

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

ExxonMobil Oil Corporation

Docket No. OR07-5-000

v.

Calnev Pipe Line, L.L.C.
Kinder Morgan GP Inc.
Kinder Morgan Inc.

Tesoro Refining and Marketing Company

Docket No. OR07-7-000

Docket No. OR07-7-001

v.

Calnev Pipe Line, L.L.C.

ORDER ON COMPLAINTS

(Issued July 20, 2007)

1. On March 28, 2007, the Commission issued an order holding the complaint in Docket No. OR07-5-000 in abeyance.¹ On April 2, 2007 the Commission issued an order holding the complaint in Docket No. OR07-7-000 in abeyance.² Recent events now enable the Commission to address these complaints further. The Commission dismisses the complaints against Kinder Morgan GP Inc. and Kinder Morgan Inc. with prejudice. The Commission accepts the complaints against Calnev Pipe Line, L.L.C. (Calnev) to the extent they challenge the rates of the company in excess of the grandfathered rate in effect in 1992. The Commission gives the complainants 90 days from the date this order issues to amend their complaints to the extent that the complaints address the grandfathered rate. The Commission consolidates these proceedings, but will continue to hold them in abeyance until receipt and its review of the amended complaints, if any.³

¹ *ExxonMobil Oil Corporation v. Calnev Pipe Line, L.L.C., et al.*, 118 FERC ¶ 61,249 (2007) (March 2007 order).

² *Tesoro Marketing and Refining Company v. Calnev Pipe Line, L.L.C.*, 119 FERC ¶ 61,002 (2007) (April 2007 order).

³ On June 21, Tesoro Refining and Marketing Company (Tesoro) filed a motion to consolidate Docket No. OR07-7-000 with Docket Nos. OR07-5-000 and IS06-296-000.

I. Background

2. The instant complaints were filed by ExxonMobil Oil Corporation (ExxonMobil) on January 8, 2007 in Docket No. OR07-5-000 and by Tesoro Refining and Marketing Company on January 30, 2007 in Docket No. OR07-7-000.⁴ The Commission issued orders in both dockets holding the complaints in abeyance until certain fundamental issues became clearer, particularly (1) whether oil pipeline pass through entities could obtain an income tax allowance, and (2) the standards for addressing whether there were substantially changed circumstances to an oil pipeline grandfathered rate. On May 29, 2007, the Court of Appeals for the D.C. Circuit issued its opinion in *ExxonMobil Oil Corporation, et al. v. FERC*.⁵ The court held that a jurisdictional pipeline partnership (or other pass through entity) could obtain an income tax allowance if it met the Commission's standard that the partners establish in an individual proceeding, that they have an actual or potential income tax liability on the distributive income allocated to them by the partnership.⁶ The court also upheld the protocol the Commission used in the consolidated cases to determine if there are substantially changed circumstances to the economic basis of a grandfathered rate.⁷ This reduces the uncertainty previously involved in these complaints and the Commission will address them on the merits.

3. The complaints raise three general issues that are discussed below. The first is whether the complaints show reasonable grounds to conclude that Calnev's rates may be unjust and unreasonable. This standard applies regardless of whether the rates at issue are grandfathered. The second issue addresses the portion of Calnev's rates that are grandfathered under the Energy Policy Act of 1992,⁸ and whether the complainants have made a sufficient showing that there may be substantially changed circumstances to the

The Commission denies the motion as to Docket No. IS06-296-000 because that is an index proceeding and the issues are materially different from those in the other two dockets.

⁴ Tesoro amended its complaint on March 16, 2007 in Docket No. OR07-7-001.

⁵ *ExxonMobil Oil Corporation, et al. v. FERC*, slip op. dated May 29, 2007, D.C. Cir. No. 04-1102 (Consolidated) (*ExxonMobil*).

⁶ *Id.* at pp.10, 11-13, 16, 18.

⁷ *Id.* at pp. 19, 25-27.

