120 FERC ¶ 61,073
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Calnev Pipe Line LLC Docket No. OR07-10-000

ORDER ON PETITION FOR DECLARATORY ORDER

(Issued July 20, 2007)

1. On May 14, 2007, Calnev Pipe Line LLC (Calnev) filed a petition for declaratory order requesting that the Commission approve its proposed rate methodology and grant other relief with respect to a substantial proposed expansion of its mainline pipeline system. Calnev proposes to construct a 16-inch diameter pipeline from Colton, California to Las Vegas, Nevada to parallel its existing 14-inch diameter pipeline. For the reasons discussed below, the Commission will grant Calnev's petition for declaratory order in part.

Background

2. Calnev owns and operates a refined petroleum products pipeline system in southern California and southern Nevada, serving consumer markets and military installations in that region. Calnev's system consists of two parallel 248-mile pipelines, one 14 inches in diameter and the other 8 inches in diameter, from an interconnection with the SFPP pipeline, through a tank farm at Colton, California to Las Vegas, Nevada. The 8-inch pipeline transports exclusively commercial jet fuel, so-called Jet-A; the 14-inch pipeline moves gasoline, diesel, military jet fuel, and, when the 8-inch pipeline is full, commercial jet fuel. Calnev also operates an approximately 55-mile lateral pipeline serving Edwards Air Force Base. The main pipeline system serves two Calnev terminals at Barstow, California and Las Vegas, Nevada. Calnev also serves Nellis Air Force Base near Las Vegas and has certain smaller intrastate delivery points in California, including the Burlington Northern Santa Fe and Union Pacific railroad yards.

3. Calnev states that demand for petroleum products in Calnev's markets, particularly in the Las Vegas, Nevada metropolitan area, has been increasing, and that trend is expected to continue. Calnev states that, in recent years, Calnev's pipeline capacity has become constrained. Calnev states that this is driven in part by growing demand for motor fuels in the Las Vegas area, reflecting the continuing rapid growth in

Las Vegas' population and its tourism industry. Calnev states the impact of this growth is compounded by the simultaneous growth in commercial jet fuel demand. Calnev states that Las Vegas' McCarran International Airport has experienced significant growth in air traffic. It is the fifth busiest airport in the U.S. and the 10th busiest in the world. Calnev states that this demand growth has resulted in the need to transport more commercial jet fuel than Calnev's 8-inch pipeline, which is dedicated to transporting commercial jet fuel, can accommodate running at full capacity. As a result, increasing volumes of commercial jet fuel are being shifted over to ship on the 14-inch multi-products pipeline, shrinking the capacity available for gasoline and diesel fuel and lowering the overall capacity of that pipeline. Calnev states that this constraint is growing.

4. Calnev states that it is not alone in identifying this constraint. On the contrary, Calnev states that the need for additional pipeline capacity to bring transportation fuels into southern Nevada is widely recognized. The Board of Commissioners of Clark County (Las Vegas), Nevada formed a blue ribbon commission to study, among other things, fuel transportation needs in this region. The report of the blue ribbon commission concludes that fuel demand will outstrip supply in southern Nevada in the coming years and that additional pipeline capacity must be built to meet the long-term needs of the region.

5. Calnev believes it would be able to meet the expected growth in demand by undertaking its proposed expansion. The project would install a 16-inch diameter pipeline from Colton, California to Las Vegas, Nevada, which obviates the current need for the existing 8-inch diameter pipeline. The new 16-inch pipeline would be placed in multi-products service, moving gasoline, diesel fuel, and military jet fuel. Initially, the existing 14-inch pipeline may transport only commercial jet fuel to the Las Vegas airport, but this could change depending on market demand. The 8-inch pipeline would be retained and maintained for near-term future use. Depending on developments in the Las Vegas market, the pipeline may be returned to refined products service to provide additional capacity. Another potential use which Calnev is evaluating is to dedicate the pipeline to the transportation of ethanol to Las Vegas and Colton, California.

6. In terms of capacity, the current Calnev pipeline configuration can, depending on the mix of products moved, transport 143,200 barrels per day (bpd), moving about 113,200 bpd on the 14-inch pipeline and 30,000 bpd on the 8-inch pipeline. With installation this year of a booster pump at the Cajon Station, the overall pipeline transportation capacity should rise to about 157,000 bpd. Calnev states that the Cajon booster is the last capacity increase that is economically feasible with the existing pipeline configuration. However, upon completion of the expansion project, the total capacity of Calnev would rise to approximately 186,000 bpd.

7. Calnev states that this expanded capacity exceeds the projections of expected refined products demand in Calnev's market in 2011; however, given the projections of continued growth in population and motor fuel demand beyond 2011, Calnev believes that sizing the expansion to accommodate future growth beyond 2011 is reasonable, cost-efficient, and necessary. Calnev states that by using 16-inch diameter pipe in the expansion, Calnev's capacity could later be increased further in response to future needs through increase in pumping horsepower, at modest cost. Calnev submits that, within certain pressure and operational limitations, it is relatively easy later to increase the capacity of a pipeline by adding pumping power; it is impractical later to increase the diameter of an installed pipe. While, with modifications implemented this year, the existing 14-inch/8-inch system will be reaching its maximum capacity, the combination 16-inch/14-inch pipeline could ultimately be developed to a capacity of over 300,000 bpd, even without bringing the 8-inch pipeline into products service. Calnev states that such expansion capability would be sufficient to meet demand through the year 2030 based on current projections.

8. Calnev estimates the expansion project will cost nearly $400 million and require about 3½ to 4 years to design, permit and install.

Calnev's Petition

9. Calnev states that in undertaking such a large project, Calnev faces significant risks. Calnev will be building capacity to meet *anticipated* population growth, with no assurance that such growth will occur as projected. Calnev also faces regulatory uncertainty due to pending shipper litigation challenging its existing rates as well as the Commission's existing cost-of-service methodology upon which Calnev has premised its project investment analysis.

10. Recognizing these risks, Calnev seeks a declaratory order providing certain assurances regarding the rate treatment of the expansion, which assurances are important predicates to the decision by Calnev's parent, Kinder Morgan Energy Partners, L.P. (KMEP), whether to commit capital to this project. Calnev asserts that the assurances sought are reasonable and consistent with the Commission's past practices. Calnev seeks three assurances.[1]

[1] In reply comments filed June 29, 2007, Calnev withdrew its request for an assurance that it may rely on the Commission's existing rate methodology or its substantive equivalent. Calnev states that because the Commission's policy on income

(continued…)

11. First, Calnev requests that it may undertake its expansion without the expansion being used as a basis to establish a "substantial change" in economic circumstances as to Calnev's grandfathered rates under section 1803(b) of the Energy Policy Act of 1992.[2] If Calnev can be assured that the grandfathered component of its rates will bear no greater vulnerability to challenge under the "substantial change" test as the result of this expansion project than if the project were not undertaken, its regulatory risk would be reduced. Calnev states that, in other words, the expansion itself, along with its volume and revenue effects, should not be treated as a substantial change in circumstances that would affect the grandfathered status of the pre-existing rates. Calnev states that if this petition is granted, the grandfathered component of Calnev's rates would remain subject to challenge under EPAct and Calnev's rates generally would remain subject to challenge under the Commission's indexing regulations, exactly as they would be if the project were not undertaken.

12. Second, Calnev requests that if it installs expanded throughput capacity as set forth in this petition, premised on reasonable projections of population and fuel demand growth and sized to accommodate that future growth, Calnev shall not be subject to a finding that the expansion line or any portion of its capacity is not used and useful.

13. Third, Calnev requests that it may add a Uniform Rate Component (URC) to its base rates to recover its expansion costs. Since the enhanced service would benefit all Calnev mainline shippers, this layer – termed the Uniform Rate Component – would be applied equally to all interstate barrels. Calnev states that the URC would be calculated in accordance with the Commission's Opinion No. 154-B cost-of-service methodology as it exists today, or its cash flow equivalent, and be subject to the indexing procedures set forth in 18 C.F.R. § 342.3 (2007). The URC would include only the incremental costs associated with construction and operation of the new line. In seeking approval of its URC methodology, Calnev is not requesting advance approval of the specific level of the URC. Given that complaints have already been filed by certain shippers against Calnev's existing rates, securing an assurance that it can separate recovery of the expansion costs from any controversy over the level of its existing rates is important. Calnev asserts that the Commission has the discretion to interpret its tariff rules to permit the proposed methodology and, if necessary, to waive for good cause the rules that might otherwise be

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tax allowances was affirmed in *Exxon Mobil Oil Corp. v. FERC*, No. 04-1102 (D.C. Cir. May 29, 2007), its concern about relying on the Commission's current ratemaking methodology to provide reasonable recovery of its investment is significantly mitigated.

[2] *See* section 1803(b) of the Energy Policy Act of 1992, Public L. No. 102-486, 106 Stat. 2276 (1992) (EPAct of 1992). The effective date was October 24, 1992.

read as preventing it.[3] Calnev asserts that in *Colonial Pipeline Company*, the Commission granted a request very similar to Calnev's, namely, that the pipeline be permitted to recover net unrecovered expansion costs through an incremental charge layered on top of the pipeline's existing rates.[4]

14. Calnev requests expedited consideration of the petition in recognition of the fact that, with a 3½- to 4-year lead-time to complete the project, initiation of the project in the near future is necessary to ensure expanded capacity to supply the southern Nevada market is available on a timely basis. Calnev requests an expedited determination by July 16, 2007, to enable Calnev to meet its timeline for the proposed expansion and to facilitate financing and other investment decisions.

Public Notice and Interventions

15. Public notice of Calnev's petition was issued on May 21, 2007. Interventions and protests were due by June 11, 2007. Pursuant to Rule 214 (18 C.F.R. § 385.214 (2007)), all timely filed motions to intervene and any motions to intervene out-of-time before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties.

16. The Director of the Clark County Department of Aviation filed a letter supporting Calnev's petition. He states that it is important that more fuel capacity becomes available on a timely basis. He states that the assurances sought by Calnev are reasonable and in line with the Commission's past practices in supporting energy infrastructure investment.

17. Protests to Calnev's petition were filed by BP West Coast Products LLC, Chevron Products Company, and ExxonMobil Oil Corporation (Indicated Shippers); ConocoPhillips Company (ConocoPhillips); Valero Marketing and Supply Company (Valero); America West Airlines, Inc., U.S. Airways, Inc., Southwest Airlines Co., Continental Airlines, Inc., and Northwest Airlines, Inc. (Airline Shippers); and Tesoro Refining and Marketing Company (Tesoro).

18. The shippers protesting the petition are in full support of Calnev's expansion project. The shippers acknowledge that additional capacity is needed to serve the

[3] *Citing, Express Pipeline Partnership*, 76 FERC ¶ 61,245 at 61,258 (1996), *order on reh'g*, 77 FERC ¶ 61,188 (1996); *see also Lakehead Pipe Line Co.*, 85 FERC ¶ 61,397 (1998).

[4] *Citing, Colonial Pipeline Company*, 116 FERC ¶ 61,078 at P 54 (2006), *reh'g denied,* 119 FERC ¶ 61,183 (2007)(*Colonial).*

consumers in Barstow, California and Las Vegas, Nevada and a pipeline expansion is the only viable alternative. The protesters dispute, however, the nature and extent of the relief requested by Calnev. Several of the protesters argue that the relief requested by Calnev is unreasonable and overly broad. One protester, Tesoro, even goes so far as to argue that Calnev needs no assurances because of its monopoly and existing economic factors which provide an overriding incentive for Calnev to undertake a project that is clearly in its economic interest.

19. Most of the protesters requested that the Commission hold the petition in abeyance and appoint a settlement judge so that a negotiated settlement can be achieved with respect to both the expansion project as well as the pending challenges to Calnev's rates.[5] The protesters assert that such an approach could help Calnev avoid needless litigation.

20. Several of the protesters assert that Calnev is already overrecovering its cost of service and the expansion project would lead to further extraordinary returns and profits. However, the protesters recognize that Calnev's grandfathered rates are already subject to challenge in pending complaints and submit that new just and reasonable rates will likely be determined prior to the implementation of new rates for Calnev's expansion. Several protesters also assert that if Calnev removes the 8-inch pipeline from jurisdictional service, the line must be removed from Calnev's rate base and could constitute a substantial change in economic circumstances affecting the grandfathered rates.

21. The protesters have several views on the used and useful issue. Indicated Shippers assert that they are willing to pay for the expansion at just and reasonable rates provided that the full capacity is put into service and is available to all shippers. Valero, on the other hand, states that shippers should not be required to prepay for expansion facilities that will not be available at the time of the filing. Valero states that it is not prejudging or precluding an equitable risk sharing mechanism as long as it is not required to bear 100 percent of the costs associated with future growth. Tesoro argues that the Calnev should not require shippers to pay for capacity that greatly exceeds current needs.

[5] Complaints against all of Calnev's oil pipeline rates were filed on January 8, 2007, in Docket No. OR07-5-000, by ExxonMobil and on January 30, 2007, in Docket No. OR07-7-000, by Tesoro. These complaints allege that Calnev's rates are unjust and unreasonable and none are grandfathered under section 1803 of the Energy Policy Act of 1992. Both complaints were held in abeyance pending the outcome of the appeal in the D.C. Circuit in *ExxonMobil Oil Corporation, et al. v. FERC*, Nos. 04-1102, *et al.* An opinion in that case was recently issued and is discussed later in this order.

22. The protesters assert that there is no justification for Calnev's proposal to segregate the costs of its proposed expansion in a surcharge. The protesters assert that since all shippers will pay both the base rate and the proposed surcharge, it is silly to break up the costs into two components. Several protesters also raise questions about whether two Page 700s would be filed on Form 6 due to the base rate and the surcharge or would the costs be rolled together.[6] The protesters also raise the issue of how general and administrative costs and operations and maintenance expenses would be allocated between the base rates and the surcharge.

Discussion

23. In its petition for declaratory order, Calnev seeks the Commission's approval of its proposed rate methodology and other assurances with respect to Calnev's proposal to construct a 16-inch diameter pipeline from Colton, California to Las Vegas, Nevada to parallel its existing 14-inch diameter pipeline. Calnev asserts that the requested relief is necessary because of the time and financial commitments of the proposed expansion and because it is sizing the project based on projections of future growth in its market areas.

24. It is important to recognize that all of Calnev's shippers agree that the proposed expansion is necessary to meet the increasing demand for capacity in Calnev's markets, especially in the Las Vegas area. Because of the increasing demand for motor fuel and jet fuel in the Las Vegas area, all parties agree that demand will outstrip supply in the next few years and that the only viable method of meeting the long term demands of the region is a pipeline expansion. The dispute between Calnev and the protesting shippers arises with respect to the extent of the relief requested by Calnev.

25. The Commission finds that this proceeding is similar in many respects to the *Colonial* case. In that proceeding, Colonial filed a petition for declaratory order seeking certain assurances with respect to a substantial expansion of its system in order to relieve capacity constraints on its system and to meet future demand in Colonial's various markets. Similarly, in *Colonial,* all parties agreed that additional capacity was needed but disputed the assurances sought by Colonial. In *Colonial* the Commission granted the petition for declaratory order to permit Colonial to recover the costs of its expansion

[6] FERC Form No. 6 is the Annual Report of Oil Pipeline Companies that collects financial and operational information from oil pipeline companies subject to the jurisdiction of the Commission. Page 700 on Form 6 is the Annual Cost of Service Based Analysis Schedule.

project through a combination of its grandfathered rates and a URC.[7] The Commission authorized Colonial to file for and recover through a URC the net cost of service associated with its expansion not recovered through the use of its existing grandfathered rates.[8] As discussed in more detail below, the Commission will grant Calnev's petition for declaratory order in part and provide Calnev the same assurances granted in *Colonial*.

26. The Commission will grant Calnev's request that the expansion itself, along with its volume and revenue effects, will not be treated as a substantial change in circumstances that would affect the grandfathered status of the pre-existing rates. In *Colonial* the Commission held that the mere act of charging grandfathered rates to incremental volumes created by an expansion of a pipeline's mainline system does not constitute a "substantial change in circumstances of the oil pipeline which were a basis for the rate" or "in the nature of the services provided that were a basis for the rate" to trigger a review of existing grandfathered rates under section 1803(b) of the 1992 EPAct.[9]

27. This determination, however, does not affect the ongoing complaints against Calnev with respect to its grandfathered rates. As mentioned above, both ExxonMobil and Tesoro filed separate complaints challenging Calnev's grandfathered rates. These complaints were held in abeyance pending the outcome of the appeal in *ExxonMobil Oil Corporation, et al. v. FERC*, Nos. 04-1102, *et al.* On May 29, 2007, the Court of Appeals for the D.C. Circuit issued its opinion in *ExxonMobil Oil Corporation, et al. v. FERC*.[10] Because of this opinion the Commission is now able to address the complaints further. Therefore, contemporaneously with this order the Commission is issuing an order in Docket Nos. OR07-5-000 and OR07-7-000 which finds, among other things, that 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. The order also gives the complainants 90 days from the date the order issues to amend their complaints to address the issue of whether there may be substantially changed circumstances to the economic basis of Calnev's grandfathered rates. To the extent that Calnev's grandfathered rates are found unjust and unreasonable and new rates are established,

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[7] *Colonial at* P 54.

[8] *Colonial* at P 55.

[9] *Colonial* at P 51.

