ORAL ARGUMENT HAS NOT YET BEEN SCHEDULED

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

Nos. 05-1471 and 05-1472 (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

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CIRCUIT RULE 28(A)(1) CERTIFICATE

A. Parties and Amici

To counsel's knowledge, all parties are presented in Petitioners' brief.

B. Rulings Under Review

1. Order Accepting and Suspending Tariffs, Subject to Refund and Conditions, *SFPP, L.P.*, 111 FERC ¶ 61,510 (June 30, 2005) ("Initial Order"), R. 8, JA 97; and

2. Order on Rehearing, *SFPP, L.P.*, 113 FERC ¶ 61,253 (Dec. 12, 2005) ("Rehearing Order"), R. 16, JA 149.

C. Related Cases

This case, regarding SFPP's indexed rates filed in 2005, has not previously been before this Court or any other court. *ExxonMobil Oil Corp. v. FER*C, Nos. 04-1102, *et al.* (consolidated); *ExxonMobil Oil Corp. v. FERC*, Nos. 06-1008 et al. (consolidated); and *SFPP L.P. v. FERC*, Nos. 02-1112, *et al.* (consolidated) are related to this proceeding as they concern SFPP's underlying rates and involve some of the same issues. Also related is *Canadian Association of Petroleum Producers v. FERC*, No. 05-1382, which concerns the Commission's *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005). In addition, *ExxonMobil Oil Corp. v. FERC*, No. 06-1273, concerns Commission orders regarding SFPP's indexed rates filed in 2006.

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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**

STATUTES:

TABLE OF AUTHORITIES

STATUTES (continued): **PAGE**

REGULATIONS:

GLOSSARY

Br.	Petitioners' Brief
Commission or FERC	Federal Energy Regulatory Commission
East/West Lines Rates Order	*SFPP, L.P.*, 113 FERC ¶ 61,277 (2005)
EPAct	Energy Policy Act of 1992
ExxonMobil	Petitioner ExxonMobil Oil Corporation
FERC Orders	Collectively, Initial Order and Rehearing Order
Form 6	FERC Form No. 6, Annual Report for Oil Pipelines
ICA	Interstate Commerce Act
ICC	Interstate Commerce Commission
Indicated Shippers	Petitioners ExxonMobil Oil Corporation and BP West Coast Products LLC
Initial Order	Order Accepting and Suspending Tariffs, Subject to Refund and Conditions, *SFPP, L.P.*, 111 FERC ¶ 61,510 (June 30, 2005), R. 8, JA 97
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. 561-A	*Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, Order No. 561-A, FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 31,000 (1994)

GLOSSARY

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)
Page 700	FERC Form No. 6, Page 700, Annual Cost of Service Based Analysis Schedule
PPI	Producer Price Index for Finished Goods
Rehearing Order	Order on Rehearing, *SFPP, L.P.*, 113 FERC ¶ 61,253 (Dec. 12, 2005), R. 16, JA 149
Remand Order	*SFPP, L.P.*, 111 FERC ¶ 61,334 (2005)
SFPP	Intervenor SFPP, L.P.
2001 SFPP Index Order	*SFPP, L.P.*, 96 FERC ¶ 61,332 (2001)
2003 SFPP Index Order	*SFPP, L.P.*, 102 FERC ¶ 61,344 (2003)
2004 SFPP Index Order	*SFPP, L.P.*, 107 FERC ¶ 61,334 (2004)
2006 SFPP Index Order	*SFPP, L.P.*, 115 FERC ¶ 61,388 (2006)

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BP WEST COAST PRODUCTS LLC,
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v.

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

STATEMENT OF THE ISSUES

1. Whether the determination of the Federal Energy Regulatory Commission ("Commission" or "FERC") not to initiate an investigation of a pipeline company's indexed rate increase filing, under § 15(7) of the Interstate Commerce Act, is reviewable.

2. Whether, assuming its determination is reviewable, the Commission reasonably determined that the Petitioners (pipeline customers) failed to meet their *prima facie* burden, in a protest against a pipeline company's indexed rate increase, of alleging reasonable grounds for asserting that the proposed rate increase was so substantially in excess of the pipeline's actual cost increases that the rate was unjust and unreasonable.

COUNTERSTATEMENT OF JURISDICTION

Petitioners ExxonMobil Oil Corporation ("ExxonMobil") and BP West Coast Products LLC (together, "Indicated Shippers") ask the Court to reverse the challenged FERC orders and to mandate that the Commission conduct a hearing on an oil pipeline rate increase filed by SFPP, L.P. ("SFPP"). As set forth more fully *infra* in Part I of the Argument, however, the Commission's determination not to initiate an investigation under § 15(7) of the Interstate Commerce Act, 49 U.S.C. App. § 15(7), of a rate filing is not reviewable.

STATUTORY AND REGULATORY PROVISIONS

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

INTRODUCTION

This case concerns the protest by the Indicated Shippers against an oil pipeline rate increase filed by SFPP in accordance with the Commission's rate indexing procedure. In short, SFPP filed a proposed rate increase for 2005 of approximately 3.63 percent, which was within the industry-wide indexed ceiling permitted by the Commission for that year; SFPP also filed supporting data reflecting an actual increase of 0.37 percent in its total costs of service from 2003 to 2004. The Commission determined that the difference between the indexed rate increase and the actual cost increase was not so substantial as to render the indexed rates unjust and unreasonable, and thus declined to set the matter for hearing.

It is important to emphasize what this case is not. This case does not involve an assessment of whether SFPP's underlying rates are just and reasonable, or whether SFPP's costs of service properly include an income tax allowance. Not only is such an assessment beyond the scope of a streamlined index proceeding, but in fact those very questions are presently pending in other proceedings before the Commission and this Court. Nor does this case involve a Commission determination on the merits whether the rate increase for 2005 was just and reasonable. In accepting indexed rate filings under the streamlined indexing scheme, the Commission does not engage in comprehensive cost-of-service ratemaking.

The only question before the Court in this case is whether the Commission reasonably found that the Indicated Shippers had failed to make a *prima facie* case that SFPP's proposed rate increase diverged so substantially from its actual cost increases that the rate was unjust and unreasonable.

The Commission contends, however, that the Court need not reach even that simple question, because the Commission's determination not to initiate an ICA § 15(7) investigation is unreviewable. Furthermore, separate FERC proceedings concerning the underlying rates have resulted in reductions in those rates, thus reducing the actual 2005 rates challenged by the Indicated Shippers in this case for most of the affected services.

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). 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 ("ICC") 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.

In 1985, the Commission established a fairly traditional cost-of-service methodology for determining oil pipeline rates. *Williams Pipe Line Company*, Opinion No. 154-B, 31 FERC ¶ 61,377 at 61,833 (1985). Following Opinion No. 154-B, adjudicated 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*, *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996) ("*AOPL*").

