REPORT OF THE OIL PIPELINE REGULATION COMMITTEE

This report summarizes significant developments with respect to oil pipeline regulation that occurred during the period beginning in January 2001. Because of their significance to oil pipeline regulation, the report also includes the Federal Energy Regulatory Commission's (FERC or Commission) orders issued in *SFPP, L.P.*, Docket No. OR92-8-000, *et al.* The topics in this report are covered in the following order: I. Complaint Cases; II. Protest Cases; III. Market-Based Rate Cases; IV. Pipeline Acquisition Costs; V. Petitions for Declaratory Order; VI. Outer Continental Shelf Tariff Cancellations; VII. Minerals Management Service Update; and VIII. Oil Pipeline Index.

I. COMPLAINT CASES

A. SFPP, L.P., Docket Nos. OR92-8-000, et al.

Since January of 1999, the Commission has issued a series of orders in *SFPP, L.P.*, Docket Nos. OR92-8-000, *et al.*[1] It was the first oil pipeline complaint case in which the threshold "changed circumstances" standard of the Energy Policy Act of 1992 (the EPAct)[2] and a host of cost-of-service issues were fully litigated before the Commission.[3] The case addresses the reasonableness of, among other things, SFPP, L.P.'s (SFPP) rates for the transportation of petroleum products from El Paso, Texas to Phoenix and Tucson, Arizona (East Line), and from Los Angeles, California to Phoenix and Tucson, Arizona (West Line). In affirming the bulk of the Administrative Law Judge's (ALJ) initial decision, the Commission held that SFPP's East Line rates were not just and reasonable, and therefore ordered those rates to be modified, and directed SFPP to make reparations accordingly. However, the Commission rejected complaints against SFPP's West Line rates on grounds that the West Line complainants had not met the threshold "changed circumstances" standard of the EPAct.

1. Background

The proceeding commenced on September 4, 1992, when El Paso Refinery, L.P. (EPR) made a filing with the Commission alleging, *inter alia*, that SFPP's prorationing policy and its re-reversal of flow on its six-inch line between

1. Opinion No. 435, *SFPP, L.P., Mobil Oil Corp. v. SFPP, L.P. Tosco Corp. v. SFPP, L.P.*, 86 F.E.R.C. ¶ 61,022 (1999), *order on reh'g*, 91 F.E.R.C. ¶ 61,135 (2000) [hereinafter *SFPP*].

2. Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (codified as 42 U.S.C. §§ 13201-556 (2003)).

3. Under section 1803 of the EPAct, oil pipeline rates are deemed just and reasonable or grandfathered if they were in effect and not subject to protest, investigation, or complaint during the 365 days prior to enactment of the EPAct. Complaints against a rate grandfathered by the EPAct must make a threshold showing that there has been a substantial change in the economic circumstances that were a basis for the rate. Pub. L. No. 102-486, 106 Stat. 3011.

Phoenix and Tucson adversely affected EPR's business, and that the East Line rates should be reduced. The Commission determined that the filing should be adjudicated as a complaint under section 13(1) of the Interstate Commerce Act (ICA).[4] Subsequent complaints were filed against SFPP by a number of other shippers challenging SFPP's East Line and West Line rates. An evidentiary hearing was conducted from April 9, 1996 until July 19, 1996.

2. Grandfathering

In orders issued prior to Opinion No. 435, the Commission determined that SFPP's East Line rates were not grandfathered under the EPAct but that its West Line rates in existence in September 1992 were. The Commission held that challenges filed in September 1992 adequately challenged the East Line rates, thus preventing grandfathering, but did not challenge the West Line rates.[5] In subsequent orders, the Commission dealt with whether certain West Line rates published after the passage of the EPAct were grandfathered.

The Commission held that West Line rates from SFPP's new East Hynes origin were grandfathered, even though East Hynes was not an origin listed in SFPP's tariff at the time EPAct was enacted. The Commission reasoned that (1) East Hynes was merely "another tap within an existing rate cluster for transportation services provided for a group of commodities from that rate cluster to points in Arizona," and (2) "[n]o rate from Los Angeles to Arizona was changed, and there was no change in the products transported or services provided."[6]

The Commission further held that SFPP's rate for transportation of turbine fuel was not grandfathered because turbine fuel was not a product carried by SFPP at the time the EPAct was enacted. Thus, even though SFPP applied the same rate to transportation of that commodity as it did to the commodities it already transported, the addition of that commodity "instituted a new service."[7] However, the Commission declined to review the rate for that service because it was the same as the grandfathered rate for transportation of other petroleum products and there were no operating or cost differences between transporting the various commodities.[8]

Finally, the Commission held that the mere fact that the tariffs containing SFPP's West Line rates were suspended at the time the EPAct became effective is irrelevant for grandfathering purposes because the tariffs that were suspended did not contain any rate changes.[9] Thus, the Commission rejected arguments that the West Line rates were not grandfathered due to their having been subject to investigation during the 365 days prior to the EPAct's enactment.

4. 49 U.S.C. § 11701 (2003).

5. *Viking Gas Transmission Co.*, 63 F.E.R.C. ¶ 61,104 (1993), *order on reh'g*, 63 F.E.R.C. ¶ 61,275 (1993), *reh'g denied*, 65 FERC ¶ 61,028 (1993).

6. *SFPP, supra* note 1, at 61,063.

7. *Id.*

8. *SFPP, supra* note 1, at 61,078.

9. *Id.* at 61,063.

3. Changed Circumstances

With respect to the grandfathered West Line rates, the Commission held that the complainants had failed to make a threshold showing under the EPAct of a substantial change in the economic circumstances that were a basis of the rate. Although the Commission did not define what constitutes a "substantial change" under the EPAct, the Commission determined that a "substantial change" is a more rigorous test than a "material" change, which, for accounting purposes, is normally defined as a change of 10% or more.[10] The Commission ruled that a substantial change could be established by one or a "number of rate elements," including "volumes, asset base, operating, and perhaps capital costs," which "in turn are most likely to influence the company's revenue requirements and return."[11]

To determine whether there has been a substantial change in the economic circumstances that were a basis for the rate, it is critical to know what the basis for the rate is. The Commission determined that the "economic basis" is not the twelve month period before enactment of the EPAct, but is instead "the basis upon which the rate was last considered to be just and reasonable, either as a filed rate, a settlement rate, or one for which the Commission has made a legal determination."[12] The Commission ruled that West Line complainants failed to establish that the increases in volumes on SFPP's West Line constituted changed circumstances within the meaning of the EPAct because the complainants mistakenly used volumes during the twelve month period before enactment of the EPAct as their basis economic circumstances.[13] The Commission also held that evidence of volume increases that occurred after the complaints were filed could not be considered in determining whether there are substantially changed circumstances under EPAct.[14]

Other alleged changed circumstances were similarly rejected. The Commission held that the mere filing of a new tariff for transportation of turbine fuel is not enough to constitute changed circumstances, although its effect on volumes, if large enough (which was clearly not the case here), could be.[15] The argument that stricter environmental regulations in California would cause petroleum products to move out of state, thereby increasing SFPP's West Line volumes, was rejected as a changed circumstance because it was conjecture.[16] The Commission acknowledged that a change in regulatory policy, such as the Commission's *Lakehead* decision,[17] could cause "changed circumstances" within the meaning of the EPAct, but held that complainants had failed to specifically address how the *Lakehead* policy affected the economic basis of the rates at

10. *SFPP, supra* note 1, at 61,065-66.

11. *Id.* at 61,067.

12. *SFPP, supra* note 1, at 61,068 (1999).

13. *Id.* at 61,067-68.

14. *SFPP, supra* note 1, at 61,069.

15. *Id.* at 61,069.

16. *SFPP, supra* note 1, at 61,070.

17. *Lakehead Pipe Line Company, L.P.*, 71 F.E.R.C. ¶ 61,338 (1995), *reh'g denied*, 75 F.E.R.C. ¶ 61,181 (1996) (imposing limits on the right of oil pipelines organized as limited partnerships to include an income tax allowance in their costs of service).

issue.[18]

4. Enhancement Facilities

SFPP constructed an enhancement facility at one of its primary West Line origin points, Watson Station, to meet increased pumping rates and pressures. The shippers had the choice of utilizing the enhancement facilities or providing their own, similar facilities. All the shippers chose to utilize SFPP's facility and entered into contracts with SFPP for that purpose. In the proceeding, the shippers claimed that the charge for use of the facility should be included in SFPP's tariffs because it was part of SFPP's jurisdictional transportation service.

The Commission determined that the facility was jurisdictional because it enabled all shippers from Watson Station to meet SFPP's mandatory pressure requirements.[19] The Commission required SFPP to file a rate for this facility equal to the historic charge in the contracts SFPP executed with its shippers. It subsequently dismissed complaints against the charges themselves because they were part of enforceable contracts and therefore the equivalent of a lawful, effective rate, and required that any party challenging those charges must establish "substantially changed circumstances" until such time as SFPP changes the nature and conditions of the charges.[20]

5. ARCO Reversal Agreement

The Commission held that it did not have jurisdiction over SFPP's decision to reverse the flow of its six-inch line between Phoenix and Tucson because construction, entry, and abandonment of service by an oil pipeline is not subject to the Commission's jurisdiction.[21] The Commission also affirmed the lawfulness of SFPP's throughput and deficiency agreement with one of its shippers, and held that the agreement need not be published in the carrier's tariff.[22]

6. Rate Design Issues

The Commission reaffirmed that oil pipelines are not limited to the use of a fully allocated cost ceiling as a justification for their rates.[23] However, the Commission held that SFPP's East and West Lines must be looked at separately for cost of service purposes because, pursuant to *Farmers Union Central Exchange v. FERC*, "the costs of providing service over a given territory" must be "recovered only from the companies that use that particular service."[24]

The Commission held that the allocation of indirect overhead costs among

18. *SFPP, supra* note 1, at 61,070-71 (1999).

19. *Id.* at 61,074-75.

20. *SFPP, supra* note 1, at 61,076; *see also* Opinion No. 435-A, *Mobil Oil Corp. v. SFPP, L.P.*, 91 F.E.R.C. ¶ 61,135, 61,502-03 (2000) [hereinafter No. 435-A].

21. *Id.* at 61,077.

22. *SFPP, supra* note 1, at 61,077-78.

23. *Id.* at 61,079.

24. *SFPP, supra* note 1, at 61,080 (quoting Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1486, 1528-29 (D.C. Cir. 1984)).

