ORAL ARGUMENT IS SCHEDULED FOR JANUARY 11, 2010

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 07-1163, 07-1164, 08-1022, and 08-1237 (Consolidated)

EXXONMOBIL OIL CORPORATION AND
BP WEST COAST PRODUCTS LLC,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION AND
UNITED STATES OF AMERICA,
RESPONDENTS.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF FOR RESPONDENTS FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

Christine A. Varney
Assistant Attorney General

John J. Powers, III
Robert J. Wiggers
Attorneys

For Respondent
United States of America
U.S. Department of Justice
Washington, D.C. 20530

Cynthia A. Marlette
General Counsel

Robert H. Solomon
Solicitor

Carol J. Banta
Attorney

For Respondent
Federal Energy
Regulatory Commission
Washington, D.C. 20426

JULY 6, 2009
FINAL BRIEF: AUGUST 25, 2009

CIRCUIT RULE 28(A)(1) CERTIFICATE

A. Parties and Amici

To counsel's knowledge, all parties are presented in the combined brief of the petitioners.

B. Rulings Under Review

1. Order Dismissing Complaints, *BP West Coast Products, LLC, et al. v. SFPP, L.P.*, FERC Docket Nos. OR07-3, *et al.*, 118 FERC ¶ 61,261 (Mar. 29, 2007) ("North Line Index Order"), NLR 11, JA 104 [D.C. Cir. Nos. 07-1163, 07-1164, 08-1022];

2. Order on Rehearing, *BP West Coast Products, et al. v. SFPP, L.P.*, FERC Docket Nos. OR07-3, *et al.*, 121 FERC ¶ 61,195 (Nov. 20, 2007) ("North Line Rehearing Order"), NLR 14, JA 124 [D.C. Cir. Nos. 07-1163, 07-1164, 08-1022];

3. Order Dismissing Complaint, *BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-20, 121 FERC ¶ 61,243 (Dec. 14, 2007) ("2007 Index Complaint Order"), BPR 8, JA 166 [D.C. Cir. No. 08-1237]; and

4. Order on Rehearing, *BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-20, 123 FERC ¶ 61,121 (May 5, 2008) ("2007 Index Rehearing Order"), BPR 16, JA 189 [D.C. Cir. No. 08-1237].

C. Related Cases

These cases, regarding complaints against a pipeline company's indexed rates filed in 2005, 2006, and 2007, have not previously been before this Court or any other court. Three previous cases, *ExxonMobil Oil Corp. v. FERC*, D.C. Cir. Nos. 05-1471, *et al.* (dismissed Feb. 27, 2007, after briefing and argument);

ExxonMobil Oil Corp. v. FERC, D.C. Cir. Nos. 06-1273, *et al.* (dismissed July 27, 2007, on FERC motion); and *Tesoro Refining & Marketing Co. v. FERC*, 552 F.3d 868 (D.C. Cir. 2009), raised some of the same issues, but the court did not reach the merits, deciding both *ExxonMobil* cases on jurisdictional grounds and *Tesoro* on exhaustion grounds. In addition, *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004); *ExxonMobil Oil Corp. v. FER*C, 487 F.3d 945 (D.C. Cir. 2007); and *SFPP L.P. v. FERC*, Nos. D.C. Cir. 02-1112, *et al.* (consolidated; in abeyance); and *ExxonMobil Oil Corp. v. FERC*, D.C. Cir. Nos. 06-1008, *et al.* (consolidated; in abeyance), concern SFPP's underlying base rates and cost of service.

Carol J. Banta
Attorney

TABLE OF CONTENTS

PAGE

TABLE OF CONTENTS

PAGE

TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

COURT CASES: **PAGE**

* Cases chiefly relied upon are marked with an asterisk.

TABLE OF AUTHORITIES

COURT CASES (continued): **PAGE**

TABLE OF AUTHORITIES

COURT CASES (continued): **PAGE**

ADMINISTRATIVE CASES:

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES (continued): **PAGE**

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES (continued): **PAGE**

TABLE OF AUTHORITIES

ADMINISTRATIVE CASES (continued): **PAGE**

STATUTES:

TABLE OF AUTHORITIES

STATUTES (continued): **PAGE**

REGULATIONS:

GLOSSARY

2005 Index Complaint Order	*BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-8, 119 FERC ¶ 61,241 (June 6, 2007)
2005 Index Rehearing Order	*BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-8, 121 FERC ¶ 61,141 (Nov. 9, 2007)
2007 Index Complaint Order	*BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-20, 121 FERC ¶ 61,243 (Dec. 14, 2007), BPR 8, JA 166, on review in Case No. 08-1237
2007 Index Protest Order	*SFPP, L.P.*, 119 FERC ¶ 61,330 (2007)
2007 Index Rehearing Order	*BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-20, 123 FERC ¶ 61,121 (May 5, 2008), BPR 16, JA 189, on review in Case No. 08-1237
BP	Petitioner BP West Coast Products LLC
BPR	Certified Index to Record of proceeding in FERC Docket No. OR07-20, filed in D.C. Cir. No. 08-1237
Br.	Combined opening brief of Shippers
Commission or FERC	Federal Energy Regulatory Commission
East Line Index Orders	*SFPP, L.P.*, 117 FERC ¶ 61,271 (2006), *reh'g denied*, 120 FERC ¶ 61,245 (2007)
EPAct	Energy Policy Act of 1992

GLOSSARY

ExxonMobil	Petitioner ExxonMobil Oil Corporation
Form No. 6	FERC Form No. 6, Annual Report for Oil Pipelines
ICA	Interstate Commerce Act
NLR	Certified Index to Record of proceeding in FERC Docket Nos. OR07-3, *et al.*, filed in D.C. Cir. Nos. 07-1163, 07-1164, and 08-1022
North Line Index Order	*BP West Coast Products, LLC, et al. v. SFPP, L.P.*, FERC Docket Nos. OR07-3, *et al.*, 118 FERC ¶ 61,261 (Mar. 29, 2007), NLR 11, JA 104, on review in Case Nos. 07-1163, 07-1164, and 08-1022
North Line Rehearing Order	*BP West Coast Products, et al. v. SFPP, L.P.*, FERC Docket Nos. OR07-3, *et al.*, 121 FERC ¶ 61,195 (Nov. 20, 2007), NLR 14, JA 124, on review in Case Nos. 07-1163, 07-1164, and 08-1022
Order No. 561	*Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 30,985 (1993)
Order No. 571	*Cost-of-Service Reporting and Filing Requirements for Oil Pipelines*, Order No. 571, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,006 (1994), *on reh'g*, Order No. 571-A, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,012 (1995)
SFPP	Intervenor SFPP, L.P.

GLOSSARY

Page 700	FERC Form No. 6, Page 700, Annual Cost of Service Based Analysis Schedule
SFPP	Intervenor SFPP, L.P.
Shippers	Petitioners ExxonMobil and BP West Coast
Tesoro Order	*Tesoro Refining & Mktg. Co. v. Calnev Pipe Line, L.L.C.*, 121 FERC ¶ 61,142 (2007) (companion to 2005 Index Rehearing Order), *appeal dismissed*, *Tesoro Refining & Marketing Co. v. FERC*, 552 F.3d 868 (D.C. Cir. 2009)

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 07-1163, 07-1164, 08-1022, and 08-1237 (Consolidated)

EXXONMOBIL OIL CORPORATION AND
BP WEST COAST PRODUCTS LLC,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION AND
UNITED STATES OF AMERICA,
RESPONDENTS.

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

BRIEF FOR RESPONDENTS FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

STATEMENT OF THE ISSUES

1. Whether the Federal Energy Regulatory Commission ("Commission" or "FERC") reasonably determined that oil pipeline customers failed to meet their initial burden, in complaints against a pipeline's annual indexed rate increases, to allege sufficient grounds for asserting that the indexed rates were excessive.

2. Whether the Commission reasonably exercised its discretion in holding that challenges to the structure of an oil pipeline's underlying cost-of-

service rates are beyond the scope of a complaint against an inflation-based annual rate increase under the Commission's simplified rate indexing methodology.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes and regulations are contained in the Addendum to this brief.

INTRODUCTION

These appeals are the latest in a series of challenges by shipping customers to rate increases filed by oil pipeline companies under the Commission's rate indexing procedure — and, more broadly, to the indexing procedure itself and to the Commission's efforts to organize rate disputes in a manner that maintains Congress's goal of streamlined pipeline ratemaking. Because previous appeals have foundered on jurisdictional or exhaustion grounds, this case presents the first opportunity for the Court to reach the merits of the shippers' arguments.

In these consolidated cases, Petitioners BP West Coast Products LLC ("BP") and ExxonMobil Oil Corporation ("ExxonMobil," and together, "Shippers") filed complaints against annual inflation-based rate increases submitted by SFPP, L.P. In one set of orders on review, the Commission dismissed Shippers' complaint against SFPP's indexed rate increases in 2005 and 2006 for its North Line, because the Commission determined that SFPP's rates were yielding less revenue than its actual cost of service. *BP West Coast Products, LLC, et al. v. SFPP, L.P.*, 118

FERC ¶ 61,261, NLR 11, JA 104, *reh'g denied*, 121 FERC ¶ 61,195 (2007), NLR 14, JA 124.[1] In the other set of orders on review, the Commission dismissed BP's complaint against SFPP's indexed rate increase for 2007 because the rate increase was less than SFPP's actual cost increase. *BP West Coast Products LLC v. SFPP, L.P.*, 121 FERC ¶ 61,243 (2007), BPR 8, JA 166, *reh'g denied*, 123 FERC ¶ 61,121 (2008), BPR 16, JA 189.

In both cases, the Commission, consistent with its policy and precedents, rejected attempts to introduce cost-of-service ratemaking disputes into the simplified rate indexing process. To that end, the Commission again explained its efforts to organize the numerous rate proceedings before it by delineating several distinct types of complaints against pipeline rates, requiring different levels of complexity and analysis.

Shippers, however, fundamentally disagree with the premise of the rate indexing methodology. Further, Shippers misapprehend the Commission's policy and pleading requirements. Separately, BP wrongly contends that the Commission

---

[1] The Commission filed the indices to the record before these cases were consolidated for briefing. Accordingly, "NLR" refers to a record item in Case Nos. 07-1163, 07-1164, and 08-1022, concerning Shippers' collective challenges to SFPP's 2005 and 2006 North Line rates. "BPR" refers to a record item in Case No. 08-1237, concerning BP's challenge to SFPP's 2007 rates. "JA" refers to the Joint Appendix page number. "P" refers to the internal paragraph number within a FERC order.

has precluded challenges to index filings, even as it conspicuously ignores Shippers' own success in obtaining a hearing (and ultimately a settlement with the same pipeline) on a complaint against an index increase — in the very dispute that BP repeatedly touts as supporting its claims of futility.

