environmental expense are in the nature of affirmative defenses, which would shift the burden, after hearing and briefing were completed, to defendant. Complainants waived this argument by failing to raise it at the proper time, which was in opening briefs or before.

Sepulveda Pipeline

Complainants claim that the PD errs in holding that the Sepulveda pipeline has not been dedicated to public use. One of the shippers, GATX, complainants argue, is not an "actual customer," but a mere "public terminal." Complainants put great emphasis upon the fact that the owners of product stored at GATX, or the "shippers of record," are billed by defendant for service on the Sepulveda pipeline. However, as the PD notes, the relationship between defendant and the shippers of record is not the result of voluntary action on the part of defendant; rather, it was required by an order of the FERC. We do not believe that the California law requirement for dedication can be satisfied by action taken solely due to an order of a federal agency. Dedication requires an element of volition that is missing here.

Complainants argue, for the first time, that defendant entered into an agreement with GATX to provide transportation service over the Sepulveda pipeline to anyone using GATX's public terminal for storage. This might be a significant fact, if it were in evidence, but complainants did not present proof of any such agreement. The PD did not err in holding that complainants failed to show dedication of the Sepulveda pipeline.

Complainants advance various policy reasons why it would be undesirable to conclude that the Sepulveda pipeline, which connects to defendant's jurisdictional pipeline, is not also subject to the jurisdiction of the Commission. Accepting that rationale would render the dedication requirement meaningless. Therefore, even if the policy reasons are sound, we cannot apply them in substitution for the factual finding that a utility has dedicated its property to public use.

Watson Initiating Facilities

While complainants agree with the PD that the Watson initiating facilities are jurisdictional, they say that PD errs in allowing defendant to file a tariff for the Watson initiating facilities because the evidence that complainants presented showed that defendant incurs little, if any, costs in association with the Watson initiating facilities. The PD found insufficient evidence to determine whether the charges for Watson initiating facilities were reasonable, in part because complainants' witness gave only a vague and unsupported assertion[6] on the subject of costs, calling them "relatively small." The PD correctly declined to assign any weight to complainants' testimony on this point.

Complainants argue that the PD errs by holding that the charges for the Watson initiating facilities would be discriminatory only if defendant had installed similar facilities at additional locations without assessing an additional charge. For reasons that are not clear to us, complainants believe that the charges are discriminatory because the use of the facilities enable defendant to increase its throughput to downstream destinations, thereby enabling defendant to reap greater revenues. Even if it is true that the Watson initiating facilities facilitate increased throughput, we do not see how that fact establishes discrimination.

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[6] "I would further expect that the unit capital and operating costs for the [Watson initiating facilities] are relatively small—especially since the system was sized for a large volume of deliveries from many shippers." (Ex. 1, at 15.)

Income Tax Allowance

Complainants argue that the PD errs "by granting [defendant] at $5.4 million income tax allowance" in undue reliance upon D.92-05-018, which included an income tax allowance. Complainants argument seems to be that a decision by this Commission which is rendered on an *ex parte* basis is not entitled to any weight. However, if complainants believe that D.92-05-018, which provided an income tax allowance to defendant, was wrongly decided, they should have filed a petition for modification of that decision. The PD properly focuses on whether any factual or legal change since the issuance of D.92-05-018 has made an income tax allowance no longer reasonable. Complainants failed to show any relevant change in the facts or tax law, and they also failed to show that the FERC's *Lakehead* decision was either binding upon this Commission or presented any compelling policy reason for adopting its treatment.

By focusing on the taxpayer rather than the taxable income, complainants try to characterize the income tax allowance as a means of recovering "phantom costs." Complainant's proposed standard – that the allowance should be based on taxes that the utility actually pays – is problematic for several reasons, some of which are highlighted in the PD: Tax payments depend on the interaction of a variety of highly complex factors that can vary from year-to-year and utility-to-utility, depending on membership in consolidated groups, timing rules on the recognition of income, whether outlays can be expensed or must be capitalized, and other considerations. Therefore, even in the case of a corporate utility, the income-tax allowance will bear no very precise relationship to the exact tax remitted in any given year. Such a lack of correspondence does not make the difference into a "phantom" cost.

If we focus on the taxable income of the utility, without regard to the form of organization of the utility, it is clear that the gross revenues of the utility less the allowable expenses times an appropriate tax rate is principally what is needed to determine the income tax liability that should correspond to the income tax allowance. The difference due to the presence of a pass-through entity, such as a limited partnership, which is how defendant is organized, is not that there is a lack of income tax liability. The limited partners must take into income their proportionate shares of the gross revenues of the utility and may claim as an expense their proportionate shares of the allowable expenses. The difference is that the limited partners may not share a single tax rate.

