ORAL ARGUMENT HAS NOT YET BEEN SCHEDULED

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

No. 06-1361
(Consolidated with Nos. 07-1034, 07-1421, 09-1160, 09-1166, 09-1170)

FLINT HILLS RESOURCES ALASKA, LLC, *et al.*,
PETITIONERS,
v.

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

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

Christine A. Varney
Assistant Attorney General

John J. Powers, III
Robert J. Wiggers
Attorneys

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

Thomas R. Sheets
General Counsel

Robert H. Solomon
Solicitor

Kathrine L. Henry
Attorney

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

March 30, 2010
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CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are listed in the brief of Petitioners.

B. Rulings Under Review

1. Order Accepting Tariff Sheets, *BP Pipelines (Alaska), Inc., et al.*, FERC Docket Nos. IS06-466, *et al.*, 116 FERC ¶ 61,208 (Sept. 1, 2006) ("First Order"), R. 33, JA 17;

2. Order Denying Rehearing, *BP Pipelines (Alaska), Inc., et al.*, FERC Docket Nos. IS06-466, *et al.*, 118 FERC ¶ 61,056 (Jan. 26, 2007) ("Second Order"), R. 44, JA 22;

3. Order Denying Rehearing, *Trans Alaska Pipeline Sys.*, FERC Docket No. OR89-2, 120 FERC ¶ 61,279 (Sept. 26, 2007) ("Third Order"), R. 55, JA 437; and

4. Order on Rehearing and Motion for Clarification, *BP Pipelines (Alaska), Inc., et al.*, FERC Docket Nos. IS06-466, *et al.*, 127 FERC ¶ 61,039 (Apr. 14, 2009) ("Fourth Order"), R. 80, JA 40.

(A fifth order, Order on Remand Granting Rehearing, *BP Pipelines (Alaska), Inc., et al.*, Docket Nos. IS06-466, *et al.*, 124 FERC ¶ 61,153 (Aug. 8, 2008) ("Remand Order"), R. 60, JA 30, is related to, but is not one of, the orders under review.)

C. Related Cases

The consolidated cases in this appeal challenge tariff filings made in compliance with *Trans Alaska Pipeline Sys.*, 113 FERC ¶ 61,062 (2005), *order on reh'g*, 114 FERC ¶ 61,323 (2006), *order on reh'g and clarification*, 115 FERC ¶

61,287 (2006) (collectively "Opinion No. 481"). Petitions for review of all aspects related to Opinion No. 481 except the one raised in the instant consolidated appeal were denied by this Court in *Petro Star Inc. v. FERC*, Case Nos. 06-1166, *et al.*, 2008 U.S. App. LEXIS 5328 (unpublished decision issued March 6, 2008), *cert. denied sub nom. Exxon Mobil Corp. v. FERC*, 129 S. Ct. 898 (2009).

Consolidated appeals are before this Court in *Flint Hills Resources Alaska, LLC v. FERC*, D.C. Cir. Case Nos. 09-1236, *et al.*, relating to the effective date for certain TAPS Quality Bank changes. That consolidated appeal is currently in briefing. In addition, *Flint Hills Resources Alaska, LLC v. FERC*, D.C. Cir. Case Nos. 08-1270, *et al.*, a consolidated appeal of FERC orders that established rates and ordered refunds for interstate service in 2005 and 2006 on TAPS, is currently in briefing.

Counsel is not aware of any other related cases pending before this Court or any other court.

s/ Kathrine Henry
Kathrine Henry
Attorney

March 30, 2010
Corrected Final Brief: June 9, 2010

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GLOSSARY

Br.	January 29, 2010 Initial Brief of Petitioners/Shippers
FERC or Commission	Federal Energy Regulatory Commission
First Order	*BP Pipelines (Alaska), Inc., et al.*, FERC Docket Nos. IS06-466, *et al.*, 116 FERC ¶ 61,208 (Sept. 1, 2006), R. 33, JA 17
Fourth Order	*BP Pipelines (Alaska), Inc., et al.*, FERC Docket Nos. IS06-466, *et al.*, 127 FERC ¶ 61,039 (Apr. 14, 2009), R. 80, JA 40
JA	Joint Appendix
R.	Record
Remand Order	*BP Pipelines (Alaska), Inc., et al.*, Docket Nos. IS06-466, *et al.*, 124 FERC ¶ 61,153 (Aug. 8, 2008), R. 60, JA 30
Second Order	*BP Pipelines (Alaska), Inc., et al.*, Docket Nos. IS06-466, *et al.*, 118 FERC ¶ 61,056 (Jan. 26, 2007), R. 44, JA 22
Shippers	Petitioners Flint Hills Resources Alaska, LLC; Petro Star, Inc.; Union Oil Company of California; Chevron U.S.A., Inc.; and Williams Alaska Petroleum, Inc., and Intervenors B.P. Exploration (Alaska) Inc. and B.P. America Production Company
TAPS	Trans Alaska Pipeline System
Third Order	*Trans Alaska Pipeline Sys.*, FERC Docket No. OR89-2, 120 FERC ¶ 61,279 (Sept. 26, 2007), R. 55, JA 437

IN THE UNITED STATES COURT OF APPEALS
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No. 06-1361
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PETITIONERS,

v.

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

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

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission ("Commission" or "FERC") reasonably determined that the two-step inflation adjustment method proposed by the Trans Alaska Pipeline System ("TAPS") Carriers in compliance tariff filings, and supported by the independent expert Quality Bank Administrator ("Administrator"), to value Resid and Heavy Distillate cuts of crude oil, was accurate and consistent relative to the valuation of other cuts shipped on TAPS.

STATUTORY PROVISIONS

The relevant statutory provisions are contained in the Addendum.

INTRODUCTION

This case is the fifth in a series before this Court relating to the Commission's regulation of TAPS, which provides the only means for shipping crude oil pumped from Alaska's North Slope oil fields to Valdez, Alaska. *See OXY USA, Inc. v. FERC*, 64 F.3d 679 (D.C. Cir. 1995); *Exxon Co. v. FERC*, 182 F.3d 30 (D.C. Cir. 1999); *Tesoro Alaska Petroleum Co. v. FERC*, 234 F.3d 1286 (D.C. Cir. 2000); *Petro Star Inc. v. FERC*, Nos. 06-1166 *et al.*, 2008 U.S. App. LEXIS 5328 (D.C. Cir. Mar. 6, 2008), *cert. denied sub nom. Exxon Mobil Corp. v. FERC*, 129 S. Ct. 898 (2009). Because there are multiple shippers and only one pipeline, the shippers' oil, which is of varying quality, is necessarily commingled during shipping, and each shipper takes delivery of a share of the common stream at Valdez. *OXY*, 64 F.3d at 684. As in the previous cases, this case involves the method for determining the relative values of various qualities of crude oil shipped in the commingled stream, which must be approved by the Commission pursuant to its authority under the Interstate Commerce Act, 49 U.S.C. app. §§ 1 *et seq.* (1988). *OXY*, 64 F.3d at 684.

"The TAPS 'Quality Bank' is an accounting arrangement approved by [FERC] that makes monetary adjustments between shippers in an attempt to place

each in the same economic position it would enjoy if it received the same petroleum at Valdez that it delivered to TAPS on the North Slope." *Id.* Thus, "the Quality Bank charges shippers of relatively low-quality petroleum who benefit from commingling and distributes the proceeds to shippers of higher quality petroleum whose product is degraded by commingling." *Id.*

Because the oil at issue is not sold until after it is commingled and shipped to Valdez, there is no independent market upon which to base the relative price of the various streams shipped on TAPS. *Exxon*, 182 F.3d at 35. The Quality Bank determines the relative value of the oil using a "distillation" methodology. *Tesoro*, 234 F.3d at 1289; *Exxon*, 182 F.3d at 35. "Under that methodology, the crude stream is separated into its component parts, or 'cuts,' market values are assigned to each cut, and the value of a crude stream is determined by the relative weighting of the cuts." *Trans Alaska Pipeline Sys.*, 113 FERC ¶ 61,062 at P 4 (2005).

The nine TAPS cuts, from lightest to heaviest, are: (1) Propane; (2) Isobutane; (3) Normal Butane; (4) Light Straight Run; (5) Naphtha; (6) Light Distillate; (7) Heavy Distillate; (8) Vacuum Gas Oil; and (9) Resid. Of the nine cuts, only two -- Resid and Heavy Distillate -- are at issue in this consolidated appeal. No published market price exists for either cut. *OXY*, 64 F.3d at 694; *Tesoro*, 234 F.3d at 1289.