Accordingly, Congress passed the Energy Policy Act of 1992 ("EPAct"),[1] requiring FERC to simplify its oil pipeline ratemaking methodology and streamline its ratemaking procedural rules "in order to avoid unnecessary costs and delays." Order No. 561 at 30,944.

Sections 1801 and 1802 of the EPAct required the Commission to promulgate regulations establishing "a simplified and generally applicable ratemaking methodology . . . in accordance with section 1(5) of the [ICA]" for oil pipelines. Order No. 561 at 30,944. In 1993, the Commission issued Order No. 561, in which it adopted a methodology for oil pipelines to adjust their rates through use of an index system that establishes ceiling levels for such rates. *See* Order No. 561 at 30,940-41; *see also* 18 C.F.R. § 342.3 (methodologies and procedures for indexed rate changes). *See generally AOPL*, 83 F.3d at 1430-31; Argument Section II.B, *infra* (discussing indexing scheme).

The ICA sets forth procedures for parties to challenge pipelines' rates. *See* ICA §§ 13(1) (providing for complaints to Commission against carriers for ICA violations), 15(1) (authorizing Commission to prescribe just and reasonable rates if it determines, "after full hearing" upon a § 13 complaint or upon an investigation undertaken on the Commission's own initiative, that a carrier's rates are unjust and

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

unreasonable), 15(7) (authorizing Commission, upon complaint or upon its own initiative, to hold hearing concerning lawfulness of newly filed rate and, at its discretion, to suspend the rate pending such hearing).[2] 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 a proposal for 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).

II. FERC Proceedings Concerning SFPP's Rates

This appeal involves two Commission orders issued in the protracted series of rate disputes between SFPP and customers shipping over its various oil

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[2] Specifically, § 15(7) provides:

> Whenever there shall be filed with the Commission any schedule stating a new . . . rate, . . . the Commission shall have, and it is given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested carrier or carriers, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate . . . ; and pending such hearing and the decision thereon the Commission, upon filing with such schedule and delivering to the carriers or carriers affected thereby a statement in writing of its reasons for such suspension, may from time to time suspend the operation of such schedule and defer the use of such rate, . . . but not for a longer period than seven months beyond the time when it would otherwise go into effect . . . .

pipelines. SFPP's indexed tariff filings in 2005 covered six different SFPP interstate services: the East Line between El Paso and Phoenix; the West Line between Los Angeles and Phoenix; the North Line between Oakland and Reno; the Oregon Line beginning in Portland; the Watson Station Drain Dry charges; and the Sepulveda Line in Los Angeles. As of December 31, 2004, the underlying rates for all of these services were in litigation in other FERC proceedings. Those proceedings either continue or have since been resolved, as follows:

East Line. The East Line rates are being litigated in FERC Docket Nos. OR92-8 and OR96-2. Those rates were reduced effective May 1, 2006 using a 1999 cost-of-service indexed forward to that date, pursuant to the Commission's December 16, 2005 order in those dockets. *See SFPP, L.P.*, 113 FERC ¶ 61,277 (2005) ("East/West Lines Rates Order"). SFPP submitted a compliance filing on March 7, 2006 in those dockets; shippers have challenged how SFPP calculated the index. Moreover, SFPP filed new East Line rates on May 1, 2006, which were effective June 1, 2006, subject to suspension and refund, in FERC Docket No.

IS06-283. *See SFPP, L.P.*, 115 FERC ¶ 61,279 (2006).[3]

West Line. SFPP's West Line rates are also being litigated in FERC Docket Nos. OR92-8 and OR96-2. Those rates were reduced effective May 1, 2006, using a 1999 cost-of-service indexed forward to that date, pursuant to the East/West Lines Rates Order. Shippers have likewise challenged SFPP's calculation of the index in developing the new West Line rates. Thus, the revised West Line rates are under challenge for the years after 2000 in FERC Docket Nos. OR04-3, OR05-4, and OR05-5.

North Line. The North Line rates were held to be grandfathered through 1999 in FERC Docket Nos. OR92-8 and OR96-2. *See SFPP, L.P.*, 111 FERC

[3] This means the East Line rates effective May 1, 2006 now reflect a one-month locked-in period that remains contested, but the rate is no longer in effect. The rates previously in effect from August 1, 2000 until April 30, 2006 were based on a 1994 cost of service indexed forward to August 1, 2000, and are Commission-prescribed just and reasonable rates subject to the *Arizona Grocery* doctrine. *See Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370, 384 (1932). Because such just and reasonable base East Line rates may be changed only prospectively, the only issue in that proceeding with regard to the East Line rates for the period from 1994 to 2006 is whether application of the indexing method resulted in increases that were substantially in excess of SFPP's actual increase in East Line costs during the same period.

The new East Line rates that became effective on June 1, 2006, are based on SFPP's actual 2005 cost of service.

¶ 61,334 (2005) ("Remand Order").[4] Those rates remain subject to further challenge in FERC Docket Nos. OR05-4 and OR05-5 for the period after 2000. In addition, SFPP filed new North Line rates, effective June 1, 2005, in FERC Docket No. IS05-230. *See SFPP, L.P.*, 111 FERC ¶ 61,299 (2005) (accepting and suspending rates and setting for hearing). SFPP based those proposed rates on its costs-of-service for a test period of January 1 through September 2005. *Id.* PP 3-4. An administrative law judge issued an initial decision on the filing on September 25, 2006. *See SFPP, L.P.*, 116 FERC ¶ 63,059 (2006).

Oregon Line. SFPP's Oregon Line rates were held to be grandfathered through 1999 in the aforementioned Remand Order, which concluded that it is unlikely the Oregon Line was recovering its full cost-of-service between 1992 and 1999. These rates are subject to further challenge in FERC Docket Nos. OR05-4 and OR05-5 for the period after 2000.

Sepulveda Line. The Sepulveda Line rates are the subject of complaints filed in 1995 and a common carrier rate filed in 1996, which has been subject to refund since that date, under FERC Docket Nos. OR96-2 and OR98-1. A FERC

[4] The Remand Order, which is the subject of another appeal currently pending before this Court in Case Nos. 04-1102, *et al.*, addressed both the remand from this Court following *BP West Coast Products, LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004), and requests for rehearing of an earlier order concerning application of the *Policy Statement on Income Tax Allowances*, 111 FERC ¶ 61,139 (2005) ("*Policy Statement*"), to SFPP's inclusion of an income tax allowance in its rates. *See* 111 FERC ¶ 61,334 (2005). *See* Argument Section III, *infra*.

administrative law judge found these rates unjust and unreasonable in a decision issued August 25, 2005. *See Texaco Refining and Marketing Inc. v. SFPP, L.P.*, 112 FERC ¶ 63,020 (2005). That decision is now pending on exceptions before the full Commission.

Watson Station. Numerous dockets involving the Watson Station drain dry charges, including charges that had been raised in FERC Dockets No. OR04-3, OR05-4, and OR05-5, were consolidated into a single case in FERC Docket No. OR92-8. The Watson Station charges were resolved in a settlement that was approved by letter order in August 2006. *See SFPP, L.P.*, 116 FERC ¶ 61,116 (2006).