STATEMENT OF FACTS

I. Statutory And Regulatory Background

In 1906, Congress extended the definition of common carrier under the Interstate Commerce Act ("ICA") to oil pipelines and required that their rates be just and reasonable. *See* 49 U.S.C. app. § 1(5) (1988). In 1977, in conjunction with the formation of the Department of Energy, regulatory authority over oil pipelines under the ICA was transferred from the Interstate Commerce Commission to the newly-created FERC. *See* Section 402(b) of the Department of Energy Organization Act, 42 U.S.C. § 7172(b). The traditional standards governing rate regulation under the ICA were not modified. *See generally Frontier Pipeline Co. v. FERC*, 452 F.3d 774, 776 (D.C. Cir. 2006) (explaining background of statute and its unusual citation format, to 49 U.S.C. § 1 *et seq.* (1976), *reprinted in* 49 U.S.C. app. § 1 *et seq.* (1988)).

In 1985, the Commission established a fairly traditional cost-of-service methodology for determining oil pipeline rates. *Williams Pipe Line Co.*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,833 (1985). Following Opinion No. 154-B,

adjudicated rate proceedings for oil pipelines, although few in number, were long, complicated, and costly. *See Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561, FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 30,985 at 30,943 (1993), *on reh'g*, Order No. 561-A, FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 31,000 (1994), *aff'd*, *Ass'n of Oil Pipe Lines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996). For that reason, Congress passed the Energy Policy Act of 1992 ("EPAct"),[2] requiring FERC to establish "a simplified and generally applicable ratemaking methodology" for oil pipelines and "to streamline procedures . . . relating to oil pipeline rates in order to avoid unnecessary regulatory costs and delays." EPAct §§ 1801(a), 1802(a). *See generally ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 956-57 (D.C. Cir. 2007) (summarizing background of EPAct and Order No. 561).

Accordingly, in 1993, the Commission issued Order No. 561, in which it adopted a methodology for oil pipelines to adjust their rates using an index system that establishes industry-wide ceiling levels for such rates. *See id.* at 30,940-41; *see also* 18 C.F.R. § 342.3 (methodologies and procedures for indexed rate changes). *See generally Ass'n of Oil Pipe Lines*, 83 F.3d at 1430-31; Argument Part II.A, *infra* (discussing indexing scheme). The purpose of this process is to

[2] Pub. L. No. 102-486, §§ 1801-1804, 106 Stat. 2776, 3010-12 (1992), *reprinted in* 42 U.S.C. § 7172 note.

allow rates to track inflation in the general economy, essentially preserving pipelines' existing rates in real economic terms. Order No. 561 at 30,948-50.[3]

The ICA sets forth procedures for parties to challenge pipelines' rates. *See* 49 U.S.C. app. §§ 13(1) (providing for complaints against carriers), 15(1) (authorizing Commission to prescribe just and reasonable rates if it determines, "after full hearing" upon a § 13 complaint or an investigation undertaken on the Commission's own initiative, that a carrier's rates are unjust and unreasonable), 15(7) (authorizing Commission to hold a hearing concerning lawfulness of newly-filed rate and, at its discretion, to suspend the rate pending such hearing). The Commission implemented procedural rules for such ICA complaints and rate protests in 18 C.F.R. Part 343. Of particular relevance here, a protest or complaint against an indexed rate increase "must allege reasonable grounds for asserting that . . . the rate increase is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable . . . ." 18 C.F.R.

[3] In 2005, 2006, and 2007 (the years of the indexed rate increases at issue here), the industry-wide ceilings for the inflation-based increases, set by the Commission based on annual changes in the Producer Price Index for Finished Goods, were 3.6288%, 6.1485%, and 4.3186%, respectively. *See* Notices of Annual Change in the Producer Price Index For Finished Goods, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, 111 FERC ¶ 61,226 (2005), 115 FERC ¶ 61,295 (2006), 119 FERC ¶ 61,155 (2007).

§ 343.2(c)(1). A protest or complaint that does not meet that requirement will be dismissed. 18 C.F.R. § 343.2(c)(4).

II. The Commission Proceedings And Orders

A. Related Proceedings: 2005 Index Disputes

Though not on appeal before this Court, FERC orders issued in a parallel set of proceedings involving the same parties provide vital context for the later orders that are on review, both because those earlier orders established the regulatory standard that the Commission applied here and because Shippers selectively describe the Commission's earlier rulings.

In mid-2005, SFPP filed a proposed rate increase of approximately 3.63%, which was within the industry-wide indexed ceiling for that year (*see supra* note 3); SFPP also filed supporting data reflecting an actual increase of 0.37% in its total cost of service from 2003 to 2004.[4] Petitioners BP and ExxonMobil filed a protest, but the Commission determined that the difference between the indexed rate increase and the actual cost increase was not so substantial as to render the

[4] Under the Commission's indexing procedures, the Commission publishes the permitted index ceiling in May of each year, after which a pipeline company may file an index increase, relying on cost data reported as of December 31 of the two previous years (to measure the change in costs of service over the immediately preceding calendar year). *See* Order No. 561 at 30,953-54; 18 C.F.R. § 342.3(c), (d); *Cost-of-Service Reporting and Filing Requirements for Oil Pipelines*, Order No. 571, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,006 at 31,168 (1994), *on reh'g*, Order No. 571-A, FERC Stats. & Regs. [Regs. Preambles 1991-1996] ¶ 31,012 (1995).

indexed rates unjust and unreasonable, and thus declined to set the matter for hearing. *SFPP, L.P.*, 111 FERC ¶ 61,510, *reh'g denied*, 113 FERC ¶ 61,253 (2005). On appeal, this Court held (in an unpublished judgment issued after briefing and argument) that Commission determinations not to investigate rate filings in response to protests under ICA § 15 are unreviewable, and dismissed the appeal for lack of jurisdiction. *ExxonMobil Oil Corp. v. FERC*, Nos. 05-1471, *et al.*, 2007 U.S. App. LEXIS 6692 (D.C. Cir. Feb. 27, 2007).

On March 23, 2007, BP filed a complaint under ICA § 13 challenging the same 2005 index-based rate increase. On June 6, 2007, the Commission issued an order that partially accepted BP's complaint, determining that BP met its initial burden as to its "core allegation" that SFPP's proposed rate increase was so in excess of the actual cost increase that the resulting rates were unjust and unreasonable. *BP West Coast Products LLC v. SFPP, L.P.*, 119 FERC ¶ 61,241 at P 10 (2007) ("2005 Index Complaint Order").

In that case, cost data submitted by SFPP pursuant to FERC's reporting requirements (FERC Form No. 6, Page 700) showed an existing overrecovery of approximately $16 million, and (as noted above) the proposed index increase of the maximum permitted 3.63% exceeded SFPP's actual cost increase of 0.37%. The rate increase added a further overrecovery of approximately $4.5 million. *Id.* at P 10.

The Commission decided to modify its pleading standard to allow a complaint to "meet the standards of [18 C.F.R. §] 343.2(c) if it establishes that the pipeline appears to substantially over-recover its costs at the time it files tariffs to increase rates under our indexation methodology." *Id.* at P 11. On the facts presented, BP alleged "that an over recovery of some $16 million will become an over recovery of some $20 million based on the July 1, 2005 index rate increases." *Id.* Accordingly, the Commission accepted the complaint and held it in abeyance pending the completion of other FERC proceedings concerning SFPP's rates and cost of service. *Id.* at PP 12-13.[5]

SFPP requested rehearing, arguing (*inter alia*) that the Commission had never previously compared a pipeline's increase in costs to its existing return (*i.e.*, the extent of its overrecovery) in considering objections to an indexed rate increase. On November 9, 2007, the Commission issued an Order Denying Rehearing, *BP West Coast Products LLC v. SFPP, L.P.*, 121 FERC ¶ 61,141 (2007) ("2005 Index Rehearing Order"). The Commission denied the rehearing request but acknowledged that its initial order "contains a revised interpretation of

[5] The Commission dismissed other portions of BP's complaint, to the extent that it reached beyond the index proceeding to challenge SFPP's base rates (which in any event were already under investigation in other FERC proceedings) and rate design. *Id.* at PP 8-9. *See generally infra* pp. 28-30 (discussing narrow scope of complaint against index increase).

18 C.F.R. § 343.2(c) and is one that the Commission had not previously had occasion to address." *Id.* at P 5.

The Commission went on to explain its approach to considering challenges to index increases, but conceded that the 2005 Index Complaint Order "as written could have some unintended consequences." *Id.* at P 9. Specifically, in holding that a complaint could meet the pleading standard where the pipeline was substantially overrecovering its costs, "[t]he phrasing did not incorporate the fact that application of the index methodology would substantially exacerbate the over-recovery because the increase substantially exceeded the actual increase (in dollar amounts) of the pipeline's costs." *Id.* Absent clarification, the revised interpretation could apply in circumstances the Commission did not intend, "lead[ing] to a denial of an index-based increase in a year in which the pipeline's cost increase exceeded or was in the same range as the index amount and thus there was no material change in its return." *Id.*; *accord Tesoro Refining & Mktg. Co. v. Calnev Pipe Line, L.L.C.*, 121 FERC ¶ 61,142 at P 6 (2007) ("Tesoro Order"), *appeal dismissed*, *Tesoro Refining & Marketing Co. v. FERC*, 552 F.3d 868 (D.C. Cir. 2009). Accordingly, the Commission refined its new standard for complaints against index-based increases:

> The Commission therefore clarifies that for the complaint to establish reasonable grounds to conclude that the resulting rate is unjust and unreasonable, it must show (1) that the pipeline is substantially over-recovering its cost of service and (2) that the index[] based increase so

> exceeds the actual increase in the pipeline's cost that the resulting rate increase would substantially exacerbate that over-recovery.

2005 Index Rehearing Order at P 10; *accord* Tesoro Order at P 6.

Following issuance of an order that addressed cost-of-service issues in a separate SFPP proceeding, the Commission set BP's complaint, together with ExxonMobil's "virtually identical" complaint against the same 2005 index increase, for hearing. *ExxonMobil Oil Corp. v. SFPP, L.P.*, 122 FERC ¶ 61,129 (2008). BP and ExxonMobil later reached a settlement with SFPP that resolved the 2005 index complaints. *See* Letter Order, *BP West Coast Products, LLC v. SFPP, L.P.*, 125 FERC ¶ 61,138 (2008) (approving settlement).