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

Calnev would be required to charge the newly established rates to shippers on the expansion. The mere fact of Calnev's proposed expansion, however, does not provide its existing shippers with any further grounds for challenging the existing grandfathered rates. Finally, this determination with respect to grandfathered rates does not prevent shippers from challenging Calnev's rates in the future once the expansion is put into service, as the underlying economic and service-related circumstances may develop.[11]

28. Because Calnev is sizing its expansion based on reasonable projections of future growth in its markets, Calnev requests that it not be subject to a finding that the expansion line or any portion of its capacity is not used and useful. The Commission recognizes that by sizing its expansion pipeline to meet future demands Calnev is attempting to build its project in a cost effective and efficient manner. Therefore, we will grant Calnev's request that its expansion capacity and costs used to develop its URC rate will not be subject to a used and useful challenge. As we discussed above, similar to *Colonial*, all protesting parties in this proceeding are in full support of Calnev's expansion project and agree that the expansion is needed. The existing facilities are at full capacity and the new expansion pipeline is the only way to address the demand for capacity. According to Calnev the expansion will increase Calnev's capacity from 157,000 bpd to 186,000 bpd. Calnev's current throughput is about 136,300 bpd. Assuming a conservative three percent growth rate in jet fuel and motor fuel, Calnev states its system would be moving 160,000 bpd by the time the expansion is in operation in 2011. Calnev asserts that at 3-percent growth that capacity could only accommodate about 5 more years of growth past 2011.[12] Based upon these reasonable projections, once built, we will not entertain an argument that the expansion will not be used or useful.

29. However, we will not grant the same assurance as it pertains to Calnev's existing capacity and rates. Calnev stated that after the expansion is complete its existing 8-inch line could remain idle or be used to transport ethanol which the Commission to date has not regulated. As a result, while the Commission recognizes the need for the expansion, it cannot provide Calnev a guarantee against a challenge to its existing rates on the basis that the 8-inch line may no longer be used and useful.

30. Calnev requests that it may add a URC to its base rates to recover its expansion costs. The Commission will grant that part of Calnev's petition for declaratory order. This assurance is the same granted in *Colonial*. Accordingly, the Commission will permit Calnev to establish a URC to recover its expansion costs so long as, in calculating

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[11] *See Colonial* at P 52-53.

[12] *See,* Calnev's June 29, 2007 Reply Comments at 9.

the URC, Calnev subtracts the revenues earned by applying the existing rate to the volumes transported over the expansion. By allowing Calnev to charge the URC, the Commission will separate the recovery of expansion costs from any ongoing controversy over its existing grandfathered rates. The Commission recognizes that a number of the protesters have raised questions about the URC. For example, protesters ask whether two Page 700s would be filed on Form 6 due to the base rate and the surcharge or would the costs be rolled together. The protesters are also concerned about the allocation of general and administrative costs and operations and maintenance expenses between the bases rates and the surcharge. The Commission finds that these are legitimate concerns that are best raised when Calnev makes its filing to implement the URC. At that time the shippers can examine the cost of service data filed by Calnev to recover its expansion costs and raise any issues with respect to the method of calculating the URC, the costs included in the URC, and the appropriate way of reflecting the expansion costs on Calnev's Form 6.

31. The Commission also rejects the protesters' requests to establish settlement judge procedures. By filing its petition for declaratory order, Calnev is asking that *the Commission* terminate a controversy or remove uncertainty with respect to its proposed expansion. The issues raised by Calnev's petition are separate and apart from the issues raised by the pending complaints against Calnev's grandfathered rates and should be treated as such. Moreover, given that Calnev has requested expedited consideration of its petition, establishing settlement judge procedures would only serve to delay the proceeding.

32. By granting Calnev's petition in part, the Commission has given assurances that should be enough to provide Calnev with the regulatory certainty necessary to go forward with its proposed expansion in order to meet the growing need for capacity in its market areas, especially Las Vegas.

33. The Commission issues this order based on the facts and projections presented by the petition. If any of the facts or projections supporting the petition change, Calnev must make a filing with the Commission to determine whether the ruling in this order would still be applicable.

34. This declaratory order does not approve any specific rate for recovery of the expansion costs. The declarations in this order are based on the condition that Calnev will, under typical rate filing requirements and consistent with Order No. 154-B, file a cost of service and adequate support for the level of the rate component it will seek to impose prior to imposing the component.

The Commission orders:

(A) Calnev's petition for declaratory order is granted in part as discussed above.

(B) Protesters' requests to hold the petition in abeyance and appoint a settlement judge are rejected.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.