Other SFPP Index Filings. In addition, each annual indexed tariff filing submitted by SFPP has been addressed in a separate FERC docket. *See, e.g., SFPP, L.P.*, 115 FERC ¶ 61,388 (2006) ("2006 SFPP Index Order") (accepting 2006 index filing in FERC Docket No. IS06-356), *appeal pending*, D.C. Cir. No. 06-1273; *SFPP, L.P.*, 107 FERC ¶ 61,334 (2004) ("2004 SFPP Index Order") (accepting 2004 index filing in FERC Docket No. IS04-323); *SFPP, L.P.*, 102 FERC ¶ 61,344 (2003) ("2003 SFPP Index Order") (accepting 2003 index filing in FERC Docket No. IS03-131); *SFPP, L.P.*, 96 FERC ¶ 61,332 (2001) ("2001 SFPP Index Order") (accepting 2001 index filing in FERC Docket No. IS01-292). The FERC orders challenged in this appeal accepted SFPP's 2005 index filing in FERC

Docket No. IS05-327.

III. FERC Proceedings And Orders Challenged In This Appeal

A. SFPP's Index Filing And FERC's Initial Order

On May 31, 2005, SFPP filed FERC Tariff Nos. 112, 113, 114, 115, 116, and 117 pursuant to the Commission's indexing methodology adopted under Order No. 561 and 18 C.F.R. § 342.3. R. 1, JA 1.[5] SFPP also filed FERC Tariff No. 118, which is an Index of Tariffs.[6] SFPP proposed that the tariffs be effective July 1, 2005. *Id.*

The Indicated Shippers protested the filing, arguing that SFPP did not qualify for an indexed rate increase because such an increase was substantially in excess of any actual cost increases incurred by SFPP. R. 2. Other entities, who are not parties to this appeal, filed comments asking the Commission to reject SFPP's filing or, in the alternative, to accept it subject to refund. R. 3, 4.

On June 30, 2005, the Commission issued its Order Accepting and

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[5] "R." refers to a record item. "JA" refers to the Joint Appendix page number. "P" refers to the internal paragraph number within a FERC order.

[6] SFPP indicated that Tariff No. 112 covers SFPP East Line interstate movements; Tariff No. 113 covers SFPP West Line interstate movements; Tariff No. 114 covers SFPP Oregon Line interstate movements; Tariff No. 115 covers SFPP interstate movements from Watson and East Hynes to Calnev Pipe Line, L.L.C.; Tariff No. 116 covers SFPP interstate movements from Sepulveda Junction to Watson; and Tariff No. 117 covers SFPP North Line interstate movements. Tariff No. 118 is an index of tariffs and does not contain any rates. *See SFPP, L.P.*, 111 FERC ¶ 61,510 at P 4 (2005), JA 97.

Suspending Tariffs, Subject to Refund and Conditions, *SFPP, L.P.*, 111 FERC ¶ 61,510 (2005) ("Initial Order"), R. 8, JA 97. The Commission concluded that SFPP's filing generally was consistent with the Commission's indexing regulations, as the proposed rate increases would result in rates that are at or below the applicable index ceiling levels. The percent change in the Producer Price Index for Finished Goods from 2003 to 2004 was 3.6288 percent; therefore, that figure was the multiplier the Commission would permit pipelines to use to increase their index ceiling levels in 2005. *Id.* at P 10, JA 99.

The indexed increase at issue, affecting rates from July 1, 2005 through June 30, 2006, was evaluated by reference to the cost of service for the calendar year 2004 compared to those for calendar year 2003. Initial Order at PP 5, 14, JA 97-98, 99. The Commission found that Indicated Shippers failed to make the requisite *prima facie* showing to protest the rate increase; that is, where the index ceiling was approximately 3.63 percent and SFPP claimed its actual cost of service increased by 0.43 percent, the difference was not so substantially in excess as to render the resulting rates unjust and unreasonable. *Id.* at P 13, JA 99.

Page 700 of SFPP's 2004 FERC Form 6 stated that SFPP's cost of service increased by $4,182,549, or 3.97 percent, from 2003 to 2004; SFPP claimed a tax allowance increase from 2003 to 2004 of $5,282,744, or 63 percent. *Id.* at P 5, JA 97-98. The Commission noted, however, that SFPP had indicated that it would

file a corrected Page 700 for its FERC Form 6. *Id.* at P 13, JA 99. Because the resulting recalculation would affect the change in SFPP's actual costs, the Commission required SFPP to file the corrected page within 10 days and allowed for the filing of additional comments by the other parties. *Id.*

The Commission accepted and suspended SFPP's proposed tariffs 112, 113, 114, 115, 116, and 117 to be effective July 1, 2005, subject to refund, and subject to the outcome of several then-pending FERC proceedings, including various complaint proceedings, concerning SFPP's underlying rates. *Id.* at P 3, Ordering Paras. (B)-(C), JA 97, 99-100. The Commission accepted FERC Tariff No. 118 to be effective July 1, 2005. *Id.* at P 3, Ordering Para. (A), JA 97, 99.

B. Rehearing Order

On July 14, 2005, SFPP filed its corrected Page 700 for the 2004 Form 6. R. 10, JA 101. SFPP asserted that the corrected filing reflected a revised 2003 interstate cost of service attributable to a change in its depreciation expense. *Id.*, JA 101-02. The footnotes to Page 700 indicated that SFPP was restating the 2003 Cost of Service results to reflect a 100-percent tax allowance. *Id.*, JA 105. The final corrected 2003 cost of service value was $109,188,314, as compared to the 2004 value of $109,594,987, representing an increase in actual costs of 0.37 percent. *Id.*, JA 104.

The Indicated Shippers filed comments challenging SFPP's revised Page

700 or, in the alternative, seeking rehearing of the Initial Order. R. 11. On December 12, 2005, the Commission issued its Order on Rehearing, *SFPP, L.P.*, 113 FERC ¶ 61,253 (2005) ("Rehearing Order," and together with Initial Order, "FERC Orders"), R. 16, JA 149, in which it denied rehearing and further explained its reasons for finding that Indicated Shippers' protest failed to meet their *prima facie* burden. The Commission treated the Indicated Shippers' filing as a request for rehearing, and considered further filings by SFPP (replying to the comments) and the Indicated Shippers (answering SFPP's reply). *Id.* at P 4, JA 150.