B. North Line Index Orders

1. North Line Index Order

The first set of orders on review before the Court in this case arose from Shippers' joint complaint under ICA § 13 against a portion of SFPP's indexed rate increases filed in 2005 and 2006 for its North Line. In December 2006, Petitioners BP and ExxonMobil filed a complaint together with three other shippers that are not parties to this appeal (Chevron Products Company, Tesoro Refining and Marketing Company, and Valero Marketing & Supply Company) (NLR 1, JA 1); another shipper, ConocoPhillips Company (also not a party here), filed a similar complaint the following month (NLR 4) which the Commission addressed in the same orders. The Commission dismissed the complaints in an order dated March

29, 2007, finding that SFPP's application of the indexing methodology did not result in North Line rates that were so substantially in excess of the actual North Line costs as to be unjust and unreasonable. Order Dismissing Complaints, *BP West Coast Products, LLC, et al. v. SFPP, L.P.*, 118 FERC ¶ 61,261 at P 1 (2007) ("North Line Index Order"), NLR 11, JA 104.

SFPP had separately filed a North Line cost-of-service rate filing on April 28, 2005; in considering SFPP's subsequent index filing (on May 31, 2005), the Commission found that the summary sheet from the cost-of-service filing in the base rate case confirmed SFPP's assertion that the new base rates would yield less revenue than the actual cost of service. *Id.* at P 8, JA 107. The Commission further agreed with SFPP that revenues would continue to recover less than the actual costs after the North Line rates were indexed starting July 1, 2005. The Commission noted that it "has consistently permitted oil pipelines to take the full index if they are not recovering their overall cost of service." *Id.*, JA 107-08.

The Commission made its determination based on cost data reported in SFPP's FERC Form No. 6 filings for the comparison years (for the mid-2005 index filing, data for calendar years 2003 and 2004), consistent with FERC practice in light of the simplicity of the indexing procedure. *Id.* Though the complaining shippers questioned that cost data, citing the initial decision of a FERC administrative law judge ("ALJ") that rejected certain elements of SFPP's April

2005 cost-of-service filing, the Commission found that the shippers' arguments concerned the embedded cost elements of the underlying base rates, and thus went beyond the scope of the index proceeding (and "simply duplicat[ed]" challenges in the base rate proceeding). *Id.* at P 10, JA 108-09. The Commission also noted that the ALJ's decision was still under review by the Commission and did not constitute binding precedent. *Id.* In addition, because the new underlying North Line rates filed in April 2005 were subject to investigation and refund, the index increases for 2005 and 2006 were also subject to potential reduction and refund. *Id.*

Because the shippers' challenges to the 2006 indexed North Line rates were based on the "false premise" that the 2005 indexed rates had been unreasonable, they likewise failed. *Id.* at P 9.

2. North Line Rehearing Order

Several shippers who are not parties on appeal (Chevron, Tesoro, and Valero) filed a joint request for rehearing of the North Line Index Order. NLR 12, JA 111. On November 20, 2007, the Commission issued its Order on Rehearing, *BP West Coast Products, et al. v. SFPP, L.P.*, 121 FERC ¶ 61,195 (2007) ("North Line Rehearing Order"), NLR 14, JA 124. First, the Commission rejected "the assumption that complainants are entitled to challenge the lawfulness of an index-based increase." *Id.* at P 4, JA 125. To the contrary, complainants must meet the threshold set forth in 18 C.F.R. § 343.2(c), by "demonstrat[ing] reasonable grounds

to conclude that the index based increase so exceeds the pipeline's actual cost increases that the resulting rates are unjust and unreasonable." North Line Rehearing Order at P 4, JA 125. Here, the complainants could not make that showing because, even with the index increase, SFPP's rates would not fully recover its actual costs. *Id.* The Commission reiterated that, because the underlying cost structure of the North Line rates remained at issue in a separate proceeding, the index-based increase was also subject to refund. Therefore, holding a separate proceeding for the index-based increase would be unnecessary and "grossly inefficient." *Id.* at P 5, JA 126.

The Commission also declined to reconsider the validity of SFPP's reported cost of service based on the ALJ's initial findings in the underlying rate proceeding. *Id.* at P 6, JA 126. The Commission explained that any challenge to the elements of the pipeline's cost of service must be disputed in a base rate proceeding, rather than in an index proceeding. *Id.*

Finally, the Commission distinguished its ruling on the indexed North Line rates from an earlier ruling on SFPP's East Line rates. Whereas the Commission had denied SFPP's mid-2006 index filing for the East Line because SFPP was already recovering its full, actual costs for the same period that would be addressed by the index increase (*i.e.*, calendar year 2005), the proposed North Line rates based on the 2004 cost of service were inadequate to recover SFPP's costs for that

year. *Id.* at P 7, JA 126-27; *cf. SFPP, L.P.*, 117 FERC ¶ 61,271 (2006) (denying 2006 index increase to East Line rates), *reh'g denied*, 120 FERC ¶ 61,245 (2007) ("East Line Index Orders").

Shippers' petitions in Case Nos. 07-1163, 07-1164, and 08-1022 followed.

C. 2007 Index Complaint Orders

1. 2007 Index Complaint Order

The second set of FERC orders on review in this case arose from BP's complaint under ICA § 13 against SFPP's indexed rate increase filed in 2007. BPR 2, JA 128. On December 14, 2007, the Commission issued its Order Dismissing Complaint, *BP West Coast Products LLC v. SFPP, L.P.*, 121 FERC ¶ 61,243 (2007) ("2007 Index Complaint Order"), BPR 8, JA 166.[6]

First, as to the challenge to the 2007 index filing, the Commission determined that the complaint did not meet the standard set forth in the 2005 Index Rehearing and Tesoro Orders. *Id.* at P 2, JA 166. As discussed *supra* at pp. 9-11, a complaint against an index increase, where the challenge is based on the pipeline's existing overrecovery rather than on a significant disparity between the index increase and the actual cost increase, must show both (1) that the pipeline is

[6] The Commission had previously denied a protest by Shippers to SFPP's 2007 index filing. *See SFPP, L.P.*, 119 FERC ¶ 61,330 (2007) ("2007 Index Protest Order").

"substantially overrecovering" its cost of service and (2) that the index increase so exceeds the actual cost increase that the resulting rate increase would "substantially exacerbate" that overrecovery. Here, the Commission determined that SFPP's actual cost of service had increased by 15.3%, far exceeding the 4.3186% index increase; accordingly, BP's complaint failed that threshold showing. 2007 Index Complaint Order at P 4, JA 167.

In addition, the Commission found that the complaint confused several distinct types of challenges that the Commission has consistently separated: to the reasonableness of an index-based increase in a single year, to the accuracy of the financial reporting underlying that increase, and to the cost elements or the cumulative effect of index increases embedded in the base rates. *Id.* at PP 2, 11-12, JA 166, 170; *see also id.* at PP 5-10, JA 167-70. *See generally* Argument, Part II.B, *infra* (discussing types of complaint proceedings).[7]

2. 2007 Index Rehearing Order

BP filed a request for rehearing, arguing both that the Commission had erred under its pleading standard and that it had precluded any challenge to index increases, in violation of its own regulations and the Interstate Commerce Act.

---

[7] The Commission also noted that the complaint included "extraneous arguments wholly unrelated to the index-filing procedures" and that it failed to meet the Commission's technical pleading requirements. *Id.* at P 3 (noting those failings were "secondary" to its ruling), JA 166.

BPR 9, JA 172. On May 5, 2008, the Commission issued an Order on Rehearing, *BP West Coast Products LLC v. SFPP, L.P.*, 123 FERC ¶ 61,121 (2008) ("2007 Index Rehearing Order"), BPR 16, JA 189. The Commission denied rehearing, explaining that it construes 18 C.F.R. § 343.2(c)(1) as comparing the results of the index increase to the cost increases that the pipeline actually incurs. *Id.* at P 6, JA 191. If a pipeline's costs increase over the relevant year by a greater percentage than the permitted index percentage, then the resulting rate increase cannot meet the threshold standard for a complaint. *Id.* at P 7, JA 192.

In this case, SFPP's index increase fell below that threshold, whether considered on a percentage basis (15.3% increase in actual costs versus 4.3186% index increase), or on a dollar basis. *Id.* at PP 6-7, JA 191-92. SFPP's costs increased by $16.4 million over calendar year 2006 (based on costs reported as of December 31, 2005 and December 31, 2006). *Id.* at P 8, JA 192. Applying the industrywide 4.3186% increase permitted for the mid-2007 index filing to SFPP's December 31, 2006 revenues of $139 million would result in a revenue increase of approximately $6 million — well below the $16.4 million increase in actual costs. *Id.* Even if SFPP were overrecovering its cost of service (an overrecovery that could be challenged by a complaint against the underlying rates, *id.* n.9), the capped index increase would cut into, rather than exacerbate, the overrecovery. *Cf. id.* at P 11, JA 194.

Responding to BP's broader challenges to the Commission's handling of complaints, the Commission noted that it "has clearly permitted complaints against yearly index increases," pointing in particular to BP's and ExxonMobil's complaints in the 2005 index disputes (discussed in Part II.A, *supra*), as well as ExxonMobil's successful protest of another pipeline company's 2006 index filing. *Id.* at P 8 & n.10 (citing cases), JA 192. Conceding that complaints against index increases "in theory can be repetitive," the Commission again explained its choice to emphasize administrative efficiency, given hundreds of index filings that are submitted each year and "the simplified procedure that the indexing procedure is intended to implement." *Id.* at P 8 (citing 2007 Index Complaint Order and 2007 Index Protest Order), JA 192-93. *See generally* Argument, Part II.A, *infra*.

The Commission again reinforced its policy of separating challenges against pipeline filings according to complexity. It held that it had appropriately relied on SFPP's cost reporting, as parties can bring complaints challenging the pipeline's calculations and accounting procedures. 2007 Index Rehearing Order at P 9, JA 193. The Commission also rejected BP's claim that index-based increases can become permanent without any review, noting that BP had not complained against SFPP's base rate and that it could preserve index challenges by filing complaints against index filings and, separately, against cumulative increases. *Id.* at P 10,

JA 193. "This may be repetitive, but it is intrinsic to the indexing procedure and enables the challenges that BP West Coast claims it cannot make." *Id.*

BP's petition in Case No. 08-1237 followed.

SUMMARY OF ARGUMENT

The Commission properly determined that Shippers' complaints did not make the required showing of reasonable grounds to conclude that the indexed rates were excessive. Furthermore, the Commission reasonably exercised its discretion in rejecting broad challenges to the pipeline's cost-of-service rates in complaints against yearly inflation-based increases.

