165 FERC ¶ 61,069
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Cheryl A. LaFleur and Richard Glick.

Chevron Pipe Line Company | Docket No. IS18-605-001

ORDER ON REHEARING

(Issued October 31, 2018)

1. In a June 29, 2018 order, the Commission rejected a proposal by Chevron Pipe Line Company (Chevron) to implement a surcharge to recover the capital investment and expenses associated with new methanol treatment facilities to be effective July 1, 2018.[1] Chevron filed a request for rehearing of the June 2018 Order. The Commission denies Chevron's request for rehearing to recover its proposed surcharge, as further discussed below.

I. **Background**

2. Chevron's Breton Sound Pipeline System (Breton Sound) transports crude oil from offshore platforms and subsea pipeline connections in the Gulf of Mexico to Chevron's Empire Terminal in Plaquemines Parish, Louisiana, for further transportation.

3. Several oil producers in the Gulf of Mexico use methanol in the deep-water crude oil production process. As Chevron explained, when methanol is used in production, a portion of the methanol enters the crude oil stream, and in the case of Breton Sound, contaminates 100 percent of the crude oil transported on the system. Methanol in crude oil poses a significant risk to refineries because it can damage infrastructure. Methanol also reduces the value of each barrel of oil, and forces shippers and refiners to seek alternative sources of supply to replace the contaminated oil, often on short notice.[2]

4. Chevron is unable to identify the platforms or shippers that are contaminating its crude oil supply. To address this issue, Chevron installed a methanol treatment facility.

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[1] *Chevron Pipe Line Co.*, 163 FERC ¶ 61,238 (2018) (June 2018 Order).

[2] Chevron Pipe Line Company, May 31, 2018 Transmittal Letter at 1-3.

5. Chevron proposed to recover the costs of the facility through an initial methanol treatment surcharge of $0.38 cents per barrel for a term of three years beginning on July 1, 2018.[3] At the end of the three year period, Chevron proposed to decrease the surcharge so that Chevron can recover ongoing expenses associated with operating the methanol treatment facility.

6. In the June 2018 Order, the Commission rejected the proposed tariff surcharge, finding that the costs of the methanol treatment facility are not appropriately recovered through a surcharge, without prejudice to Chevron recovering the costs as part of its index rate or through a cost-of-service filing.[4]

II. Rehearing Request

7. On rehearing, Chevron argues the Commission erred by rejecting its proposed surcharge and requiring Chevron to instead recover the investment and operating expenses associated with Chevron's methanol treatment facilities through a cost-of-service filing, or through the ordinary operation of periodic index adjustments.[5] Specifically, Chevron contends that the Commission should have approved the surcharge because: (1) the costs satisfy the three-pronged test for surcharge use;[6] (2) the costs are consistent with other costs recovered through surcharges approved by the Commission;[7] (3) the Commission improperly found that a change in law was necessary for the costs to be recoverable by a surcharge; (4) the costs are not suitable for recovery under indexing;[8] and (5) the costs are not suitable for recovery under cost-of-service ratemaking.[9]

[3] *Id*. at 6.

[4] June 2018 Order, 163 FERC ¶ 61,238 at P 22.

[5] Chevron Rehearing Request at 4.

[6] *Id*. at 5-13.

[7] *Id*. at 5-15.

[8] *Id*. at 15-18.

[9] *Id*. at 18-23.

