UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Revisions to Indexing Policies and	**)**	
Page 700 of FERC Form No. 6	**)**	**Docket No. RM17-1-000**

COMMENTS OF THE ASSOCIATION OF OIL PIPE LINES

The Association of Oil Pipe Lines ("AOPL") hereby submits its comments in response to the *Revisions to Indexing Policies and Page 700 of FERC Form No. 6*, 157 FERC ¶ 61,047 (2016) ("ANOPR"). AOPL is a nonprofit trade association that represents the interests of oil pipelines regulated by the Federal Energy Regulatory Commission ("FERC" or "Commission"). AOPL members transport approximately 96 percent of the crude oil and refined petroleum products shipped through pipelines in the United States.

INTRODUCTION

The ANOPR proposes a fundamental change in the regulatory regime that has governed oil pipelines for the past two decades. As shown below, if adopted, the ANOPR's proposed changes would: (1) conflict with Congress's intent in the Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 3010 (Oct. 24, 1992) ("EPAct"); (2) significantly impair the effectiveness of the existing indexing system that has largely achieved its goals of streamlining and simplifying oil pipeline regulation, while providing strong incentives for cost efficiency and innovation on the part of pipelines; and (3) burden the entire oil pipeline industry with expensive and unnecessary accounting and reporting requirements that far outweigh any asserted benefits. In other words, the ANOPR would not fix a broken system, but instead would undermine a system that has worked well for the vast majority of pipelines and shippers for more than twenty years.

A few key elements of the ANOPR include:

- Transforming Page 700 from a screening tool into a binding limitation on the ability of a pipeline to adjust its rates under the index;
- Sharply limiting the use of the index where pipeline revenues diverge from costs shown on Page 700; and
- Requiring Page 700 to be broken down into separate cost-of-service calculations for vaguely defined subsets of total company information.

Taken together, these and the other ANOPR proposals would move the oil pipeline rate indexation mechanism toward the very cost-of-service regulatory regime that EPAct intended to limit and elevate the Page 700 information in Form No. 6 to a dispositive rate setting role it was never intended to have. These changes are inappropriate and unwarranted for the oil pipeline industry and are directly contrary to Congress's mandate in EPAct and the Commission's post-EPAct regulations.

Oil pipelines have been regulated for more than 110 years as common carriers, in recognition that they lack many of the key characteristics of regulated public utilities, including franchised territories and the ability to dictate prices to their customers in the absence of regulation. Congress, the courts and the Commission have all acknowledged the strong influence of competition on the activities of oil pipelines and the inefficiencies and burdens of regulating oil pipelines on a utility style, cost-of-service basis. Under EPAct and the Commission's subsequent rulemakings, cost-of-service rates were always expected to play a limited rather than dominant role in oil pipeline ratemaking. They were a back-up mechanism for those few cases where the other post-EPAct ratemaking alternatives – such as indexed rates, market-based rates, negotiated rates or grandfathered rates – were inapplicable or failed to provide a just and reasonable outcome. They were emphatically not the standard by which all rates were to be measured.

Moreover, the preliminary rate screening information reported on Page 700 was never intended to be the final measure of a pipeline's cost-of-service, let alone the ultimate yardstick of just and reasonable rates. Yet under the ANOPR's proposals, the Page 700 cost-of-service information would become the primary measure of oil pipeline ratemaking, sharply limiting the ability of pipelines to make rate adjustments that would otherwise be warranted. In addition, even pipelines that establish their rates largely by non-cost-based methods, such as market-based or negotiated rates, will be negatively affected, since agreements with shippers are negotiated in the context of the Commission's indexing rules, and many existing agreements explicitly incorporate indexing as the agreed-upon method for changing rates.

The inevitable effect of tying indexed and other rates to the Page 700 information will be a substantial upswing in rate litigation, as parties will rarely agree on the details of cost-of-service ratemaking (as decades of Commission rate litigation demonstrate). Moreover, because oil pipelines face competition from multiple sources in addition to other pipelines (including railroads, trucks, tankers, barges, refiners and local production), they are subject to far more pervasive constraints on their pricing than other

Commission-regulated industries. If competition makes it impossible for a pipeline to charge rates for certain of its movements at the cost-of-service level, while the pipeline's rates remain capped at the cost-of-service level on the other movements, the predictable result will be a heads-I-win, tails-you-lose system leading to reduced service and higher rates on the remaining services. Such a system would not only be unfair to the pipeline, but over time would negatively affect shippers and consumers by deterring investment in new infrastructure and creating artificial bottlenecks that raise prices and distort competitive markets.

Attempting to impose a public utility-type cost-of-service ratemaking regime that has never been successfully applied to the oil pipeline industry would be bad economics and bad public policy. Such a fundamental rewrite of oil pipeline regulation would be particularly concerning at this time when significant investments are needed in pipeline safety and new infrastructure to respond to the domestic energy boom. The proposals in the ANOPR all share a common flaw, which is the presumption that cost-of-service should be the yardstick for all other ratemaking approaches. At least for the oil pipeline industry, that presumption is inapplicable and unwarranted.

EXECUTIVE SUMMARY

- *The ANOPR proposes a major, unwarranted change in oil pipeline regulation.* Far from merely reforming the current system, the proposed changes in the ANOPR would be a fundamental departure from the regulatory regime that has governed oil pipelines for more than two decades. Indeed, the ANOPR proposals would dramatically overhaul the oil pipeline regulatory structure by turning back the clock to an over reliance on cost-of-service ratemaking, which Congress and the Commission have determined to be inappropriate for this industry. *See* Section I.B.

- *The ANOPR's proposals are contrary to the "simplified and generally applicable" ratemaking methodology mandated in EPAct and implemented by the Commission over the past two decades.* The primary purpose of EPAct is to minimize the need for burdensome and expensive cost-of-service ratemaking by requiring a "simplified and generally applicable ratemaking methodology for oil pipelines." EPAct § 1801. The Commission implemented this mandate by establishing its inflation-based rate index. While cost-of-service rates are permitted as a safety valve when indexed rates prove inadequate, cost-of-service rate filings are intended to be "the exception, rather than the rule." *Ass'n of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1442 (1996) ("*AOPL v. FERC I*"). In fact, the D.C. Circuit has made clear that an oil pipeline regulatory construct based in large part on the use of cost-of-service rates "*would be inconsistent with Congress's mandate under the EPAct*." *Ass'n of Oil Pipe Lines v. FERC*, 281 F.3d 239, 244 (D.C. Cir. 2002) ("*AOPL v. FERC II*") (emphasis added). The ANOPR proposals to require all oil pipelines to file an individual cost-of-service for each "system" and to assess indexed rate increases based on whether they conform to an individual system cost-of-service would move oil pipeline regulation back to the very cost-of-service regime that EPAct sought to avoid. *See* Section I.B.2-4.

- *The ANOPR proposals are contrary to EPAct's requirement to avoid "unnecessary regulatory costs," and would instead impose significant burdens on the oil pipeline industry and the Commission.* EPAct requires the Commission to "streamline" its procedures relating to oil pipeline rates and "avoid unnecessary regulatory costs." EPAct § 1802(a). The ANOPR proposals would upend this statutory mandate. Requiring oil pipelines to prepare separate Page 700 reports by "system" would be a burdensome and unnecessary new expansion of the Form No. 6 process. Any such requirement would fundamentally transform the Form No. 6 from an annual financial report into a document whose preparation would encompass many of the burdens involved in a full-blown, cost-of-service rate case, including, for example, the need to assign costs to different systems, perform complex cost allocations, and compile carrier property and depreciation data by system *going back to 1983*. The burden of performing these calculations has been conservatively estimated to easily *exceed a thousand hours* for an individual company with only two "systems," not including the cost related to additional systems and the ongoing work of maintaining data for the different systems. There is no justification for requiring oil pipelines to incur this substantial additional reporting burden given that the vast majority of oil pipelines have never been and are unlikely to be involved in a cost-of-service rate case. *See* Sections I.B.2 and III.C.

- *The ANOPR proposals would undermine the effectiveness of indexing and lead to increased burdensome cost-of-service ratemaking contrary to EPAct*. The

ANOPR proposals to deny pipelines an indexed rate increase when (1) the pipeline's Page 700 revenues exceed its Page 700 costs by 15 percent or more for the prior two years, or (2) the indexed rate increase exceeds five percentage points above the percentage change in the pipeline's costs, would sharply limit the use of the index where it diverges from the cost-of-service reported on Page 700. This in turn would undermine the goals of indexing by (1) effectively ensuring that pipeline rates fail to keep pace with inflation, (2) eviscerating the efficiency-enhancing incentives which encourage pipelines to better manage their costs (such as for electricity consumption) and tend to reduce future index levels, and (3) reducing oil pipeline pricing flexibility. By its very nature, indexing is not intended to match individual pipeline costs on a year-to-year basis, and the ANOPR's assumption to the contrary could cause significant harm. For example, if a pipeline experiences a surge in throughput, or a temporary increase in costs for integrity maintenance during a limited period, both of which commonly do occur, the ANOPR proposals could seriously impair the pipeline's ability to recover its costs through the index and wrongly deprive it of index increases in years when they may be needed most. Undermining the indexing system would lead inevitably to increased burdensome cost-of-service ratemaking. *See* Section II.

- *The ANOPR proposals apply an improper measure of cost recovery to indexed rates and would undermine market-based rates, settlement rates and grandfathered rates*. The Commission has made clear that it is improper to reduce a pipeline's cost-based rates because of perceived "over-recovery" related to revenue generated from just and reasonable non-cost-based rates such as market-based rates, settlement rates or grandfathered rates. The ANOPR proposal to deny an indexed rate increase based solely on a comparison of the total costs and revenues on Page 700 would therefore be a blatant violation of the EPAct's grandfathering provision and the Commission's market-based rate and settlement rate regulations and precedents. Indeed, the ANOPR proposal could undermine the economics of long-term infrastructure projects based on settlement rates. *See* Section II.B.1.

- *The ANOPR breaks from the Commission's consistent and carefully-considered holdings over the past two decades that Page 700 is a "preliminary screening tool" based on total-company data, not the basis for determining whether individual pipeline rates are just and reasonable or for assessing individual system costs.* Since cost-of-service rates are the exception rather than the rule in oil pipeline ratemaking, the Commission's post-EPAct regulations explicitly and purposefully limit the amount of cost-of-service information that pipelines are required to report on Page 700 or to provide in support of a cost-of-service rate filing. In both cases, the Commission requires cost-of-service data to be presented on a *total-carrier* basis, rather than on an individual system or individual rate basis. The Commission has long held that "Page 700 is designed to be a preliminary screening tool for pipeline rate filings" and "*is not intended to show what a just and reasonable rate should be*." Order No. 571, at 31,168; Order No. 571-A at 31,254 (emphasis added). The Commission has made clear that requiring "a pipeline to demonstrate with precision its cost-of-service attributable to each individual pipeline system it operates," is a matter for a rate case, and should not be "required as part of Form No. 6, which is and shall remain primarily a financial report." Order No. 571 at 31,168-69. *See* Sections I.B.4 and III.A.

- *The ANOPR fails to demonstrate any changed circumstance that would justify the dramatic departure from existing precedent and the significant burden that the ANOPR would impose.* The ANOPR fails to demonstrate that there is any problem that needs fixing, let alone that the ANOPR proposals provide the solution. In fact, the experience of the past two decades demonstrates that indexing is a success and has been working as intended. The primary reason given for the proposals is that some pipelines report "over-earning" on their Page 700. But that is an inherent part of indexing, which encourages efficiency precisely because it permits pipelines to retain the profits from cost savings provided their rates remain within the index cap. Moreover, "over-earning" on the Page 700 may reflect pipeline earnings from just and reasonable market-based rates, settlement rates or grandfathered rates. To the extent a pipeline's rates are deemed "excessive," shippers may challenge them. Indeed, the D.C. Circuit upheld the Commission's post-EPAct regulations in part because the Commission's pleading rules do not unduly restrict shippers from challenging pipeline rates. *See AOPL v. FERC I*, 83 F.3d at 1444 (rejecting claim that post-EPAct regulations improperly limit shippers' ability to challenge pipeline rates). *See* Sections II.C and III.E.

- *The ANOPR's definition of a "system" is overly-simplistic and contrary to Commission precedent.* The ANOPR assumes it is a simple matter to determine what constitutes a pipeline "system." On the contrary, the determination of what constitutes a system is a heavily contested, fact-intensive inquiry that is properly conducted in the context of a cost-of-service rate case. There have been very few oil pipeline cost-of-service rate cases, and only *one case* (as the ANOPR acknowledges) in which a pipeline's "systems" were ever determined by the Commission. The precedent that does exist makes clear that various factors must be considered in determining what constitutes a "system" for a specific pipeline, including the "underlying transportation economics" of the relevant facilities. There is no justification for the ANOPR's one-size-fits-all proposal, which is not consistent with Commission precedent and would lead to needless disputes over annual Page 700 reporting. *See* Section III.B.
- *The ANOPR's proposed move toward greater cost-of-service ratemaking is bad policy and a particularly bad policy at this time*. The oil pipeline industry differs from traditional regulated utilities in several ways, and is governed by a regulatory construct that reflects the unique industry characteristics. Crucially, oil pipelines have no certificated monopoly service territories and face significant risk from competition and changing market dynamics. As recognized by Congress and established Commission policy, cost-of-service regulation is therefore a poor fit for the oil pipeline industry. Imposing a public utility-type cost-of-service model on the oil pipeline industry would discourage efficiency and new investment in

pipeline infrastructure. That would be a particularly bad policy change at this time given the requirements to make significant investments in pipeline safety and to develop new infrastructure in response to market changes resulting from the expansion of domestic oil shale markets. *See* Sections I.A., I.B.1, and IV.