In the orders on review, the Commission properly interpreted and applied its regulations implementing the simplified rate indexing procedure. That scheme applies industry-wide rate ceilings and thus allows some divergence between an individual pipeline's index increases and its actual costs. The Commission reasonably found that SFPP's index increases were not so substantially in excess of its actual cost increases as to satisfy Shippers' requisite *prima facie* showing that the proposed increases were unjust and unreasonable. Also, in accordance with the streamlined procedure set forth in its regulations and orders, the Commission properly relied on cost data reported by SFPP to compare the rate and cost increases.

The Commission also appropriately declined to consider the merits of SFPP's underlying rates and cost of service in indexed rate adjustment proceedings. The Commission's determination that Shippers' challenges were outside the scope of the streamlined index proceedings was consistent with the Commission's policy and precedents and within its broad discretion to structure its own proceedings. The Commission has established various categories of complaint proceedings, in accordance with its statutory discretion as to oil pipeline ratemaking and its prerogative to organize its own proceedings. In so doing, the Commission has not foreclosed challenges to indexed rate increases — as is shown by Shippers' own successful challenge to SFPP's 2005 index increase.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See, e.g.*, *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). A court must satisfy itself that the agency "articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)). Deference to the Commission's decisions regarding rate issues is broad, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *see also Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. 1*, 128 S. Ct. 2733, 2738 (2008) ("The statutory requirement that rates be 'just and reasonable' is obviously incapable of precise judicial definition, and we afford great deference to the Commission in its rate decisions."); *ExxonMobil*, 487 F.3d at 951 ("In reviewing FERC's orders, we are 'particularly deferential to the Commission's expertise' with respect to ratemaking issues.") (quoting *Ass'n of Oil Pipe Lines*, 83 F.3d at 1431).

In addition, courts "afford substantial deference to the Commission's interpretations of its own regulations, deferring to the agency unless its interpretation is plainly erroneous or inconsistent with the regulation[s] . . . ." *N. Border Pipeline Co. v. FERC*, 129 F.3d 1315, 1318 (D.C. Cir. 1997) (internal quotation marks and citation omitted); *accord Central Vt. Pub. Serv. Corp. v. FERC*, 214 F.3d 1366, 1369 (D.C. Cir. 2000).

II. THE COMMISSION REASONABLY EXCLUDES CHALLENGES TO AN OIL PIPELINE'S UNDERLYING RATES AND COSTS OF SERVICE FROM STREAMLINED INDEX PROCEEDINGS

Shippers raise an array of challenges to the Commission's policy choice to separate pipeline rate disputes into distinct proceedings to preserve the simplicity of rate indexing — indeed, Shippers' arguments go to the basic validity of the Commission's indexing methodology. In both sets of orders on review, the Commission rejected Shippers' attempts to challenge SFPP's reported cost of service in index proceedings and to show that indexed rate increases were inappropriate because the underlying rates were excessive. Therefore, we provide a short overview explaining the Commission's reasonable efforts to organize the proceedings before it.

A. The Streamlined Indexing Process Is Designed To Allow Annual Rate Changes Without Extensive Cost-Of-Service Ratemaking Proceedings And To Allow Some Divergence Between Rate Increases And Actual Cost Increases

As discussed *supra* at pp. 5-6, the Commission established a process for allowing index increases in oil pipeline rates in Order No. 561, which this Court upheld in *Association of Oil Pipe Lines*. *See* 83 F.3d at 1428 ("We conclude that by establishing a general indexing methodology along with limited exceptions to indexed rates, the Commission has reasonably balanced its dual responsibilities of ensuring just and reasonable pipeline rates and simplifying and streamlining ratemaking through generally applicable procedures.").

The principal benefit of indexing is that it achieves the streamlining that Congress demanded (*see supra* p. 5) in the Energy Policy Act of 1992:

> The Commission believes that the approach of applying an industry-wide cap on rate changes derived by an appropriate index would achieve the above-described policy objectives [of simplifying oil pipeline ratemaking while ensuring just and reasonable rates], as well as meet the statutory criteria of simplicity and general applicability. This is because the indexing approach allows rates to be changed without a detailed and comprehensive presentation and examination of the individual pipeline's cost of service in each case.

Order No. 561 at 30,946. Indeed, "the hallmark of an indexing system is simplicity." *Id.* at 30,948; *accord* North Line Index Order at P 8, JA 108. That is, "pipelines adjust rates to just and reasonable levels for inflation-driven cost changes without the need [for] strict regulatory review of the pipeline's individual

cost of service, thus saving regulatory manpower, time and expense." Order No. 561 at 30,948; *see also Frontier*, 452 F.3d at 777 ("This system dispenses with intricate calculations of specific pipeline costs.").

1. Index Increases Are Based On Inflation Rather Than Actual Cost-Of-Service Ratemaking

The indexing system is primarily "a cost-based methodology, even though it tracks general economy-wide costs rather than specific company costs." Order No. 561 at 30,950. By limiting pipelines to an inflation-based increase, indexing is designed to protect shippers from rate increases greater than the rate of inflation. *Id.* at 30,948-49. At the same time, pipelines receive the real value of their underlying rates because the annual changes track inflation:

> In regard to justifying the effects of indexing on rates, it should be understood that indexing, conceptually, merely preserves the value of just and reasonable rates in real economic terms. This is because it takes into account inflation, thus allowing the nominal level of rates to rise in order to preserve their real value in real terms.

Id. at 30,950; *see also id.* at 30,948 (explaining purpose to "adjust rates to just and reasonable levels for inflation-driven cost changes").

But the indexing methodology — by design — is not entirely cost-based. Under an indexing scheme, "some divergence between the actual cost changes experienced by individual pipelines and the rate changes permitted by the index is inevitable." *Id.* at 30,949. By eliminating full cost-of-service proceedings for

annual rate filings, the indexing process simplifies ratemaking and disconnects the rate increase from the specific pipeline's costs:

> This is because the indexing system utilizes average, economy-wide costs rather than pipeline-specific costs to establish rate ceilings. It is this focus on economy-wide costs that makes the methodology of indexing simplified and streamlined, because there is no need to present and examine the costs of each individual pipeline each time a rate change in compliance with the ceiling rate is proposed.

Id. at 30,949; *see also id.* at 30,963 ("Rate changes under indexing are not required to be justified by the actual cost changes experienced by the individual pipeline filing the rate. The indexing system is predicated upon cost changes in the economy as a whole, not to individual pipelines.").

Pure cost-based regulation frequently blunts the incentive to operate efficiently. *See, e.g.*, *Associated Gas Distribs. v. FERC*, 824 F.2d 981, 995 (D.C. Cir. 1987). By relaxing the relationship between costs and rates, an indexing scheme gives "greater emphasis to productive efficiency in noncompetitive markets than does traditional cost-of-service regulation." Order No. 561 at 30,948 (footnote omitted). It incorporates both a carrot and a stick: pipelines that do better than average in containing costs can keep some of the savings; a pipeline whose cost increases exceed the industry-wide ceiling will see its rate of return decline. *Cf. Five-Year Review of Oil Pricing Index*, 114 FERC ¶ 61,293 at P 57 (2006) ("We recognized in adopting a uniform index for all pipelines that inevitably some pipelines would over-earn while others will under-earn. It is a fact

simply inherent in an industry-wide pipeline index."). In either event, "use of such a formula gives the pipelines incentives to pursue cost-saving innovations." *Flying J Inc. v. FERC*, 363 F.3d 495, 496 (D.C. Cir. 2004). *See generally Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (recognizing that reasonableness is a "zone," not a precise point, and FERC has discretion to consider legitimate non-cost factors to allow variation within that zone); *accord Permian Basin*, 390 U.S. at 797-98; *Me. Pub. Utils. Comm'n v. FERC*, 520 F.3d 464, 471 (D.C. Cir. 2008); *Interstate Natural Gas Ass'n v. FERC*, 285 F.3d 18, 31 (D.C. Cir. 2002).

2. The Indexing Procedure Maintains Simplicity By Relying On Data Provided Under FERC's Cost Reporting Requirements

To maintain the relative simplicity of the indexing process, the Commission intended the data reported on FERC Form No. 6, Annual Report for Oil Pipelines, to be integral to index filings and challenges: "Cost data included in Form No. 6 can be used by an interested person to form the basis of a complaint or protest that the increase sought under any of the methodologies is not justified. . . . It will thus serve as a 'reality check' on increases under the indexing methodology." Order No. 561 at 30,948; *see also id.* at 30,956 (noting that Form No. 6 is useful because data "are available to all parties to challenge a pipeline's rate increase") (footnote omitted).

To that end, when it established the indexing scheme in Order No. 561, the Commission also issued a companion order that modified the Form No. 6 reporting requirements. *See* Order No. 571 at 31,162; *see also Ass'n of Oil Pipe Lines*, 83 F.3d at 1430 n.11 (noting expansion of annual reporting requirement in Order No. 571 for purpose of obtaining basic information to review indexed rate filings). The Commission added a new required schedule (Page 700) that would report, both for the reporting year and the preceding year, the pipeline's total annual cost of service, operating revenues, and throughput. Order No. 571 at 31,168. By making year-to-year comparison of such data available, Page 700 was expressly "designed to be a preliminary screening tool for pipeline rate filings. . . ." *Id.* ("This schedule would permit a shipper to compare proposed changes in rates against the change in the level of a pipeline's cost of service."); *see also id.* at 31,169 ("[T]he information contained in a single place . . . will be useful in [FERC's] monitoring of the performance of the index . . . [and] may indeed be useful as a 'substantial divergence' screen."); *e.g.*, 2007 Index Complaint Order at P 8 (standard for index "is a narrow test that is based on a comparison of Page 700 of the relevant years"), JA 169.

Accordingly, the cost data to which the Commission refers in index proceedings is mandated by the Commission's comprehensive regulations, provided in a standardized format, prepared using a FERC-prescribed cost-of-

service methodology, available to all parties, and subject to the Commission's ongoing audit procedures. *See* 18 C.F.R. § 346.2 (prescribing data to be provided); Order No. 571 at 31,168-70; 2007 Index Complaint Order at P 9, JA 169. (In addition, FERC Form No. 6 is submitted under oath, exposing the pipeline and its employees to civil and criminal sanctions for purposeful errors. *Id.*)

B. The Commission Has Reasonably Determined That Requiring Different Types Of Complaints Serves The Goal Of Streamlining Rate Proceedings

The intended simplicity of the rate indexing process and the related cost reporting regime underlie the Commission's delineation of three types of complaint proceedings. Exercising its discretion under the Interstate Commerce Act and its discretion to order its own proceedings, the Commission has limited the scope of challenges to oil pipelines' annual index filings consistent with the streamlined and simplified indexing procedures:

> In an index-rate adjustment proceeding the focus . . . is only whether the index increase is so substantially in excess of cost changes for the index year. *Otherwise, each proceeding is likely to evolve into litigation about the return already present in the base rates* . . . . This would defeat the goal of administrative simplicity that is the core rationale of the indexing methodology.