A. Chevron's Proposed Surcharge Fails to Satisfy the Commission's Three-Factor Test

8. The Commission has deemed surcharges appropriate when the costs at issue are: (1) necessitated by factors beyond the pipeline's control; (2) extraordinary and non-recurring; and (3) not industry-wide.[10] In the June 2018 Order, the Commission found that while the costs at issue satisfied prongs one and three, the costs incurred for the methanol treatment facility were not extraordinary and non-recurring, failing prong two. Chevron contends that the Commission incorrectly applied its analysis to the prong two "extraordinary and non-recurring" factor by failing to focus on the nature of the costs themselves and the reasons the pipeline incurred such costs.[11] Chevron argues that the Commission erroneously concluded that because methanol is used by producers in deep-water drilling and production, such practices are a routine part of normal pipeline operations for those pipelines that transport crude oil from deep-water production platforms and therefore the type of cost a pipeline should expect to incur if it operates a pipeline that transports deep-water production.[12] Chevron contends, however, that the activities and costs associated with managing methanol events and developing the methanol treatment facilities are not an inherent part of normal pipeline operations from pipelines accepting crude oil from deep-water platforms, and thus are extraordinary.[13] Chevron claims these operations are less routine than the costs associated with handling ultra low sulfur diesel (ULSD), which the Commission found were appropriately recovered by a surcharge.[14] Chevron further contends that such costs are non-recurring.

9. Chevron argues that even if producers' use of methanol in deep-water drilling and production operations is not itself extraordinary and non-recurring, the costs that Chevron incurred to install and operate its methanol treatment facilities and to combat methanol contamination are extraordinary and non-recurring.[15]

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[10] *Id*. at 4 (citing *Magellan Pipeline Co. L.P.*, 115 FERC ¶ 61,276, at P 11 (2006) (*Magellan*)).

[11] *Id*. at 8.

[12] *Id*.

[13] *Id*. at 9-10.

[14] *Id*. at 10.

[15] *Id*. at 11.

10. We disagree. We do not find the costs Chevron incurred as a result of the construction of the methanol treatment facilities to be extraordinary or non-recurring.

11. As Chevron recognizes, methanol is commonly used in deep-water production.[16] Pipelines entering into and engaging in operations obtaining crude oil from deep water platforms must manage the quality of crude oil or product being shipped via their pipelines, and monitor the levels of harmful contaminants entering their systems.

12. We therefore find that crude oil pipelines that transport crude oil from deep-water production platforms must address methanol contamination in their systems. In fact, many oil pipelines commonly include quality specifications or maximum allowable thresholds for methanol in their tariffs.[17] Thus, Chevron's contention that the methanol contamination is an extraordinary circumstance simply suggests that the quantity of contamination is greater than average.[18] Although Chevron might not have anticipated constructing the facility, or may have underbudgeted for the actual costs of methanol removal in its system, all oil pipelines must monitor and manage the quality of their commodity. Consequently, we find the issue of contaminated crude oil is an ordinary, ongoing, and recurring aspect of oil pipeline transportation operations connected to deep-water production.

13. Next, we find the proposed surcharge costs to be recurring. Chevron seeks to impose a surcharge for three years, and thereafter reduce the price of the surcharge. A portion of the surcharge will remain indefinitely. This feature is unlike surcharges that the Commission has approved in the past, which are only assessed for a limited quantity or duration and are ultimately removed.[19]

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[16] Chevron Transmittal at 2.

[17] *See, e.g.,* Grand Prix Pipeline LLC, Tariff No. 1.1.0, Item No. 35 Product Specifications. *See also* Chevron Rehearing Request at 9 (citing Ship Shoal Pipeline Company, LLC, FERC Tariff No. 14.15.0 at § 25; Zydeco Pipeline Company, LLC, FERC Tariff No. 1.2.0 at § 25; Norco Pipe Line Company, LLC, FERC Tariff No. 31.8.0 at § 15).

[18] Chevron Rehearing Request at 9.

[19] *See, e.g., Enbridge Pipelines (North Dakota) LLC*, 142 FERC ¶ 61,242, at P 12 (2013); *SFPP, L.P.*, 126 FERC ¶ 63,010, at P 7 (2009); *Yellowstone Pipe Line Co.*, Docket No. IS14-201-001 (2014) (effective by operation of law).