- *The ANOPR proposal to change the rules after pipelines have invested significant capital is fundamentally unfair and would have a significant chilling effect on future pipeline investment.* Given the significant capital investments involved and the need to recover those investments over many years, it is crucial for the Commission to establish clear rules regarding how oil pipeline rates are set and for the Commission to be consistent in its application of those rules. The ANOPR is particularly troubling since it proposes to change the rules under which pipelines have made significant capital investments. After encouraging pipelines to make cost-saving investments and undertake major expansion projects under a given set of rules, the ANOPR now proposes rules that would make it harder for pipelines to recover their investments. In addition to this fundamental unfairness, the ANOPR would have a significant chilling effect on future pipeline investment. *See* Section IV.
- *AOPL's comments are supported by Dr. David Reishus, Dr. Ramsey Shehadeh and Robert G. Van Hoecke.*
    - Dr. Reishus, an economist and Executive Vice President of Compass Lexecon, explains why the ANOPR's proposed movement toward greater reliance on cost-of-service for regulating oil pipeline rates is a move in the

wrong direction. Traditional cost-of-service regulation is a poor fit for oil pipelines given the industry's unique regulatory and competitive risks, and fails to provide the proper price signals and incentives for oil pipelines, including the incentive to expand pipeline capacity.

- Dr. Shehadeh, an economist and Managing Director of National Economic Research Associates, Inc., explains why the ANOPR's proposed changes would undermine the efficiency-enhancing benefits arising from index-based regulation, to the detriment of pipelines, shippers and consumers.
- Mr. Van Hoecke, a Principal with the Regulatory Economics Group, focuses on the Page 700 issues and discusses the significant costs and burdens, and other negative consequences, of requiring separate Page 700s for each individual pipeline system.

COMMUNICATIONS

AOPL requests that the following persons be placed on the Commission's service list for this proceeding:

Steven M. Kramer
Senior Vice President, General Counsel
and Corporate Secretary
Association of Oil Pipe Lines
1808 Eye Street, NW, Suite 300
Washington, DC 20006
(202) 292-4502
skramer@aopl.org

Steven H. Brose
Steven Reed
Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036-1795
(202) 429-6250
sbrose@steptoe.com
sreed@steptoe.com
dpoynor@steptoe.com

DISCUSSION

As discussed below, the ANOPR proposes a fundamental and unjustified departure from the Commission's existing regulatory regime for oil pipelines, which has worked well for more than 20 years. The proposed changes would cause significant negative consequences and are directly counter to Congress's mandate that oil pipeline rates be established using a simplified mode of regulation, rather than reliance on a cost-of-service regulatory regime.

I. Oil Pipelines Differ From Traditional Regulated Utilities and are Governed by a Unique Regulatory Regime That Recognizes the Significant Competition That Oil Pipelines Face.

A. Unlike traditional utilities, oil pipelines face significant competition and their rates do not significantly affect the consumer.

Oil pipelines differ from traditional regulated utilities in several ways. Crucially, oil pipelines have no certificated, captive markets and face significant risks from competition and changing market dynamics. Indeed, as Dr. Reishus explains, oil pipelines face competition, not only from other pipelines, but from other modes of transportation such as rail, trucks, barges and tankers. Reishus Decl. at ¶ 14; *see also* Oil Pipeline Deregulation, Report of the U.S. Department of Justice, at 16-18 (May 1986). In addition, crude oil pipelines compete with local refineries in their origin markets and local crude oil production in their destination markets. Similarly, refined petroleum products pipelines compete with local marketers of petroleum in their origin markets and local refineries in their destination markets. *Id.* Oil pipeline shippers are also generally sophisticated customers that have significant bargaining leverage and various transportation alternatives.

Moreover, because oil pipelines are capital-intensive, immobile assets that lack a franchised monopoly, they are at significant risk that changing market dynamics will render them unprofitable. Reishus Decl. at ¶ 11. Indeed, as Dr. Reishus explains, "[c]hanges in domestic oil supply have … demonstrated how vulnerable existing pipeline investments are to change in market demand." *Id.*at ¶ 18. "While changes in supply and demand have always exposed oil pipelines to market risk, the recent oil shale boom, and the corresponding rapid shifting of the location of oil supply and transportation flows have exacerbated this risk." *Id.*

Another key distinction between oil pipelines and traditional regulated utilities is that the rates charged by oil pipelines for transportation have minimal (if any) effect on individual consumers. In part, this is because the price of transportation generally accounts for a small fraction of the price that consumers pay for refined petroleum products such as motor gasoline or diesel. *See Buckeye Pipe Line Co.*, 13 FERC ¶ 61,267, at 61,594 (1980); *Williams Pipe Line,* 21 FERC ¶ 61,260, at 61,585, 61,601.[1] Moreover, the price of petroleum products distributed to end use consumers is

[1] As the Commission has observed, "[f]rom the consumer's perspective, oil pipeline regulation is akin to efforts … to contain the cost of food by seeing to it that the price of spice is always 'just and reasonable,' and to limit the cost of apparel by hitting hard at the price of buttons." Opinion No. 541, at 61,601 (footnotes omitted).

unregulated. As the Commission has explained, since regulation of pipeline transportation is a small part of a "vast unregulated whole," the "prices people pay for gasoline … are determined not by regulatory concepts, but by market forces." *Buckeye Pipe Line Co.*, 13 FERC ¶ 61,267, at 61,594 (1980); *see also Gooch v. Colonial*, 142 FERC ¶ 61,220, at P 15 (2013) (the "market price for petroleum products, such as motor gasoline, is influenced by a variety of factors, and the relatively insignificant influence of marginal changes in pipeline rates can be subsumed by other market forces"). Ultimately, the primary interests of the public with respect to oil pipelines are (a) ensuring adequate capacity so that sufficient motor gasoline and other fuels are delivered to market, and (b) pipeline safety and integrity.

B. Oil pipeline regulation reflects the competitive environment and other unique characteristics of the industry.

1. Oil Pipelines are regulated as common carriers, not traditional utilities.

In recognition of the specific commercial environment in which they operate, oil pipelines are not subject to a traditional public utility regulatory model, but rather, are regulated as common carriers under the Interstate Commerce Act. 49 U.S.C. app. §1, *et seq*. (1988) ("ICA"). As the Commission has observed, under the ICA "[m]any constraints commonly associated with utility-type regulation … were not imposed on oil pipelines," which "has been interpreted as reflecting a Congressional intent to allow market forces freer play within the oil pipeline industry than was allowed for other common carrier industries." *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, 58 Fed. Reg. 30,985 (Oct. 22, 1993), FERC Stats. & Regs.,

Regs. Preambles, 1999-1996, ¶ 30,985, at 30,942 (1993), *order on reh'g.*, Order No. 561-A, FERC Stats. & Regs., Regs. Preambles, 1991-1996 ¶ 31,000 (1994) ("Order No. 561") (citing *Farmers Union Central Exchange v. FERC*, 584 F.2d 408, 413 (D.C. Cir. 1978) ("*Farmers Union I*"), *cert. denied*, 439 U.S. 995 (1978)).

Moreover, in contrast to FERC's regulation of other industries where consumer protection is paramount, oil pipeline regulation "is not a consumer-protection measure." *Suncor Energy Marketing Inc. v. Platt Pipe Line Company*, 132 FERC ¶ 61,242, at P 104 & n.62 (2010) (citing *Williams Pipe Line Co.*, 21 FERC ¶ 61,260, at 61,584 (1982)). Instead, the focus of oil pipeline regulation is on the relationship between business enterprises, carrier and shipper, which "differs fundamentally" from the relationship "between utilities and their customers." *Suncor Energy Marketing*, 132 FERC ¶ 61,242, at P 104 & n.62 (citing *Williams Pipe Line Co.*, 21 FERC ¶ 61,260, at 61,655); *see also Buckeye Pipe Line Co.*, 13 FERC ¶ 61,267, at 61,595 (1980) (the ICA is "primarily designed to promote equity among entrepreneurs" rather than consumer protection).

From 1906 to 1977, oil pipelines were regulated by the Interstate Commerce Commission ("ICC"), which used a ratemaking methodology based largely on the "fair value" of pipeline assets (the "valuation methodology"). *See, e.g.*, *Farmers Union I*, 584 F.2d at 412-13; *Ass'n of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1428-29 (1996) ("*AOPL v. FERC I*"). Very few ICC decisions, however, addressed oil pipeline ratemaking. *See Farmers Union I*, 584 F.2d at 413-414.

After jurisdiction over oil pipelines was transferred to FERC in 1977, the Commission grappled with how best to regulate oil pipeline rates. In *Farmers Union I*, the D.C. Circuit remanded a pending oil pipeline rate case to FERC and instructed the Commission to consider whether the valuation methodology should continue to be used or whether some other type of ratemaking approach was more appropriate. 584 F.2d at 421-22. In issuing its remand, the court observed that oil pipelines have never been subject to the same level of pervasive regulation that Congress applied to other regulated industries. *Id.* at 412-13. Given that history, the court concluded that it would "be *especially loath uncritically to import public utility notions into this area*." *Id.* at 413 (emphasis added).

On remand, the Commission adhered to the valuation methodology, and the court again remanded. *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1500-10 (D.C. Cir. 1984) (*Farmers Union II*), *cert. denied*, 469 U.S. 1034 (1984). On the subsequent remand from *Farmer's Union II*, the Commission adopted a cost-based ratemaking methodology for oil pipelines (the "Opinion No. 154-B methodology"). *Williams Pipe Line Co.*, 31 FERC ¶ 61,377 (1985) ("Opinion No. 154-B"), *opinion on reh'g*, 33 FERC ¶ 61,327 (1985).

The result of *Farmers Union II* and Opinion No. 154-B was a significant increase in the potential for lengthy cost-of-service rate litigation before the Commission along with the added costs and burdens that such cases invariably entail. As the Commission noted in the aftermath of EPAct, "[a]djudicated proceedings for oil pipelines, though few in number, have been long, complicated and costly, and required considerable expenditure of participants' time and resources, including that of the Commission." Order No. 561 at 30,943.

2. In EPAct, Congress mandated a simplified ratemaking methodology for oil pipelines in order to reduce the burden associated with cost-of-service ratemaking.

In EPAct, Congress addressed the problem of burdensome cost-of-service rate litigation "[i]n order to reduce costs, delays, and uncertainties" with respect to oil pipeline ratemaking. *AOPL v. FERC I*, 83 F.3d at 1429 (citing H.R. Rep. No. 474, pt. 1, 102d Cong., 1st Sess. 225, *reprinted in* 1992 U.S.C.C.A.N. 1953, 2048). EPAct retained the basic framework of the ICA, but mandated various procedural and rate reforms. As an initial matter, the statute "grandfathered" most of the oil pipeline rates existing in 1992, making them just and reasonable as a matter of law. EPAct § 1803. EPAct further required the Commission to "streamline" its procedures "relating to oil pipeline rates in order to avoid unnecessary regulatory costs and delays" and directed the Commission to implement a "simplified and generally applicable ratemaking methodology for oil pipelines." EPAct §§ 1801, 1802(a).

3. The Commission's post-EPAct regulations established indexing as the generally-applicable ratemaking methodology for oil pipelines and made cost-of-service ratemaking the "exception rather than the rule."

Consistent with Congress's instructions, the Commission promulgated three major rules (Order Nos. 561, 571, and 572), which "comprehensively revised its oil pipeline regulations in response to the mandate of [EPAct]." *AOPL v. FERC I*, 83 F.3d at 1428. The Commission explained that these regulations work together to fulfill the policy objective of EPAct "to simplify and expedite the Commission's regulation of oil pipeline rates," consistent with the ICA's requirement that rates be just and reasonable. Order No.

561 at 30,940. On judicial review, the D.C. Circuit concluded that the post-EPAct regulations "*reasonably balanced [the Commission's] dual responsibilities of ensuring just and reasonable pipeline rates and simplifying and streamlining ratemaking through generally applicable procedures*." *AOPL v. FERC I*, 83 F.3d at 1428 (emphasis added).

Order No. 561 established the oil pipeline rate index mechanism as the "simplified and generally applicable" ratemaking methodology for changing oil pipeline rates. Order No. 561 at 30,940, 30,946-51. Under indexing, oil pipelines are permitted to increase (or required to decrease) their rates consistent with an annual inflation-based rate cap. *Id.* The Commission also provided exceptions to indexed rates in those instances where cost-of-service rates, market-based rates, or settlement rates are demonstrated to be appropriate. *Id.* at 30,951. Order No. 561 also revised the Commission's tariff filing requirements and the procedures related to protests and complaints, among other changes. *Id.* at 30,955-74.

Order No. 571 established specific standards related to cost-of-service rate filings. *Cost-of-Service Reporting and Filing Requirements for Oil Pipelines*, 59 Fed. Reg. 59,137 (Nov. 16, 1994), FERC Stats. & Regs., Regs. Preambles, 1991 – 1996, ¶ 31,006 (1994) ("Order No. 571"), *order on reh'g*., FERC Stats. & Regs., Regs. Preambles 1991-1996, ¶ 31,012 (1994) ("Order No. 571-A"). Order No. 571 also added the Page 700 filing requirement as a preliminary screening tool to assist in the review of indexed rate changes. *Id.*

Order No. 572 codified the Commission's existing practice of permitting market-based rates by promulgating specific requirements for market-based rate applications.