Calnev Pipe Line, L.L.C., 119 FERC ¶ 61,332 at P 7 (2007) (emphasis added), *cited in* 2007 Index Complaint Order at P 5 & n.4, JA 168. *Cf.*, *e.g.*, BPR 2 at 17-24, JA 149-56, & NLR 1 at 9-10, JA 13-14 (complaints challenging SFPP's index increases based on existing return in base rates and cost components of those base

rates). The Commission reiterated its policy rationale in the orders now on review, explaining that to allow shippers to attack the underlying rates in an index case "would defeat the central purpose of the indexing regulations, which is a simplified method for recovering industry-wide cost increases." 2007 Index Complaint Order at P 11, JA 170; *see also* North Line Index Order at PP 8, 10, JA 108-09. Specifically, bringing cost-of-service disputes into an indexing case:

> would almost certainly result in confusion of the issues to be addressed at the filing stage or at hearing, the scope of discovery, a muddled record, and significantly more cost than is warranted given the purpose of the regulations and the goal of simplified oil pipeline regulation embodied in the [EPAct].

2007 Index Complaint Order at P 11, JA 170; *see also id.* at P 12 n.13 (citing earlier orders), JA 170. Moreover, the Commission's emphasis on administrative efficiency in handling challenges to index increases is "essential given that there are over 320 index rate filings made in the second quarter of each calendar year." 2007 Index Rehearing Order at P 8, JA 193.

Accordingly, the Commission's pleading standard for such a complaint limits the focus to the effect of each individual year's rate increase. *See* 2007 Index Complaint Order at P 5 (rejecting as irrelevant both BP's assertions and SFPP's responses concerning levels of recovery in earlier years: "The Commission has consistently held that a complaint against a single index-based increase can only reach the increase in that year."), JA 167; 2005 Index Complaint

Order at PP 8-9 ("The Commission has consistently held that a challenge to an index increase taken in a specific year is limited to an evaluation of the increase taken in the index year and not a review of the base rate or any cumulative increases taken in prior years.") (citing cases).

In addition, the Commission requires, again because of the streamlined nature of indexing, that a complaint against an index increase be based on information presented on Page 700 of the pipeline's FERC Form No. 6, taken on its face. *See* North Line Index Order at P 8 (challenge to index increase "is normally limited to matters that appear on the face of the Page 700"), JA 108; 2007 Index Complaint Order at P 8 (test is "based on a comparison of Page 700 of the relevant years"), JA 169; Tesoro Order at P 7 ("Commission relies solely on Page 700 . . . in evaluating this type of complaint."); *accord* 2005 Index Complaint Order at P 9.

If a party alleges that such information on Page 700 is inaccurate (because, for example, the pipeline improperly calculated the costs), it must file a complaint against the pipeline's FERC Form No. 6 itself. *See, e.g.*, 2007 Index Complaint Order at P 9 ("These are mechanical costing and accounting matters that are normally handled as part of the Commission's ongoing audit procedures unless a complainant shows credible grounds to believe that a significant problem is involved."), JA 169; *accord* 2007 Index Rehearing Order at P 9, JA 193.

The most complex inquiry arises from a complaint against a pipeline's base rates — for example, claiming that the pipeline is overrecovering its cost of service. A complaint against base rates, in this context, "can mean two different things, which are not mutually exclusive":

> One is that the cumulative increases from the index-based increases over the years now exceed the cumulative increases in the pipeline's actual costs to the point that the resulting rates are unjust and unreasonable. The second is that the cost components embedded in the pipeline's cost-of-service are improperly defined or no longer accurately measure the pipeline's costs. These can include the specifics of income tax allowances, return, rate base, operating and maintenance expenses, capital structure, and overhead costs, which are the type of factors listed in the complaint.

2007 Index Complaint Order at P 10, JA 169-70. *See also* 2007 Index Rehearing Order at P 8 n.9 (proper challenge to overrecovery "is a complaint against the base rates that are the source of the over-recovery, regardless of whether the over-recovery is caused by the cumulative increases in the index or some more fundamental change in the pipeline's revenues or cost-of-service"), JA 192.

Even where there is no dispute as to the elements of a pipeline's cost of service, a complainant could meet its pleading threshold by showing that index increases, though close enough to actual cost increases to pass review each year, have outpaced those cost increases to the point where the cumulative rate impact has become unjust and unreasonable. *See* 2007 Index Complaint Order at P 10, JA 169. For example, in December 2007, in *America West Airlines, Inc. v. Calnev*

Pipe Line, L.L.C., 121 FERC ¶ 61,241 (2007), the Commission determined that an overrecovery reflected in the pipeline's reported cost data was sufficient to provide reasonable grounds for investigation. *Id.* at P 5 ("A difference of these magnitudes [where revenue figures were approximately 135% of costs] . . . is sufficient to satisfy the . . . threshold standard.").[8] Similarly, in *ARCO v. Calnev Pipe Line, L.L.C.*, 97 FERC ¶ 61,057 (2001), the Commission set for hearing a complaint against an alleged overrecovery resulting from cumulative indexing. *Id.* at 61,311.

Whether a challenge is based on cumulative increases or on disputed cost elements, a proceeding against the pipeline's base rates entails a full cost-of-service inquiry and a determination whether the specific rate is just and reasonable:

> While the indexing method is an efficient method to recover the inflation-driven cost increases occurring in a given year, it is not normally adequate to determine whether any specific rate is just and reasonable. This is because a reasonableness determination requires the detailed regulatory review of the pipeline's individual cost of service and the allocation of those costs among the different services and rates stated in the pipeline's tariff, a process that is clearly not simple.

Calnev, 119 FERC ¶ 61,332 at P 5. For that reason, this third type of complaint proceeding is inconsistent with, and thus handled separately from, the streamlined indexing process. North Line Rehearing Order at P 6 ("[T]he Commission has

---

[8] Though the *America West* complainants also objected to various cost elements embedded in the pipeline's cost of service, the Commission found the cumulative overrecovery alone was enough to find reasonable grounds. *Id.*

consistently held that shippers cannot challenge the appropriateness of the cost-of-service components that underpin a rate in an index proceeding."), JA 126; *cf.* 2005 Index Rehearing Order at P 8 ("Commission policy [as to index cases] precludes an analysis of the reasonableness of the underlying cost of service factors embedded in the pipeline's cost of service, which limits the scope of the proceeding and preserves at least part of the Commission's simplicity goal that is the hallmark of its rate cap indexing methodology.").

The Commission's choice to sort challenges against oil pipelines' rate filings into categories that reflect their differing complexity is a reasonable exercise of its statutory discretion. *Cf. ExxonMobil*, 487 F.3d at 953 ("policy choices about ratemaking are the responsibility of the Commission"); ICA § 13(1) ("[I]t shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall deem proper."). As a general matter, it is within the Commission's broad discretion to determine how best to allocate its resources for the most efficient resolution of matters before it. *See, e.g., Mobil Oil Exploration & Producing Se., Inc. v. United Distrib. Cos.*, 498 U.S. 211, 230 (1991) ("The question of 'how best to handle related, yet discrete, issues in terms of procedures' is a matter committed to agency discretion[]"; lower court "clearly overshot the mark" if it required the agency to resolve a particular issue in a particular proceeding) (internal citations omitted); *N. Border Pipeline*, 129 F.3d at

1319 (same); *Tenn. Valley Mun. Gas Ass'n v. FERC*, 140 F.3d 1085, 1088 (D.C. Cir. 1998) ("An agency has broad discretion to determine when and how to hear and decide the matters that come before it.") (citing cases); *Mich. Pub. Power Agency v. FERC*, 963 F.2d 1574, 1579 (D.C. Cir. 1992) (agencies accorded substantial deference in ordering their proceedings).

III. THE COMMISSION PROPERLY DISMISSED SHIPPERS' COMPLAINTS AGAINST SFPP'S INDEX-BASED RATE INCREASES

A. The Commission Properly Dismissed BP's Complaint Against The 2007 Index Increase [Case No. 08-1237]

The Commission applied the test it had articulated in the 2005 Index Rehearing Order and reasonably concluded that, because SFPP's actual cost increase far exceeded the permitted index increase for 2007, BP's complaint could not show reasonable grounds to conclude that the rate increase was unjust and unreasonable. 2007 Index Complaint Order at P 4, JA 167; 2007 Index Rehearing Order at P 8, JA 192. On appeal, BP contends that the Commission's pleading standard is arbitrary and capricious. Br. 34. But BP misses the central point of the Commission's analysis: that, in keeping with the language of 18 C.F.R. § 343.2(c) and FERC's indexing policy, a complaint against an index increase must focus on the index increase itself.

The applicable FERC regulation requires that a protest or complaint against an indexed rate increase "must allege reasonable grounds for asserting that the rate

violates the applicable ceiling level, or that the rate increase is *so substantially in excess of the actual cost increases* incurred by the carrier that the rate is unjust and unreasonable . . . ." 18 C.F.R. § 343.2(c)(1) (emphasis added); Order No. 561 at 30,955-56, *aff'd*, *Ass'n of Oil Pipe Lines*, 83 F.3d at 1444.[9] Though the 2005 Index Complaint and Rehearing Orders, reinforced by the Tesoro Order, adopted an interpretation that would allow complaints against index increases that add to ("exacerbate") an existing overrecovery of costs, the Commission maintained the regulation's focus on the relationship between the rate increase and the change in actual costs. *See supra* pp. 28-30 (discussing complaints against index filings).

The Commission adopted this interpretation of § 343.2(c)(1) — in a case in which Shippers *met* the standard — to expand the cases where a disparity between the index and the cost increase may be unreasonable. In the usual case, a shipper must make a *prima facie* showing, based on data reported in Form No. 6, of a significant disparity between the rate increase and the actual cost increase (or decrease). *See, e.g.*, *Calnev Pipeline L.L.C.*, 115 FERC ¶ 61,387 at PP 10-11 (2006) (finding ExxonMobil made initial showing based on 11% spread between index increase of 6.15% and actual cost decrease of 4.8%). Under that standard,

[9] Though BP contests the Commission's interpretation of its regulation as to complaints against index increases, BP does not appear to question the validity of § 343.2(c) itself (even assuming it could raise such a collateral attack).