14. Chevron states that the Commission should instead focus on the fact that the construction of the facility itself is a one-time event, and thus is non-recurring. We disagree and find that because the proposed surcharge will be charged indefinitely, it is not a one-time cost incurred due to an extraordinary event. Rather, the costs more appropriately represent the continued operational and capital costs associated with oil pipeline operations.

B. Chevron's Surcharge is not Similar to Previously Approved Surcharges

15. Chevron argues that the Commission erred by finding the costs did not satisfy prong two of the surcharge test (that costs must be extraordinary and non-recurring) and that the costs of installing and operating the methanol treatment facilities are precisely the type of extraordinary and non-recurring costs the Commission has previously found may be recovered through a surcharge.[20] Chevron contends that its situation is similar to *Magellan* and *SFPP*, where the Commission permitted pipelines to recover costs using a surcharge,[21] and *Tesoro*, where the Commission declined to impose a surcharge.[22] Chevron states that all three cases demonstrate that the Commission's rejection of Chevron's proposed tariff was in error because the costs the Commission rejected in the June 2018 Order are precisely the types of costs the Commission has allowed pipelines to recover via surcharges.[23]

16. We disagree. First, as a general matter, the Commission generally disfavors surcharges, and only approves their use in limited circumstances.[24] Pursuant to the Commission's regulations, most pipelines entering into interstate service file their initial

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[20] Chevron Rehearing Request at 5.

[21] *Id*. at 5 (citing *Magellan*, 115 FERC ¶ 61,276 at PP 3, 8, 9, 11, and 13 and *SFPP, L.P.*, 118 FERC ¶ 61,267, at P 6 (*SFPP*), *reh'g denied*, 121 FERC ¶ 61,162 (2007)).

[22] *Id*. at 7 (citing *Tesoro Logistics Northwest Pipelines LLC*, 153 FERC ¶ 61,118, at PP 2, 23 (2015) (*Tesoro*)).

[23] *Id*. at 5-7.

[24] *Tennessee Gas Pipeline Co.*, 51 FERC ¶ 61,232, at 61,659 (1990) ("[s]urcharges are disfavored and not usually approved absent customer agreement"); *SFPP, L.P.*, 121 FERC ¶ 61,162, at P 3 (2007)); *Tennessee Gas Pipeline Co.*, 52 FERC ¶ 61,085, at 61,316 n.5 (1990).

cost-of-service rates by providing the Commission cost, revenue, and throughput data.[25] To change the rate, other than through indexing or an uncontested settlement, a pipeline must resubmit its changed costs, revenues, and throughput and demonstrate changed circumstances. A cost-of-service rate review, which looks at the entirety of a pipeline's costs and revenue elements, will also ensure that the pipeline's rates are just and reasonable.

17. In contrast, a surcharge is a cost assessed on shippers that only considers particular pipeline costs, in isolation from the other elements affecting the pipeline's profitability, such as other costs that may have diminished, as well as revenue and throughput. Although a methanol treatment facility is an added cost for Chevron, there are other factors (such as increased shipments, markets, volumes, customers, lower costs elsewhere, and depreciated assets) that may offset some of the costs associated with this facility. Chevron's requested surcharge for this routine purchasing of new facilities does not appear to arise from the limited, extraordinary circumstances (such as hurricanes and post-September 11 security costs) for which the Commission has previously approved a surcharge.

18. In any event, the approved surcharges in *Magellan* and *SFPP* are distinguishable from the current instance. In *Magellan,* the Commission found that the new Environmental Protection Agency (EPA) ultra low sulfur distillates requirements represented an extraordinary circumstance in which pipelines had to undertake significant costs. In contrast, here we do not find the circumstances Chevron experienced rise to the level of extraordinary. Rather, these costs are routine capital and operating costs associated with the construction and operation of a methanol treatment facility. As discussed above, we find that managing the quality specifications of the commodity transported through a pipeline is a commonplace activity for all oil pipelines, and specifically managing methanol quantities for deep-water production connected oil pipeline operations is routine.[26]

19. Moreover, in *Magellan*, the Commission conditioned the surcharge to be charged to only shippers of ULSD, and not to shippers of any other distillates.[27] Here, however, the methanol contaminator(s) have not been specifically identified by Chevron, but all shippers and producers on Breton Sound will benefit from the removal of the methanol from crude oil. Thus, a narrowly tailored surcharge is not appropriate in this instance,

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[25] 18 C.F.R. § 342.2 (2018); 18 C.F.R. § 342.4(a) (2018).