Some limited partners may be organized as corporations; some may themselves be pass-through entities[7]; and some may be individuals whose rates will differ depending upon income. As a result, the composite tax rate of the limited partners may be less than, the same as, or greater than the corporate tax rate. As the PD notes, in the case of a limited partner that is publicly traded, such as one of defendant's limited partners, the composition of the taxpayers in whose hand the items of income and expense comes to rest is constantly changing. Accordingly, the composite tax rate would be extremely difficult to ascertain with any degree of confidence.

We can take the three possibilities in turn. If we knew that the composite tax rate of the limited partners were the same as the corporate tax rate, everyone would be indifferent whether the utility were organized as a

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[7] In which case, we would need to know the beneficial ownership of such pass-through entities to determine what tax rate was ultimately applicable.

corporation or as a limited partnership. If we knew that the composite tax rate of the limited partners were greater than the corporate tax rate (because, for example, a high proportion of the limited partners were relatively wealthy individuals, whose income is taxed at marginal rates greater than the corporate tax rate), the utility might think it was entitled to claim a greater income tax allowance than one based on the corporate rate, but permitting only the corporate tax rate would not disturb the utility's ratepayers. On the other hand, if we knew that the composite tax rate of the limited partners were less than the corporate tax rate (because, for example, a high proportion of the limited partners were individuals of modest means, whose income is taxed at marginal rates less than the corporate tax rate), there would be the potential for the concern that complainants raise. On this record, however, we do not know what the composite tax rate of defendant would be once all the distributions of income and allocations of expense have come to rest in the hands of taxpayers, and the evidence shows that it would be utterly impracticable to obtain that information. Treating the composite tax rate as if it were the same as the corporate tax rate has the advantage, as the PD notes, of making ratepayers indifferent to whether they are being served by a utility organized as a corporation or by one organized as a limited partnership.

Complainants argue that the Commission's tax allowance policies are designed to protect the utility's owners from being subject to double taxation, once at the corporate level and once at the owner's level. Although it may[8] have that effect, that is not the purpose of the Commission's tax

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[8] In the case of a corporate utility shareholder that is itself a corporation, such a policy does nothing to protect the ultimate shareholder, whose receipts have been subjected to taxation at both the corporate and personal level.

allowance policy, which is to recognize that economic activity may give rise to tax liability that reduces the rate of return earned by the utility on its investment if not taken into account. Since a utility organized as a limited partnership is not taxed at an entity level, but rather is the sum of its partnership component parts, it makes sense to apply the same policy to the constituent owners of such a utility.

Environmental Expense

Complainants argues that the PD errs by allowing $2.8 million for environmental expense and give an elaborate rationale for why complainants now believe that amount to be overstated. The position that complainants were maintaining previously is that nothing should be allowed for environmental expense. As a factual matter, the PD finds defendant's estimate of what its environmental expense consisted more credible than complainants' estimate. No legal or factual error exists.

Military Revenues

Complainants claim that the PD errs by not shifting the burden from complainants to defendant to show which portion of movements of military shipments are over jurisdictional facilities and which portions are over dedicated pipelines. Assuming that the potential for cross-subsidization exists, complainants presented no evidence to demonstrate that such potential has been realized to a sufficient degree to make it necessary to include military revenues in the calculations. While it may be appropriate to task the absence of evidence against an applicant in a ratesetting case to prevent cross subsidization, the same principle does not apply in a complaint case. Complainants cannot meet their burden of proof by borrowing a presumption that operates against an applicant in a ratesetting case.

Classification under PU Code Section 1757.1

Complainants claim the PD errs in classifying the proceeding solely as a ratemaking proceeding, because complainants alleged violations of the PU Code by charging rates without having a tariff on file with the Commission. Complainants argues that this case is an adjudicatory proceeding with respect to non-rate issues addressed in the PD.

PU Code Section 1757.1 defines "adjudicatory proceedings" to include "enforcement proceedings and all complaint cases, except those challenging the reasonableness of rates and charges as specified in [PU Code] Section 1702." This proceeding is undoubtedly a complaint case, it challenges the reasonableness of rates and charges as specified in PU Code Section 1702, and it joins other matters, as permitted by PU Code Section 1703. The question, therefore, is whether, for purposes of PU Code Section 1756, a decision of the Commission can be appealed both to the Court of Appeal, as relates to supposed elements of the decision that do not relate to the reasonableness of rates and charges, and to the Supreme Court, as relates to the reasonableness of rates and charges.