⁸ *See* Section 1803(a) of the Energy Policy Act of 1992, Public L. No. 102-486, 106 Stat. 2276 (1992) (EP Act of 1992). The effective date was October 24, 1992.

economic basis of those rates for that case to proceed to hearing.⁹ The third issue is the validity of the complaints filed by ExxonMobil against parties other than Calnev. In addition, the Commission policy on the inclusion of master limited partnerships (MLPs) in an equity cost-of-capital proxy group was also unsettled when these complaints were filed.¹⁰

II. Discussion

A. Reasonable Grounds to Conclude Calnev's Rates are Unreasonable

4. The Commission finds there are reasonable grounds to conclude that Calnev's rates may be unjust and unreasonable. Calnev's FERC Form No. 6 for 2006 states that its 2005 jurisdictional revenues were \$52,007,917 compared to a total jurisdictional cost of service derived according to the Commission's Opinion No. 154-B of \$38,271,901, and its 2006 jurisdictional revenues were \$55,964,596 compared to a cost of service of \$40,494,137. A difference of these magnitudes between revenues and costs is sufficient to satisfy the first threshold standard. Thus, the complainants have established reasonable grounds to proceed to hearing on that portion of Calnev's rates that are in excess of the grandfathered rates.

B. Substantially Changed Circumstances

5. Neither complaint adequately addresses the issue of substantially changed circumstances. Both appear to concede that at least some portion of Calnev's existing rates were grandfathered, although in ExxonMobil's case the distinction between the grandfathered and non-grandfathered portion of the rate is not particularly well drawn. Be this as it may, both complaints rely heavily on assertions that Calnev may not obtain an income tax allowance. Moreover, ExxonMobil's complaint asserts that a substantial change in one major cost factor, including the availability of an income tax allowance, is sufficient to satisfy the substantially changed circumstances standard. ExxonMobil also asserts that the barrel-mile test establishes a substantial change in economic circumstances. Tesoro further argues that the substantial increase in volumes since 1992 establishes substantially changed circumstances, as do certain improper cost allocations between Calnev and its parent partnership, Kinder Morgan Energy Partners (KMEP). ExxonMobil further argues that Calnev's rate base improperly includes a purchase

⁹ See Section 1803(b) of the EP Act of 1992, which provides that a complaint against a grandfathered rate must demonstrate that "a substantial change has occurred after the date of the enactment of this Act . . . in the economic circumstances which were a basis for the rate."

¹⁰ Cf. *Kern River Gas Transmission Company*, 117 FERC ¶ 61,077 (2006) (Opinion No. 486); *SFPP, L.P.*, 117 FERC ¶ 61,285 (2006) (December 2006 Order).

accounting adjustment (PAA) that is embedded in the return component of its rates and that its capital structure should be determined by reviewing the capital structure of Kinder Morgan, Inc. Both complaints also assert that Calnev's cost of capital structure assumes that it is proper to include master limited partnerships, or other types of partnerships, in the proxy group used to determine the equity cost of capital of a jurisdictional pipeline entity.

6. The complaints, as framed, rely on arguments that have been rejected by the court in *ExxonMobil*. In particular, these include the income tax allowance issue and the reliance on a substantial change to any one of several significant economic factors. Neither argument is valid at this point. Moreover, Calnev filed an answer to the ExxonMobil complaint asserting that ExxonMobil's barrel-mile test does not properly compare the various periods the analysis advances. Calnev further asserted that the complaint provides no credible evidence that its accounts or rates were stepped up or that its return or other costs were affected by the inclusion of a PAA. Calnev also asserts that KMEP is the proper firm for determining Calnev's cost of capital because it is publicly traded and the controlling partnership. It further opines that Tesoro supports its assertion about the allocation of overhead costs only by the general experience of its supporting witness or unresolved issues in a related proceeding.

7. The Commission concludes there is merit to many of Calnev's arguments in its answer to the complaints. This is particularly true concerning the generalized cost-of-service arguments presented by both ExxonMobil and Tesoro. While both complaints address purported changes in volumes, revenues, and expenses, neither effectively addresses the ultimate conclusion on any substantial change in Calnev's return, as required under *ExxonMobil*, or sufficiently explains why the Commission should excuse them from doing so. A general assertion that addressing a change in return is difficult and that therefore the Commission should defer detailed evaluation of the substantially changed circumstances to the hearing phase is insufficient. Finally, the generalized nature of these complaints lends credence to Calnev's argument that neither it nor the Commission can respond to the complaints in a focused or efficient manner.

8. Under most circumstances the Commission would be justified in dismissing the complaints to the extent they are directed to the grandfathered component of Calnev's rates. However, given the substantial uncertainty that existed on several important legal or technical issues at the time these complaints were filed, the Commission will give the complainants 90 days to revise their complaints on the issue of substantially changed circumstances if they so choose. This will allow the complainants to review their positions in response to *ExxonMobil* and the other observations here if they should choose to do so.

C. Allegations against Respondents Other Than Calnev

9. ExxonMobil combined its complaint against Calnev with complaints against certain of its affiliated companies, Kinder Morgan GP Inc. and Kinder Morgan Inc. The first of these provides management services to Calnev, SFPP, and in some regards KMEP. The latter is the general partner for KMEP and controls Kinder Morgan GP, Inc. which is one of its subsidiaries. This portion of ExxonMobil's complaint asserts that Kinder Morgan, GP, Inc. and Kinder Morgan Inc. control KMEP, and through KMEP, Calnev, to the detriment of the latter's customers. At bottom, ExxonMobil asserts that these two additional defendants use the MLP structure to extract capital from Calnev, that it is insolvent, and KMEP and the two Kinder Morgan corporations have disclaimed responsibility for any refunds that may be due Calnev's shippers. In addition, scattered throughout the complaint are assertions that MLPs are structured for fraudulent purposes and are inimical to the health of the pipeline industry.

10. Calnev in its February 7, 2007 answer, and both Kinder Morgan corporations in their joint answer of the same date, deny the allegations. Calnev asserts that it is not insolvent given a strong balance sheet with extensive equity, strong income and cash flow, and adequate credit to meet its obligations. The two Kinder Morgan corporations make the same assertion, and further argue that ExxonMobil fails to cite a single case where the Commission permitted a customer complaint against a regulated entity to include claims against a non-common carrier affiliated company. They argue that section 13 of the Interstate Commerce Act permits orders for payment of sums due only against the carrier.¹¹ The Kinder Morgan corporations further assert that while section 12 may authorize the Commission to inquire into the role of parent companies in their control of regulated carriers, this does not authorize an investigation of such companies under the complaint procedures of section 13(1).¹² They also argue that the Commission dismissed a requested investigation of a parent company in *Big West Oil v. Alberta Energy Co., Ltd.*,¹³ and that the Commission's supervisory powers do not even extend to the record keeping of non-jurisdictional entities controlling jurisdictional firms.¹⁴ The Kinder Morgan corporations further assert that the Commission would only

¹¹ 49 U.S.C. app. § 16(1).

¹² *Citing Smith v. Interstate Commerce Commission*, 245 U.S. 40, 43 (1917), discussing the respective roles of Sections 12, 13, and 20 of the Act.

¹³ *Big West Oil v. Alberta Energy Co., Ltd.*, 100 FERC ¶ 61,171 at 61,610 (2002).

¹⁴ Order No. 634-A, *Regulation of Cash Management Practices*, FERC Stats. and Regs., Regulations Preambles, 2001-2005 ¶ 31,152, 68 F.R. 62994 (October 31, 2003) (Order No. 634-A).

investigate any non-carrier affiliate cautiously, and if so, would not do so based on a single factor, and then only where there is an element of injustice or fundamental fairness.¹⁵ They thus conclude that the complaint fails to meet these tests and therefore should be dismissed.

11. The Commission agrees with Calnev. Neither the law nor anything in this record supports this portion of ExxonMobil's complaint. The Commission lacks direct jurisdiction over the Kinder Morgan corporations because they are not jurisdictional entities engaged in the transportation of petroleum products under the ICA. Under *Big West* the Commission will pierce an institutional veil to reach a non-jurisdictional entity only if there is an element of injustice, fundamental fairness, or fraud. ExxonMobil's complaint fails in this standard. First, the controlling entity for cash management practices under Order No. 634-A would be KMEP, which is not even joined here. As such, an essential party is not joined for purposes of any cash flow investigation under Order No. 634-A or section 12 of the ICA. Second, there are only general allegations regarding the role of the two Kinder Morgan corporations with inadequate specifics of why their managerial practices have created Calnev's purported insolvency. Under the rare situation where the Commission reaches the finances of a controlling entity, it does so only to protect its jurisdiction over the rates and services of the jurisdictional entity. As such, in order to do so there must be some sound factual predicate based on the finances of the jurisdictional entity, not simply allegations directed toward the general corporate policies and practices of the non-jurisdictional entity.