[26] *Supra* P 12.

[27] *Magellan,* 115 FERC ¶ 61,276 at P 11.

because it cannot be narrowly tailored to affect only the offending shipper(s), yet all shippers will benefit.

20. Next, we also find this case can be distinguished from *SFPP*. In *SFPP*, the Commission permitted SFPP to recover ULSD costs via a surcharge rather than indexed base rates. There the Commission found that ULSD costs are not the type of general, industry wide or carrier-wide costs that the Commission intends to permit recovery through the annual oil pipeline index. The ULSD costs do not necessarily apply to all oil pipelines or to all products transported on such pipelines, nor are those costs attributable to shipments by all shippers on a given pipeline.[28] However, here, we find that the methanol treatment facility would benefit all shippers on the pipeline. And, the proposed costs to be recovered are general capital and operating costs associated with crude oil pipelines connected to deep-water production.

21. Finally, Chevron argues that the Commission departed from the test it applied in *Tesoro.*[29] In *Tesoro*, the Commission rejected a proposed surcharge, finding the ongoing maintenance, repair, and safety of a pipeline, as well as compliance with the Pipeline and Hazardous Materials Safety Administration (PHMSA) federal safety regulations, are the type of ongoing and routine expenses that are appropriately recovered through the normal ratemaking process. The Commission held that the costs Tesoro sought to recover were not extraordinary or non-recurring, were within the pipeline's control, and were not due to external events.

22. While the June 2018 Order found that the producers' use of methanol is beyond Chevron's control,[30] we nonetheless find that *Tesoro* supports the Commission's rejection of the proposed surcharge here. Where, as here, the costs at issue are operational and capital costs for managing and monitoring product quality that can appropriately be recovered through the normal ratemaking process, control is not a determinative factor. Further, similar to *Tesoro*, we do not find the costs are extraordinary, but ongoing operational costs Chevron will continue to incur.

23. As we stated above, while the size of the methanol treatment facility and the circumstances surrounding its construction may have been unanticipated, it is nevertheless still common for oil pipelines to monitor and manage the quality of the crude oil they receive. Chevron itself acknowledges that "[d]eep water platforms connected to Mountaineer Pipeline upstream of Breton Sound frequently use methanol in

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[28] *SFPP*, 118 FERC ¶ 61,267 at P 6.

[29] Chevron Rehearing Request at 7 (citing *Tesoro*, 153 FERC ¶ 61,118).

[30] June 2018 Order, 163 FERC ¶ 61,238 at P 23.

the production of crude oil."[31] Indeed, Chevron monitored and managed methanol contamination prior to the construction of the methanol facility. Thus it is reasonable to find that before Chevron developed the Breton Sound System, it assessed the need to remove methanol from its system, and that it is a routine part of crude oil pipeline operations.

C. A Change in Law is Unnecessary to Recover Costs Via a Surcharge

24. Chevron states that the Commission erred by denying the surcharge on the basis that the costs incurred did not arise due to a change in regulation or law.[32] Chevron argues that in both *Magellan* and *SFPP*, the change in federal regulations was the factor that caused the incurrence of the costs at issue to be beyond the carriers' control, and was not a separate, stand-alone factor in the Commission's analysis of whether a surcharge was appropriate.[33] Chevron contends the Commission approved the use of a surcharge to recover the costs of repairs associated with Hurricane Katrina and with security investments following the events of September 11, 2001, neither of which involved a change in law or regulation.[34] Thus, Chevron contends the Commission incorrectly denied the surcharge because the costs did not occur as a result of a change in law.