SFPP's jurisdictional and non-jurisdictional operations should be based on the KN method (*i.e.*, an allocation based on the ratio of direct labor and capital investment for each function or service to the total direct labor and capital investment for all of the divisions involved), rather than based on the subjective allocations used in SFPP's general ledger entries.[25] The Commission held that the allocation of indirect costs among various portions of SFPP's South System should be based on the KN method as well, rather than the Massachusetts Formula, because affiliates are not involved.[26]

7. Rate Base Issues

As an initial step in calculating SFPP's starting rate base (SRB), the Commission ruled that the ratio of (a) the net depreciated original cost of SFPP's South Lines to (b) the net depreciated original cost of its system as a whole, should be applied to the total Interstate Commerce Commission (ICC) valuation rate base to determine the valuation figure to be used for the South Lines. For purposes of determining the debt and equity portions of the SRB as of December 31, 1983, the Commission held that SFPP should use its own 61% debt ratio as of December 19, 1988, the date when SFPP became a publicly traded limited partnership.[27] The Commission noted that while this decision imputed SFPP's capital structure as a publicly traded limited partnership to its predecessor entity that was not publicly traded, "this is appropriate in light of the significant difference in the nature of the pipeline's operations and those of its parent company on June 28, 1985."[28] The Commission also stated that there is no reason to believe the predecessor's operations or risks were in any way materially different from SFPP's at the time of SFPP's initial public offering.[29]

The Commission also ruled that once the SRB is determined, it is not modified to reflect subsequent changes in the capital structure.[30] The Commission rejected the pipeline's proposed approach, which would have increased the SRB to reflect any increase in the equity component of SFPP's capital structure, thereby slowing its amortization rate.[31] The Commission also determined that the SRB should be amortized based on the composite remaining life of the pipeline's assets as of December 31, 1983.[32] The Commission rejected SFPP's proposed "variable method," under which the amortization period would change annually to reflect the effect on remaining life of subsequent additions or retirements made to the pipeline's property accounts.[33]

25. *Id.* at 61,082.

26. *SFPP, supra* note 1, at 61,083.

27. No. 435-A *supra* note 20, at 61,505-06. Prior to the creation of SFPP as a limited partnership, the pipeline was known as Southern Pacific Pipe Lines, Inc. (Southern Pacific), a wholly-owned subsidiary of Santa Fe Southern Pacific Corporation. As of the date Opinion No. 154-B, *Williams Pipe Line Co.*, 31 F.E.R.C. ¶ 61,377 (1985) was issued, Southern Pacific had no outstanding debt.

28. No. 435-A *supra* note 20, at 61,505.

29. *Id.*

30. *SFPP, supra* note 1, at 61,089-90.

31. *Id.*

32. *SFPP, supra* note 1, at 61,090.

33. *Id.*

SFPP's proposal would have extended the amortization period for the SRB, a result the Commission considered inconsistent with the concept of the SRB as a one-time adjustment mechanism to ease the shift from the ICC's valuation rate base to the Commission's use of a trended original cost rate base for oil pipelines.

The Commission ruled that after December 18, 1988, SFPP's actual capital structure in any given year should be used in determining the portion of the equity component that is to be deferred in each year.[34] The Commission further determined that the composite depreciation rate for the year in which the return is first deferred must be used to amortize that deferred return in all subsequent years until it is fully amortized. This, the Commission held, would "assure that the deferred return is amortized in a reasonable period of time and prevent its indefinite extension."[35]

With respect to accumulated deferred income taxes (ADIT), the Commission held that the *South Georgia* method must be used to amortize the excess or deficiency of ADIT for each category of property resulting from changes in income tax rates.[36] This method amortizes the over-funded and under-funded ADIT balance for each category and vintage of property over the remaining life for that category and vintage. Further, the Commission rejected SFPP's proposal to begin amortization of its unfunded ADIT in 1984, the effective date of Opinion No. 154-B,[37] and ordered SFPP to begin amortizing its unfunded ADIT beginning in 1974, the year the pipeline's predecessor adopted normalization. Finally, the Commission determined that the ADIT balance existing at the time the SFPP partnership was formed in 1988 should be retained because no tax was payable by the partner at the time it contributed property to the partnership.

The Commission approved an allowance for funds used during construction (AFUDC) based on the ratio that actual interest capitalized on SFPP's books (from 1989-1993) bore to the total interest that would have been capitalized using the pipeline's debt cost. In addition, the Commission found that although the record "could be read to imply"[38] that SFPP adjusted its capital structure by writing up its equity for ratemaking purposes in connection with its creation as a partnership, the record was too thin to order a rate adjustment.[39]

8. Cost of Capital

The Commission held that only oil partnership equities should be used in developing the equity cost of capital for an oil pipeline limited partnership because there was now sufficient evidence of market pricing and trading patterns

34. *SFPP, supra* note 1, at 61,091.

35. *Id.* at 61,092.

36. *Natural Gas Pipeline Company of America*, 13 F.E.R.C. ¶ 61,266, 61,587-88 (1980); *Natural Gas Pipeline Company of America*, 26 F.E.R.C. ¶ 61,047, 61,149 (1984).

37. Opinion No. 154-B, *Williams Pipe Line Co.*, 31 F.E.R.C. ¶ 61,377 (1985).

38.No. 435-A *supra* note 20, at 61,507.

39. Writing up an asset to reflect a purchase price for ratemaking purposes is normally disallowed. *See generally Rio Grande Pipeline Co.*, 78 F.E.R.C. ¶ 61,020 (1997); *Longhorn Partners Pipeline*, 82 F.E.R.C. ¶ 61,146 (1998).

in those shares.[40] The Commission also determined that the short-term growth forecast should be given two-thirds weight, while the long-term component should be given only one-third weight, consistent with the policy established in *Transcontinental Gas Pipe Line Corporation.*[41] The Commission found that SFPP was of average risk, and therefore, adopted the average cost of capital for the oil pipeline proxy group.[42]

9. Income Taxes

The Commission applied the *Lakehead* decision to SFPP, and denied the pipeline an income tax allowance for income attributed to interests other than Subchapter C corporations.[43] The Commission stated that without evidence of the tax paying attributes of other forms of ownership, such as street accounts, IRA's, Keogh, and other individual retirement plans, it was proper to deny the allowance for income attributable to such interests.[44] The Commission did, however, allow SFPP an income tax allowance on the 42.7% of the limited partnership interests held by SFPP, Inc., a holding company that controlled a 1% general partnership interest and a 42.7% limited partnership interest in SFPP. To do otherwise, the Commission indicated, would be inconsistent with the Commission's "stand-alone" method under which "a utility is considered as nearly as possible on its own merits and not on those of its affiliates."[45] Thus, any deductions held by SFPP, Inc. that offset income from SFPP are irrelevant to SFPP's tax allowance. The Commission applied its *Lakehead* policy as of the date of the complaints in these proceedings.

10. Litigation Expenses

There were two main categories of litigation expenses at issue in the case, SFPP's FERC litigation expenses incurred in defending the complaint proceeding, and litigation costs incurred with respect to civil litigation brought by two shippers. With respect to its FERC litigation costs, the Commission permitted SFPP to recover its test year costs, but required that they be amortized over five years, exclusive of any settlement payments.[46] The Commission stated that a five-year amortization was required "to mitigate the impact of the substantial costs that were incurred" litigating the rate case.[47] In addition, the Commission required the litigation expenses to be allocated 50-50 between the East and West lines, rather than on the basis of throughput.

The Commission denied SFPP recovery of litigation or settlement costs for antitrust litigation brought by two shippers related to SFPP's reversal of flows on portions of its East Line. As the Commission explained,

40. *SFPP, supra* note 1, at 61,099.
41. *Id.* at 61,100 (citing *Transcontinental Gas Pipe Line Corp.*, 84 F.E.R.C. ¶ 61,084, 61,423 (1998)).
42. *SFPP, supra* note 1, at 61,101.
43. *Id.* at 61,102.
44. *SFPP, supra* note 1, at 61,103.
45. *Id.* at 61,103-04.
46. No. 435-A *supra* note 20, at 61,513.
47. *Id.* at 61,512.

> [J]ust as the Commission does not permit environmental costs that are incurred by the pipeline's non-jurisdictional operations to be included in its FERC tariff rates, the Commission will not permit civil litigation and settlement costs concerning a non-jurisdictional commercial decision to be included in SFPP's common carrier rates. The reasonableness of this position is re-enforced by the common sense observation by the East Line shippers that the costs and awards relating to their litigation will be borne primarily by themselves if the litigation and settlement costs are included in the East Line rates, rather than being distributed over a large number of East Line rate payers.[48]

11. Other Costs

The Commission rejected rate recovery of large reserves SFPP created to fund the reconditioning of its South System over 15 years on the basis that no such costs were incurred in the test year and that SFPP had "failed to establish the validity of the proposed expenditures" in accordance with Commission test year practices.[49] It also refused to allow recovery of anticipated environmental remediation obligations for similar reasons.[50] In addition, the Commission denied SFPP much of its claimed allowance for post-retirement benefits other than pensions (PBOP) because SFPP failed to "comply with the PBOP Policy Statement's requirement to establish an irrevocable trust for the benefit of its employees, and within two years of implementation of SFAS 106, amended the plan and reduced benefits, recognizing a gain for its investors."[51]

12. Prorationing Policy

The Commission held that SFPP need not include the details of its prorationing policy in its tariff.[52] However, the Commission required that SFPP's tariff be modified to state the following: (a) that a more detailed prorationing policy circular exists; (b) where the circular can be obtained; and (c) the minimum notice period for any proposed changes to the circular.[53] The Commission also ordered SFPP to reduce the period of time the pipeline would have to respond to a request for capacity from 90 days to 30 days due to "the competitive nature of the petroleum industry and the need to determine whether capacity will be available to support an executory contract."[54] Further, although the Commission found no grounds to reject SFPP's "demonstrated need" policy, the Commission required SFPP to delete language from its prorationing policy that gave the pipeline the right to contact a shipper's customers.

13. Reparations

The Commission ordered SFPP to calculate reparations for each East Line

48. Opinion No. 435-B, Mobil Oil Corp. v. *SFPP, L.P.*, 96 F.E.R.C. ¶ 61,281, 62,071 (2001).

49. *SFPP, supra* note 1, at 61,108 (1999).

50. *Id.* at 61,108-09.

51. *SFPP, supra* note 1, at 61,110. *See also* Statement of Policy, *Post-Employment Benefits Other Than Pensions*, 61 F.E.R.C. ¶ 61,330 (1992).

52. *SFPP, supra* note 1, at 61,115.

53. *Id.*

54. *SFPP, supra* note 1, at 61,115.

complainant based on the difference between the per barrel rates charged to those shippers and the per barrel rates that would have been charged had SFPP charged cost-based rates using a 1994 test year, and indexed those rates annually going forward. The Commission allowed SFPP to recover certain post-test period litigation, environmental, and reconditioning costs through a five-year surcharge, but only to the extent those costs exceeded the excess revenues SFPP was not required to refund in the form of reparations.