Market-Based Ratemaking for Oil Pipelines, FERC Stats. & Regs., Regs. Preambles, 1991-1996, ¶ 31,007 (1994) ("Order No. 572"). Under those regulations, a pipeline that is able to demonstrate that it lacks significant market power in a given market may set rates in that market based on competition without regard to the index ceiling or the pipeline's regulated cost-of-service. *Id.* at 31,180-81; 18 C.F.R. § 348.1 (2016). As the Commission explained, "[u]nder the market-based approach, the oil pipeline will be able to engage in competitive pricing in order to react to changes in market conditions." Order No. 572, at 31,180. "This can result in pricing that is both efficient and just and reasonable." *Id.* (citation omitted).

Although not addressed in a separate rulemaking, the Commission's post-EPAct regulations permitted pipelines to charge settlement rates agreed to "by each person who … is using the service covered by the rate." 18 C.F.R. § 342.4(c). Pursuant to that regulation, the Commission has upheld contract rates agreed to between pipelines and shippers as just and reasonable without regard to whether the agreed-upon rates are cost-based. *See, e.g., Seaway Crude Pipeline Company LLC*, 154 FERC ¶ 61,070, PP 36-56 (2016); *Seaway Crude Pipeline Company LLC*, 146 FERC ¶ 61,151, PP 13-38 (2013). The Commission's policy regarding contract rates has been extremely successful and has helped to encourage the expansion of pipeline infrastructure by supporting numerous new pipeline and expanded pipeline projects.

Consistent with the Congressional mandate, one of the primary goals of the Commission's post-EPAct regulations was to minimize reliance on expensive and time-consuming cost-of-service ratemaking. As the Commission emphasized, the post-EPAct regulations provide "*several ways of establishing just and reasonable rates*" other than cost-of-service ratemaking (*i.e.*, settlement rates, market-based rates and grandfathered rates). Order No. 561, at 30,940 (emphasis added). Moreover, by adopting indexing as the generally applicable method for changing oil pipeline rates, the Commission stated its intent to "eliminate the need for much future cost-of-service litigation." Order No. 561 at 30,941. In other words, the Commission established indexing as the "ordinary scheme of rate changes," but permitted exceptions such as cost-of-service ratemaking in "special circumstances." Order No. 571 at 31,165.

For example, pipelines may file a cost-of-service rate change if they can show a "substantial divergence" between their costs and the revenue permitted under indexing. 18 C.F.R. § 342.4(a). Shippers may also challenge a pipeline's annual indexing changes if they can show that the indexing increase is substantially in excess of the pipeline's actual cost changes. 18 C.F.R. § 343.2(c)(1). Shippers may also file complaints against existing pipeline rates. 18 C.F.R. §§ 343.1.

Nevertheless, as the D.C. Circuit has explained, while cost-of-service rates are permitted as a safety valve when indexed rates prove inadequate, cost-of-service rates are intended to be "the exception, rather than the rule." *AOPL v. FERC I*, 83 F.3d at 1442. Indeed, the D.C. Circuit has made clear that an oil pipeline regulatory construct based in large part on the use of cost-of-service rates "*would be inconsistent with Congress's mandate under the EPAct*." *Ass'n of Oil Pipe Lines v. FERC*, 281 F.3d 239, 244 (D.C. Cir. 2002) ("*AOPL v. FERC II*") (emphasis added).

4. Page 700 is a "preliminary screening tool" that reports total-company data; it is not intended to demonstrate whether a pipeline's rates are just and reasonable.

Given that cost-of-service rates are the exception rather than the rule in oil pipeline ratemaking, the Commission's post-EPAct regulations explicitly and purposefully limit the amount of cost-of-service information that pipelines are required to report on Page 700 or to provide in support of a cost-of-service rate filing. In both cases, the Commission requires cost-of-service data to be presented on a *total-carrier* basis, rather than on an individual system or individual rate basis. The use of total-carrier data was not arbitrary, but was fully considered by the Commission, and its decision was rooted in EPAct's policy of reducing the costs and burdens of oil pipeline ratemaking. *See* Order No. 571 at 31,166; Order No. 571-A at 31,253.

The Commission explained that "Page 700 is designed to be a preliminary screening tool for pipeline rate filings," not the information that "in itself, either forms the basis of a Commission decision on the merits of a pipeline filing, or demonstrates that the pipeline's proposed or existing rates are just and reasonable." Order No. 571, at 31,168. Instead, the Commission explained that Page 700 "permits a shipper to compare proposed changes in rates against the change in the level of a pipeline's cost of service" and to compare a shipper's own change in rates against the change in the average barrel-mile rate. *Id.* The Commission further explained that, the "*Page 700 information alone is not intended to show what a just and reasonable rate should be*," but is sufficient to allow a shipper to "compare the yearly percentage change in the average barrel-mile rate with the yearly percentage change in the rate it is charged to determine whether there is a substantial divergence between the rate of change in the two figures such as to warrant a challenge to an indexed rate." Order No. 571-A at 31,254 (emphasis added). The Commission therefore concluded that requiring "a pipeline to demonstrate with precision its cost-of-service attributable to each individual pipeline system it operates," is a matter for a rate case, and should not be "required as part of Form No. 6, which is and shall remain primarily a financial report." Order No. 571 at 31,168-69.

*****

In sum, the Commission's post-EPAct rules, which have governed oil pipelines for more than two decades, properly reflect the specific commercial and statutory context applicable to oil pipelines by giving oil pipelines the flexibility to establish rates through various mechanisms including indexing, market-based rates and contract rates. Cost-of-service rates are the exception, rather than the rule, and Page 700 is a preliminary screening tool, not the measure of what a pipeline's cost-based rates would be determined to be in a cost-of-service hearing.

II. The ANOPR Proposals Would Undermine the Effectiveness of Indexing and Lead Inevitably to More Burdensome Cost-of-Service Ratemaking Contrary to EPAct and the Commission's Post-EPAct Regulatory Regime.

A. The ANOPR proposes significant new limitations on the ability of pipelines to increase their indexed rates and index ceiling.

Under the Commission's indexing regulations, a pipeline is permitted to increase its rates to a level that does not exceed the index ceiling provided the rate increase is not "so substantially in excess of actual cost increases incurred by the carrier that the rate is unjust and unreasonable." 18 C.F.R. § 343.2(c)(1). If protested, the Commission determines whether a pipeline's rate increases are "substantially in excess" of actual cost increases by comparing the proposed percentage change in the pipeline's rates to the change in the total cost-of-service for the prior two years shown on the pipeline's Page 700. *See, e.g., BP West Coast Prods., LLC v. SFPP, L.P.*, 121 FERC ¶ 61,141, at P 6 (2007). "If the percentage comparison test differential is greater than 10 percent, the Commission has historically investigated the protested index filing" through a hearing. ANOPR at P 10. If the differential is less than 10 percent, the Commission has generally accepted the indexed rate change. *Id.*

The 10 percent test is also used to assess complaints against indexed rates. *BP West Coast Prods., LLC v. SFPP, L.P.*, 123 FERC ¶ 61, 121, at P 6 (2008). In addition, a complaint will be allowed to proceed if it shows that: (1) the pipeline is substantially over-recovering its cost of service, and (2) the indexing increase "so exceeds the actual increase in the pipeline's costs that the resulting rate increase would substantially exacerbate that over-recovery." *BP West Coast Prods., LLC v. SFPP, L.P.*, 121 FERC ¶ 61,141, at P 6-10 (2007); *see also* ANOPR at P 11.

The ANOPR proposes two primary changes to its standards for challenges to indexed rates. First, the new "exacerbate" test would deny any increase in the indexed rate or index ceiling for pipelines whose Page 700 revenues exceed Page 700 total costs by 15 percent or more for both of the prior two years. ANOPR at P 13. Unlike the current standard, this test would apply to both protests and complaints. *Id.* Moreover, unlike the Commission's current approach, the proposed "exacerbate" test would only take into account whether the pipeline was over-recovering by the 15 percent threshold; it would not consider whether the over-recovery would be increased by the indexing change.[2]

Second, the new "percentage comparison" test would deny any pipeline that shows an "over-recovery" on its Page 700 an increase in the indexed rate or index ceiling that exceeds five percentage points above the percentage change in the total costs per-barrel mile shown on Page 700 for the two most recent years. *Id.*[3] Again, this test would apply to both protests and complaints. ANOPR at P 13.

In addition, as discussed further in Section III, the ANOPR proposes to require pipelines to submit separate page 700s for each individual pipeline "system," as the ANOPR defines that term. ANOPR at PP 6, 21. While not entirely clear, it appears that the ANOPR contemplates that the new exacerbate test and percentage comparison test would be determined based on the costs and revenues shown on the applicable individual

[2] Thus, as discussed further below, the ANOPR's proposed "exacerbate" test does not actually measure whether the "over-recovery" shown on Page 700 would be "exacerbated" by an indexing increase, since it does not take into account the relationship between the indexed rate increase and changes in the pipeline's costs.

[3] The Commission currently permits pipelines that are under-recovering their cost of service to take an indexing increase even if the pipeline's actual costs have declined. *See BP West Coast Prods., LLC v. SFPP, L.P.*, 118 FERC ¶ 61,261, at P 8 n.10 (2007), *aff'd on reh'g*, 121 FERC ¶ 61,195, at P 4 (2007); *Shell Pipeline Co.*, 102 FERC ¶ 61,350, at PP 4, 7, 10 (2003), *aff'd on reh'g*, 104 FERC ¶ 61,021, at P 9 (2003). The ANOPR does not propose to change this policy. ANOPR at P 16 ("However, as is the case with the existing percentage comparison test, if a pipeline's page 700 reported costs exceed its revenues, the Commission would permit the pipeline to take the full index increase because the pipeline is not recovering its costs.").

system Page 700, rather than based on total company-wide costs and revenues. *Id.* at PP 6, 21, 29, 32 n.44.

As noted, the exacerbate test and percentage comparison test would apply, not only to the indexed rates, but also to the index ceiling. ANOPR at P 17. Under the ANOPR proposal, oil pipelines would be required to submit an annual filing showing changes in their ceiling levels, regardless of whether they propose to change their indexed rates. *Id*. The ceiling levels would be subject to challenge using the new exacerbate and percentage comparison tests. *Id.* The ANOPR's proposal would therefore restrict the ability of pipelines to carry indexing increases forward to future years. *Id.*

The ANOPR further proposes to accept or reject proposed increases to a pipeline's indexed rate or ceiling level based solely on the application of the new exacerbate and percentage comparison test using the cost data reported on Page 700. *Id*. at P 18. In other words, if the pipeline failed one or more of the tests based on the data shown on Page 700, the proposed indexed rate or ceiling level increase would be denied without an administrative hearing to determine the pipeline's actual costs as is the Commission's current practice.

The ANOPR does not propose to change the Commission's policies for evaluating index rate decreases. Thus, if the index causes the pipeline' rate ceiling to decline, then the pipeline must adjust its rates so that they remain at or below the reduced rate ceiling. ANOPR at n.19 (citing 18 C.F.R. § 342.3(e)).

B. The ANOPR's proposed changes to the indexing methodology would undermine the effectiveness of the index and lead to increased burdensome cost-of-service ratemaking contrary to EPAct.

As discussed above, the primary purpose of EPAct's oil pipeline provisions is to minimize the need for burdensome and expensive cost-of-service ratemaking by requiring a "simplified and generally applicable ratemaking methodology for oil pipelines." EPAct §§ 1801, 1802(a). The ANOPR, by contrast, will effectively impose cost-of-service regulation on index-based rate changes by sharply limiting the use of the index where it diverges from the information reported on Page 700. This will significantly impair the effectiveness of indexing as the simplified and generally applicable rate methodology for oil pipelines and instead increase the likelihood that oil pipelines will be required to resort to burdensome and expensive cost-of-service ratemaking in order to recover their costs. The result would drive oil pipeline regulation back to the very regime that Congress sought to reform with the enactment of EPAct, and be directly contrary to the Commission's post-EPAct regulations that have governed oil pipeline ratemaking for the past two decades.

As the Commission explained, "the hallmark of an indexing system is simplicity. Under indexing, pipelines adjust rates to just and reasonable levels for inflation-driven cost changes without the need for strict regulatory review of the pipeline's individual cost of service, thus saving regulatory manpower, time and expense." Order No. 561 at 30,948. In other words, indexing preserves the value of rates in real terms by permitting oil pipelines to increase their rates to keep pace with inflation without having to file a cost-of-service rate increase, while providing shippers with "protection from rate increases greater than the rate of inflation" without requiring shippers to challenge a pipeline's rates on a cost-of-service basis. Order No. 561 at 30,948-50.

Indexing is also "a form of incentive regulation," which "gives greater emphasis to productive efficiency in noncompetitive markets than does traditional cost-of-service regulation." *Id.* "Indexing fosters efficiency by severing the linkage under traditional cost-of-service ratemaking between a pipeline's rate changes and changes in its current operating and investment costs," which provides the pipeline with an incentive to better manage its costs, "since it is assured that it may retain a portion of the savings it generates." *Id.* at 30,948 n.37. As Dr. Shehadeh explains, the incentive for pipeline operators to act efficiently, both by expanding output and managing costs, is the central economic benefit of indexed-based regulation, which makes both pipelines and shippers better off. Shehadeh Decl. at ¶¶ 2, 8.