We would be very surprised were that the intent of the Legislature. However, this is a question best left to the courts to decide. We do not think that the Court of Appeal or the Supreme Court would consider themselves bound by our view of the proper construction of PU Code Section 1757.1 as it goes to the jurisdiction of the Court of Appeal.

Defendant

Defendant supports the PD, but wishes to see additional language, in dictum, to discuss the principle that the reasonableness of oil pipeline rates is not solely measured by cost-of-service ratemaking and to state that the Commission has the discretion to consider other factors, including, specifically, market power and the need of particular classes of customers for protection. In short, defendant wishes that the PD had applied the factors enunciated in *Unocap* to its type of oil pipeline.

We do not think that a complaint proceeding is well suited to develop ratemaking policy, and we would prefer that defendant submit a rate case with a developed proposal for market-based rates if it wishes its rates to be assessed primarily by such criteria.

Findings of Fact

1. Defendant is a pipeline corporation engaged in the business of transporting refined petroleum products.

2. D.92-05-018 approved defendant's application for an increase in its rates, based on a cost-of-service analysis.

3. Defendant has failed to establish unreasonable delay in the challenge by complainants of the rates approved in D.92-05-018 in 1992.

4. Defendant owns and operates the Sepulveda pipeline and the Watson initiating facilities.

5. Defendant charges for the use of the Sepulveda pipeline and the Watson initiating facilities and such charges are not in any tariff filed with this Commission.

6. The Sepulveda pipeline was constructed in 1982, pursuant to a private agreement among defendant, Texaco, Champlin, and GATX.

7. The Sepulveda pipeline was constructed at the request of Texaco, Champlin, and GATX.

8. Texaco and GATX own and operate tanks for product storage and the pumping facilities that are needed to move product through the Sepulveda pipeline to Watson station.

9. GATX stores and transports product for others.

10. Champlin/Ultramar used a combination of its own facilities and those of GATX.

11. For ten years, only Texaco, GATX, Champlin/Ultramar used the Sepulveda pipeline.

12. At the expiration of the agreement, in 1993, defendant established a charge of $0.05/bbl.

13. Currently, only Texaco and GATX have connections to the Sepulveda pipeline.

14. No one has ever been denied service on the Sepulveda pipeline, and no one, other than Texaco, Champlin/Ultramar, and GATX, has ever requested service on the Sepulveda pipeline.

15. Defendant's marketing brochure contains a reference to the Sepulveda pipeline as one of six inbound gathering systems serving defendant's Watson station terminal.

16. The Watson initiating facilities were constructed after 1989.

17. Defendant's tariff rules and regulations require that shippers into the Watson station meet a specified minimum incoming pumping rate.

18. Shippers can do this by installing new pumps and larger diameter pipelines; however, it is potentially expensive to do so.

19. Four shippers requested that defendant develop an alternative that would permit delivery into the Watson station at the rate of 10,000 barrels per hour, rather than 15,000 barrels per hour, as required by defendant's tariff rules and regulations.

20. By installing a vapor handling system for each tank at the Watson station, defendant could use each tank for a variety of product.

21. The ability to use tanks for multiple grades of products effectively expanded the operating capacity of Watson station, thereby providing an effective substitute for higher incoming pumping rates.

22. Shippers who use the Watson initiating facilities are charged $0.032/barrel.

23. Any customer can use the Watson initiating facilities.

24. Evidence that the unit capital and operating costs of the Watson initiating facilities are "relatively small" and that "little or no costs" should be allocable to the Watson initiating facilities is insufficient to determine whether rates for the Watson initiating facilities are not just and reasonable.

25. Defendant's 1996 revenues in California were at least $77.04 million.

26. No evidence in this record indicates that any of the military revenues derived from public utility facilities.

27. Complainants have failed to show that $2.5 million in military shipments should be added to defendant's $77 million in 1996 revenues.

28. Complainants have failed to show that $1 million in inter-refinery shipments should be added to defendant's $77 million in 1996 revenues.

29. Defendant's 1996 revenues were $79.5 million.

30. Defendant incurred no costs in connection with this proceeding in 1996.

31. Environmental remediation costs in 1996 were more likely to have been $2.6 million than zero.

32. Defendant's 1996 expenses were $56.2 million.

33. Defendant is a publicly traded partnership which itself incurs and pays no income tax and its affiliated corporate unitholders may incur no federal income tax liability on income generated by defendant because of the availability of interest payment offsets under a consolidated income tax return.