BP's challenge to SFPP's 2007 index increase would fail outright, as SFPP's actual reported costs increased by 15%, far exceeding the 4.3% index ceiling for that year. 2007 Index Complaint Order at P 4, JA 167. Indeed, the Commission rejected BP's protest to SFPP's index filing on that basis. 2007 Index Protest Order at P 6.

In the 2005 index dispute, the Commission allowed a new, alternative basis for challenges by complaint, ruling that "under certain very limited circumstances" a complaint could meet the pleading requirement — even without showing a significant percentage disparity — if the pipeline is already substantially overrecovering its costs. 2005 Index Rehearing Order at P 5; *see also* 2005 Index Complaint Order at P 11. In fact, the Commission found that BP met that standard in the very dispute that BP selectively cites. *See* Br. 17-18, 22 (citing percentages and dollar figures from 2005 index dispute).[10]

---

[10] BP acknowledges that the Commission found reasonable grounds to order a hearing in that case (Br. 18, 33), but glosses over the fact that Shippers' index complaints passed muster *even under the interpretation* set forth in the 2005 Index Rehearing Order (clarifying that the index increase must "substantially exacerbate[]" an overrecovery) — BP even insists that the standard is "virtually impossible" to meet. Br. 18; *cf.* Br. 22 ("an impossible burden for all practical purposes . . . ."), 31-32, 38, 43.

Indeed, BP seems to claim (Br. 22, 31, 41) that the Commission found the divergence between cost increase and index increase in 2005 could not meet the substantial exacerbation test, despite the fact that the Commission *actually found that it did*. *See* 2005 Index Rehearing Order at PP 2, 9 (reaffirming that BP (continued...)

As discussed *supra* at pp. 7-8, the Commission rejected Shippers' protest of SFPP's 2005 index increase because the Commission found the percentage disparity between the 3.63% index factor and a .37% cost increase insufficient to warrant investigation. *Cf.* Br. 18. On BP's complaint against the same increase, however, the Commission expanded its review to consider that the 3.63% rate increase would add $4.5 million to SFPP's existing $16 million overrecovery, far outpacing the $407,000 cost increase, thereby substantially exacerbating that overrecovery. 2005 Index Complaint Order at P 10-11; 2005 Index Rehearing Order at PP 2, 8 (noting rate increase would raise overrecovery by 25%); *supra* pp. 8-9; *cf.* Br. 17, 22 (citing disparity). Thus, the Commission's modified interpretation found grounds for investigation where its usual test would not.

Of course, the Commission was free to revise its interpretation of its own regulation. *See Mich. Pub. Power Agency v. FERC*, 405 F.3d 8, 12 (D.C. Cir. 2005) (holding Commission can change its policy, so long as it explains its reasoning to show the change is deliberate). Moreover, the Commission's expanded interpretation of what constitutes "reasonable grounds" under 18 C.F.R. § 343.2(c) is entitled to substantial deference. *See N. Border Pipeline*, 129 F.3d at

---

"satisfied the standard for filing a complaint against an index[] based increase"; on the facts of that case, "application of the index methodology would substantially exacerbate the over-recovery because the increase substantially exceeded the actual increase (in dollar amount) of the pipeline's costs").

1318. The Commission made clear that the alternative test is a narrow exception to the general rule (*see supra* Part II.B) that the pipeline's return is not considered in the streamlined procedures for challenges to index increases. 2005 Index Rehearing Order at P 5 ("[I]t is reasonable under certain very limited circumstances to compare the rate increase that will result from application of the index methodology to a pipeline's over recovery.").

The Commission realized, however, that its initial statement of the test could have "unintended consequences," improperly sweeping in cases where the index tracked (or lagged behind) actual cost increases and thus did not materially affect the overrecovery: "This could lead to a denial of an index-based increase in a year in which the pipeline's cost increase exceeded or was in the same range as the index amount and thus there was no material change in its return." 2005 Index Rehearing Order at P 9. Indeed, those were the circumstances in a companion proceeding, where the pipeline's index filings "were based on cost increases that were actually more than the increases permitted by the index, [so] that the index increase failed to enable [it] to recover all of its actual cost increases." Tesoro Order at P 7.[11]

[11] In that case, the pipeline reported a 6.3% cost increase and claimed an index increase of 6.14% for one year, and reported a 5.81% cost increase with a 4.3% index increase for another. *Id.* at P 4.

And those are the circumstances in SFPP's 2007 index filing, challenged in the present case, where the 4.3% rate increase ($6 million in revenues) fell far short of recovering a 15.3% increase in actual costs ($16.4 million). 2007 Index Complaint Order at P 4, JA 167; 2007 Index Rehearing Order at P 8, JA 192. Though the rate increase would add revenues to an existing overrecovery (which could be challenged separately in a complaint against the underlying rate), the Commission found that the index increase itself did not materially affect the return. *Id.* & n.9 ("This is true even though the pipeline might continue to over-recover its cost of service as BP West Coast asserted in its complaint"; noting such overrecovery should be challenged in a complaint against the base rates).

In keeping with the language of 18 C.F.R. § 343.2(c), therefore, the Commission reasonably concluded that indexed rate increases that do not exceed cost increases are, by definition, not unjust and unreasonable, and accordingly clarified its pleading standard to require that the index increase must have a material effect: "[F]or the complaint to establish reasonable grounds to conclude that the resulting rate is unjust and unreasonable, it must show . . . that the index[] based increase so exceeds the actual increase in the pipeline's cost that the resulting rate increase would substantially exacerbate th[e] over-recovery." 2005 Index Rehearing Order at P 10. The Commission further explained that its clarified interpretation furthered FERC's policy aims, because it would not serve

the purpose of the indexing methodology to deny an inflation-based increase even if the pipeline's *actual* cost increase exceeded or was close to the index ceiling for a specific year. *Id.* at P 9; Tesoro Order at PP 6-7. *See generally ExxonMobil*, 487 F.3d at 955 (Court defers to Commission's policy choices, as long as they are explained and reasonable).

The 2005 Index Complaint Order also answers BP's present argument that the Commission acted inconsistently in allowing SFPP's index increases to its North Line rates in 2005 and 2006, based on an underrecovery, while also allowing SFPP's index increase to all rates in 2007, despite an overrecovery. Br. 36-38. "Generally, if a pipeline is not recovering its cost of service, the Commission permits the carrier to apply the full increase allowed under the index methodology even if its costs declined, and has held that the resulting rate could not be unjust and unreasonable since the pipeline was not recovering its cost of service." 2005 Index Complaint Order at P 10 (citing *Shell Pipe Line Co.*, 102 FERC ¶ 61,350, *order on reh'g*, 104 FERC ¶ 61,021 (2003)). Hence, as discussed in the next section, the Commission concluded that SFPP's 2005 North Line index increase could not be unjust and unreasonable due to its underrecovery. North Line Complaint Order at P 8 & n.10 (also citing *Shell*), JA 107-08.

B. The Commission Reasonably Dismissed Shippers' Complaint Against The 2005 And 2006 Index Increases To North Line Rates [Case Nos. 07-1163, 07-1164, and 08-1022]

The Commission also appropriately determined that Shippers could not show reasonable grounds to assert that SFPP's 2005 and 2006 increases to its North Line rates were unjust and unreasonable. Again, the Commission based its finding on the relationship between rate increases and actual costs.

Because SFPP had already used the actual cost of service from the previous calendar year (2004) to support its base rate filing, the Commission did not compare the index percentage to the previous year's cost increases, as 18 C.F.R. § 343.2(c) would ordinarily provide. Instead, the Commission considered whether the indexed rate exceeded the cost of service. North Line Index Order at P 8 ("The Commission has consistently permitted oil pipelines to take the full index if they are not recovering their overall cost of service."), JA 107-08; *id.* n.10 ("[T]his is true even if the pipeline experienced a cost decrease in the index year at issue") (citing *Shell*, 102 FERC ¶ 61,350), JA 108. The Commission found that the supporting cost data showed not only that the proposed base rate would not fully recover the cost of service, but also that even the indexed rate for 2005 would fall short of the full cost of service. North Line Index Order at P 8, JA 107; North Line Rehearing Order at P 4 ("Under Commission policy this precludes a finding that the resulting rate is unjust and unreasonable by definition."), JA 125.

Shippers assert that the Commission's decision contradicted the earlier East Line Index Orders, in which the Commission denied SFPP an index increase on the heels of a cost-of-service increase, and that the Commission's decision here marks an unreasonable departure from precedent. Br. 52-53. In the East Line Index Orders, SFPP similarly filed an index increase within a month after filing a cost-of-service increase. *See* 117 FERC ¶ 61,271 at P 1. The Commission rejected that index increase because it found that SFPP, according to its own East Line cost of service filing, was already recovering its full, actual costs for the same period that the index increase was supposed to recover cost increases. *Id.* at P 5 ("the additional revenue from the 2006 index increase of 6.15 percent results in an over-recovery of SFPP's specific East Line costs"); 120 FERC ¶ 61,245 at P 11. Here, however, the Commission reasonably explained that the North Line Index Orders are different because of the continuing underrecovery of the cost of service. North Line Rehearing Order at P 7, JA 126-27; *see also* 120 FERC ¶ 61,245 at PP 7-10 (distinguishing North Line Index Order from East Line case). Thus, the North Line and East Line cases are not "factually identical" (Br. 55) and the Commission reasonably came to different conclusions.

Shippers also contend that the Commission's reliance on SFPP's cost-of-service filing was arbitrary and capricious. Br. 55-56. They point out that, at the time of these orders, an ALJ had already found that certain elements of SFPP's

cost of service for the North Line were overstated. Br. 55 (discussing *SFPP, L.P.*, 116 FERC ¶ 63,059 (2006), *pending on exceptions*, FERC Docket No. IS05-230). Therefore, Shippers argue, the Commission should have set the index filing for a hearing. *See* Br. 55. The Commission disagreed for two reasons. First, the ALJ's decision was (and still is) on review before the Commission and, therefore, did not constitute binding precedent. North Line Index Order at P 10, JA 108.

Second, and more important, the Commission explained that Shippers' attacks on SFPP's underlying cost of service — including their reliance on developments in an ongoing base rate proceeding — demand precisely the sort of complex inquiry that the streamlined indexing process is designed to avoid. North Line Rehearing Order at P 6 ("[T]he Commission has consistently held that shippers cannot challenge the appropriateness of the cost-of-service components that underpin a rate in an index proceeding. Shippers can only advance this rate challenge by a complaint against the base rate."), JA 126; *see also* North Line Index Order at P 10 (attack on underlying cost elements duplicated issues in base rate proceeding), JA 109. Thus, the Commission's rejection of Shippers' arguments was reasonable and consistent with its precedents.