The efficiency enhancing aspect of indexing also furthers EPAct's purpose of minimizing the need for burdensome cost-of-service ratemaking in at least two ways. First, indexing encourages individual pipelines to keep their costs below the level of the index, which reduces the likelihood that pipelines will need to file a cost-of-service rate increase or that shippers will need to challenge pipeline rates on a cost-of-service basis. Second, by encouraging individual pipelines to better manage their costs, the index helps constrain cost increases for the entire industry. That in turn tends to reduce future index levels and thus the incentive for shippers to file cost-of-service rate challenges. *See* Shehadeh Decl. at ¶ 15. Indeed, as Dr. Shehadeh explains, average costs in the industry can be expected to be lower under indexing than under cost-of-service regulation. *Id.*

Finally, indexing is intended to provide pricing flexibility for oil pipelines by permitting them to adjust rates as needed, provided the rates remain below the index ceiling. Order No. 561 at 30,950-51. Because "challenges to changes that comply with the index will be limited," the time and expense traditionally associated with filing rate cases should be greatly reduced." *Id.* at 30,951. Moreover, "the indexing system accommodates the need to change rates rapidly to respond to competitive forces in many markets served by pipelines." *Id.* at 30,950. This gives pipelines the opportunity to recover their costs without having to raise rates above the index level through a cost-of-service rate filing. Pipelines also may, and do, decline to raise rates to the index ceiling because of competition or other considerations.

As Dr. Shehadeh explains, indexing has proven to be a robust and successful methodology, as shown by a review of the industry's cost experience. During the two decades the indexing methodology has been in place, there have been relatively few challenges to indexed rates (with the notable exception of the perennial challenges to the indexed rates of SFPP and affiliated pipelines) and relatively few cost-of-service cases in general (again, with exception of SFPP). *See* Shehadeh Decl. at ¶ 55. Dr. Shehadeh further notes that indexing passes the "market test," because it is often incorporated into transportation services agreements, rate settlements and other contracts. *Id.* at ¶¶ 53-54. As Dr. Shehadeh explains, this "revealed preference of shippers and operators alike for the Commission's existing index method in the context of a negotiated commercial transaction is significant economic evidence of its efficiency as a mechanism for rate adjustments." *Id.* at ¶ 54.

The proposals in the ANOPR to effectively impose cost-of-service regulation on indexed rates will create various one-sided and downwardly-biased limitations on the use of the index that will significantly constrain the ability of oil pipelines to increase their rates in line with inflation and maintain pricing flexibility. As Dr. Shehadeh explains in detail in his declaration (and as discussed further below in Section IV), the ANOPR proposals will also undermine the fundamental goals of indexing. These consequences in turn will make it less likely that oil pipelines will be able to recover their costs under the indexing methodology and will lead to the very result that EPAct was intended to prevent; namely, an increase in burdensome and expensive cost-of-service ratemaking. Ultimately, as Dr. Shehadeh explains, this "asymmetric" regulatory proposal is a "harbinger of regulatory failure." Shehadeh Decl. at ¶ 42.

1. The "Exacerbate" Test

First, the ANOPR's proposed "exacerbate" test would deny a pipeline any ability to increase its rates if the pipeline's Page 700 revenues exceed its Page 700 costs by 15 percent or more for both of the prior two years. ANOPR at P 13. That proposal is highly flawed and rests on a fundamental misperception of how oil pipeline ratemaking operates.

As a threshold matter, it is entirely inappropriate to use the total cost-of-service shown on Page 700 as a measure of "over-recovery." As noted, oil pipelines are permitted to charge grandfathered rates, market-based rates and settlement rates that are just and reasonable even if they may exceed the cost-based level. Thus, the so-called "over-recovery" reported on Page 700 may be due to revenue earned under one or more of these just and reasonable rates.[4] The Commission has made clear that not only is it entirely appropriate for a pipeline to earn revenue in excess of a company-wide cost-of-service as a result of just and reasonable non-cost-based rates, it is directly contrary to Commission precedent and policy to attempt to reduce a pipeline's cost-based rates because of perceived "over-recovery" related to revenue generated from the just and reasonable non-cost-based rates. *See, e.g., Seaway Crude Pipeline Company LLC*, 154 FERC ¶ 61,070, at PP 47, 219-222 (2016) ("Opinion No. 546"). Thus, denying pipelines the ability to adjust indexed rates for inflation (in other words, requiring them to reduce their indexed rates in real terms) because of revenue earned from just and reasonable non-indexed rates as the ANOPR proposes would be a blatant violation of the EPAct's grandfathering provision and the Commission's market-based rate and settlement rate regulations and precedents. Moreover, with respect to settlement rates that support pipeline construction and capacity expansions, the ANOPR proposal could deny the pipeline the benefit of its bargain and undermine the economics of the project.

Even with respect to the cost-based rates, Page 700 is a "preliminary screening tool," not the ultimate measure of a pipeline's cost-of-service. Order No. 571, at 31,168. As the Commission made clear in establishing Page 700, it "is not intended to be the

---

[4] In addition, a pipeline with indexed-based rates may show an "over-recovery" on Page 700 because it was able to realize greater cost efficiencies than its peers. As explained herein, by its very nature, indexing is not intended to match individual pipeline costs on a year-to-year basis as the ANOPR appears to assume.

information which, in itself, either forms the basis of a Commission decision on the merits of a pipeline filing, or demonstrates that the pipeline's proposed or existing rates are just and reasonable." *Id.* For example, the Commission made clear cost allocation and rate design issues were reserved for hearing, and were not part of the Page 700 filing. *Id.* at 31,166.

The ANOPR's one-size-fits-all cost-of-service approach also does not square with the fact that parties are not precluded from proposing alternative cost-of-service methods, such as stand-alone cost or some other method, as part of a rate case. *Id.* at 31,165-66; see also Opinion No. 154-B at 61,834 n.22 (Commission will consider alternatives to the Opinion No. 154-B cost-of-service methodology if "innovative solutions … are presented to it"). For example, the Commission has approved the use of a depreciated original cost ratemaking methodology (instead of the trended original cost methodology employed by Opinion No. 154-B) where the pipeline was required to offer rate discounts to obtain volume commitments and needed the flexibility to recover its remaining costs from walk-up shippers. *TransCanada Keystone Pipeline, LP*, 125 FERC ¶ 61,025, at PP 34-38 (2008); *TransCanada Keystone Pipeline, LP*, 144 FERC ¶ 61,089, at P 20 (2013).

Ultimately, the ANOPR rests on the flawed assumption that there is an easy way to determine a pipeline's cost-of-service without undertaking a cost-of-service hearing. If that were true, then Congress would not have needed to pass EPAct and the Commission would not have needed to establish indexing, since pipeline rates could simply be set based on Page 700. In reality, cost-of-service ratemaking is not susceptible to these types of shortcuts. Instead, as discussed above in Section I.B.1, Congress and the Commission have recognized it is difficult, time-consuming and expensive to determine what an oil pipeline's cost-based rates should be, and have concluded that it is not worthwhile to incur such costs except in unusual cases.

In addition, the ANOPR's proposal to deny any rate increase during periods of "over-recovery" while continuing to cap rate increases at the rate of inflation during periods of under-recovery is one-sided and downwardly-biased. Over time, it will (1) ensure that pipeline rates do not keep pace with inflation, (2) undercut the incentives for efficiency, and (3) reduce pipeline pricing flexibility, all of which will increase the likelihood of burdensome cost-of-service rate cases contrary to the purpose of EPAct.

Finally, while the ANOPR suggests that the new "exacerbate" test is an extension of its prior standard for assessing complaints, the proposed test does not actually measure whether a pipeline's over-recovery would be increased, let alone substantially exacerbated, by the indexing increase. Indeed, unlike the Commission's current policy, the ANOPR's proposed "exacerbate" test does not assess the relationship between the proposed index and the changes in the pipeline's costs. Instead, the proposed test simply asks whether the pipeline has "over-recovered" for the past two years, and would deny a rate index adjustment even if the level of "over-recovery" is stable or declining. Thus, even if a pipeline's actual costs increased by a greater percentage than the proposed index, the pipeline would not be permitted to take the indexed rate increase (or increase its index ceiling) despite the fact that the indexing increase would not exacerbate the Page 700 over-recovery.

2. The "Percentage Comparison" Test

The percentage comparison test imposes additional unwarranted limitations on the ability of pipelines to adjust their rates consistent with the index. The ANOPR proposes to cap increases to oil pipeline rates and rate ceilings for "over-recovering" pipelines at no more than five percentage points above the per barrel-mile changes in the pipeline's Page 700 cost-of-service for the two prior years. That proposal is one-sided and downwardly-biased, because the index will continue to constrain the ability of pipelines to increase their indexed rates in years in which the pipeline's individual cost increases exceed the index level and will continue to limit "under-earning" pipelines to the level of the index. Thus, the percentage comparison test will make it more difficult for pipeline rates to keep pace with inflation. In other words, over time it will lower pipeline rates in real terms.

Moreover, for the reasons discussed above with respect to the "exacerbate" test, there is no justification for imposing the five percentage point limitation on a pipeline simply because it shows an "over-recovery" on Page 700.[5] For example, a pipeline's Page 700 may show "over-recovery" because of grandfathered, market-based or settlement rates. Imposing a one-sided rule that tends to lower a pipeline's indexed rates

---

[5] As noted, the ANOPR appropriately does not intend to apply the five percentage point limitation to pipelines that show under-recovery on Page 700. ANOPR at P 16.

in real terms because of revenue received from just and reasonable non-cost based rates would be directly contrary to Commission precedent and policy.

The problems related to the percentage comparison test are increased by the proposal to measure cost changes on a barrel-mile basis. While this proposal may seem innocuous, it fundamentally changes the incentives of the indexing methodology in a manner that will lead to negative results. Instead of encouraging pipelines to control costs, the ANOPR proposal could have the result of discouraging pipelines from moving additional volumes, which is directly contrary to what the Commission policy should be and historically has been. In other words, as Dr. Shehadeh explains, the ANOPR would not give pipelines the incentive to pursue "the efficient amount of throughput." Shehadeh Decl. at ¶ 41. For example, a pipeline that was successful in attracting additional volumes to its system by offering a volume discount might find that its costs per barrel-mile had declined even though its overall costs remained the same or even increased. If the reduction in per barrel-mile costs limits the pipeline's ability to increase its rates for indexing and thus keep pace with inflation, the pipeline may be discouraged from offering a volume discount, which could ultimately make shippers worse off.

3. Application of Proposed Tests to Individual Systems

The problems identified above with respect to the ANOPR proposals are further compounded by the ANOPR's proposal to apply the index tests to each individual system. Under that proposal, a pipeline's rates are effectively capped at the fully allocated cost-of-service level for each "system," based solely on the information shown on the Page 700. Such a regulatory regime would be inconsistent with Commission precedent and could lead to significant real-world harms to both pipelines and shippers alike, including increased cost-of-service litigation, reduced transportation services for shippers and higher rates for the remaining services.

Under a "fully allocated cost" methodology, direct costs are assigned to specific movements where possible, and joint and common costs are allocated on some proportionate basis (*e.g.*, on the basis of barrel-miles or by using plant, labor or revenue factors to allocate costs). *See Williams Pipe Line Co.*, 84 FERC ¶ 61,022, at 61,109-111 (1998). The ANOPR proposals are plainly based on the assumption that a fully allocated cost methodology must be used to set rates, since they assume that the cost of service for each system must be based solely on costs that are either directly assigned to that segment or allocated using "established allocation methodologies," such as the "Massachusetts Formula, the Kansas-Nebraska methodology, and volumetric allocations." ANOPR at PP 30, 35-42 & n.59. The Commission, however, has made clear that a fully allocated cost methodology is not the only permissible approach for designing cost-of-service rates for oil pipelines, and the Commission explicitly relied on that finding as a reason for requiring cost-of-service rate filings to be supported with total-carrier costs. Order No. 571, at 31,166.

In addition to being contrary to precedent, the ANOPR proposal would make it significantly harder for pipelines to recover their costs under indexing. It is highly unlikely that the costs and revenues for each of a pipeline's individual systems will perfectly match the fully-allocated cost-of-service attributed to each system as shown on Page 700 in any given year. Thus, even if a pipeline were consistently under-recovering its overall cost-of-service, the Page 700 for certain individual systems may show over-recovery for those systems in certain years. If a pipeline were denied indexing increases for the systems on which the Page 700 showed revenues exceeding costs in the applicable period, while continuing to be capped at the industry-wide rate of inflation with respect to the systems on which it is under-recovering, the result would be to make it even more difficult for the under-recovering pipeline to recover its costs without resorting to a burdensome and expensive cost-of-service rate proceeding. A fully allocated cost approach could also cause the pipeline to eliminate its less profitable transportation services, thus leaving shippers with fewer transportation alternatives. The pipeline's incentive to increase the efficiency of its operations would also be reduced, since the pipeline would be less able to retain the benefits of any efficiency gains.

The same is true with respect to cost changes. Even if a pipeline's cost changes are fully in line with the index, it could have some systems with cost changes above the index level and other systems with cost changes below the index level. If the pipeline's cost increases were capped at the level of the index for those systems where the cost changes exceeded the index, but the pipeline was not permitted to increase its rates at the full index level to the extent certain systems' cost changes were less than five percentage points below the index level, the pipeline's rates would inevitably fail to keep pace with inflation.

Moreover, review of cost increases on a system-by-system basis instead of a total company basis may produce erratic results that show significant variability in cost changes from year to year for individual systems, even though the pipeline's overall costs may not have changed. For example, pipeline integrity costs, which can be a significant portion of a pipeline's cost of service, may not be incurred every year with respect to each individual system. Instead, pipeline integrity inspections are commonly conducted on a five-year cycle or some other regular interval. Thus, a pipeline with five different systems that conducts pipeline integrity inspections every year (but only once every five years on any given system) may incur generally the same level of annual costs on a total company basis. The costs for the individual systems, however, may show a high degree of variability with costs spiking in the year in which the integrity assessment occurs and then declining the next year. If shippers are able to challenge the pipeline's indexing increases on an individual system basis, then a pipeline might be unable to index its rates for one system each year (the system that showed costs decreasing) even though the rates for the other systems (including the one in which costs spiked) remain capped by the index and even though the pipeline's overall costs do not change significantly from year to year.

Moreover, the Commission has recognized that, in cases where competition is present, use of a fully-allocated cost rate design methodology can lead to unreasonable results, by allocating costs to movements where they cannot be recovered. The Commission has therefore made clear that pipelines are not limited to use of a fully allocated cost methodology, and that various forms of differential pricing are consistent with the Interstate Commerce Act. *See Williams Pipe Line Co.*, 84 FERC ¶ 61,022, at 61,102-103 (concluding that "the [Interstate Commerce Act] contains no statutory bar to permitting oil pipelines to establish their rates utilizing other than a conventional fully allocated cost methodology"); *SFPP, L.P.*, 86 FERC ¶ 61,022, at 61,079 (1999) (confirming that "oil pipelines are not necessarily limited to the use of a fully allocated cost ceiling as a justification for their rates, and … there are other theories available under the Interstate Commerce Act") (footnote omitted); Order No. 561-A, at 31,107 (confirming that pipelines may propose rate design methods other than fully allocated cost); Order No. 571, at 31,166; *see also Eastern-Central Motor Carriers Ass'n v. United States*, 321 U.S. 194 (1944) (reversing ICC finding of discrimination which appeared to be based on an absolute rule that rate differentials could never be justified by competition); *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1011 (D.C. Cir. 1987) ("For nearly 100 years … the courts have interpreted the Interstate Commerce Act to allow the ICC to approve differentials justified exclusively by competition.") (internal citations omitted).

In discussing differential pricing in the oil pipeline context, the Commission has pointed to its "practice of adjusting historical gas volumes to reflect past discounts by natural gas pipelines" as a viable alternative to a fully allocated cost methodology under the ICA. *Williams Pipe Line Co.*, 84 FERC ¶ 61,022, at 61,102. The Commission has also approved the use of iterative discounting in the oil pipeline context. *Laclede Pipeline Co.*, 114 FERC ¶ 61,335 (2006), *order on reh'g*, 119 FERC ¶ 61,236 (2007). Differential pricing benefits both the pipeline and shippers as a whole, by encouraging the pipeline to offer discounts that increase the volumes over which costs can be shared. As the Commission has explained in approving use of an iterative discounting rate design approach, if the pipeline was not able to recover its cost of service by shifting certain costs to the rates that were not constrained by competition, it would likely not be able to offer the volume discounts, and, if the discounts were not offered, the remaining shippers would be forced to bear the entire cost of service and pay higher rates. *Laclede*, 114 FERC ¶ 61,335, at P 10 & n.4; 119 FERC ¶ 61,236, at P 8.

In short, in its attempt to "reform" a system that is working well, the ANOPR threatens to cause real-world harm. Ultimately, use of individual system Page 700 data to review indexing cost changes would make it a near certainty that oil pipelines will not be able to recover their costs over time under the indexing methodology, which will make it more likely that oil pipelines will be forced to file cost-of-service rate increases in order to recover their costs and continue to provide service. The ANOPR proposal may also force pipelines to abandon service in more competitive markets and concentrate on those where full cost recovery can occur, thus reducing competition and transportation options and leading to higher rates for shippers.

4. Cap on Index Ceiling

As noted, the ANOPR proposes to apply the above procedures, not only to pipeline rates, but also to pipeline rate ceilings. The ANOPR fails to justify this proposal, especially since the Commission has previously made clear that the index ceiling calculation is not a rate or practice that can be challenged under the Commission's regulations. *See Chevron Products Company v. SFPP, L.P.*, 138 FERC ¶ 61,115, at PP 17-21 (2012); *Colonial Pipeline Company*, 139 FERC 61,270, at PP 7-11 (2012). Nor is there any basis to preclude a pipeline from carrying forward indexed rate increases that it was unable to take in the current year because it failed the proposed two-part test in a given year.

Because the index ceiling ensures that pipeline rates do not exceed industry-wide inflation over time, the ANOPR fails to explain why it is also necessary to constrain rates within a narrow range of the pipeline's Page 700 cost-of-service in each individual year. Since a limitation on the index in any given year has a compounding effect going forward, the ANOPR proposal can be expected to greatly reduce the ability of a pipeline to recover its costs over time simply because of its performance in a prior year. *See* Reishus Decl. at ¶ 47 n.28 (explaining that under the ANOPR proposal if the ceiling rate were reduced by 2% in a given year "this becomes the level to which future ceiling rates are escalated [and] represents a 2% reduction in all potential future indexed rates and potential future revenue"). Not only is that fundamentally unfair, but it also ensures that indexed rates will not keep pace with inflation and further mutes the efficiency incentives of the index.

5. Summary denial of pipeline rate filings based on proposed tests

The ANOPR proposes that the "exacerbate" and "percentage comparison" tests "would serve as a sufficient basis … to deny a challenged index rate filing," and that it would not be necessary to refer the matter to an administrative law judge for further hearing. ANOPR at P 18. The ANOPR, however, specifically seeks comments on whether such a summary denial of indexing increases would be reasonable. *Id.*

Summary denial of an indexing increase would be a fundamental denial of due process. At the very least, a pipeline should be given the opportunity to show that an apparent "over-recovery" on Page 700 is the result of revenue derived from non-indexed rates. Moreover, the ANOPR fails to explain why moving from a ten percentage point comparison of cost changes to a five percentage point differential requires doing away with the opportunity for a hearing regarding the pipeline's actual cost changes where one is necessary.

The ANOPR also fails to explain why a hearing should not be held if a complaint (as opposed to a protest) is brought against a pipeline's indexed rates. As the ANOPR observes, the Commission "has explained that it will consider additional factors in a complaint because it has more time to evaluate complaints and the complainant must carry the burden of proof." ANOPR at P 11 n.17 (citing *BP West Coast Products LLC v. SFPP, L.P.*, 122 FERC ¶ 61,141, at PP 6-7 (2007)). Relying solely on the proposed two-part screen to lower a pipeline's indexed rates, without allowing the pipeline to defend its rates at hearing, would eliminate the challenger's burden of proof and inappropriately deny the pipeline the opportunity to present evidence that may have arisen since its rates were filed. For example, if a pipeline's indexed rate increase is protested when it is filed, the ANOPR indicates the Commission will deny the increase if the pipeline was "over-recovering" by more than 15 percent during the two years prior to the filing. However, if a complaint is brought a year or two after the indexed rate is filed, the pipeline should have the right to show that it is no longer over-earning or that the level of over-earning has declined such that it was not "exacerbated" by the indexing increase. *See HollyFrontier Refining & Marketing LLC v. SFPP, L.P.*, 157 FERC ¶ 61,186, at PP 8-10 (2016) (dismissing complaint against indexing increase based on evidence that the difference between the pipeline's costs and revenues declined after the indexed rate was filed).

6. Continued reliance on shippers to challenge pipeline rates

The ANOPR states that the above two-part screen would be used to evaluate protests and complaints of indexed rates as well as any investigations of an indexed rate filing brought by the Commission on its own initiative. ANOPR at P 13 & P 13 n.20 (stating that the Commission retains the authority to investigate oil pipeline rates, including indexed rates, on its own motion). The ANOPR indicates, however, that the Commission "anticipates continued reliance upon affected shippers to bring challenges that apply the standards contemplated by the ANOPR to indexed rate changes." *Id.* at P 13 n.20.

Continued reliance on shippers to challenge pipeline rates is appropriate as any deviation from that policy would be disruptive to settled industry expectations and inconsistent with the purposes of EPAct. The Commission has previously explained that the "policy of streamlining and expediting the regulation of oil pipelines, as reflected in [EPAct], supports the notion of relying primarily upon the affected parties to bring challenges to rates." Opinion No. 561, at 30,967. The Commission has therefore made clear "that it does not contemplate invoking its authority [to initiate investigations of pipeline rates] except in the most unusual circumstances." *Id.* AOPL is not aware of any instance during the more than twenty years since EPAct in which the Commission has initiated an investigation of an oil pipeline rate. Nothing in the ANOPR provides any basis for overturning this settled practice.

7. Rejection of indexing increases due to untimely filing of Page 700

The ANOPR states that, although "waivers may still be granted in limited circumstances, the Commission must be able to evaluate the indexed rates before they become effective on July 1 of each year," and that "[f]ailure to timely file the Form No. 6 could delay the effective date of a pipeline's proposed indexed increase or, potentially, lead to the outright rejection of the requested increase." ANOPR at n.31. There may be good reasons for a late filing of Page 700, however, and legitimate delays (or minor omissions in the Form 6 unrelated to Page 700) should not keep a pipeline from having its rates keep pace with inflation or undo the incentives for efficiency that benefit not just the individual pipeline but shippers as well.

Nor is there any legal support or policy basis to impose the extreme penalty of outright rejecting an indexing increase due to the delay in filing a Form No. 6. To the extent the Commission contemplates imposing such a penalty, the standards used to make such a determination should be clearly set out in order to avoid potential arbitrary application of the policy.

C. The ANOPR fails to point to any changed circumstance or other valid reason to support the proposed changes.

Completely missing from the ANOPR is any valid reason for why the drastic changes proposed are necessary. The ANOPR fails to demonstrate that there is any problem that needs fixing, let alone that the ANOPR proposals provide the solution.

As discussed above, the experience of the past two decades in which the Commission's post-EPAct regulations have been in effect demonstrates that indexing has generally been a success and is working as intended. But despite the likelihood that the ANOPR proposals will significantly undermine this success, the ANOPR fails to demonstrate that the changes it proposes are justified or point to any concrete facts or data to support its proposal. Instead, the ANOPR refers to general regulatory goals, but provides no support to demonstrate that those goals are not currently being achieved or that that the proposed sweeping changes are warranted. ANOPR at P 4 (changes intended to "protect against excessive rate increases" and "minimize costly and time-consuming litigation regarding pipelines rates"); *id.* at P 12 (Commission "seeks to ensure that oil pipelines rate under the ICA are just and reasonable by reducing the likelihood that an oil pipeline's rates substantially deviate from its costs through the application of indexed rate increases").

The primary reason given by the ANOPR for the proposed changes is that "some pipelines continue to obtain additional index rate increases despite reporting on [Page 700] revenues that significantly exceed costs." ANOPR at P 4. As discussed above, however, that observation fails to justify the proposed changes. In promulgating the indexing regulations, the Commission recognized that the simplified, industry-wide indexing regime will cause some pipelines to over-earn on a cost-of-service basis and some pipelines to under-earn. Opinion No. 561, at 30,949. That is inherent in an indexing regime. Indeed, as Dr. Shehadeh explains, it is necessary to encourage efficiency. Shehadeh Decl. at ¶¶ 12-16. Moreover, as discussed above, the fact that a pipeline may show over-earning on its Page 700 does not mean that its indexed rates exceed the just and reasonable level, since the pipeline may be earning revenue from non-cost-based just and reasonable rates such as grandfathered rates, market-based rates or settlement rates.

In any event, to the extent a pipeline's rates are deemed excessive, shippers may challenge them. Indeed, the D.C. Circuit upheld the Commission's post-EPAct regulations in part because the Commission's pleading rules do not unduly restrict shippers from challenging pipeline rates. *See AOPL v. FERC I*, 83 F.3d at 1444 (rejecting claim that post-EPAct regulations improperly limit shippers' ability to challenge pipeline rates). The Commission has also made clear that shippers have the necessary tools to challenge pipeline rates and that shippers have exercised those rights on numerous occasions in the past. *See Review of FERC Form Nos. 6 and 6-Q*, 125 FERC ¶ 61,308 at P 7 (2008) ("the information provided in FERC Form No. 6 has been adequate to allow shippers over the last 10 years to file numerous complaints challenging rates").

It is also important to emphasize that the oil pipeline industry as a whole has been under-earning on an Opinion No. 154-B basis every year going back to at least 1993. *See* Shehadeh Decl. at ¶ 51. Indeed, in the vast majority of those years the total industry under-recovery has been more than $1 billion annually. *Id.* There is thus no ground to suggest that shippers are unfairly burdened by, or that there is any systemic problem with, the current regulatory regime.

On the contrary, for the reasons discussed above, the ANOPR proposals could cause significant harm to oil pipelines and shippers alike, resulting in decreased pricing flexibility, less efficiency and the inability of pipelines to recover their cost of service, which could lead to reduced transportation services, higher rates for shippers over time and an increase in expensive and time-consuming cost-of-service rate litigation. In short, the proposals in the ANOPR would undermine the achievements of EPAct and the Commission's indexing regulations over the past two decades.

III. The ANOPR Imposes Unduly Burdensome Additional Page 700 Reporting Requirements That Are Inconsistent With EPAct and the Commission's Post-EPAct Regulations.

The ANOPR proposes substantial changes to the Page 700 reporting requirements. First, the ANOPR proposes requiring pipelines to file supplemental Page 700s for "crude oil systems" and "petroleum product systems." ANOPR at P 28. Within each of the crude and products systems, pipelines would be required to file additional supplemental Page 700s for "non-contiguous (geographically separate) pipeline systems," and "major" pipeline systems. *Id.*

Second, the ANOPR would require pipelines to report additional data on Page 700 and the supplemental Page 700s. *Id*. at P 34. Pipelines would be required to explain how costs are allocated between the different systems for which supplemental Page 700s are required. *Id*. Pipelines would also be required to report additional information on Page 700 in order to differentiate between directly assigned costs and allocated costs. *Id.* at PP 39-40. The ANOPR also proposes to add additional line items to Page 700 related to rate base. Specifically, the ANOPR proposes adding line 5a, Rate Base—original cost; line 5a1—Total Carrier Property In Service (Gross Plant); line 5a2—Net Carrier Property In Service (Net Plant); line 5a3—ADIT; and line 5a4—Total Working Capital. *Id.* at P 41.

Third, the ANOPR would require pipelines to disaggregate Page 700 reporting of "revenue, barrel, and barrel-mile data associated with (a) cost-based rates (resulting from indexing and cost-of-service), (b) non-cost-based rates (resulting from settlement rates and market-based rates), and (c) other jurisdictional revenues (such as penalties)." *Id.* at P 43. The ANOPR contemplates that "this revenue data should be relatively simple for the pipeline to identify and track." *Id.* at P 45. The ANOPR does not propose "to use the disaggregated cost-based revenues in the indexing screens," but contends the "additional information would nonetheless enable the Commission and the industry to evaluate the relative effect of the Commission's different ratemaking methodologies," and "could also provide an initial assessment for shippers contemplating a cost-of-service complaint against a pipeline's rates." *Id.* at P 46.

The ANOPR's proposed additional Page 700 reporting obligations are inconsistent with EPAct's requirement that the Commission "streamline" its procedures in order to "avoid unnecessary regulatory costs." EPAct § 1802(a). As explained above, the primary purpose of EPAct's oil pipeline provisions and the Commission's regulations implementing those provisions is to minimize the need for burdensome and costly cost-of-service ratemaking. The ANOPR's proposal to require pipelines each year to report individual costs of service for each system on Page 700, however, significantly *exceeds* the requirements for filing a cost-based rate. Ultimately, the ANOPR proposal would add significant additional burdensome cost-of-service reporting and regulation and, inevitably, lead to additional disputes and litigation contrary to the purpose of EPAct. There are no grounds to impose such an onerous individual system cost-of-service reporting requirement on an industry where cost-of-service regulation is intended to be "the exception, rather than the rule." *AOPL v. FERC I*, 83 F.3d at 1442.

The ANOPR proposal is also unnecessary, since over the approximately two decades the Commission's post-EPAct regulations have been in effect shippers have been fully able to evaluate and challenge oil pipeline rates using the data currently reported. The ANOPR fails to provide any reason for the proposed change that would justify the substantial burden that will result.

The Commission should therefore adhere to its established policy that use of the complex allocations and rate design methodologies necessary to derive separate costs of service for individual systems are a matter for rate case litigation after a challenger has made the applicable threshold showing and a case has been set for hearing; they are not necessary for annual Page 700 reporting, just as they are not necessary to support a cost-of-service rate filing.

A. The Commission has repeatedly and purposefully rejected requiring individual system Page 700 reporting as inconsistent with EPAct.

The Commission's existing regulations require cost-of-service data reported on Page 700 and included in pipeline cost-of-service rate filings to be presented on a *total-carrier* basis, rather than on an individual system basis. The use of total-carrier data was not arbitrary, but was fully considered by the Commission, and its decision was rooted in EPAct's policy of ensuring just and reasonable rates by means of a simplified ratemaking methodology.

The Commission explained that "[a]n oil pipeline seeking cost-of-service rate treatment for some or all of its rates" must submit the information required by Part 346 of the Commission's regulations. Order No. 571 at 31,165. Part 346 requires pipelines to submit cost-of-service data on a total-carrier basis. *See* 18 C.F.R. § 346.2(b)(1) (requiring a "[t]otal carrier cost of service"). At the time that rule was promulgated, certain shippers argued that the cost-of-service rate filing requirements should require that "the carrier provide cost allocation and rate design schedules with its rate filing." Order No. 571 at 31,166. The Commission rejected that proposal and made clear that "there will be no need for allocation and rate design information except at a hearing on a challenged cost-of-service rate filing." *Id.* The Commission explained that the burden that would be imposed by a requirement to provide cost allocation and rate design information with a cost-of-service rate filing is not justified, particularly since the cost-of-service methodology is an alternative to indexing, and the initial filing need only show that there is a substantial divergence between the costs of the pipeline … and the revenues that would be produced by the indexed ceiling rates. *Id.*; *see also id.* at 31,165-66 (stating that an oil pipeline cost-of-service rate filing must be supported with a total-carrier cost-of-service, and that "[m]atters of rate design and cost allocation will be at issue only if the rates are protested and a hearing is conducted"). The Commission made clear that its assessment of the filing requirements for cost-of-service rate submissions was "not arbitrary" but instead "*carefully balanced the need for threshold information against the burden that filing requirements could impose on pipelines*." Order No. 571-A at 31,253 (emphasis added).

"For the same reasons," the Commission rejected shipper requests to require a Page 700 to be filed for "each separate system operated by the pipeline." Order No. 571 at 31,166, 31,168-69 ("Requests that the pipelines be required to file separate cost-of-service information for each individual system are denied."). The Commission explained that "[c]ontrary to what appears to be the assumption by most commenters, Page 700 is designed to be a preliminary screening tool for pipeline rate filings," not the information that "in itself, either forms the basis of a Commission decision on the merits of a pipeline filing, or demonstrates that the pipeline's proposed or existing rates are just and reasonable." *Id.* at 31,168. Instead, the Commission explained that Page 700 "permits a shipper to compare proposed changes in rates against the change in the level of a pipeline's cost of service" and to compare a shipper's own change in rates against the change in the average barrel-mile rate. *Id.* The Commission further explained that, the "Page 700 information alone is not intended to show what a just and reasonable rate should be," but is sufficient to allow a shipper to "compare the yearly percentage change in the average barrel-mile rate with the yearly percentage change in the rate it is charged to determine whether there is a substantial divergence between the rate of change in the two figures such as to warrant a challenge to an indexed rate." Order No. 571-A at 31,254. The Commission therefore concluded that requiring "a pipeline to demonstrate with precision its cost-of-service attributable to each individual pipeline system it operates," is a matter for a rate case, and should not be "required as part of Form No. 6, which is and shall remain primarily a financial report." Order No. 571 at 31,168-69.

Subsequent to Order No. 571, the Commission again rejected shipper proposals to turn Page 700 into an individual system cost-of-service rate filing. For example, during its review of Form No. 6 data in 2000, the Commission denied a request to require oil pipelines to make Page 700 filings for individual systems or segments. *Revisions to and Electronic Filing of the FERC Form No. 6 and Related Uniform System of Accounts*, 93 FERC ¶ 61,262 (2000) ("Order No. 620"), *aff'd on reh'g*, 94 FERC ¶ 61,130 (2001). The Commission explained that the reasons set forth in Order No. 571 remained valid and found there was no basis to require oil pipelines to file a separate cost of service for each system or segment.

Later, in 2007, the Commission issued a Notice of Inquiry concerning the adequacy of its various financial forms, including Form No. 6. *Assessment of Information Requirements for FERC Financial Forms*, Notice of Inquiry, 72 Fed. Reg. 8316 (Feb. 15, 2007). In that proceeding, shippers argued that the Commission should require pipelines to provide segmented Page 700 information. The Commission denied the proposals, and reaffirmed that Form No. 6 is intended to be used as a "screening tool" and is "not intended to be at the level of detail necessary to litigate a [rate] case." *Review of FERC Form Nos. 6 and 6-Q*, Notice Terminating Proceeding, 125 FERC ¶ 61,308 at P 7 (2008). The Commission explained that:

(1) "the information provided in FERC Form No. 6 has been adequate to allow shippers over the last 10 years to file numerous complaints challenging rates;"

(2) Form No. 6 appropriately contains "only enough information for a threshold determination of whether the existing rates are just and reasonable;" and

(3) Form No. 6 "provide[s] sufficient information to allow shippers to file a complaint requesting a determination of the justness and reasonableness of a pipeline's rates."

Id. at PP 7, 9.

Notwithstanding these clear and well-justified rulings, some shippers have continued to request disaggregated Page 700 data. The Commission has consistently and properly declined to adopt these proposals. *See, e.g.*, *Revisions to Page 700 of FERC Form No. 6*, 144 FERC ¶ 61,049 at PP 42, 45 (2013), *order on reh'g*, 148 FERC ¶ 61,235 (2014); *Revisions to Form No. 6*, 140 FERC ¶ 61,218 at PP 25-29 (2012); *Five-Year Review of Oil Pipeline Pricing Index*, 133 FERC ¶ 61,228 at PP 129-132 (2010).

In short, after careful consideration, the Commission has consistently and repeatedly ruled that Page 700 should reflect the same total-carrier data that is required for a cost-of-service rate filing. The Commission found that in both cases aggregate data was sufficient to show the relationship between a pipeline's costs and revenues and that it was appropriate to require more detailed information only after a challenger had made the requisite threshold showing and the pipeline's rates were set for hearing. Order No. 571, at 31,166-70; Order No. 571-A, at 31,253-54.

The Commission should continue to adhere to its existing policy, not simply because it has done so in the past, but because no justification for a change in policy has been provided and because the Commission's previous decisions properly comply with Congress's mandate that the Commission apply a simplified and generally applicable ratemaking methodology and avoid unnecessary costs. Ultimately, while an agency has a certain amount of discretion to interpret the statutes that it is charged with enforcing, departure from the Commission's existing, long standing interpretation of EPAct's requirements, would be arbitrary and capricious absent compelling reasons.

B. The proposed requirement to file separate Page 700s for individual pipeline systems would undermine the simplified indexing methodology by injecting complex, fact-specific disputes into the index review process and imposing an unworkable definition of a system.

The existing requirement to file a Page 700 and submit cost-of-service filings on a total-carrier basis is clear and straightforward and has worked well for more than two decades. Requiring separate page 700s for individual pipeline "systems" would undermine the simplified indexing methodology mandated by EPAct by injecting into the indexing process complex, fact-intensive disputes over whether and how to divide a pipeline into "systems" and how to allocate costs and revenues among those "systems." The ANOPR's proposed definition of a "system" would only exacerbate this problem as it is inconsistent with Commission precedent, based on unsupported assumptions regarding pipeline operations and ultimately unworkable.

As the ANOPR acknowledges, how a pipeline defines its systems "could fundamentally affect which rates are eligible for an indexed increase based upon the supplemental page 700s." ANOPR at P 36 n.44. The requirement to file separate Page 700s for each individual pipeline system is therefore likely to lead to disputes and litigation before the Commission, including during the index review process. In fact, the ANOPR cited this very ground as a reason for not supporting the shippers' proposal to require separate Page 700s for individual pipeline *rate design segments.* ANOPR at P 32 (noting the lack of Commission precedent regarding what constitutes a rate segment and explaining that "[r]ate design segmentation of page 700 would likely insert into the Commission's 'simplified' indexing methodology complex, fact-specific disputes regarding the appropriate rate design segmentation").

Despite acknowledging the complexities associated with determining "rate design segments," the ANOPR nonetheless attempts to define a pipeline "system" based on whether the facilities (1) move crude oil or refined petroleum products, (2) are contiguous or non-contiguous, or (3) are "major" (based largely on the length of the pipeline). The ANOPR's overly-simplistic test for what constitutes a "system" is inconsistent with Commission precedent and fails to provide a workable standard for the industry.

The ANOPR appears to assume that a pipeline's crude oil operations will be completely separate from its petroleum products operations, but no basis is provided for this assumption of separate "systems." In fact, a pipeline could use the same facilities for both crude oil and petroleum products. For example, as Mr. Van Hoecke explains, the pipeline may batch crude oil and petroleum products in the same line. Van Hoecke Decl. at 11. Moreover, a pipeline may transport crude oil and refined products in separate but parallel lines that use the same right-of-way and share various operational facilities and incur significant shared costs. In short, the ANOPR fails to explain why it would be appropriate or useful to file separate Page 700s for crude oil and refined products movements.

The ANOPR's attempt to define systems based on whether the facilities in question are "non-contiguous" or "major" is also based on various arbitrary and unjustified assumptions. The ANOPR fails to explain clearly what is meant by "non-contiguous" systems or justify why such facilities should be categorically deemed separate systems. Facilities that are not connected to each other and that operate in completely different parts of the country may constitute separate systems for ratemaking purposes, but this may not always be the case. For example, there may be shared facilities (*e.g.*, a central office or operations control center) that form a significant part of both non-contiguous facilities. Moreover, pipelines that are not connected may nevertheless share cost centers (*e.g.*, if they run parallel or are otherwise nearby).

The definition of "major" systems is also problematic. The ANOPR states that "major" pipeline systems "would consist of large pipeline systems (at least over 250 miles) that serve markets (either origin or destination) different from the remainder of the pipeline's system." ANOPR at P 28. The ANOPR further states that "[a] major pipeline system would include one branch of a "V" where different parts of the total company system share a similar origin but where one 250-mile system serves destinations to the northwest and another part travels to destinations to the northeast." *Id.* at P 28 n.39. "Laterals, different divisions of an integrated and interconnected reticulated pipeline, different divisions of a straight-line pipeline, and granular rate segments are not intended to be a major pipeline system within the Commission's contemplated definition." *Id.* Finally, a "major" pipeline system would include separate pipeline systems established by a final Commission order in a litigated rate case. *Id.* at P 28.

The ANOPR's definition of a "major" system is unworkable and simply highlights the difficulty of imposing one-size-fits-all rules on a complex, dynamic network of oil pipelines. At bottom, it appears that the ANOPR would only treat as separate systems pipeline facilities that form one branch of a "V" configuration where at least one side of the "V" is over 250 miles long (since the ANOPR does not propose to treat laterals, straightline pipelines and networked (*i.e.* "reticulated") pipelines as separate systems). ANOPR at P 28 n.39. But the ANOPR fails to explain why a "V" configuration constitutes two separate systems, instead of a mainline and a lateral.

Ultimately, the ANOPR's focus solely on the shape and length of the pipeline ignores the various factors that the Commission has held are relevant to defining systems. Although there is limited precedent on the issue as the ANOPR recognizes (ANOPR at P 33 & n.51), in the one case in which the Commission has required an oil pipeline to design rates based on separate systems, the Commission indicated that some of the factors that may be considered in determining whether a carrier's operations should be divided into separate systems include whether different markets and shippers are served, whether the pipelines at issue are "differently sized" or reflect "different patterns of investment," the relative number of terminals and pump stations on the pipelines at issue, the relative volumes and available capacity, and the "underlying transportation economics" of the applicable facilities. *See SFPP, L.P.*, 86 FERC ¶ 61,022, at 61,080-81 (1999).

Indeed, given the need to assess the "underlying transportation economics" in determining what constitutes an appropriate system for ratemaking purposes, it is important to assess whether the pipeline has market-based rates or volume discounts or is otherwise constrained by competition with respect to certain movements. As discussed above, the Commission has made clear that pipelines with competitively-based discounts are permitted to adopt rate design methods that give the pipeline an opportunity to recover its costs. *See, e.g., Williams Pipe Line Co.*, 84 FERC ¶ 61,022, at 61,102-103; *Laclede Pipeline Co.*, 114 FERC ¶ 61,335 (2006), *order on reh'g*, 119 FERC ¶ 61,236 (2007). Thus, the Commission has indicated if a pipeline has rates that are constrained by competition, it may be appropriate, in setting cost-based rates, for certain of the costs related to the movements where the rates are competitively constrained to be reallocated to other movements where costs may be recovered. In other words, it may not be appropriate to establish individual fully-allocated costs of service for each system separately without taking into consideration the competitive constraints affecting the pipeline, because the pipeline otherwise might not be able to recover its overall cost of service.

In short, the test for what constitutes a "system" for ratemaking purposes is multi-factored and highly dependent on the specific facts and circumstances of the pipeline at issue. Ultimately, the multi-pronged test set out in *SFPP* (which the Commission by no means indicated was exclusive) emphasizes that determining what constitutes a separate "system" for any given pipeline is a fact-specific analysis that is best left to a rate case. Requiring all pipelines to separate their operations into systems will not only require them to undertake one of the most burdensome aspects of a rate case when few oil pipelines have been or will be required to file cost-based rates, but will inevitably lead to disputes before the Commission, including as part of the indexing process, contrary to

Congress's requirement that the Commission establish a simplified methodology for oil pipeline ratemaking that eliminates unnecessary regulatory costs and burdens.[6]

Moreover, because the ANOPR's definition of a system is inconsistent with the Commission's precedent regarding how a system would be defined for cost-of-service ratemaking purposes, there is no justification for requiring the industry to file separate Page 700s based on the ANOPR's definition of a system, since it will not necessarily shed any light on how a pipeline's cost-based rates would be determined. In sum, the proposal is simply arbitrary, and there is no justification for limiting oil pipeline indexing rate increases to the "costs-of-service" derived from the ANOPR's definition of a "system."

C. The ANOPR's proposed requirement to file separate Page 700s for individual systems would impose substantial unwarranted burdens on oil pipelines without any demonstration of countervailing benefits.

In their comments in response to the petition for a rulemaking by a joint group of shippers, both AOPL, as well as individual pipeline companies, expressed specific concerns regarding the burden of filing disaggregated Page 700 data. *See Comments of*

---

[6] Treating a facility as a separate pipeline system if the Commission made such a determination in a final order in a litigated rate case is a clear standard, but, as the ANOPR acknowledges, there is only one case in the approximately 40 years that FERC has regulated oil pipelines in which the Commission has ruled on whether a pipeline's rates should be based on separate systems. ANOPR at 32 n.43 (citing *SFPP*, *LP*, 86 FERC ¶ 61,022, at 61,080 (1999)). Moreover, as the ANOPR further acknowledges (*id.* at P 33), pipeline systems change over time, so a Commission determination that was valid when made may not apply to the current facts.

the Association of Oil Pipe Lines in response to *Petition for a Rulemaking of the Liquids Shippers Group, Airlines for America, and the National Propane Gas Association*, FERC Docket No. RM15-19-000 (Sep. 25, 2015). AOPL described how requiring oil pipelines to prepare separate Page 700 reports, by segment or system, or separately for crude and refined products transportation, would be a burdensome new expansion of the Form No. 6 process. As AOPL explained, any such requirement would fundamentally transform the Form No. 6 from an annual financial report into a document whose preparation would encompass many of the burdens involved in a full-blown, cost-of-service rate case, including the need to assign costs to different systems and services, perform complex cost allocations, and compile carrier property and depreciation data by system going back to 1983.

Mr. Van Hoecke, who submitted an affidavit in support of the AOPL comments, estimated that the initial burden associated with separately reporting disaggregated Page 700 information would likely exceed 1,000 hours and, depending on the complexity of the pipeline system, could easily approach 2,000 hours per company, with additional time required to update the Page 700s each year. Mr. Van Hoecke further explained that a requirement to file disaggregated Page 700 reports would likely require carriers to change the way costs are captured, change the process by which the Form No. 6 is assembled and force carriers to make assumptions regarding cost allocations which are not required to manage their business.

In proposing individual system Page 700s, the ANOPR fails to address the significant burdens that were discussed in AOPL's and the pipeline companies' comments. For example, AOPL showed that a requirement to file separate Page 700s for individual systems would require pipelines to develop new accounting and record keeping systems that differ from the uniform system of accounts. The individual pipeline commenters further emphasized the thoroughgoing revisions that a requirement to file disaggregated Page 700s would require with respect to pipeline accounting. Magellan Midstream Partners, L.P., explained that such a proposal would require it to "redesign [its] books and records," which "would involve numerous Magellan departments, first, to determine how to define the appropriate "segments" or "systems" then, second, to restructure Magellan's IT billing systems, cost accounts, property records and regulatory records." Magellan Comments at 7. In other words, "Magellan's IT development, property accounting, general accounting, payroll, and regulatory departments, as well as external consulting firms, all would be involved." *Id.* Shell Pipeline Company LP explained that disaggregated Page 700 reporting would "require significant changes to every aspect of Shell Pipeline's accounting, oil movements, and operations functions, from the creation of new account codes to training staff in how the network has been carved up to recording assets for depreciation." Shell Comments at 4 (citation omitted). Other pipeline commenters discussed the same issue. *See* Comments of Enterprise Products Partners L.P., Enterprise TE Products Pipeline Company LLC, and Mid-America Pipeline Company, LLC at 6 (disaggregated Page 700 reporting "would fundamentally change the record-keeping structure in place for Enterprise and its subsidiaries, forcing the devotion of new internal and/or external resources to the compilation of such segmented data"); Comments of Plains Pipeline, L.P., at 3 (disaggregated reporting would alter "Plains' data-collection and record-keeping structure, and [require Plains] to expend significant resources, both internal and external"); Buckeye Comments at 12 (Shippers' proposal would "fundamentally change the data-collection and record-keeping structure in place for Buckeye, and would likely require investment in new IT infrastructure"). The ANOPR fails to address these burdens and assumes without any support that no additional accounting or record keeping systems would be required. ANOPR at P 38.

The ANOPR rejected the shippers' proposal to require separate Page 700s for each individual "rate design segment" in part because of "burdens imposed by a fact-specific inquiry into a pipeline's segmentation." ANOPR at P 33. The ANOPR further noted that the "burden associated with segmentation is not a one-time burden, as pipeline systems change over time and pipelines will need to re-evaluate their rate design segments in future years." *Id.* But the ANOPR fails to acknowledge that the very same burdens are involved in filing separate Page 700s for each individual "system."

In his declaration in this proceeding, Mr. Van Hoecke concludes that his prior estimate of the burdens of reporting disaggregated data remains a reasonable estimate of the burdens that would be involved in complying with the ANOPR proposals. Van Hoecke Decl. at ¶¶ 23-24. Mr. Van Hoecke supports that conclusion with a detailed description of how pipelines track costs. As Mr. Van Hoecke explains, oil pipelines do not generally track costs separately for the different "systems" as defined by the ANOPR, and the Uniform System of Accounts, which underpins much of the data shown on Form 6, does not require pipelines to separate carrier property or expenses by systems. Mr.

Van Hoecke further responds to the ANOPR's assumption that the use of cost centers and locations codes would allow pipelines to identify readily which costs are related to each system (ANOPR at P 30 n.41), explaining that a pipeline's cost centers and location codes may be organized geographically or by function, but they are unlikely to align with the ANOPR's definition of a "system." Van Hoecke Decl. at ¶ 8. Moreover, as Mr. Van Hoecke notes, under the Commission's accounting regulations for oil pipelines, carrier property is recorded based on function (*e.g.*, land, right-of-way, line pipe), not by "system" as defined in the ANOPR.

Mr. Van Hoecke further identifies the various steps that would be required to prepare individual system cost-of-service information. As Mr. Van Hoecke explains, the efforts required to identify the various systems, isolate the specific capital and expense items directly assignable to those systems and develop reasonable methods for allocating shared capital and expenses among the systems involve numerous subjective judgments that are normally made only as part of litigated rate proceedings, where those issues are generally heavily contested. Moreover, the time required to conduct such an analysis vastly exceeds what is currently required to develop Page 700.

In sum, the ANOPR fails to acknowledge the extraordinary burden that would be involved in developing individual system Page 700s. Nor does the ANOPR provide any valid explanation of why the onerous new regulatory burdens it proposes are necessary or point to any benefits that would justify its proposal.

D. The proposed requirement to file individual system Page 700s could reveal competitively sensitive information.

In certain cases, the requirement to file separate Page 700s for individual systems could reveal competitively sensitive information. For example, if a pipeline were required to provide cost and revenue information that demonstrates the profitability of individual systems or movements, it could compromise the pipeline's competitive position vis-à-vis other pipelines and alternative transportation modes that are not subject to rate regulation. Moreover, if there are a limited number of shippers on a "system," a separate Page 700 filing could reveal an individual shipper's volume data and business transactions, which could harm the shipper's competitive position in contravention of the purpose of Section 15(13) of the ICA, which prohibits oil pipelines from disclosing confidential shipper information. *See* 49 U.S.C. § 15(13). The risks of disclosing such information would be particularly troubling given the robust competition prevalent in the oil pipeline industry. In addition, Form No. 6 is submitted as a public document so the Commission and all interested stakeholders can review pipeline financial information. Imposing requirements that can be expected to trigger requests for confidential treatment, and the attendant need to establish a mechanism to address such requests, would be extremely cumbersome to administer and undermine the purpose of filing an annual financial report.

E. The ANOPR fails to justify its proposed departure from the Commission's previous decisions rejecting Page 700 reporting for individual systems.

The ANOPR states that supplemental Page 700 reporting "may enhance the Commission's and shippers' ability to evaluate a pipeline's indexed rates." ANOPR at P 26. That fails to explain the significant proposed departure from Commission precedent. Nor does the ANOPR point to any changed circumstance or problem with the current system that would justify the new reporting requirements.

As is evident from the various protests and complaints that have been set for hearing since EPAct was enacted, Page 700 and the other information in Form No. 6 is more than adequate to allow shippers to evaluate the reasonableness of a pipeline's rates and to challenge those rates when necessary. Individual system Page 700 data is not necessary to evaluate pipeline rates or to file a protest or complaint under the Commission's regulations. Nor has the Commission ever dismissed any complaint or protest because of the absence of individual system Page 700 data.

The Commission's regulations require a party filing a complaint against an existing pipeline rate to allege a "reasonable ground" for the Commission to investigate. 49 U.S.C. § 13(1); 18 C.F.R. §§ 343.2, 385.206. In order to protest a proposed rate change, a party must show that it has a "substantial economic interest" in the rate at issue. 18 C.F.R. § 343.2(b). The Commission's regulations, therefore, do not require parties challenging pipeline rates to provide individual system cost-of-service data, and the Commission has never required that level of data in order to set a challenge for hearing. *See, e.g., Delta Air Lines, Inc. v. Enterprise TE Products Pipeline Company LLC*, 157

FERC ¶ 61,214 (2016) (setting for hearing complaint against certain movements on a lateral line); *Flint Hills Resources, LP v. Mid-America Pipeline Company, LLC*, 130 FERC ¶ 61,086 (2010) (setting for hearing complaint against rates for certain product movements on one of the pipeline's various segments). Indeed, as noted above, the D.C. Circuit upheld the Commission's post-EPAct regulations in part because the Commission's pleading rules do not unduly restrict shippers from challenging pipeline rates. *See AOPL v. FERC I*, 83 F.3d at 1444.

Moreover, the current Form No. 6 and Page 700 already provide significant cost and operational detail that shippers can use to evaluate and challenge pipeline rates. As an initial matter, Page 700 shows how a pipeline's cost-of-service compares to its revenues on a total company basis, so a shipper can determine whether the pipeline as a whole is over-earning or under-earning based on its reported Opinion 154-B cost of service. Page 700 also reports the carrier's total interstate barrels and barrel-miles. As the Commission explained in Order No. 571, a shipper can therefore "compare the change in a shipper's individual rate with the change in the pipeline's average company-wide barrel-mile rate." Order No. 571, at 31,168. A shipper can also use that information to determine whether the rates for a certain system, segment or service are higher or lower than the carrier-wide average.

Form No. 6 also provides significant detailed information that can be used to evaluate and, if necessary, to challenge the total-carrier cost of service and revenues reported on Page 700. For example, Form No. 6 shows:

- Operating and maintenance expense by year separately reported for crude oil and products and broken down by individual cost categories such as salaries and wages, fuel and power, outside services, rentals, insurance, taxes, and depreciation. *See* Form No. 6, pages 302-303.

- Significant payments (over $100,000) to outside vendors. *See* Form No. 6, page 351.

- The amount invested in carrier property, annual changes in carrier property, and accrued depreciation broken down by property account. *See* Form No. 6, pages 212-217.

- Revenues separated by crude oil and products movements and broken down by various categories such as trunk revenue (*i.e.*, transportation revenue from trunk line movements) as well as non-transportation revenue such as storage, demurrage and oil loss revenue. *See* Form No. 6, pages 300-301.

- The capital structure used to calculate the rate of return. *See* Form No. 6, Page 700, lines 6a and 6b.

- The cost of long-term debt. *See* Form No. 6, Page 700, line 6c.

- The cost of equity. *See* Form No. 6, Page 700, line 6d.

- The composite tax rate used to calculate the income tax allowance. *See* Form No. 6, Page 700, line 8a.

In short, the current Form No. 6 and Page 700 contain more than sufficient data for a shipper to evaluate and challenge a pipeline's rates. The ANOPR fails to point to any changed circumstance or other problem that justifies departing from the Commission's longstanding and thoroughly considered policy that Page 700 should reflect total-company data.

F. The ANOPR provides no basis for imposing additional reporting requirements regarding cost allocations and rate base.

For the same reasons discussed above, there is no justification for the additional reporting requirements related to allocation of costs among systems, nor is there any reason to require reporting of the additional rate base line items. The ANOPR proposed these additional reporting requirements regarding cost allocations "in order to facilitate the creation" of the individual system page 700s. ANOPR at P 34. The requirement to report additional rate base items is further intended to "facilitate understanding of these allocations," since the ANOPR indicates the "data may provide the means for allocating the Opinion No. 154-B cost data." *Id.* at P 41. But since there is no justification for requiring individual system Page 700 reporting, there is no basis to require pipelines to report the proposed allocation data or additional rate base information. Ultimately, the need to make and explain various complex allocations demonstrates that the ANOPR's individual system Page 700 proposal is inconsistent with the streamlined regulatory approach that applies to oil pipelines, particularly for an annual report of basic rate screening information. The requirement to report detailed allocations and additional rate base data would lead to more contentiousness and challenges, not streamlining and simplification.

G. The requirement to separately report revenue and throughput data associated with cost-based and non-cost-based rates is unduly burdensome and unworkable.

The ANOPR proposes to require pipelines to separately report on Page 700 the revenue, barrel, and barrel-mile data associated with "cost-based rates" and "non-cost-based rates" as well as "other jurisdictional revenues (such as penalties)." *Id.* at P 43. The ANOPR contemplates that "this revenue data should be relatively simple for the pipeline to identify and track." *Id.* at P 45. The ANOPR does not propose "to use the disaggregated cost-based revenues in the indexing screens," but contends the "additional information would nonetheless enable the Commission and the industry to evaluate the relative effect of the Commission’s different ratemaking methodologies,” and “could also provide an initial assessment for shippers contemplating a cost-of-service complaint against a pipeline’s rates.” *Id.* at P 46.

As an initial matter, since the ANOPR does not propose to use the data, there is no justification for requiring pipelines to report it, especially since identifying and tracking the data would not necessarily be as simple as the ANOPR suggests. The primary difficulty is the lack of a clear distinction between cost-based and non-cost-based rates. The ANOPR suggests that cost-based rates are those “resulting from indexing and cost-of-service,” while non-cost-based rates are those “resulting from settlement rates and market-based rates.” ANOPR at P 43. But many rates established by agreement with shippers (*i.e.*, settlement rates) will subsequently be indexed. It is unclear from the ANOPR how the revenue, barrels and barrel-miles relating to those rates would be reported.

The ANOPR suggests that there is a greater need for the contemplated data than when EPAct was first enacted. The ANOPR states that “[w]hen page 700 was created following EPAct 1992, most oil pipeline revenues resulted from rates subject to cost-based regulation,” whereas “in recent years, an increasing percentage of pipelines are using settlement rates.” ANOPR at P 44. On the contrary, EPAct declared all existing rates (with minor exceptions) to be just and reasonable as a matter of law without any examination of costs. There is no basis to assume that the pre-EPAct rates were any less the product of negotiation with shippers. There is certainly no reason to assume they were related in any way to the Commission's Opinion No. 154-B cost-of-service methodology, since, as discussed above, prior to the issuance of Opinion No. 154-B in 1985, oil pipelines were subject to the Valuation methodology used by FERC's predecessor the ICC. Moreover, few ICC decisions addressed oil pipeline ratemaking. *See Farmers Union I*, 584 F.2d at 413-414.

IV. The ANOPR's Proposed Move Toward Greater Cost-of-Service Ratemaking is Bad Policy.

As demonstrated above, the overall thrust of the ANOPR is to curtail rate indexing and move toward imposing onerous cost-of-service regulations on the industry. That is inconsistent with the entire history of oil pipeline regulation as discussed above, including EPAct and the Commission's post-EPAct regulations. It is also bad policy.

As an initial matter, as Dr. Reishus explains, cost-of-service regulation imposes a heavy burden on all parties, including pipelines, shippers and regulators. The costs of preparing and adjudicating cost-of-service rates can be large. Moreover, the end result often involves backward-looking results that can be inconsistent with current market conditions and often results in arbitrary allocations of costs among shippers using different services and in arbitrary allocation of costs over time. Reishus Decl. at ¶ 27.

Furthermore, as Dr. Reishus explains, the oil pipeline industry is subject to significant competition and other commercial factors that make it a poor fit for cost-of-service regulation. *Id.* at ¶¶ 28-29. By imposing a public utility-type cost-of-service model on an industry with significant competition and other market risks but no certificated monopoly, the ANOPR proposals have the economically undesirable effect of limiting the potential upside return to investors while providing no protection against downside risks. The ANOPR proposal thus has a significant potential to discourage new investment in oil pipeline infrastructure. *Id.* at ¶ 9.

Moreover, by potentially requiring rate reductions (in real terms) on fully utilized pipelines where economics indicate that rates should be increased, the ANOPR proposal would further distort pricing away from efficient levels consistent with market outcomes. The ANOPR's proposed limits on indexed rates may therefore reduce the incentives for expansion. Reishus Decl. at ¶ 52.

Furthermore, as discussed above and in Dr. Shehadeh's declaration, the ANOPR's proposal to tie the index more closely to each individual pipeline's Page 700 cost-of-service undermines the efficiency-enhancing aspect of the index. As Dr. Shehadeh explains, the ANOPR proposals will "punish more efficient firms and reward inefficient firms." Shehadeh Decl. at ¶ 10. Because efficient operators therefore will have less "incentive to pursue cost-reducing and output-expanding investments, shippers and end consumers will suffer." *Id.* A properly applied index can be expected to reduce industry-wide costs below the level of cost-of-service regulation, and any move away from indexing towards greater cost-of-service regulation can be expected ultimately to increase industry costs to the detriment of shippers. *Id.* at ¶¶ 8 & 15.

Moreover, as both Dr. Shehadeh and Dr. Reishus emphasize, implementation of the ANOPR proposals would undermine the incentives for efficiency and capacity expansion beyond the specific pipelines that the ANOPR appears to anticipate will be covered by its proposals. Since pipeline operators are unlikely to know at the time they are deciding whether to undertake a new pipeline project or make a particular efficiency-enhancing investment if they will be over-recovering or under-recovering on Page 700 in the future or if so by how much, the ANOPR proposals will create significant uncertainty for all pipeline and potential pipeline operators about whether they will be able to recover their costs. *See* Shehadeh Decl. at ¶ 20; Reishus Decl. at ¶ 31.

Given the significant capital investments involved, and the need to recover those investments over many years, it is impossible to overstate how important it is for the Commission to establish clear rules regarding how oil pipeline rates are established and adjusted and for the Commission to be consistent in its application of those rules. The ANOPR is particularly troubling since it proposes to change the rules under which pipelines have invested capital. After encouraging pipelines to make cost-saving investments and undertake major infrastructure projects under a given set of rules, the ANOPR now proposes to change the rules to make it harder for pipelines to recover their investments. In addition to this fundamental unfairness, the ANOPR proposals would have a significant chilling effect on future pipeline investment for the reasons stated above.

Indeed, the ANOPR's proposals would be particularly bad policy at this time given the requirements to make additional investments in pipeline safety and to develop new infrastructure in response to market changes resulting from the expansion of the domestic oil shale market. For example, the U.S. Department of Transportation Pipeline and Hazardous Materials Safety Administration recently issued a Final Rule that imposed significant additional requirements on oil pipelines with respect to pipeline safety.[7] Those regulations will undoubtedly result in pipelines making substantial additional expenditures beyond the considerable amounts already incurred. The oil pipeline industry is also facing additional regulatory uncertainty as a result of the Commission's December 15, 2016 notice of inquiry into its income tax allowance and rate of return policies. *Inquiry Regarding the Commission's Policy for Recovery of Income Tax Costs*, 157 FERC ¶ 61,210 (2016). Given the need for predictability in making long-term pipeline investments, now is not the time to create additional regulatory uncertainty.

In sum, the ANOPR's proposed changes to the index and reliance on cost-of-service ratemaking will remove the incentives for efficiency and expansion of pipeline capacity that the Commission's existing policies have worked hard to foster and will instead create precisely the opposite incentives. Simply put, the ANOPR proposals would harm shippers and consumers over time and lead to increased transportation costs and less overall capacity.

---

[7] Pipeline and Hazardous Materials Safety Administration, Pipeline Safety: Safety of Hazardous Liquid Pipelines, Docket No. PHMSA-2010-0229, Amdt. No. 195-102, http://www.phmsa.dot.gov/staticfiles/PHMSA/DownloadableFiles/Files/Hazardous_Liquid_Pipelines_Final_Rule11317.pdf (Jan. 13, 2017) (awaiting publication in Federal Register).

CONCLUSION

There is no basis for the Commission to depart from the streamlined regulatory approach mandated by Congress and implemented by the Commission in its post-EPAct regulations. In the ANOPR, the Commission fails to show any change in circumstances that would justify drastically changing the Commission's policies for evaluating oil pipeline index rate changes and the data reporting requirements reflected in Page 700 of Form No. 6. The Commission's proposal for additional Page 700 cost-of-service reporting requirements is inconsistent with the regulatory construct that applies to oil pipelines and exceeds the Commission's rate-setting standards that apply pursuant to EPAct. Ultimately, the proposals would lead the Commission back to the very circumstance that caused Congress to "streamline" and "simplify" oil pipeline regulation in the first place – a significant increase in the potential for protracted cost-of-service rate review in an industry that has markedly different characteristics from the public utility model. For the reasons set forth above, the Commission should therefore decline to implement the changes proposed in the ANOPR.

Respectfully submitted,

/s/ Steven H. Brose

Steven M. Kramer
Senior Vice President, General Counsel
and Corporate Secretary
Association of Oil Pipe Lines
1808 Eye Street, NW, Suite 300
Washington, D.C. 20006
(202) 292-4502

Steven H. Brose
Steven Reed
Daniel J. Poynor
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036-1795
(202) 429-6250

January 19, 2017

Counsel for the Association of Oil Pipe Lines

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing document on each party designated on the official service list compiled by the Secretary for this proceeding.

Dated at Washington, D.C. this 19th day of January 2017.

/s/ Thomas C. Kirby

Thomas C. Kirby
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 429-6454