

ORAL ARGUMENT HAS NOT YET BEEN SCHEDULED

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

No. 07-1461

**TESORO REFINING AND MARKETING COMPANY,
PETITIONER,**

v.

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

**ON PETITION FOR REVIEW OF AN ORDER OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

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

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AUGUST 13, 2008

CIRCUIT RULE 28(A)(1) CERTIFICATE

A. Parties and Amici

To counsel's knowledge, all parties are presented in the combined brief of the petitioner and petitioner-intervenor.

B. Ruling Under Review

Order Dismissing Complaint, *Tesoro Refining & Mktg. Co. v. Calnev Pipe Line, L.L.C.*, FERC Docket No. OR07-16, 121 FERC ¶ 61,142 (2007) ("Tesoro Order"), R. 7, JA 89.

C. Related Cases

This case, regarding a complaint against a pipeline company's indexed rates filed in 2005, 2006, and 2007, has not previously been before this Court or any other court. *ExxonMobil Oil Corp. v. FERC*, Nos. 07-1163, *et al.* (consolidated), and *BP West Coast Products LLC v. FERC*, No. 08-1237, are related to this proceeding as they concern some of the same issues. Two previous cases, *ExxonMobil Oil Corp. v. FERC*, Nos. 05-1472, *et al.*, and *ExxonMobil Oil Corp. v. FERC*, Nos. 06-1273, *et al.*, also raised some of the same issues, but were decided on jurisdictional grounds not relevant here.

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GLOSSARY

BP Complaint Order	Order Holding Complaint in Abeyance, <i>BP West Coast Products LLC v. SFPP, L.P.</i> , FERC Docket No. OR07-8, 119 FERC ¶ 61,241 (2007), <i>reh'g denied</i> in BP Rehearing Order, issued in Companion Proceeding
BP Rehearing Order	Order Denying Rehearing, <i>BP West Coast Products, LLC v. SFPP, L.P.</i> , FERC Docket No. OR07-8, 121 FERC ¶ 61,141 (2007), issued in Companion Proceeding
BP West Coast	Intervenor BP West Coast Products LLC
Br.	Combined opening brief of the Shippers
Calnev	Intervenor Calnev Pipe Line, L.L.C.
Commission or FERC	Federal Energy Regulatory Commission
Companion Proceeding	Proceeding in FERC Docket No. OR07-8, on BP West Coast's complaint against a 2005 indexed rate increase by SFPP
EPAct	Energy Policy Act of 1992
Form No. 6	FERC Form No. 6, Annual Report for Oil Pipelines
ICA	Interstate Commerce Act
Order No. 561	<i>Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992</i> , Order No. 561, FERC Stats. & Regs. [Regs. Preambles, 1991-1996] ¶ 30,985 (1993)

GLOSSARY

Page 700	FERC Form No. 6, Page 700, Annual Cost of Service Based Analysis Schedule
SFPP	SFPP, L.P., an oil pipeline company whose rates are at issue in the Companion Proceeding and certain other FERC proceedings
Shippers	Petitioner Tesoro and Intervenor BP West Coast
Tesoro	Petitioner Tesoro Refining and Marketing Company
Tesoro Order	Order Dismissing Complaint, FERC Docket No. OR07-16, <i>Tesoro Refining & Mktg. Co. v. Calnev Pipe Line, L.L.C.</i> , FERC Docket No. OR07-16, 121 FERC ¶ 61,142 (2007), R. 7, JA 89

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STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission (“Commission” or “FERC”) reasonably determined that an oil pipeline customer failed to meet its initial burden, in a complaint against a pipeline company’s indexed rate increases, to allege reasonable grounds for asserting that the proposed rate increases were so substantially in excess of the pipeline’s actual cost increases that the rates were unjust and unreasonable.

STATUTORY AND REGULATORY PROVISIONS

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

INTRODUCTION

In recent years, shipping customers of several oil pipeline companies have challenged rate increases filed by those pipeline companies under the Commission's rate indexing procedure. This appeal arises from one of the first cases in which the Commission applied a revised pleading standard for certain complaints against index-based increases.

In a separate FERC proceeding (the "Companion Proceeding") that is not before the Court but is referenced in the challenged order, the Commission established, and on rehearing further clarified, a revised interpretation of its regulation (*see* 18 C.F.R. § 343.2(c)(1)) governing a complainant's initial burden in challenging an oil pipeline company's index-based rate increase. *BP West Coast Products LLC v. SFPP, L.P.*, 119 FERC ¶ 61,241, *reh'g denied*, 121 FERC ¶ 61,141 (2007). In the Companion Proceeding, the Commission found that the shipper's complaint satisfied that burden, and accordingly set the matter for hearing. 119 FERC ¶ 61,241 at PP 10-11; 121 FERC ¶ 61,141 at P 2. Applying the same standard in the instant case, however, the Commission concluded that Tesoro's complaint failed to meet its burden, and thus dismissed the complaint.

Tesoro Refining and Marketing Company v. Calnev Pipe Line, L.L.C., 121 FERC ¶ 61,142 (2007) (“Tesoro Order”), R. 7, JA 89.