25. Chevron argues that, similarly, the Commission in *Tesoro* focused on whether the costs that Tesoro sought to recover through the surcharge were caused by factors within the carrier's control and whether those costs were extraordinary and non-recurring, rather than whether there had been a change in regulations.[35] Chevron argues that *Tesoro* did not hold or suggest that an underlying change in law or regulation is a necessary element that must be found before a surcharge may be approved, but that the Commission instead focused on the fact that additional costs that Tesoro sought to recover via the surcharge were always in the control of the pipeline and not due to external events.[36] Chevron contends that simply because the methanol contamination and methanol treatment facilities do not result from a change in law or regulation does not present a valid basis

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[31] Chevron Transmittal at 2.

[32] Chevron Rehearing Request at 13.

[33] *Id*.

[34] *Id*. at 14.

[35] *Id*.

[36] *Id*.

for distinguishing the Commission's decision in *Magellan*, or for rejecting the proposed Methanol Treatment Surcharge.[37]

26. Chevron misinterprets the Commission's analysis of surcharges. In the June 2018 Order, the Commission found that Chevron's proposed methanol treatments are not costs imposed on the pipeline due to an extraordinary event, which in the past have been events such as Hurricane Katrina, post-September 11 security costs, or compliance with new EPA ULSD requirements.[38] There, the Commission merely found that a federal requirement can be an example of a qualifying extraordinary event, not that a regulation itself is a standalone requirement for a surcharge.

27. Further, the Commission also noted in the June 2018 Order that in prior cases, the costs at issue were a result of federal regulation and thus were not suitable for recovery through the oil pipeline index.[39] That the costs arose from a federal regulation supported the Commission's determination that the costs were not suitable for recovery via the oil pipeline index; the federal regulation was not, as Chevron argues, a standalone factor in determining whether the surcharge is appropriate.

D. The Proposed Costs are Appropriately Recovered Through the Index

28. Next, Chevron argues that the costs of the methanol treatment facilities are not industry-wide and are therefore not the type of costs typically recovered through the indexed rates.[40] Chevron explains that methanol contamination is not an issue outside of deep-water production, and not all pipelines transport crude oil from deep-water production platforms.[41] Chevron contends that few, if any, pipelines are faced with methanol contamination at the scale faced by Breton Sound, and fewer pipelines accept and transport crude oil containing methanol in excess of the allowable limits.[42]

29. Chevron states the methanol events are similar to that in *Magellan,* where the Commission preferred a surcharge for proposed ULSD costs on the basis that only a

[37] *Id*.

[38] June 2018 Order, 163 FERC ¶ 61,238 at PP 23-24.

[39] *Id*. P 24.

[40] Chevron Rehearing Request at 15.

[41] *Id*. at 16.

[42] *Id*.

small number of shippers ship ULSD, only a small amount of oil pipelines transport ULSD, and thus the costs are not industry wide.[43] Chevron states that the Commission reasoned there that indexing is not an appropriate means for pipelines to recover extraordinary, non-industry-wide costs and that non-industry wide costs should be excluded from the index.[44]

30. Chevron also argues this circumstance is dissimilar to that in *Tesoro*,[45] where the Commission rejected a proposal to implement a surcharge to recover certain costs that the pipeline incurred to comply with a PHMSA corrective action order and to address other pipeline integrity issues. There, the costs at issue were related to the ongoing maintenance, repair, and safety of a pipeline as well as compliance with PHMSA orders and regulations, which the Commission found should be recovered through the normal ratemaking process, rather than through a surcharge.[46] The Commission based its rationale on the fact that the costs Tesoro sought to recover were experienced by all pipeline carriers. Chevron argues that in contrast, here, methanol in a crude stream is not an industry-wide problem outside of deep water, and thus is more appropriately recovered through a surcharge.[47]

31. We disagree. As discussed above and in the June 2018 Order, we find the costs Chevron seeks to recover are capital costs and operational costs associated with typical oil pipeline transportation operations connected to deep-water production.