In calculating reparations, as explained in Opinion No. 435-A, SFPP must determine what the just and reasonable rate would be in each year between 1994 and August 1, 2000 (as well as two years back from the date of the earliest complaint), and then calculate what the appropriate gross revenues would have been from that rate. The difference between the gross revenue under the new just and reasonable rates creates the total reparations pool. SFPP would then calculate the reparations due each eligible shipper (including interest), leaving a residual in the pool of funds that could not be distributed because certain shippers had not filed a complaint within the time frame of this proceeding. The residual pool would then be credited against the total supplemental costs permitted under Opinion No. 435-A between 1995 and 1998. Any remaining allowable costs would then be recovered through a five-year surcharge beginning on August 1, 2000.[55]

14. Present Posture of Proceeding and Related Proceedings

As of March 2003, the proceeding is still pending before the Commission. SFPP has made a compliance filing following each of the Commission's orders, and one or more shippers have challenged each compliance filing. Notwithstanding the fact that a rehearing request is pending before the Commission, an appeal of the case in the United States Court of Appeals for the District of Columbia Circuit is proceeding with final briefs to be submitted in September 2003.

Additional challenges to SFPP's rates on its East Line, West Line, and the remainder of its system are also pending before the Commission in Docket No. OR96-2-000, *et al.* This case was tried before an Administrative Law Judge over a four and a half month period during the winter of 2001-2002, and an initial decision is expected at any time.

B. Complaints Against Joint Rates—Big West Oil Co. and Chevron Products Co. v. Frontier Pipeline, Anschutz Ranch East Pipeline Inc. and Express Pipeline

In 1998, four carriers established a joint rate for transporting crude oil from the International Border with Canada to Salt Lake City, Utah. The carriers justified the joint rate as being less than the sum of the individual rates posted by each carrier, using the doctrine established by the Commission in *Texaco Pipeline Inc.*[56] In 2000, two shippers, Big West Oil Co. (Big West) and Chevron Products Co. (Chevron) filed a series of complaints challenging the individual rates of two of the carriers, Frontier Pipeline (Frontier) and Anschutz Ranch East

55. Opinion No. 435-B, 96 F.E.R.C. ¶ 61,281, at 62,073-74.

56. *Texaco Pipeline Inc.*, 72 F.E.R.C. ¶ 61,313 (1995).

Pipeline Inc. (Anschutz), and the joint rate. The shippers alleged that Frontier's and Anschutz' individual rates were too high. They alleged that if those rates were adjusted to just and reasonable levels, the joint rate would also have to be lowered, as it would then exceed the sum of the individual rates. The shippers included Express Pipeline (Express) as a named respondent because it was the administrator of the joint tariff and the shippers claimed they could not receive the proper relief without Express being a party.[57]

Frontier, Anschutz, and Express filed answers requesting that the complaints be dismissed.[58] The carriers argued that a shipper cannot challenge a portion of joint rate, or the division of joint rate revenues, but must challenge the joint rate in its entirety and show that the joint rate exceeds the carriers' combined cost of service. Express also asked that the scope of any proceeding be limited to the issues raised regarding the level of Frontier's and Anschutz' local rates and that Express be severed from the proceeding.[59] In reply, complainants challenged the carriers' argument that they could not contest the lawfulness of the individual rates that are used to determine the reasonableness of the joint rates.[60]

The Commission accepted the complaints and consolidated them for hearing in two separate proceedings, with the complaints against Frontier and Express in one proceeding and the complaints against Anschutz and Express in the other.[61] The Commission found the complainants were disputing the Frontier and Anschutz local rates because they were used to determine the joint rate. It was also addressing the joint rates because they are affected by the local rates.[62] The Commission explained that its policy, as set forth in *Texaco*, had "been that a joint rate is just and reasonable if it is less than or equal to the sum of the local interstate rates currently on file with the Commission."[63] The Commission concluded that if Frontier and Anschutz' current local rates were shown to be just and reasonable, then the joint rates would be just and reasonable. If however, the carriers' current local rates were not just and reasonable, the joint rates would have to be "recalculated in accordance with *Texaco*."[64]

57. *Big West Oil Co. v. Frontier Pipeline Co.*, 94 F.E.R.C. ¶ 61,339, 62,257 (2001). *See also Big West Oil Co. v. Frontier Pipeline Co.*, 95 F.E.R.C. ¶ 61,229, 61,792-93 (2001).

58. 94 F.E.R.C. ¶ 61,339, at 62,258; 95 F.E.R.C. ¶ 61,229, at 61,793.

59. *Id.*

60. 94 F.E.R.C. ¶ 61,339, at 62,258; 95 F.E.R.C. ¶ 61,229, at 61,793.

61. 94 F.E.R.C. ¶ 61,339, at 62,260; 95 F.E.R.C. ¶ 61,229, at 61,792.

62. 94 F.E.R.C. ¶ 61,339, at 62,259; 95 F.E.R.C. ¶ 61,229, at 61,793-94.

63. 94 F.E.R.C. ¶ 61,339, at 62,259.

64. *Id.* at 62,260. In discussing the calculation of the joint rate, the Commission noted that one of the participating carriers, Chevron Pipe Line Company (CPL) did not have an interstate rate on file with the Commission for its portion of the transportation. The Commission further argued that any calculation done in accordance with *Texaco* should not include a rate for CPL. The rate in CPL's FERC tariff for its segment of the joint rate transportation was designated "Applies on Intrastate Traffic only." Subsequent to the Commission's order, CPL filed a tariff supplement removing that designation. CPL explained that it had been moving interstate traffic under the rate in its FERC tariff for years and that the intrastate designation should have been removed years earlier, but had not been due to an administrative oversight. *Chevron Pipe Line Co.*, 95 F.E.R.C. ¶ 61,260, 61,920 (2001). Big West protested the tariff supplement, arguing that CPL was in actuality establishing an initial rate without complying with the Commission's regulations. *Id.* CPL replied that it was not establishing a new service but that interstate transportation had been provided for shippers, including

The Commission agreed with the carriers that the division of revenues resulting from a joint rate "is the exclusive business of the participating carriers."[65] As a corollary, the Commission stated that if reparations had to be paid as a result of the adjustment of the joint rate, it would be the responsibility of the carriers to determine who makes the actual payments.[66] On rehearing, the Commission expanded upon this, stating that:

> The participants in the joint rate are jointly and severally responsible for the reparations because they all are parties to the joint rate. They should either voluntarily agree on the amount, or if agreement cannot be reached they should utilize whatever their joint rate agreement provides.[67]

The cases were settled before hearing. The proceeding against Anschutz was terminated, but the proceeding against Frontier remains before the Commission with respect to the amount of reparations, if any, that Frontier must pay the complainants.[68]

II. PROTEST CASES

A. Protests Against Proposed Rates

1. Indexed Rates

a. Rocky Mountain Pipeline System LLC

In early 2002, Rocky Mountain Pipeline System LLC acquired from BP Pipelines Company a pipeline running from the Canadian border to Casper, Wyoming. Shortly after Rocky Mountain bought the pipeline, it filed to reduce its rates for certain deliveries on the pipeline and to establish incentive rates for certain deliveries. The incentive rates were based on satisfying minimum barrels per day and term requirements. Sinclair Oil Corporation protested the tariff. Sinclair requested that the Commission require Rocky Mountain to prepare a cost-of-service study for the rates in question.[69] Sinclair pointed out that Rocky Mountain had never been authorized to charge market-based rates; therefore, Sinclair argued, Rocky Mountain is required to support its rates on a cost of service basis.

The FERC rejected Sinclair's protest and accepted the tariff.[70] The FERC

Big West, under the rate for years. Moreover, CPL had treated the rate as a FERC-jurisdictional rate, for example, decreasing when required to do so by the index for oil pipeline rates. 95 F.E.R.C. ¶ 61,260, at 61,920-21. The Commission accepted CPL's tariff supplement. It noted that there was no dispute that the shipments had been interstate for many years. It also noted that not only CPL, but the shippers had overlooked the intrastate traffic-only notation for years. The Commission concluded that "all parties have treated this rate as an interstate one, and accepting the filing merely corrects the omission to remove the footnote, but makes no other change." *Id.* at 61,922-23.

65. 94 F.E.R.C. ¶ 61,339, at 62,260.

66. *Id.*

67. *Big West Oil Co. v. Frontier Pipeline Co.*, 95 F.E.R.C. ¶ 61,281, 61,986 (2001).

68. *Big West Oil Co. v. Frontier Pipeline Co.*, 95 F.E.R.C. ¶ 61,229 (2001).

69. *Rocky Mountain Pipeline System LLC*, 99 F.E.R.C. ¶ 61,074, 61,336 (2002).

70. *Id.* at 61,337.

found that the rates in question were set "in 1996 on the basis of an agreement with a non-affiliated shipper," which is an accepted basis for setting initial rates.[71] Moreover, the Commission said, once such rates are set, a carrier is entitled to index such rates in accordance with the Commission's indexing regulations. Finally, under the "indexing regulations, a rate charged by a carrier may be changed, at any time, to a level which does not exceed the carrier's established index ceiling levels."[72] Therefore, the Commission held, Rocky Mountain was not required to file a cost-of-service study to support its discounted rates. Sinclair subsequently filed a complaint against Rocky Mountain's rates in Docket Number OR02-6-000.

b. Calnev Pipe Line LLC

On June 1, 2001, Calnev Pipe Line, LLC (Calnev) filed a tariff seeking to increase its rates in accordance with the Commission's rate indexing methodology.[73] Several parties protested the tariff, arguing that Calnev was substantially over-recovering its cost of service under its existing rates, and thus Calnev was not entitled to increase its rates further. The protestants claimed that a comparison of Calnev's 1998 and 1999 FERC Form No. 6's indicated that Calnev's cost per barrel was decreasing. The protestants indicated that they were unable to make a similar comparison for 2000 because Calnev had been granted an extension for the filing of its 2000 FERC Form No. 6.

On June 29, 2001, the Commission issued an order accepting and suspending Calnev's tariff, and making its rates subject to refund.[74] The Commission stated that, in order to challenge a rate increase made pursuant to the rate indexing procedures, a party must allege reasonable grounds for asserting that the rate increase is so substantially in excess of the pipeline's actual year-to-year cost increases as to cause the rate to be unjust and unreasonable. To make this comparison, the protestants needed Calnev's 2000 Form No. 6. Accordingly, the Commission ruled that the protestants would have 30 days to supplement their protests after Calnev filed its Form No. 6 with the Commission.

After Calnev filed its Form No. 6 for 2000, one of the protestants, ARCO, filed a supplemental protest. The Commission then issued an order in which it concluded that the supplemental protest primarily challenged Calnev's underlying rates rather than Calnev's rate indexing increase.[75] ARCO argued that the Commission had not evaluated Calnev's filing under the appropriate standard and that all ARCO was required to show was reasonable grounds for believing that the proposed rates are unjust and unreasonable. The Commission stated that it had rejected this argument in Order No. 561-A, where it ruled that disallowing challenges to underlying rates in the context of a rate indexing increase is necessary to protect rates grandfathered under the EPAct and

71. 99 F.E.R.C. ¶ 61,074, at 61,337.

72. *Id.*

73. *Calnev Pipe Line, LLC*, 95 F.E.R.C. ¶ 61,491 (2001).