12. The essential factual predicate is lacking here because ExxonMobil's complaint fails to establish any reasonable grounds to believe that Calnev is insolvent and that the Commission should institute an investigation of its finances, and by extension, those of its controlling partnership, KMEP. Calnev's FERC Form No. 6 contains operating and financial information for both calendar year 2005 and 2006.¹⁶ Those reports disclose that Calnev had large annual operating income, as well as substantial non-jurisdictional income, in both years, and extensive cash flow from depreciation. In fact, ExxonMobil protested Calnev's July 1, 2007, index-based rate increase based on the asserted financial health and "excess profits" of that pipeline.¹⁷ Moreover, Calnev is proposing to spend over \$400 million to replace and expand portions of its line.¹⁸ It is unlikely that KMEP,

¹⁵ *Citing Dewitt Truck Brokers v. W. Ray Fleming Fruit Co.*, 540 F.2d 681 at 683-687 (4th Cir. 1976).

¹⁶ See Calnev Annual FERC Form No. 6 at pp. 111-114 and 700.

¹⁷ See protest of ExxonMobil in Docket No. IS07-234-000 dated June 11, 2007, at 3-5, and the order in *Calnev Pipe Line, L.L.C.*, 119 FERC ¶ 61,332 (2007).

¹⁸ See *Calnev Pipe Line, L.L.C.*, 120 FERC ¶ 61,073 (2007).

the controlling partnership, would be prepared to commit this amount of capital if its existing equity in Calnev was at risk. Finally, insolvency is defined as a negative balance sheet (liabilities exceed assets) or the inability to meet one's obligations as they come due. There is no evidence in this record to suggest either is true. Similarly, there is no reason here to conclude that the figures in Calnev's FERC Form No. 6 for 2005 and 2006 establish that it cannot access the cash management pool KMEP maintains at the partnership level. Such pools are a common commercial practice that results in substantial efficiencies for firms that have multiple affiliated entities and this in itself is no cause for concern absent more than has been asserted here.

13. Moreover, ExxonMobil's more general claims that MLPs are inimical to the welfare of the pipeline industry as a whole and the public welfare in general are not appropriate matters for a Commission rate proceeding. What is at issue in a rate proceeding is whether the jurisdictional entity's rates are just and reasonable. As such, the Commission recognizes the rate making complexities presented by MLPs and has acted to assure that any resulting rates are just and reasonable.¹⁹ However, to include such issues as the cash management practices of Calnev's controlling entities and their other financial practices in this rate proceeding would unduly burden both the Commission and the other parties. For these reasons the Commission dismisses that portion of ExxonMobil's allegations directed to the cash management practices of the Kinder Morgan corporations or to the broader social welfare and efficiency concerns raised by ExxonMobil's complaint.

The Commission orders:

(A) In the instant dockets the complainants have established reasonable grounds to proceed to hearing on that portion of Calnev's rates that are in excess of its grandfathered rates.

(B) In the instant dockets complainants have not established sufficient grounds to proceed to hearing on the issue of substantially changed circumstances, but may amend, within 90 days from the date this order issues, their complaints in this regard.

(C) The complaints against Kinder Morgan GP, Inc. and Kinder Morgan, Inc. in Docket No. OR07-5-000 are dismissed with prejudice, together with all general allegations asserting that MLPs are socially and economically inefficient.

¹⁹ See *ExxonMobil v. FERC*, *supra*; *Kern River Gas Transmission Company*, *supra*; *SFPP, L.P.*, *supra* (December 2006 Order).

(D) The instant dockets are consolidated but will be held in abeyance until further order of the Commission addressing any amended complaints that may be filed herein.

(E) Tesoro's motion to consolidate the instant proceedings with Docket No. IS06-296-000 is denied.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.