IV. SHIPPERS' REMAINING OBJECTIONS ARE WITHOUT MERIT

Shippers contest the Commission's treatment of their complaints in these indexing cases on a variety of grounds. BP contends that shippers can no longer

challenge index increases at all, that the Commission's pleading standard denies shippers due process, that complaints against base rates are too burdensome, and that the Commission's policy requires shippers to file three or four complaints, including a base rate complaint, every year. Both Shippers argue that the Commission unquestioningly accepts pipelines' claimed costs of service and that refunds resulting from base rate cases do not remedy improper index increases. Shippers' arguments fail on all counts.

A. The Commission Has Not Foreclosed Challenges To Indexed Rates

1. BP's Claim Of Futility Is Provably False

As a procedural matter, BP claims that the Commission has eliminated all avenues for shippers to contest indexed rate increases. Br. 20, 24 (arguing such challenges are "virtually impossible"); *id.* 19, 40, 43 (asserting Commission will not consider protests). But this claim is demonstrably untrue — as shown most notably by Shippers' own success in the 2005 Index Complaint and Rehearing Orders. BP's and ExxonMobil's own complaints against this same pipeline's 2005 index increase proved beyond question that shippers can meet the Commission's standard — indeed, the Commission formulated its revised interpretation of 18 C.F.R. § 343.2(c) in the course of ruling that BP had provided reasonable grounds for further inquiry. Its complaint, together with ExxonMobil's similar complaint, was set for hearing, and both Shippers ultimately reached a settlement with SFPP.

See supra p. 11; *see also* 2007 Index Rehearing Order at P 8 & n.10 ("Since the Commission has clearly permitted complaints against yearly index increases, BP West Coast's second assertion, that the Commission is precluding any complaint against index-based increases, is unfounded.") (citing hearing on Shippers' 2005 index complaints), JA 192.

In addition to the 2005 index dispute, the Commission also has initiated other investigations based on both protests and complaints. For example, in *Calnev,* 115 FERC ¶ 61,387, *cited in* 2007 Index Rehearing Order at P 8 n.10, JA 192, the Commission found that ExxonMobil had met the burden of production in an ICA § 15(7) protest to Calnev's 2006 indexed rate filing. Calnev sought to increase its rates by the ceiling index amount, but reported a decrease in its costs. 115 FERC ¶ 61,387 at P 5. The Commission considered the difference between the inflation-based increase and the actual change in costs and concluded that ExxonMobil had "presented reasonable grounds to call into question whether Calnev's rate increase is so substantially in excess of the actual cost increases incurred that the rate is unjust and unreasonable." *Id.* at P 11. The Commission therefore set the matter for hearing and settlement judge procedures. *Id.* at PP 11-12.

2. The Commission Properly Declines To Hold An Evidentiary Hearing Where A Complaint Fails To Show Reasonable Grounds

BP goes on to claim that the Commission's (supposed) rejection of all challenges to indexed rate filings contravenes the Interstate Commerce Act and deprives complainants of due process. Br. 39-40, 42-47. If BP means to contend that *every* challenged index filing must be subject to a full investigation and evidentiary hearing, if not on a protest then on a complaint (*see, e.g.*, Br. 40-41), it is again wrong. *See* North Line Rehearing Order at P 4 (shippers' argument that Commission improperly denied hearing "appears premised on an assumption that complainants are *entitled* to challenge the lawfulness of an index-based rate increase. This is incorrect. Complainants must demonstrate reasonable grounds . . . .") (emphasis added), JA 125.

The Commission reasonably imposes a threshold standard under 18 C.F.R. § 343.2(c), as an exercise of its statutory discretion under the ICA and its general discretion to order its own proceedings. *See Ass'n of Oil Pipe Lines*, 83 F.3d at 1428, 1444 (upholding indexing scheme, including protest and complaint procedures); *see also Mobil Oil*, 498 U.S. at 230; *supra* p. 33-34.[12] Moreover, the

[12] The Commission has not, as BP contends (Br. 20, 39-40), improperly shifted the burden of proof in index cases onto shippers. In *Association of Oil Pipe Lines*, this Court addressed the "reasonable grounds" standard as the burden of production in protests under ICA § 15(7); the instant cases, however, arose from complaints (continued...)

Interstate Commerce Act does not guarantee that the Commission will hold an evidentiary hearing on every complaint regardless of whether it states reasonable grounds. *See* ICA § 13(1) ("[I]t shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall deem proper."). Rather, the statute gives the Commission reasonable discretion to prescribe the format of complaints, and if complaints do not set forth the elements required by the rules, the Commission can dismiss them, just as courts dismiss complaints for failure to state a cause of action.

Nor has the Commission guaranteed a hearing on every complaint filed by shippers. *Contra* Br. 40 & n.116. BP mistakenly bases its claim of such a commitment on FERC counsel's reference (at oral argument in Case No. 05-1471) to the Supreme Court's observation in *Southern Railway*, in holding denials of protests to rate filings to be unreviewable, that the Commission's decision not to

---

under ICA § 13(1), under which complainants have always had the burden of proof. *See S. Ry. Co. v. Seaboard Allied Milling Corp.*, 442 U.S. 444, 454-55 (1979).

This Court's statement that judicial review would be available if the Commission "shifted the burden of proof in a specific section 15(7) protest" (83 F.3d at 1444) implies no change in that settled law. By its terms it was limited to the § 15(7) context, and referred to review of FERC decision on the merits after an investigation. *Cf. S. Ry.*, 442 U.S. at 452, 454 (though statute precludes review of agency decision not to investigate upon protest, decision on rates issued after investigation remains reviewable).

hold a hearing on a shipper complaint *is* subject to judicial review. 442 U.S. at 454 ("[We are not] holding entirely unreviewable the Commission's exercise of its rate-investigation authority. For any shipper may require the Commission to investigate the lawfulness of any rate at any time — and may secure judicial review of any decision not to do so — by filing a § 13(1) complaint."). Accordingly, as in the instant case, the shipper may appeal the FERC order on complaint and the Commission must provide a reasonable explanation for its decision that a hearing was not warranted.

Moreover, BP erroneously states that the Commission "summarily dismiss[ed]" its complaints in these cases. Br. 2, 20. To the contrary, the Commission addressed the substance of the claims and found that the complaints failed to show reasonable grounds for investigation within the scope of the indexing regulations — and extensively explained its reasoning. *Cf.*, *e.g.*, *Nat'l Ass'n of Broadcasters v. FCC*, 569 F.3d 416, 425 (D.C. Cir. 2009) (holding extent of agency's explanation distinguished case from one where agency had "summarily dismissed" data).

B. The Commission's Separation Of Index Complaints From Challenges To Underlying Rates Is Consistent With The Interstate Commerce Act

BP also argues that the Commission's pleading requirement for index complaints, under which a pipeline's existing overrecovery of its costs does not categorically preclude an inflation-based rate increase (absent substantial exacerbation), violates the statutory just and reasonable standard. *See* Br. 19, 32-33. Shippers, however, misunderstand the relationship between base rates and index increases (and challenges to each). The base rate must be a just and reasonable rate; the indexing process is an efficient methodology for maintaining the real economic value of that base rate from year to year and thus maintaining a rate within the zone of reasonableness, by accounting for effects of inflation, until the next full consideration of the base rate itself (whether on the pipeline's own rate filing or on a shipper's complaint). *See supra* pp. 24 (discussing Order No. 561 at 30,950), 26 (discussing indexed rates within zone of reasonableness). Therefore, BP's argument is rooted in its disagreement with the Commission's rate policy choices, which, as set forth *supra* in Part II, are a reasonable exercise of the Commission's statutory discretion under the Interstate Commerce Act.

Moreover, both BP's arguments regarding multiple complaints (Br. 43-44) and Shippers' arguments regarding refunds and reparations (Br. 58-59) reflect their misunderstanding of the Commission's procedures.

1. Refunds And Reparations

As the Commission explained in the North Line Index Order, "[t]he Commission's indexing regulations provide that if the underlying base rate is subject to refund, any increase under the index is automatically subject to refund." *Id.* at P 11 & n.15 (citing 18 C.F.R. § 342.3(a)), JA 109; *accord* North Line Rehearing Order at P 5 ("the index-based increase at issue here is also fully subject to refund if the indexed component of any new rate would result in a rate that is unjust and unreasonable"), JA 126. Shippers argue that the Commission was wrong and that the full index increases to the North Line rates would not be subject to refund if the Commission were ultimately to determine, in the separate base rate proceeding, that SFPP had overstated its cost of service. Br. 58-59 & n.163 (citing *SFPP, L.P.*, 113 FERC ¶ 61,277 at P 129 (2005)).

But Shippers incorrectly rely on Commission precedent regarding reparations, not refunds; the order they cite concerned a complaint against SFPP's existing base rates — not a § 15 investigation, subject to refund, of a newly filed rate, such as the North Line base rate proceeding. *See* North Line Index Order at P 11, JA 109. Therefore, if Shippers are correct that SFPP is overrecovering its North Line cost of service and thus charging an excessive rate, their concerns can be addressed in the ongoing investigation of SFPP's North Line base rate filing — including the 2005 and 2006 North Line index increases.

The treatment of index increases differs where the underlying rate is investigated pursuant to a complaint under ICA § 13.[13] When a shipper successfully challenges a pipeline's base rate by complaint, resulting in a Commission finding that the rate is unjust and unreasonable, the Commission will determine the just and reasonable rate and then adjust the rate going forward by multiplying that new, lawful base rate by the inflation-based index for each year. *See* 18 C.F.R. § 342.3(d)(5). If the pipeline has been charging an excessive rate, the Commission will order reparations not only of the excess in the base rate but also of the annual increases. *See SFPP*, 121 FERC ¶ 61,163 at P 5.

Based on that method for calculating reparations, Shippers object that each index increase results in a "permanent percentage rate increase" that cannot be undone. *See* Br. 22, 58-59. The percentage of each index increase is merely an inflation factor, applied industry-wide; its impact on a pipeline's rates depends entirely on the underlying (base) rate by which it is multiplied — an underlying rate that may be reduced by a successful challenge either to the cost of service or to the cumulative effect of index increases that outpace actual cost increases over several years. *See generally supra* Parts II.A.1 and II.B. Nevertheless, a shipper

[13] Another difference is that refunds arising from an investigation of a newly-filed rate inure to all shippers, whereas reparations resulting from a complaint proceeding are available only to complainants. *See SFPP, L.P.*, 121 FERC ¶ 61,163 at PP 5-6 (2007) (explaining difference).

can preserve its challenge to that percentage factor by filing a complaint directed to the index increase, without attempting to bootstrap cost-of-service disputes into the indexing process. *See* 2007 Index Rehearing Order at P 10, JA 193.