74. *Id.*

75. *Calnev Pipe Line, LLC*, 96 F.E.R.C. ¶ 61,350 (2001).

consistent with the differing burdens of proof under the Interstate Commerce Act (ICA) in protest versus complaint proceedings.[76]

Having found that the ARCO could not challenge Calnev's underlying rates, the Commission considered whether ARCO or the other protestants had established that Calnev's rate increase was so substantially in excess of its actual cost increases that the resulting rates were unjust and unreasonable. The Commission found that the rate increase was 2.7594% and the actual year-to-year increase in Calnev's cost of service was 7.7%. It subsequently held that the protestants did not meet their burden. The Commission accepted Calnev's rates and terminated the investigation and refund obligation established in its prior order. The protestants subsequently filed a complaint in Docket No. OR01-8-000 challenging Calnev's rates, which was ultimately resolved by settlement.[77]

2. Settlement Rates – Chevron Pipe Line Company

On March 15, 2001, Chevron Pipe Line Company (CPL) filed for a rate increase on its line from El Paso, Texas, to Albuquerque, New Mexico, under 18 C.F.R. § 342.4(c), which allows pipelines to file settlement rates, or rates that are supported by all current shippers. Chevron also requested that the tariff be allowed to take effect on short notice.[78] Burlington Northern and Santa Fe Railway Company (BNSF) protested the rate increase. BNSF argued that it had standing, notwithstanding it was not a shipper, because it bore the effect of the rate increase under its fuel purchase agreement with CPL's affiliate, Chevron Products Company.

BNSF then argued that it was unjust and unreasonable and unduly discriminatory for CPL to increase the rates that BNSF bore. BNSF first explained that the rate increase was attributable to increased right-of-way costs that CPL paid under an agreement with the Isleta Pueblo Indians to continue using right-of-way over tribal lands. Those lands were downstream of the point at which BNSF took delivery. Therefore, BNSF argued that it should not be required to bear any portion of the costs.[79] BNSF also argued that CPL had not shown "unusual circumstances" that would justify allowing the rate to become effective on short notice.

CPL answered BNSF's argument that it should not bear the increased right-of-way costs by pointing out that CPL could not make deliveries to BNSF at an economic price if CPL did not also make other deliveries at points down-stream of the tribal lands. CPL pointed out that, to oppose settlement rates, BNSF was required by section 343.2(c)(2) of the Commission's regulations to show that "the rate is so substantially in excess of the actual cost increases incurred by the carrier that the rate is unjust and unreasonable," which BNSF had not done.[80]

The FERC first noted that CPL had not disputed BNSF's standing, so the

76. *Id.* at 62,304 (citing Order No. 561-A, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act*, [Regs. Preambles 1991-1996] F.E.R.C. STATS. & REGS. ¶ 31,000, 31,104 (1994)).

77. *ARCO v. Calnev Pipe Line, LLC*, 99 F.E.R.C. ¶ 61,209 (2002).

78. *Chevron Pipe Line Co.*, 95 F.E.R.C. ¶ 61,059, 61,160 (2001).

79. *Id.*

80. 95 F.E.R.C. ¶ 61,059, at 61,160-61.

Commission allowed its protest and intervention. The Commission noted the requirement of section 342.4(c) that BNSF show that the rate is in excess of actual costs and that BNSF had not filed any such evidence. The Commission then evaluated whether the specific rate increase CPL had proposed was reasonable in light of its increased right-of-way costs and concluded that it was. The Commission also found that it was reasonable for BNSF to bear a portion of the increased costs because CPL historically allocated right of way costs on a system-wide basis.[81] Finally, the Commission granted CPL's request for short notice, finding that the agreement to the rates of all current shippers was sufficient to show "unusual circumstances."

3. Cost-of-Service Rates

a. Olympic Pipe Line Company

On May 30, 2001, Olympic Pipe Line Company made a cost-of-service tariff filing requesting a 76% increase in rates for transportation from Anacortes, Ferndale, and Cherry Point, Washington to Linnton and Portland, Oregon. The Tosco Corporation and Tesoro West Coast Company protested the tariff claiming that Olympic's cost of service and throughput data was insufficient and that Olympic was improperly seeking to recover through its rates costs associated with the 1999 Whatcom Creek rupture of Olympic's mainline. The Commission rejected Olympic's filing. The Commission found that, although Olympic indicated that its cost of service was for the period ending December 31, 2001 and had a "2001" column in its supporting information, the filing failed to identify the base and test periods or include throughput data for the test period.[82]

On July 30, 2001, Olympic made a revised cost-of-service tariff filing, this time seeking a 62% increase in its rates. In its filing, Olympic indicated that the base period for the cost-of-service data was 2000. Because Olympic's 1999 and 2000 throughput was affected by the Whatcom Creek rupture, Olympic based its throughput on 1998, adjusted to reflect a reduction in Olympic's operating pressure imposed as a result of the rupture. Olympic also stated that it had removed all Whatcom Creek costs from its cost of service.

Tosco and Tesoro again protested Olympic's tariff filing. They noted the large increases in operating costs and questioned Olympic's claim that all Whatcom Creek costs had been excluded. They also challenged Olympic's capital structure and proposed rate of return. The Commission accepted and suspended Olympic's filing, subject to refund.

Olympic filed its direct case in December 2001 and included in it two separate cost-of-service presentations, which Olympic labeled as "Case 1" and "Case 2." Case 1, like Olympic's tariff filing, used 2000 as the base period, but also reflected test period adjustments for nine months following the base period. Case 2 used October 2000 through September 2001 as a base period and also included test period adjustments. In a prehearing conference held shortly after

81. *Id.* at 61,161.

82. *Olympic Pipe Line Co.*, 95 F.E.R.C. ¶ 61,488, 62,731 (2001).

Olympic filed its direct case, Olympic indicated that, of the two cases, it intended to rely on Case 2.[83]

On June 14, 2002, Tesoro filed a motion for summary disposition in which it argued that Olympic had failed to advance a prima facie case and asked that Olympic's entire case be dismissed. On July 19, 2002, the ALJ issued an initial decision agreeing with Tesoro and recommending that Olympic's case be dismissed and refunds ordered. The ALJ first considered Olympic's Case 2. The ALJ reviewed the Commission's regulations and prior decisions and concluded that they require "a carrier [to] use the same base and test periods in its direct case that it used in its tariff filing."[84] The ALJ determined that, by filing alternate cases, Olympic was essentially attempting to evade the requirement that its base and test periods be consistent with its tariff filing. Concluding that this was inappropriate, the ALJ struck Olympic's Case 2, which returned Olympic to where "it should be . . . with supporting data that uses the same base and test periods as those used in its initial filing."[85]

The ALJ then considered whether the case could go forward on the basis of Olympic's Case 1 alone and concluded that it could not. First, the ALJ reasoned that Olympic itself did not consider its Case 1 to be reliable since it preferred Case 2.[86] The ALJ then reviewed various deficiencies that caused Case 1 to be less than reliable, including uncertainties resulting from a change in ownership and pipeline operatorship in 2000, changes in Olympic's accounting system, the lack of testimony from Olympic personnel with historical knowledge, the lack of audited accounting data, uncertainty regarding throughput data, and incomplete and unreliable information relating to the Whatcom Creek incident.[87] After reviewing each of these in turn, the ALJ found that Olympic's filing should be entirely rejected and that refunds be ordered.[88]

On exceptions, the Commission upheld the bulk of the ALJ's Initial Decision.[89] In response to Olympic's challenge to the ALJ's rejection of Olympic's Case 1, the FERC ruled that it was proper to dismiss Case 1 because it became irrelevant when Olympic indicated it would rely on a different base and test period.[90] Olympic argued that Case 2 should not have been summarily rejected because a pipeline has discretion to select a different base and test period. The Commission, however, held that, while a pipeline does have discretion to *request* such a deviation, the Commission grants such requests only for good cause shown. After concluding that Olympic had not shown good cause, the Commission held that the ALJ properly dismissed Case 2.[91]

Olympic argued that the ALJ's decision to strike its testimony violated its due process rights because it neither received notice that the ALJ might strike its

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83. *Olympic Pipe Line Co.*, 100 F.E.R.C. ¶ 63,005, 65,007-08 (2002).

84. *Id.* at 65,009 (relying in part on *Gaviota Terminal Co.*, 76 F.E.R.C. ¶ 63,004 (1996)).

85. 100 F.E.R.C. ¶ 63,005, at 65,010.

86. *Id.*

87. 100 F.E.R.C. ¶ 63,005, at 65,010-13.

88. *Id.* at 65,013-14.

89. *Olympic Pipe Line Co.*, 101 F.E.R.C. ¶ 61,245 (2002).

90. *Id.* at 62,041.

91. 101 F.E.R.C. ¶ 61,245, at 62,041-42.

evidence nor had a chance to respond. The Commission rejected this argument, finding that Olympic was aware of the motion to strike, that it was offered a chance to respond in writing and failed to do so, and that there was an oral argument on the matter.[92]

Olympic argued that the granting of the summary disposition was procedurally incorrect because it went to the merits of the rate case and because the finding of unreliability for Case 1 was incorrect. The FERC concluded that the ALJ's decision to grant summary disposition was done not on the merits but on the procedural grounds that Olympic had abandoned its Case 1 and that it could not use Case 2 in this proceeding because the base and test periods were different from those used in its filing. Thus, it was a proper use of summary disposition.[93] The Commission upheld the ALJ's finding of unreliability of Case 1 because it said Olympic itself had admitted the unreliability.[94]

b. Equilon Pipeline Company

On April 17, 2000, Equilon Pipeline Company made a cost-of-service filing to increase many of the rates for its pipeline system. Equilon included a schedule that broke down its system and showed the prior rate for each movement, the proposed change in the rate, and the justification for the change. Equilon supported its filing with a cost of service presentation that showed that it was under-recovering its cost of service by 11%, which Equilon argued constituted a substantial divergence under the Commission's rate indexing regulations.[95]

Sinclair Oil Corporation protested the tariff filing.[96] Sinclair claimed a substantial economic interest in Equilon's filing because it had previously moved significant amounts of oil over Equilon's system and claimed that it would continue to do so in the future. It also claimed that Equilon's increases would have a significant impact on the price of crude oil that it refines. Sinclair challenged Equilon's cost of service and its rate structure. It claimed that Equilon had inflated the costs of its outside services and its fuel costs and that, when this was taken into account, Equilon had failed to show a substantial divergence. Sinclair also claimed that Equilon was engaging in differential pricing and raising prices in markets where it had market power in order to compensate for having rates below the index ceiling in markets where it had to compete with other carriers.[97]

Equilon answered Sinclair's protest, challenging Sinclair's standing as well as Sinclair's assertions about the cost of service and whether a substantial divergence had been shown. Equilon stated that Sinclair had moved very minimal volumes over Equilon's lines for which rates were increased, and that Sinclair actually bore the transportation costs in relatively few instances.

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92. *Id.* at 62,042.

93. 101 F.E.R.C. ¶ 61,245, at 62,042-43.

94. *Id.* at 62,043-44.

95. *Equilon Pipeline Co., LLC*, 91 F.E.R.C. ¶ 61,210, 61,760 (2000).

96. *Id.*

97. 91 F.E.R.C. ¶ 61,210, at 61,760.

Equilon acknowledged that it had not raised all rates, noting that it had only 19% of the total capacity in the Cushing area and that this kept it from significantly raising those rates. Equilon argued that Sinclair in fact benefited from this lower rate structure on many of its shipments. With regard to its cost of service, Equilon stated that Sinclair had failed to take into account amortization and return elements in its rate calculations. Finally, Equilon asserted that Sinclair was really only protesting the filing in order to gain leverage in a separate dispute with Equilon regarding a pipeline running between Cushing and Tulsa, Oklahoma, for which Sinclair was trying to force Equilon to file an interstate rate.

Sinclair answered Equilon's reply, primarily addressing the issue of standing. Sinclair argued that, by conceding that Sinclair shipped some volumes over its lines, Equilon had conceded that Sinclair had standing. Moreover, Sinclair claimed, it had a substantial economic interest in this filing because its concerns extended to the way costs were allocated across the entire system. It argued that transportation costs are necessarily included in the delivered price of crude oil and that a 19% share of the market is enough to dominate that market. Regarding the ongoing dispute between the parties relating to the Cushing to Tulsa pipeline, Sinclair noted that it had shipped significant volumes on the line, which Sinclair stated were interstate in nature, thus obligating Equilon to file an interstate tariff. Nevertheless, Sinclair said, it was Equilon and not Sinclair that raised the issue of the Cushing to Tulsa pipeline, and Equilon's allegations about using the protest for leverage were untrue.[98]

"Equilon filed a motion to reject Sinclair's reply" or in the alternative for leave to answer.[99] Equilon reiterated that Sinclair lacked standing because it did not bear the transportation costs of the crude oil that it refined in Cushing. Equilon also stated that some Sinclair allegations were properly raised by complaint and not by protest to Equilon's rate increase.

The Commission rejected Sinclair's protest and accepted Equilon's tariffs.[100] The Commission ruled that Sinclair had failed to show a substantial economic interest in the filings and thus lacked standing to challenge the tariffs. The Commission stated that Sinclair had submitted no evidence of its shipments over the routes for which rate increases were sought. Furthermore, Sinclair had not rebutted Equilon's statements that Sinclair did not bear transportation charges for barrels Sinclair purchased at Cushing and that these charges are instead borne by parties from whom Sinclair purchases. The Commission stated that Sinclair could challenge Equilon's failure to file a tariff for the Cushing to Tulsa pipeline, but must do so by complaint, since the tariff filings at issue did not implicate that pipeline.

98. *Id.* at 61,761.

99. 91 F.E.R.C. ¶ 61,210, at 61,761.

100. *Id.* at 61,762.

4. Penalties and Incentive Rates

a. Colonial Pipeline Company

On August 31, 2000, Colonial Pipeline Company filed tariffs to implement a "Nomination Integrity Program," which introduced a volume-based fee for origin nomination changes (3¢ per barrel for one period during the nomination cycle and 6¢ per barrel for a later period). Colonial stated that the fee was designed to prevent late changes in nominations, which would improve the integrity of the nomination process and the delivery of products on the pipeline system. ExxonMobil Corporation protested that Colonial was required either to follow the indexing rules to establish fees or to provide cost-of-service data to justify the fee. Colonial countered that the fee was non-jurisdictional and that, even if jurisdictional, it is a penalty and is necessary to deter behavior that may keep it from meeting its delivery commitments. For that reason, no cost-of-service justification was required.

The Commission accepted and suspended Colonial's filing.[101] The Commission stated that Colonial had not demonstrated the nomination problems that the fee was intended to address, nor had it shown that the fee would prevent the problems. In addition, the Commission said that Colonial had not shown that the penalty would compensate Colonial for the costs incurred as a result of the nomination problems. The Commission therefore conditioned its acceptance of the tariff on Colonial filing within 30 days information supporting the need for the fee and the appropriate amount of the fee.

Colonial made its compliance filing as required. It first argued that the fee was not jurisdictional under section 1(5) of the ICA because it was not incident to the provision of transportation service. Colonial compared the fee to a bookkeeping service. Recognizing that the Commission may not accept the jurisdictional argument, Colonial filed information to support its imposition of the fee. Colonial stated that it did in fact incur increased costs due to nomination changes, but that these costs were not quantifiable. Colonial therefore did not seek to justify its rates on its cost, but rather on the basis that the penalty strikes "a balance between shippers' need for ratability and flexibility."[102]

In support of this position, Colonial explained that the Nomination Integrity Program, of which the fee is one part, was designed to balance shipper need for flexibility to respond to changes in product demand against the operational demands of the pipeline. The program allows for flexibility by not penalizing changes in nominations made up to ten days before a nomination cycle commences and allows nominations to be adjusted within certain limits after that period.[103] Because Colonial carries several different products in batches, the pipeline must be concerned with ratability, which "is the speed at which the various constituent lines [carrying different products] will operate."[104] The penalty of three or six cents was determined "in relation to the degree of

101. *Colonial Pipeline Co.*, 92 F.E.R.C. ¶ 61,289 (2000).

102. *Colonial Pipeline Co.*, 98 F.E.R.C. ¶ 61,082, 61,247 (2002).

103. *Id.*

104. 98 F.E.R.C. ¶ 61,082, at 61,247.

untimeliness of the nomination changes."[105]

Exxon responded to both arguments. Exxon responded to the jurisdictional argument by contending that, unlike bookkeeping services, the fees were "inextricably tied to transportation."[106] Exxon responded to the argument that the penalty struck a reasonable balance by contending that Colonial had still failed to give any cost justification for the penalty and had not justified the penalties of three or six cents.

The Commission first found that the proposed fees were "inextricably tied to transportation" and thus jurisdictional.[107] This was because the "charges are designed to affect shipper conduct."[108] The Commission, however, approved the Nomination Integrity Program on the basis that it was a penalty, properly designed to "deter shipper conduct that could be detrimental to the interest [of] all shippers on Colonial."[109] It found that the charge was not imposed to generate revenue, so cost justification was unnecessary.[110] It also found that Colonial had given adequate justification for the fees because it had shown "that accurate nominations are required at all times."[111] However, the FERC did require Colonial to keep track of the revenues collected under the program.[112]

b. Mid-America Pipeline Company

On November 22, 2000, Mid-America Pipeline Company (Mid-America) made a tariff filing on its line from Conway, Kansas, to Mont Belvieu and Stratton Ridge, Texas, which added a volume incentive program. The program gave lower incentive rates to shippers with written commitments of ten years with a commitment volume of 7,300,000 barrels per year. Amoco Oil Company (Amoco) protested and argued that the tariff was designed intentionally so that only one or two predetermined shippers could qualify for the incentive rates. Thus, Amoco argued that the rates were unduly discriminatory and preferential in violation of sections 2 and 3(1) of the ICA.[113]

Mid-America answered the protest and denied that the program was discriminatory. It stated that Amoco, or any other shipper for that matter, was free to join the program. Mid-America argued that its program was "indistinguishable" from others accepted by the Commission.[114]

The FERC rejected the protest and accepted the tariff. The Commission agreed with Amoco that Mid-America's tariff targeted particular shippers, which could commit to ship large volumes for a long period of time. However, the Commission found this was not discriminatory. Focusing specifically on the

105. *Id.*
106. 98 F.E.R.C. ¶ 61,082, at 61,248.
107. *Id.* at 61,249.
108. *Colonial Pipeline Co.*, 98 F.E.R.C. ¶ 61,082, 61,249 (2002).
109. *Id.* at 61,246.
110. 98 F.E.R.C. ¶ 61,082, at 61,249.
111. *Id.*
112. 98 F.E.R.C. ¶ 61,082, at 61,249.
113. *Mid-America Pipeline Co.*, 93 F.E.R.C. ¶ 61,306, 62,048 (2000).
114. *Id.*

minimum volume commitments, the Commission stated, "shippers meeting these volume [and minimum term] requirements are not similarly situated with other shippers tendering lower volumes[.]"[115] Thus, the Commission ruled, "no discrimination results from differential pricing in these circumstances."[116] Moreover, it found that these rates were all within the index ceiling and that Mid-America was perfectly within its rights to try to attract long-term, high-volume commitments.[117]

c. Tri-States NGL Pipeline, LLC

On December 29, 2000, Tri-States NGL Pipeline (Tri-States), operated by WFS-NGL Pipeline Company, Inc. (Williams Pipeline), filed a tariff giving a three cent per barrel discount to shippers who agreed to ship products with lower carbon dioxide levels. The tariff also contained a change of the effective date for the separately published quality specification sheet, which had been revised to reduce the dryness specifications. Owners of a processing plant, led by Mobile Bay Processing Partners, protested, arguing that the change in specifications would force them to spend millions of dollars and would unfairly benefit the Williams Field Services Company processing plant (Williams Processing), an affiliate of Williams Pipeline and the operator of Tri-States. Williams Processing was already set to install equipment that would meet the new standards.

Mobile Bay complained that Williams Processing, due to its contracts with producers, would be able to recover its construction costs while Mobile Bay would not, giving Williams Processing an unfair competitive advantage. In its contracts with shippers, Williams Processing bore the transportation costs, allowing it to receive the benefit of any lower rate. Mobile Bay, on the other hand, did not bear the costs of transportation under its contracts. Mobile Bay reasoned that this led to a subsidy of Williams Processing's construction, while Mobile Bay would bear all of its construction costs. Mobile Bay also claimed that the new rate had not been justified, arguing that Tri-States already had an effective operational maintenance program, and that Tri-States had produced no evidence that a change was necessary. Finally, Mobile Bay claimed that the tariff filing failed to give adequate notice of the change in dryness specifications because the filing reflected only a change in effective date for its dryness specifications, without indicating any substantive changes to the specifications.

Tri-States responded to the protests both on procedural grounds and on the merits. First, Tri-States pointed out that none of the shippers had protested.[118] It claimed that Mobile Bay lacked standing because it did not have a substantial economic interest. Second, Tri-States argued on the merits that the program did not favor any shipper over another or any plant. It stated that both Williams Processing and the protesters would be required to invest a substantial amount of

115. 93 F.E.R.C. ¶ 61,306, at 62,048-49.

116. *Id.*

117. 93 F.E.R.C. ¶ 61,306, at 62,048-49.

118. *Tri-States NGL Pipeline, LLC*, 94 F.E.R.C. ¶ 61,087, 61,381 (2001).

money to meet the new quality specifications, making them similarly situated.[119] In response to the processors' claim that the change of the quality specifications was unnecessary, Tri-States stated that it was concerned with "the long-term integrity and safety of the pipeline."[120] It explained that "free water in the pipeline system complicates operations, decreases measurement accuracy, and creates problems at downstream fractionators."[121]

The FERC rejected the protest on two separate grounds. First, it found that the protesters did not have a substantial economic interest since the plant passed shipping costs through to producers. The FERC went on, however, to state that the program did not unduly prefer Williams Processing because it would have to invest just as much money as the other processing plants to meet the new dryness specifications. Furthermore, any shipper could qualify for the discount by agreeing to meet the new carbon dioxide standards. Second, the FERC found that the new program was beneficial to pipeline safety and longevity, which would benefit all shippers.[122] Therefore, it found the rates to be just and reasonable, and not discriminatory.[123] The FERC did not address the issue of adequate notice in the filing.

B. Protests of Cancellation of Joint, Through or Other Rates

1. Rate Cancellations

a. Shell Pipeline Co. & All American Pipeline Company, L.P.

In a series of related cases, the Commission rejected protests to the cancellation of certain tariffs containing discounted rates. In each instance the Commission held, *inter alia*, that because shippers could continue to make movements under combined local rates, the protestor's arguments were without merit.

Phillips Petroleum Company, Tosco Corporation, and Toscopetro Corporation (collectively Tosco) protested Shell Pipeline Co.'s (Shell) cancellation of a tariff containing discounted through rates. Shell cancelled the rates because it sold part of the assets needed to make the movement to All American Pipeline Company, L.P. (All American), and thus could no longer offer the service. The Commission rejected Tosco's protest, noting that Shell had no obligation to continue offering the discount and that Tosco could continue to make movements under local rates.[124] The Commission affirmed its holding on rehearing, rejecting Tosco's claim that cancellation of discounted through rates would cause a violation of the applicable rate ceilings.[125]

119. *Id.* at 61,382.

120. 94 F.E.R.C. ¶ 61,087, at 61,382.

121. *Id.*

122. 94 F.E.R.C. ¶ 61,087, at 61,382.

123. *Id.*

124. *Shell Pipeline Co. LP*, 100 F.E.R.C. ¶ 61,139, 61,534 (Aug. 1, 2002).

125. *Shell Pipeline Co. LP*, 100 F.E.R.C. ¶ 61,330, 62,537 (Sept. 25, 2002); *see also All American Pipeline, L.P.*, 100 F.E.R.C. ¶ 61,266, 62,014 (Sept. 13, 2002) ("[T]he ceiling level for a joint rate is the sum of

Additionally, the Commission rejected Tosco's claim that because Shell did not designate the lower through rates as discount or incentive rates, those rates were not discounted. The Commission noted that a pipeline has no legal obligation to so designate discounted rates, and that the discount was clear on the face of the tariff.[126] The Commission also distinguished its holding in *West Texas LPG Pipeline Limited Partnership*,[127] and noted that its holding in *Express Pipeline LLC*,[128] although it involved joint rates, was on point.[129] Tosco has appealed the Commission's orders to the D.C. Circuit.

In a related case, *All American Pipeline, L.P.*,[130] Tosco protested All American's adoption of Shell's cancelled tariff, claiming that the Commission should require All American to file a joint tariff with Shell to preserve the discounted through rates Shell previously offered. The Commission, relying on its previous rulings in the *Shell*[131] and *Express*[132] cases held that "Tosco's protest . . . has no merit."[133] Tosco has appealed the Commission's orders to the D.C. Circuit.

Tosco also protested Shell's cancellation of a joint tariff with Mobil that contained discounted rates. The Commission rejected Tosco's protest, again holding that shippers would still receive service for the movement under a combination of local rates, all established under the ICA.[134]

b. Amoco Pipeline Company

On September 22, 2000, Amoco Pipeline Company (APC) filed a tariff supplement to cancel Little Buffalo Station (Little Buffalo) as an origin on the Big Horn pipeline in Wyoming, which APC owned in undivided joint interest with Conoco Pipe Line Company. APC stated that the cancellation was due to its decision to discontinue its gathering operations at Little Buffalo. It also stated that this was done for environmental concerns because of the poor condition of the facilities.

Citation Oil & Gas Corp. (Citation), a producer in the Little Buffalo Basin Field, protested. Citation indicated that it did not oppose APC's termination of gathering service at Little Buffalo, but that this termination did not require it to cancel Little Buffalo Basin as an origin on the Big Horn pipeline. Citation indicated that there was still significant production in the area, which would be transported on the pipeline. In fact, Citation intended to construct a gathering

the ceiling levels associated with individual tariff rates currently on file.") (citing *Texaco Pipeline Inc.*, 72 F.E.R.C. ¶ 61,313 (1995)). *Id.*

126. *Id.*

127. *West Texas LPG Pipeline Ltd. P'ship*, 100 F.E.R.C. ¶ 61,038 (July 5, 2002); *see infra* Part I.D.2.c.

128. *Express Pipeline LLC*, 99 F.E.R.C. ¶ 61,229 (May 31, 2002); *see infra* Part I.D.2.b.

129. 100 F.E.R.C. ¶ 61,330, at 62,014.

130. *All American Pipeline, L.P.*, 100 F.E.R.C. ¶ 61,266 (Sept. 13, 2002).

131. *Shell Pipeline Co. LP*, 100 F.E.R.C. ¶ 61,139 (Aug. 1, 2002); *Shell Pipeline Co. LP*, 100 F.E.R.C. ¶ 61,330 (Sept. 25, 2002).

132. 99 F.E.R.C. ¶ 61,229; *see infra* Part I.D.2.b.

133. 100 F.E.R.C. ¶ 61,266, at 62,013-14.

134. *Shell Pipeline Co. LP*, 100 F.E.R.C. ¶ 61,207, 61,714-15 (Aug. 23, 2002).

system to transport petroleum to the Little Buffalo origin point.[135] Citation claimed that cancellation would hamper the recovery of oil in the Little Buffalo Basin Field.

APC answered Citation's protest, pointing out that it was not seeking cancellation of Little Buffalo Station as an origin. In fact, APC explained that the FERC had approved the cancellation of that origin over two years ago. Only Conoco continued to show Little Buffalo Station as an origin point. Accordingly, it argued that Citation was protesting something that was not proposed.[136]

The FERC denied Citation's protest and accepted APC's tariff supplement.[137] The Commission found that APC had indeed previously cancelled Little Buffalo Station. Since APC sought only to cancel its gathering service, which Citation did not oppose, there was no basis for rejecting its cancellation.[138]

2. Other Tariff Cancellations[139]

a. Express Pipeline LLC

The Commission rejected protests by Big West Oil, LLC, Chevron Products Co., and Tesoro Refining and Marketing (collectively Protestors) to Express Pipeline LLC's (Express) cancellation of certain joint rates for the shipment of crude oil and synthetic crude oil from the U.S.-Canadian border to Salt Lake City. The joint tariffs resulted from an agreement between Express, Frontier Pipeline Company (Frontier), and Anschutz Ranch East Pipeline (Anschutz)[140] to discount the otherwise applicable local rates of Express, Platte Pipe Line Company (which provided a pumpover facility), Frontier, Anschutz and Chevron Pipeline Company (CPL).

The Commission allowed the cancellations over the Protestors' claim that cancellation would increase transportation by up to 40%, and noted that "there is a through route already established . . . and service over that route will continue to be available under the local rates of the individual carriers, just as it has been under the joint rates."[141] The Commission also noted that the joint rates at issue "constitute a discount from the sum of the individual local rates, which are established under the provisions of the ICA" and that once the agreement establishing joint rates terminates, no "carrier[ ] is obligated to continue" the joint rates.[142]

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135. *Amoco Pipeline Co.*, 93 F.E.R.C. ¶ 61,052, 61,114-15 (2000).

136. *Id.* at 61,115.

137. 93 F.E.R.C. ¶ 61,052, at 61,114-15.

138. *Id.* at 61,116.

139. *See also* the discussion of Outer Continental Shelf tariff cancellations in Section V.

140. As the Commission noted, although the joint tariff included Chevron Pipeline Company (CPL) as a participating carrier, CPL was not a party to the joint tariff agreement. *Express Pipeline LLC*, 99 F.E.R.C. ¶ 61,229, 61,949-50 (May 31, 2002). CPL was a party to a separate agreement with Frontier and Anschutz.

141. *Id.* at 61,951.

142. 99 F.E.R.C. ¶ 61,229, at 61,951.

b. West Texas LPG Pipeline Limited Partnership

On June 6, 2002, West Texas LPG Pipeline Limited Partnership (West Texas) filed tariffs to eliminate certain volume incentive rates, cancel two destination points, and increase its rates via the Commission's indexing methodology.[143] Additionally, West Texas requested a shortened notice period so that the new rates could go into effect in only twenty-four days, on July 1, 2002. Duke Energy NGL Services, LP, (Duke) protested the proposal to cancel the two destination points, claiming that although the points had not been used in the previous twelve months, Duke had recently nominated volumes for delivery to one of the points.[144]

As to West Texas's attempt to eliminate the volume incentive rates, the Commission noted that when it initially filed FERC Tariff No. 24 on May 31, 2002, West Texas apparently omitted a provision from that tariff that would have added a June 1, 2002 cut-off date for entering into agreements for volume incentive rates. On June 6, 2002, West Texas attempted to rectify its mistake by withdrawing FERC Tariff No. 24 and filing a revised tariff that included the June 1, 2002 cut-off. The Commission rejected this *post hoc* revision, noting that "the June 1 prerequisite for contract execution cannot stand, since it retroactively eliminates the existing tariff provision."[145]

The Commission found that it had insufficient information to resolve the dispute over the destination points and, as a result, suspended the portion of West Texas' filing dealing with the cancellation of the two destination points. The Commission encouraged the parties to settle the dispute.[146] The Commission accepted West Texas' rate revisions.[147] Duke and West Texas subsequently settled the rest of the dispute and Duke formally withdrew its protest on July 24, 2002.[148]

c. Line Fill Cases—Kinder Morgan and Mid-America Pipeline Co.

Two carriers, Kinder Morgan Operating Partnership L.P. "A"[149] and Mid-America Pipeline Co.,[150] filed tariffs in 2001 to implement programs to require propane shippers to provide linefill. Two shippers and the National Propane Gas Association protested each of the tariff filings. The Commission accepted the protests, suspended the tariff filings, and convened technical conferences to examine the issue.[151]

The primary argument that the protestants raised was that the imposition of

143. *West Texas LPG Pipeline Ltd. P'ship*, 100 F.E.R.C. ¶ 61, 038, 61,129-30 (July 5, 2002).

144. *Id.* at 61,130.

145. 100 F.E.R.C. ¶ 61,038, at 61,130-31.

146. *Id.* at 61,131.

147. 100 F.E.R.C. ¶ 61,038, at 61,131.

148. *Notice of Withdrawal of Motion to Intervene, Protest and Request Rejection or in the Alternative, Request for Suspension and Investigation of Duke Energy NGL Services, LP*, IS02-331-000 (FERC docketed July 24, 2002).

149. *Kinder Morgan Operating L.P. "A"*, 99 F.E.R.C. ¶ 61,133 (2002).

150. *Mid-America Pipeline Co.*, 99 F.E.R.C. ¶ 61,119 (2002).

151. 99 F.E.R.C. ¶ 61,133, at 61,557; 99 F.E.R.C. ¶ 61,119, at 61,507.

a linefill requirement on shippers would be a rate increase not permitted under the Commission's regulations, unless justified by a cost-of-service filing.[152] Each carrier responded that linefill was necessary to provide on-demand service and that it had not historically provided the necessary linefill but relied upon shipper inventory in the system. Each carrier contended that on one or more occasions, shipper inventory was insufficient for the functioning of the on-demand service.[153]

The Commission rejected each of the tariff filings. The Commission found that neither carrier had met its burden of proving that the linefill requirement was necessary for system operation. While all the parties conceded that linefill was necessary for on-demand service, the Commission found that neither carrier was obligated by its tariff to provide on-demand service.[154] With respect to Mid-America, the Commission stated that the carrier had "failed to persuade the Commission that its proposed linefill program does not constitute a cost-of-service rate increase" and suggested that Mid-America make a cost-of-service filing if it wished to impose the linefill requirement.[155]

III. MARKET-BASED RATE CASES

A. West Shore Pipe Line Company.

On July 1, 2002, the Commission issued an order granting West Shore Pipe Line Company's (West Shore) application for a market power determination in its Chicago BEA[156] origin and destination markets. It also authorized West Shore to file tariffs reflecting market-based rates for the transportation of refined petroleum products in those markets.[157] The Commission noted that the application was uncontested,[158] and that it had previously "authorized three refined product pipelines to charge market-based rates in the Chicago BEA origin market, and five refined product pipelines to charge market-based rates in the Chicago BEA destination market."[159] In addition, the Commission accepted West Shore's uncontested calculation of: (1) a Herfindahl-Hirschman Index (HHI)[160] of 1,157 and market share percentage of 17.7 for the Chicago BEA

152. 99 F.E.R.C. ¶ 61,133, at 61,558; 99 F.E.R.C. ¶ 61,119, at 61,509.

153. 99 F.E.R.C. ¶ 61,133, at 61,557-58; 99 F.E.R.C. ¶ 61,119, at 61,507.

154. 99 F.E.R.C. ¶ 61,133, at 61,559-60; 99 F.E.R.C. ¶ 61,119, at 61,509-10.

155. 99 F.E.R.C. ¶ 61,119, at 61,510.

156. A BEA is an "Economic Area," as defined by the U.S. Department of Commerce, Bureau of Economic Analysis. For purposes of oil pipeline applications for market-based rate authority, the Commission has frequently defined the relevant geographic markets by reference to BEAs. *See generally Buckeye Pipe Line Co., L.P.*, 53 F.E.R.C. ¶ 61,473 (1990), *order on reh'g*, 55 F.E.R.C. ¶ 61,084 (1991); *Williams Pipe Line Co.*, 68 F.E.R.C. ¶ 61,136 (1994); *Kaneb Pipe Line Operating P'ship*, 83 F.E.R.C. ¶ 61,183 (1998).

157. *West Shore Pipe Line Co.*, 100 F.E.R.C. ¶ 61,001 (2002).

158. The lone protest to the filing had been withdrawn by the time of the Commission's decision.

159. 100 F.E.R.C. ¶ 61,001, 61,002 (2002).

160. An HHI is calculated by summing the squares of the market shares of all the firms competing in a particular geographic market. Thus, a market that is completely monopolized would have an HHI of 10,000 (100 x 100), while a market with two equally dominant suppliers would have an HHI of 5,000 [(50 x 50) + (50 x 50)].

origin market; and (2) an HHI of 1,471 and an Excess Capacity Ratio[161] of 3.9 for the Chicago BEA destination market. Finding these uncontested market power values to be well within the initial screening thresholds, the Commission granted West Shore's application.

B. Rocky Mountain Pipeline System, LLC

On July 22, 2002, Rocky Mountain Pipeline System, LLC (Rocky Mountain) filed an application with the Commission seeking authority to charge market-based rates for the transportation by pipeline of crude oil. The application involves transportation over Rocky Mountain's "Western Corridor" pipeline system running from the U.S./Canadian border to Billings, Montana and Casper and Guernsey, Wyoming. Several shippers on the system filed motions to intervene, protested, and requested an evidentiary hearing. The case is currently pending before the Commission.

IV. PIPELINE ACQUISITION COSTS

In July 2002, the Commission acted on the remand of an order involving a carrier's ability to include in a rate base the acquisition cost of pipeline facilities, rather than their net depreciated original cost. The Commission had issued orders in 1995 and 1997 holding that acquisition cost could not be used when the prior owner of the pipeline retained an equity interest in the pipeline (*i.e.*, *Rio Grande Pipeline Co.*[162] and *Longhorn Partners Pipeline L.P.)*. Rio Grande appealed the Commission's Order and the Court of Appeals for the District of Columbia remanded the case to the FERC in late 1999. The Court found that the Commission had adopted a new *per se* exclusion prohibiting what might otherwise be an acceptable use of the acquisition cost solely on the basis that the prior owner retained some equity interest. The Court stated that the creation of this *per se* exclusion made "no sense" and remanded the case for further consideration.[163]

On remand, the Commission noted that it had already approved Rio Grande's rate of $1.26 as a negotiated rate with a shipper. The Commission ruled that if Rio Grande still wished to establish a cost-based rate, it would have to file a cost of service analysis in accordance with 18 C.F.R. § 342.2(a) within 30 days. Rio subsequently notified the Commission that it was not going to pursue cost-based rates at that time and the proceeding was terminated.

161. An Excess Capacity Ratio is derived by dividing the effective capacity available to serve a market (*i.e.*, all available refinery, pipeline, truck and barge capacity not being used to serve other markets) by the annual consumption in the market.

162. *Rio Grande Pipeline Co.*, 78 F.E.R.C. ¶ 61,020 (1997); *Longhorn Partners Pipeline*, 73 F.E.R.C. ¶ 61,355 (1995). Longhorn did not appeal the Commission's ruling but sought to intervene in Rio Grande's appeal. The Court order addressed the merits of only Rio Grande's appeal.

163. Rio Grande Pipeline Co. v. FERC, 178 F.3d 533, 541-43 (D.C. Cir. 1999).

V. PETITIONS FOR DECLARATORY ORDERS

A. Colonial Pipeline Company

In 1999, Colonial Pipeline Company (Colonial) filed a request for declaratory order relating to a proposed new pipeline from central Alabama to Murfreesboro, Tennessee (a suburb of Nashville). According to its petition, Colonial had concluded that the projected $180 million cost of the new pipeline could only be justified if it obtained advance approval from the FERC for its proposed rate treatment of the new service. In particular, Colonial sought FERC approval that:

(1) Its cancellation of the pre-existing rates to Nashville using an existing line would not be subject to challenge when the new line went into service; (2) Its grandfathered rates on its mainline system would not be subject to challenge due solely to the connection to the new pipeline; (3) Colonial's proposed initial rates for the new service (combining its existing grandfathered mainline rates with cost-of-service rates for the new line segment) would be accepted; and (4) The cost of service rates on the new segment would be subject to the FERC indexing rules on a going-forward basis.

Over a number of protests, the Commission issued the requested declaratory order,[164] and subsequently sustained it on rehearing.[165]

The *Colonial* orders were then appealed by two of Colonial's shippers to the U.S. Court of Appeals for the D.C. Circuit. While the case was pending on appeal, Colonial announced that it had, for business reasons, terminated the Nashville pipeline project. Accordingly, all parties to the appeal joined in a motion to vacate the agency orders and dismiss the pending petitions for review. That unopposed motion was granted on July 30, 2002.[166]

B. Plantation Pipe Line Company

While the *Colonial* case was pending, Plantation Pipe Line Company (Plantation) filed a similar request for a declaratory order relating to a proposed new pipeline to Chattanooga and Knoxville, Tennessee.[167] Plantation's plan, involved two steps: (1) constructing a new pipeline from Bremen, Georgia to Chattanooga and Knoxville in the right-of-way of Plantation's existing Bremen-Knoxville line and (2) abandoning the existing line segments in place, thus routing all movements to Chattanooga and Knoxville through the new line.[168] Before embarking on the proposed construction project, Plantation sought Commission assurance that:

(1)The abandonment of the existing line and cancellation of the existing rates would not be subject to challenge; (2) The proposed new rates (which would be joint rates between Plantation and a new entity to be created to own and operate

164. *Colonial Pipeline Co.*, 89 F.E.R.C. ¶ 61,095 (1999).

165. *Colonial Pipeline Co.*, 95 F.E.R.C. ¶ 61,355 (2001).

166. Marathon Ashland Petroleum, LLC v. FERC, 2002 WL 1760295 (D.C. Cir. July 30, 2002).

167. *Plantation Pipe Line Co.*, 98 F.E.R.C. ¶ 61,219 (2002).

168. *Id.* at 61,864.

the new line) would be found just, reasonable and not unduly discriminatory; and (3) The establishment of the new service would not affect Plantation's existing grandfathered rates.[169]

On February 28, 2002, the FERC issued the requested declaratory order. Among other things, the order reaffirmed that the Commission does not have jurisdiction over pipeline abandonments (including the abandonment planned by Plantation), approved in concept Plantation's proposed rate structure (subject to the filing of actual new rates by the proposed new pipeline entity), and confirmed the continued grandfathered status of Plantation's existing mainline rates.[170] The order was not appealed.

C. SFPP, L.P.

SFPP requested a declaratory order in connection with the planned expansion of its East Line from Texas to Arizona. SFPP's planned expansion is estimated to cost $180 million, which SFPP states would increase the East Line's rate base five and one-half times.[171] Before embarking on the expansion, SFPP seeks the following rulings: First, that a substantial divergence pursuant to 18 C.F.R. § 342.4(a) can be based on a capital investment. Second, that if cost-of-service rates calculated on the East Line costs after expansion exceed indexed rates by 20 percent or more, the Commission will find that substantial divergence exists. Lastly, that SFPP's rates filed after the expansion will be allowed to go into effect, subject to refund if protested, on the effective date proposed when the tariff filing is made.[172] Filings were made both supporting and protesting SFPP's petition. On January 29, 2003, the Commission granted SFPP's petition in part.[173] Among other things, the order held that SFPP may file cost-based rates that exceed its indexed rates, but it declined to adopt a particular percentage change in cost of service as the standard for establishing a "substantial divergence" for purposes of the indexing rules.

D. Caesar and Proteus

Two other virtually identical petitions sought advance rulings relating to proposed new OCS pipelines in the Gulf of Mexico. Caesar Oil Pipeline Company, LLC and Proteus Oil Pipeline Company, LLC each propose to construct new, large-capacity oil pipelines in the deepwater portion of the Gulf. In each case, the sponsors filed petitions seeking clarification of the terms on which they will be permitted to operate.[174] In particular, each company asserted that, because its pipeline will be located entirely in the OCS, its operations are

169. 98 F.E.R.C. ¶ 61,219, at 61,864.

170. *Id.* at 61,219

171. Petition for Declaratory Order and Request for Expedited Consideration, *SFPP, L.P.*, OR02-12-000, at 3 (FERC docketed Sept. 19, 2002).

172. *Id.* at 4.

173. SFPP, L.P., 102 F.E.R.C. ¶ 61,089 (Jan. 30, 2003).

174. Petition for Declaratory Order and Request for Expedited Consideration, *Caesar Oil Pipeline Co., LLC*, OR03-2-000 (FERC docketed Dec. 6, 2002) [herinafter *Caesar Petition*]; Petition for Declaratory Order and Request for Expedited Consideration, *Proteus Oil Pipeline Co., LLC*, OR03-3-000 (FERC docketed Dec. 6, 2002) [hereinafter *Proteus Petition*].

subject to the Outer Continental Shelf Lands Act (OCSLA) and not to the ICA. Unlike the ICA, the petitions stated, OCSLA has not been construed to require common carriage (including pro rata allocation of pipeline capacity), but only "open access."[175] The petitions therefore request confirmation that the new pipelines could: (1) function as contract carriers; (2) hold an open season to commit pipeline capacity on a long-term basis; (3) give contract shippers priority access to capacity; and (4) satisfy future requests for service on a first-come, first-served basis.[176] The Commission granted the requested declaratory orders on March 27 and March 28, 2003, respectively.[177]

VI. OUTER CONTINENTAL SHELF TARIFF CANCELLATIONS

A recurring issue in the past several years has been the scope of the FERC jurisdiction under the ICA over oil pipelines in the offshore waters of the United States constituting the OCS. In a case involving an offshore pipeline operated by Amberjack Pipeline Company (Amberjack), the FERC accepted Amberjack's cancellation of its tariffs covering transportation of crude oil between two points in the Gulf of Mexico on the ground that transportation wholly within the OCS is excluded from the coverage of the ICA.[178] At the same time, the Commission declined to rule on the merits of the cancellation of Amberjack's joint tariffs with another pipeline that covered transportation from the OCS to certain onshore points in Louisiana. In the latter case, the FERC ruled that the relevant tariff cancellations had not been protested and therefore became effective by operation of law.[179]

With respect to its OCS tariffs, Amberjack filed a cancellation supplement on November 15, 2001, to be effective December 28, 2001. In its filing, Amberjack asserted that the tariffs it was seeking to cancel related solely to movements from Louisiana Green Canyon Block 65 to Louisiana Green Canyon Block 19, both of which are located in the OCS. Although Amberjack acknowledged that its OCS operations would continue to be governed by the OCSLA,[180] which imposes "open access" requirements, but not a requirement to file tariffs with the FERC, it argued that movements that occur entirely offshore are not subject to ICA jurisdiction, citing *Bonito Pipe Line Co.*[181] and *Ultramar Inc. v. Gaviota Terminal Co.*[182]

Amberjack's tariff cancellation was challenged by two parties claiming standing as shippers, who argued that the Commission should consider the ultimate disposition of the transported oil after it reached shore in determining

175. *Caesar Petition*, *supra* note 174, at 19-26; *Proteus Petition*, *supra* note 174, at 17-24.

176. *Caesar Petition*, *supra* note 174, at 29; *Proteus Petition*, *supra* note 174, at 27.

177. *Proteus Oil Pipeline Co.*, LLC, 102 F.E.R.C. ¶ 61,333 (2003); *Caesar Oil Pipeline Co.*, LLC, 102 F.E.R.C. ¶ 61,339 (2003).

178. *Amberjack Pipeline Co.*, 97 F.E.R.C. ¶ 61,381 (2001), *reh'g denied*, 98 F.E.R.C. ¶ 61,209 (2002).

179. *Public Utils. Comm'n of the State of Cal. v. El Paso Natural Gas Co.*, 98 F.E.R.C. ¶ 61,210, 61,761 (2002).

180. 43 U.S.C. §§ 1331-56a (1988).

181. *Re Bonito Pipe Line Co.*, 61 F.E.R.C. ¶ 61,050, 61,219 (1992), *aff'd on other grounds sub nom.* Shell Oil Co. v. FERC, 47 F.3d 1186 (D.C. Cir. 1995).

182. *Ultramar, Inc. v. Gaviota Terminal Co.*, 80 F.E.R.C. ¶ 61,201, 61,810 (1997).

whether the OCS-only movement was subject to ICA jurisdiction. They also contended that permitting cancellation of the tariff for OCS movements would leave them vulnerable to possible rate increases and rule changes without oversight under the ICA. The Commission nonetheless sided with Amberjack, holding that "the ICA does not cover the transportation of crude oil on the OCS and hence the OCS does not come within the ICA's jurisdictional language."[183] The question of the ultimate disposition of the oil onshore was, the Commission ruled, "not relevant to the issue of jurisdiction."[184] On rehearing, the FERC confirmed its original ruling, noting that it had not addressed the jurisdictional status of the movements from the OCS to onshore points in Louisiana because no party had protested the cancellation of the joint tariffs applicable to those movements.[185]

VII. MINERALS MANAGEMENT SERVICE UPDATE

During the past two years, the Department of the Interior's Minerals Management Service (MMS) has been relatively dormant with respect to specific regulatory actions affecting oil pipelines. In the meantime, its prior actions on the proper calculation of royalties on oil production continue to make their way through the Department of Interior's administrative appeals process and the federal courts.

On the royalty front, most MMS actions affecting the oil pipeline industry arise out of its interpretation of how oil is to be valued for royalty purposes, specifically whether and to what extent oil pipeline transportation costs may be deducted as a transportation allowance from royalty payments. In the past two years, the Interior Department's Board of Land Appeals (IBLA) and the federal courts have addressed what transportation costs can be deducted from royalty payments in a number of cases. For example, in *Wagner & Brown, Ltd.*,[186] the IBLA addressed the MMS's position that while transportation costs may be deducted from royalties, gathering and marketing costs may not. In the circumstances of that case, the IBLA upheld MMS's decision that Wagner & Brown, Ltd. was required to pay royalties based on the price its affiliate received in third party sales of oil, including a portion of that price that had been designated as a pipeline transportation charge. The IBLA disallowed the transportation charge deduction because it determined that the fee did not relate to transportation, but was a non-deductible marketing cost.

Whether lessees have an implied duty to market oil at no cost to the lessor has been a constant point of friction between MMS and the oil industry. Recent federal court decisions relating to royalty calculations on gas production indicate that MMS may prevail on its position that oil producers may not deduct marketing costs from royalties.[187] In another recent case, the IBLA addressed

183. 97 F.E.R.C. ¶ 61,381, at 62,742-43.

184. *Id.* at 61,743.

185. *Public. Utils. Comm'n of the State of Cal. v. El Paso Natural Gas Co.*, 98 F.E.R.C. ¶ 61,210, at 61,761 (2002).

186. Wagner & Brown, Ltd., 155 IBLA 18 (2001).

187. *See generally* Fina Oil and Chemical Co. v. Norton, 209 F. Supp.2d 246 (D.D.C. 2002) (granting

the question of what constitutes gathering for purposes of royalty calculations.[188] The IBLA sided with MMS and concluded that the producer could not deduct the cost of transporting oil via pipeline from a central accumulation point on one platform to another platform where the oil was treated to put it into marketable condition. The IBLA reasoned that the lessee had an implied duty to place the oil into marketable condition without cost to the lessor, and that the movement to the point where that treatment took place was gathering and part of placing the oil into marketable condition rather than transportation.

By comparison to the IBLA, the federal courts have been less amenable to some of MMS's arguments. Two courts recently overruled MMS's attempt to disallow lessees' deductions of the FERC tariffs on offshore oil pipelines from royalties in non-arm's length transactions under its 1987 regulations.[189] The MMS is alleged to have changed its interpretation of the 1987 regulations in order to disallow such deductions after the FERC began to disclaim jurisdiction over certain offshore oil pipelines in the early 1990's. The courts required such a change in interpretation to be made through a notice and comment rulemaking. MMS has since revised its oil valuation regulations (effective for production after June 1, 2000) to exclude the use of the FERC tariffs as transportation allowances as well as to require lessees to place production in marketable condition and to market production explicitly.[190]

In the offshore area, MMS has released a final rule updating the decommissioning requirements for offshore pipelines.[191] In addition, MMS is considering a proposed rule to require lessees, lease operators, and pipeline right-of-way holders to report the measures they plan to undertake to ensure safety and prevent pollution when modifying or repairing an offshore pipeline that involves cutting into the pipeline or opening a pipeline flange.[192] MMS is also performing several technological assessment and research projects on offshore pipelines (*e.g.*, assessment of unsupported subsea pipeline spans, double versus single wall design in arctic environment, homopolar welding, retrofit cathodic protection, deepwater repair methods) that might later result in changes to its regulations or procedures.

VIII. OIL INDEX PIPELINE

On February 24, 2003, the Commission issued anOrder on Remand in *Five Year Review of Oil Pipeline Pricing Index*, Docket Nos. RM00-11-000 and RM00-00-001, in which it revised the index to be applicable to oil pipeline

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Interior Department motion for summary judgment that upholds lessee's duty to market gas); *see also* Independent Petroleum Assoc. of America v. DeWitt, 279 F.3d 1036 (D.C. Cir. 2002), *reh'g denied*, 2002 U.S. App. LEXIS 13214, *reh'g en banc denied*, 2002 U.S.App. LEXIS 13217 (2002), *petition for cert. filed*, (upholding MMS's gas royalty valuation regulations that disallow inclusion of portions of the FERC's gas tariff, which constitute marketing costs, from transportation allowance).

188. Nexen Petroleum U.S.A., Inc., 157 IBLA 286 (Oct. 28, 2002).

189. *See generally* Shell Offshore, Inc. v. Babbitt, 238 F.3d 622 (5th Cir. 2001); Torch Operating Co. v. Babbitt, 172 F. Supp. 2d 113 (D.D.C. 2001).

190. 30 C.F.R. §§ 206.106, 206.111 (2001).

191. 67 Fed. Reg. 35,372, at 35,393 (2002).

192. 66 Fed. Reg. 45,236 (2001).

rates.[193] The Commission had previously established the index as the Producer Price Index minus one percent (PPI-1). In the Order on Remand, the Commission revised the index as of July 2001 to be the PPI. The Commission allowed oil pipelines to recalculate their rates from July 2001 and file for prospective rate changes on the statutory thirty-day notice.

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193. 102 F.E.R.C. ¶ 61,195 (2003).