32. Although Chevron claims that crude oil pipeline costs associated with methanol removal from deep-water production are not representative of the general cost experience of most oil pipelines and thus should be excluded from the index, we reiterate that each pipeline encounters unique cost experiences, which, if taken to the extreme, include costs that should be excluded from the index.[48] And, as discussed above, maintaining quality is a common function of oil pipeline operations, whether connected to deep-water or not.

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[43] *Id*. at 15.

[44] *Id*. at 16.

[45] *Id*. at 17.

[46] *Id*.

[47] *Id*.

[48] June 2018 Order, 163 FERC ¶ 61,238 at P 24.

33. We further find that the index includes a wide variety of cost experiences of oil pipelines, and the index is derived from the middle 50 percent of the data set of all oil pipelines' cost experiences. In the 2010 *Five-Year Review of the Oil Pipeline Index* proceeding, the Commission found that this data trimming would sufficiently address any outlying data sets, and explicitly rejected arguments similar to those put forth by Chevron.[49] Thus we are not convinced that Chevron's arguments warrant exclusion of these costs from the oil pipeline index.

E. The Proposed Costs are Appropriately Recovered Under Cost-of-Service Ratemaking

34. Next, Chevron argues that its proposed surcharge would more accurately match the Commission's cost causation principles compared to a general cost-of-service filing.[50] Chevron explains that the Commission's alternative suggestion that it recover costs through a general cost-of-service rate increase is less desirable in Chevron's circumstances because the costs associated with the methanol treatment facilities are caused by and benefit only a small subset of the pipeline's shippers.[51]

35. Chevron explains that the methanol-contaminated crude comes only from deep-water platforms, not shallow-water platforms, and thus comes from only a small portion of shippers.[52] Chevron contends that because only deep-water platforms cause the methanol issues, cost-of-service recovery would not be appropriate, because this would allocate costs of the methanol treatment facilities to all volumes that flow through Breton Sound on a barrel per barrel-mile basis. As a result, a significant portion of the cost of the methanol treatment facilities would be allocated to shippers that do not contribute to the problem of methanol contamination, in contravention to prior Commission policy and cost causation principles.[53] Chevron argues that targeting the

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[49] *Five-Year Review of Oil Pricing Index*, 133 FERC ¶ 61,228, at P 48 (2010) ("To the extent that a particular pipeline's cost change is an anomalous outlier compared to the changes on other pipelines, using the middle 50 percent of cost changes, should remove any distorting impact resulting from the pipeline's presence in the index").

[50] Chevron Rehearing Request at 18.

[51] *Id*. at 18-19.

[52] *Id*. at 19.

[53] *Id*. at 20-21.

deep-water shippers through a surcharge will ensure that the costs are narrowly tailored to the smallest subset of shippers that may be the source of the methanol contamination.[54]

36. We disagree and find the costs of the methanol treatment facility are correctly recovered in Chevron's rates, through the ordinary process of periodic adjustments, or through Chevron's filing a cost-of-service filing if it so elects. This ensures the costs of the facility are distributed amongst all shippers, which is appropriate in this instance because Chevron is unable to specifically identify which shippers on which platforms are causing the methanol contamination issue, yet because all shippers' volumes are combined on the pipeline, all shippers on Breton Sound experience the benefits of the methanol treatment facility. Moreover, the costs at issue are more of the typical capital and operational costs that are recovered by cost-of-service ratemaking.

37. Accordingly, the request for rehearing filed by Chevron is denied.

<u>The Commission orders:</u>

The request for rehearing is denied, as discussed in the body of this order.

By the Commission. Commissioner McIntyre is not voting on this order.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[54] *Id*. at 22.