2. Complaints Against Base Rates And Indexed Rates

The Commission has not, as BP claims (Br. 19, 22-23, 41-43), suggested that a shipper must file a new complaint against a pipeline's cost-of-service rate every year to preserve its objections. To the contrary, the Commission has repeatedly explained that a party can challenge the cost-of-service elements embedded in a pipeline's base rates, or cumulative index increases that result in overrecovery, in a complaint against the base rate, then (as noted above) preserve its right to reparations in subsequent rate years by filing protests or complaints against the index increases. *See supra* Part II.B. "This may be repetitive, but it is intrinsic to the indexing procedure and enables the challenges that BP West Coast claims it cannot make." 2007 Index Rehearing Order at P 10, JA 193.

Furthermore, such an index complaint is far less complicated than a base rate complaint. *See supra* Part II.B. And even as to the index complaint, the burden on shippers is even less than BP apprehends — because index filings are subject to a two-year statute of limitations under 49 U.S.C. app. § 16(3)(b), even a shipper that wishes to dispute every annual index filing by a pipeline need only file an index

complaint every two years, challenging two annual filings in each complaint.[14] Accordingly, even the most litigious shipper could satisfy the Commission's distinct pleading requirements with far fewer, and far simpler, filings than BP contends.

C. The Commission Reasonably Relies On Pipelines' Mandatory Cost Reporting In Index Cases

In these appeals, Shippers argue that the Commission improperly treats a pipeline's cost reporting as inviolate, contrary to this Court's holding in *Frontier*. *See* Br. 17, 21-22, 26-27, 35, 54-55. Shippers are wrong in several respects.

First, as discussed in Part II.A.2, *supra*, the Commission refers to publicly available cost data that the pipeline must report in compliance with detailed FERC regulations, using a prescribed methodology and standardized format — not, as Shippers imply (*see* Br. 26, 54), on self-serving claims and subjective, inscrutable figures that the pipeline cherry-picks and compiles to support a particular filing. *See* 18 C.F.R. § 346.2; Order No. 571 at 31,168-70; *see also* 2007 Index Rehearing Order at P 9 (noting that "many of the important source numbers are reflected in

[14] As to the remaining category of complaints, challenging the pipeline's mechanical calculations or accounting errors in its annual cost reporting, a shipper may file such a complaint if it can show reasonable grounds to do so. *See supra* p. 30. BP's contention that a shipper must file such a complaint every year (Br. 43) apparently assumes that a pipeline would consistently make such errors on every FERC Form No. 6, without correction by the Commission's auditing process or imposition of civil or criminal penalties for purposeful errors.

the detailed numbers in the pipeline's FERC Form No. 6"), JA 193; *cf. ARCO*, 97 FERC at 61,311 (setting case for hearing because complainant had shown grounds based on data on Page 700, even without having been given opportunity to review pipeline's workpapers). Indeed, the Commission designed its cost reporting requirements to provide exactly the cost information that it considered necessary in evaluating indexed rate filings under its streamlined procedures. *See supra* Part II.A.2 (discussing interrelation of Order Nos. 561 and 571).[15]

Moreover, in addition to the Commission's own auditing procedures, parties can challenge the validity of a pipeline's calculations or accounting procedures by bringing a separate complaint. *See* 2007 Index Complaint Order at P 9, JA 169; 2007 Index Rehearing Order at P 9, JA 193; *supra* p. 30.

As Shippers' arguments make clear, however, their objection to the Commission's reliance on data reported on FERC Form No. 6 is only a variation of

---

[15] The Commission's use of Page 700 for this purpose is not inconsistent with *Frontier*, which did not involve an index proceeding and did not address the "reasonable grounds" threshold under 18 C.F.R. § 343.2(c) or the cost reporting requirements established in Order No. 571. In *Frontier*, the Commission had (after an investigation) determined a joint rate to be unlawful and ordered reparations, based on cost-of-service evidence regarding only one of the joint rate's segments, without allowing the pipelines to defend the reasonableness of the joint rate. 452 F.3d at 780-81, 787. In the context of rate indexing, by contrast, the Commission relies on data provided in mandatory annual cost reports only for the purpose of screening the extent of divergence between inflation-based rate increases and actual cost increases to determine whether further investigation is warranted. *See supra* Part II.A.2.

their insistence on the right to litigate underlying cost-of-service issues in every index case. *E.g.*, Br. 21 ("in the index complaint, shippers still cannot challenge the *cost claims* of the pipeline"), 26 ("SFPP's unilateral and unexamined claims *as to its cost-of-service*"), 27 ("[FERC] accepted SFPP's claimed cost of service without providing Petitioners an opportunity to challenge the [index] increase *on grounds that SFPP had overstated its cost-of-service*"), 54 ("unquestioning acceptance of this *cost-of-service data*") (all emphases added).

For that reason, the Commission appropriately rejected Shippers' efforts to turn the index proceedings into full-blown cost-of-service cases. In the 2007 Index Complaint Order, the Commission observed that BP "purports to assert numerous errors with the cost figures that underpin Page 700 of SFPP's 2006 FERC Form No. 6" — but those "errors" included "the excessive return on equity based on the risk assumptions included in the equity cost-of-capital, phantom income tax allowances, inflated equity ratios, improper purchase accounting adjustments, padded operation and maintenance expenses, inclusion of subjective reserves, and improper costs from parents and affiliates." *Id.* at P 6, JA 168. Those are substantive attacks on the cost elements embedded in SFPP's underlying rate structure; therefore, the Commission appropriately concluded that BP's arguments must be raised in a challenge to the base rate, not in an index case. *Id.* ("[T]hese are generic cost issues that address how [SFPP's] cost-of-service is constructed and

are not properly raised by a complaint against an increase for a single year."); *accord* North Line Index Order at P 10 ("the fact-based issues advanced by the [Shippers] . . . go to the merits of the issues" in the separate base rate proceeding; "As such, the complainants are simply duplicating the matters at issue in that [base rate] proceeding . . . ."), JA 109.

D. Cost-of-Service Ratemaking Proceedings Are Complex And Time-Consuming By Nature, Not Due To Commission Delay

BP contends that a complaint against the underlying rate (which BP calls a "general complaint") is difficult to pursue because it is: (1) expensive, requiring consideration of the entire cost of service, with expert witnesses and prolonged litigation; (2) futile, because a pipeline has no incentive to minimize expenses and because each complaint would reach only a single year's index increase; and (3) illusory because the Commission allows such cases to "languish[]." Br. 23-25, 44-45, 48-49.

On the first point, BP is exactly right: *of course* base rate cases are difficult and complex — which is precisely why the Commission has consistently rejected Shippers' efforts to shoehorn cost-of-service challenges into index proceedings. *See, e.g.*, *Calnev*, 119 FERC ¶ 61,332 at P 5 ("[A] reasonableness determination requires the detailed regulatory review of the pipeline's individual cost of service and the allocation of those costs among the different services and rates stated in the pipeline's tariff, a process that is clearly not simple."); *supra* Part II.B. Shippers

have repeatedly tried to bypass the extensive litigation that a cost-of-service case can entail by seeking to challenge, via index protests and complaints, the validity of various cost elements embedded in SFPP's rates — most notably a contentious cost-of-service issue that has already been the subject of two appeals to this court from an SFPP base rate proceeding. *See BP W. Coast Prods., LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004), *after remand*, *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007). That strategy, if successful, would defeat the streamlining that Congress demanded in the Energy Policy Act of 1992 and that the Commission implemented in Order No. 561. *See supra* pp. 5-6.

The inherent complexity of a base rate proceeding — and, of particular relevance here, extensive litigation (hard-fought by these same Shippers) regarding SFPP's cost of service — refutes BP's accusation that the Commission allows rate proceedings to languish. *See*, *e.g.*, *BP W. Coast*, 374 F.3d at 1271 (describing "lengthy, complex, and convoluted proceedings"). BP's chart of pending rate cases[16] is misleading on this point: while a number of pipeline filings and shipper complaints have indeed been pending before the Commission for several years (shown in red), that is because the pipelines and shippers have been litigating cost-

16 The Commission will not try to address all of Shippers' representations in the (newly created for this appeal) chart appended to their brief, and does not concede the accuracy or completeness of those representations.

of-service issues. (Hence the chart's reflection of the two appeals (shown in white) and references to the "7/20/04 Remand" [*i.e.*, *BP West Coast*, 374 F.3d 1263] and the "5/29/07 Remand" [*i.e.*, *ExxonMobil*, 487 F.3d 945].) The Commission has, quite understandably, held numerous rate proceedings in abeyance pending the ultimate resolution of those central disputes, some of which date back at least a decade. *See, e.g., SFPP, L.P.*, 86 FERC ¶ 61,022 (1999), *vacated by BP West Coast*.[17]

Finally, BP mistakes the Commission's procedures: as discussed *supra* at p. 52, the Commission has repeatedly explained that a complaint against cumulative increases or cost of service need only be filed once, with the resulting adjusted base rate then carried forward in recalculating indexed rates for subsequent periods. *See, e.g., SFPP, L.P.*, 115 FERC ¶ 61,388 at P 12 (2006) (referencing separate, ongoing complaint proceeding against base rates); *SFPP, L.P.*, 96 FERC ¶ 61,332 at 62,272 (2001) (same), *both cited in* 2007 Index Complaint Order at P 12 n.13, JA 170. In claiming that a shipper must file a new, separate "general complaint" against the base rate every year, BP misapprehends the Commission's orders.

---

[17] Nevertheless, BP's claim that pipelines have no incentive to resolve cases fails to account for SFPP's resolution of some proceedings by settlement — such as Shippers' complaints against the 2005 index increase.

CONCLUSION

For the reasons stated, the petitions should be denied and the challenged FERC Orders should be affirmed in all respects.

Respectfully submitted,

Christine A. Varney
Assistant Attorney General

John J. Powers, III
Robert J. Wiggers
Attorneys

U.S. Department of Justice
Washington, D.C. 20530
(202) 514-2460

Cynthia A. Marlette
General Counsel

Robert H. Solomon
Solicitor

Carol J. Banta
Attorney

Federal Energy Regulatory Commission
Washington, DC 20426
(202) 502-6600

July 6, 2009
Final Brief: August 25, 2009