Tesoro never challenged the Commission’s revised standard, or the application of that standard to Tesoro’s complaint, before the Commission, choosing instead to raise all such objections to this Court in the first instance. In addition, Tesoro and an intervenor, BP West Coast Products LLC (“BP West Coast”) — the shipper that *did* satisfy the Commission’s standard in the Companion Proceeding — go beyond the narrow scope of the ruling below to introduce a sweeping challenge to the Commission’s interpretation of its regulations and the Interstate Commerce Act. Moreover, Tesoro and BP West Coast (together, “Shippers”) base their argument on a false premise — *i.e.*, that the Commission has foreclosed all avenues for challenging index-based increases — that is belied by BP West Coast’s own success in the Companion Proceeding.¹

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

¹ “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.

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.

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 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). Accordingly, Congress passed the Energy Policy Act of 1992,² 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.

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

See generally ExxonMobil Oil Corp. v. FERC, 487 F.3d 945, 956-57 (D.C. Cir. 2007).

Sections 1801 and 1802 of the Energy Policy Act of 1992 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 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 III.A.1, *infra* (discussing indexing scheme). The purpose of this process is to 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 to Commission against carriers

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).

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 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). The Commission implemented procedural rules for such ICA complaints and rate protests in 18 C.F.R. Part 343. Of particular relevance here, a 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. § 343.2(c)(1). A 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. Companion Proceeding: BP Complaint Order and BP Rehearing Order

Though it is not on appeal before this Court, a brief overview of the Companion Proceeding is relevant because the Commission issued contemporaneous orders, stating in both orders that the Tesoro Order (on appeal here) followed the standard established in the Companion Proceeding. *See Tesoro Order* at P 1 (“The instant order [in the Tesoro case] follows the standard

established by a companion order on rehearing in [the BP West Coast case].”),
JA 89.

On March 23, 2007, BP West Coast filed a complaint challenging the indexed rate increase that SFPP, L.P. had filed in 2005. On June 6, 2007, the Commission issued its Order Holding Complaint in Abeyance, *BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-8, 119 FERC ¶ 61,241 (2007) (“BP Complaint Order”).⁴ The Commission partially accepted BP West Coast’s complaint, determining that BP West Coast 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. *Id.* at P 10.

In that case, cost data submitted by SFPP in accordance with FERC’s reporting requirements (FERC Form No. 6, Page 700) showed an existing overrecovery of approximately \$16 million, and the proposed indexed increase of the maximum permitted 3.6 percent exceeded SFPP’s actual cost increase, which would result in a further overrecovery of approximately \$4.5 million. BP Complaint Order at P 10. The Commission explained that, generally, if a pipeline is not recovering its costs of service, the Commission permits it to apply the full

⁴ In subsequent orders, including the FERC order on review here, the Commission referred to this as the “June 6 Order.” We will refer to the order herein as the “BP Complaint Order,” rather than by date, to avoid confusion about the separate FERC proceedings and the orders that were issued together on November 9, 2007.

increase allowed under the indexing methodology for a given year even if the pipeline's costs actually declined; the Commission has held that the resulting rate is not unjust and unreasonable because the pipeline is not recovering its costs of service. *Id.* BP West Coast argued that, conversely, if a pipeline is overrecovering its costs of service, the Commission should not permit a further increase by indexing, even if the rate increase for that particular year is not substantially in excess of the increase in costs. *See id.*

The Commission agreed with that principle and concluded that “a complaint will 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 West Coast 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 costs of service. *Id.* at PP 12-13.⁵

⁵ The Commission dismissed other portions of BP West Coast'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. 30-31 (discussing narrow scope of complaint against indexed increase).

The pipeline requested rehearing, arguing (*inter alia*) that the Commission had never previously compared a pipeline's increase in costs to its existing profit margins in considering objections to an indexed rate increase. On November 9, 2007, the Commission issued its Order Denying Rehearing, *BP West Coast Products LLC v. SFPP, L.P.*, FERC Docket No. OR07-8, 121 FERC ¶ 61,141 (2007) ("BP Rehearing Order"). The Commission denied the rehearing request but acknowledged that the BP Complaint Order "contains a revised interpretation of 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 indexed increases, but conceded that the BP Complaint Order "as written could have some unintended consequences." *Id.* at P 9. Specifically, in the Commission's prior holding that a complaint met the standard in § 343.2(c) 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.* Therefore, the revised standard 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.* Moreover, the “overly broad language” of the BP Complaint Order did not account for the important distinction between a challenge to an indexed increase in a single year and a more complex investigation of the cumulative return over several years. *Id.* at P 10. For those reasons, 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 indexed based increase so exceeds the actual increase in the pipeline’s cost that the resulting rate increase would substantially exacerbate that over-recovery.

Id.

The Commission also specified that its holding would apply to Tesoro’s complaint in the parallel proceeding: “This order on rehearing contains the standard to be applied to the August 1, 2007 complaint addressed by a companion order in Docket No. OR07-16-000, *Tesoro Refining and Marketing Company v. Calnev Pipe Line, L.L.C.*” BP Rehearing Order at P 1 n.2.

The Commission later set BP West Coast’s complaint, together with another shipper’s “virtually identical” complaint against the same (2005) indexed increase by the same pipeline company, for hearing. *ExxonMobil Oil Corp. v. SFPP, L.P.*, FERC Docket Nos. OR07-11, *et al.*, 122 FERC ¶ 61,129 (2008). That consolidated proceeding remains pending before the Commission.

B. Tesoro Order

On August 1, 2007, Tesoro filed a complaint against index-based rate increases that Calnev Pipe Line, L.L.C. (“Calnev”) had filed in 2005, 2006, and 2007. Complaint, R. 1, JA 4. Tesoro asserted that Calnev’s Form No. 6 cost data for the relevant years showed substantial overrecovery in those years. Complaint ¶¶ 18-20 (alleging that Calnev’s revenues exceeded its costs of service by over 25% in 2005, over 24% in 2006, and over 27% in 2007), JA 9-10. Tesoro also submitted a witness declaration alleging that Calnev’s overrecovery would have been even greater if its increased returns were adjusted to reflect that its increase in throughput was relatively larger than its increase in costs. Complaint Ex. C (Declaration of Peter K. Ashton), JA 34. Tesoro contended that its showing of Calnev’s overrecovery met the standard established in the BP Complaint Order.

Calnev filed an answer to the complaint. R. 4, JA 59. Based on its cost reporting (including revised data it had filed in corrected forms), Calnev asserted that its annual rate increases had been consistent with or even lower than its actual cost increases, which had increased by 2.4% for 2005 (compared to the indexed increase of 3.6288%), by 6.3% for 2006 (compared to the indexed increase of 6.1485%), and by 5.81% for 2007 (compared to the indexed increase of 4.3186%). Answer at 4, 6, JA 62, 64. Tesoro filed a reply to Calnev’s answer. R. 6, JA 77.

On November 9, 2007, the Commission issued, contemporaneously with the BP Rehearing Order, its Order Dismissing Complaint, *Tesoro Refining and Marketing Company v. Calnev Pipe Line, L.L.C.*, FERC Docket No. OR07-16, 121 FERC ¶ 61,142 (2007) (“Tesoro Order”), R. 7, JA 89. The Commission rejected Tesoro’s reply under its procedural rules. *Id.* at P 4, JA 90; *see* 18 C.F.R. § 385.213(a)(2) (“An answer may not be made to . . . an answer . . . unless otherwise ordered by the decisional authority. . . . If an answer is not otherwise permitted under this paragraph, no responsive pleading may be made.”). Accordingly, the reply was not considered by the Commission and is not part of the decisional record.⁶ On the merits, the Commission applied the standard established in the BP Complaint Order and refined in the BP Rehearing Order and dismissed Tesoro’s complaint because it did not satisfy the second prong of the Commission’s standard: that the indexed increase would substantially exacerbate Calnev’s overrecovery.

As in the companion BP Rehearing Order, the Commission clarified the standard it had established in the BP Complaint Order, explaining that the overly broad language in that earlier order did not clearly draw the distinction between a

⁶ Having failed to challenge that ruling in its initial Brief, Tesoro has waived any objection on appeal to the Commission’s rejection of its answer. *See Power Co. of Am., L.P. v. FERC*, 245 F.3d 839, 845 (D.C. Cir. 2001) (argument not raised in opening brief was waived).

single indexed increase and the cumulative return. Tesoro Order at P 5, JA 90. The language in the BP Complaint Order on which Tesoro relied “did not incorporate the facts” upon which the Commission had based its determination to investigate SFPP’s rate increase in that case. *Id.*; *see also id.* at P 6 (“As discussed in the companion [BP Rehearing] order, the phrase upon which Tesoro relies did not incorporate the central holding of the [BP Complaint] Order . . .”), JA 90. The Commission again stated its two-pronged standard for a complaint against an indexed increase and its reasons for requiring that a complaint show that the indexed increase would substantially exacerbate overrecovery. *Id.*

In particular, the Commission repeated its concern that broad application of the language in the BP Complaint Order could lead to a denial of an inflation-based increase even where the pipeline’s actual cost increase exceeded or was close to the index ceiling for that year. *Id.* The Commission concluded that such an outcome “is precisely what could occur if the Commission accepted [Tesoro’s] complaint,” because Calnev’s indexed increases in 2006 and 2007 were “based on cost increases that were actually more than the [rate] increases permitted by the index, [so] that the index increase failed to enable Calnev to recover all of its actual cost increases.” *Id.* at P 7, JA 90. Accordingly, the Commission concluded that Calnev’s index-based rate increases in 2006 and 2007 “did not substantially exacerbate its current over-recovery.” *Id.* It followed from that finding that

“Tesoro’s complaint does not meet the standard contained in [18 C.F.R. §] 343.2(c) of the Commission’s regulations.” *Id.*

The Commission noted that it “relies solely on Page 700 of the pipeline’s FERC Form No. 6 in evaluating this type of complaint” (against an index-based increase), so “Tesoro’s arguments that Calnev’s return is understated in the complaint years for various reasons are simply irrelevant.” *Id.* To challenge the accuracy of Calnev’s reported returns, Tesoro would have to file a complaint against the cost components of Calnev’s base rates. *Id.* (citing recent orders that so held).

Finally, the Commission concluded, as to the challenge to Calnev’s index-based increase in 2005, that Tesoro’s complaint, which was filed on August 1, 2007 but requested reparations from July 1, 2005 (Complaint ¶¶ 34, 40, 41, JA 12, 13), was time-barred by “the strict two-year statute of limitations” under 49 U.S.C. app. § 16(3)(b). Tesoro Order at P 7, JA 90.

Having disposed of Tesoro’s complaint as to all three years, the Commission found it did not need to reach Calnev’s arguments concerning the holding of the BP Complaint Order. *Id.* (As discussed above, however, the Commission addressed the similar arguments of another pipeline, SFPP, on rehearing of the BP Complaint Order, in the BP Rehearing Order.)

This petition followed.⁷

SUMMARY OF ARGUMENT

The Commission reasonably determined that Tesoro's complaint against Calnev's indexed rate increases failed to make the required showing under the Commission's standard for such complaints. Moreover, none of the Shippers' arguments to the contrary was raised before the Commission.

In the Companion Proceeding, the Commission established a revised standard for ICA § 13 complaints against indexed rates, construing "reasonable grounds for asserting that . . . the rate increase is so substantially in excess of the actual cost increases . . . that the rate is unjust and unreasonable" (18 C.F.R. § 343.2(c)(1)) to include a showing that (1) the pipeline is substantially overrecovering its cost of service and (2) the indexed adjustment so exceeds the actual cost increase that the resulting rate increase would substantially exacerbate that overrecovery.

In the proceeding underlying this appeal, the Commission appropriately applied the revised pleading standard and reasonably determined that Tesoro's complaint against Calnev's indexed increases failed to meet its initial burden as to

⁷ BP West Coast and ExxonMobil Oil Corporation, having moved to intervene late in the FERC proceeding, moved to intervene before this Court in support of Tesoro. ExxonMobil later withdrew its intervention; BP West Coast joined Tesoro in a combined Brief.

the second prong. Though the Shippers now raise a variety of objections to the Commission's determination in this case, the validity of its revised standard, and its entire process for addressing challenges to oil pipeline rates, Tesoro never presented any of these arguments to the Commission before seeking judicial review. Accordingly, the Commission had no opportunity to respond to the Shippers' contentions, and the administrative record provides no basis for this Court to consider their merits. For those reasons, the Court should decline to consider the Shippers' arguments in the first instance.

In any event, the Commission reasonably adopted the revised standard for certain complaints against indexed rates and properly applied it to Tesoro's complaint. More generally, the Commission has reasonably 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. The Commission has not foreclosed challenges to indexed rate increases — as is shown by its acceptance of intervenor BP West Coast's complaint in the Companion Proceeding.

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

II. THE SHIPPERS’ BROAD ARGUMENTS ARE BEYOND THE SCOPE OF THIS PROCEEDING

The Shippers’ criticisms of the Tesoro Order and FERC policies were never presented to the Commission in this case and therefore are beyond the scope of this appeal.

To be clear: this is not a jurisdictional argument. The Commission does not contend that judicial review of the Tesoro Order is wholly precluded.⁸ But the

⁸ The longstanding rule that Commission determinations not to investigate rate filings in response to protests under ICA § 15 are unreviewable, which was dispositive in earlier shipper appeals, of course does not apply to this case arising from a complaint under ICA § 13. *Cf. Southern Ry. Co. v. Seaboard Allied Milling Corp.*, 442 U.S. 444, 454-59 (1979); *ExxonMobil Oil Corp. v. FERC*, No. 05-1471, 2007 U.S. App. LEXIS 6692 (D.C. Cir. Feb. 27, 2007); *ExxonMobil Oil Corp. v. FERC*, No. 06-1273, 2007 U.S. App. LEXIS 18087 (D.C. Cir. July 27, 2007).

Notably, as discussed *supra* at pp. 7-8, Intervenor BP West Coast’s similar challenge to another pipeline company’s indexed rate increase, having been rejected by the Commission when raised as an ICA § 15(7) protest — the determination that this Court held in Case No. 05-1471 to be unreviewable per (continued...)

arguments that the Shippers may properly raise, and this Court may consider, are limited to those that were actually raised before the Commission in the underlying proceeding.

This Court has made clear that, though the ICA does not impose a formal rehearing requirement, arguments that were *never* presented to the Commission are barred on appeal. *See ExxonMobil*, 487 F.3d at 962 (“A party must first raise an issue with an agency before seeking judicial review.”); *Frontier Pipeline Co. v. FERC*, 452 F.3d 774, 793 (D.C. Cir. 2006) (“[Petitioners] did not raise this argument below . . . and thus we do not consider it.”). This is not a mere procedural hurdle, but a matter of basic fairness and recognition of the scope of judicial review of agency decisionmaking:

This requirement serves at least two purposes. It ensures “simple fairness” to the agency and other affected litigants. It also provides this Court with a record to evaluate complex regulatory issues; after all, the scope of judicial review under the APA would be significantly expanded if courts were to adjudicate administrative action without the benefit of a full airing of the issues before the agency.

ExxonMobil, 487 F.3d at 962; *see also Advocates for Highway & Auto Safety v. Fed. Motor Carrier Safety Admin.*, 429 F.3d 1136, 1150 (D.C. Cir. 2005).

Responding to the argument that the ICA does not impose a rehearing requirement, the Court in *ExxonMobil* was unequivocal: “Petitioners miss the

Southern Railway — was later *accepted* by the Commission when raised in a § 13(1) complaint in the Companion Proceeding.

point: Their error was not failing to seek rehearing, but rather *failing to raise the issue at all.*” 487 F.3d at 962 (emphasis added) (citing, *inter alia*, *Frontier*).

Accordingly, the Court determined it “need not consider the merits of those arguments because none of them was raised below.” *Id.*; *accord Frontier*, 452 F.3d at 793.

ExxonMobil and *Frontier* are directly on point. In the present case, the Shippers likewise introduce arguments that were never raised or addressed in the underlying FERC proceeding. For that reason, the Tesoro Order and the supporting record provide little to inform the Court’s consideration of these new arguments. (This would not change even if Tesoro’s reply to Calnev’s answer — rejected on procedural grounds and thus not considered by the Commission — were taken into account, as the reply only defended the pleading standard established in the BP Complaint Order and did not address any of the arguments now raised on appeal. *See* JA 77-87.)

Tesoro’s choice to proceed directly to judicial review is particularly problematic in this case because the Commission revised its approach to complaints against indexed increases. The Commission established and refined the standard for such complaints in a series of orders — the BP Complaint Order in June 2007 and the BP Rehearing Order and Tesoro Order in November 2007 — that were challenged below only from a pipeline company’s (SFPP’s) perspective,

contending that the standard is *too* accommodating of complainants. (BP West Coast did not raise its arguments against the revised standard in the Companion Proceeding because it *prevailed* under that standard in the BP Complaint Order and the BP Rehearing Order.) Indeed, the Shippers object to the Commission’s clarification of its standard in the BP Rehearing Order and the application of that standard in the Tesoro Order on the grounds that the required showing “had not been a part of any previous FERC decision.” Br. 18; *see also* Br. 5 (arguing standard was “new and different”). On that point, the Shippers are right — and for that very reason, Tesoro should have presented its arguments against that newly revised standard to the Commission rather than ask this Court to evaluate its reasonableness in the first instance.

Now, on appeal, the Shippers raise an array of challenges to the Commission’s policy, both as a general approach and as specifically applied in this case, and more broadly accuse the Commission of foreclosing shippers’ objections to pipelines’ filings and “abandon[ing] the requirement that oil pipeline rates be just and reasonable.” Br. 6. The Commission, of course, was entitled to modify its interpretation of its own regulations under a statute it administers (*see infra* p. 35), but Tesoro’s decision not to present its objections to that interpretation left the

Commission without an opportunity to consider and respond to those objections.⁹

Accordingly, this Court should reject the Shippers' gambit to obtain judicial review of the Commission's new policy without having first given the Commission an opportunity to respond.

III. THE COMMISSION REASONABLY DISMISSED TESORO'S COMPLAINT UNDER ITS REVISED STANDARD FOR COMPLAINTS AGAINST INDEXED INCREASES

The Commission has, in numerous recent orders, worked to organize oil pipeline rate proceedings in a manner that distinguishes between types of challenges to pipelines' rates and recognizes different levels of complexity for each. The Shippers now raise a broad challenge to the Commission's handling of complaints in index cases. *See* Br. 41-60. Because, as discussed above, the Shippers never presented those arguments to the Commission in the underlying proceeding, the Tesoro Order offers no direct response. Nevertheless, the Tesoro Order is consistent with orders issued in contemporaneous FERC proceedings in

⁹ In contrast, BP West Coast has, in contemporaneous and subsequent cases where the Commission dismissed complaints on similar grounds, raised such arguments on rehearing before filing for judicial review. *See BP West Coast Products, LLC v. SFPP, L.P.*, FERC Docket Nos. OR07-3, *et al.*, 118 FERC ¶ 61,261, *on reh'g*, 121 FERC ¶ 61,195 (2007), *appeal pending*, *ExxonMobil Oil Corp. v. FERC*, D.C. Cir. Nos. 07-1163, *et al.* (consolidated); *BP West Coast Products, LLC v. SFPP, L.P.*, FERC Docket No. OR07-20, 121 FERC ¶ 61,243 (2007), *on reh'g*, 123 FERC ¶ 61,121 (2008), *appeal pending*, *BP West Coast Products LLC v. FERC*, D.C. Cir. No. 08-1237. Only in the latter proceeding did the Commission have its first opportunity to respond to challenges from a shipper regarding the revised standard for complaints against indexed increases.

which the Commission has more fully explained its rationale, often in response to similar arguments. Thus, we provide a short overview based on reasoning that has been set forth by the Commission itself. Given the Shippers' failure to raise any of their arguments before the Commission in this proceeding, the Shippers cannot fairly object to these points as *post hoc* rationalizations.

A. The Commission Has Reasonably Distinguished Between Three Kinds Of Complaints Against Oil Pipeline Rates

The Commission has distinguished among three types of complaints under ICA § 13 against oil pipelines' rates, in order of ascending factual complexity:

- Complaint against an indexed rate increase
- Complaint against the pipeline's FERC Form No. 6 cost reporting
- Complaint against the pipeline's underlying base rates

See BP West Coast [FERC Docket No. OR07-20], 121 FERC ¶ 61,243 at PP 8-10

(explaining differences among types of complaint proceedings). As the

Commission has explained, requiring separate proceedings for each type of challenge furthers the statutory goal of streamlined ratemaking:

Each of the three basic complaints described here involves a different order of accounting, analytical, and procedural complexity. Combining them 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 Energy Policy Act of 1992.

Id. at P 11; *see also id.* at P 12 n.13 (citing numerous cases, involving Calnev and SFPP and same objecting Shippers, in which Commission has explained three types of complaints); *infra* Part III.A.1 (discussing simplified indexing process).

Only the first, and narrowest, type of complaint is at issue in this case. *see* Complaint at ¶ 3 (“This Complaint relates only to the rate increases . . . [instituted under] the Commission’s index price regulations”), JA 5. Tesoro correctly filed a complaint against Calnev’s base rates in a separate FERC proceeding, which remains ongoing. *See ExxonMobil Oil Corp. v. Calnev Pipe Line, L.L.C.*, FERC Docket No. OR07-5, *et al.*, 120 FERC ¶ 61,075 (2007) (ruling that Tesoro and ExxonMobil, in separate complaints, both had met one threshold burden: “The Commission finds there are reasonable grounds to conclude that Calnev’s rates may be unjust and unreasonable. . . . [T]he complainants have established reasonable grounds to proceed to hearing”); Complaint ¶ 3 (noting separate challenge to base rates and contrasting with this complaint’s specific focus on indexed increases), JA 5. Though the Shippers’ Brief makes broad allegations that Calnev is overrecovering its costs of service and that certain figures in its reported data should be adjusted (Br. 30-35, 37-38), these more complex objections go to the structure of the regulatory costs of service embedded in Calnev’s underlying rates. As such, they are beyond the scope of the instant complaint against Calnev’s indexed rate increases. *See* Tesoro Order at P 7, JA 90.

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); *Northern 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).

1. 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. 4-5, the Commission established a process for allowing indexed 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 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, Calnev Pipe Line, L.L.C.*, 119 FERC ¶ 61,332 at P 5 (2007), *cited* in Tesoro Order at P 7 & n.7, JA 90, 91. 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." Order No. 561 at 30,948; *see also Frontier*, 452 F.3d at 777 ("This system dispenses with intricate calculations of specific pipeline costs."); *Calnev*, 119 FERC ¶ 61,332 at P 5 ("[T]he indexing approach allows pipelines to establish new rate ceiling rates without a detailed and comprehensive presentation and examination of the individual pipeline's cost of service in each case.").

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").

The indexing methodology 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.

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 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 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). *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 the agency has the discretion to consider legitimate non-cost factors to allow variation within that zone); *accord, 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).

To maintain the relative simplicity of the 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 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 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 (“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.”).

2. The Commission Reasonably Determined That Different Types Of Complaint Proceedings Serve The Goal Of Streamlining The Indexing Process

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 filings for indexed increases 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, 119 FERC ¶ 61,332 at P 7 (emphasis added), *cited in* Tesoro Order at P 7 n.7, JA 91. *Cf., e.g.,* Br. 30-32, 37-38 (challenging Calnev’s indexed increases based on the existing return in Calnev’s base rates and the cost components of those base rates). Accordingly, the Commission’s pleading standard for such a complaint reflects a specific focus on the effect of each individual year’s rate increase. *See, e.g.,* BP Complaint Order at PP 8-9 (“[A] complaint against an index increase in a single year is limited to the increase in that year. . . . 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 indexed increase be based on information presented on Page 700 of the pipeline’s FERC Form No. 6, taken on its face. *See* Tesoro Order at P 7 (“[T]he Commission relies solely on Page 700 of the pipeline’s FERC Form No. 6 in evaluating this type of complaint.”), JA 90; BP Complaint Order at P 9 (challenge to indexed increase “is normally limited to

matters that appear on the face of the Page 700”); *BP West Coast* [FERC Docket Nos. OR07-3, *et al.*], 118 FERC ¶ 61,261 at P 8 (same).

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., BP West Coast* [FERC Docket No. OR07-20], 121 FERC ¶ 61,243 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.”).

The most complex inquiry arises from a complaint against a pipeline’s base rates — for example, claiming that the pipeline is overrecovering its costs of service. This kind of complaint could challenge the cumulative effect of several years of annual rate increases under the indexing scheme, where the individual increases might not be unjust and unreasonable, but the cumulative result is a rate that substantially overrecovers costs:

[I]f a shipper wishes to challenge the cumulative increases embedded in the base rates or the cost components of those rates, the shipper must file a complaint under section 13 of the Interstate Commerce Act against those base rates. . . . Tesoro’s arguments that Calnev’s return is understated in the complaint years for various reasons are simply irrelevant. Complaining shippers must present those arguments in a complaint against the base rates.

Tesoro Order at P 7, JA 90; *id.* at P 5 (challenge to cumulative return “requires a more complex inquiry”), JA 90. As another example, in the instant case, Tesoro argued that Calnev had understated its return and that the costs of service should be adjusted based on changes in throughput. *See* Complaint ¶¶ 20-21 & Ex. C ¶¶ 5, 11-13, JA 10, 36, 40-41; Tesoro Order at P 2, JA 89. Such 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 (*see supra* p. 23) is inconsistent with, and thus handled separately from, the streamlined indexing process. *Cf.* BP 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.”).

B. As To Complaints Against Indexed Increases, The Commission Adopted A New Pleading Standard Consistent With Its Regulations

The FERC orders in the Companion Proceeding, reinforced by the Tesoro Order, established a revised standard for the first of the three types of complaints, one that challenged an indexed increase. *See supra* pp. 7-10. 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).

In the usual case, a shipper must meet this burden by showing (based on data reported in Form No. 6) 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 because difference between indexed increase of 6.15% and actual cost *decrease* of 4.8%, together with fact that Calnev’s revenues exceeded cost of service, constituted reasonable grounds for further inquiry).¹⁰ But in the Companion Proceeding, the Commission ruled, for the first time, that “under certain very limited

¹⁰ Calnev later filed a corrected Form No. 6 reflecting a 6.3 percent cost increase for the relevant year. *See* Tesoro Order at P 4 & n.5, JA 90-91; Calnev Answer at 5-6, JA 63-64.

circumstances” a complaint could meet that pleading requirement if the pipeline is already substantially overrecovering its costs. BP Rehearing Order at P 5; *see also* BP Complaint Order at P 11; *cf.* Br. 4-5 (noting that BP Complaint Order promulgated new standard), 13 (same).

The Commission acknowledged that its ruling was based on “a revised interpretation of 18 C.F.R. § 343.2(c) . . . [that] the Commission had not previously had occasion to address.” BP Rehearing Order at P 5. Of course, that “does not mean that the interpretation is arbitrary.” *Id.* The Commission is free to change its policy, so long as it provides “a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored.” *Mich. Pub. Power Agency v. FERC*, 405 F.3d 8, 12 (D.C. Cir. 2005) (quoting *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970)). The Commission further noted that the new standard is a narrow exception to the general rule that the pipeline’s underlying base rates are not considered in the streamlined procedures for challenges to indexed increases: “[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.” BP Rehearing Order at P 5.

After the Commission adopted the new rule in the BP Complaint Order, Tesoro filed its complaint in the instant case, relying on the BP Complaint Order as

precedent and alleging that Calnev was substantially overrecovering its costs when it filed indexed rate increases in 2005, 2006, and 2007. Complaint ¶¶ 14-22, JA 9-10; Br. 13. On rehearing in the Companion Proceeding, however, the Commission clarified the new standard, formalizing a second prong that was present in the facts in the Companion Proceeding but had not been expressed in the Commission’s statement of its revised policy in the BP Complaint Order. *See* BP Rehearing Order at PP 9-10; *supra* pp. 9-10. Again, the Commission explained its reasoning for the clarification, in both the BP Rehearing Order and the accompanying Tesoro Order. *See* BP Rehearing Order at PP 9-10; Tesoro Order at PP 6-7, JA 90; *supra* pp. 9-10, 12-13. In particular, the Commission believed 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 — as Calnev’s costs did here. BP Rehearing Order at P 9; Tesoro Order at PP 6-7, JA 90. Because the indexed increases would leave Calnev in the same position or even prevent it from fully recovering its actual cost increases, the annual rate increases “did not substantially exacerbate its current over-recovery.” *Id.* at P 7, JA 90.

The Commission appropriately employed the clarified standard in considering Tesoro’s complaint in the instant case. *See* BP Rehearing Order at P 1 n.2 (stating that revised ruling would apply to Tesoro’s complaint); Tesoro Order

at P 1 (noting that order follows standard established in BP Rehearing Order), JA 89. The Shippers correctly point out that the Commission had not previously applied the second prong of the standard in any case. Br. 18. The application of a newly adopted (and fully explained) policy, however, is not improper. *Cf. Mich. Pub. Power Agency*, 405 F.3d at 12. In any event, the Commission’s decision is entirely reasonable and in accord with the language of the controlling regulation. Thus, the analysis in the Tesoro Order demonstrates that the Commission reasonably found that Tesoro had not met its burden under the Commission’s revised policy. *See* Tesoro Order at P 7 (finding, based on Form No. 6 cost data, that “Calnev’s July 2006 and July 2007 indexed increases did not substantially exacerbate its current over-recovery”), JA 90; *id.* at P 4 (summarizing Calnev’s cost data indicating that inflation-based increases were lower than actual cost increases), JA 89; *see generally supra* pp. 11-14.

C. The Commission Has Not Foreclosed Challenges To Indexed Rates

Finally, we briefly address the Shippers’ sweeping criticism of the Commission’s treatment of complaints, in this specific case and under the indexing process generally. *See* Br. 41-60. Again, because the Shippers never raised any such arguments before the Commission in the underlying proceeding, the Tesoro Order and the administrative record provide no foundation for the Court to

consider the Shippers' wide-ranging criticisms of the Commission's efforts to organize the many challenges to oil pipeline rates that come before it.

As a procedural matter, the Shippers claim that the Commission has eliminated all avenues for shippers to contest indexed rate increases. Br. 10 (“[T]he Commission has now dismissed both a complaint and a protest against an oil pipeline rate filing, thus leaving shippers no means of challenging an unjust and unreasonable rate and no means of securing a remedy against payment of the rate.”), 23 (“the Commission has left shippers without a remedy”), 46 (same), 59 (same). This claim is demonstrably untrue — as intervenor BP West Coast knows better than anyone. BP West Coast's own complaint against a different pipeline's indexed increase is Exhibit A for a successful pleading under the same test that Tesoro's complaint failed — the Commission formulated its revised standard in the course of ruling that BP West Coast had provided reasonable grounds for further inquiry. Its complaint, together with a similar complaint by ExxonMobil, has been set for hearing. *See supra* p. 10.

Nor is the Companion Proceeding the only challenge to indexed rates to meet the initial burden; the Commission also has initiated other investigations based on both protests and complaints. For example, in *Calnev*, 115 FERC ¶ 61,387, the Commission found that ExxonMobil had met the burden of

production in an ICA § 15(7) protest to Calnev's pipeline's 2006 indexed rate filing. Calnev sought to increase its rates by the ceiling index amount for 2006, but had reported a decrease in its costs. *Id.* at P 5. (*But see supra* note 10.) The Commission considered the difference between the inflation-based increase and the actual change in costs and concluded that the shipper 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. In another case, a shipper filed an ICA § 13(1) complaint that challenged a 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. *ARCO v. Calnev Pipe Line, L.L.C.*, 97 FERC ¶ 61,057 at p. 61,310 (2001). The Commission set the matter for hearing to allow the shipper to review the work papers and conduct discovery. *Id.* at 61,311.

If the Shippers here mean to argue that *every* challenged rate filing must be subject to a full investigation and evidentiary hearing, if not on an ICA § 15(7) protest then on an ICA § 13(1) complaint (*e.g.*, Br. 23, 42-43, 46), they are wrong. *Cf. BP West Coast* [FERC Docket No. OR07-3, *et al.*], 121 FERC ¶ 61,195 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). 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; *Mobil Oil*, 498 U.S. at 230; *supra* p. 25.

Contrary to the Shippers’ suggestion (Br. 46-51), the Interstate Commerce Act does not guarantee that the Commission will hold a 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.”). Nor did the Supreme Court in *Southern Railway* state otherwise. (Nor, for that matter, did Commission counsel — even if she could bind the Commission — in discussing that passage of *Southern Railway* at oral argument in Case No. 05-1471.) Rather, *Southern Railway* merely recognized that, in contrast to a denial of a protest to a pipeline rate filing, the Commission’s decision not to hold a hearing on a shipper complaint is subject to judicial review:

[I]t is important to note the extremely limited scope of the administrative decision that we conclude is not judicially reviewable. . . . [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.

442 U.S. at 454 (emphasis added). Accordingly, as here, the shipper may appeal the FERC order and the Commission must provide a reasonable explanation — that is sufficient in the Court’s view — for its decision that a hearing was not warranted. *Southern Railway* requires no more.

As a substantive matter, the Shippers contend that, by determining that a pipeline’s overrecovery of its costs does not make every inflation-based rate increase unjust and unreasonable, absent a showing that the indexed increase will substantially exacerbate the overrecovery, the Commission has “abandon[ed] the just and reasonable rate standard.” Br. 32. The Shippers, however, misunderstand the relationship between base rates and indexed 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 just and reasonable rate, by accounting for effects of inflation, until the next full consideration of the base rate itself (whether on a shipper’s complaint or the pipeline’s own rate filing). *See supra* pp. 5, 27 (discussing Order No. 561 at 30,950).

When a shipper successfully challenges the base rate, resulting in a Commission finding that the rate is unjust and unreasonable (for example, because

the pipeline is overrecovering its costs of service — perhaps as a result of cumulative inflation-based increases that outpaced actual cost increases), the Commission will determine the just and reasonable rate and then adjust the rate for each year using the inflation-based index adjustments. *See* 18 C.F.R.

§ 342.3(d)(5). If the pipeline has been charging an unjust and unreasonable rate, the Commission will order reparations not only of the excess in the base rate but also of the indexed increases:

First, the base rates are recalculated at just and reasonable levels for the complaint year. The approved index factor is then applied to the reduced base rate and is carried forward This reduces the total amount of the revised rate and increases the reparations, which provides the appropriate remedy.

SFPP, L.P., 121 FERC ¶ 61,163 at P 5 (2007). In addition, “[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.” *BP West Coast* [FERC Docket Nos. OR07-3, *et al.*], 118 FERC ¶ 61,261 at P 11 & n.15 (citing 18 C.F.R. § 342.3(a)). *Accord*, *BP West Coast* [FERC Docket Nos. OR07-3, *et al.*], 121 FERC ¶ 61,195 at P 5 (“The Commission notes that the instant case involves an index-based increase to a rate subject to refund. Accordingly, 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”).

Therefore, if the Shippers are correct that Calnev is overrecovering its costs of service and thus charging an unjust and unreasonable rate, their concerns could be fully addressed in a challenge to Calnev's base rate — including any effects of the annual indexed increases contributing to such overrecovery.

D. The Dismissal of Tesoro's Complaint As Untimely With Respect To The 2005 Increase Is Not Properly Before This Court

The Commission dismissed Tesoro's complaint against Calnev's July 1, 2005 rate increase because Tesoro filed its complaint on August 1, 2007. Tesoro Order at P 7 (citing two-year statute of limitations under ICA § 16(3)(b)), JA 90. Tesoro challenges that ruling on appeal. Br. 39-41. (Because the Commission's ruling on the 2006 and 2007 indexed increases applies equally to the 2005 increase, however, the timing issue is moot unless the Commission's decision is reversed on the merits.)

Like the broader issues raised in the Shippers' opening brief, Tesoro never raised the discrete issue of the statute of limitations before the Commission; therefore, its objections to dismissal should not be considered on appeal. *See supra* Part II. If Tesoro believed the Commission wrongly dismissed the complaint as to Calnev's 2005 indexed increase, it should have requested rehearing on that point so the Commission could correct that mistake. If the Commission erred as a matter of law, it could have reconsidered its application of ICA § 16(3)(b). If the Commission misunderstood the time period covered by Calnev's allegations, it

could have corrected its finding. Having failed to challenge the Tesoro Order on this point, however, Tesoro now claims that it can only guess at the Commission's reasoning: "Although the FERC decision does not discuss this point in any detail, the FERC *apparently* concluded" Br. 39 (emphasis added). Because the Commission had no opportunity to respond, this Court should not now consider Tesoro's first, and only, objection to the Commission's finding.

In any event, the Commission found that "the complaint against the July 1, 2005 increase was filed on August 1, 2007 and is time barred given the strict two year statute of limitations." Tesoro Order at P 7, JA 90. On appeal, Tesoro argues that its cause of action accrued, not upon Calnev's tariff filing, but "upon delivery or tender [of petroleum products] by the carrier," so that it is entitled to reparations on all shipments after August 1, 2005. Br. 40. Before the Commission, however, Tesoro repeatedly demanded reparations and other relief for a period beginning on July 1, 2005. *See* Complaint ¶¶ 23, 34, 40, 41, JA 10, 12, 13.

CONCLUSION

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

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August 13, 2008