In this consolidated appeal, certain shippers challenge a series of orders in

which the Commission accepted compliance tariff filings by the TAPS Carriers, the owners of the pipeline,[1] which proposed a two-step inflation adjustment method to calculate the value of Resid and Heavy Distillate. *BP Pipelines (Alaska), Inc., et al.*, 116 FERC ¶ 61,208 (2006) ("First Order"), JA 17, *reh'g denied*, 118 FERC ¶ 61,056 (2007) ("Second Order"), JA 22, and *order on reh'g and clarification*, 127 FERC ¶ 61,039 (2009) ("Fourth Order"), JA 40. In addition, one shipper challenges the final order in a related FERC docket, issued between the Second and Fourth Orders, in which the Commission declined to act on a protest to certain voluntary filings which involved the Quality Bank Administrator's calculations for the refund period established in Opinion No. 481. *Trans Alaska Pipeline Sys.*, 120 FERC ¶ 61, 279 (2007) ("Third Order"), JA 437. *See* fn. 3 *infra*. (A fifth order, issued on voluntary remand by the Commission after Shippers appealed the First and Second Orders, *BP Pipelines (Alaska), Inc., et al.*, 124 FERC ¶ 61,153 ("Remand Order"), JA 30, is related to, but is not one of, the orders under review.)

[1] The current TAPS Carriers are BP Pipelines (Alaska) Inc., ConocoPhillips Transportation Alaska Inc., ExxonMobil Pipeline Company, Koch Alaska Pipeline Company, LLC and Unocal Pipeline Company.

STATEMENT OF FACTS

I. Events Leading To The Challenged Orders

A. *OXY* Proceeding

When the TAPS Quality Bank was first instituted in 1984, it used a gravity methodology to determine the monetary adjustments between shippers. *OXY*, 64 F.3d at 685; *see also Tesoro*, 234 F.3d at 1288; *Trans Alaska Pipeline System*, 29 FERC ¶ 61,123 (1984) (approving the Quality Bank and its use of the gravity methodology). In 1993, however, as the components of the oil shipped on TAPS had changed, the Commission found use of the gravity methodology was no longer just and reasonable, and approved use of the distillation methodology as the just and reasonable replacement. *OXY*, 64 F.3d at 686-87; *see also Tesoro*, 234 F.3d at 1288-89; *Trans Alaska Pipeline System*, 65 FERC ¶ 61,277 (1993) (approving the Quality Bank's use of the distillation methodology).

This Court affirmed the Commission's determinations to replace the gravity methodology with the distillation methodology and to apply the distillation methodology only prospectively. *OXY*, 64 F.3d at 689-92, 696-701. The Court remanded, however, as to the method for valuing Resid and Distillate cuts. The Court found that the valuation of the Distillate cuts was flawed, because the market proxies were refined product prices that require processing and there was no reduction on the proxy price to reflect these processing costs. With respect to

Resid, the Court found that there was no evidence to show a relationship between the proxy prices and the value of Resid. *Id.* at 692-96.

B. The 1997 Settlement

In response to *OXY*, the Commission set the remanded issues for hearing. *Exxon,* 182 F.3d at 36. A contested settlement was approved by the Commission in 1997. *Trans Alaska Pipeline Sys.*, 81 FERC ¶ 61,319 (1997). Among other provisions, the settlement established values prospectively for Resid and Light and Heavy Distillates, which reflected the cost to process each cut to its respective market proxy's specification at a specific time. *Id.* at 62,460.

The settlement further provided that the Quality Bank Administrator would revise the agreed-upon cost adjustment each year by projecting the inflation of those costs for the year in question based upon the average inflation trend during the preceding two years. Specifically, the settlement provided that each year, beginning January 1, 1998, regardless of when the settlement became effective, "the adjustments to the specified prices . . . shall be revised in accordance with changes in the Nelson-Farrar Index -- Operating Cost Index for Refineries[2] by

[2] The Nelson-Farrar Index is published monthly by the *Oil and Gas Journal*. It tracks, compares and reflects overall refinery operating costs rather than those costs' individual components. It is regularly corrected for the productivity of labor, changes in the amounts of fuel used, productivity in the design and construction of refineries and the amounts of chemicals and catalysts employed. Fourth Order P 12, n.14, JA 44.

multiplying the adjustments provided hereunder for the previous year by the ratio of (a) the average of the monthly indices that are then available for the most recent 12 consecutive months to (b) the average of the monthly indices for the previous (*i.e.*, one year earlier) 12 consecutive months." Fourth Order P 12, JA 44. Since there is a lag by the index publisher in reporting the monthly indices, the calculation for January 1 of each year would include the 12-month period from September 1 to August 30. *Id.* (This method, which was incorporated into the Quality Bank tariff, is referred to by the Commission as the "Tariff Method." *Id.*)

In January 1998, the TAPS Carriers filed their first yearly Quality Bank tariff after the 1997 Commission order, which reflected the revisions in the remanded cuts. Subsequent tariffs revised the processing cost adjustments annually using the Tariff Method. *Id.* P 15, JA 45.

C. *Exxon* Proceeding

On review of FERC's 1997 order approving the contested settlement, this Court substantially upheld FERC's determinations, including provisions relating to the valuation of Heavy Distillate and the valuation of Resid based on the latter's use as a feedstock for "cokers," *i.e.*, refinery equipment that breaks Resid down into its constituent products. *Exxon*, 182 F.3d at 36, 40-41, 42, 46. The Court remanded for lack of substantial evidence, however, the Commission's determination to use an adjusted market price as the proxy for the market value of

Resid, because it had not been shown that "the chosen proxy [bore] a rational relationship to the actual market value of resid." *Id.* at 42. (The provisions relating to the use of the Nelson- Farrar index in the Tariff Method were not at issue in *Exxon*.)

D. *Tesoro* Proceeding

In 1996, while the *OXY* remand was pending, Exxon filed a complaint challenging use of the distillation methodology. *Tesoro*, 234 F.3d at 1289. "Upholding an ALJ decision, the Commission dismissed the complaint, holding that Exxon had failed to produce evidence of changed circumstances to justify re-examination of the 1993 adoption of the distillation method." *Id.* (citing *Exxon Co., U.S.A. v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,133 at 61,527-30 (1999)).

Then, in 1998, Tesoro filed a complaint challenging the Naphtha and VGO cut valuations. *Id.* The Commission dismissed Tesoro's complaint, finding that no changed circumstances justified re-examining those valuations. *Id.* (citing *Tesoro Alaska Petroleum Co. v. Amerada Hess Pipeline Corp.*, 87 FERC ¶ 61,132 at 61,517-20 (1999)).

On review, this Court remanded to the Commission, finding that the Commission had not responded meaningfully to Exxon's and Tesoro's evidence of changed circumstances. *Id.* at 1294, 1295.

E. Notice Regarding Change in Valuation for Heavy Distillate

On November 24, 1999, the Administrator notified the Commission of a change in the published proxy price used to value the West Coast Heavy Distillate cut. The Commission accepted the proxy change on February 9, 2000. Since the parties could not agree on the amount of the processing cost adjustment for Heavy Distillate, it became an issue in the hearing discussed below. Fourth Order P 16, JA 45.

F. The ALJ Hearing

On November 1, 2001, the Commission ordered a hearing before an Administrative Law Judge to address, among other things, the remanded valuation issues from *Exxon* regarding the Resid cut and the amount of the processing cost adjustment for Heavy Distillate. *Trans Alaska Pipeline Sys. v. Amerada Hess Pipeline Corp.*, 97 FERC ¶ 61,150 at 61,652 (2001). After an extensive evidentiary hearing in 2002-03, the ALJ issued an Initial Decision. *Trans Alaska Pipeline Sys.*, 108 FERC ¶ 63,020 (2004).

The parties presented competing data regarding Resid processing costs, one set stated in 1996 dollars and the other in year 2000 dollars. Fourth Order P 17, JA 45. Except for the TAPS Carriers, the parties stipulated ("2002 Stipulation") that Resid would be valued as a coker feedstock and that the coker feedstock value of Resid would be determined in accordance with the following formula: "Resid =

Before-Cost Value of Coker Products – (Coking Costs * Nelson Farrar Index)." *Id.* The Nelson Farrar Index was defined as the ratio of: "(a) the Nelson Farrar Index (Operating Indexes Refinery) for the year in which the value is being determined to (b) the Nelson Farrar Index (Operating Indexes Refinery) for the base year." *Id.*

G. Opinion No. 481

The Commission affirmed virtually all of the ALJ's rate determinations. *Trans Alaska Pipeline Sys.*, 113 FERC ¶ 61,062 (2005), *order on reh'g*, 114 FERC ¶ 61,323, *order on reh'g*, 115 FERC ¶ 61,287 (2006) (collectively, "Opinion No. 481"). Among other determinations, the Commission affirmed that the processing cost adjustment for Heavy Distillate and the capital investment (for a petroleum coking unit as specified in Opinion No. 481) cost adjustment for Resid, which were based on 1996 data submitted at the hearing, should be adjusted to a 2000 base year using the Nelson-Farrar indices, effective February 1, 2000. *Trans Alaska Pipeline Sys.*, 108 FERC at P 1258 and 1450; Fourth Order P 18, JA 46.

H. *Petro Star* Proceeding

On review of certain aspects of Opinion No. 481, this Court affirmed the Commission in all respects. *Petro Star Inc. v. FERC*, Nos. 06-1166 *et al.*, 2008 U.S. App. LEXIS 5328 (D.C. Cir. Mar. 6, 2008), *cert. denied sub nom. Exxon Mobil Corp. v. FERC*, 129 S. Ct. 898 (2009). Among other issues, the Court

upheld the Commission's determination that the price of the Resid byproduct coke should have been adjusted to reflect shipping and handling costs, against assertions that such adjustment was discriminatory and contrary to the relative consistency requirement in *OXY*, because those costs were ignored for other cuts. The Court found that the Commission's different treatment of coke was "perfectly reasonable," given that shipping and handling costs are dramatically higher relative to coke's value than the relative costs of any other oil product. Slip op. at 2. The Court also rejected challenges to the Commission's determinations regarding the effective date of the Resid valuation methodology. *Id*.

I. The Compliance Tariff Filings

On July 3, 2006, the TAPS Carriers filed identical tariffs to comply with Opinion No. 481. R. 1-5, JA 63-91. The tariff filings included a memorandum from the Quality Bank Administrator explaining, among other things, the two-step process he used to revise valuations for Resid and Heavy Distillate.

First, in accordance with Opinion No. 481, he converted 1996-based capital investment coking costs for Resid and the 1996 processing cost for Heavy Distillate to a year-2000 basis. *Id.* The memorandum explained that the Administrator revised the cost adjustment in the 1997 settlement for Light Distillate for the entire period until 2006, using the Tariff Methodology. Fourth Order P 20, JA 46. This method resulted in a reduction of processing costs for

Light Distillate by a factor of 0.9812. *Id.* P 22, JA 47. However, the Administrator used a different method (the Nelson-Farrar Index Method) to convert the 1996 cost adjustments for Resid and Heavy Distillate to the year 2000. The Administrator converted the Resid/Heavy Distillate cost adjustments from 1996 to 2000 using the ratio of the average of the Nelson-Farrar Index for calendar year 2000 to the average of the Nelson-Farrar Index for calendar year 1996, which resulted in an increase in costs for Resid/Heavy Distillate by a factor of 1.0742. *Id.* PP 20, 22, JA 46, 47.

In the second step, the Administrator escalated those costs from the 2000 base year to each subsequent year through 2005 using the Tariff Method. First Order P 5, JA 19.

In a July 5, 2006 memorandum to all interested parties, the Administrator explained why he did not use the Tariff Method to convert the Resid/Heavy Distillate cuts from 1996 to the year 2000. R. 13, JA 267; Fourth Order P 21, JA 46-47. The Administrator stated that in the Opinion No. 481 proceeding, the ALJ accepted processing cost data for the overall year 1996, not costs as of January 1, 1996. Thus, the costs could come from any part of the year. The Administrator concluded that, in complying with Opinion No. 481's instruction to convert the 1996 costs to 2000 costs using the Nelson-Farrar indices, it seemed logical to use a ratio of the average 2000 Nelson-Farrar index to the annual average 1996 index.

R. 13, JA 267; Fourth Order P 21, JA 46-47.

Protestors to the tariff filings claimed that the two-step method used by the Administrator for Resid/Heavy Distillate resulted in double-counting of inflation from September 1999 through December 2000, and a reduction in the relative value of those cuts, because the 1996-2000 base year and 2001-2002 annual adjustments both included inflation for that period. R. 13, JA 186, 190. In addition, the protests argued that the two-step method violated the *OXY* requirement that the Commission accurately value all cuts or overvalue (or undervalue) all cuts to the same degree, since different inflation methods were used for Light Distillate on one hand and Resid/Heavy Distillate cuts on the other, resulting in different valuations. *Id.*, JA 13-14.

II. The Challenged Orders

A. First Order

On September 1, 2006, the Commission accepted the tariff sheets, effective November 1, 2005, the date directed by Opinion No. 481. The Commission found that the Administrator's calculations were consistent with the directives of Opinion No. 481. First Order P 13, JA 21. The Commission further found that the fact that the Administrator used 2000 Nelson-Farrar Index values in different calculations pertaining to different years did not result in a double count, as argued by the protestors. *Id.* PP 10-12, JA 20-21. In addition, the Commission found fault with

the method advocated by protestors, which would apply the Tariff Method to inflate 1996 costs for the Resid/Heavy Distillate cuts into year 1999 costs, not year 2000 costs as required by Opinion No. 481. *Id.* P 12, JA 20-21.

B. Second Order

On rehearing, the Commission explained again the errors in the arguments that (1) the Administrator's calculations resulted in double-counting and (2) the protestors' proposal to inflate 1996 costs to year 2000 costs using the Tariff Method was superior. In addition, the Commission addressed the argument that the inflation factor applied by the Administrator to Resid/Heavy Distillate was inconsistent with the inflation factor applied to Light Distillate.

The Commission explained that, for the cost escalation from 1996 to 2000, the Nelson-Farrar indices for those years were available, and the Administrator correctly compared the average value of the indices for 1996 and 2000 to arrive at the 1.0742 inflation factor for Resid/Heavy Distillate. Second Order P 18, JA 28. That calculation established the cost figures for going forward from the 2000 base year. The Administrator was then able to make the required annual inflation adjustments for the subsequent years, pursuant to the Tariff Method established in the 1997 Settlement. *Id.*

Under the Tariff Method, in calculating the 2001 annual adjustment for Resid/Heavy Distillate, the Administrator used the average Nelson-Farrar index for

the twelve months of September 1999 to August 2000 compared to the same twelve months of the prior year, September 1998 to August 1999. *Id.* P 19, JA 28-29. The fact that the indices from September 1999 to December 2000 were included initially in the 1996 to 2000 conversion calculation and then used in the annual adjustment calculation for 2001 does not equate to double counting of inflation in that period. *Id.*

In addition, the Commission explained again the reasons for rejecting application of the Tariff Method used for annual escalation to the conversion of the 1996 costs for Resid/Heavy Distillate to a 2000 base year. The request for rehearing argued that the Commission should have divided the average Nelson-Farrar indices for September 1998 through August 1999 by the average indices for September 1994 through August 1995 to convert 1996 values to 2000 values. However, this proposed method would use no data from either 1996 or 2000, even though the annual indices for both years were known. *Id.* P 20, JA 29.

Finally, the Commission stated that there was no inconsistency between the inflation factor applied to Resid/Heavy Distillate under the Administrator's calculations and the inflation factor applied to Light Distillate. *Id.* P 21, JA 29.

C. Third Order

On August 15, 2006, in a separate docket, the Commission denied a motion to approve a Notice of Filing Basis for Retroactive Calculations. This filing

consisted of the Administrator's calculations of the component values for the refund period established in Opinion No. 481. Third Order P 5, JA 438-39. Petro Star protested the Notice on the ground it contained the same error as the tariff compliance filings. *Id*.

On June 7, 2007, the Commission denied the motion on the ground that the Notice was voluntary and that the Commission had no role in overseeing the operations of the Quality Bank; thus, there was no reason to take any action with respect to the Notice. *Trans Alaska Pipeline Sys.*, 119 FERC ¶ 61,254 at PP 9-10 (2007). Petro Star requested rehearing, asserting that the Commission erred in failing to rule on its protest of the Notice, which left no final order from which to seek judicial review. Third Order P 10, JA 440. In its Order Denying Rehearing, the Commission reiterated that there was no need to address the Notice. In addition, the Commission clarified that any court ruling in the tariff filing case would apply to the Notice. *Id.* PP 16-17, JA 441-42.

D. Initial Judicial Proceedings and Remand Order

On October 27, 2006, Flint Hills Resources Alaska, LLC filed a petition for review of the First Order, *Flint Hills Resources Alaska, LLC v. FERC*, D.C. Cir. No. 06-1361, which was held in abeyance pending Commission action on rehearing. Petro Star, Inc. filed a petition for review on February 8, 2007, of the First and Second Orders. *Petro Star, Inc. v. FERC*, D.C. Cir. No. 07-1034. *Flint*

Hills and *Petro Star* were consolidated on March 23, 2007.

On October 18, 2007, Williams Alaska Petroleum, Inc. ("Williams") filed a petition for review of the Third Order, *Williams Alaska Petroleum, Inc. v. FERC*, D.C. Cir. No. 07-1421. On October 22, 2007, Williams filed a motion to consolidate the petition for review in D.C. Cir. 07-1421 with the consolidated petitions for review filed by Flint Hills, *et al.* in D.C. Cir. Nos. 06-1361, *et al.* On November 2, 2007, the Commission filed a motion to dismiss Case No. 07-1421 for lack of jurisdiction on the ground that Williams had not participated in the underlying agency proceeding, and Williams filed a response in opposition.

Petitioners in D.C. Cir. No. 06-1361, *et al.* filed their initial brief on November 14, 2007. Thereafter, on January 14, 2008, the Commission filed an unopposed motion to hold the consolidated appeals in *Flint Hills, et al.* in abeyance and for voluntary remand to permit further consideration of the claims on appeal regarding the relative consistency requirement in *OXY*. The Court granted the voluntary remand motion on January 22, 2008.

On February 14, 2008, the Court ordered the appeal in D.C. Cir. No. 07-1421 to be held in abeyance pending further order, in light of the January 22, 2008 remand order in *Flint Hills, et al.* In the same order, the Court directed the parties to address in their briefs the issues presented in the Commission's motion to

dismiss.[3]

The Commission issued an Order on Remand Granting Rehearing on August 8, 2008. *BP Pipelines (Alaska) Inc., et al.*, 124 FERC ¶ 61,153 (2008) ("Remand Order"). (That order was not challenged in this appeal.) In the Remand Order, the Commission -- now agreeing with the protestors and now departing from the Administrator's calculations -- held that there was no overriding reason not to use the agreed-upon Tariff Method to convert the 1996 processing cost adjustments for Resid/Heavy Distillate to year 2000 costs, in the same manner as applied to escalate the adjustment for Light Distillate. Remand Order P 28, JA 38. The Commission directed the Administrator to recalculate the processing cost adjustments for Resid/Heavy Distillate using the Tariff Method. *Id.* P 29, JA 38.

E. Fourth Order

On rehearing of the Remand Order, the Commission again approved the Administrator's calculations. The Commission found there was good reason not to

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[3] Other than mentioning the appeal in D.C. No. 07-1421, Br. at 2 and fn.9, Shippers do not address either the motion to dismiss or the specific merits of the Third Order in their arguments. Shippers apparently assume that the merits of D.C. Cir. No. 07-1421 are the same as those in the other consolidated dockets. Given the Commission's statement in the Third Order, PP 16-17, JA 441-42, concerning the applicability of a court ruling on the First and Second Orders to the Administrator's Notice underlying the Third Order, the subsequent issuance of the Fourth Order, and Williams' petition for review of the Fourth Order in D.C. Cir. No. 09-1170, the Commission will not further address the motion to dismiss or the separate merits of the Third Order in this brief.

use the Tariff Method to convert 1996 cost adjustments for Resid/Heavy Distillate to year 2000 costs; therefore, the use of different escalation methods for different cuts did not violate the *OXY* relative consistency requirement.

In particular, the data presented on rehearing of the Remand Order showed that the processing cost of Light Distillate is only about one-half cent per gallon, equal to just 0.54 percent of its adjusted value. In contrast, processing costs for Resid and Heavy Distillate represent a significant portion of the value of those cuts, 19 cents and 5 cents, equal to 47.51 and 5.87 percent of their adjusted values, respectively. Fourth Order P 62, JA 59, and n.32, JA 54. Thus, while the value of Light Distillate is basically the same, regardless of the method used to escalate processing cuts, there is a substantial difference in the values of Resid/Heavy Distillate depending on which escalation method is used. *Id.* P 62, JA 59. These data were not contested. *Id.* P 67, JA 60.

It was also undisputed that the Nelson-Farrar Index Method was the more accurate method to convert 1996 processing costs to year 2000 costs for Resid/ Heavy Distillate, because it reflected actual inflation for those years. *Id.* P 64, JA 59. Using the Tariff Method, which is based on past inflation due to the unavailability of current data as a result of the four-month index publishing lag, would unnecessarily overvalue Resid/Heavy Distillate by about 9 percent relative to other cuts and bestow an unjustifiable benefit on producers whose oil contained

significant amounts of Resid/Heavy Distillate. *Id.*

Accordingly, the Commission determined that the more accurate Nelson-Farrar Index method of calculating the conversion from 1996 costs to 2000 costs for Resid/Heavy Distillate should be used, in this limited, locked-in period, even if it differed from the Tariff Method applied to Light Distillate. *Id.* P 67, JA 60-61. The Commission found that it was permissible to treat different Quality Bank cuts differently where there was a valid reason for doing so, since the goal is to assure that a Quality Bank cut is not being overvalued in relation to other cuts. *Id.* P 68, JA 61. The Commission referenced as an example of valid different treatment this Court's decision in *Petro Star*, slip op. at 2, which found that it was "perfectly reasonable" for the Commission to treat the Resid coke product differently for valuation purposes. In *Petro Star*, the Commission had reduced coke's value by its shipping and handling costs, while ignoring those costs in valuing other cuts, because those costs were significantly higher relative to coke's value than the same costs were relative to the value of other oil products. *Id.*

The Commission also affirmed the ruling in the First and Second Orders on the double-counting issue. *Id.* P 69, JA 61.

F. Later Judicial Proceedings

Petro Star, Chevron U.S.A. Inc./Union Oil Company of California, and Williams filed petitions for review of the Fourth Order in D.C. Cir. Nos. 09-1160,

09-1166 and 09-1170. Those appeals, as well as Case No. 07-1421, were consolidated with the earlier petitions for review of the First and Second Orders.

SUMMARY OF ARGUMENT

This case addresses the one TAPS valuation issue not addressed two years ago by this Court in *Petro Star v. FERC* (affirming the Commission on numerous other valuation issues). The remaining issue – concerning the accuracy of inflation adjustments, affecting the relative valuation of Resid and Heavy Distillate cuts of crude oil – is difficult. The Commission asked for a voluntary remand and later reversed itself twice. Despite the belated outcome, the Commission ultimately reached a decision that is mathematically accurate, consistent with the calculations of the independent expert Quality Bank Administrator, and consistent relative to the valuation of other cuts of TAPS oil. As such, it is a reasonable decision that, like the other valuation decisions affirmed in *Petro Star*, deserves judicial deference.

Specifically, the Commission determined that the Quality Bank Administrator's two-step inflation adjustment method to value Resid/Heavy Distillate crude oil cuts complied with Opinion No. 481 and did not double-count inflation. In addition, the Commission determined that the Administrator's method met the relative consistency requirement established by this Court in *OXY USA Inc. v. FERC*, because there was good reason to treat the processing cost adjustment for

Resid and Heavy Distillate cuts differently than the adjustment for Light Distillate.

On appeal, Shippers continue to argue that the Administrator's two-step method double-counted inflation for the 16-month period of September 1999 through December 2000, since Nelson-Farrar index values from that period were used in both steps. This argument reflects the fundamental misconception that the Tariff Method used for annual inflation adjustments is intended to account for inflation that has already occurred. Instead, as explained in the challenged orders, the Tariff Method forecasts inflation for the upcoming year, based upon the inflation trend in the preceding two years. The 1999-2000 Nelson-Farrar index values at issue here were used in two different calculations to calculate the inflation adjustment for two different time periods, first to convert 1996 costs to year 2000 costs, then to project inflation for 2001 forward; therefore, there was no double-counting.

In addition, Shippers make virtually no attempt to challenge the Commission's reasonable finding, based on processing cost differences, that the use of different cost adjustment methods for the Resid/Heavy Distillate cuts and the Light Distillate cut satisfied the *OXY* relative consistency requirement. Instead, Shippers revert to their erroneous double-counting argument. They claim that, because the Administrator's two-step method results in inaccurate valuations for Resid/Heavy Distillate, it necessarily violated *OXY*'s relative consistency

requirement. But because there was no double-counting, there was no mathematical inaccuracy undervaluing Resid and Heavy Distillate cuts relative to all other cuts.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *OXY*, 64 F.3d at 690. Under that standard, the Commission's decision must be reasoned and based upon substantial evidence in the record.

Deference to the Commission's decisions regarding rate issues is broad, because of "the breadth and complexity of the Commission's responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 790 (1968); *see also Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. 1*, 128 S. Ct. 2733, 2738 (2008) ("The statutory requirement that rates be 'just and reasonable' is obviously incapable of precise judicial definition, and we afford great deference to the Commission in its rate decisions."); *ExxonMobil v. FERC*, 487 F.3d 945, 951 (D.C. Cir. 2007) ("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 v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996)). *See also OXY*, 64 F.3d at 690 ("Where the necessary analysis 'requires a high degree of technical

expertise, we must defer to the informed discretion of the responsible federal agencies'") (citation omitted); *Petro Star*, Slip op. at 2 (FERC's consideration of tests estimating Resid content of Alaskan oil was "exactly the type of expert judgment about which we defer to FERC").

II. THE COMMISSION APPROPRIATELY DETERMINED THAT THE QUALITY BANK ADMINISTRATOR'S INFLATION ADJUSTMENT METHOD FOR RESID/HEAVY DISTILLATE DID NOT RESULT IN DOUBLE COUNTING

A. The Commission's Determination That No Double-Counting Occurred Was Rational And Based On Substantial Evidence.

The Commission reasonably determined that the Administrator's two-step method for determining inflation adjustments for the valuation of Resid/Heavy Distillate did not double-count inflation. The Commission fully explained its conclusion regarding double-counting, which was supported by substantial evidence in the record, in the First and Second Orders and affirmed that conclusion in the Fourth Order. Thus, the Court should defer to the Commission's determinations on this issue of fact. *See Public Service Co. of New Hampshire v. FERC*, 600 F.2d 944, 950 (D.C. Cir. 1979) (deferring to FERC's determination that rate surcharge was not retroactive ratemaking where costs incurred during prior test period were used as a proxy for current costs); *see also Petro Star*, slip op. at 2 (agreeing with FERC's explanation that it did not double-count certain refining costs in its Resid valuation).

In the First Order, the Commission explained that, contrary to protestors' claims, the fact that the Administrator used Nelson-Farrar Index data from the same time period in different calculations for different years did not result in double-counting of inflation for the same period. First Order P 10, JA 20. The Administrator did not use the Nelson-Farrar Index values twice in the same ratio or calculation. Rather, in converting the 1996 costs for Resid/Heavy Distillate to base year 2000 costs, as required by Opinion No. 481, the Administrator reasonably used the ratio of the known average of all twelve monthly Nelson-Farrar Index values for 2000 divided by the known average of all twelve monthly Nelson-Farrar index values for 1996. *Id.* Using the twelve-month Nelson-Farrar indices for 1996 and 2000 accurately reflected the inflation to costs for the period 1996-2000 and was available when the Administrator made the conversion calculation.

Once the Administrator determined the base year 2000 costs, that amount was then used going forward in estimating the inflation adjustment for 2001 (*i.e.*, February 2001 through January 2002), following the required Tariff Method of comparing the two most recent consecutive 12-month periods for which Nelson-Farrar Index data existed (September 1999 to August 2000 and September 1998 to August 1999). *Id.* P 11, JA 20.

In addition, the Commission found flaws with the method advocated by protestors. First, the protestors' method, which would apply the Tariff Method

using the average Nelson-Farrar Index for September 1998 through August 1999 divided by the average Nelson-Farrar Index for September 1994 through August 1995, would convert 1996 costs for Resid/Heavy Distillate into year 1999 costs, not year 2000 costs, as required by Opinion No. 481. *Id.* P 12, JA 20-21. Moreover, protestors' method would use no data from either 1996 or 2000, even though the purpose of the calculation was to convert 1996 costs to year 2000 costs and the average indices for both years were known. *Id.* Finally, the Commission found that the protestors' position was inconsistent with their own witness at the ALJ hearing leading to Opinion No. 481, who employed a conversion method that was substantially the same as the Administrator's method and used an essentially identical inflation factor for the period 1996 to 2000. *Id.*

In the Second Order, the Commission explained again that the Administrator appropriately used Nelson-Farrar Index data for the full calendar years 1996 and 2000, which were known when he performed his conversion calculations. Second Order P 16, JA 28. Moreover, the Commission stated, the parties to the 2002 Stipulation understood that the process to convert 1996 costs to 2000 costs for Resid was exclusive to the Tariff Method for calculating annual adjustments. *Id.* P 17, JA 28. The Tariff Method necessarily uses Nelson-Farrar indices for twelve consecutive months that span portions of the previous two years, because of the four-month lag in reporting by the index publisher. *Id. See also Petro Star*, slip

op. at 2 (reasonable for FERC to rely on exhibit prepared by petitioners' own expert witness).

The Second Order then explained again why the use of the inflation factor experienced during September 1999 to December 2000 for both sets of calculations did not equate to double-counting of inflation during that period. For the escalation from 1996 to 2000, the Nelson-Farrar indices for those years were known, and the Administrator correctly calculated the ratio to arrive at the 1.0742 inflation factor for Resid/Heavy Distillate. *Id.* PP 18-19, JA 28- 29. That calculation established the cost figures for going forward from 2000. *Id.*

Going forward from the base year 2000, the agreed-upon Tariff Method required the Administrator to calculate the ratio of (a) the average of the monthly indices then available for the most recent twelve months to (b) the average of the monthly indices for the previous (*i.e.*, one year earlier) twelve consecutive months. *Id.* Because of index publisher's reporting lag, in January of each year, when the annual inflation adjustment is calculated for the upcoming year, the most recent available Nelson-Farrar indices are through August of the previous calendar year.

For projecting the cost adjustment for the year 2001, in January 2001, the Administrator, in accordance with the Tariff Method, used the average Nelson-Farrar index for the twelve months of September 1999 to August 2000, the most recent monthly indices that were available at the time the projection would be

made, for comparison with the previous twelve consecutive months from September 1998 to August 1999. *Id.* P 19, JA 28-29. The fact that the same data from the indices for September 1999 to December 2000 were used by the Administrator initially in the conversion calculation to derive base year 2000 costs and were then used in a different calculation to derive the annual adjustment calculation for 2001 did not double-count the inflation that occurred between September 1999 and December 2000. *Id.*

Moreover, in contrast to Shippers' arguments concerning double-counting, the Commission's orders were supported by substantial evidence in the record. This evidence included the memoranda and exhibits from the Administrator explaining the rationale for his methodology, R. 1 at 3, JA 65; testimony and exhibits from the ALJ hearing that led to Opinion No. 481, R. 16, JA 5-6; and affidavits submitted in the underlying proceeding, R. 17, JA 329; R. 19, JA 369; R. 67, JA 504. *See* First Order PP 10-12, JA 20-21; Second Order PP 5, 18-19, JA 23-24, 28-29.

B. Shippers' Claim That Double-Counting Occurred Is Based on Their Misunderstanding Of The Predictive Operation Of The Tariff Method.

Despite these explanations by the Commission, Shippers persist in arguing that the two-step method used by the Administrator double-counted inflation for Resid/Heavy Distillate for the sixteen-month period between September 1999

through December 2000. Br. at 16, 25, 29. Shippers attempt to blur the distinction between the two steps by claiming that they equate to a "unified computation" and are part of "the same computation formula." Br. at 34, 36. This characterization is merely a self-serving attempt to bolster Shippers' double-counting claim. The Commission correctly explained that the two steps constituted two separate calculations. Second Order P 19, JA 28.

More important, Shippers' argument that the Commission misperceived that the annual adjustments using the Tariff Method are intended to forecast inflation for the coming year, Br. at 34-36, illuminates the central flaw in Shippers' double-counting claim. Shippers' view that the annual adjustments are intended to account for inflation that has already occurred is incorrect.

The Commission correctly described the forward-looking nature of the Tariff Method. Fourth Order P 64, JA 59-60. In contrast to the Nelson-Farrar Index method, which reflected actual, known data for 1996 and 2000, the Administrator must use index data from past periods, the only available known data at the time of the calculation, to predict or estimate the annual escalation adjustment for the upcoming year. *Id.* This is consistent with the Commission's explanations elsewhere concerning how the Tariff Method is used to calculate the annual inflation adjustments. *See, e.g.*, Second Order P 5, 9, 18, JA 23-24, 25, 28; Remand Order P 25, JA 37. In addition, the Commission's description is

supported by substantial evidence. *See, e.g.*, Administrator's June 28, 2006 Memorandum, R. 1 at 3-5, JA 65-67; Administrator's July 5, 2006 Memorandum, attached as Appendix I to Motion to Intervene and Protest of Petro Star Inc., R. 13, JA 266; Affidavit of David I. Toof, attached to Motion to Intervene and Answer to Protests of Exxon Mobil Corporation and Tesoro Alaska Company, at 7-8, R. 18, JA 335-36 (describing the prospective operation of the Tariff Method).

Shippers' argument, Br. at 34-35, that the 1997 Settlement, which was incorporated into the Quality Bank Tariff, supports its view regarding the historical operation of the Tariff Method is incorrect. Shippers claim that, under the settlement, the fact that the first inflation of the 1996-based deductions contained in the settlement would be performed in January 1998 demonstrates that the calculation would account for inflation that occurred during 1997. *Id.* at 35. However, nothing in the language of the 1997 Settlement supports this view. The mere fact that the 1997 stipulated costs were based on 1996 cost calculations does not necessarily mean that the 1997 stipulated costs were intended to represent 1996 costs. Instead, the Commission could reasonably infer that the stipulated costs were intended as approximations of 1997 costs and that the inflation adjustments performed in January 1998, which used the approximated 1997 costs, were intended to approximate 1998 costs. This interpretation of the Tariff Method would be rational, consistent with the Administrator's two-step method, and would

not result in double-counting inflation. *See Lomak Petroleum, Inc. v. FERC*, 206 F.3d 1193, 1198 (D.C. Cir. 2000) (deferring to FERC's interpretation of settlement agreement); *Colorado Interstate Gas Co. v. FERC*, 599 F.3d 698 (D.C. Cir. 2010) (deferring to FERC's reasonable interpretation of tariff language).

In addition, Shippers claim that the parties' course of dealing with respect to Light Distillate demonstrates that the annual Tariff Method adjustments captured inflation that had occurred during each preceding year. This claim is conclusory and lacks merit; it also ignores the fact that Opinion No. 481 did not require conversion of 1996 costs to year 2000 costs for Light Distillate, as it did for Resid and Heavy Distillate. The mere fact that annual adjustments to Light Distillate were made under the Tariff Method using Nelson-Farrar index data from the preceding year does not demonstrate that the adjustments were intended to account for inflation for the previous year. Instead, the previous year's data were used as a proxy to estimate inflation adjustments for the upcoming year.

Shippers primarily rely on the Sanders Affidavit, which was submitted with a protest to the compliance filing. R. 12, JA 165. Shippers claim that this affidavit, which described the alleged double-counting, was not challenged by any party. Br. at 27. Contrary to Shippers' claim, several parties disagreed with the protestors' claim, based on the Sanders Affidavit, that the Administrator's approach double-counted inflation for the year 2000. *See, e.g.*, Response and

Motion to Intervene of ConocoPhillips Alaska, Inc., R. 17, JA 297; Affidavit of David I. Toof, attached to Motion to Intervene and Answer to Protests of Exxon Mobil Corporation and Tesoro Alaska Company, R. 18, JA 329.

The responses explained that, consistent with the Quality Bank Tariff, after the base year 2000 costs were established by the Administrator in compliance with Opinion No. 481, he then had to adjust those costs year-by-year to derive year 2006 costs, based on the most recent Nelson-Farrar indices available. ConocoPhillips Response at 3-4, R. 17, JA 299-300. Because of the timing of reporting of the indices, it was necessary to use year 2000 Nelson-Farrar data to derive the escalation from the Base Year 2000 costs to the adjustment used for the year 2001. This was a single year of escalation and did not result in double-counting the escalation for either 2000 or 2001. *Id.*

Shippers also claim that the Commission could have corrected the Administrator's method in alternative ways that would have eliminated double-counting of inflation. Br. at 30-32. These alternatives, which differed from the primary method advocated by Shippers to the agency, were mentioned at different times during the underlying proceeding in the context of correcting the alleged inconsistency between the inflation factor applied to Resid/Heavy Distillate by the Administrator's methodology and the inflation factor applied to Light Distillate. *See* Request for Rehearing of Petro Star Inc. at 18-19, R. 38, JA 419-420; Motion

for Leave to Answer and Answer of Chevron U.S.A. Inc. and Union Oil Company of California to Requests for Rehearing of Exxon Mobil Corporation and ConocoPhillips Corporation at 13, R. 74, JA 562.

Contrary to Shippers' claim that the Commission ignored these alternatives, Br. at 32, they were acknowledged in the challenged orders. *See* Second Order PP 14, 21, JA 27, 29; Fourth Order PP 57-58, JA 57-58. Since the Commission determined that Shippers' arguments concerning inconsistent treatment of Resid/Heavy Distillate and Light Distillate were incorrect, there was no need for the Commission to address the alternative methods in greater detail. Finally, even assuming *arguendo* that the alternative methods now advocated by Shippers were reasonable or more favorable to them, the standard of review requires only that the method approved by the Commission be reasonable, even if or regardless of whether other reasonable methods might exist. *See, e.g.*, *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 703 (D.C. Cir. 2007) (Commission is not required to choose the best solution, only a reasonable one) (citing *Deaf Smith County Grain Processors, Inc. v. Glickman*, 162 F.3d 1206, 1215 (D.C. Cir. 1998) (under the arbitrary and capricious standard, "the action … need be only a reasonable, not the best or most reasonable, decision" (citations omitted)). *See also, OXY*, 64 F.3d at 694 ("We agree with the Commission that there is no 'perfect way' to value the different quality oils shipped on TAPS . . ., especially in the case of products

without a readily ascertainable market price; and we will not hold the Commission to an impossibly high standard" (citation omitted)).

III. THE COMMISSION APPROPRIATELY DETERMINED THAT THE QUALITY BANK ADMINISTRATOR'S INFLATION ADJUSTMENT FOR RESID AND HEAVY DISTILLATE WAS ACCURATE AND MET THE CONSISTENCY REQUIREMENT IN *OXY USA v. FERC*

A. Based On Substantial Evidence, The Commission Reasonably Concluded That Good Reason Existed To Use Different Inflation Adjustment Methods For Different Cuts.

The Commission's orders on voluntary remand from this Court focused on the claim by Shippers in their November 14, 2007 initial brief that the Commission's approval of the two-step inflation adjustment method used by the Administrator for Resid/Heavy Distillate, in contrast to the one-step Tariff Method used for Light Distillate, violated the requirement in *OXY* that all crude oil cuts must be valued accurately and consistently. After careful consideration of all the data and arguments submitted by the parties, the Commission concluded that the more accurate Nelson-Farrar Index Method should be applied to convert 1996 costs to 2000 costs for Resid/Heavy Distillate for the base year 2000, even if it differed from the Tariff Method applied to Light Distillate. Fourth Order P 67, JA 61. Consistent with *OXY* and *Petro Star*, the Commission found there were valid reasons for the different treatment. *Id.*

Based on substantial evidence, the Commission determined that the requests for rehearing of the Remand Order provided good reason why the Tariff Method

should not be applied to convert 1996 costs for Resid/Heavy Distillate to 2000 costs. *Id.* P 62, JA 59. Specifically, the Commission found that the unchallenged data presented in the requests showed that the value of Light Distillate is basically the same, whether the Tariff Method or the Nelson-Farrar Index Method is used to escalate processing costs. On the other hand, because the processing costs for Resid/Heavy Distillate are much higher, there is a substantial difference in their value depending on which escalation method is used. *Id.* Therefore, the Commission found it appropriate, in the limited, locked-in period, to apply a different inflation adjustment method to the Resid/Heavy Distillate cuts than the method applied to Light Distillate. *Id.* P 63, JA 59. The Commission cited *OXY*, 64 F.3d at 693-94, for the principle that where one cut's processing costs are minimal and other cuts' processing costs are not, it might be appropriate to apply different valuation methods to those cuts. *Id.*

The Commission further found that using the less accurate Tariff Method, which would not reflect actual inflation for those years, "would unnecessarily greatly overvalue Heavy Distillate and Resid (by about 9 percent) relative to other cuts. Reducing the amounts of these costs for these cuts bestows an unreasonable and unjustifiable benefit on producers whose oil contained significant amounts of Heavy Distillate and Resid." *Id.* P 64, JA 59-60. This was the same concern in *OXY*, where the Court found that the Commission overvalued cuts that required

processing by ignoring the processing costs. 64 F.3d at 693.

In concluding that it is permissible to treat different Quality Bank cuts differently where there is a valid reason for doing so, since the goal is to assure that a Quality Bank cut is not overvalued in relation to other cuts, the Commission appropriately relied on this Court's decision in *Petro Star*. Fourth Order P 68, JA 61. There, the Court, in upholding the Commission's different valuation treatment for coke, stated: "Although FERC ignored the shipping and handling components of most oil components, it explained that the costs of shipping and handling coke are dramatically higher relative to its value than are those of any other oil product, *making it perfectly reasonable for FERC to treat coke differently*." *Petro Star*, slip op. at 2 (emphasis added). Similarly, in this case, since the processing costs for Resid/Heavy Distillate are significantly higher relative to their value than for Light Distillate, the Commission's different treatment of Resid/Heavy Distillate for cost inflation purposes was reasonable.

B. Shippers Fail To Address The Commission's Reasons For Different Treatment Of Resid And Heavy Distillate Cuts.

Shippers make virtually no attempt to address the Commission's conclusion that, consistent with *OXY* and *Petro Star*, there were valid reasons to treat Resid/Heavy Distillate differently than Light Distillate. Instead, they merely assert that "there can be no valid reason . . . for placing Heavy Distillate and Resid

valuations at the significant economic disadvantage that results from . . . the [Administrator's] erroneous two-step method of adjusting for inflation." Br. at 46. Unable to respond to either the evidence or the Commission's reasonable determinations, Shippers simply revert back to their erroneous double-counting argument.

Shippers fail to address the crucial evidence that, if the Tariff Method used for Light Distillate were applied to adjust 1996 costs for Resid/Heavy Distillate to 2000 costs, as Shippers advocated before the Commission, Resid/Heavy Distillate would be overvalued by about 9 percent relative to all other cuts, not just Light Distillate. Fourth Order P 63, JA 59; Affidavit of David I. Toof, attached to Request for Rehearing and Stay of Exxon Mobil Corporation, Exhibits DIT-6 and DIT-9 (quantifying impact on TAPS Quality Bank calculation of alternative Resid/Heavy Distillate processing costs and miniscule impact of alternative Light Distillate costs, respectively), R. 67, JA 517, 520. Such a result would be plainly inconsistent with *OXY* and *Petro Star*.

Shippers attempt to distinguish *Petro Star* on the basis that the issue there was what costs to include in the valuation of Resid and Heavy Distillate, while the issue in this case is the correct application of the Nelson-Farrar Index inflation adjustment. Br. at 45-46. This is a distinction without a difference. As in this case, the relevant broader issue in *Petro Star* was whether it is permissible for the

Commission to treat cuts differently for valuation purposes. This Court concluded that it is "perfectly reasonable" to value cuts differently where there is a valid reason. *Petro Star* at 2. As explained above, there are significant differences in processing Resid/Heavy Distillate and Light Distillate that justified using different cost escalation methods to estimate their values. Those differences were strikingly similar to those in *Petro Star*, which also considered the percentage of processing costs relative to the value of the crude oil cuts at issue.

CONCLUSION

For the foregoing reasons, the petitions should be denied.

Respectfully submitted,

Christine A. Varney
Assistant Attorney General

John J. Powers, III
Robert J. Wiggers
Attorneys

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

Thomas R. Sheets
General Counsel

Robert H. Solomon
Solicitor

/s/ Kathrine L. Henry
Kathrine L. Henry
Attorney

Federal Energy Regulatory Commission
Washington, D.C. 20426
Tel: (202) 502-8861
Fax: (202) 273-0901
E-mail: Kathrine.henry@ferc.gov

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CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C)(i), I certify that the Brief of Respondents Federal Energy Regulatory Commission and the United States of America contains 8,731 words, not including the tables of contents and authorities, the certificates of counsel, or the addenda.

s/ Kathrine Henry
Kathrine Henry
Attorney

Federal Energy Regulatory
Commission
Washington, D.C. 20426
Tel: (202) 502-8861
Fax: (202) 273-0901
Email: kathrine.henry@ferc.gov

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ADDENDUM
Statute

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Interstate Commerce Act, 49 U.S.C. app. §§ 1, et seq., provides as follows:

TITLE 49--TRANSPORTATION

SUBTITLE VIII--PIPELINES

CHAPTER 605--INTERSTATE COMMERCE REGULATION

Sec. 60502. Federal Energy Regulatory Commission

The Federal Energy Regulatory Commission has the duties and powers related to the establishment of a rate or charge for the transportation of oil by pipeline or the valuation of that pipeline that were vested on October 1, 1977, in the Interstate Commerce Commission or an officer or component of the Interstate Commerce Commission.

(Pub. L. 103-272, Sec. 1(e), July 5, 1994, 108 Stat. 1329.)

Historical and Revision Notes

Revised Section	Source (U.S. Code)	Source (Statutes at Large)
60502	42:7172(b).	Aug. 4, 1977, Pub. L. 95-91, Sec. 402(b), 91 Stat. 584.
	49:101 (note prec.).	Oct. 17, 1978, Pub. L. 95-473, Sec. 4(c)(1)(B), (2) (related to Sec. 402(b) of Department of Energy Organization Act), 92 Stat. 1470.

The words ``duties and powers . . . that were vested . . . in'' are coextensive with, and substituted for, ``transferred to, and vested in . . . all functions and authority of'' for clarity and to eliminate unnecessary words. The word ``regulatory'' is omitted as surplus. The words ``on October 1, 1977'' are added to reflect the effective date of the transfer of the duties and powers to the Federal Energy Regulatory Commission.

Abolition of Interstate Commerce Commission and Transfer of Functions

Interstate Commerce Commission abolished and functions of Commission transferred, except as otherwise provided in Pub. L. 104-88, to Surface Transportation Board effective Jan. 1, 1996, by section 702 of this title, and section 101 of Pub. L. 104-88, set out as a note under section 701 of this title. References to Interstate Commerce Commission deemed to refer to Surface Transportation Board, a member or employee of the Board, or Secretary of Transportation, as appropriate, see section 205 of Pub. L. 104-88, set out as a note under section 701 of this title.

TITLE 49, APPENDIX—TRANSPORTATION

This Appendix consists of sections of former Title 49 that were not included in Title 49 as enacted by Pub. L. 95-473 and Pub. L. 97-449, and certain laws related to transportation that were enacted after Pub. L. 95-473. Sections from former Title 49 retain the same section numbers in this Appendix. For disposition of all sections of former Title 49, see Table at beginning of Title 49, Transportation.

CHAPTER 1—INTERSTATE COMMERCE ACT, PART I; GENERAL PROVISIONS AND RAILROAD AND PIPE LINE CARRIERS

§ 1. Repealed. Pub. L. 95-473, § 4(b), (c), Oct. 17, 1978, 92 Stat. 1466, 1470; Pub. L. 96-258, § 3(b), June 3, 1980, 94 Stat. 427

Section repealed subject to an exception related to transportation of oil by pipeline. Section 402 of Pub. L. 95-607, which amended par. (14) of this section by adding subdiv. (b) and redesignating existing subdiv. (b) as (c) subsequent to the repeal of this section by Pub. L. 95-473, was repealed by Pub. L. 96-258. For disposition of this section in revised Title 49, Transportation, see Table at beginning of Title 49. See, also, notes following Table.

Prior to repeal, section read as follows:

§ 1. Regulation in general; car service; alteration of line

(1) Carriers subject to regulation

The provisions of this chapter shall apply to common carriers engaged in—

(a) The transportation of passengers or property wholly by railroad, or partly by railroad and partly by water when both are used under a common control, management, or arrangement for a continuous carriage or shipment; or

(b) The transportation of oil or other commodity, except water and except natural or artificial gas, by pipe line, or partly by pipe line and partly by railroad or by water; or

(c) Repealed. June 19, 1934, ch. 652, title VI, § 602(b), 48 Stat. 1102;

ed or to be transported in interstate or foreign commerce, or for any such carrier or express company to continue after April 1, 1941, as a party to any such contract, agreement, or arrangement unless and until such contract, agreement, or arrangement has been submitted to and approved by the Commission as just, reasonable, and consistent with the public interest: *Provided*, That if the Commission is unable to make its determination with respect to any such contract, agreement, or arrangement prior to said date, it may extend it to not later than October 1, 1941.

(15) Powers of Commission in case of emergency

Whenever the Commission is of opinion that shortage of equipment, congestion of traffic, or other emergency requiring immediate action exists in any section of the country, the Commission shall have, and it is given, authority, either upon complaint or upon its own initiative without complaint, at once, if it so orders, without answer or other formal pleading by the interested carrier or carriers, and with or without notice, hearing, or the making or filing of a report, according as the Commission may determine: (a) to suspend the operation of any or all rules, regulations, or practices then established with respect to car service for such time as may be determined by the Commission; (b) to make such just and reasonable directions with respect to car service without regard to the ownership as between carriers of locomotives, cars, and other vehicles, during such emergency as in its opinion will best promote the service in the interest of the public and the commerce of the people, upon such terms of compensation as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable; (c) to require such joint or common use of terminals, including main-line track or tracks for a reasonable distance outside of such terminals, as in its opinion will best meet the emergency and serve the public interest, and upon such terms as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable; and (d) to give directions for preference or priority in transportation, embargoes, or movement of traffic under permits, at such time and for such periods as it may determine, and to modify, change, suspend, or annul them. In time of war or threatened war the President may certify to the Commission that it is essential to the national defense and security that certain traffic shall have preference or priority in transportation, and the Commission shall, under the power herein conferred, direct that such preference or priority be afforded.

(16) Rerouting of traffic on failure of initial carrier to serve public

(a) Whenever the Commission is of opinion that any carrier by railroad subject to this chapter is for any reason unable to transport the traffic offered it so as properly to serve the public, it may, upon the same procedure as provided in paragraph (15) of this section, make such just and reasonable directions with respect to the handling, routing, and movement of the traffic of such carrier and its distribution over other lines of roads, as in the opinion of the Commission will best promote the service in the interest of the public and the commerce of the people, and upon such terms as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable.

(b) Whenever any carrier by railroad is unable to transport the traffic offered it because—

(1) its cash position makes its continuing operation impossible;

(2) it has been ordered to discontinue any service by a court; or

(3) it has abandoned service without obtaining a certificate from the Commission pursuant to this section;

the Commission may, upon the same procedure as provided in paragraph (15) of this section, make such just and reasonable directions with respect to the handling, routing, and movement of the traffic available to such carrier and its distribution over such carrier's lines, as in the opinion of the Commission will best promote the service in the interest of the public and the commerce of the people subject to the following conditions:

(A) Such direction shall be effective for no longer than 60 days unless extended by the Commission for cause shown for an additional designated period not to exceed 180 days.

(B) No such directions shall be issued that would cause a carrier to operate in violation of the Federal Railroad Safety Act of 1970 [45 U.S.C. 431 et seq.] or that would substantially impair the ability of the carrier so directed to serve adequately its own patrons or to meet its outstanding common carrier obligations.

(C) The directed carrier shall not, by reason of such Commission direction, be deemed to have assumed or to become responsible for the debts of the other carrier.

(D) The directed carrier shall hire employees of the other carrier to the extent such employees had previously performed the directed service for the other carrier, and, as to such employees as shall be so hired, the directed carrier shall be deemed to have assumed all existing employment obligations and practices of the other carrier relating thereto, including, but not limited to, agreements governing rate of pay, rules and working conditions, and all employee protective conditions commencing with and for the duration of the direction.

(E) Any order of the Commission entered pursuant to this paragraph shall provide that if, for the period of its effectiveness, the cost, as hereinafter defined, of handling, routing, and moving the traffic of another carrier over the other carrier's lines of road shall exceed the direct revenues therefor, then upon request, payment shall be made to the directed carrier, in the manner hereinafter provided and within 90 days after expiration of such order, of a sum equal to the amount by which such cost has exceeded said revenues. The term "cost" shall mean those expenditures made or incurred in or attributable to the operations as directed, including the rental or lease of necessary equipment, plus an appropriate allocation of common expenses, overheads, and a reasonable profit. Such cost shall be then currently recorded by the carrier or carriers in such manner and on such forms as by general order may be prescribed by the Commission and shall be submitted to and subject to audit by the Commission. The Commission shall certify promptly to the Secretary of the Treasury the amount of payment to be made to said carrier or carriers under the provisions of this paragraph. Payments required to be made to a carrier under the provisions of this paragraph shall be made by the Secretary of the Treasury from funds hereby authorized to be appropriated in such amounts as may be necessary for the purpose of carrying out the provisions hereof.

(17) Directions of Commission as to car service; disobedience; rights of States; bribery

(a) The directions of the Commission as to car service and to the matters referred to in paragraphs (15) and (16) of this section may be made through and by such agents or agencies as the Commission shall designate and appoint for that purpose. It shall be the duty of all carriers by railroad subject to this chapter, and of their officers, agents, and employees, to obey strictly and conform promptly to such orders or directions of the Commission, and in case of failure or refusal on the part of any carrier, receiver, or operating trustee to comply with any such order or direction such carrier, receiver, or trustee shall be liable to a penalty of

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CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 9th day of June, 2010, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system or via U.S. Mail, as indicated below:

Bradford G. Keithley — Email
Perkins Coie, LLP
1029 West Third Ave., Suite 300
Anchorage, AK 99501-1981

Bradley S. Lui — Email
Edward J. Twomey
Morrison & Foerster LLP
2000 Pennsylvania Ave., NW, Suite 5500
Washington, DC 20006-1812

Bruce J. Barnard — Email
Morrison & Foerster LLP
2000 Pennsylvania Ave., NW, Suite 5500
Washington, DC 20006-1812

Carter Glasgow Phillips — Email
Eugene R. Elrod
James F. Bendernagel Jr.
Sidley Austin, LLP
1501 K Street, NW
Washington, DC 20005

David W. D'Alessandro — Email
Stinson Morrison Hecker LLP
1150 18th Street, NW, Suite 800
Washington, DC 20036-3816

Dennis Lane — Email
Stinson Morrison Hecker LLP
1150 18th Street, NW
Suite 800
Washington, DC 20036-3816

Glenn S. Benson — Email
Perkins Coie LLP
607 14th St., NW, Suite 800
Washington, DC 20005-2003

Howard E. Shapiro — Email
Patricia F. Godley
Van Ness Feldman
1050 Thomas Jefferson Street, NW
Suite 700
Washington, DC 20007

James M. Armstrong — Email
Foulston Siefkin LLP
1551 North Waterfront Parkway
Suite 100
Wichita, KS 67206-0000

Jeffrey G. DiSciullo — Email
Wright & Talisman
1200 G Street, NW, Suite 600
Washington, DC 20005-3802

John A. Donovan — Email
Skadden, Arps, Slate, Meagher &
Flom, LLP
300 South Grand Ave., Suite 3400
Los Angeles, CA 90071-3144

John E. Kennedy — Email
Vinson & Elkins, LLP
2300 First City Tower
1001 Fannin Street
Houston, TX 77002-6760

John W. Griggs — Email
Griggs & Adler, PC
12020 Sunrise Valley Drive, Suite 100
Reston, VA 20191-0000

Marie Denyse Zosa — Email
Stinson Morrison Hecker LLP
1150 18th Street, NW
Suite 800
Washington, DC 20036-3816

Matthew W. S. Estes — Email
Skadden, Arps, Slate, Meagher &
Flom, LLP
1440 New York Ave., NW
Washington, DC 20005-2111

Randolph L. Jones, Jr. — Email
Conner & Winters, LLP
1700 Pacific Ave., Suite 2250
Dallas, TX 75201

Richard A. Curtin — Email
Petro Star Inc.
3900 C Street, Suite 802
Anchorage, AK 99503-5966

Richard J. Brean — US Mail
United Steelworkers of America,
AFL-CIO
5 Gateway Center, Room 913
Pittsburgh, PA 15222

Robert Hugh Loeffler — Email
Morrison & Foerster LLP
2000 Pennsylvania Avenue, NW, Suite 6000
Washington, DC 20006-1888

Robert J. Wiggers — Email
John J. Powers, III
U.S. Department of Justice
Antitrust Division, Appellate Section
950 Pennsylvania Ave., NW, Room 10528
Washington, DC 20530-0001

Ronald S. Flagg — Email
Sidley Austin, LLP
1501 K Street, NW
Washington, DC 20005

Stephen B. Kinnaird — Email
Paul, Hastings, Janofsky & Walker LLP
875 15th St., NW
Washington, DC 20005-2400

Travis A. Pearson — US Mail
Flint Hills Resources, LP
Legal Department
4111 East 37th St., North
Wichita, KS 67220-0000

/s/ Kathrine L. Henry
Kathrine L. Henry
Attorney

Federal Energy Regulatory
Commission
Washington, DC 20426
Tel: (202) 502-8861
Fax: (202) 273-0901
kathrine.henry@ferc.gov