Indicated Shippers argued that SFPP was not entitled to a 100-percent corporate income tax allowance. The Commission ruled, however, that the issue was improperly raised in the indexed increase proceeding, where "the only relevant issue is whether the amount of the increase in SFPP's indexed rates is so substantially in excess of SFPP's actual cost increases that it renders the resulting rates unjust and unreasonable." Rehearing Order at P 8, JA 150. The Commission explained that the challenged tax allowance "is a component of SFPP's underlying base rates; therefore, it is not properly subject to examination in this proceeding." *Id.* Moreover, Indicated Shippers had challenged SFPP's entitlement to a 100-percent income tax allowance in FERC Docket No. IS05-230, which involved a tariff filing with a cost-of-service justification and was then pending before a presiding administrative law judge. *Id.* The Commission ruled that the IS05-230

rate proceeding, not this proceeding concerning indexed rates, was the proper proceeding in which to address the eligibility for and the level of an income tax allowance. *Id.*

In addition, the Commission explained that the Indicated Shippers' allegations were based on a faulty analysis, as they focused on cost and revenue figures without reference to percentage increases: "It is only the percentage of the indexed increase in rates that is at issue here; therefore, Indicated Shippers' references to the actual dollar amounts of costs or rates are misleading without reference to the percentages of cost increases and rates they represent." Rehearing Order at P 11, JA 151. If Indicated Shippers wished to challenge the underlying rates, they could do so by filing a complaint under ICA § 13. *Id.* The Commission also noted that SFPP's underlying rates were not properly before the Commission in the indexed increase proceeding and were being addressed in other FERC proceedings. *Id.*

Looking to the increase in costs based on the recalculated costs for 2003, the Commission recognized that SFPP's revised Page 700 reflected a smaller increase in costs — 0.37 percent instead of 0.43 percent. *Id.* at P 13, JA 151. The Commission found, however, that the difference between the change in the index (3.63 percent) and the change in costs (0.37 percent), approximately 3.25 percent, was not so substantially in excess of SFPP's cost increases as to render the

resulting indexed rates unjust and unreasonable. *Id.*

This petition followed.

SUMMARY OF ARGUMENT

The Commission's decision not to set a hearing to investigate SFPP's indexed rate filing, pursuant to § 15(7) of the Interstate Commerce Act, is not subject to judicial review. The Supreme Court and this Court have long held that the Commission has unreviewable discretion to determine whether to initiate § 15 investigations. To obtain a reviewable decision on the merits, the Indicated Shippers would have to file a complaint under § 13(1) of the Act.

Assuming reviewability, the Commission properly interpreted and applied its regulations implementing the pipeline rate indexing scheme. That scheme applies industry-wide rate ceilings and thus allows some divergence between a pipeline's indexed increases and its actual costs. The Commission reasonably found that the incremental difference between a 3.63 percent rate increase and a 0.37 percent cost increase was not so substantially in excess of its actual cost increases as to satisfy Indicated Shippers' requisite *prima facie* showing that SFPP's proposed rate increase was unjust and unreasonable. Also, in accordance with the streamlined procedure set forth in its regulations and orders, the Commission properly used SFPP's Form 6 to screen the divergence between the rate and cost increases.

Finally, the Commission properly declined to consider the merits of SFPP's underlying rates and costs of service in the 2005 indexed rate adjustment proceeding. The Commission's determination that the Indicated Shippers' challenges were outside the scope of the streamlined index proceeding was consistent with the Commission's precedents and within its broad discretion to structure its own proceedings. The Commission's decision also was reasonable because SFPP's base rates and costs of service, including its claimed tax allowance, are being litigated in several other FERC proceedings and in other appeals pending before this Court.

ARGUMENT

I. THE COMMISSION'S DETERMINATION NOT TO INITIATE AN INVESTIGATION UNDER SECTION 15 IS NOT REVIEWABLE

The relief that the Indicated Shippers seek on appeal is a mandatory "hearing on any rate increase for SFPP, with the burden of proof on SFPP to show that the resulting rate will be just and reasonable" — *i.e.*, a hearing under ICA § 15(7). Br. 46. That request for relief, however, runs squarely into the longstanding rule that Commission determinations not to investigate rate filings under § 15 are unreviewable. *See Southern Ry. Co. v. Seaboard Allied Milling Corp.*, 442 U.S. 444, 454 (1979). Indeed, the Supreme Court found that Congress affirmatively intended to preclude judicial review of such determinations. *Id.* at 455-59.

Southern Railway involved former § 15(8)(a) of the ICA, a derivative of § 15(7) that contained similar language.[7] In that case, shippers had protested railroads' proposed rate increase and asked the ICC to suspend the rates and investigate charges of illegality. The Supreme Court held that the ICC's decision, in accepting the rate filing, was not a final decision on the merits that the proposed rates were lawful, but rather a discretionary decision not to investigate their

[7] *See supra* note 2 (quoting ICA § 15(7)). The subsection at issue in *Southern Railway* provided that "the Commission may, upon the complaint of an interested party or upon its own initiative, order a hearing concerning the lawfulness of [a] rate [which] hearing may be conducted without answer or other formal pleading . . . ." ICA § 15(8)(a).

lawfulness. 442 U.S. at 452. The Court explained that the statute was "written in the language of permission and discretion" and was "silent on what factors should guide the Commission's decision"; indeed, "on the face of the statute there is simply 'no law to apply' in determining if the decision is correct." *Id.* at 455 (citations omitted). In fact, "[t]he structure of the [ICA] also indicates that Congress intended to prohibit judicial review." *Id.* at 456 (contrasting permissive language in § 15(8)(a) with mandatory language in § 13(1)).[8] The Court went on to reason that interpreting the statute to impose a duty on the agency "would allow shippers to use the open-ended and ill-defined procedures in § 15(8)(a) to render obsolete the carefully designed and detailed procedures in § 13(1)." *Id.* Moreover, the Court found its interpretation of the ICA was confirmed by "[t]he disruptive practical consequences" of allowing review, given the numerous rate filings the ICC reviewed each year and the time frame (usually 30 days) in which it generally decided whether to initiate a § 15(8)(a) investigation. *Id.* at 457.

Likewise, this Court has held that FERC "enjoys unreviewable discretion to determine whether to initiate section 15 investigations at all . . . ." *Arctic Slope Regional Corp. v. FERC*, 832 F.2d 158, 164-65 (D.C. Cir. 1987) (citing *Southern*

[8] *Southern Railway* is one of the cases the Supreme Court cited in *Heckler v. Chaney*, 470 U.S. 821, 828-29 (1985), as illustrative of cases where "statutes preclude judicial review" within the meaning of 5 U.S.C. § 701(a)(1), as opposed to those where "agency action is committed to agency discretion by law" under § 701(a)(2) simply because there are no standards to apply.

Ry.). Indeed, "decisions under the ICA not to pursue an investigation once begun lie squarely within the agency's discretion, even if the initial investigation reveals that some rates, though not all, are illegal." 832 F.2d at 165 (citing cases).

The FERC Orders challenged here neither ruled on the merits of SFPP's indexed rates nor caused irreparable injury to the Petitioners. Moreover, review at this stage would unduly interfere with the agency's judgment as to the best use of its resources. *See Southern Ry.*, 442 U.S. at 456-58; *Cities of Carlisle and Neola v. FERC*, 704 F.2d 1259, 1263 (D.C. Cir. 1983). Sections 15(1) and 15(7) of the ICA "confer broad discretion upon the Commission to structure its proceedings as it sees fit." *Arctic Slope*, 832 F.2d at 164.

As in *Southern Railway*, the time constraints on suspension and investigation orders further confirm their nonreviewability. The limits are implicit in 18 C.F.R. § 343.3(c), which provides that the Commission will make a decision on investigation requests "before the effective date of the tariff publication or within 30 days of the tariff filing, whichever is later . . . ."

To obtain a reviewable decision on the merits, the Indicated Shippers would have to file a complaint against SFPP's rates under ICA § 13(1). This case is controlled by *Southern Railway*, and should be dismissed for lack of a reviewable order.

II. EVEN IF THE COMMISSION'S DECISION NOT TO INVESTIGATE IS REVIEWABLE, ITS DETERMINATION WAS REASONABLE

A. 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).

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] . . . ." *Northern Border Pipeline Co. v. FERC*, 129 F.3d 1315, 1318 (D.C. Cir. 1997) (internal quotation marks and citation omitted; alterations in original); *see also Central Vt. Pub. Serv. Corp. v. FERC*, 214 F.3d 1366, 1369 (D.C. Cir. 2000).

B. The Indexing Process Is Designed To Be Streamlined And Simplified

1. Indexing Is Designed To Allow Annual Rate Changes Without Extensive Cost-Of-Service Ratemaking Proceedings And To Allow Some Divergence Between Rate Increases And Actual Costs

The Commission established a process for allowing indexed increases in oil pipeline rates in Order No. 561, which this Court upheld in *AOPL*. *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 in the EPAct:

> 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. That is, "pipelines adjust rates to just and reasonable levels for inflation-driven cost changes without the need of strict regulatory review

of the pipeline's individual cost of service, thus saving regulatory manpower, time and expense." *Id.*; *see also Frontier Pipeline Co. v. FERC*, 452 F.3d 774, 777 (D.C. Cir. 2006) ("This system dispenses with intricate calculations of specific pipeline costs.").

Like other methodologies for "the fixing of 'just and reasonable' rates," the indexing system "involves a balancing of the investor and the consumer interests." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). It 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 would receive the real value of their underlying rates because the annual changes would 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").

It is not entirely cost-based, however. 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. 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 cost and rates, an indexing scheme serves as "a form of incentive regulation" giving "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 their costs can keep some of the savings; a pipeline whose cost increases exceed the industry-wide ceiling will see its rate of return decline. 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).

Petitioners suggest that whenever the Commission allows pipelines to retain higher earnings if their rate increases exceed their cost increases, it is allowing

unreasonable rates, and repeat four times in six pages the mantra that "'not even a little unlawfulness is to be tolerated.'" Br. 18-23 (quoting *Farmers Union Cent. Exch., Inc. v. FERC*, 734 F.2d 1486, 1508 (D.C. Cir. 1984)). But as the Court also recognized in *Farmers Union*, among other cases, reasonableness is a "zone," not a precise point, and the agency has the discretion to consider legitimate non-cost factors to allow variation within that zone. *Id.* at 1502; *accord*, *Interstate Natural Gas Ass'n v. FERC*, 285 F.3d 18, 31 (D.C. Cir. 2002). Implementing a statutory mandate to simplify ratemaking and promoting efficiency are legitimate regulatory goals underlying various indexing and deregulatory steps that this Court has approved over the years. *See, e.g., United States Tel. Ass'n v. FCC*, 188 F.3d 521, 527-28 (D.C. Cir. 1999). Indeed, while the means to implement them were thoroughly debated when these indexing regulations were adopted, no one questioned the validity of those basic policies. *See, e.g., AOPL*, 83 F.3d at 1431, 1436-37.

2. Protestors Against Indexed Rate Increases Must Make A *Prima Facie* Showing That The Divergence Between Rate Increases And Actual Costs Is So Substantial As To Be Unjust And Unreasonable

In the context of this incentive form of regulation, the Commission acknowledged "the need to avoid indexed rates that increase substantially above a pipeline's actual costs," Order No. 561 at 30,955, and established a process for shippers to challenge a pipeline's indexed rate increase:

> [T]he Commission will implement a standard for considering protests to proposed rate changes, that comply with the index, that will ensure that individual pipeline rates *do not diverge substantially* from the pipeline's costs. Under the indexing system, the Commission will not entertain, on the merits, a protest filed pursuant to section 15(7) of the ICA alleging simply that the proposed rate change does not reflect a change in the pipeline's actual costs of rendering the service in question. Rather, a protest must allege reasonable grounds for believing that the *discrepancy* between the actual cost increase to the pipeline and the proposed change in rate *is so substantial* that the proposed rate change is not just and reasonable within the meaning of the ICA.

Id. at 30,955 (emphases added; footnote omitted). *See also* 18 C.F.R. § 343.2(c)(1). In establishing that remedy, the Commission emphasized the obvious — that indexed rate increases would not precisely track individual pipeline's cost increases — and thus the rebuttable presumption could not be challenged "based upon a mere divergence between the pipeline's cost of service and the level of the existing rate." Order No. 561 at 30,956. It was this explicit policy that the Court affirmed in *AOPL*, 83 F.3d at 1437.

3. Page 700 Of Form 6 Is Used As A Screening Tool In The Indexing Process

In response to commenters' concerns about the specificity required and the time for filing protests to an indexed rate increase, the Commission noted that the data reported on FERC Form No. 6, Annual Report for Oil Pipelines ("Form 6"), "are available to all parties to challenge a pipeline's rate increase." Order No. 561 at 30,956 (footnote omitted). Indeed, the Commission intended the data provided

in Form 6 to be integral to the indexing process: "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." *Id.* at 30,948.

To that end, the Commission issued a companion order that modified the Form 6 reporting requirements. *See 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). *See also AOPL*, 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).

Specifically, the Commission added to Form 6 a new required schedule, Page 700, entitled Annual Cost of Service Based Analysis Schedule:

> The new schedule would require each pipeline company to report, as of the end of the reporting year and the immediately preceding year, its Total Annual Cost of Service . . . , operating revenues, and throughput in barrels and barrel-miles. 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.

Order No. 571 at 31,168. The underlying calculations and supporting data for those figures, however, would not have to be reported on Form 6. *Id.* Nevertheless, in order for Page 700 to serve its purpose of disclosing cost-of-

service changes and allowing comparisons of data between years, the Commission explained, the pipeline company would have to report any major changes in its application of FERC's rate methodology "and recalculate the prior year's cost of service to reflect such a change." *Id.*

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. . . ." Order No. 571 at 31,168; *see also id.* at 31,169 ("The Commission finds that the information contained in a single place [at Page 700] in Form No. 6 will be useful in its monitoring of the performance of the index, and that the information may indeed be useful as a 'substantial divergence' screen."). *See also* Initial Order at P 13 n.14 (citing Order No. 571), JA 99.

C. In The FERC Orders Challenged Here, The Commission Reasonably Found That Indicated Shippers Failed To Make A *Prima Facie* Showing

1. The Commission Properly Applied A Burden Of Production To Indicated Shippers' Protest

It is undisputed that the proposed rate increase filed by SFPP did not exceed the 3.63-percent ceiling applicable to all pipelines for 2005 rate filings, established in accordance with Order No. 561 and based on the annual change in the Producer Price Index for Finished Goods ("PPI"). *See* Initial Order at P 10, JA 99; Rehearing Order at P 12, JA 151. Therefore, the indexed increase was presumptively valid. *Cf.* Order No. 561 at 30,956. To rebut that presumption,

Indicated Shippers had to make the *prima facie* showing required by 18 C.F.R. § 343.2(c)(1). Thus, the only question presented in this appeal is whether the Commission reasonably determined that Indicated Shippers failed to make a *prima facie* showing that the indexed rate increase is "so substantially in excess of the actual costs increases incurred by [SFPP]" as to be unjust and unreasonable.

Indicated Shippers argue that the Commission improperly shifted onto them the ultimate burden of proof on the merits of the rate filing. Br. 7, 25, 44. But the Commission simply found that Indicated Shippers had failed to show that the rate increase diverged so substantially from SFPP's cost increase as to warrant further investigation. Initial Order at P 13, JA 99. Because Indicated Shippers failed to raise a viable challenge to the indexed increase, the Commission determined that a hearing on the rate filing, in which the pipeline would have borne the burden of proving the rates were just and reasonable, was not necessary. *See id.* at PP 12-13, JA 99.

Indicated Shippers' claim that the burden on protests and complaints is "impossible to meet" (Br. 44) is contradicted by the Commission's rulings in other cases. For example, in *Calnev Pipeline L.L.C.*, 115 FERC ¶ 61,387 (2006), the Commission found that ExxonMobil had met the burden of production in a protest to another pipeline's 2006 indexed rate filing. The Commission therefore set the matter for hearing and settlement judge procedures. *Id.* at PP 11-12. *See also infra*

page 32. In addition, the Commission has set for hearing shippers' complaints under ICA § 13(1) against indexed increases. *See, e.g., ARCO v. Calnev Pipe Line, L.L.C.*, 97 FERC ¶ 61,057 (2001).

2. The Commission Appropriately Considered The Difference Between The Increase In Costs And The Indexed Increase In The Rate

Indicated Shippers contend that the Commission erred in the way it computed the relationship between the indexed cost increase and SFPP's cost increases. Br. 31-32. Their challenge, however, is not to the Commission's math, but to its interpretation of its own regulation, on which the agency is afforded great deference. *See Northern Border Pipeline*, 129 F.3d at 1318. The Commission's rule states that a protest of an indexed rate filing "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. § 343.2(c)(1). It sets forth no formula for determining the substantiality of the difference.

The Commission's analysis of SFPP's rate filing was reasonable and consistent with precedent. The Commission compared the percentage change in the index based on PPI with the percentage change in SFPP's total costs. Specifically, the Commission considered the divergence between the change in the index and the change in SFPP's costs. The Commission found that the difference

of approximately 3.25 percent (3.6288% [index ceiling] – 0.3725% [change in costs] = 3.2563%) was "not so substantially in excess of the increases in its costs as to render the indexed rates unjust and unreasonable." Rehearing Order at P 13, JA 151.

The Commission's focus on the difference between the percentages is a reasonable application of Order No. 561, which explained that protests of rate changes "must show that the *increment* of the rate change produced by application of the index is substantially in excess of the individual pipeline's increase in costs." *Id.* at 30,952-53 (emphasis added). Order No. 561 also explained that the focus of a protest must be on "the *discrepancy* between the actual cost increase to the pipeline and the proposed change in rate . . . ." *Id.* at 30,955 (emphasis added).

Moreover, the comparison of percentages is consistent with the Commission's methodology in other rate indexing cases. The Commission likewise compared percentages in previous decisions regarding SFPP's annual rate increases. *See* 2006 SFPP Index Order at P 10 (comparing 6.15 percent index change for 2006 rate filing to 6.6 percent increase in actual costs); 2004 SFPP Index Order at PP 4, 7 (comparing 3.17 percent index change for 2004 rate filing to 11.9 percent increase in actual costs); 2003 SFPP Index Order at PP 8, 12 (comparing 5.79 percent rate increase from 1999 to 2001 to 4.8 percent cost increase for same period); 2001 SFPP Index Order at 62,271 (comparing 2.76

percent index change for 2001 rate filing to 10.5 percent increase in actual costs).

The Commission took the same approach in *Calnev Pipeline*, 115 FERC ¶ 61,387. In that case, Calnev sought to increase its rates by the maximum index amount for 2006, which was 6.1485 percent. The pipeline's reported change in its cost of service was a decrease of 4.8 percent. *Id.* at P 5. To determine whether the proposed rate increase was substantially in excess of the change in costs, the Commission considered the difference between the amounts: 6.1485% – (4.8%) = 10.9485%.[9] The Commission drew a distinction between "the less than 4 percent differential between rates and costs" in the SFPP case that is the subject of this appeal and Calnev's proposed increased indexed rates that "exceed[ed] its cost decrease by almost 11 percent." *Id.* at P 10. Under those circumstances, the Commission 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's approach makes sense because it compares degrees of change. The indexed ceiling itself is expressed as a percentage, given its reliance

[9] The fact that the pipeline's actual costs had decreased, taken alone, would not preclude a rate increase. *See Shell Pipeline Co.*, 104 FERC ¶ 61,021 at 61,053 (2003) ("[W]hile costs might decline, this does not necessarily mean that a rate increase resulting from the application of the index must be unjust and unreasonable."); *see also Calnev Pipeline*, 115 FERC ¶ 61,387 at P 9 (rejecting argument that 18 C.F.R. § 343.2(c)(1) "automatically precludes any index adjustment if a pipeline has not experienced a cost increase").

on the percentage change in the Producer Price Index and its purpose of approximating the effects of inflation. *See* Order No. 561 at 30,950. The index is inherently dynamic, reflecting changes in the economy. *See id.* at 30,952-53. As such, the proper basis for comparison of the change in inflation, on one hand, and the change in costs, on the other, is the percentage expression of each.

In addition, because the annual indexed rate changes are determined separately from the underlying rates (*see infra* Section III), changes to the underlying rates result in the recalculation of each year's rates using the index percentage. For example, SFPP's rates for the West Line have been reduced, as of 1999, in a full cost-of-service ratemaking. SFPP's West Line rates have been reassessed by indexing those rates forward from 1999, using the approved indexed increases for each rate year. *See supra* page 8. For the period from July 2005 to June 2006, the multiplier used for that calculation is the PPI-derived 3.63 percent.

For those reasons, the Commission reasonably rejected Indicated Shippers' emphasis on the underlying dollar amounts. Indeed, as the Commission explained, Indicated Shippers miss the point of the indexing method and present figures that are misleading. First, "only the percentage of the indexed increase in rates . . . is at issue here; therefore, Indicated Shippers' references to the actual dollar amounts of costs or rates are misleading without reference to the percentages of cost increases and rates they represent." Rehearing Order at P 11, JA 151. Put differently, the

$407,000 increase in costs from 2003 to 2004 is meaningless without reference to the over $109,000,000 in total costs; in that context, $407,000 represents a change of 0.37 percent. Likewise, a $4,500,000 increase in revenues lacks context without reference to SFPP's total revenues; it reflects only the index level of 3.63 percent.[10] Therefore, the relative changes in rates and costs can only be fairly represented by the percentages.

Even when addressing the percentages, Indicated Shippers insist that the difference between the indexed increase and the cost increase should be determined by dividing the cost change into the PPI. *See* Br. 16, 32. Indicated Shippers thus contend that the divergence between the 3.63 percent index and SFPP's 0.37 percent increase in costs is 981 percent. But again, their math is misleading. Indicated Shippers' method would make no distinction between, for example, a filing in which a pipeline with a cost increase of 0.1 percent proposed an rate increase of 1 percent and a filing with a cost increase of 1.5 percent and a proposed rate increase of 15 percent. Indicated Shippers would conclude in both cases that the rate increase is 10 times (or 1000 percent) "in excess of" the cost increase. The Commission, on the other hand, under its reasonable interpretation

[10] In fact, the $4,500,000 figure itself is no longer valid. Because, as discussed *supra* at pages 7-10, several of SFPP's underlying rates have been reduced in other FERC proceedings, the yearly revenue increases have changed. The 3.63 percent index will be applied to the modified rates, resulting in an entirely different (and lower) numerical increase for 2005.

of the standard for rate protests under Order No. 561, would find a minimal discrepancy of 0.9 percent in the first case and a substantial difference of 13.5 percent in the second.

3. The Commission Appropriately Considered SFPP's Revised Page 700 In Measuring The Divergence Between The Rate Increase And The Actual Cost Increase

Indicated Shippers contend that the Commission afforded SFPP's revised Page 700 too much weight, treating it as "conclusive evidence" and refusing to allow Indicated Shippers to challenge the accuracy of the data. Br. 21-22, 30. The Commission did not, however, decide the merits of SFPP's rate increase.[11] Rather, it properly treated Page 700 only as a "preliminary screening tool," as provided in Order Nos. 561 and 571. *See* Initial Order at P 13 n.14 (citing Order No. 571), JA 99; Rehearing Order at P 22, JA 152. *See generally supra* Section II.B.3. The Commission also held that Indicated Shippers would be able to investigate the costs reflected on Page 700 if they filed an ICA § 13 complaint. *See* Rehearing Order at P 22 ("In a complaint proceeding addressing the underlying rates, or in a

[11] Indicated Shippers accuse the Commission of inconsistency in its approach to Page 700, because in Order No. 571 the Commission stated that Page 700 was not intended to be the basis for a decision on the merits of a rate increase. Br. 30; *see also* Order No. 571 at 31,168 ("[Page 700] is not intended to be the information which, in itself, either forms the basis of a Commission decision on the merits of a pipeline filing, or demonstrates that the pipeline's proposed or existing rates are just and reasonable."). Indicated Shippers, however, confuse a determination not to initiate an ICA § 15(7) investigation with a decision on the merits. *Cf. Southern Ry.*, 442 U.S. at 452; *see generally* Section I, *supra*.

proceeding involving a cost-of-service justification advanced by SFPP, Indicated Shippers could investigate the types of costs reflected on Page 700, subject to appropriate discovery rules."), JA 152.

The Commission's treatment of Page 700 was consistent with its precedents. *See, e.g.*, 2001 SFPP Index Order at 62,271 (evaluating percentages based on Form 6 cost data); 2003 SFPP Index Order at PP 6-8, 12 (same); *Calnev Pipeline*, 115 FERC ¶ 61,387 at PP 10-11 (finding ExxonMobil met *prima facie* burden using Page 700 data). Moreover, in previously protesting SFPP's 2004 indexed rate increase, Indicated Shippers and other protestors similarly challenged the accuracy of the amounts and methodology reflected on Page 700 of SFPP's 2003 Form 6. *See* 2004 SFPP Index Order at P 3. The Commission found that their claims were "more appropriately resolved" in another FERC proceeding concerning SFPP's underlying rates. *Id.* at P 11. And in *ARCO*, a shipper filed a § 13(1) complaint that challenged the pipeline's 2000 and 2001 rate increases, based on Page 700 data, and sought to review the work papers underlying that data and to challenge the reported costs. 97 FERC at 61,310. The Commission set the matter for hearing to allow the shipper to review the work papers and conduct discovery. *Id.* at 61,311.

Nor was it inappropriate, as Indicated Shippers contend (Br. 14, 29-30) for the Commission to accept SFPP's revised 2004 Form 6 reflecting adjustments to

its 2003 costs of service. As discussed in Section II.B.3, *supra*, Order No. 571 specifically contemplated that pipelines would revise their rate methodology and recalculate prior years' cost of service accordingly, in order to permit meaningful comparisons of data from different years. *See* Order No. 571 at 31,168. Thus, in accepting SFPP's 2003 indexed rate increase, the Commission discussed SFPP's corrections to its 2002 Form 6 that recalculated costs for a prior year: "The Commission has also reviewed the corrections that SFPP made to its 2000 interstate cost of service when SFPP filed its 2002 Form No. 6. The Commission accepts these corrections as reasonable and appropriate." 2003 SFPP Index Order at P 11. The Commission's acceptance of SFPP's revised 2004 Form 6 was consistent with these precedents.

III. THE COMMISSION PROPERLY REJECTED INDICATED SHIPPERS' ATTEMPT TO LITIGATE SFPP'S UNDERLYING RATES AND COSTS OF SERVICE IN THE INDEXED INCREASE PROCEEDING

Indicated Shippers claim that, because they alleged that SFPP is not entitled to include an income tax allowance in its costs of service and that SFPP's rates are unjust and unreasonable, the Commission was required to set SFPP's 2005 indexed rate adjustment for hearing. *See* Br. 33-42, 45-46. The Commission, however, ruled that such challenges to SFPP's underlying rates were improperly raised in the indexed increase proceeding. Questions regarding the permissible components and the overall validity of SFPP's base rates were not within the scope of the indexed

rate proceeding, where the only relevant issue was whether the indexed increase for 2005 was so substantially in excess of SFPP's year-to-year change in costs that the 2005 rate increase rendered the resulting rates unjust and unreasonable. Rehearing Order at P 8, JA 150.

As discussed more fully in Section II.B.1, *supra*, the streamlined indexing procedure established by the Commission in Order No. 561 and upheld by this Court in *AOPL* is not designed to be a comprehensive cost-of-service ratemaking. Accordingly, the Commission has consistently limited the scope of indexed adjustment proceedings and the grounds for challenging a presumptively valid rate increase. *See, e.g.*, 2001 SFPP Index Order at 62,272 ("[Shipper's] challenge to SFPP's underlying rates is inappropriate in this proceeding where SFPP seeks only an incremental increase."); 2006 SFPP Index Order at P 10 ("In an index-rate adjustment proceeding, the issue is not the accumulation of costs and revenue variances over many years. Rather, the focus of an index adjustment cases is only whether the index increase is so substantially in excess of cost changes for the index year."); *see also* 2004 SFPP Index Order at P 8 (rejecting protestors' argument that they needed only to show that pipeline's underlying rates were unjust and unreasonable even before the proposed increase: "The Commission . . . specifically rejected this argument in Order No. 561-A. . . . [T]he Commission concluded that it is not subject to a statutory duty to examine the whole rate when

an oil pipeline proposes an indexed rate change."); *Calnev Pipe Line, L.L.C.*, 96 FERC ¶ 61,350 at 62,304 (2001) (same); Order No. 561-A at 31,104.

The Indicated Shippers contend that the Commission foreclosed any challenge to SFPP's claimed tax allowance, the lawfulness of its return on equity, the accuracy of its calculation of costs of service, or the resulting rates. Br. 6-7, 43, 45. That is simply false, in several respects.

Basic legal issues regarding the same tax allowance issue are already posed in two other cases currently pending before this Court. First, the question of whether SFPP in particular is eligible for an income tax allowance in its regulated rates, based on the Commission's application of its *Policy Statement on Income Tax Allowances*, adopted in response to *BP West Coast*, is squarely presented in *ExxonMobil Oil Corp. v. FERC*, Case Nos. 04-1102, *et al.*, which has been fully briefed.[12] Second, the *Policy Statement* itself, in which the Commission decided that partnerships are eligible for an income tax allowance under certain circumstances, has been challenged in *Canadian Association of Petroleum Producers v. FERC*, No. 05-1382, which the Court has ordered to be scheduled for

[12] The Commission noted in its brief in that case that no final decision had been reached in the FERC proceeding regarding SFPP's base rates whether to afford SFPP an income tax allowance. The Commission stated that it anticipated making that determination by applying the *Policy Statement*. Parties in that case, including the Indicated Shippers — ExxonMobil as a petitioner and BP West Coast as an intervenor, both represented by the same counsel as in this case — challenge the income tax allowance policy adopted in the *Policy Statement*.

argument on the same day as Nos. 04-1102, *et al.*

There are, of course, also issues of application. As the Commission noted, the *Policy Statement* "specifically addressed the question of whether the partners of [master limited partnerships] have actual tax liability for any income recognized by the partnership . . . and cautioned that such matters 'can present complex allocation and timing issues that would be addressed in individual rate proceedings.'" Rehearing Order at P 8 n.9 (quoting 111 FERC ¶ 61,139 at P 37 n.35 (2005)), JA 150. The Indicated Shippers, however, are litigating those issues in numerous other FERC proceedings. Indeed, they challenged SFPP's entitlement to a 100-percent income tax allowance in FERC Docket No. IS05-230, which involved a tariff filing with a cost-of-service justification and was pending before an administrative law judge at the time of the Rehearing Order. *Id.* at P 8, JA 150; *see supra* page 9 and note 4 (discussing cost-of-service ratemaking in FERC Docket No. IS05-230, regarding SFPP's North Line base rates). Accordingly, the Commission reasonably concluded, "[t]hat rate proceeding, not this proceeding concerning indexed rates, is the proper proceeding in which to address the eligibility for and the level of an income tax allowance." Rehearing Order at P 8, JA 150.

The same is true of other SFPP costs of service. As the Commission recognized, SFPP's base rates are at issue in several other FERC proceedings. *See*

id. n.8 (citing *SFPP, L.P.*, 111 FERC ¶ 61,299 at PP 8-9 (2005)); *see also* Initial Order at P 15 n.15 (citing numerous other FERC proceedings concerning SFPP's base rates), JA 99; *see generally supra* pages 7-10 (discussing FERC proceedings concerning base rates for various pipelines).

Nor are SFPP's 2005 indexed rates insulated from further recalculations. If an underlying rate is determined to be unjust and unreasonable in a rate proceeding, the base rate would then be recomputed forward using each year's indexed increase. *See* 2006 SFPP Index Order at P 11; *see also* 18 C.F.R. § 342.3(a) (providing that indexed rate filings are subject to refund based on outcome of investigations of base rate). Indeed, that is precisely what has happened, or will happen, with respect to most of the relevant rates. As explained *supra* at page 8, the Commission has reduced SFPP's rates on the West Line, using a 1999 cost of service, and SFPP has thus been required to recalculate its rates forward from 1999. Therefore, the 3.63 percent index for 2005 is to be multiplied by a reduced rate base, resulting in lower revenues for the July 2005-June 2006 rate year. SFPP's rates for the Oregon and Sepulveda Lines may be similarly recalculated, depending on the outcomes of those rate proceedings. Furthermore, SFPP has filed new North Line rates, effective June 1, 2005, based on costs of service derived from a nine-month period in 2005, and new East Line rates, effective June 1, 2006, based on 2005 costs of service; therefore, neither the 2005

indexed increase nor Indicated Shippers' inability to challenge the underlying cost elements in this proceeding will have any relevance to the 2005-2006 rates for those lines. The Watson Station Line rates have been resolved by settlement and are no longer in dispute. *See supra* pages 7-10.

The Commission has "broad discretion" to structure its proceedings and allocate its resources as it sees fit. *Arctic Slope*, 832 F.2d at 164; *see also Southern Ry.*, 442 U.S. at 456-58; *Cities of Carlisle and Neola*, 704 F.2d at 1263; *Michigan Pub. Power Agency v. FERC*, 963 F.2d 1574, 1579 (D.C. Cir. 1992) (agencies accorded substantial deference in ordering their proceedings); *Richmond Power & Light v. FERC*, 574 F.2d 610, 624 (D.C. Cir. 1978) ("Agencies have wide leeway in controlling their calendars") (citing *City of San Antonio v. Civil Aeronautics Bd.*, 374 F.2d 326, 329 (D.C. Cir. 1967)). The Commission properly exercised that discretion in this case in declining to consider challenges to SFPP's underlying rates in the context of the streamlined indexed rate proceeding. The Commission also noted that, in addition to the numerous base rate proceedings, the Indicated Shippers could raise any of their challenges in an ICA § 13 complaint. *See* Rehearing Order at P 11, JA 151.

CONCLUSION

For the reasons stated, the petition should be dismissed for lack of jurisdiction. In the alternative, the petition should be denied on the merits and the challenged FERC Orders should be affirmed in all respects.

Respectfully submitted,

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