34. Defendant was a limited partnership at the time of D.92-05-018.

35. D.92-05-018 included an income tax allowance for defendant.

36. There have been no relevant factual changes since the issuance of D.92-05-018 with respect to tax matters.

37. Complainants failed to introduce evidence as to the portion of defendant's limited partner's unitholders that consists of individuals or to provide any other basis for calculating the proper partial income tax allowance if the Commission were to follow FERC's *Lakehead* precedent.

38. The best evidence on this record for defendant's 1996 tax expense is that given by defendant, $5.4 million.

39. Defendant's rate base is $133,900 million, taking into account ADIT.

40. ADIT also requires return on rate base to be reduced by $3.5 million for 1996.

41. In 1996, defendant had an excess of revenues over costs of $2.1 million; however, the costs attributable to the Watson initiating facilities are unknown.

42. Reducing revenue by the amount associated with the Watson initiating facilities, $2.5 million, gives revenues of $77.0 million, which represents a deficit of costs over revenues in the amount of approximately $0.4 million.

43. Evidence that "there may be a basis for a further reduction" in the property tax expense is insufficient to show that defendant's rates are not just and reasonable.

44. Complainants present no reasoned basis to believe that the allocation of general partner expense to interstate and intrastate components is necessarily *pro rata* to the respective revenues.

45. Defendant has produced no evidence to show that other origin points have facilities comparable to the Watson initiating facilities.

Conclusions of Law

1. Defendant's motion to dismiss the complaint as a collateral attack on a final decision should be denied.

2. Defendant's motion to dismiss on the equitable defense of laches should be denied.

3. The complaint is not barred by PU Code Section 1702.

4. The reasonableness of rates is determined as a matter of fact based on the totality of the circumstances, and among such circumstances is whether the utility has or is proposing market-based rates rather than cost-of-service based rates.

5. The allegations are sufficient to withstand defendant's motion to dismiss, inasmuch as complainant has alleged facts that *could* show a totality of circumstances leading the Commission to conclude that defendant's rates are not just and reasonable.

6. A variety of facts and circumstances may be sufficient to show dedication, and some such facts may be exclusively within the possession of a defendant in a particular case, such as records of correspondence.

7. As a matter of pleading, it is not advisable to attempt to decide dedication issues solely on the allegations, and defendant's motion to dismiss the complaint for failure to allege sufficient facts to show dedication should not be granted.

8. Defendant is a transportation company and a common carrier for purposes of PU Code Sections 461.5 and 486, respectively.

9. To find a dedication of private property to public use as a utility, we look for acts that objectively express or imply an unequivocal intent to serve the public, as opposed to particular customers.

10. The Sepulveda pipeline has not been dedicated to public use.

11. The Watson initiating facilities meet the definition of "pipeline" contained in PU Code Section 227.

12. The Watson initiating facilities have been dedicated to public use, because defendant permits any customer who wishes to use the facilities to do so, not only those customers who originally requested the construction of the Watson initiating facilities.

13. We should order defendant to file a tariff for the Watson initiating facilities.

14. Complainants bear the burden of establishing a *prima facie* case to support the relief they claim in the complaint.

15. Meeting the burden of production, by itself, is insufficient to meet the burden of persuasion.

16. The jurisdictional status of the transportation services provided to the military is relevant to the determination of whether they should be included in revenues for purposes of this proceeding.

17. In light of our determination that the Sepulveda pipeline has not been dedicated, it would be improper to include the associated revenues.

18. Revenues of $2.5 million in respect of the Watson initiating facilities should be added to defendant's 1996 revenues.

19. Defendant should be required to file a tariff for the Watson initiating facilities.

20. Complainants have failed to carry their burden of showing that defendant's rates are not just and reasonable.

21. Market power issues would be relevant to determine whether to permit defendant to use market-based rates.

22. A complaint is not a vehicle by which to establish proper rates for the future.

23. No discrimination with respect to the Watson initiating facilities has been proven.

24. This is a complaint case challenging the reasonableness of rates or charges, and so this decision is not issued in an "adjudicatory proceeding" as defined in PU Code Section 1757.1.

ORDER

IT IS ORDERED that:

1. SFPP, L.P. shall file a tariff for its gathering enhancement system at Watson station within 60 days of the date of this decision.

2. In all other respects, the complaint of ARCO Products Company, Mobil Oil Corporation, and Texaco Refining and Marketing, Inc. is dismissed.

3. Case 97-04-025 is closed.

This order is effective today.

Dated August 6, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners