126 FERC ¶ 61,300
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Suedeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

MarkWest Michigan Pipeline Company, L.L.C. Docket No. IS09-147-000

ORDER ON TARIFF FILING AND GRANTING CLARIFICATION

(Issued March 31, 2009)

1. This order addresses a February 24, 2009 tariff filing[1] by MarkWest Michigan Pipeline Company, L.L.C. (MarkWest) to raise its currently effective rates established under a settlement to the maximum amount permitted under the Commission's oil pipeline indexing regulations.[2] MarkWest requests the Commission permit the tariff to become effective April 1, 2009. The filing is protested by two shippers, Merit Energy Company, LLC, and GulfMark Energy, Inc., collectively Intervenors. The Commission rejects MarkWest's tariff filing as inconsistent with the Commission's regulations, as discussed below.

Background

2. On January 31, 2006, MarkWest filed an uncontested settlement (January 2006 Settlement) that established as its interstate rates certain rates it previously used as Michigan intra-state rates. Under the settlement terms, MarkWest was permitted to increase these new interstate rates, but for a lesser amount than would have been permitted under the Commission's indexing regulations. The settlement became effective January 31, 2006, and expired January 31, 2009. The Commission approved the January 2006 Settlement by Commission letter order issued April 2, 2006, in Docket No. IS06-41-000, *et al.*.[3] The record here establishes that MarkWest made periodic filings to increase its rates pursuant to the settlement on July 1, 2006, July 1, 2007, and July 1, 2008. The relevant filings were unprotested and specifically noted that the proposed rate

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[1] Supplement No. 3 to F.E.R.C. No. 5 issued February 24, 2009.

[2] 18 C.F.R. § 342.3 (2008).

[3] *MarkWest Michigan Pipeline*, 115 FERC ¶ 61,002 (2006).

increase was less than the amount that would have been permitted absent the settlement.[4] With the expiration of the settlement, MarkWest now proposes to raise its rates to the full amount that would have resulted *as if* it had taken the index increases that would have been permitted under the Commission's regulations absent the settlement.

3. The Intervenors object that the increase proposed here is inconsistent with the Commission's regulations and constitutes retroactive ratemaking. They assert that there are several ways of establishing rates under the Commission's regulations. Among these are rates under 18 C.F.R. § 342.2(b), which provides in part that a pipeline can establish an initial rate by filing a sworn affidavit agreed to by at least one non-affiliated person who intends to use the service in question.[5] Intervenors argue that 18 C.F.R. § 342.3 (d)(5) prohibits the proposed index ceiling increase at issue here because that section states: "When an initial rate, or a rate changed by a method other than indexing, takes effect during the index year, such rate will constitute the applicable ceiling level for that index year."[6] At bottom, Intervenors are asserting that the July 1, 2008 rate increase to a level that is less than would otherwise be permissible under the Commission's indexing regulations, was a rate established pursuant to a settlement. As settlement rates establish a rate by a method other than indexing, they conclude that section 342.3(d)(5) precludes any additional increase before the end of the current index year, i.e. before July 1, 2009. Intervenors also request that the Commission define the current ceiling rate so there is no need to litigate this issue at the end of the current index year.

4. MarkWest answers that Intervenors' arguments are inconsistent with the Commission's indexing regulations. It asserts that if a pipeline increases its rates under the indexing procedures by less than the permitted amount of the annual index, the pipeline may raise its rates to the ceiling level at any time.[7] MarkWest asserts that consistent with the settlement, it took less than the permitted increase for the three indexed years 2006, 2007, and 2008. Now that the settlement has expired, it argues that it is permitted to raise its rates to the highest index ceiling level that would have been applicable had the settlement never existed, as it proposes here. MarkWest argues that the rates that became effective January 31, 2006 were not "settlement" rates because the initial filing made pursuant to the settlement with Intervenors was not accompanied by an

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[4] *See* Answer of MarkWest Michigan Pipeline Company, L.L.C. to Joint Motion to Intervene, Protest, and Request for Clarification of Merit Energy Company, LLC and GulfMark Energy, Inc., Attachments 1 through 3.

[5] 18 C.F.R. § 342.2(b) (2008).

[6] 18 C.F.R. § 342.3 (d)(5) (2008).

[7] *Citing* 18 C.F.R. § 342.3(a) (2008).

affidavit and because all shippers using the rates did not agree to the settlement. It claims that the regulatory limits on the number of indexing opportunities allowed per year do not apply here and that the expiration of the January 2006 Settlement allows it to raise its rates to the ceiling level indexing would have allowed currently, had the settlement not required it to make earlier lower filings. It also argues that Intervenors' requested clarification of what its current index ceiling is, is unnecessary, since its rates are being increased prospectively, albeit from an indexing level untrammeled by any impact from the prior settlement. Given the settlement's expiration, MarkWest asserts there is no retroactive ratemaking involved here.

Discussion

5. This case presents a case of first impression involving interpretation of the Commission's oil pipeline ratemaking regulations. First, the facts are undisputed and the only issue is how the regulations for setting oil pipeline rates should be applied to the facts. This requires a brief review of the Commission's procedures for establishing oil pipeline rates. At bottom, oil pipeline rates are divided into two categories: those that existed when the Commission adopted its indexing regulations and those that did not exist at that time. The instant rates clearly fall into the latter category since they were first filed with the Commission in January 2006. Any such rates are initial rates for purposes of the regulations and can be established either by a full cost of service proceeding or by agreement.[8] MarkWest is correct that the instant rates were not filed in complete conformance with the provisions of section 342.2(b), but this point is unpersuasive. That section provides for filing of rates with the agreement of one shipper supported by an affidavit. Such rates are to be investigated only if they are protested. Here three of four shippers using the service at the time agreed by settlement to rate terms which were without protest. Once the rates pursuant to the settlement were established and were unopposed, there was no need for any affidavits or other process as the settlement was implemented each indexing season thereafter. Moreover, section 342.4(c)[9] provides for a change in existing rates with the support of all the existing shippers, and Opinion No. 561 clearly encourages the setting of rates by agreement.[10]

6. Thus, it is true that the January 2006 settlement as filed did not meet the literal language of either 18 C.F.R § 342.2(b) (initial rates) or § 342.4(c) (settlement rates). However, the broader purpose of the Energy Policy Act of 1992 is to simplify oil pipeline

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[8] *See* 18 C.F.R. § 342.2 (2008).

[9] 18 C.F.R. § 342.4(c) (2008).

[10] Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992, Opinion No. 561, FERC Stats. & Regs. ¶ 30,985, at 30,941, 947, 959 (1993).

regulation, including encouraging settlements in the context of litigation because of the efficiencies that may result.[11] The interpretation of the Commission's regulations advanced by MarkWest would defeat both purposes. The interesting feature of this case is that the rates established by the settlement were to be implemented as part of an indexing process over the course of the settlement. It thus requires the Commission to determine how settlement rates that require indexing increases to a level lower than the index ceiling permitted under the Commission's regulations are to be treated. Since the indexing regulations allow only one "bite of the apple," once the settlement expires, should the index rates under the settlement be the new basis for further indexing increases under the Commission's indexing regulations, or should the index rates under the settlement be increased so that further indexing increases begin from a rate level as if the settlement had never existed.

7. The Commission considers the January 2006 settlement rates as initial rates, for purposes of an analysis of the effects of indexing such rates. An initial rate normally establishes the ceiling rate for purposes of the indexing regulations.[12] The first indexed-based increase from the initial rate becomes effective at the beginning of the next indexing year, that is no sooner than the first July 1 of the year after the initial rate became effective. The index ceiling is then raised by the amount of the applicable index and becomes the new index ceiling *whether or not the pipeline actually chooses to raise its rate to the ceiling level permitted for that year*. This continues forward until the indexed rate is modified by one of the methods for changing an existing rate, or by a Commission prescriptive order.[13] The structure of the regulations is clear.

8. As noted, the dispute centers on the interpretation of the January 2006 Settlement and the point at which the last ceiling rate was established. Intervenors believe that the last ceiling rate was the increase taken on July 1, 2008, because that increase was taken under the settlement terms and not pursuant to the Commission's regulations. At bottom, they claim that this is the case regardless of how MarkWest may have characterized each annual increase when it made its filings through July 2008. Thus, under Intervenors' theory, each annual increase made under the settlement was a new settlement rate to which section 342.3(d)(5) would apply. Section 2.04(a) of the settlement provides in part:

> (a) During the Moratorium Period, MarkWest shall not seek at

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[11] *Id.* at 30,940-41, 944-45, 946-47.

[12] *See* 18 C.F.R. § 342.2(b) (2008).

[13] *Id. See also ExxonMobil Oil Corporation v. FERC*, 487 F.3d 945, 963-64 (D.C. Cir. 2007).

> the FERC or the MPSC to alter any rates or charges (including the pipeline loss allowance) for service on the Michigan Line, except as follows:
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> (i) MarkWest may file to increase the Michigan Line rates effective each July 1st during the Moratorium Period to reflect positive inflation adjustments as promulgated annually by FERC pursuant to 18 C.F.R. Section 342.3(d); and Sunoco, GulfMark, and Merit agree not to protest MarkWest's rate changes, provided, however, that any increase in rates does not exceed an annual inflation cap herein agree to by the Parties ("Annual Inflation Cap"), which Annual Inflation Cap shall be the sum of the following: ….[14]

9. After reviewing the quoted text, the Commission concludes that the January 2006 Settlement contemplates that there would be only one adjustment during each annual adjustment period. Section 2.04(a) describes the cap as an Annual Inflation Cap, which makes sense only if the increase is projected forward for an entire year. Otherwise, in the last six months of the Moratorium Period, the Annual Inflation Cap, as stipulated by the parties, would only be a semi-annual inflation cap.[15] The purpose of the cap is to hold down the index increase below what MarkWest would otherwise have been able to pursue, that is, a full annual index increase under the indexing regulations. Having agreed to limit the amount of the annual increase by contract, the Commission concludes MarkWest cannot shorten that period. This is true even though the rates in effect when the January 2006 Settlement expired were less than might have been available under the Commission's indexing methodology absence of the restrictive language of Section 2.04(a)(i). Therefore, MarkWest may not increase the rates at issue further before July 1, 2009, and its filing is rejected.

10. Intervenors' second request is that the Commission determine the relevant ceiling rate before the next index adjustment on July 1, 2009. As discussed, the issue is whether the July 1, 2008 increases established a new ceiling rate or the initial ceiling rates are those adopted by the January 2006 Settlement. If the former is true, the July 1, 2009 increase would be applied only to the reduced rates that became effective on July 1, 2008. If the latter, the ceiling rate would be the rates adopted in the January 2006 Settlement plus the maximum increase permitted under the Commission's indexing regulations through July 1, 2008. Consistent with the previous ruling, the Commission concludes

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[14] The balance of section 2.04(a) describes the mechanics of the Annual Inflation Cap and need not be considered further here.

[15] The semi-annual period would run from July 1, 2008 to March 31, 2009 rather than the annual period July 1, 2008 through June 30, 2009.

that the current ceiling rates are the July 1, 2008 rates. Under the January 2006 Settlement MarkWest gave up the right to index its rates to the full percentage allowed for the three subsequent increases, July 1, 2006, 2007, and 2008. This decision was contractually binding and precludes MarkWest from later increasing the ceiling rate to the level that would otherwise have been available under the Commission's regulations. Those regulations recognize that oil pipelines may not always be able to take the full annual increase due to competitive pressures. Thus, they are permitted to raise their rates at any time to the ceiling rate if the competitive situation later permits such a rate increase because any increase up to that level is presumed to be just and reasonable.[16] This rationale does not apply when the parties have established a contractual rate level that has been accepted by the Commission as reasonable in the context of a litigated proceeding.[17] MarkWest permanently surrendered the right to a maximum rate increase above the agreed levels regardless of the actual format of MarkWest's index rate filings for the increases effective July 1, 2006, 2007, and 2008.

The Commission orders:

(A) MarkWest's tariff filing Supplement No. 3 to F.E.R.C. No. 5 is rejected as inconsistent with the January 2006 Settlement as discussed in the body of this order.

(B) The Commission clarifies that MarkWest's current ceiling rates are those established on July 1, 2008 pursuant to the January 2006 Settlement.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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[16] Opinion No. 561, FERC Stats. & Regs. ¶ 30,985 at 30949-50.

[17] For example, there is little doubt that if a challenged rate were reduced as a result of Commission action the ceiling rate becomes the lowered rate established or approved by the Commission. *See* 18 C.F.R. § 342.4(d)(5) (2008).